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The Geopolitics of US Dollar Stablecoins

The expansion and regulation of stablecoins have become major policy goals of the Trump administration. This form of cryptocurrency has the potential to dramatically improve the transfer of funds between economic entities and could be a new source of demand for US Treasurys. In this report, we will define what stablecoins are and then examine the evolving regulatory framework, how the emerging stablecoin market relates to monetary and geopolitical history, and the ways in which stablecoins could become a tool of geopolitical power for the US. As always, we will conclude with market ramifications.

What Are Stablecoins?

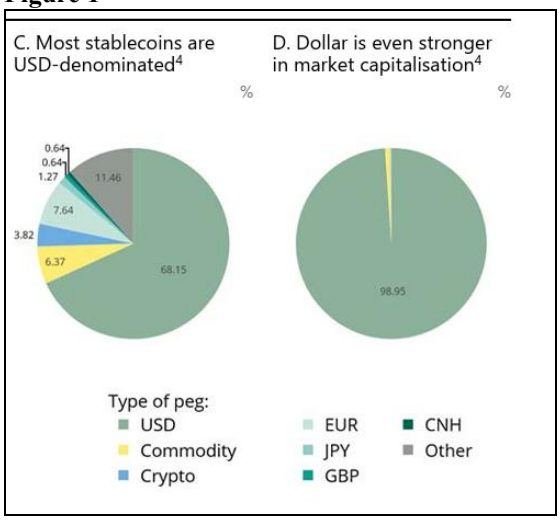
Cryptocurrencies are currency-like assets that are transferred on permissionless blockchains. This means that a public ledger exists (the blockchain) where a buyer and a seller of a particular cryptocurrency can engineer a transfer without using an existing banking system. Stablecoins are a type of cryptocurrency designed to hold a stable asset value relative to a fiat currency.[1] They differ from Bitcoin, Ethereum, or other cryptocurrencies, as these are not usually tied to any particular asset and thus their prices often fluctuate wildly. The initial use case for stablecoins was to offer holders of traditional cryptocurrencies an "off-ramp" from their cryptocurrency holdings. Essentially, if a cryptocurrency holder liquidated their position, acquired a fiat currency, and returned to the traditional financial system, that holder would be exposed to the regulation of that financial system. In other words, if a cryptocurrency position, which is pseudonymous, is liquidated and the proceeds end up in a bank account, that transaction would no longer be anonymous and thus would likely be subject to tax and potentially other regulations. By moving into stablecoin, the position would remain pseudonymous, avoiding regulation, but would not be subject to the volatility of cryptocurrencies. The drawback compared to fiat currencies is that stablecoins are not as widely accepted for payment. Thus, stablecoins, to date, are not perfect substitutes for fiat cash instruments.

And so, the current primary use of stablecoins is to provide an off-ramp within the cryptocurrency space. Mechanisms to use stablecoins as a medium of exchange have not been developed at present. Nevertheless, stablecoins do have promise to expand as a medium of exchange. Being fully electronic, they can facilitate transactions on a 24/7 basis even for cross-border transactions. Currently, cross-border transactions within the correspondent banking system take days and can be quite expensive. Stablecoins offer the potential for nearly instantaneous transactions. In fact, 80% of all US dollar (USD) stablecoin transactions occur overseas.

Although stablecoins can, in theory, be created for any fiat currency, in practice, the dollar dominates current issuance.

[1] Or other assets as well, including gold.

