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EXECUTIVE SUMMARY

While the Russia Ukraine conflict continues to have the world's attention, Europe vs Russia is the key to understanding what drives Europe's problems.

The European Central Bank (ECB) President, Christine Lagarde announced an unprecedented 75 bps rate hike amidst the energy crisis, rampant inflation, a weak Euro and alarmingly low earnings data from the equity markets.

September — as we have said many times in this newsletter — is a pivotal month: markets are focused on the forthcoming Federal Open Market Committee meeting in a couple of weeks and critical economic reports such as inflation data and consumer sentiment reports which are due in between. Signs of entrenched inflation will drive markets lower, but glimmers of hope in the data will be a cause for relief.

While we have discussed the issue of US inflation for several weeks in Bitfinex Alpha, this week we deep dive into Europe's struggle to tame inflation. We also provide data-backed insights into three key threats that European companies face in the current economic landscape.

In the world of crypto, there is a huge focus on the Ethereum Merge. In our On-Chain section, we track on-chain wallets and open interest data to explain the current uptick in on-chain activity, and the high price volatility leading up to the Merge. We compare BTC and ETH flows to draw conclusions regarding market direction as we inch closer to the historic Ethereum update. We also monitor whale behaviour to shed light on the discounts currently available on staked Ether across various centralised and decentralised protocols and services. As the hyper-data-focused Fed and ECB streamline their actions based on inflation data, we use correlation data to re-evaluate how Bitcoin is proving to be digital gold (perhaps being the most scarce of all risk assets) in this hiking cycle.

We have also analysed available supply patterns in Bitcoin wallets while utilising more updated and efficient metrics. Wallet tracking reveals the amount of accumulation that has taken place in the asset over the past few months.

In crypto news, fears regarding a cryptocurrency mining ban continue to loom in the US. We have also included an update on the Voyager situation as the crypto lender continues to claw its way back from insolvency. Finally, the geopolitical relevance of cryptocurrencies continues to increase as Russia plans to utilise stablecoins for all cross-border settlements.

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GENERAL MARKET UPDATE

September Economic Data Update

On September 8, Federal (Fed) Reserve Chair Jerome Powell gave a talk on monetary policy at a virtual event hosted by the Cato Institute. Like a broken record, the Fed Chair underlined once again the importance of keeping inflation under control. He also reiterated that he took a "concise and targeted strategy" to convey his hawkish message to the market participants in his Jackson Hole talk on August 26.

In the coming week, the most important economic news will be US inflation data. The market continues searching for more evidence that price pressure is subsiding. If US inflation did further slow down in August, Wall Street might gain confidence that the Federal Reserve may conclude its hiking cycle by the end of the year.

Though speculation that the Fed is close to slowing down its rate hikes might be premature, a few more inflation data points showing lower-than-expected inflation might be enough to persuade the Fed..

Figure 1. Important US Economic Data for this Week

Date	US economic Data
September 13, 2022	US Inflation data (CPI, Consumer Price Index)
September 14, 2022	US Producer Inflation (PPI, Producer Price Index)
September 15, 2022	US Business inventories, manufacturing, retail sales, initial jobless claims
September 16, 2022	US University of Michigan Consumer Sentiment report

As critical US economic data is yet to come, in today's newsletter, we pay more attention to the worsening economic and political situation in Europe that continues to make the job of the European Central Bank more complicated.

Powell's continued hawkish statements last week came just after the European Central Bank announced a historic rate hike of 75 basis points on September 8. President of the ECB, Christine Lagarde said that future rate rises could be possible as she strengthens the fight against inflation. However, one possible result of such an approach is that Europe's fragile economy may be pushed into a quick decline, given it faces multiple economic threats.

Euro Falls as Energy Woes Worsen

The Russia-Ukraine conflict triggered a more aggressive selloff of the euro, accelerating a trend of losing ground against the US dollar since the beginning of the year. The risk of a sudden increase in inflationary pressures and the region's lack of energy and defence security were substantial factors contributing to the decline.

Figure 2 EURO/US Dollars (July 2019 to September 2022, Source: Yahoo Finance)

Following the invasion of Ukraine, energy costs in the region skyrocketed due to concerns over natural gas export interruptions from Russia. A concern that materialised when Gazprom, the Russian state-owned energy firm ceased gas supplies through the Nord Stream 1 pipeline.

