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What do stablecoins mean for dollar dominance?

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Stablecoins are emerging as the US administration's response to keeping the dollar as the dominant global currency. This paper explores whether this will indeed be the case, and how it might work. We focus on the implications of dollar stablecoins for the world's three main geopolitical blocs: US, Europe and China.

How might stablecoins support the dollar?

There are two main elements to the dollar's dominance. First, the willingness of the world to save in dollars which gives the US exorbitant privilege. Second, the use of the dollar for cross-border payments, which gives the US geoeconomic leverage. Crucially, the two are linked via private sector preferences for invoicing and savings. The USD has been losing ground in central bank reserve holdings, and the battle for global payments has been heating up. Dollar correspondent banking has been at risk of disruption from new technology, geopolitical competition, alternative payment systems, and underserved corridors in the Global South.

Stablecoins appear to be the US' answer to defending the dollar's position in global payments, opting for a private-sector solution over CBDCs. It is arguably a punt on a new technology, and a new mechanism of payment that spurns the existing two-tier monetary architecture rooted in central bank settlement. Corporate adoption has thus far been limited, and skepticism around the money properties of stablecoins needs to be overcome. The proof of the pudding will be in the paying. But with the US regulatory blessing, the benefit of incumbent FX dominance, and a first-mover advantage, the potential cannot be ignored. Significant growth in dollar stablecoins for cross-border payments could challenge Europe's efforts to promote a more global euro, and China's agenda for RMB internationalization.

How should Europe and China respond?

Europe should develop an ecosystem of bank and corporate issued EUR stablecoins as a competitive hedge to both domestic payments sovereignty and global EUR invoicing. Europe is getting a lot right in improving its potential as a global savings asset - but remaining relevant in global payments will be key. Importantly, Europe is better placed than China to support local currency stablecoins: it has a higher share of trade invoicing in euros, deeper trust with trade partners, an open capital account, and transparent institutions.

China's ability to compete in a stablecoins world could be more constrained by a managed capital account and a more limited pool of offshore RMB deposits. But China's stakes for payments independence are also higher, and China is making it's own bid for reserve currency status. A fiercer global payments battle centered on stablecoins could be the catalyst to encouraging greater capital account openness.

Authors

Mallika Sachdeva
Strategist
+44-207-545-1941

George Saravelos
Strategist
+44-20-754-79118

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What is the real power of stablecoins?

In a fiat system, the currency is backed by the fiscal, monetary and institutional credibility of the government, rather than a hard asset like gold. A defining question for the dollar is thus whether stablecoins extend - or at least defend - fiscal financing support for the US. While a lot of focus has fallen on the demand that stablecoin issuance creates for front-end T-bills, we see this as a red herring. If stablecoin demand comes out of bank deposits, this would be a poor substitute for UST demand. And greater front-end issuance by the US Treasury, even if lower cost, would create higher rollover risks for the government.

The real power of stablecoins will come if they secure - or ideally expand – the private sector's commitment to dollar-based payments. Invoicing preferences are closely linked to private sector savings behaviour, and should ultimately be mirrored by official reserves. This is the weapon that stablecoins may hope to become.

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What do stablecoins mean for dollar dominance?

"We are going to keep the U.S. the dominant reserve currency in the world, and we will use stablecoins to do that" – Scott Bessent, US Treasury Secretary

The US government appears to have thrown its weight behind stablecoins, claiming they will help secure the dollar as the world's reserve currency by driving demand for US Treasuries and making the US the leader of the digital currency revolution (White House). The goal of this paper is to probe deeper into whether this will indeed be the case, and how it could work.

We begin by diagnosing the state of dollar dominance today, focusing on its role as the currency of global savings and global payments, and the crucial inter-linkage between the two. We offer our understanding of some different facets of stablecoins: the regulatory landscape, whether they can be considered money, and the parallels to dollar cash and eurodollar deposits. **But the crux of this paper looks at the battle for cross-border payments and the role that stablecoins will play in shaping this, with dramatic implications for the global role of major currencies like the USD, EUR and RMB.**

1. Diagnosing the state of dollar dominance

We begin by diagnosing the state of dollar dominance today: if we can identify where there might there be chinks in the dollar's armor, we can analyze where stablecoins might help plug them.

There are two critical elements to the dollar's global dominance: the willingness of the world to save in USD ("reserve currency"), and the use of the USD and dollar-based rails for cross-border payments ("global invoicing currency"). These are both big sources of global power.

Being the currency of choice for reserve assets gives a country the *exorbitant privilege* of being able to borrow more cheaply. Moreover, in times of crisis, when there is a rush for the global safe asset, the reserve currency country is best able to fund countercyclical stimulus.

Meanwhile, control of cross-border payments gives a country enormous *geoeconomic leverage* with the ability to levy sanctions and control the economic activity of all other countries in the world. We look at a range of metrics to gauge the evolving dominance of the dollar on these two pillars.

How is the dollar faring?

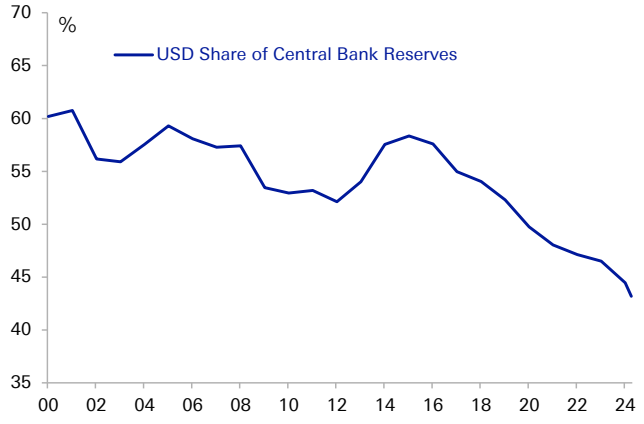
One can argue that the dollar's role as a "reserve currency" - in which foreign central banks hold their savings - appears to be in retreat. The USD has gone from being 72% of foreign central bank FX reserves at the start of this century to 57% today on IMF's COFER data. We prefer a measure that accounts for holdings of gold into which central banks have been more actively diversifying. Here the USD's decline has been sharper - declining to a share of 43% from 60% at the start of the century, and down by almost 10% in the past five years alone (Figure 1). There are perhaps reasons to not be alarmed yet. The USD's lost ground in central bank

reserves has been partly on account of higher gold prices. And the diversification of the foreign exchange share of reserves has mostly gone to smaller currencies like AUD and CAD, rather than alternative power-blocs like EUR or CNY so far. This might moderate concerns around a hegemonic currency transition. Nevertheless, there could room for this trend to build and accelerate.

Policy developments - in the US and in other geopolitical blocs - may add to the momentum around official sector de-dollarization. Growing concerns around US policy erraticism, the US security umbrella, less friendly trade dealings, worrying fiscal trends, central bank independence, and the spectre of Mar-a-Lago and Section 899, are just some reasons to expect more reservations about dollar based savings by foreign official sectors. Competition for reserves is also set to go up, as the world becomes more multipolar and as the funding needs of other geopolitical blocs rise. The ECB has spoken about a "global euro" moment: where the combination of growing hard power, greater safe asset issuance, and institutional credibility should enhance the prospects for the EUR (we also explored this here). Meanwhile, the PBOC has spoken of the need to reduce reliance on a single sovereign currency.

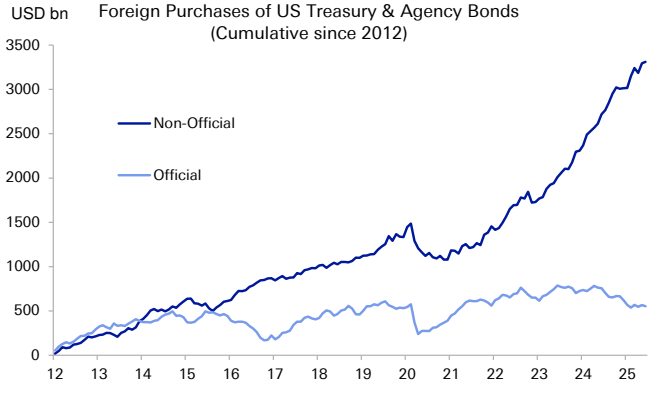
The foreign private sector has however remained happy to add to savings in USD in recent years. While the foreign official sector[1] has not added any USD savings in the past 10 years, the non-official or foreign private sector has bought close to USD3tn in US government fixed income (US Treasuries and Agency bonds) over the same period. Foreign private capital has thus continued to fund both the US external and fiscal deficits, even as foreign reserve managers have become more circumspect. The continued growth in the eurodollar market - that we discuss in more depth below - also exhibits a continued willingness by foreign corporates and retail to hold USD in offshore deposit accounts. **As we will explore, stablecoins may look to leverage on this *private sector* demand for dollars.**

Figure 1: The USD has been losing ground as a "reserve currency" for central banks



Source : Deutsche Bank, Haver Analytics; Note: We use total reserves including gold at market prices

