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WEEKLY ECONOMIC COMMENTARY

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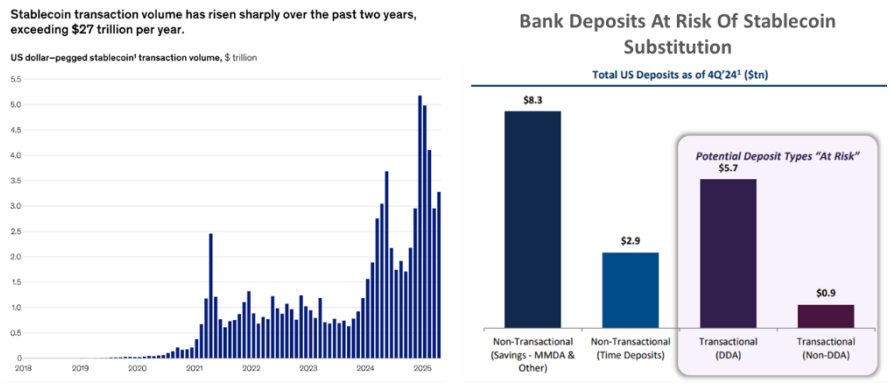
Parents are rarely prepared when their children have a growth spurt. Without warning, a child takes on new proportions, speaks with a new voice and expresses a whole new attitude. The transition is years in the making but feels like it happens in an instant.

The blossoming of stablecoins has caught us similarly off guard. Through 2024, they were obscure instruments used primarily to convert fiat currency into crypto assets. This past spring, following the election of a U.S. administration that promised to be "crypto-friendly," we defined and offered thoughts on the future of stablecoins. Now, a regulatory framework for these vehicles is in place, and interest is growing rapidly.

In July, Congress approved the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act. The Act created a legal definition of *payment stablecoins*: digital assets on a blockchain used to settle payments. They are not bank deposits, nor are they government-backed currencies, securities or credit obligations. Stablecoin issuers will be nonbanks or bank subsidiaries permitted by their federal or state regulators. Issuers must hold safe, liquid collateral like cash, U.S. Treasury bills and repurchase agreements on a 1:1 value with their issued coins. To keep these payment vehicles distinct from banking products, stablecoins are not permitted to pay interest on balances.



Sources: Federal Reserve Bank of New York, U.S. Treasury

Financial regulations have a reputation for being costly and onerous, but in this case, regulation will be beneficial. Cryptocurrencies have been the "Wild West" of finance, often the object of fraud and speculation. Legal boundaries will build institutional trust and promote greater adoption.

Passage of the GENIUS Act was only the first regulatory step. Now, agencies like the Treasury Department and prudential regulators like the Federal Reserve and the Office of the Comptroller of the Currency will start work on putting the GENIUS Act into force.

Designing controls will be a challenging effort. The instant settlement of transactions will complicate fraud mitigation. The decentralized nature of these networks does not align with know-your-customer and anti-money laundering (KYC/AML) requirements of all financial institutions. The Act gives these agencies 18 months to enact the law; GENIUS-compliant stablecoins may then launch in 2027.

