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| Case Studies

# Stablecoins in Japan: Regulatory Architecture, Monetary Strategy, and the Construction of Hybrid Digital Money Infrastructure.

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**Abstract**
Stablecoins have evolved from niche instruments supporting crypto-asset trading into structurally significant components of global payment infrastructure and digital monetary strategy. Japan was among the first major economies to establish a comprehensive legal framework governing fiat-backed stablecoins, embedding issuance within prudential supervision and restricting participation to regulated financial institutions. This early regulatory clarity positioned Japan as a pioneer in stablecoin governance.
However, global developments-particularly the rapid expansion of U.S. dollar-denominated stablecoins, which collectively hold over USD 150–180 billion in U.S. Treasury-related assets-have reframed stablecoins as instruments of currency competition and sovereign financial influence. At the same time, multilateral institutions such as the Bank for International Settlements (BIS) and the Financial Stability Board (FSB) have emphasised the need for governance safeguards, reserve transparency, and cross-border coordination to mitigate systemic risk.
This article situates Japan's stablecoin framework within comparative international policy debates and argues that Japan is moving toward a hybrid digital money architecture. In this emerging model, regulated stablecoins coexist with tokenised deposits and prospective central bank digital currency (CBDC) initiatives. While Japan's prudential model enhances systemic resilience, maintaining strategic relevance will require interoperability, scalability, and deeper integration into cross-border digital financial networks, particularly in the Asian region.

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## 1. Introduction

*Stablecoins as Systemic Financial Infrastructure:* The first generation of stablecoins emerged as transactional tools within crypto-asset exchanges. Their primary objective was functional: to reduce settlement friction without exposure to volatile cryptocurrencies. However, over time, three structural transformations occurred:

1. Stablecoins became embedded in decentralised finance (DeFi) ecosystems.

2. They increasingly served as cross-border remittance mechanisms.
3. Their reserve assets became linked to sovereign bond markets.

This transformation altered their regulatory and macroeconomic significance. Stablecoins now function as:

- Programmable liquidity instruments
- Parallel payment infrastructures
- Synthetic digital representations of sovereign currency

International organisations have correspondingly recalibrated their analytical frameworks. The BIS has questioned whether privately issued stablecoins can replicate the singleness of money - a foundational characteristic of modern monetary systems. The FSB has emphasised governance, reserve transparency, and redemption risk mitigation. The ECB has raised concerns regarding currency substitution effects and monetary transmission.

Japan's regulatory approach predates this convergence but aligns with its underlying principles. The question is whether alignment is sufficient in a world where scale, interoperability, and strategic adoption matter as much as prudential design.

*Digital Money Hierarchy and Monetary Sovereignty:* Modern monetary systems operate through a hierarchy.

- Central bank money (ultimate settlement asset)
- Commercial bank deposits
- Narrow money instruments
- Shadow banking liabilities

Stablecoins introduce a novel layer. They are:

- Privately issued
- Backed by sovereign currency
- Operable on distributed ledger infrastructure
- Programmable through smart contracts

Unlike bank deposits, stablecoins may circulate globally without direct reliance on domestic banking rails. This characteristic introduces potential shifts in monetary hierarchy.

Monetary sovereignty involves control over currency issuance, payment systems, and transmission mechanisms. If foreign-currency stablecoins become dominant in cross-border digital commerce, domestic currency influence may erode — even without traditional capital account shifts.

In the Japanese context, this shift in monetary hierarchy is further shaped by the country's bank-centric financial system and regulatory emphasis on institutional trust. Unlike jurisdictions where non-bank fintech entities drive stablecoin adoption, Japan's framework embeds digital money innovation within existing financial intermediaries. This institutional configuration may limit rapid scaling but enhances credibility and

regulatory consistency. Therefore, the strategic question for Japan is not merely regulatory adequacy but currency presence in programmable financial ecosystems.

## 2. Japan's Regulatory Architecture: Structure and Intent

Japan classifies fiat-backed stablecoins as electronic payment instruments. This legal classification reflects three strategic intents:

- Integration into prudential supervision
- Avoidance of crypto-asset volatility spillover
- Preservation of banking intermediation

Issuance restrictions to licensed banks and trust entities ensure institutional accountability. Reserve backing requirements mitigate credit risk. Segregation of assets protects consumers.

However, the conservative design also limits rapid market scaling relative to jurisdictions permitting fintech-led issuance. The trade-off is clear: credibility versus speed.

In addition, Japan's Payment Services Act introduces a tiered framework for fund transfer service providers, which indirectly influences stablecoin design and issuance models. Emerging initiatives, including yen-linked digital payment tokens such as JPYC, illustrate how private-sector experimentation is taking place within regulatory boundaries. At the same time, digital-native banks such as GMO Aozora Net Bank, Minna Bank, and UI Bank indicate potential future integration points between stablecoins and retail digital banking services.

## 3. Financial Stability Implications of Stablecoin Growth

Stablecoins introduce new financial stability channels:

1. Liquidity Risk

Large-scale redemption events could trigger rapid asset liquidation if reserves include longer-duration securities.