Figure 2: But the foreign private sector has continued to increase exposure to US government fixed income



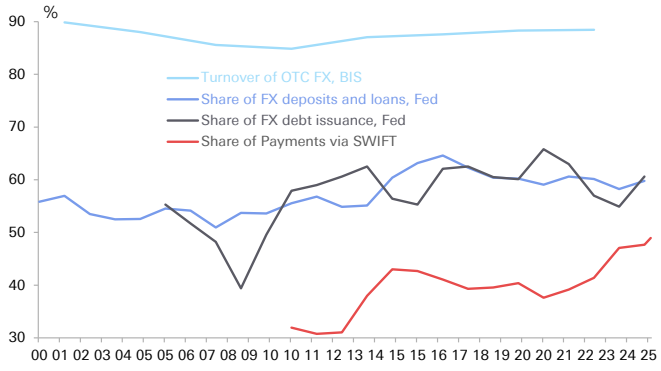
Source : Deutsche Bank, Haver Analytics; Note: We use cumulative foreign monthly purchases (valuation-adjusted using Bertaut-Judson method)

1 A partial list of the foreign institutions classified as "official" according to the US Treasury TICS data can be found here

On cross-border activity and payments, the USD appears to be holding its own for now, but this masks growing threats from technology and geopolitical competition. According to the Fed, the USD makes up around 60% of the share of cross-border FX deposits, loans and debt securities. The USD is just below 50% of all messages exchanged on SWIFT for cross-border payment, which has actually edged up in recent years. Data on the actual USD share of trade invoicing is hard to come by, but recent studies put it around 40% of all global trade, around 50% when intra-EU trade is excluded, and as high as 74% in Asia-Pacific trade. On FX transactions, the dollar remains hugely dominant: 88% of FX transactions have a USD leg, according to BIS. On many of these metrics, dollar dominance appears to be comfortable.

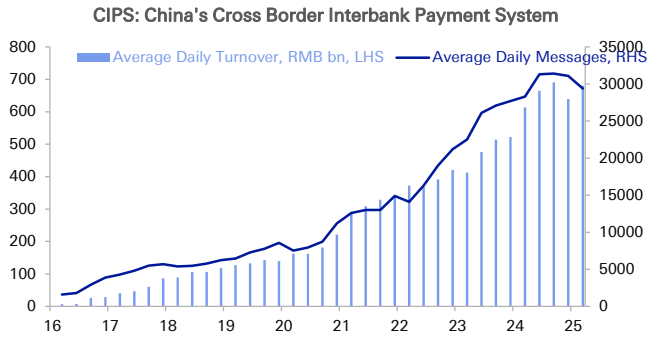
But the dollar's role in payments is also where there has been a growing risk of disruption, with the development of alternatives and increased competition over payment rails particularly in the Global East and South. As we discuss in this paper, the correspondent banking system is both archaic and in retreat, and is thus at risk from technology that offers superior solutions to slow settlement times, high fees, and fractured access. Geopolitically, the use of US sanctions to cut Russian banks off SWIFT has led to renewed interest in developing alternative payment rails, particularly by the BRICS. China has developed CIPS and is supporting Project mBridge that explores cross-border CBDC payments. BRICs countries have been making a push for local currency invoicing, with China seeing a renewed rise in RMB invoicing of local trade. Therefore, while the data suggests nothing has yet made a real dent in the dollar's role in cross-border payments, the battle for alternative payment systems is heating up and the US will need to respond to defend its turf. **Stablecoins may play an important role defending the dollar's dominance in global payments, but will require broader corporate adoption for cross-border payments, which are still a very small share of use cases.**

Figure 3: The dollar's use in cross-border activity and payments appears steady and secure at first glance...



Source : Deutsche Bank, Fed, BIS, Bloomberg Finance LP

Figure 4: But there is a growing threat from geopolitical competition and technology that the US needs to respond to



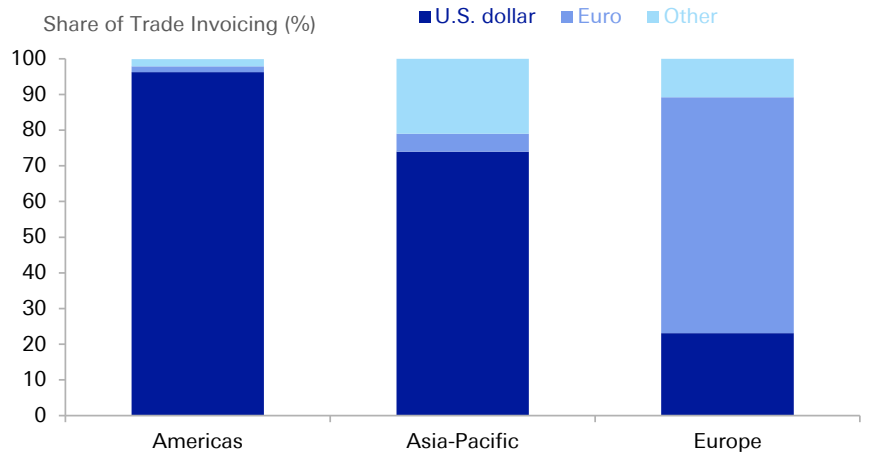
Source : Deutsche Bank, CEIC

Crucially, the dollar's role in global payments and savings are themselves deeply interconnected. As Gopinath and Stein (2018) found: "a currency's role as a unit of account for invoicing decisions is complementary to its role as a safe store of value." The building blocks of this relationship as described in the paper are as follows: a private sector agent will naturally hold deposits in the currency in which it can buy a known quantity of a specific good in the future. Dollar deposits best serve that

function if goods are priced and invoiced in dollars in the global market, given exchange rates fluctuate in value. It follows that: the more the world uses dollar-based payment rails, the more that goods will be invoiced in dollars, the more the private sector will hold savings in dollars. An excess demand for safe dollar claims means the expected return on dollar assets eventually declines (the exorbitant privilege), which in turn makes it cheaper for foreign firms to borrow in dollars in capital markets. This reinforces firms' desire to invoice in dollars as they can source trade finance more cheaply in the currency. The feedback loop therefore extends both ways. Ultimately, the dollar based liabilities of banks and firms in an economy encourages the central bank to hold reserves in dollars in order to serve the function of being a lender of last resort.

Therefore, the extent to which stablecoins defend - or even extend - the dollar's role as the global *payments* currency of choice will help reinforce the dollar's role as the global *savings* currency in a mutually reinforcing way. Keeping the private sector on dollar payment rails is deeply tied in to keeping the dollar as the world's reserve currency and stablecoins may be being used to reinforce this.

Figure 5: Keeping the world on dollar payment rails and the dollar as dominant invoicing currency is deeply intertwined with it's reserve currency status



Source : Deutsche Bank, Federal Reserve

2. A 101: What are stablecoins?

Stablecoins are a particular subset of cryptocurrencies: they use blockchain rails but have the backing of fiat currencies as their driver of value.

Like cryptocurrencies, stablecoins are digital tokens hosted on blockchains: they are issued and traded on distributed ledgers, are accessible anywhere through the internet, and are programmable. But they are fundamentally different from a cryptocurrency like Bitcoin in how they are valued and backed. A stablecoin aims to maintain a peg to a fiat currency like the USD, offering the ability to convert from a digital "on-chain" token to a fiat "off-chain" currency at par. A stablecoin is thus a *liability* of the issuer.This is not the case for Bitcoin where no liability is borne by the issuer. Bitcoin's value fluctuates in USD terms based on market demand for its fixed supply of 21 million coins, while a stablecoin is expected to retain its value in USD terms at 1:1. **While Bitcoin can be regarded as an *alternative* to fiat currency, sometimes referred to as digital "gold", a stablecoin is the digital on-chain *representatio*n of fiat currency.**

Stablecoins emerged to support on-chain payments in cryptocurrency trading, but have created the wider possibility of transferring fiat value in real-time and across borders for economic activity. According to BCG, 88% of stablecoin transactions in 2024 were for crypto trading. While gold and crypto are alternatives to fiat, they are not necessarily good means of payment. But with stablecoins theoretically maintaining a stable value, they better served the function of money as a unit of account and means of exchange on chain. We note that retail and corporate payments are still only around 6% of stablecoin use cases (BCG), but this is where potential could be immense. While everything from music to messages can move across borders immediately, moving money has remained a slower, sequential process with many separate workflows moving through a network of banks. Being "on-chain", stablecoins offer the possibility of near-instant settlement - where all aspects of monetary value transfer from messaging to reconciliation happen together in the form of a ledger update. In this, they perhaps resemble the virtual exchange of USD cash between two 'hands' on the internet. They are thus often conceptualized as the equivalent of digital cash.

The regulation of dollar stablecoins: the GENIUS Act

Stablecoins have recently received the regulatory blessing of the GENIUS Act in the US, which designated payment stablecoins as "a digital asset designed to be used as a means of payment or settlement; the issuer of which is obligated to convert, redeem or repurchase for a fixed amount of monetary value" the stablecoin at 1:1 against fiat USD currency. Our Thematic Research colleagues have written on the GENIUS Act here. We highlight a few elements of the regulation for our discussion.

