ALT 5 – DIGITAL ASSETS WEEKLY

Bitcoin and ether prices slide as macro pressures reemerge

NEW YORK, NEW YORK, US, August 19, 2022 /EINPresswire.com/ -- ALT 5 Sigma Inc. a global fintech that provides next generation blockchain powered technologies for tokenization, trading, clearing, settlement, payment, and insured custodianship of digital instruments releases its Digital Assets Weekly.

• Europe's stresses intensify, with potential ramifications for digital assets

• Renewed US dollar strength concurs with the recent pullback in bitcoin

• Another form of Fed tightening set to accelerate in September

• Ether's outsized gains in advance of the merge leave it somewhat vulnerable

Friday's sharp drop in bitcoin and ether serves as a reminder that the recent gains and stability in crypto token prices does not represent a new era of sustainably lower volatility for digital assets. On the contrary, the 9% drop in the major token prices Friday highlights that the road to recovery from crypto winter (which ironically was most intense during the spring months) will not be a straight line to higher valuations and more stable market conditions.

Central banks have more tightening to do

There are several factors that coincided with the pullback in crypto prices. Recent economic data as well as actions and guidance from global central bank officials underscore the notion that additional policy tightening will be forthcoming.

German producer price gains are off the charts

On Friday, Germany reported that its producer price index (PPI) surged to 37.2% y/y in July, the biggest rise since current records started in 1949. Germany is the Eurozone's largest economy and its performance tends to set the pace for the rest of the euro area bloc of countries.

The inflation data under underscores the need for tighter monetary policy. But markets also recognize that aggressive rate hikes from the European Central Bank (ECB) would increase the risk of instigating a recession in the euro area. Alternatively, less ECB tightening could allow inflation to persist at higher levels and in turn to weigh on economic growth via reduced purchasing power of consumers and businesses. In short, Europe is in a difficult position. And those concerns will also put attention on the Eurozone PMI, due in the coming week, as it is used as an indicator of future economic growth.

The conundrum in Europe and the importance for crypto markets

For crypto markets, the implications from these developments come in several forms. First, higher interest rates increase the discount/funding rates for investors, which tends to create headwinds for financial assets, including crypto currencies. Second, weaker economic growth in the Eurozone will have negative ripple effects on global growth, a development typically associated with lower investment returns (versus would otherwise be the case in a higher growth environment), which is also likely to be felt in the digital asset space.

Euro weakness translates into US dollar strength…

Importantly as well, those dynamics have put renewed downward pressure on the euro, with the dollar benefitting in kind. The EUR/USD exchange rate is down 2.7% in the past week and, at levels of 1.0040, is threatening to break back below the "parity" threshold of 1.00. That move is also reflected in the Dollar Index (DXY), up a similar 3.0% in the past week.

…which concurs with the latest slippage in bitcoin

It is common to see crypto currencies such as bitcoin move in the opposite direction as the dollar. The negative correlation stems from the notion that bitcoin, with its finite supply and lack of government alignment/potential manipulation can act as a hedge against fiat currency debasement. That logic also works in reverse and accordingly, the US dollar's recent gains concur with the pullback in bitcoin.

Fed messaging underscores more rate hikes are coming

The dollar is also benefitting from ongoing expectations of additional tightening by the Federal Reserve. This past week a series of Fed officials underscored the notion that inflation remains too high and that additional rate hikes will be needed in order to slow demand and ultimately help tame inflation.

That messaging was in contrast to the dovish spin from Fed Chair Powell at the July 26 FOMC meeting, and has resulted in some downward pressure on risk assets (Nasdaq Composite down 3.5% from its August 16 intraday high), including crypto currencies. And a big focus in the coming week is the Federal Reserve's annual symposium in Jackson Hole, Wyoming, where officials are generally expected to reiterate that same, generally hawkish message.

Fed balance sheet reduction is out of the headlines but could pressure crypto prices
More under the radar but potentially very important for financial markets, including crypto, is the second element of Fed tightening which involves shrinking its balance sheet, known as quantitative tightening (QT). That process started in June with the Fed reducing its balance sheet by $47.5 bln each month. But on September 1 the pace of QT doubles to $95 bln per month.

