FTX bankruptcy fallout continues unchecked in crypto market

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The fallout from the $32 billion collapse of Sam Bankman-Fried's FTX crypto exchange and his associated company Alameda Research is continuing to spread as more firms report their exposure to his Ponzi scheme operation.

Last week, the *Wall Street Journal* (WSJ) reported what it called the "massive crypto lender" Genesis Global Trading had laid off 30 percent of its staff and was in discussions about filing for chapter 11 bankruptcy.

Genesis had been previously hit by the failure of the crypto-based hedge fund Three Arrows Capital after providing it with a $2.4 billion loan.

Its financial problems deepened with the implosion of FTX because it had lent hundreds of millions of dollars to Alameda.

Last November, Genesis halted redemptions, hitting the crypto exchange Gemini which had $900 million of its customers' funds tied up in the firm. Other firms may also be affected.

According to the WSJ article, Genesis is owned by the crypto conglomerate Digital Currency Group, which operates several other crypto-based firms, including the crypto news outlet *Coinbase*.

The FTX collapse also sparked a run on a major crypto bank, Silvergate, whose business involved the movement of money from institutional investors in and out of the crypto markets.

Last Thursday it announced that deposits from its customers had fallen from $12 billion to just $4 billion in the fourth quarter. To cover the withdrawals, it was forced to sell off $5 billion worth of financial assets at a loss of $718 million, far more than its total profits going back to 2013.

As a result of the announcement, Silvergate's shares dropped by 43 percent last Thursday, bringing the total decline to 84 percent over the past three months.

A report in the WSJ said the magnitude of the run on Silvergate was "highly unusual—even by the standards of the Great Depression." In a conference call with analysists on Thursday morning, Silvergate executives said customers did not simply close their accounts but indicated they were getting out of crypto altogether and putting their money into safe assets such as US Treasury bonds.

If the crypto debacle were just an isolated event, fuelled by excessive speculation, it would not be of major significance.

Its importance lies in the fact that the crypto market—trading and profiting from an asset with no intrinsic value—has been the most egregious expression of processes in the broader financial system.

There is no fundamental difference between making a profit from an increase in the share value of a company, whose rise has been fuelled by the expectation that it will go still higher and profiting from trading in crypto in the expectation that coin values will continue to climb.

Bankman-Fried's "business model" has been characterised as a Ponzi scheme dependent on the continued inflow of money. But the same could be said equally of Wall Street.

Its rise and rise, particularly after the Fed injected another $4 trillion into the financial markets at the start of the pandemic in 2020, following the market freeze in March, lifted the prices of stocks to record highs and provided the fuel for speculation in other areas.

But by March last year, recognising that inflation was not "transitory," as it has previously maintained, the US Federal Reserve, followed by other central banks, initiated a new regime of monetary tightening to try to suppress the global wages struggles of the working class in response to the biggest price hikes in four decades.

Share markets have been impacted, with the S&P 500 index finishing almost 20 percent lower in 2022. The loss in share values has been concentrated in high-tech stocks whose market valuations are most sensitive to interest rates increases, as reflected in the 33 percent fall in the NASDAQ index over 2022.

According to an analysis presented in the *Financial Times*, the ten biggest stocks by market capitalisation at the start of 2022, including Tesla, Apple and Microsoft, lost a combined total of $4.9 trillion last year, equivalent to around 20 percent of US GDP, and have lost a further $110 billion so far this year.

Tesla shares, one of the more speculative share market bets, lost two thirds of their market value last year.

The massive losses in share values mean that many small, so-called retail investors, will have taken a heavy hit, together with their 401K pension plans. But market losses of nearly $5 trillion means that major investments have also been impacted.

So far, these effects have yet to surface. But the events in the crypto market point to how rapidly the situation can change. After all, barely two months ago Bankman-Fried was the toast of the financial world. Now he is facing criminal charges.

Halting the endless supply of money and increasing interest rates, the full effects of which have yet to be felt, will have a major impact on the global economy and its financial system over the coming year.

According to an abstract of the World Bank’s bi-annual Global Economic Prospects report due to be released today, “further adverse shocks” could push the world economy into recession this year, with smaller countries particularly vulnerable.

It said that even without another crisis this year, global growth is “expected to decelerate sharply, reflecting synchronous policy tightening aimed as containing very high inflation, worsening financial conditions” as well as continued disruption flowing from the war in Ukraine.

There were similar forecasts from participants, reported by *Bloomberg*, at the annual meeting of the American Economic Association in New Orleans which concluded on Sunday.

Summarising the conclusions, the report said ending the era of ultra-low interest rates ushered in a new world “where an intensifying US-China rivalry and dangerous debt blow-ups are more the norm.”

Former International Monetary Fund chief economist, Kenneth Rogoff said: “We live in an era of many shocks. We may be at a turning point for the global economy.”

Atlanta Fed president Ralph Bostic, a member of the Fed’s governing body, admitted he had no real idea of the direction of economic events. Because the pandemic was so unique, “it’s hard to have firm expectation about how things are going to evolve over time.”

But Bostic was sure of one thing: in line with the agenda of central banks around the world, the Fed would have to keep raising rates, even if wage rises were lower than expected.

A former Bank of England policy official, Kristin Forbes, said the policy response to COVID had “introduced new vulnerabilities and risks.”

Those risks arise from the refusal of governments to deal with the pandemic, for fear that public health measures would adversely impact on profits and market valuations, as well as the buying by central banks of trillions of dollars of financial assets.

The build-up of government debt and the creation of asset bubbles via ultra-low interest rates created vulnerabilities that could manifest themselves “sooner rather than later” as the cost of credit rose, Forbes stated.

The ongoing turmoil in the crypto market, which was so heavily dependent on the low-interest rate regime, is the sign of a much bigger storm approaching.