

Drofa's Future of Money

Monthly digest on Fintech, Crypto and everything related

Another One Bites The Dust

In March, three US banking failures shocked the financial community. Despite the government's attempts to put an end to this trend, it seems financial institutions' collapses are not stopping yet. As the largest banking failure since the 2008 financial crisis, regulators seized First Republic shortly after revealing that client withdrawals reached \$102 billion in Q1 2023. After taking possession of the institution, regulatory authorities auctioned the bank, with JPMorgan coming out as the winner. According to a JPM statement, the largest US financial institution now owns all of First Republic's deposits and a "substantial majority" of its assets. A few days after First Republic's seizure, a US Federal Reserve study revealed that 722 banks out of the over 4,500 in total within the United States reported unrealized losses above 50% of their capital at the end of Q3 2022 as the potential result of rising interest rates.



A Risky Fight Over The Fate Of A Large Economy

Besides the ongoing cost of living crisis, fears of a looming recession, and the failures of multiple financial institutions, a political fight over the US debt ceiling caused widespread panic on global markets. As Republicans and Democrats are in a fierce battle over the issue, investors are anxiously preparing for a worst-case scenario, which could result in the default of a large economy. To avoid such a scenario, members of Congress must agree to lift or suspend the debt ceiling, a limit determining how much the government can borrow, by as early as June 1. Unless a deal takes place by then, former Treasury Secretary Larry Summers expects a potential US default to cause \$6 trillion in damage to the stock market.



Interest Rates: To Hike Or Not To Hike?

As governments all over the world are trying to keep inflation under control, there is an intensifying debate in the US about whether to continue with rate hikes or pause for now. On the one hand, a high-interest rate environment drives investors away from stocks to cash and may reduce economic growth through decreased consumer spending and investment. However, record rates of inflation in the past months have triggered a cost of living crisis on a global scale. While the last rate hike decision signaled a possible pause ahead, Fed officials are skeptical about suspending the practice in the near future. In the meantime, Bank of England (BoE) Deputy Governor Dave Ramsden expects the central bank's quantitative tightening to increase as UK inflation fell by less than expected in April.



No More Market Making

Jane Street Group and Jump Crypto, two of the top market-making companies on the globe, have announced the pause of their digital asset trading activity within the United States, citing regulatory uncertainty and scrutiny. While the latter firm continues to expand internationally, Jane Street is reportedly scaling back its cryptocurrency activities on a global scale due to a failure to meet internal standards as a consequence of unclear regulation. Regarding the latter, the US Securities and Exchange Commission's (SEC) Gary Gensler has recently doubled down on the agency's negative crypto stance, saying digital asset markets are non-compliant and blaming the industry for three of the four recent banking failures.



Falling For The First Time

The crypto market has been having a good year in 2023 so far, especially when compared to 2022's extremely bearish conditions. By the end of April, Bitcoin closed four consecutive months with positive gains, and the total market capitalization of cryptocurrencies surged from \$794 billion on January 1 to \$1.22 trillion by April 30. But it seems there's a first time for everything. As of May 24, the BTC price has been down by 10.58% since May 1, with the digital asset expecting to close the month with a loss. During the same period, the combined crypto market cap has fallen by 6.35%, while ETH has been trading 5.64% lower than at the start of the month.



A Potential Bull Run Catalyst

A high-interest rate environment combined with fears of a looming recession amid the ongoing regional banking crisis has driven investors towards money market funds. In fact, a recent note from the Bank of America has revealed that the latter assets have reached a record \$5.3 trillion with \$588 billion of inflows over ten weeks. According to analysts, while this growth rate surpasses the one after Lehman Brothers' collapse in 2008, it could potentially fuel the next bull run if we see positive developments in the banking sector, economy, and financial markets. They argue that massive cash hoarding signals a lack of investor confidence, which can be restored by a series of favorable news and events, ultimately leading to growing investments in stocks.



'Burn It To The Ground'

Ledger, a leading crypto hardware wallet manufacturer, has found itself in a massive PR disaster this month after announcing the launch of a new controversial service. Called Ledger Recover, the solution would enable users to back up the private seed phrase of their wallets directly to their personal identity via three custodians for a monthly price of \$9.99. While the service is optional and is only available for Nano X devices, the move has sparked a public backlash against the company, with critics arguing the feature could create a new attack vector for all customers, not just the ones who have opted in. A Twitter user has gone as far as to smash his physical Ledger wallet with a hammer and burn it with a blow torch. In response to the criticism, the firm has decided to delay the launch of its Recover solution and "accelerate" its open-sourcing roadmap to provide increased transparency for customers.



Regulators Step Up Their Game

As a consequence of the US banking crisis, regulators are actively working on a long-term solution to prevent or at least minimize the impact of future failures of financial institutions. Regarding that, the Federal Deposit Insurance Corp (FDIC) has recently proposed to raise the insured deposit limit for businesses from the current \$250,000 level to provide more safeguards and flexibility in this field. In the meantime, multiple US regulators are investigating short-selling activity, which could have potentially caused increased volatility in banking shares as part of market manipulation. According to an analytics firm, short sellers generated nearly \$380 million in paper profits on May 4 alone by betting against certain regional financial institutions. Moreover, KPMG, the largest auditor of the US banking sector, has come under scrutiny recently after it reportedly gave a clean bill of health for the financial statements of the now-defunct First Republic, Signature, and Silicon Valley Bank.