First, stablecoin issuers need to hold 100% reserve backing for US-issued stablecoins in the form of high-quality liquid assets. If an issuer mints $100 worth of a stablecoin, they need to invest that $100 immediately in either USD cash, demand deposits in an insured bank, US T-bills with <93 days maturity, short-term repo/reverse repo arrangements, money market funds with equivalent instruments, or central bank reserve deposits. These highly liquid short-term assets are expected to maintain their value, with an expectation that they allow the stablecoin to redeemed for its full value at any time by selling the underlying asset. The GENIUS act mandates that these reserves are reported monthly to the regulator and examined by an accounting firm.

Second, the GENIUS act prohibits US-issued stablecoins from paying interest. The Fed will also not provide deposit insurance, and non-bank stablecoin issuers will not have recourse to the Fed discount window to meet liquidity needs. This appears to be designed to prevent competition with banks whose deposits have these provisions. Banks serve an important credit intermediation function in an economy which stablecoins could disrupt if they cannibalize the deposit base. We note however that in the event of stablecoin issuer insolvency, stablecoin holders will be given priority over all other claims similar to depositors in bank resolutions.

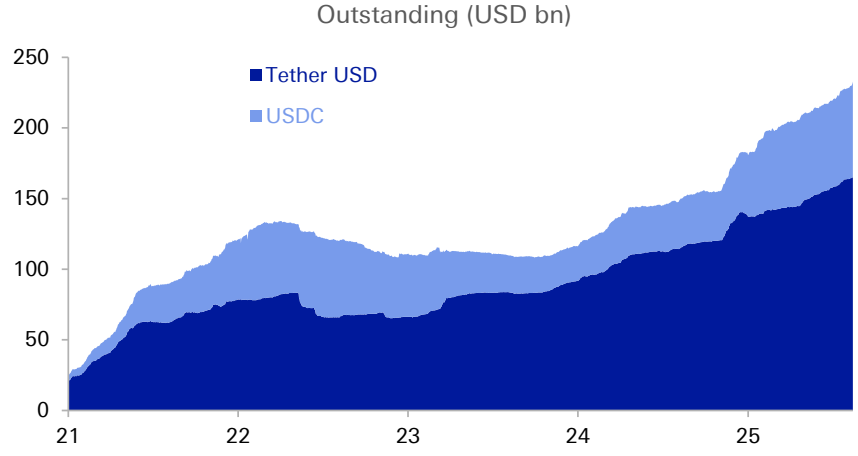
Third, the GENIUS Act extends the arm of the US Bank Secrecy Act to stablecoin issuers, mandating effective AML/CFT, customer identification, transaction record keeping, and complying with sanctions and lawful orders to seize, freeze, burn or prevent the transfer of stablecoins. This is designed to extend the US sanctions arms to this new form of payments.

Finally, it is worth noting that regulation supporting stablecoins has come alongside anti-CBDC legislation that prevents the Fed from exploring a digital dollar, taking a diametrically different approach from Europe and China. This will be crucial in the battle for cross-border payments that is taking shape.

Sizing up the stablecoin market today

At the time of writing, the outstanding market cap of global stablecoins was USD299bn (CoinMarketCap). This is less than 8% of the nearly USD4tn cryptocurrency market, of which Bitcoin alone makes up USD2.2tn. The USD stablecoin market is currently dominated by two large coins: Tether's USDT (USD168bn) and Circle's USDC (USD72bn) that make up 80% of the stablecoin market. Other notable coins including Ethena USDe, DAI, World Liberty Financial USD and issuances from Paypal and Ripple, followed by a tail of over 100 smaller stablecoins. But this is likely just be the beginning as more large corporates and banks are expected to issue. **Crucially, USD-backed stablecoins are over 98% of the overall market,** with the largest non-USD stablecoin - EURC only USD238mn in market cap at present. Our Thematic Research colleagues regularly cover important developments in the stablecoin market's growth in their chartbooks.

Figure 6: Tether and Circle make up 80% of outstanding stablecoins, with USD-backed stablecoins over 98% of the market today



Source : Deutsche Bank, Haver Analytics

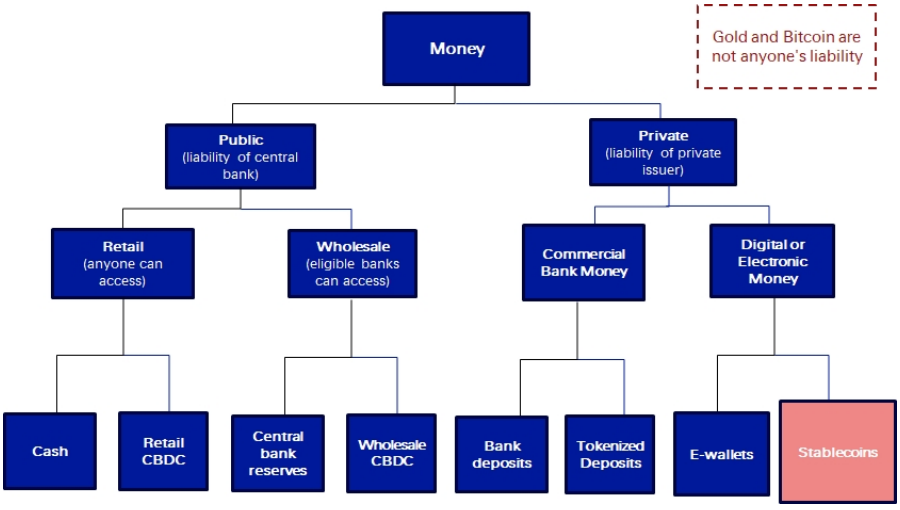
3. Are stablecoins money?

There remains a debate around the extent to which stablecoins are money. Money needs to fulfil three main functions: unit of account, medium of exchange and store of value. In short, stablecoins can be seen as a new form of private money, redeemable for public fiat. While regulation mandating reserves backing and regular audits should help ensure par convertibility, the extent to which stablecoins will respect singleness, and therefore function as a good unit of account and means of exchange remains unclear. The use of stablecoins as a store of value will likely be more appealing outside, than within, the US.

Public versus private money

Private money is not a new phenomenon. The current (or traditional) monetary system is made up of *both* public and private forms of money. There are two main kinds of public money: cash (physical notes) and central bank reserves (accessible only to eligible banks). These are liabilities of the central bank, and form the monetary base of an economy. In contrast, commercial bank deposits are a form of private money as they are the liability of the bank that holds them on behalf of the depositor. Federal deposit insurance provides some measure of public backing to deposits, but the real key to ensuring money in one bank is treated the same as money in another bank is the mechanism of *settlement.* When payments are made from one bank account to another, they are settled through bank reserves on the central bank balance sheet. In the US, the Fed credits one bank's reserve account and debits the other's. To quote the BIS, the fact that "money can be issued by different banks and accepted by everyone without hesitation...is because it is settled at par against a common safe asset which are central bank reserves." This two-tier monetary system is fundamentally different from the one being created by stablecoins.

Figure 7: Understanding the different types of money



Source : Deutsche Bank

Singleness: will questions be asked?

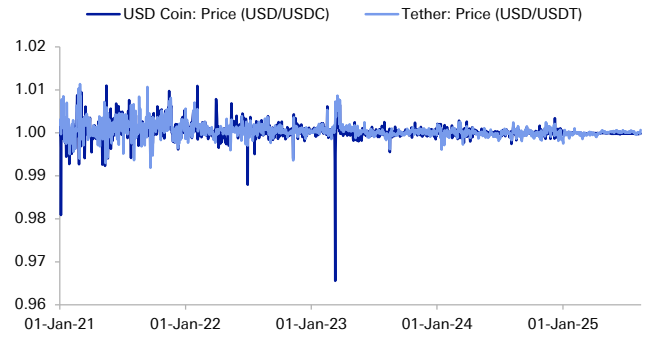
When a payment is made using a stablecoin, it remains the liability of the private issuer: the payer transfers the claim on the stablecoin issuer to the receiver of the coin. It is thus important that both the payer and receiver regard the stablecoin as having the same value. This is singleness, which can also be understood as a 'no

questions asked' principle: that $1 of Stablecoin X is seen as being worth $1 by everyone. In a world of multiple stablecoins issued by multiple issuers with different reserves holdings, singleness could be even more complicated. In the traditional monetary system, the 'singleness' of private money deposits are assured by having their settlement occur on the public balance sheet. This is not the case for stablecoins where there is no central bank settlement.

To the extent that the underlying liquid assets backing the coin are fully transparent, and regarded as being perfectly redeemable for par by both parties, singleness may be preserved, but the proof of the pudding will be in the eating particularly as more coins are issued by different private sector issuers. While stablecoins are set to be redeemable at par, the reality is that even the most "stable" ones have deviated from par. USDC dropped to $0.97 when questions were asked about the $3.3bn they held in Silicon Valley Bank in March 2023. Front-end T-bills have traded away from par during episodes of debt ceiling uncertainty.