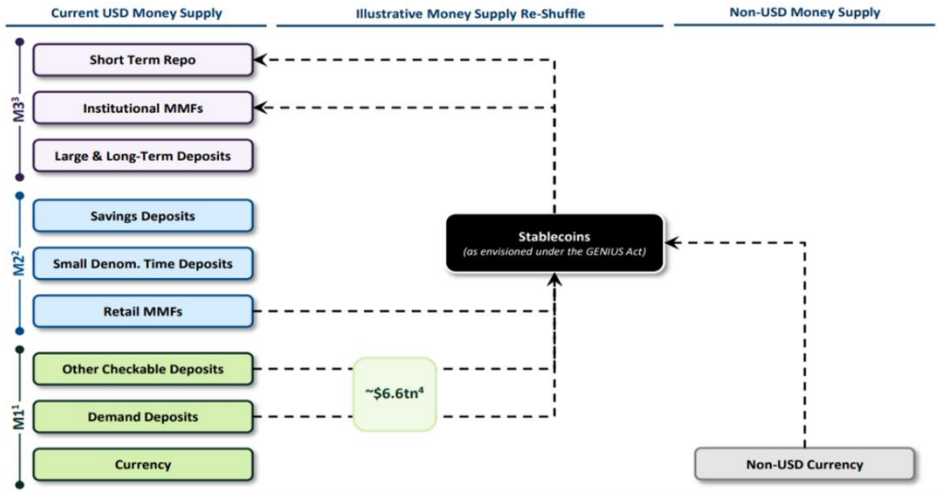
Issuers will be required to publicly share monthly summaries of their collateral positions, and larger issuers must post annual audited financial statements. This transparency is meant to simplify regulation and maintain trust.

An issuer cannot disburse interest to coin holders, but the issuer must carry interest-bearing assets as collateral. This arrangement sounds too good to be true. Already, loopholes are being identified. An issuer-affiliated party like an exchange platform can pay interest. Or, the incentive to holders can be relabeled a "reward." Regulators may have difficulty preventing this behavior.

The GENIUS Act was only the start of the regulatory process for stablecoins.

The use cases for stablecoins are becoming clearer. Their most immediate opportunities arise in the international context. Cross-border payments and remittances are often slow and costly due to the series of intermediaries involved; stablecoins can be exchanged directly. Residents of nations with weak and unstable currencies may be the most rapid adopters of future U.S. stablecoins. The easier international exposure to the dollar may also support global lending and facilitate exchange rate transactions.

Mainstream domestic adoption will require something new to compel a change; existing payment protocols are working well enough today. Stablecoins can underpin smart contracts, payments that are programmed to be contingent on an embedded rule. They may see adoption as a faster and more secure payment method than checks for business-to-business payments. Widespread consumer uptake could come from an organized push by merchants seeking to reduce their payment processing costs, but no such effort is yet underway.



Source: U.S. Treasury

The financial sector will face disruption. Stablecoins could prove to be competition for bank deposits and money market fund shares. A loss of deposits will raise banks' funding costs, impairing their capital and leading to higher interest rates for loans. The smaller the bank, the greater the pain of higher funding costs. As stablecoin volumes increase, their issuers will become a greater source of demand for Treasuries and money market shares; time will tell whether they represent net new demand or a reshuffling of existing demand.

Rulemaking is nascent today, with only the Treasury thus far issuing a request for comment. We encourage regulators to give thought to interoperability of stablecoins, facilitating flows across chains. Without this capability, the U.S. risks a reversion to its historic frictions of currencies issued by individual banks or states.

How and why will stablecoins be used?

The GENIUS Act only applies to payment stablecoins. The crypto evolution will continue well beyond this application. Several major banks are working toward tokenized deposits, moving electronic funding into a blockchain structure. The "rails" of existing interbank payment networks are dated, and the investment may facilitate faster and easier transfers. Further efforts are underway to codify the blockchain to be used for investment transactions, legal contracts and more. The CLARITY Act has been drafted to offer a wider framework for the regulation of digital assets.

Stablecoins are in their growth spurt, a time that may be fractious and stressful for all involved. Maturing includes behavioral development, reflecting a greater understanding of one's role in the world and duties to others. The GENIUS Act is an important milestone on this developmental journey, but we will be braced for further growing pains along the way.

Urgentina

Argentina has long been a poster child of economic instability. Recurring cycles of debt defaults, hyperinflation, balance of payment crises and abrupt policy shifts have steadily eroded investor confidence. Over time, economic turmoil has become less an exception and more a baseline feature of the country's macroeconomic landscape.

Argentine President Javier Milei's radical reform agenda was starting to yield some positive results. His aggressive fiscal tightening delivered a rare budget surplus and helped curb inflation. Yet the country once again finds itself on the brink.

