99 ADVISORY
A clever transformation

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"Explaining economic and financial news in order to better anticipate and manage the risks"

Libra: « Everyone can create money ; the problem is to get it accepted »

It is the exchange of money when paying salaries that generates the "production" of social security charges and it is the exchange of money when buying a good that generates the production of VAT. Money can therefore only be a common good: without control over money, there cannot be a State.

Before it even existed, Libra was already written about extensively and elicited a huge response.

When its launch was announced on 17 June, as well as the support of a consortium of around 30 iconic companies, Facebook saw its share price climb by 1% on the stock market that day to $189.10, and by 15.2% since speculation began about the announcement at the start of June, representing an increase in its market capitalisation of $75 billion in two weeks. Already, some members of the consortium are setting out their intentions and figureheads like PayPal (around 0.25 billion customers), Visa (over 3 billion customers) and Mastercard (over 2 billion customers) are starting to express serious doubts. This comes down to pressure from regulators, who have reportedly opened their eyes about the responsibilities of operating payment systems. But their eyes also could well have been opened by themselves...

The Facebook share price does not seem unduly affected as it currently stands at $184.19, down 2.6% over the last three months.

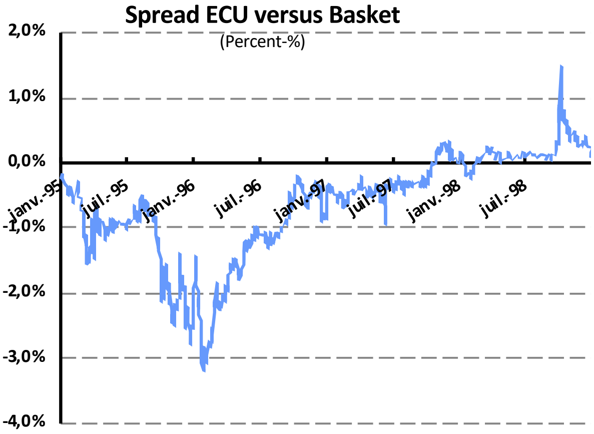
Libra has been designed as an official basket of currencies: the dollar would have a weighting of 50%, followed by the euro (18%), the yen (14%), the pound sterling (11%) and the Singapore dollar (7%). The idea is to provide a basis for objective stability as with certain other so-called currency board systems, where forex reserves are equal to the money supply. This is the case for example for the Hong Kong dollar or Gulf currencies. However, these examples remain exceptions and most of these systems have disappeared because they are difficult to manage: this is the case for Colombia, Costa Rica, Ecuador and Argentina, to mention just the most emblematic.

There are also other units of account like the Special Drawing Right (SDR), the IMF's unit of account since 1969, and the ECU (European Currency Unit), which "became" the euro on 1 January 1999. The SDR is made up of dollar, euro, renminbi, yen and the pound sterling representing 41.73%, 30.93%, 10.92%, 8.33% and 8.09% respectively. However, it is not used in financial transactions so to speak and certainly not to buy goods or services.

It should be noted that the proportions of currencies that make up the SDR fluctuate daily depending on the closing rates of each of the currencies in the basket, as the value of the SDR is the sum of the exchange rates of each of the currencies making up the basket multiplied by fixed amounts (0.58252 USD - 0.38671 EUR - 1.0174 RMB - 11.9 JPY - 0.085946 GBP). As a result, the composition of this basket has been revised over the years (2005, 2010) up to the introduction of the renminbi in 2016.

Another famous unit of account made up from a basket of currencies (and amounts), the ECU is a good illustration of potential speculative movements that could affect Libra. Although it is just a basket of currencies, the ECU has fluctuated on the forex market well above its theoretical value, as the chart below shows: -3% in June 1996 and +1% in September 1998. These divergences appeared on the occasion of arbitrage transactions between the respective interest rates of currencies in the basket and that of the ECU itself. The same types of arbitrages have affected the Icelandic currency in the past and led to the collapse of the Icelandic banking system at the end of 2008.

Fears that Libra could suffer a similar fate are therefore very real. Particularly as unlike the ECU, Libra is not subject to strict control by a central authority that could intervene to restore stability as in 1996 on the occasion of the devaluation of the Italian lira.