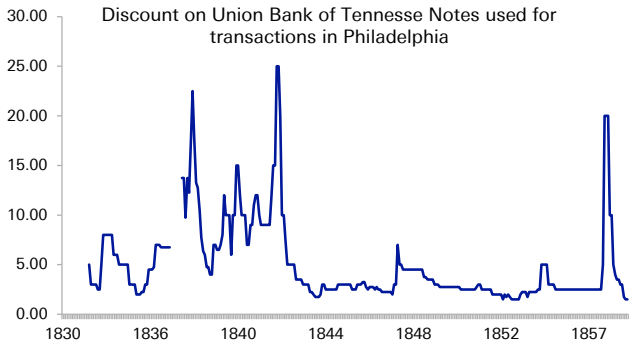
This has led to parallels being drawn between stablecoins and the Free Banking Era in the US from the 1830s to 1863. During this time, banks in different states issued their own private bank notes, which were backed by state bonds, although rules on asset backing varied across states. Bank notes were meant to be redeemable into hard money like gold or silver. In reality, private bank notes traded at various rates across the United States. A $1 bank note issued by a bank in Tennessee at time was worth less $0.80 in Philadelphia, complicating their use in transactions and their functioning as money.

Figure 8: The largest stablecoins are quite "stable" but even they have deviated from par in the past



Source : Deutsche Bank, Haver Analytics

Figure 9: Growing private sector coin issuance could invite parallels to the Free Banking Era in the US when state bank notes often traded away from par



Source : Deutsche Bank, Federal Reserve Bank of Minneapolis

Store of value proposition

Current regulations preventing the payment of interest on stablecoins are designed to limit their competitiveness with bank deposits for domestic residents Without interest, stablecoins should also be less attractive stores of value for the foreign official and institutional sectors that can access US-interest bearing instruments.

Stablecoins may however be regarded as an accessible store of value by non-resident retail or private sectors from less stable currency regimes where the ability to hold funds in USD even without interest could be an attractive form of saving, with parallels to USD cash held offshore. Stablecoins could thus have an

impact on dollarization risks in some emerging markets, with implications for their monetary sovereignty. We would be careful about overstating these risks though. Many EM countries run effective inflation targeting and fiscal regimes. And many of the BRICS are far ahead of the US in their own digital payments infrastructures which have very successful adoption rates. The strongest examples are UPI in India which processes over 75% of the country's digital retail payments (Atlantic Council) and Pix in Brazil. The attractiveness of dollar stablecoins in EM are likely to be highest in weak monetary regimes with unstable currencies, not necessarily in the biggest countries. The extent to which EM capital control regimes are tightened to cover capital flight into stablecoins will be important to watch.

4. Parallels to offshore USD cash and the eurodollar market

To the extent that stablecoins open up access to the USD to anyone in the world with internet, two parallels are instructive: the holdings of USD cash offshore, and the offshore USD deposit market known as eurodollars.

About half of all physical USD cash notes, or USD1.2tn are held offshore. Like stablecoins, bank notes do not pay interest, but people in foreign jurisdictions still hold them under mattresses or in safes - both as stores of value and to transact in dollarized parts of the economy. Like stablecoins, cash offers atomic settlement - when money changes hands: the entire value transfer process is settled near-instantly and at once. The willingness of people to hold USD cash offshore therefore provides one comparison for the potential size of offshore demand for stablecoins. But unlike cash which is limited by the amount of notes the Fed prints, that limit is not there for stablecoins which can thus be seen to have a wider perimeter.

The eurodollar, or offshore USD deposit market, is many multiples the size of the USD cash market at over USD10tn. Eurodollars are dollar deposits held outside the US banking system. From the 1980s to the GFC, the eurodollar market was even larger than onshore USD deposits, and till more recently, the London Interbank Offer Rate (LIBOR which measured the cost of borrowing USD *offshore,* was the market-standard rate for the USD. Unlike cash, both eurodollars and stablecoins are private liabilites held under the premise that they offer par settlement to a dollar. **Eurodollars are perhaps the best analogy for stablecoins.**

The origins of the eurodollar market have interesting parallels to stablecoins. In the late 1940s, concerns about sanctions on Soviet bloc countries led to a desire to hold USD outside of the US, initially in Paris and later in London where it was presumed they would be harder to freeze. Even for allied countries, slow transatlantic communications led to a preference for maintaining USD access closer to home. Offshore banks were not subject to US caps on deposit rates (Regulation Q) and could offer higher rates. Meanwhile, post-war capital controls in the UK, which limited financing of trade with third parties in GBP, did not apply to transactions in the USD and offered a way for London to remain an international financial centre even as the GBP's role declined. Existing outside of the onshore US banking system, eurodollar deposits were not covered by Fed deposit insurance and did not have access to the Fed discount window, similar to stablecoins today.

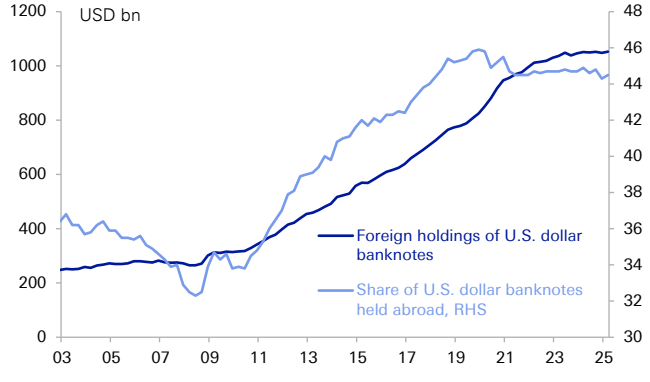
While initially just tolerated, US policymakers began to actively support the eurodollar market in the 1960s, offering another interesting parallel to today's regulatory support for stablecoins. In the 1960s, the Bretton Woods USD peg to gold began to come under pressure as the US balance of payments deficit widened.

For the US administration, encouraging foreign central banks to retain USD offshore in eurodollar deposits instead of swapping them for gold at the Fed window was a way of propping up the Bretton Woods system. Eurodollar deposits began to spawn growth in offshore dollar loans and bonds, with a self-sustaining ecosystem of USD assets and liabilities offshore able to finance global trade in USD.

How exactly did the US support the eurodollar market? In the 1960s, the Fed gave an implicit backstop to the liquidity risks being taken by offshore banks by offering USD swap lines to foreign central banks. These swap lines remain in place today, and were used in 2008 and 2020. We have written on how critical FX swaps lines are to the dollarization of the world financial system in our research here. This was a critical step to enabling further growth in eurodollars. Bringing stablecoins under the regulatory umbrella of the GENIUS Act can be seen as another such step: by forcing issuers to hold 100% reserve backing, the government is increasing market confidence in them. The extent to which stablecoin issuers will have recourse to traditional forms of liquidity support in the future to manage periods of redemptions or stress, could be key to their growth and to systemic risk management. And while eurodollars exist outside the US banking system, secondary sanctions risk and the ability to cut off foreign banks from the correspondent banking system gives the US geoeconomic leverage over them. Bringing stablecoins under the US Banking Secrecy Act again aims to extend this oversight.

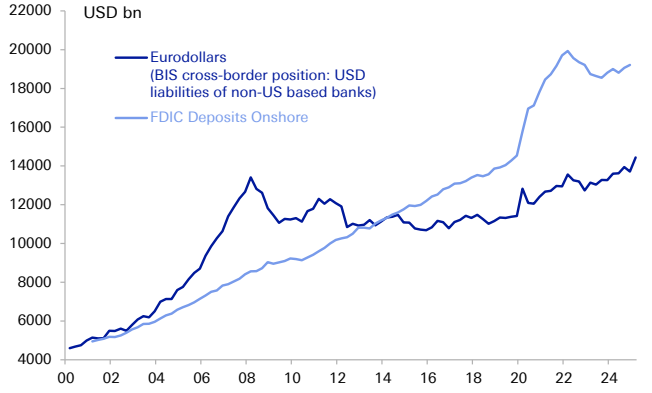
Even if eurodollars might initially have been a risk for US monetary sovereignty with dollars being held outside of US reserve requirement and interest rate regulation, they actually helped extend the stability and dominance of the USD at a time when it was under pressure. The support for stablecoins may have similar ambitions. During the time of the Bretton Woods gold-backed exchange rate system, offshore eurodollars helped the US manage *balance of payments pressure*. In today's fiat currency system, where the value of the USD is backed by the fiscal capacity and creditworthiness of the government, stablecoins may be used to help manage *fiscal financing pressure.* The presence of a large stock of offshore USD is a unique feature of the US dollar. The amount of offshore USD cash and eurodollar deposits at close to USD15tn can be seen as an outer perimeter for offshore demand for USD stablecoins, with growth set to be informed by real economy use cases and private sector adoption.