Investor confidence has been rattled by mounting political uncertainty ahead of the October 26 midterm elections, as Milei has faced a string of domestic setbacks. These include allegations of corruption and a weak showing for his party in provincial elections. But the most consequential blow came when the Argentinian Congress overturned key elements of the government's fiscal consolidation plan. This reversal not only threatens to push the budget back into deficit next year but also risks derailing Argentina's support from the International Monetary Fund (IMF).

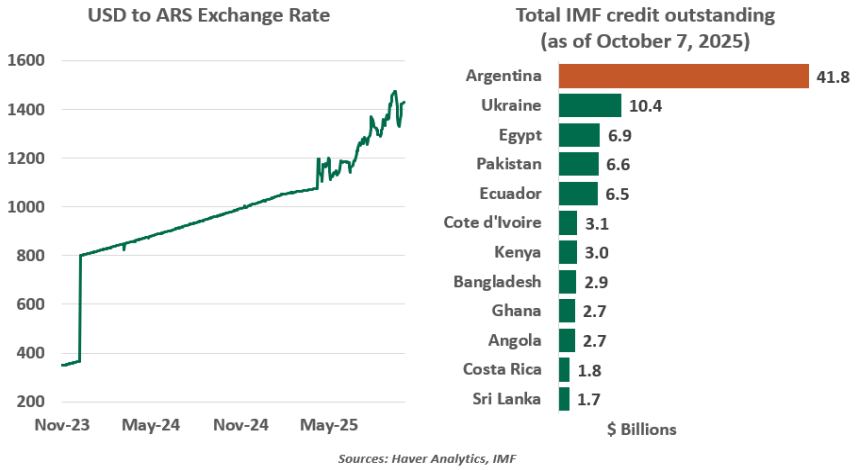
These developments rattled markets, triggering a sharp sell-off in the Argentine peso. The central bank stepped in to defend the currency, but its already depleted international reserves could not turn the tide. Fortunately for Mr. Milei, support came from an unexpected quarter: the Trump administration extended a $20 billion lifeline to Argentina. The extraordinary move has, for now, calmed market nerves and helped stabilize the peso.

Although U.S. support has secured Argentina's bond payments through 2026, it does little to address the country's financial problems. Mounting job losses and weak consumer spending have raised fears of a recession. Nearly one-third of Argentines live in poverty. The central bank has struggled to rebuild reserves, leaving it vulnerable during episodes of market panic. While Argentina has several options to boost its U.S. dollar reserves, each comes with trade-offs. Slashing the value of its currency could attract more dollars, but it would come at the cost of higher inflation and political backlash. Given its long history of debt restructurings, skepticism around Argentina's repayment capacity is far from misplaced.

The U.S. intervention is not a direct cash injection, but rather a liquidity backstop via the Exchange Stabilization Fund (ESF). The U.S. Treasury finalized a $20 billion currency swap framework with

Argentina's central bank and bought pesos in the open market on Thursday. However, the lack of clarity around the terms has raised questions about the conditions attached, fueling concerns over legal oversight and transparency.

While the ESF gives the U.S. Treasury flexibility to act without congressional approval in emergencies, longer-term or larger-scale commitments may still require legislative backing. Republican lawmakers have voiced opposition, citing concerns over taxpayer exposure.



Sources: Haver Analytics, IMF

The U.S. rescue package will fall short of stabilizing Argentina's economy.

U.S. intervention in this form is not without precedent. The use of the ESF and swap lines dates back to the 1995 Mexican peso crisis, when the U.S. extended a similar lifeline to its Southern neighbor. The amount was ultimately repaid with interest and viewed as a successful stabilization effort. However, Argentina's structural weaknesses make this case far riskier. The country has defaulted on its sovereign debt nine times and remains the IMF's largest debtor, still owing over $40 billion from its 2018 bailout.

