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When will cryptocurrency's winter come to an end?

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With the price of Bitcoin and other cryptocurrencies dropping dramatically, what is in store for the digital asset market?

The global cryptocurrency market has been on a rollercoaster ride over the past few months. Like many other financial markets around the world, the crypto market is going through a particularly brutal time right now. A sell-off in the popular cryptocurrency Bitcoin – the bell weather of crypto markets – saw its value plunge more than 70 percent from a high of US\$69,000 in November 2021 to a recent low of US\$17,567 in June this year. Similarly, Ether (also known as Ethereum) has also crashed along with Bitcoin, falling more than 80 percent from a high of US\$4868 to a low of US\$880 over a similar timeframe.

All players in the crypto market have been affected, and the world's largest cryptocurrency exchange, Coinbase, has sacked 18 per cent of its staff. At the time, the co-founder said the "crypto winter" signalled an extended period of revenue loss for the company. Crypto enthusiasts are watching the volatile market closely (with many licking their financial loss wounds) and hoping the crypto winter will thaw soon. UNSW Business School's **Dr Elvira Sojli**, Associate Professor of Finance at the School of Banking and Finance, together with **Dr Eric Lim**, Senior Lecturer in the School of Information Systems and Technology Management, examine what the future might hold for crypto markets around the world.

WHAT IS CURRENTLY HAPPENING WITH CRYPTOCURRENCY MARKETS?

The cryptocurrency markets have seen one of the worst months and years to-date, according to A/Prof. Sojli. Their value has tumbled from highs of close to US\$66,000 to about US\$33,000 at the time of writing – representing an almost 50 per cent loss over the year-to-date. Most of this decrease has occurred in recent months, however, A/Prof. Sojli said this depreciation is not unique to cryptocurrencies, albeit it is more pronounced in this market.

"Currently the crypto markets are following what is happening in the equity market, where the S&P500 has lost 14 per cent per cent in the year-to-date. All markets are getting affected by the increasing interest rates around the world, which makes money more expensive, and the uncertainty of future interest rate changes. In general, as money becomes more expensive the opportunity cost of investing increases," said A/Prof. Sojli. In addition, demands and costs of investments elsewhere are also increasing, which pushes investors to take money out from more volatile assets (such as the crypto and equity markets) and move them into safer assets (such as cash and bonds). This is a phenomenon known as flight to safety/quality.

WHAT BROUGHT ON THE CRYPTO MARKET CRASH?

Investment in cryptocurrencies was fuelled by ample money supply in search of returns, and the expansion in the retail market, which A/Prof. Sojli said found the returns very alluring. “A market that is sustained by new money coming in (with increases in user and investor growth) – without increases in fundamental value attached to it, will run out of steam, as there are fewer and fewer new market participants that can join. This issue is exacerbated when the cost of money and market uncertainty increases,” she explained.

Dr Lim echoed A/Prof. Sojli’s observations and affirmed the crypto market is not divorced from the reality of global or macro events. “We are seeing a macro environment where all financial assets are not having a good time. The US Federal Reserve is doing its biggest and best impression of a hawkish dance without trying to induce a global recession by consecutively raising interest rates by 75 basis points,” said Dr Lim, who also serves as founder of the UNSW Crypto Clinic and the Fintech Director of UNSW Sydney’s translational research lab UNOVA.

“The latest CPI figures again defied the Fed’s expectations, that if it were to increase its balance sheet significantly over a short period to fund the government’s largesse, the inflation it was seeing by the end of 2021 was never going to be ‘transitory ... The last thing that any investors want to do is to fight the Fed on this. This means investors are going to deleverage most financial assets and seek safer investments. Therefore, there will not only be selling pressure and general weakness in the crypto market but also in the financial markets more generally.”

WHAT DOES THE FUTURE HOLD FOR CRYPTO MARKETS?

While the current crypto winter may take time to thaw, A/Prof. Sojli said she sees the digitalisation process continuing and the crypto market will be much more consolidated. While there will be a move towards digital currencies, centralised digital ledgers for different supply chains and investment assets, she predicted their value as a currency will diminish – unless they can provide a sustainable business model, with business-related returns.

In addition, work is being done on digitising shareholder registers, and when complete A/Prof. Sojli said this work will make owners of companies “more precisely known at higher frequencies, and they can possibly be made public. Overall, the technology will be pervasive, and providers of such services will be companies in their own right, which one can invest in. Cryptocurrencies without a business case or peg to a profit-yielding business will not have a future,” she said.

Dr Lim was more optimistic, and noted that even in these market conditions, those who believe in crypto are still working on its future. “The technology inspires others – its ideals have taken root, and it will take more than this current volatility to quash that. The fundamentals of crypto haven’t changed and still represent individual freedom and self-sovereignty. While fair-weather individuals who do not believe there is meaning to crypto beyond the accumulation of wealth might fall behind, the cryptocurrency caravan will move on with or without them,” he said.