**Digital Economy / Digital Trends**

# Libra, a digital currency that is still surrounded by questions

Expansión (Spain)

**Alejandro Neut**

The announcement of the launch of Libra, the digital currency that Facebook plans to implement, has sparked interest, concern and, above all, great uncertainty about its viability as a business and its financial and social impact. This uncertainty can be conveyed in the form of three key questions: How convertible, how well supported and how well regulated would Libra be?

Convertibility is an essential property that would set it apart from other digital currencies such as Bitcoin. Each Libra would be a promise by the issuer to "convert it" into a predetermined and as-yet-undefined basket of currencies, which will probably be similar to the basket of currencies of the Special Drawing Rights used by the IMF when providing loans to different countries. However, there are different degrees of convertibility, which depend on the credibility of said contract. From a simple promise of parity backed up by the reputation or strength of the issuer, to the mechanisms by means of which each unit issued is supported, individually, by the assets in question.

Facebook says that each Libra would be individually backed by the currencies in the aforementioned basket or, alternatively, by bonds issued by the associated governments. However, the price of the bonds isn't fixed over time, which would immediately put Libra in danger of abandonment when the price of said assets drops (or exchange rates rise) or, in a less extreme scenario, there is the risk of a liquidity crisis.

But the problem doesn't end there. According to Facebook, Libra will also be backed by bank deposits. Will these deposits be 100% backed by the respective central banks and not just the banks where they are held? The thing is that, if the convertibility of each individual Libra isn't backed up by specific reserves, it runs the risk of creating a self-fulfilling prophecy that promotes the potential risk of abandonment and instability. This is an original sin that can only be resolved if the central banks issuing the currencies in the basket offer their unconditional support as "insurers of last resort." But will the leading central banks be willing to offer their support?

The support of the central banks is never free and it is always in exchange for greater regulation. For example, if Libra intends to use its reserves to invest in even the safest of bonds, then it would be stepping into commercial banks' very own business of liquidity transformation, with the resulting creation of money and risks to financial stability. But would the central banks support Libra without demanding strict regulation in exchange? Their concern doesn't end there. Even if Libra doesn't go into the transformation business, there is the wild scenario in which the digital currency becomes so successful that it ends up replacing deposits in commercial banks. This would sabotage a significant source of credit for developed economies, something that would only be welcomed by long-standing supporters of narrow banking. In the most extreme version of events, imagine a future in which Libra is extremely successful, to the point of becoming a "unit of account." In other words, all prices –from the price of coffee to the price of real estate– would be understood when measured in Libra. In this scenario, how would we determine the efficiency of the central banks involved when it comes to controlling inflation?

There are other important reasons for regulating the Libra, beyond those that only concern the central banks. Depending on its model, the digital currency could facilitate illegal transactions, tax evasion and money laundering. Furthermore, there is increasing awareness about the misuse of the data stored by large platforms, with Facebook in the eye of the storm. But how do we go about monitoring and regulating the way the social network claims it plans to use and sell data on transactions in Libra? Ultimately, Facebook's business is using data – and it has never been shy about the fact.

A clear vision in terms of the three key questions mentioned above is essential in order to evaluate its viability, both in terms of its appeal to possible investors in Libra/Facebook and in terms of offering a response to the concerns raised by the respective authorities.

# DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com