The U.S. may not be purely driven by economic altruism. Many observers view the aid to the ideologically-aligned Argentine administration as a strategic move to counter China's growing influence in the region. Washington is reportedly pressuring Argentina to cancel its $18.5 billion currency swap line with China, and to increase mining of rare earth minerals. The U.S. may also see a stable Argentina as a buffer against further migration flows, particularly in light of the ongoing Venezuelan refugee crisis.

America's helping hand simply postpones the next crisis and does not mark a turning point. Without meaningful reform, that reality is unlikely to change.

Missing Numbers

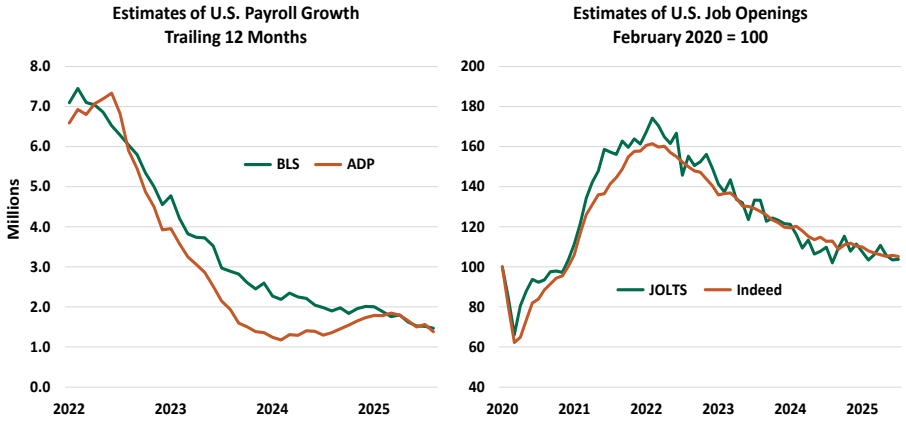
With the U.S. government shut down, the Labor Department was unable to release the monthly employment report on October 3. You could almost sense the economics community experiencing a kind of withdrawal, not sure of how to cope with deprivation of data.

Fortunately, alternative measures of the labor market have emerged over the past decade. The payroll processor ADP has been releasing estimates of job creation since 2010. The outcomes track very closely with "official" figures produced by the Bureau of Labor Statistics (BLS).

The ADP report covers more firms than the BLS sample, but it does not capture government employment. The representation of smaller businesses, which may not use payroll services, is less comprehensive. ADP does not attempt to estimate the size of the labor force, and does not

produce an alternative to the unemployment rate. It could not replace the establishment survey: ADP is only able to scale their trends to the national economy by using BLS data as a benchmark.

Online job portals like LinkedIn and Indeed provide time series on job postings and hiring which are comparable to the Job Openings and Labor Turnover Survey (JOLTS) report issued by the BLS. Directionally, these are aligned; however, sampling limitations are a factor, as they reflect only listings on their own platform.



Sources: BLS, ADP, Indeed, Haver Analytics, Bloomberg

While there are alternatives, the lapse in government economic data will challenge investors and policy makers.

If the shutdown continues, we will also miss readings on consumer spending and inflation. The major credit card providers produce measures of sales that rival those produced by the Commerce Department. PriceStats prepares measures of inflation by aggregating online prices; many industry associations produce cost measures for their sectors. None of these sources does a particularly good job of covering services, which account for more than two-thirds of U.S. economic output.

If the shutdown continues, interruption in data flow will make life more difficult for the Federal Reserve, whose decision making has been described as “data dependent.” Their next meeting occurs at the end of October.

Even after government operations resume, alternative sources of economic data deserve attention. Some official statistics have been challenged by poor response rates to surveys and other imperfections. And concerns have arisen recently over whether government economic data will continue to be produced in an objective fashion. While “official” statistics are still the gold standard, other data sources can help us keep them in context.

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