Gazprom first stated that the gas supply would be interrupted for only three days owing to maintenance but later declared that the interruption would be permanent until sanctions against Russia were lifted. (Sanctions against Russia were announced by The Group of Seven (G7) nations on September 2 as part of its "unified" response to Moscow's invasion. The European Union has also committed to immediately establish a price ceiling on Russian oil imports.)

Figure 3. Under the Baltic Sea, the Nord Stream 1 pipeline extends 1,200 kilometres from the Russian coast near St. Petersburg to northeastern Germany. In 2021, this pipeline supplied 40 per cent of the EU's natural gas (Source: Wikipedia)

Russia's move to cease gas supplies comes at a time when nations such as Germany are stockpiling natural gas reserves to ensure that they have enough stock to last the winter. We anticipate that Germany and other European countries that have usually relied on Russian gas in the past will eventually have to switch to other energy sources, such as renewables and liquefied natural gas (LNG).

However, we can expect continued supply constraints and rising energy costs in the short term. Disruptions to the energy supply are also happening at a time when other problems with supply chains have already been making prices climb north across the continent.

Like the US, Europe too is dealing with levels of inflation that have never been seen before. EU consumer prices were up 9.1 per cent year on year in August, a record increase, and up 0.5 per cent from the previous month. In response to these inflationary pressures, the European Central Bank (ECB) and the US Federal Reserve (Fed) have been raising interest rates at different pace, with the US being more aggressive this year. This difference in approach is making it even worse for the euro.

Higher borrowing costs from the ECB’s decision is unlikely to blunt the spike in energy prices and inflationary pressures look set to worsen.

Europe's economy is being affected in different ways by the fall of the euro. People from the US have been travelling to Europe in large numbers, which has been good for the growth of countries, especially in Southern Europe, that were impacted severely by COVID-19. The more substantial dollar purchasing power attracted more tourists to Europe, which is good for the local economy. According to Travelpulse.com, air travel across Europe for the next three months will only be down 21 per cent from 2019, compared to 25 per cent this month, showing a gradual recovery in its tourism industry.

However, as the euro falls in value, the cost of imports, especially those priced in US dollars, like commodities shall go up for European consumers.

European Markets Face More Threats

On the day of the ECB rate hike, stocks in Europe closed higher, adding to a weeklong gain, and the Stoxx 600 Index finished 1.5 per cent higher, marking the first weekly increase in a month.

The market appears to be reacting positively to the expectation that the ECB will continue to battle inflation through several rate hikes. However, whether the rally can be sustained is still a question as Europe faces several threats contributing to a brewing economic contraction. Thus, the downward slope of economic output for businesses continues

Figure 4. European Stocks ended a 3-week losing streak post-ECB rate hike

This year has been a bloodbath for European equities and corporate bonds, yet despite the strains of a devastating energy crisis, red hot inflation, and tighter central bank policies, stock market valuations continue to remain higher than levels reached during the pandemic selloff in 2020 and the 2008 financial crisis. Investors seem to still be in denial about how bad things might go.

These valuations will be tested further on multiple fronts, from the energy crisis, to surging inflation, and even a weakening Euro. A big challenge will likely come when the earnings season comes around again. While wider European regional markets have lost a total of $4.5 trillion, there are still three threats that tell us that a bloodbath in the stock market is still likely.