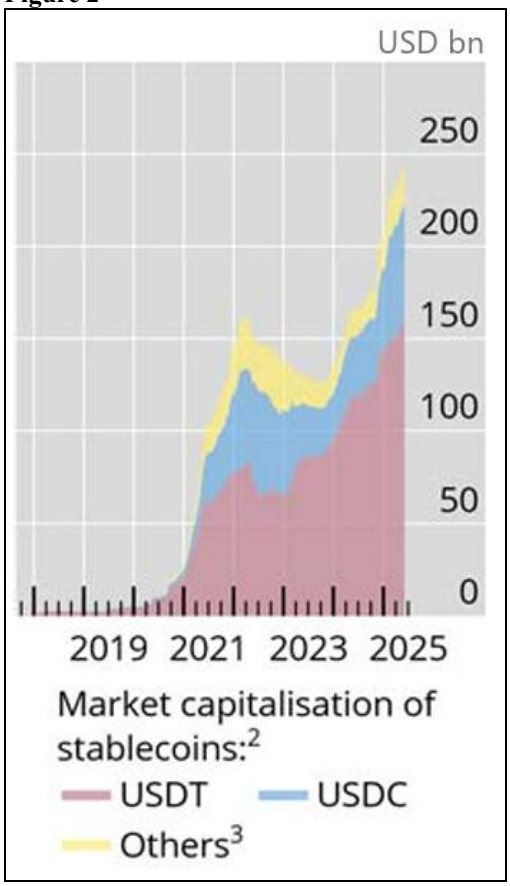
Figure 1



(*Source: Bank of International Settlements*)

Currently, there are two dominant USD stablecoins: Tether's USDT and Circle's USDC.

Figure 2



(*Source: Bank of International Settlements*)

The Evolving Regulatory Environment

Stablecoins have seen episodes where they "break the buck." Although they are advertised as offering a 1:1 relationship with currency, they haven't always been able to maintain that peg. The most spectacular breakdown was the collapse of TerraLuna, a stablecoin that was backed by a derivative scheme, which raised concerns about the overall stability of stablecoins. There have been episodes where USDT and USDC have seen their pegs broken.[2] Tether's USDT, the most popular USD stablecoin, has consistently refused to perform an audit of its holdings, occasionally fueling concerns about its stability. Both hold US Treasury bills and bank deposits to back their stablecoins, although there is no regulatory body that audits these claims.

After years of regulatory skepticism surrounding cryptocurrencies, in general, and stablecoins, in particular, the US government reversed course and embraced the technology, signing the GENIUS Act into law in July. The act creates a regulatory framework that should reduce the risk of holding stablecoins. First, permitted insurers must either be banks, approved non-banks, or state-qualified issuers. Although an approved insurer can choose either federal or state oversight, those using the latter are subject to a $10 billion cap. Second, issuers must maintain a 1:1 backing of issued stablecoins with US currency, bank reserves, short-term Treasurys, or similar highly liquid assets. Third, the act requires stablecoin issuers to undergo monthly

[2] USDT saw prices fall to as low at $0.80 in 2018 on solvency concerns. When the aforementioned TerraLuna collapse occurred, USDT fell to $0.95. The collapse of Silicon Valley Bank raised worries because USDC held its reserves as a deposit in the bank, and it fell to $0.88. Reports that the New York Attorney General was investigating Tether led USDT to a small drop below the peg.

reserve examinations conducted by a registered public accounting firm and to provide an annual audit of financial statements for issuers with more than $50 billion of outstanding stablecoins. Fourth, stablecoins cannot pay interest.

The GENIUS Act ensures the assets backing stablecoins are solid. However, while the assets backing it are above reproach, the liquidity may not be. In other words, there is the potential to "break the buck" if there is a rush for liquidity and the financial system can't liquidate T-bills or repo fast enough. It is therefore possible that stablecoins backed by bank deposits might be preferred, even though they will earn much less than stablecoins backed by T-bills.[3]

Back to the Future

What has been will be again, what has been done will be done again; there is nothing new under the sun. (Ecclesiastes 1:9)

The Genius Act creates conditions that are likely to replicate earlier challenges surrounding the nature of money. There are three issues that could emerge. The first is the prohibition against paying interest. This restriction has been a policy goal of commercial banks, who fear there will be disintermediation of bank deposits if stablecoins pay interest. In other words, the bank's existing low-cost deposit base will flee. Currently, there are alternatives to low-return bank deposits, such as money market funds and certificates of deposit. However, the former usually require a brokerage account, which have high minimum balance thresholds, and the latter usually have restrictions on withdrawals. Stablecoins would not have such constraints and thus are a threat to the bank's deposit base.