Source : Banque de France - ECB - Agata Capital

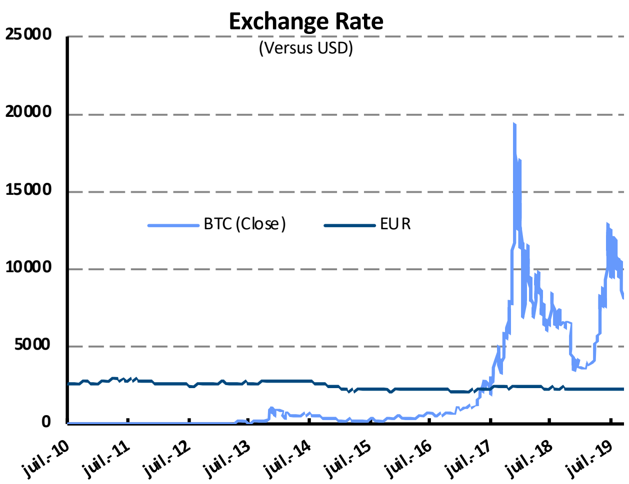
The intense debate surrounding the birth of Libra show that in addition to the curiosity relating to the emergence of a "breakthrough" technology, instincts of mistrust are arising.

"Explaining economic and financial news in order to better anticipate and manage the risks"

The questions about Libra resonate with **Hyman Minsky**, the economist famous for his prediction, 30 years ahead of time, of the Great Recession of 2008 when he said:" **"Everyone can create money; the problem is to get it accepted**.

And in his book **"The Wealth of Nations"** written in 1776, **Adam Smith** defines money through the roles it plays in societies, in particular how money serves as a store of value, medium of exchange and unit of account, three indissociable roles and each one contained in the last. The Governor of the Bank of England, the world's oldest central bank, reminded us recently in a very enlightening speech about "the future of Money" (*) that in fact, cryptocurrencies do not fulfil any of these three roles:

As a store of value, observation of the respective performances of Bitcoin (BTC) and the euro against the dollar shows how difficult it is to regard Bitcoin as a store of value given how its exchange rate fluctuates over time (see chart below). The same goes for other cryptocurrencies today. And as stated above, it is not Libra's status as a basket that will guarantee better stability. Without tighter control of how the currency is used and by whom, it will be difficult to escape the suspicions of laundering that currently hang over Bitcoin, for example. Lastly, cryptocurrency thefts are now legion. The Bank of England has reported many, including the theft of 530 million Bitcoin in January 2018.



Source : Bureau of Economic Analysis - Agata Capital

As a medium of exchange, the usefulness of cryptocurrencies is far from proven: a payment company like Visa can carry out more than 65,000 transactions per second, while this figure is barely higher than 7 transactions for Bitcoin. The fees associated with Bitcoin transactions are around €2, which makes them prohibitive compared with cash (1.5 cents) or payment cards (8 cents). Nothing has been revealed as yet about the characteristics of Libra in this regard. Technology being what it is today, it is likely that the orders of grandeur will be the same.

Furthermore, use of cryptocurrencies is extraordinarily energy-intensive as the electricity consumption associated with mining BTC alone is reportedly equivalent to 52 terawatts/hour, double that of Scotland, while Visa uses just 0.5% of this amount for 9,000 times more transactions processed.

Lastly, at present, the majority of cryptocurrencies are only issued in a potentially limited quantity and therefore present the same disadvantages as gold, the "rarity" of which has led to major economic crises.

As a unit of account, unlike certain "private" currencies like casino tokens, Switzerland's WIR or a certain community currency bearing the effigy of David Bowie in the United Kingdom, cryptocurrencies are not used as a unit of account within the real economy.

In addition to these roles defined by Adam Smith, it is critical to remember that money plays a central role in state financing: it is the exchange of money when paying salaries that **generates the "production" of social security charges** and it is the exchange of money when buying a good that **generates the "production" of VAT**. Money can therefore only be a common good: **without control over money, there cannot be a State**.

This does not necessarily condemn **technology**. States may become "makers" of these currencies as they are of notes and coins: we currently talk about the concept of the Central Bank Digital Currency or CBCD. However, the CBCD would be very intrusive in nature: the state would know and could influence each of our "transactions", regardless of type. This is incompatible with western societies' current idea of liberty. Unless we imagine that CBCDs could be "intermediated" by the banks... and then...

On 8 October, the **CoinFlex platform** announced the creation of a derivative product, which is a gamble on the chances of Libra becoming operational. This product is still to be launched and the first-time listing of this "derivative" would be set at **20%** (1 LIB = 0.20 USDT), which is therefore **the probability** – from the current viewpoint – **that Libra will come into being**.

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