Figure 10: Almost half of all USD cash bank notes are held offshore



Source : Deutsche Bank, Fed

Figure 11: The size of the offshore dollar - or eurodollar - market is well over USD10tn



Source : Deutsche Bank, BIS Locational Banking Statistics, Haver Analytics

5. The battle for cross-border payments: enter stablecoins

The battle for control over cross-border payments systems and infrastructure is hugely important for global power: if you control the rails of payment, you can control economic activity in the world. Stablecoins are far from the only innovation looking to disrupt the existing system, but they appear to be the US's bet on *retaining* control of it.

The age-old dollar correspondent banking system has long been ripe for disruption. While real-time settlement has become much more prevalent and effective *within* economies, cross-border payments that rely on correspondent banking can still encounter high fees, long settlement times and a cumbersome sequence down a chain of network banks. A SWIFT payment involving an intermediary still takes an average of 1 day and 11 hours according to Statrys. Bank-initiated international wires can absorb 13.65% of principal in some cases, with even the most efficient cross border fintechs charging an average of 1.25% according to BCG.

To be sure, a lot of these inefficiencies are corridor specific. There has been a big retrenchment in the number of correspondent banks and corridors in recent years according to BIS, presumably as AML/CFT regulation has become more stringent. This has left a lot of corridors underserved. For instance, South & Central America saw a 50% decline in the number of active USD correspondents from 2011-22, while Eastern Europe has seen a 45% decline. This is only likely to have increased since the 2022 Russian invasion of Ukraine. This tallies with research from FXC Intelligence on where stablecoins might have the greatest opportunity for usage in cross-border payments. They identify corridors such as Latin America-North America as well as Sub-Saharan Africa-Europe as having significant potential. Out of a USD200 trillion cross-border payments market, they estimate that these corridors - largely connecting the Global South - could be worth USD16-24tn. Indeed, BCG reports that 10% of cross-border remittances in the US-Latam corridor are already made through stablecoins or cryptocurrency. **In some sense, the battle for payments can be seen as a battle of the Global South from where the US correspondent banking system has been retreating and where China has been building a greater presence across trade, investment, swap lines and RMB payments.**
We consider below how cross-border payments currently work through correspondent banking, and how stablecoins could change this.

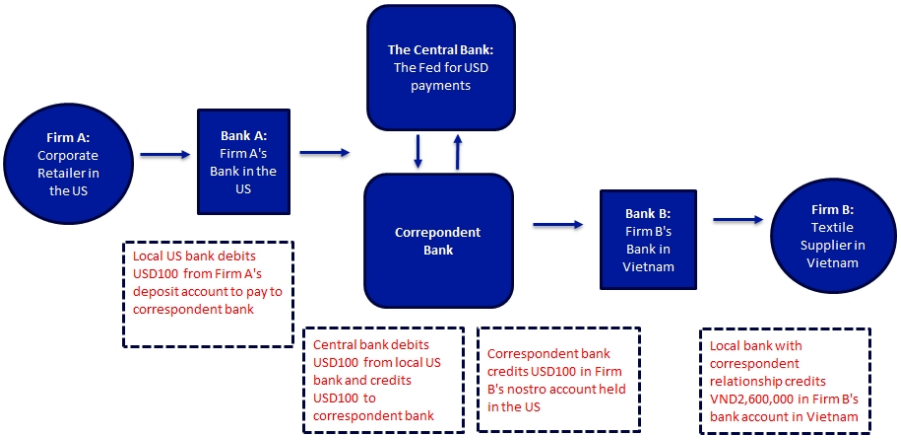
How does correspondent banking currently work?

We illustrate an example of a correspondent banking transaction, borrowing extensively from the BIS' characterization of this process.

We consider the example of a corporate retailer in the US (Firm A) looking to pay USD100 to a supplier in Vietnam (Firm B). The corporate retailer instructs its local US bank (Bank A) to send the funds. Bank A has a relationship with a correspondent bank such as JP Morgan and makes a payment of USD100 to them. Since this is a domestic payment between two bank accounts in the US, it is settled on the Fed balance sheet. The Fed debits USD100 from Bank A, and credits the Correspondent Bank's account with USD100. The Correspondent bank also has a relationship with Bank B, that is Firm B's bank in Vietnam. Bank B maintains a nostro account with the Correspondent Bank in the US. The Correspondent Bank credit's Bank B's nostro account with USD100. Once Bank B has confirmed they have received the funds, they credit VND2,600,000 to Firm B's bank account in Vietnam.

Importantly, the USD settlement happens in the US on the central bank balance sheet. USD payments go through either Fedwire (real-time gross settlement) or CHIPS (netting system), which is a private consortium of banks backed by the NY Fed. Very few non-US banks have direct access to this infrastructure and need to work through correspondents. No non-banks have access, so corporates cannot currently settle directly. **The correspondent banking system bridges the divide between local banks in different jurisdictions, and retains the principle of a two-tier monetary system where private bank deposits are settled on the public central bank balance sheet, always at par.**

Figure 12: How correspondent banking facilitates a cross-border payment



Source : Deutsche Bank, BIS

Through this process, banks are communicating with each other through a messaging system run by SWIFT, a Belgium based network with 11,500+ institutions connected across 200 countries. SWIFT reportedly processes close to 50 million messages per day. Payments themselves do not flow through SWIFT, only communication does. Every bank in the chain conducts its own KYC, AML/CFT and sanctions compliance checks. The sequential nature of the process means it is more prone to errors, duplication, slower and more onerous. It also needs to respect the market timings and holidays of different jurisdictions which can slow it down. The reduction in the number of correspondent relationships means some corporates and countries are now poorly served by it.

How would a cross-border stablecoin payment work?

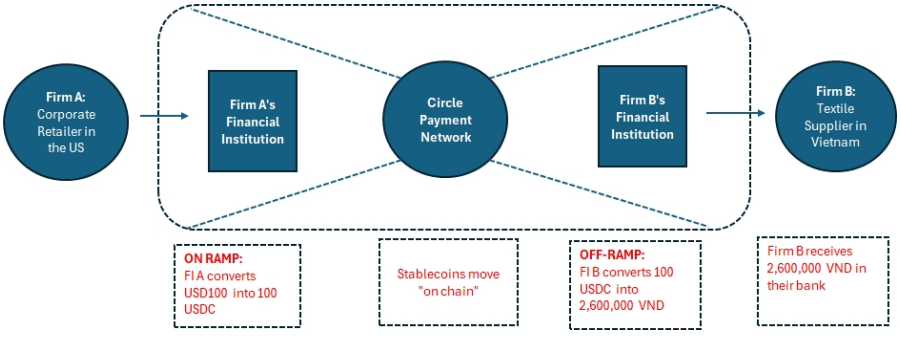
Stablecoins offer a significant opportunity to disrupt correspondent banking which has been ripe for a challenge, by combining the technological offering of blockchain, with the familiar fiat backing of the USD. We borrow below from the Circle Payments Network White Paper to illustrate a potential stablecoin cross-border payment *with* on and off ramping to the traditional fiat currency system. We consider the same scenario as above, where Firm A in the US wishes to pay USD100 to Firm B in Vietnam. Firm A approaches a financial institution that converts USD100 of fiat into 100 USDC (stablecoins are minted). These coins are transferred on-chain. Firm B's financial institution then redeems these 100 USDC for fiat and undertakes an additional FX transaction into VND. Firm B receives VND in his local bank.

We note that while the moving of stablecoins on DLT rails is near instant and low cost, the on and off ramping is still expensive, with BCG reporting that this can add as much as 7% to the cost. In a world where Firm A and Firm B both maintain stablecoin wallets and balances of USDC (or another stablecoin) and are happy to keep them on chain, the transaction could theoretically happen without the need to mint and burn stablecoins on each side. For now though, the assumption is that most economic agents will not want to keep funds on chain given the lack of interest paid on stablecoins, and more importantly the need to pay onward local suppliers, salaries, and spend the money in a local currency fiat environment. In a potential future where stablecoin wallets interact with tokenized assets like money market funds or other investment funds, stablecoins may indeed be kept on chain. Increased onward retail and merchant acceptance of stablecoins would also reduce the need for on and off ramping into fiat bank accounts. This could become a concern for foreign jurisdictions if dollar stablecoin activity starts to move into the domestic payments sphere.

The exact mechanisms and offerings for stablecoin cross-border payments are still evolving. Currently they are likely to still involve local banks for on-and-off ramps and for FX transactions, but there is a future where a fully borderless on-chain network could compete with correspondent banking. A fully on-chain transaction would be atomic, where payment, messages and reconciliation happen almost at once, rather than sequential across a chain of intermediaries. Stablecoin funds can be transferred regardless of banking hours or local holidays. Stablecoins would also grant access to USD settlement to anyone with internet anywhere in the world, compared to the present day where it is restricted only to economic agents with a correspondent banking relationship.

Importantly, corporates and non-banks that issue their own stablecoins may enter the payment landscape directly as major players instead of having to go through the banking system. While banks are likely to remain big players in the on-and-off ramping process, the incentives for banks to issue their own stablecoins could rise: both to preserve competitiveness against shifts in deposits and their presence in the payment rails.

