

Crypto currency meltdown points to deeper financial crisis

Nick Beams**20 June 2022**

It has been described as the week when the financial world shifted—the business channel CNBC described it as a “new reality”—when it became apparent global central banks were intent on lifting interest rates, come what may.

The major action was the decision by the US Federal Reserve to raise its base rate by 0.75 percentage points, the biggest single increase since 1994, with more to come.

The Bank of England lifted its rate for the fifth time and predicted the UK inflation rate would rise to 11 percent. Smaller central banks, such as the Reserve Bank of Australia, have indicated further rate rises are in the pipeline.

One of the most significant decisions was that of the Swiss National Bank which lifted its base rate by 0.5 percentage points. Previously it had been one of the firmest advocates of maintaining rates at historic lows.

The official reason for the rate rises is the need to combat inflation, but the central banks are well aware that their actions will not reduce price hikes. Their concerted action has another target. As inflation reaches its highest levels in four decades, it is aimed at clamping down on the wage demands of the working class around the world by inducing a recession, if that proves necessary.

The interest rate hikes have resulted in a sharp fall on stock markets around the world led by Wall Street. The broad-based S&P 500 is down by around 22 percent from its previous high, and the fall in the Dow is approaching 20 percent. The tech-heavy and interest-rate sensitive NASDAQ index has fallen by more than 30 percent, with significant stocks dropping by more than 50 percent from their highs.

One of the indications of the growing instability is the precipitous fall of crypto currencies, and the decisions by traders to suspend operations because of turbulent market conditions.

The crypto currency lender Celsius Network, which sent a shock wave through the crypto market last week when it suspended withdrawals, has said it will “take time” to normalise its operations. In a blog post message yesterday, it said it would continue to work “with regulators and officials

regarding this pause and our company’s determination to find a resolution.” But it provided no details.

The chaos began last month when the so-called stablecoin TerraUSD, used to facilitate crypto currency trading by providing a link to the US dollar, failed to maintain dollar parity.

The shutting down of withdrawals has extended beyond Celsius. On Friday the crypto lender Babel Finance, based in Hong Kong, said it was pausing withdrawals because of “unusual liquidity pressure” and the Singapore-based crypto hedge fund Three Arrows has failed to meet margin calls from lenders.

Yesterday the Hong Kong-based crypto exchange Hoo halted transactions which were threatening to exhaust its funds. It said it was trying to reconfigure its medium- and long-term assets in an “orderly and reasonable manner.”

Previously, the swings and gyrations in the crypto market were regarded as somewhat isolated from the equity market and the broader financial system. That was generally the case in the period prior to the COVID-19 pandemic.

In a comment piece published in the *Australian Financial Review*, columnist Karen Maley drew attention to an analysis from an International Monetary Fund staffer published in January which pointed to the growing correlation between the crypto and stock markets.

Writing in response to the fall of bitcoin to below \$20,000 over the weekend—down from near \$70,000 in November, amid predictions that it would go to \$100,000—she said more conservative investors “might be quietly congratulating themselves on their sagacity in not succumbing to the crypto craziness. But their smugness may be premature. That’s because the sharp drop in the bitcoin price will inevitably rattle global equity markets.”

According to the IMF research note entitled *Cryptic Connections*, “the analysis suggests that crypto and equity markets have become increasingly interconnected across economies over time.”

The research note detailed the extraordinary expansion of the crypto market, particularly following the bailout

operations launched by the major central banks in response to the March 2020 crisis at the start of the pandemic.

“Launched in 2009,” the note began, “the total market capitalization of crypto assets has increased exponentially from less than \$20 billion in January 2017 to more than \$3 trillion in November 2021. Much of this increase has occurred during the COVID-19 pandemic as trade in crypto assets has accelerated, leading to a twentyfold increase in the market capitalization of crypto assets between March 2020 and November 2021.”

The IMF research found that in September 2021 two major crypto currencies, bitcoin and ether, “ranked among the world’s top traded assets, competing with the market capitalization of some of the world’s largest companies.”

While the risks from crypto were deemed to be minimal until a few years ago, “their widespread adoption could pose financial stability risks given their highly volatile prices, the rising use of leverage in their trading, and financial institutions’ direct and indirect exposures to these assets. Because of the relatively unregulated nature of the crypto ecosystem, any significant disruption to financial conditions driven by crypto price volatility could potentially be largely outside the control of central banks and regulatory authorities.”

The findings of the research, the IMF note said, “suggest that the interconnectedness between crypto and equity markets has increased notably over 2017-2021.”

Together bitcoin and the stablecoin tether explained about 19-23 percent of the variation in the volatility of major global equity markets and about 12-17 percent of the variations in their return in what it called the “post-pandemic period.” Spillover effects went both ways—from crypto assets to equity markets and vice versa. Crypto assets could no longer be considered as a fringe asset class and “could pose financial stability risks due to their extreme price volatility.”

The movement in bitcoin prices was associated with a nontrivial share of the variation of US equity prices, accounting for about one-sixth of the volatility in US equity prices and about tenth of the variation in US equity returns.

It described these results as “quite remarkable” given that five years ago, “the contribution of crypto assets to explaining the variations in US equity markets was one percent at the most and suggest a significant integration of the crypto asset markets, most likely because of the increased adoption of crypto assets by retail and institutional investors.”

The crypto crash also attracted the attention of academic economist Robert Reich, the labor secretary in the first Clinton administration.

He characterised the crypto markets as a Ponzi scheme

which was now crashing, citing the words of Securities and Exchange Commission chief Gary Gensler who has characterised crypto investments as “rife with fraud, scams and abuse.”

“There are no standards for risk management or capital reserves. There are no transparency requirements. Investors often don’t know how their money is being handled. Deposits are not insured. We’re back to the wild west finances of the 1920s,” Reich wrote.

But as always with Reich and other would-be reformers of the capitalist system, there is no explanation of the underlying objective dynamic which has led to the increasing integration of criminality into the very centre of the financial system. Reich simply claimed that by the 1980s, “America forgot the financial trauma of 1929.”

Reich’s answer was a call for increased regulation to the crypto world. But in doing so he revealed the bankruptcy of even that limited perspective, pointing to the revolving door which exists between the financial system and the regulatory bodies that supposedly control it.

He noted that the crypto industry had hired “scores of former government officials and regulators” to lobby on its behalf against controls. These included “three former chairs of the Securities and Exchange Commission, three former chairs of the Commodities Futures Trading Commission, three former US senators, one former White House chief of staff, and the former chair of the Federal Deposit Insurance Corporation.”

Former treasury secretary Lawrence Summers advises a crypto currency investment firm and is on the board of a financial technology firm investing in crypto currency payment systems.

The mounting turmoil in crypto and the financial system is not the result of forgetfulness but is rooted in response by governments and central banks to the deepening crisis of the capitalist system.

Over the past period, starting with the stock market crash of 1987, and intensifying after the 2008 crisis, financial authorities have pumped in still more money as the “solution” to the growing storms.

But the effect of these actions has only been to the create the conditions for the re-emergence of the crisis at a higher level. This essential dynamic is once again at work as the central banks move to deal with rocketing inflation which their previous policies have created.



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