This situation is similar to money market conditions that evolved from the early 1930s into the early 1980s. The Banking Act of 1933,[4] passed during the Great Depression, had a clause called "Regulation Q" that prevented banks from paying interest on demand deposits and capped interest rates on savings deposits and certificates of deposits. The idea was that if banks competed to acquire deposits and paid higher costs of funds, they would be inclined to make risky loans to compensate. When inflation was contained, these constraints were not a serious problem, but as inflation rose from the late 1960s into the early 1980s, bank deposit rates fell below the rate of inflation. Bank savers had limited options to protect purchasing power, and eventually bank deposits left the banking system. Less affluent households simply stockpiled goods. Wealthier households moved deposits overseas to the Eurodollar market, which was not encumbered by Regulation Q. In the early 1970s, the money market fund was introduced in the US. These were essentially open-end mutual funds that invested in short-dated debt and paid more attractive interest rates. However, they were not demand deposits and were generally not designed to facilitate payment.

If the banks are successful in prohibiting the payment of interest on stablecoins, we expect non-GENIUS Act stablecoins to be established that will be interest-bearing. Currently, Tether's USDT and Circle's USDC offer interest but only if the stablecoin is deposited on a platform, allowing borrowers to use it and pay interest. Both companies earn interest based on the collateral assets that back the stablecoins (e.g., bank deposits, T-bills,

[3] For an in-depth analysis of the hierarchy of money and the liquidity issue, see *The Hidden Plumbing of Stablecoins: Financial and Technological Risks in the GENIUS Act Era*.

[4] Also known as the Glass-Steagall Act.

repo, etc.), but they do not share the revenue with the owners of the stablecoin. Thus, we could see new competitors emerge that would simply offer an interest rate less than what the issuer is earning on the assets backing the stablecoin.

An interest-bearing stablecoin, as we described above, that would pay out of the interest earned on its assets would have less of a buffer compared to a GENIUS Act-compliant stablecoin. During periods of financial stress, the non-GENIUS Act stablecoin would be more likely to break its peg. Presumably, holders of such stablecoins would be aware of this risk, so this type of event shouldn't necessarily create systemic risk. However, if the money market industry offers any parallel, a non-GENIUS Act stablecoin could lead to runs on stablecoins and cause systemic risk. Although money market funds are technically subject to "breaking the buck," the financial system treats them as cash and thus such events tend to trigger runs. Simply put, while stablecoins do offer a new method for making payments and holding currency, they could easily echo the pattern from the 1970s of investors attempting to boost returns without fully recognizing the potential risks. If the future turns out to be inflationary, as we fear, this problem could become acute.

The second "back to the future" issue is that under the terms of the GENIUS Act, non-banks will have the ability to issue stablecoins. Thus, companies like Amazon, Walmart, or any others that meet the bill's criteria can issue their own stablecoins. Since cryptocurrencies have the ability to be programmed, banks fear that such stablecoins could offer rewards points in lieu of interest. In addition, it is not clear if, or why, one company would honor a stablecoin issued by another (e.g., Amazon honoring a stablecoin from Walmart).

Again, something similar has occurred before. During the Free Banking era after President Jackson closed the Second Bank of the United States, banks were able to issue their own banknotes, which were treated as currency. However, these banknotes were not universally accepted. First, many banks were state regulated, and the notes from these banks were less appealing outside the state of the issuing bank. Second, there was uncertainty surrounding the assets backing the banknotes. Over time, a system of exchange rates developed where some banknotes were not accepted at face value. Although complying with the GENIUS Act should give anyone accepting such a stablecoin confidence that they are worth what they represent, the potential conflict of accepting a stablecoin from a competitor could create problems for non-bank issuers.

The third issue arises from the debate about who can create money. Throughout history, there has been tension between private sector issuers of money (mostly banks) and government. Banks issue money through lending. Since this money is backed by a liability (a loan), there is always a risk that the borrower defaults, which would act to reduce the money supply. Thus, bank runs are a systemic risk to money issued in this fashion. Government-issued money carries a different risk. Under a fiat monetary system, the government can always fund its liabilities, but it could issue too much currency (via spending) and trigger inflation. Over time, governments have managed the risks from bank-issued currency through a combination of market discipline and regulation. Banks don't want to lose money, so they exercise caution in lending, and regulation also works to prevent reckless behavior. Placing constraints on government varies by nation; some do it via the

legislative process, while others do so through laws that restrain spending.

