

# Central banks face dilemma over rise of dollar-backed stablecoins

Countries balance the public's demand for digital cash against sector's financial stability risks

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Global central banks face a dilemma over whether to embrace stablecoins or promote alternatives to the new technology as the US's aggressive backing of privately issued tokens thrusts the fast-growing sector into the financial mainstream.

Politicians in Washington are this week advancing legislation to ban the US Federal Reserve from issuing a digital currency and provide a regulatory framework for privately issued stablecoins.

For the Trump administration, such tokens, which are mostly backed by dollar assets, offer a vehicle to project the strength of the greenback globally.

But the Bank for International Settlements, the umbrella body for central banks, last month warned that the unchecked rise of stablecoins could threaten the public's trust in money, imperil monetary sovereignty and potentially pose financial stability risks.

Policymakers are also wary that these tokens can act as conduits for crime.

Some countries are instead trying to develop their own central bank digital currencies, which would give the public access to safe central bank money in digital form and could stem the tide of dollarisation. But such projects have so far had limited success.

“We’re in this bizarre world right now where dollar-backed stablecoins are dominant,” said Christian Catalini, founder of the Cryptoeconomics Lab at the Massachusetts Institute of Technology. “Left unchecked, this is a road towards rampant dollarisation.”

He added: “But this isn’t the equilibrium. Other countries around the world understand this. Their dilemma is: do you try to slow this down or embrace stablecoins as a source of financial innovation by promoting domestic [versions]?”

There are around \$250bn of stablecoins in circulation globally, with virtually all linked to the dollar.

Investors have piled into such instruments, which can be used to park cash before trading cryptocurrencies or as a means of payment.

Transactions settle in minutes rather than days and usually at a fraction of the fee charged by banks.

Analysts expect the sector to expand rapidly. The Citi Institute recently said it expected the supply of stablecoins to reach \$1.6tn by 2030 and could grow to as much as \$3.7tn, boosted by the US’s more crypto-friendly legislation.

But the sector’s rapid growth creates the risk that countries that do not follow suit could miss out on sector growth and the chance to shape regulation.

The Bank of Korea last month suspended trials of its own central bank digital currency and eight local commercial banks are working on a joint won-backed stablecoin.

In recent months, the Bank of England has signalled that it will relax its previous restrictive stance on stablecoin issuers.

“UK authorities have moved because they’re suddenly worried about losing competitiveness in a world in which the US wants to make stablecoins mainstream,” said Varun Paul, senior director for financial markets at Fireblocks and former head of the BoE’s fintech unit.

He added that much had changed since the BoE launched its first consultation on regulating stablecoins in 2023.

“Back then, the technology was on the fringes of the financial system but now its growth is skyrocketing,” Paul said. “The BoE understands that, if it doesn’t relax its approach, it will lose the ability to set the rules.”

However, this month Bank of England governor Andrew Bailey told The Times that moves by big banks to launch their own stablecoins could threaten financial stability.

He also said it would be “sensible” for the UK to move towards tokenised deposits — digital versions of commercial bank money that allow for faster settlement — rather than launching a central bank digital currency.

In the Eurozone — where some policymakers hope to promote the euro as an alternative reserve currency to the dollar — the European Central Bank has been a strong advocate for a central bank-issued digital currency.

The bank has been working on its own digital euro project for retail use since 2021 and is keen to limit the bloc’s dependence on US companies for payments infrastructure.

But while there are 69 retail CBDC projects in development globally, only three are live while two have been cancelled, according to the Atlantic Council, a think-tank.

Overshadowing CBDC projects is the experience of Nigeria. In 2021, the west African country launched its own digital currency but consumers largely shunned it, instead opting to buy privately-issued dollar-backed stablecoins.

The project’s failure led to the government cracking down on cryptocurrency exchanges.

The Nigeria experiment failed in part because the so-called e-naira was only a digital version of the underlying fiat currency, which was also not trusted by the public, said Nitin Datta, chief of staff at UNDCIF, a United Nations body for digital assets.

“Nigeria was an open market experiment,” he said. “Exchanges and stablecoins will have a role to play as you can’t shut out the market.”

But Ruth Wandhöfer, chair of the UK payments systems regulator, said stablecoins still had to prove they could be used at a large scale.

A global corporate treasurer “can’t use stablecoins to make large value transactions across borders”, she said at a conference last month, citing foreign exchange costs.

“In some countries, there is also a lack of consumer financial education, payment network and IT hardware and transparency,” she said. “Ultimately it means that, if you start using stablecoins in the middle, to get cash in and cash out, you may end up paying more than if you went to Western Union.”

She added that more transactions taking place in cryptocurrencies would mean less taxation for governments.

“So of course we have to have a digital sterling and digital euro eventually,” she said.

For such projects, the creation of a digital euro is now the litmus test, said Josh Lipsky, senior director of the geoeconomics centre at the Atlantic Council.

“If the Eurozone gets this right, it would show the world that a public-sector option is viable — and become the global standard-setter for it,” he said.