2. Sovereign Bond Market Linkages

If reserves are invested in sovereign debt, stablecoin growth may affect yield dynamics and liquidity conditions.

3. Interconnectedness with Tokenised Finance

Stablecoins increasingly serve as collateral in decentralised lending protocols and tokenised securities markets.

4. Operational and Cyber Risk

Programmability introduces smart contract vulnerabilities. Japan's prudential model addresses redemption and reserve risk but must adapt to interconnectedness and operational complexity as scale increases.

*Comparative Regulatory Strategies: Divergent Paths in Digital Currency Governance*

Stablecoin regulation has evolved along three identifiable models: prudential integration, innovation-led licensing, and strategic federalisation.

1. United States: Strategic Federalisation

The United States initially allowed rapid private-sector growth of dollar-denominated stablecoins before regulatory consolidation. Stablecoins such as USDC and USDT scaled globally, embedding themselves in digital asset markets and cross-border liquidity networks.

Recent legislation of the GENIUS Act signals a shift toward federal-level oversight frameworks. Importantly, U.S. discourse increasingly recognises that regulated stablecoins may reinforce demand for U.S. Treasury securities, creating a feedback loop between digital liquidity growth and sovereign bond markets.

This reflects a strategic reframing: stablecoins are not merely fintech innovations but potential instruments of dollar reinforcement.

2. European Union: Stability and Monetary Autonomy

The EU's Markets in Crypto-Assets (MiCA) regulation introduces licensing requirements, reserve backing rules, and supervisory oversight for stablecoin issuers. However, the European debate extends beyond prudential design.

The ECB has repeatedly highlighted risks of currency substitution, emphasising that large-scale stablecoin adoption could influence monetary transmission and financial stability. The digital euro initiative can be understood partly as a response to private digital currency expansion. Europe's model thus combines prudential oversight with defensive monetary strategy.

3. Hong Kong and Singapore: Innovation-Oriented Supervision

Hong Kong has pursued a licensing regime designed to attract stablecoin issuers while maintaining risk-based safeguards. Singapore similarly adopts calibrated regulation that encourages fintech experimentation within supervisory frameworks.

These jurisdictions aim to position themselves as digital asset hubs, balancing innovation and systemic stability.

4. Japan in Comparative Context

Japan's model is institutionally conservative but strategically coherent. It aligns with multilateral prudential guidance and avoids fragmentation between banking and digital asset sectors.

However, unlike the United States, Japan has not yet achieved scale in stablecoin issuance. This raises a central strategic question: can prudential foresight translate into ecosystem leadership without scale?

## 4. Stablecoins and Sovereign Debt Markets: Macro-Financial Feedback Loops

Stablecoins backed by sovereign assets create new macro-financial linkages. Recent estimates suggest that major U.S. dollar stablecoin issuers collectively hold more than USD 150 billion in U.S. Treasury bills and related short-term instruments, making them non-negligible participants in sovereign debt markets. This development introduces a structural linkage between digital liquidity expansion and public debt financing.

1. Reserve Composition and Duration Risk

Stablecoin issuers typically hold reserves in cash equivalents, short-term government securities, or money market instruments. As issuance scales, reserve portfolios grow correspondingly.

If reserves are concentrated in sovereign bonds, stablecoin growth may:

- Increase demand for short-duration government securities
- Influence yield curves
- Create new liquidity channels in secondary markets

In the U.S., the accumulation of Treasury bills by major stablecoin issuers has become economically significant.

2. Implications for Japan

If yen-denominated stablecoins scale meaningfully, reserve allocation could affect the Japanese Government Bond (JGB) market.

Possible dynamics include:

- Increased demand for short-term JGBs
- Interaction with Bank of Japan yield curve control policies
- Liquidity effects during redemption cycles

Given Japan's large sovereign debt stock and central bank asset purchases, the integration of private digital reserve holders introduces novel complexity.

3. Redemption Stress Scenarios

Large-scale redemptions could force liquidation of reserve assets. While Japan's prudential framework mandates reserve quality, liquidity mismatches cannot be entirely eliminated.

Thus, stablecoins create new feedback channels between digital asset markets and sovereign debt stability.

## 5. Tokenised Deposits versus Stablecoins: Convergence or Competition?

A critical conceptual question is whether stablecoins and tokenised deposits represent competing models or converging forms.

1. Tokenised Deposits

Tokenised deposits are commercial bank liabilities represented on distributed ledgers. They remain within traditional banking balance sheets and are subject to capital and liquidity regulation.

2. Stablecoins

Stablecoins may be issued by regulated financial institutions but are structurally distinct digital instruments backed by segregated reserves.

3. Convergence Dynamics

As regulatory frameworks mature, distinctions may narrow:

- Both instruments represent claims on fiat currency
- Both may operate on programmable infrastructure
- Both require compliance with AML and prudential safeguards

Japan's framework, by limiting issuance to supervised institutions, accelerates this convergence. Rather than replacing deposits, stablecoins may evolve as interoperable settlement layers.