Figure 13: How stablecoins might change a cross-border payment



Source :Deutsche Bank, Circle Payment Network White Paper

The dollar's current dominance in FX markets supports the initial dominance of dollar payment stablecoins. The present day need to on-and-off-ramp from fiat currencies could mean USD stablecoins are favoured as a means for intermediate exchange because local banks on either side of a cross-border transaction would still find it easier to trade in USD FX crosses. One might perhaps conceptualize a fully on chain world in the future, without necesssary conversion to fiat, where an

FX market for converting stablecoins across currencies might exist.

Stablecoins disintermediate the Fed from the settlement process for international payments in USD. This could reduce the Fed's oversight over cross-border payments which would then occur on distributed ledgers rather than settling on the central bank balance sheet. This could mean a big change to the "centrality" of central banks in global payments, which helps unify the value of private dollars today. It may fit with a broader paring back of the Fed's mandate by the current administration.

Stablecoins are not the only proposed solution

Stablecoins are not the only solution being proposed to upgrade and respond to the market failures of correspondent banking. They are also not the only solution that uses distributed ledger technology.

The BIS in their recent paper on the next-generation monetary and financial system proposes a tokenization of the existing financial system which preserves the current model. Tokenisation is the process of shifting claims on real or financial deposits that are currently on traditional digital ledgers, onto programmable crytographic ledgers. Commercial bank deposits could be tokenized and represented on chain, as could central bank reserves via wholesale CBDCs**.** Cross-border payments could then still take place through the banking system operating off a unified ledger where the current chain of workflow would be replaced by a single, integrated process. All payment, messaging and reconciliation instructions would be merged and occur together. In this tokenized system, USD settlement would still happen through central bank reserves and not private liabilities such as stablecoins. The players would not change. Correspondent banking and two-tier settlement would be preserved - only the technology they use would change.

There are many projects in the works on this. Project Jura between Banque de France and the Swiss National Bank has already experimented with exchanging wholesale EUR and CHF CBDCs for cross-border payments on a single DLT platform as a proof of concept. Project Agora being explored by the Fed, ECB, BoJ, BoK, SNB, BOE and Banxico along with the BIS expands this in scope to multilateral settlement across multiple CBDCs.

Technically, correspondent banking can itself be brought into the blockchain era by tokenizing the current system. But we note that progress on multilateral public-sector projects has been slower and more fragmented. China is exploring its own version of a cross-border DLT settlement called Project mBridge along with select Global South central banks in the Gulf and Asia that seeks to disintermediate the dollar-based financial system and settle in local currencies.

Stablecoins as a private sector solution may move to disrupt the correspondent banking system faster than central banks are able to evolve it. With the US administration having thrown its weight behind stablecoins and in firm opposition to CBDCs, the hurdles to developing a globally interoperable CBDC system for cross-border payments are likely now higher, particularly with Europe and China - the two largest trading blocs - pursuing independent projects and objectives. Dollar stablecoins take advantage of this lack of global consensus with the US able to assume leadership over its own solution.

6. Impact on the US: Do stablecoins increase US fiscal capacity?

In a fiat system, the currency is backed by the fiscal, monetary and institutional credibility of the government, rather than by a hard asset like gold. The dollar today is therefore backed by the sovereign credit of the US government and the willingness of the world to save in US government liabilities, under the expectation they will be repaid in an asset and currency that retains its value. The credibility of managing inflation and the independence of the central bank, is therefore an important anchor for savers holding a reserve currency's debt. Looked at another way, the more readily a country is able to fund its fiscal requirements, the less risk that it will turn to inflation, money printing and resulting currency debasement to manage its debt, and the more it will retain its status as a reserve currency in which others are willing to save.

The core question for the US dollar is whether stablecoins increase - or at least defend - the fiscal financing support for the government. We note that foreign holdings of US Treasuries have gone from a peak of around 55% of the outstanding before the Global Financial Crisis to just 32% today. This is still mostly a function of a rapidly expanding denominator of outstanding debt, but we have noted the softening in foreign official sector interest in US Treasuries that could be further dampened by weaker US security guarantees and erratic policymaking. Lower trust with allies would come to bear as they currently account for a majority of official offshore holdings. **Can stablecoins arrest or offset these risks? There is indeed a growing narrative that dollar stablecoins will boost demand for Treasuries, and that this is a core goal of the adminstration (FT).**

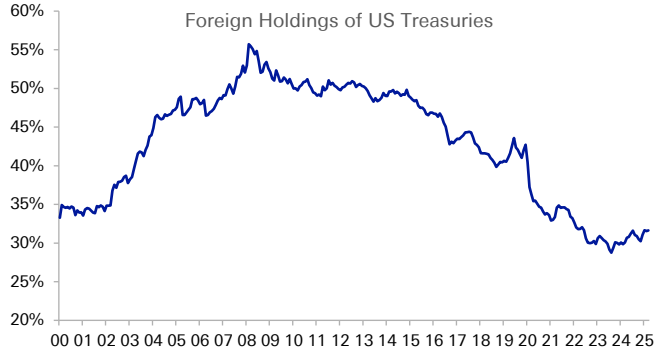
While most analysis focuses on the demand that stablecoin issuance introduces for T-bill holdings via reserves backing requirements, we do not think this is the most relevant angle. Regulation indeed mandates that dollar-issued stablecoins are fully backed by HQLA, of which US T-bills are expected to be a big share, but these need to be at the very front-end with less than 93 day maturities. Even if the coming years see USD1tn of fresh stablecoin demand for 3M bills, in duration terms, this would only be equivalent to USD60bn of 10Y purchases. Stablecoin demand at the very front-end does not meaningfully substitute for demand from long-standing allies and trade partners in terms of duration and even stability, where recent US policies may be eroding trust and sponsorship.

The US Treasury could potentially shift more financing to the front-end to take advantage of incremental T-bill demand and lower front-end rates, but this would come at the cost of greater rollover risk. Currently out of $29tn in marketable interest-bearing debt, $6tn is already in T-bills. Front-end funding costs may indeed be coming down - both as the Fed cuts rates, and as stablecoin related inflows increase demand for front-end bills that push down market-yields. A BIS study found that every USD3.5bn of stablecoin inflows (2 standard deviations of 5 day flows) reduces three-month US Treasury yields by 2–2.5 basis points within 10 days, while outflows can raise yields by 6–8 basis points. Embracing stablecoins may be a way of the US government lowering their costs of funding, by issuing more in the front-end of the curve over which they are also taking more control. But we are skeptical about this argument, because an increased dependence on short-term funding would also introduce more rollover risk to government finances. It is not a free lunch.

There are broader uncertainties around the extent to which stablecoins generate *fresh* demand - versus simply substitute - for existing demand for UST. To the extent that stablecoin demand is generated from onshore US banking deposits, this may end up being a weaker substitute for duration demand: banking books tend to hold longer-dated UST as assets against some of their deposit liabilities, while stablecoin issuers will hold only short-dated bills. Even some eurodollar deposits may already be invested in longer-dated USTs. The degree of deposit substitution is likely to be a function of the interest rate environment, with the opportunity cost of holding stablecoins falling as interest rates fall. We note that stablecoins do not themselves lead to an expansion of the monetary base. Stablecoins are not being issued by the Federal Reserve like cash notes, and T-bill purchases by issuers are not akin to Fed QE, where bank reserves held at the Fed expand. New stablecoins are not *fresh* liabilities of the central bank, but a swap of existing liabilities (public or bank) into stablecoin issuer liabilities.

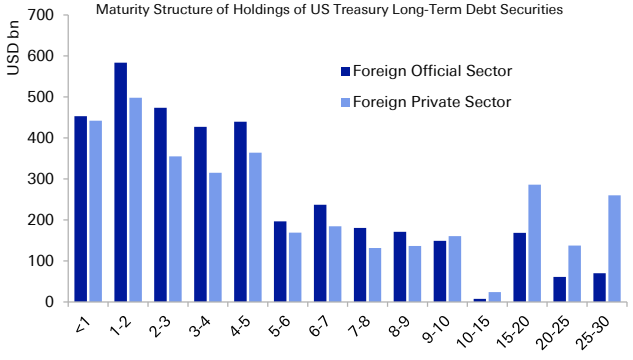
How then might stablecoins help support the fiscal capacity of the US government? We think it comes down to the degree to which stablecoins keep the world on dollar payment rails and help secure foreign private sector support for dollar assets. We note that foreign private sector holdings of US long-term Treasuries are similar to the foreign official sector at around USD3.5tn each. But the average maturity of foreign private sector holdings at roughly 7.5 years exceeds that of the foreign official sector at just over 5 years, given more long-dated holdings. As we discussed in Section 1, there is a strong link between private sector payments in a currency and its willingness to hold savings in it. Therefore, the real value of stablecoins for the US government is not in the incremental stablecoin *issuer demand* for T-bills, but in securing foreign private sector interest in US debt. **It is the extent to which stablecoins cement or even expand the usage of the USD in global invoicing that will be important for fiscal capacity via the private savings channel.**

Figure 14: The share of US Treasuries held by foreigners has fallen from a peak of 55% to just 32%



Source : Deutsche Bank, Haver Analytics

Figure 15:The foreign private sector holds as many long-term US Treasuries as the official sector, with a skew towards longer-end holdings



Source : Deutsche Bank, Haver Analytics, Data as of end-2024

7. Impact on Europe: The case for EUR stablecoins

The battle for global payment systems is not new. Europe and China have been developing their own strategies to have their currencies play a bigger global role for some years. But the regulatory support for dollar stablecoins by the US administration can be seen as a "throwing down the gauntlet" moment, that creates a need for Europe and China to take stock, and potentially adapt their own approaches.