Threat 1: Energy Crisis

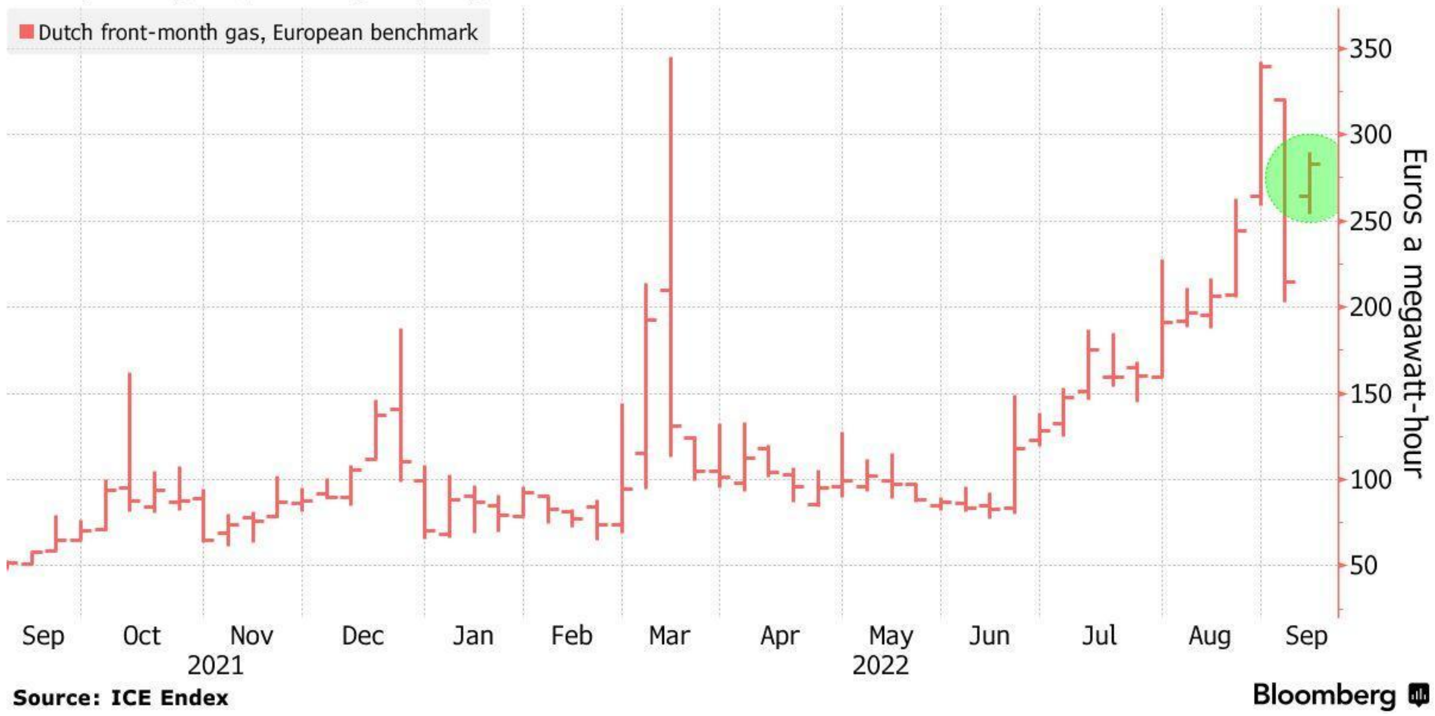


Figure 5. Energy costs in Europe soared after Russia suspended its main natural gas pipeline to the continent indefinitely on Monday, September 5 (Source: ICE Index, Bloomberg)

Investors are most concerned about the long-term consequences of the energy crisis. Price increases are putting pressure on consumers and businesses. At the same time, the increasing threat of power outages presents significant concerns to industrialised nations like Germany.

Because of this grave scenario, indicators of economic confidence and activity surveys, such as the PMIs, may continue to deteriorate. According to the S&P Global Survey data released on September 5, the composite reading as shown in the figure above is at an 18-month low as the eurozone economy continues to shrink in August.

Related	Last	Previous	Unit	Reference
Services PMI	49.80	51.20	points	Aug 2022
Manufacturing PMI	49.60	49.80	points	Aug 2022
Composite PMI	48.90	49.90	points	Aug 2022

Figure 6. Euro Area Composite PMI (Source: S&P Global, Chart by Trading Economics)

Threat 2: Declining Valuation

Figure 7. Declining European Stock Valuations (Source: Bloomberg)

European stock values have fallen below their long-term average, making them more affordable in comparison to their US counterparts. However, they have not yet reached previous crisis-period lows. This makes market observers think there might be some more room on the downside.

Threat 3: Cost of Borrowing

Another threat to the European market is the availability of money and its cost. Higher interest rates make it more difficult for businesses to fund themselves through loans. Due to central bank tightening, the higher trend in rates and overall risk aversion, the cost of refinancing loans is rising. Eventually, this shall reflect on the company's growth and profitability.

The Russia and Ukraine conflict and the pandemic's ongoing impact have affected nations worldwide. Still, Europe seems to have been struck the worst, with the most considerable rise in energy costs, some of the highest inflation rates and an increased risk of economic contraction.

Western central banks are anticipated to keep raising interest rates to push inflation down. Following the European Central Bank's decision to raise interest rates, the United States might likely do the same in this month’s FOMC meeting. The Bank of England too took a similar stance in early August.

However, higher interest rates won't significantly reduce oil and gas prices. Rate hikes probably can't do much because the world is in an energy supply crisis unless central banks crash the economy so much that it severely brings down demand.

