

Chapter 2 at a Glance

- The crypto ecosystem continues its rapid growth, presenting both opportunities and challenges. This chapter discusses the latest developments and financial stability challenges posed by the crypto ecosystem, with a focus on emerging market and developing economies.
- Crypto assets come in different flavors and have evolved to meet varying needs for speculative investment, store of value, currency conversion, and payments. Decentralized finance (DeFi) is gaining momentum by offering new services to users.
- Financial stability risks are not yet systemic, but risks should be closely monitored given the global implications and the inadequate operational and regulatory frameworks in most jurisdictions.
- Challenges posed by the crypto ecosystem include operational and financial integrity risks from crypto asset providers, investor protection risks for crypto assets and DeFi, and inadequate reserves and disclosure for some stablecoins.
- In emerging markets, the advent of crypto assets has benefits but can accelerate *cryptoization* and circumvent exchange and capital control restrictions. Increased trading of crypto assets in these economies could lead to destabilizing capital flows.
- Policymakers should implement global standards for crypto assets and enhance their ability to monitor the crypto ecosystem by addressing data gaps. As the role of stablecoins grows, regulations should correspond to the risks they pose and the economic functions they perform. Emerging markets faced with *cryptoization* risks should strengthen macroeconomic policies and consider the benefits of issuing central bank digital currencies.

Introduction

The rapid growth of the crypto ecosystem presents new opportunities. Technological innovation is ushering in a new era that makes payments and other financial services cheaper, faster, more accessible, and allows them to flow across borders swiftly. Crypto asset technologies have potential as a tool for faster and cheaper cross-border payments. Bank deposits can be transformed to stablecoins that allow instant access to a vast array of financial products from digital platforms and allow instant currency conversion. Decentralized finance could become a platform for more innovative, inclusive, and transparent financial services.

Despite potential gains, the rapid growth and increasing adoption¹ of crypto assets also pose financial

stability challenges. This chapter discusses the implications of the expansion of the crypto ecosystem and provides an assessment of their associated financial stability risks. For emerging market and developing economies, greater use of crypto assets presents some benefits, but also macro-financial risks, especially with respect to asset and currency substitution—referred to in this chapter as *cryptoization*. The chapter concludes with a set of eight actionable policy recommendations. For readers less familiar with the terminology and developments, Online Annex 2.1 provides a brief description of the taxonomy of crypto assets as well as a brief primer on the crypto ecosystem.² The IMF has discussed many critical issues relating to regulatory frameworks with respect to crypto assets and digital money. Some topics that are not covered in detail in this chapter can be found in IMF (2020a) and IMF (2021) along with analysis of financial integrity issues,

²A stablecoin is a type of crypto asset that aims to maintain a stable value relative to a specified asset or a pool of assets. Online Annex 2.1 offers more information on definitions. All online annexes are available at www.imf.org/en/Publications/GFSR.

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¹“Adoption” refers to the degree of use of crypto assets by users for transferring and storing value.