In simple terms, that will increase the supply of Treasury securities in the open market, potentially putting downward pressure on prices and boosting yields. As it happens, the 10yr Treasury note yield rose to 3.0% on Friday, its highest level in nearly a month and up 50 basis points from the intraday low on August 2. While that those gains are not entirely attributable to expectations of accelerated QT, the bond market knows it is coming and it is a development to consider.

The great central bank liquidity drain

Recall that the Fed's aggressive easing measures to combat the covid pandemic starting in March 2020 included interest rate cuts and its balance sheet expanding quantitative easing (QE). That massive liquidity injection boosted financial asset prices significantly, right up through November 2021 when the Fed first signaled it would begin to reverse that process.

To date, most of that tightening has come via policy rate hikes but going forward it will be compounded by accelerated QT. This kind of double-barreled policy tightening/liquidity drain can create challenges for financial asset prices. To the extent that financial assets, including crypto assets, benefitted from the extreme levels of central bank easing in 2020 and 2021, the reversal of that process this year has and can continue to pressure prices.

Markets have already experienced some good portion of that process, evident in the decline in crypto prices, as well as US/global equities from last November into this past June. But as the Fed ramps up the pace of QT in September, some of those pressures may reemerge, and crypto market participants need to be cognizant of those risks. And if rate hikes and QT also boosts market yields and the US dollar further, that could also create more headwinds for crypto token prices, beyond the central bank liquidity drain alone.

On the charts

With the pullback this past week, bitcoin is now threatening a test of support at $20,900, defined by the uptrend drawn off the June 18 low. A sustained break below that trend would likely alter the bullish momentum that has developed in the past two months and open scope for a further correction lower in the price.

On Friday ether made a convincing break below the steep uptrend formed off the July 13 low. That has already led to some selling from the trend-following community and, if the trendline break is sustained, suggests more downside risk to the price in the near-term. (Source of all price and chart data is Tradingview.com.)

Positive sentiment around the Ethereum merge had boosted ether's price…

Ether may also be facing some risks associated with its upcoming merge, now slated for around September 15. The merge will move Ethereum to a proof-of-stake (POS) platform from its current proof-of-work (POW) mechanism. This much-anticipated move is generally expected to be a boon for the Ethereum platform generally and for the ether token price specifically. And indeed, those sentiments had contributed to ether's strong performance from the June lows. Prior to this week's pullback, it rose some 130%, more than triple the (still-impressive) 40% rise in bitcoin over that same period.

…but now there could be some near-term vulnerabilities

Now, with investors already positioned for the ether price to benefit from the merge, additional buying interest may be diminished and positioning imbalances (i.e., excessive long positions) could lead to some downward pressure if a selling catalyst intensifies.

Along those lines, there has been increasing speculation that some of the current Ethereum miners could fork a proof-of-work chain from the main Ethereum blockchain. It is not at all clear that will happen, or if a POW fork could succeed and sustain itself. But it is something that has captured the market's attention and could be problematic for the post-merge POS Ethereum's success. And that perceived risk may be contributing to the latest slippage in ether's price. All of this will be a key focus in the crypto world in the run-up to the mid-September merge.

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ABOUT ALT 5 Sigma

ALT 5 Sigma is a global fintech that provides next generation blockchain powered technologies for the trading, clearing, settlement, payment, and insured custodianship of digital instruments.

ALT 5 was founded by financial industry specialists out of the necessity to provide the digital asset economy with security, accessibility, transparency, and compliance. ALT 5 provides its clients the ability to buy, sell and hold digital assets in a safe and secure environment deployed with the best practices of the financial industry. ALT 5 Sigma's products and services are available to Banks, Broker Dealers, Funds, Family Offices, Professional Traders, Retail Traders, Digital Asset Exchanges, Digital Asset Brokers, Blockchain Developers, and Financial Information Providers. ALT 5's digital asset custodian services are secured by Fireblocks.

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