In Japan, this convergence is likely to be accelerated by regulatory design. Because stablecoin issuance is restricted to supervised institutions, the functional distinction between tokenised deposits and stablecoins may narrow more rapidly than in other jurisdictions. Over time, both instruments may be integrated within bank-led digital platforms, supporting programmable settlement without displacing traditional deposit structures.

*CBDC Interaction Scenarios:* Japan, like many jurisdictions, has explored central bank digital currency experimentation. Three possible interaction models exist:

1. Competitive Model

CBDC displaces stablecoins as the dominant digital settlement asset.

2. Complementary Model

CBDC serves as wholesale settlement anchor, while stablecoins operate at retail or enterprise level.

3. Layered Hybrid Model

CBDC, tokenised deposits, and stablecoins coexist within unified ledger environments.

Japan's prudential integration approach suggests the third scenario is most plausible. For example, the Bank of Japan has adopted a cautious and exploratory approach to CBDC development, focusing on technical feasibility and institutional implications rather than immediate issuance. This cautious stance reinforces the likelihood that private-sector stablecoins and tokenised deposits will play a significant role in early-stage digital money innovation.

*Cross-Border Settlement and Asian Trade Corridors:* Digital currencies may reshape cross-border trade settlement. Yen-denominated stablecoins could:

- Facilitate settlement in regional supply chains

- Reduce reliance on correspondent banking
- Enable programmable trade finance

However, network effects favour early movers. Dollar-denominated stablecoins already dominate global digital liquidity.

Japan must therefore consider:

- Bilateral interoperability agreements
- Regional digital currency corridors
- Integration with Asian fintech ecosystems

Without cross-border adoption, domestic stablecoin frameworks risk remaining inward-looking. In this context, regional initiatives such as cross-border payment connectivity in Asia and potential interoperability frameworks among digital currencies will be critical. Without such integration, yen-denominated stablecoins may remain confined to domestic use cases, limiting their strategic impact.

*Geoeconomic Competition and Digital Currency Strategy:* Stablecoins increasingly intersect with geopolitical considerations. Digital currency dominance may influence:

- Global trade invoicing patterns
- Financial sanctions architecture
- Sovereign liquidity preferences

The expansion of dollar stablecoins strengthens the digital footprint of the U.S. currency. And for Japan, maintaining yen relevance requires strategic engagement rather than passive alignment. Digital monetary architecture is becoming an element of statecraft.

## 6. Strategic Options for Japan

Japan has been developing a legal framework based on the premise of an evolving hybrid digital money system where fiat currency, stablecoins, and CBDCs coexist. However, financial systems featuring a mix of various digital currencies are still in the early stages of development worldwide, and research into them has only just begun. Consequently, there is a growing need for Japan to formulate policies that adapt to the advancement of such a hybrid digital monetary ecosystem.

Japan faces three broad strategic pathways:

1. Conservative Prudential Stability

Maintain strict supervision and gradual scaling.
Advantage: systemic resilience. Risk: marginalisation in global digital liquidity networks.

2. Regional Digital Integration

Position yen stablecoins within Asian trade ecosystems.
Advantage: regional influence. Risk: coordination complexity.

3. Hybrid Leadership Model

Leverage prudential credibility while enabling scalable ecosystem development through targeted measures such as:

- API standardisation for bank–stablecoin interoperability
- Integration with tokenised securities settlement (e.g. DvP frameworks)
- Pilot projects for cross-border yen-denominated digital settlement

Advantage: balanced resilience and competitiveness. Risk: execution complexity and coordination challenges.

*Policy Roadmap for Hybrid Digital Money Architecture:* A coherent roadmap could include:

1. Enhancing interoperability standards across banks and digital asset platforms
2. Encouraging tokenised deposit experimentation within regulated banking environment
3. Coordinating CBDC pilot programs with private-sector stablecoin initiatives
4. Promoting cross-border pilot projects in Asian trade corridors
5. Establishing common technical standards for programmable settlement (e.g. API and smart contract frameworks)

The objective should not be digital currency dominance, but digital currency relevance.

## 7. Conclusion: Toward Programmable Monetary Infrastructure

Stablecoins have evolved into structural components of global financial architecture. Japan's regulatory framework demonstrates foresight and institutional coherence. However, digital currency competition is accelerating. Prudential clarity alone is insufficient, scale and interoperability matter.

The evidence suggests Japan is constructing a hybrid digital money architecture integrating stablecoins, tokenised deposits, and CBDC experimentation. This layered approach preserves monetary hierarchy and financial stability. Yet maintaining strategic relevance will require proactive engagement in shaping international digital financial governance. The digital monetary order is no longer emerging - it is consolidating.

Japan's next phase will determine whether its early regulatory leadership translates into enduring influence. In particular, Japan's ability will depend on whether yen-denominated digital money can achieve meaningful adoption beyond domestic use cases. Future empirical analysis will be necessary as transaction data accumulates and practical use cases emerge.

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