There are two strategic considerations for Europe when it comes to the role of the euro. First, control of *domestic* payments which is seen as important for internal monetary sovereignty. This is behind the digital euro project. Second, ambitions to increase the international role of the euro in payments and savings. The case for a *global* euro is, very simply, to allow the Euro-zone to enjoy more of the exorbitant privilege and geoeconomic power that the US currently dominates.

The digital euro

The first consideration of securing control over domestic payments infrastructure is behind the ECB's retail CBDC project: the digital euro. With a decline in the use of cash in the economy, the ECB is becoming more concerned about the dependence of *internal* euro-area transactions on foreign-based credit cards like Visa and Mastercard, with the ECB noting that nearly two thirds of card transactions in the euro area were settled through international payment schemes in 2023. A digital euro is seen by the ECB as offering a *European* alternative: acting as a "public good to stand alongside private payment" solutions, functioning as a "digital form of cash available to everyone in the euro area." The digital euro is about reducing reliance on foreign payment tools and increasing payment sovereignty.

The risk of *dollar* stablecoins being adopted for domestic payments within the eurozone is mitigated by regulation and the sound monetary foundations of the euro. We note that existing MICA regulation prevents the risk of dollarization of euro-area transactions using USD stablecoins: there is a cap of €200mn on the daily transactions in non-EUR based e-money tokens within the euro-area. Moreover, the euro has sound monetary foundations with a credible and independent central bank that is inflation-targeting. We therefore see little risk that euro-area residents would want to move away from the EUR for euro-area transactions. Nevertheless, there remains a risk that technology and innovation drives consumer preferences akin to credit card adoption. If for instance, large foreign e-commerce firms start to encourage stablecoin usage for transactions on their platforms, it would be advisable for EUR-denominated stablecoins to be better developed and issued by European entities.

EUR stablecoins may be more competitive than a retail CBDC as it is currently envisioned. While the digital euro has the benefit of being public money which respects singleness and has no issuer risk, it could be less competitive than EUR stablecoins for a few reasons: first, the digital euro is set to have a holding limit of €3000 to prevent deposit competition. Cash and stablecoins do not have limits. Second, the digital euro is likely to only be available to euro-area residents. Third, it is not clear if it would be easily interoperable (exchangeable) for other currencies or tokens. Finally, there is very little global evidence for retail CBDC adoption, even in China where the public prefers private payment wallets. Promoting EUR stablecoins issued by European financial institutions and corporates could be an alternative private sector offering to move the EUR into the digital payments age. And while it may not be the ECB's preferred instrument of a CBDC, it could still be

preferable to using foreign infrastructure.

The global euro

The real case for EUR stablecoins is to ensure that Europe's ambitions for a more global euro are not snuffed out because it lags in embracing a potentially new technology for cross-border payments. To be sure, a lot of the competitive risks come *only if* stablecoins are widely adopted for cross-border payments, which is far from the case yet. But to the extent that US regulatory support lays the foundations for this, it should be taken seriously, and **Europe should develop its own ecosystem of EUR stablecoins as a competitive hedge against this scenario.**

The ECB has been giving more attention to increasing the euro's global status. Lagarde in a recent speech noted the "tangible benefits" of a more global euro from "lower borrowing costs, reduced exposure to currency fluctuations and insulation from sanctions and coercive measures." Europe already invoices a significant share of its trade in EUR, roughly 60% of exports and 50% of imports for *extra-EU* trade. But we note this is still far less than the USD, which is used for almost all US trade and for trade between third countries. The use of the USD as the unit of account for commodities plays a foundational role in this. In fact the USD's role as a global invoicing currency is about four times its role in global imports. Lagarde noted that the euro's global standing rests on its role in trade which presents an opportunity. While the US is retreating from global trading relationship, Europe remains focused on building out more trade corridors, particularly with the Global South. This creates opportunities to encourage trade partners to invoice more trade in EUR and save resulting surpluses in EUR. **If stablecoins become a significant means of cross-border payments for trade, having a deep and liquid market of EUR-based stablecoins will be important to ensure EUR-based trade invoicing can not only grow, but can also be defended. As we have noted, this will have direct implications on foreign private and official sector savings in EUR.**

There is a lot that Europe is starting to get right, which makes hedging these gains even more important. As Lagarde noted, Europe is "undergoing a major shift towards rebuilding its hard power, which should also bolster global confidence in the euro." Countries that are better able to defend themselves in the case of war, are more likely to repay their debts, and be better stores of value. The European sovereign debt crisis and era of negative yields are behind us; Europe has acted together on Covid and Ukraine; and compares favourably to many regions on "rule of law" and "independence of key institutions." This all leaves the EUR in a strong position to capitalize on a global diversification in savings particularly as the supply of EUR safe assets will also be rising.

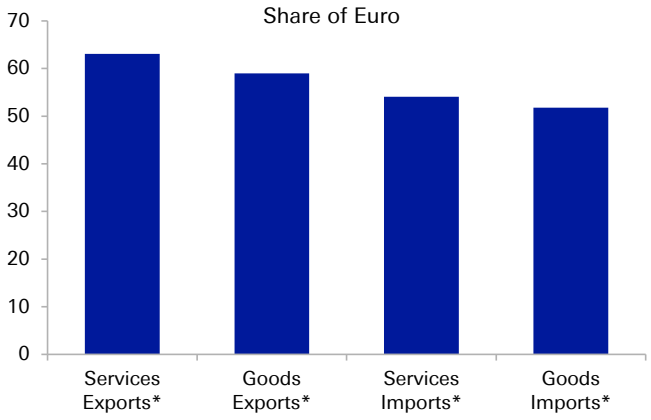
Stablecoin issuance could have the supplementary positive impact of creating a new pooled EUR asset. Europe has started to issue some shared liabilities like NGEU bonds in recent years, backed by the EU budget. EUR stablecoin reserves could create the case for another truly pooled asset. Stablecoin issuers could be regulated to invest in a EUR-area T-bill which could be structured as a fully joint and several liability backed by all members. The ECB did indeed note that building a more robust capital markets union is key for the euro to gain in profile.

The euro's improving potential as a savings asset makes it all the more important that Europe does not fall behind in the payments battle given the strong linkages between the two. While Europe has been actively involved in wholesale CBDC projects like Project Agora, there is a risk that these public-sector solutions could be slower to come to fruition. The interoperability of CBDCs still in pilot stages is

perhaps a longer-term game, with the risk that a private-sector approach of dollar payment stablecoins leaps ahead as a technology solution. To hedge against this scenario, **Europe should allow a healthy development of EUR stablecoins to ensure it does not lose ground in EUR invoicing.**

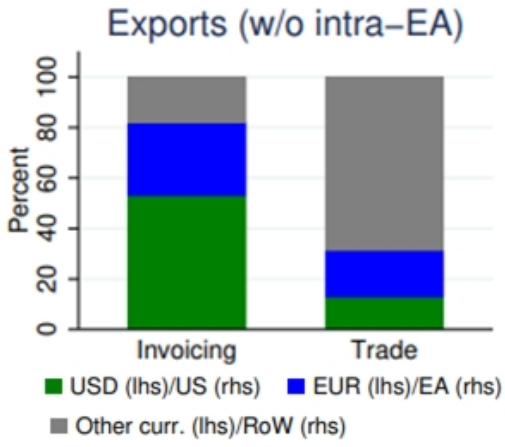
As we discuss further below, Europe may be in a competitively better position than China to support the growth of local currency stablecoins: it already has a higher share of trade invoicing in euros, has a high level of trust with trade partners, an open capital account, and transparent institutions.

Figure 16: The euro is used for about 60% of extra-EU trade transactions today



Source : Deutsche Bank, ECB, The international role of the euro, June 2025, Statistical Annex

Figure 17: But the US's role in global invoicing is far larger than its share in global trade, and larger than the EUR



Source : Deutsche Bank, Boz et al. Patterns of invoicing currency in global trade: New evidence, Journal of International Economics (2022)

8. Impact on China: A spanner in the works for RMB internationalization

The push for dollar stablecoins presents a more direct threat to China's recent efforts for RMB internationalization.

