Discussion of Paper: Libra or Librae? Basket based stablecoins to mitigate foreign exchange volatility spillovers
by P. Giudici, T. Leach and P. Pagnottoni

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Challenges facing Stablecoins

- Stablecoins are a new type of digital money that try to address **the shortcomings** of the first generation crypto currencies (CC) initiated by the Bitcoin that suffered significant price volatility;

- Stablecoins use **different stabilization mechanisms** for pegging their value to an underlying currency or a pool of currencies or assets that can offer a more stable digitally transferable asset to support liquidity in traditional cryptotcurrency networks – stabilisation mechanisms can also use protocols and applications

- Governments generally fear the rise of **stablecoins issued by non-government bodies** (Ward and Richemont (2019))

- Research on this field is growing rapidly –my advice is to review the latest papers on the topic

Challenges facing Stablecoins

- Many of the first generation SC were launched and circulated **taking advantage of gaps in regulation and supervision** ;

- **Different stability mechanisms** can be exposed to significant risk if not properly managed and regulated – according to the FSB (OCT. 2020)

  - Financial stability
  - Consumer and investor protection
  - Data privacy and protection
  - Financial integrity and compliance with AML/CFT rules…
  - Cyber security

- The stability provided by currency baskets could eventually shift liquidity away from the internationally dominant USD and may disrupt the exchange market dynamics – but still to be tested empirically

- If SC achieve high liquidity in crossborder payments, There might be negative externalities because of operational difficulties in the companies that provide them

- CC and SC trading/liquidity might be polluted with **wash trades**

This paper: Objective, Data and Methodology

- **Objective**: to explore empirically stablecoins whose value is derived from a basket of underlying currencies as compared to SC that is pegged to the value of a major currency

- It builds a basket based SC whose weights can maximise stability over a long time period

  - This is a **paper** that contributes to the policy debate about stabilization mechanisms ;

This paper: Objective, Data, Methodology and Results

- **Data:**

➢ Use of daily foreign exchange rate data from Jan 2002 to Nov 2019, data from investing.com

➢ To build the optimal basket of currencies, collect data relative to the foreign exchange pairs between the currencies that are included in the IMF's Special Drawings Rights: the US dollar, the Chinese Renmimbi, the Euro, the British pound and the Japanese Yen.

➢ What drives the choice of the basket of currencies? More explanation is needed in the paper

- **Methodology**:

1. Optimal basket and stability analysis computing the normalized value in exchange (RNVAL)
2. Assess the spillovers using VAR and Network analysis

- **Results**:
- The proposed stable coin appears to be less volatile than single currencies and to single currency stable coins
- When proposing a variance decomposition technique, they show that a basket based SC is better than a dollar based one, from a stability and value storage standpoint
- A basket based stablecoin allows to offset the risk of currencies shocks

Improvements/extensions:

- On the data:
  - Period of analysis could be extended to 2020 to include COVID-19 period
  - Justify the choice of the currencies in the basket

- On the overall structure of the paper :
  - Better organisation will be benefit the paper – streamlining and emphasise the discussion on the risks of different stabilisation schemes

- On the results and policy discussion :
  - Extend the policy discussion on the impacts of SC on the determinants of a dominant currency in terms of additional loss absorbency and minimum capital requirements, liquidity coverage ratio and NSFR - See Ogawa and Muto (2019 and 2017)

  - What are the impacts on the existing regulatory and supervisory frameworks? Should there be a new regulatory and supervisory requirement for issuing and exchanging SC? FSB (2020)

- *Thank you*
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