As one might guess, there is a similar pattern for stablecoins as well. The US, via the GENIUS Act, is clearly leaning toward the private issuance of money. But other nations are issuing, or investigating, central bank digital currencies (CBDC).[5] The Federal Reserve has explored the issuance of CBDCs, but the *H.R. 1919: Anti-CBDC Surveillance State Act* strictly prohibits the issuance of such currencies. The bill was introduced on July 17, 2025; it has not yet passed through the Senate, but the fact that the House bill exists shows strong opposition to CBDCs.

Because cryptocurrencies are potentially programmable, there are concerns that a state-issued stablecoin could be used by the government to impede behavior. For example, the CBDC could be programmed not to transact for certain goods or services, e.g., illicit drugs. Although the private sector does restrict some of this behavior via "know your customer rules," currency is a bearer instrument and can be used for anything. In addition, as mentioned, cryptocurrencies are pseudonymous; although transactions can be difficult to monitor, it isn't impossible. It really comes down to which issuing entity one trusts more — your government or a company. In the US, there is mostly a tendency to prefer the latter. Other nations, notably China, have opted for CBDCs.

It is unknown if foreign holders of USD would prefer privately issued stablecoins compared to a CBDC. Put another way, would a stablecoin holder in the Middle East prefer a USD stablecoin issued by JP Morgan or a CNY stablecoin issued by the People's Bank of China? It's probably impossible to know in advance, but our take is that there is a growing distrust of governments, and thus, a USD stablecoin issued by a well-known company or bank will likely be more popular than any government-issued stablecoin.

The Geopolitics of USD Stablecoins

The dollar's reserve currency status was made official at Bretton Woods in 1944. The postwar structure, unfortunately, was flawed as Robert Triffin discussed in the early 1960s. Triffin noted that when a nation uses its currency as the global reserve, there is a strong incentive to run trade deficits; the deficits allow the global supply of the reserve currency to grow. But this creates a dilemma: If the supply of the reserve currency outside the issuing nation becomes too large, it creates depreciation pressures and, under the Bretton Woods system, a gold outflow. To prevent such a problem, the nation issuing the reserve currency can implement policy austerity, but that leads to a contraction of the global money supply.

The resolution of the Triffin dilemma was to break the link with gold and end fixed exchange rates. On August 15, 1971, President Nixon unilaterally and formally ended the Bretton Woods system by closing the gold window and allowing the dollar to float. It took nearly a decade for the replacement system to evolve. After the financial turbulence of the 1970s, the monetary austerity implemented by Fed Chairman Paul Volcker established a global monetary framework in which the dollar was the reserve currency and the US Treasury became the primary reserve asset. The setup was remarkably elastic, fostering expanded globalization and the absorption of the former Soviet bloc following the collapse of the Soviet Union.

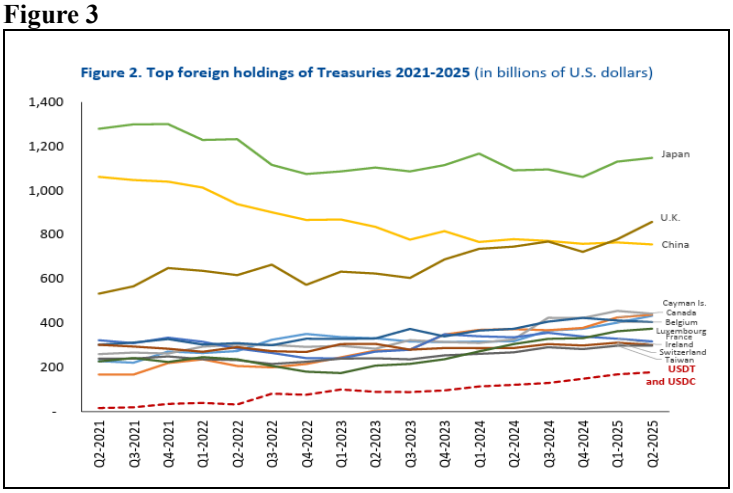
[5] See our series on "The Geopolitics of Central Bank Digital Currencies," Part 1, Part 2, Part 3, and Part 4.