China arguably has less immediate concern than Europe around domestic payments, which are very well-served by local players. China has been a global leader in digital payments adoption, led by private sector solutions like AliPay and WeChat Pay, and the central bank has already piloted a retail CBDC (e-CNY).

Where China may be more threatened by dollar stablecoins is in its *international* ambitions for the RMB, both in the adoption of the alternative payment rails it is developing, and in the usage of RMB for trade, particularly down Global South corridors. As we have discussed, correspondent banking was in retreat from these corridors, creating space for China to fill, but stablecoins may provide readier access to the USD here again. Dollar stablecoins may pose a risk to the progress China has been making towards RMB internationalization and take things in a different direction.

It has made strategic sense for China to invest in its own cross-border payments infrastructure. Given the growing strategic and power competition with the US and

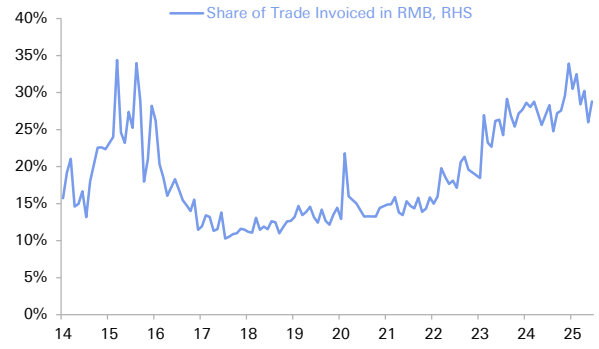
the use of sanctions against Russia - China has grounds to fear a dependence on dollar payment rails. Unlike central banks in Europe, China does not have access to Fed swap lines. And indeed, China's official sector has been one of the most active in diversifying reserves away from US Treasuries in recent years, with holdings falling from a reported peak of USD1300bn to USD750bn.

China has been investing simultaneously in two approaches: an RMB *alternative* to USD correspondent banking known as CIPS, and a cross-border CBDC approach with other central banks called Project mBridge that fundamentally *re-imagines* the cross-border payment mechanism. CIPS can be thought of as China's correspondent banking model for RMB-denominated payments. Just as USD payments settle through Fedwire or CHIPS, and EUR payments via TARGET2 on their central bank balance sheets, RMB payments can settle through CIPS at the PBOC. CIPS is capable of messaging, clearing and settling, but most transactions still use SWIFT for messaging with global banks. CIPS reportedly handles about 30,000 messages per day compared to 50 million at SWIFT, and intermediates around USD100bn in RMB equivalent of daily flows. While still much smaller than the USD based correspondent banking system, these rails have been built, and can be ramped up if required. Meanwhile, Project mBridge, led by China alongside central banks of Thailand, UAE, Saudi and Hong Kong is testing cross-border payments using the direct exchange of multiple CBDCs on a purpose-built ledger. This is a shift away from - rather than an upgrade to - correspondent banking, with different rails. The BIS pulled out of the Project mBridge after the BRICS Summit in November 2024 spoke of a BRICS Bridge, given fears that it would be designed to circumvent US sanctions. Project mBridge has reportedly reached minimum viability with test trades having been made. **If however, dollar stablecoins *reinforce* the use of the USD and create a USD-centric alternative to correspondent banking that continues to exist under the regulatory and sanctions arm of the US, this could interfere with China's plans to move the world away from it.**

We note that China has begun exploring the development of offshore yuan-backed stablecoins in Hong Kong, but their potential could be contained by the limited size of offshore RMB deposits. We note that the amount of offshore CNH deposits in Hong Kong at RMB882bn is just 0.3% of the size of onshore CNY deposit base of RMB320tn. This compares to our estimate of the eurodollar market where offshore USD deposits are 75% the size of the onshore USD deposit market. China has tried to encourage the growth of the offshore CNH market and to promote greater trade invoicing in RMB by making RMB swap lines available to more central banks, but these have arguably been used more as a means of borrowing by indebted foreign governments rather than to drive RMB liquidity for corporates abroad. The offshore CNH deposit market has hardly grown in the past 10 years, after the shock of the August 2015 "mini-deval" led to a retrenchment of interest in holding the currency. We note that China still has a managed capital account, and thus issuing an onshore yuan stablecoin that global retail and corporates can freely subscribe to, may be harder to manage. **China may not be ready to grant the world open access to the RMB in the way the US is. This could constrain China's ability to compete in a stablecoins world, unless it starts to entertain bolder capital account openness.**

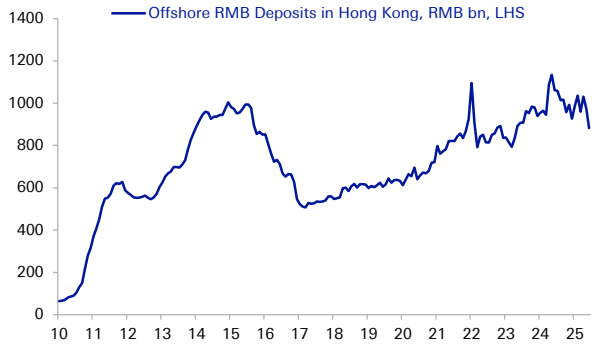
Finally, the ready access to dollars that stablecoins enable in the Global South could threaten China's RMB ambitions down these corridors. China is the biggest trading partner with the Global South. These countries have been the focus of China's Belt & Road Initiative, and Chinese banks have played a significant role in lending to Global South countries. And while still a small group - China is emerging as a bigger military partner for some countries. We wrote in detail about this here. As discussed earlier, the retreat of the USD based correspondent banking system has been most pronounced in the Global South, and this is therefore where China's opportunity for internationalization of the RMB would be most obvious, dovetailing with a growing BRICS focus on local currency invoicing. If now, dollar stablecoins provide easy access to anyone in the Global South to USD-based cross-border payments, they could leapfrog the gains made by China in encouraging the use of RMB and China-backed systems down these corridors. **In many ways, the battle for payments dominance is also a battle for influence in the Global South, one that is only likely to grow between the US and China.**

Figure 18: RMB invoicing in China's trade has only just recovered to 2015 levels and sits at around 30% of total trade



Source : Deutsche Bank, CEIC

Figure 19: The offshore CNH deposit base in HK has also only just returned to 2015 levels and is less than 0.3% the size of onshore deposits



Source : Deutsche Bank, CEIC

9. Conclusion

We think the US push for dollar stablecoins is fundamentally about keeping the USD as the dominant invoicing currency in cross-border payments, which is crucial to supporting its status as a private savings vehicle and reserve currency.

Whether the US succeeds or not will ultimately depend on the genuine economic uptake for dollar stablecoins in cross-border payments. While the US remains the current leader in payments - controlling correspondent banking rails and functioning as the dominant currency of global invoicing - this advantage has been at risk of narrowing. New technology, geopolitical competition, underserved economic corridors, and the development of alternative payment systems were all threats the US had to respond to to maintain its geoeconomic leverage.

The US has chosen to throw its weight behind stablecoins as the answer to this challenge, opting for a private-sector solution over CBDCs. It is arguably a punt on a new technology, and a new mechanism of payment that spurns the existing two-tier monetary architecture rooted in settlement on the central bank balance sheet. Corporate adoption of stablecoins for genuine economic activity has thus far been limited, and skepticism around the money properties of stablecoins will need to be overcome. The proof of the pudding will thus be in the paying. But with the regulatory blessing of the US administration in place, the US having the benefit of incumbent FX dominance, and now a first-mover advantage with stablecoins, the potential is immense and cannot be ignored by other geopolitical contenders.

Significant growth in dollar stablecoins for cross-border payments could pose a challenge to Europe's efforts to promote a more global euro, and to China's internationalization of the RMB. While both Europe and China have been actively exploring CBDC style innovations for cross-border payments, there is a risk that dollar stablecoins may leapfrog this progress.

Europe should develop an ecosystem of bank and corporate issued EUR stablecoins as a competitive hedge to both domestic payments sovereignty and global EUR invoicing. Europe is getting a lot right in improving its potential as a global savings asset - but remaining relevant in global payments will be key. Importantly, Europe is better placed than China to support local currency stablecoins: it has a higher share of trade invoicing in euros, deeper trust with trade partners, an open capital account, and transparent institutions.

China's ability to compete in a stablecoins world could be more constrained by managed capital account policies and the more limited pool of offshore RMB deposits. But China's stakes for payments independence are higher and a fiercer global payments battle could well be the catalyst to encouraging greater capital account openness given China's own bid for reserves currency status.

Finally, in a fiat system, the currency is backed by the fiscal, monetary and institutional credibility of the government, rather than a hard asset like gold. A defining question for the dollar is whether stablecoins extend - or at least defend - fiscal support for the US. While a lot of focus has bee on the demand that stablecoin issuance creates for front-end T-bills, we see this as a red herring. If stablecoin demand comes out of bank deposits, this would be a poor substitute for bank UST demand. And greater front-end debt issuance, even if lower cost, would create rollover risks for the government. The real play on stablecoins is keeping the private sector on USD payment rails to continue to attract private sector savings.

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Appendix 1

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