However, the resolution rested on the US capacity to create debt that was considered safe and acceptable to global reserve managers. Foreign reserve managers liked the depth of the US Treasury market but were also aware that it could tempt US policymakers toward fiscal profligacy. Concerns about this issue were persistent into the late 1980s, but the end of Communism and the improvement in the US fiscal situation, mostly from the reduction in defense spending, raised confidence. Unfortunately, this confidence has eroded over time due to the policy measures tied to spending for the wars in Afghanistan and Iraq and the policy stimulus implemented after the Global Financial Crisis. Adding to this uncertainty is the inclination of American policymakers to expand the use of financial sanctions against nations that engage in policies opposed by Washington. The most potent example of this was the decision by the Biden administration to freeze Russia's foreign reserves after Moscow invaded Ukraine in 2022.

One way to improve confidence in Treasury assets would be to find a new source of demand. Here is where USD stablecoins enter the picture. US dollars are used for roughly 88% of global foreign exchange transactions but only about 60% of forex reserves. This report from the Federal Reserve shows the degree of USD dominance. Nevertheless, the recent rise in gold prices, in part due to increased demand from foreign reserve managers, suggests that foreign demand for dollars and US Treasurys may weaken in the future.

USD stablecoins represent a potential source of new demand for Treasurys. A GENIUS Act stablecoin can be backed by T-bills, and it's conceivable that non-GENIUS Act stablecoins would also use them for backing. Already, the Treasury holdings of USDC and USDT are rising among a league of foreign national Treasury holdings.

Figure 3



(Source: Brookings Institute)

Another factor to consider is that there are $1.5 trillion of physical dollars held overseas. If USD stablecoins become an alternative to holding physical currency, demand for stablecoins will rise. There is no doubt that some physical currency held abroad is tied to illegal activities and there is a risk that using stablecoins could reveal the holder. But some portion of these currency holdings are likely for safekeeping.

In addition to physical dollars, cross-border payments represent between $1.0 trillion to $1.5 trillion and Eurodollar deposits are between $10 trillion to $13 trillion. Thus, the total offshore dollar system is in the neighborhood of $15 trillion.

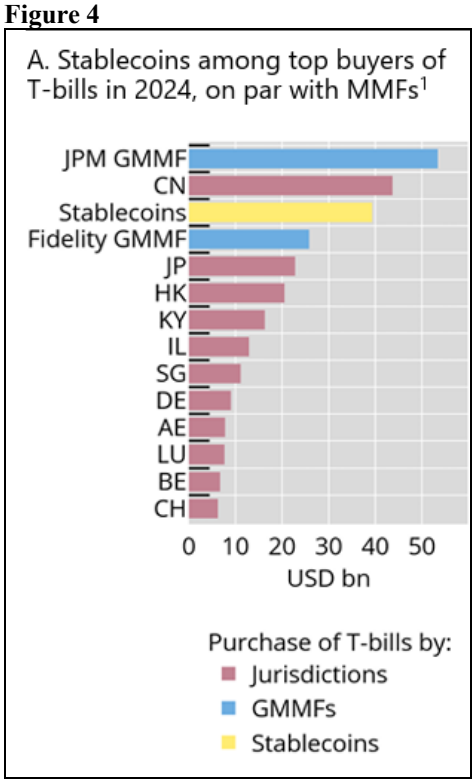
Building on this idea, stablecoins could expand the use of dollars by foreigners, especially in unstable currency regimes. During my tenure as a country risk analyst for a bank in the late 1980s, I saw firsthand how wealthy Argentines and Brazilians held dollars and D-marks as savings and only transacted in local currency[6] for purchases.

[6] Both nations went through a series of currencies during this time period.

Such protection was not available for the less affluent as the costs of a corresponding bank relationship made holding foreign currency unfeasible. USD stablecoins would reduce the cost of holding dollars, allowing less affluent households to protect their purchasing power. This demand remains today. A study from 2022 found that cryptocurrency use increases with corruption and capital controls. Countries such as Argentina and Venezuela — both dealing with currency instability, high inflation, and political instability — are increasingly using various forms of cryptocurrencies in order to protect purchasing power.

Brookings estimates that USD stablecoin penetration of total offshore dollar holdings is about 1.5%. With no growth, the think tank projects that T-bill demand could rise to $3.0 trillion by 2030; with 10% growth, it would reach $4.8 trillion. In 2024, the BIS estimated that USD stablecoins were the third largest buyer of T-bills.

Figure 4



(*Source: Bank for International Settlements*)

This is where geopolitics becomes interesting. Foreign governments face the possibility that USD stablecoins could undermine monetary sovereignty. Often, countries facing debt problems resort to financial repression, which includes forced purchases of government debt at interest rates below inflation. Currency depreciation is a natural result. If households and businesses have access to USD stablecoins, they could thwart these efforts. As we've noted, in the past, only wealthy households had the option of holding dollars. USD stablecoins would "democratize" this protection by being accessible to anyone with a smartphone and a digital wallet. Obviously, less developed nations are concerned about the loss of monetary sovereignty, but even developed economy financial authorities are expressing concern. For example, when the eurozone was facing financial stress in 2011, Switzerland saw inflows that disrupted its financial system. At the time, there were concerns that some of the southern European nations might not be able to remain in the eurozone, and investors sought safety in Switzerland. USD stablecoins could be an alternative to such flows that would be simple to implement.

In response, nations are considering accelerating the development of CBDCs as an alternative. China, especially, has been moving forward with its CNY CBDC. The programable nature of cryptocurrencies makes state-issued currencies attractive. For example, during the pandemic, the US Treasury labored to send money to households quickly. Millions of checks had to be cut; it isn't hard to envision instead the ablility to instantly transfer a digital stablecoin to a household wallet. In addition, the currency could be programmed with restrictions on what it could be used for or the purchasing power could be adjusted

according to household income.[7] The programmability may actually make private sector-issued stablecoins more attractive; it seems likely that a company or bank issuing a stablecoin would be less inclined to place the same constraints that a government would deploy. Of course, private issuers could have their own rules, giving preferential treatment for using a retailer-issued stablecoin within the retail network. In addition, spending patterns could be tracked and the data used for purchasing decisions.

The ability of a nation to restrict USD stablecoins will depend on its ability to monitor digital activity. China has proven it can monitor and control digital activity; for example, it ended bitcoin mining in 2021 (although we note that China's expansion of electrical power has led to a return of bitcoin miners despite the ban). The country has successfully blocked some US-based social media companies from operating within its borders. The restrictions are not completely successful as some Chinese users have managed to operate outside the "Great Firewall" by using VPNs. But we would expect that China will mostly be able to prevent widespread adoption of USD stablecoins. Most other nations, however, do not have the degree of obstruction that China deploys and thus could see their monetary sovereignty erode.

Market Ramifications

The most obvious market ramification is that the expansion of USD stablecoins will tend to boost the dollar and support Treasury prices. If the Treasury sells more T-bills to meet the demand for stablecoin collateral, it should reduce the need to issue longer-duration notes and bonds. Interestingly enough, a stronger dollar may not be in America's best interests. If the US wants to reindustrialize, a weaker dollar would assist in that effort. Thus, using USD stablecoins to maintain the dollar's reserve currency status may bring unwanted externalities. That doesn't mean that a stronger dollar is inevitable; the Treasury and the Federal Reserve could take other steps to weaken the dollar, including currency intervention, capital restrictions, and interest rate reductions. However, the process of weakening the dollar could be more difficult.

Overall, a successful launch of USD stablecoins will tend to solidify America's hegemonic position and should offer support for US assets. Again, this is a *ceteris paribus* situation. Other factors, such as internal political stability, reindustrialization policy, overall policy stability, etc., will also factor into the relative performance. On its own, the emergence of USD stablecoins is likely to be a positive for US financial and real assets.

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[7] In other words, a government could give its currency a premium for lower income households and a discount for wealthier ones.

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