Summary

- Jerome Powell attended a Cato Institute virtual event on monetary policy on September 8, where the Fed Chair emphasised controlling inflation.
- Economists expectations for US inflation was the primary economic data released for the trading week, with consensus at an 8 per cent year-on-year rise in CPI.
- The European Central Bank announced a 75 basis points rate hike on Thursday, September 8, the highest in history.
- While the euro declined gradually against the US dollar at the start of the year, Russia’s invasion of Ukraine sparked a more aggressive selloff.
- The Europe energy crisis is worsened by Russia's move to halt supply through the Nordstream 1 pipeline until sanctions are lifted
- In response to these inflationary pressures, the European Central Bank (ECB) and the Federal Reserve Bank of the United States (Fed) increased interest rates at differing rates. This gap is worsening the euro's weakness.
- European Stock Markets reacted positively to the ECB rate hike and ended a 3-week long decline with a weekly gain. However, the sustainability of this rally in the European market is still in question as the economy faces multiple threats in inflation, energy crisis and geopolitics.

NEWS FROM CRYPTO-SPHERE

Binance To Stop Supporting USDC And Converting Several Stablecoins To BUSD

Figure 8. Beyond its exchange, the change affects several Binance services.

Binance, the world's largest cryptocurrency exchange, announced on Monday, September 5, 2022, that the platform is introducing a “BUSD Auto Conversion” and will be delisting three stablecoins- USD Coin (USDC), Pax Dollar (USDP) and TrueUSD (TUSD).

According to the announcement, all investments in USDC, USDP, and TUSD will be automatically converted to Binance USD (BUSD) starting from September 29, 2022. The company claims that the move will "enhance liquidity and capital-efficiency for users."

“This will not affect users' choice of withdrawal: users will continue to be able to withdraw funds in USDC, USDP, and TUSD at a 1:1 ratio to their BUSD denominated account balance,” the company said.

The company said that the converted balance (in BUSD denominated amounts) will be visible in the user's account within 24 hours and the minimum amount for a user to manually convert is 1 USDC, USDP, or TUSD. Smaller amounts are treated as dust balances and thus, accounts with lower balances are converted to BUSD automatically.

Binance will also discontinue trading pairs for the three stablecoins against BUSD and Tether (USDT), as well as for all major cryptocurrencies.

"All pending trade orders will be automatically removed after trading ceases in each respective trading pair. Users can then trade the assets in the respective BUSD trading pairs," the company said.

The company also announced additional changes, including removing support for USDC, USDP & TUSD products, staking, spot trading, futures & margin lending.

Russia Wants to Use Stablecoins for Cross-Border Settlements

Figure 9. This would allow Russia to boycott the United States and the United Kingdom's restrictions.

Russia's Deputy Finance Minister Alexey Moiseyev stated on Tuesday, September 6, 2022, that the country is looking into stablecoins for making payments with "friendly countries", according to Russia's state news agency Tass.

As per the reports, Moiseyev said that Russia was working to "create bilateral platforms" with "tokenised instruments" to avoid using the U.S dollar (USD) and euros.

"We are currently working with several countries to create bilateral platforms in order not to use dollars and euros," Moiseev explained, adding that Moscow is offering to use "mutually acceptable tokenised instruments" on these platforms.

Moiseev further elaborated that "stablecoins can be pegged to some generally recognised instrument, for example, gold, the value of which is clear and observable for all participants."

Tass also added that the Finance Ministry hopes to resolve issues concerning cross-border cryptocurrency payments during the autumn session.

According to Bloomberg, after Russia invaded Ukraine in February, the West imposed harsh sanctions. Its access to the dollar and euro markets is now restricted, significantly impacting the country's economy.

Voyager Digital To Auction Off Its Remaining Assets

Figure 10. Voyager Digital is making a fortune by allowing suitors to compete for its remaining assets.

Bankrupt centralised crypto lender Voyager Digital announced on Wednesday, September 7, 2022, that it would auction off its remaining assets this week.

In a series of tweets, the company said that several bids have been submitted as part of its restructuring plan. The auction will take place on September 13 this year and a court hearing will approve the auction results on September 29.

The company says it will share more information about the winning bidder and the auction's implications for customers after the auction concludes.

In an August 4, presentation, Voyager claimed that 88 parties were interested in purchasing its assets, with 22 of them in active discussions with the company.

Although the identity of the bidders has not been revealed, the exchanges FTX and Binance are known to have expressed interest in purchasing Voyager's assets.

However, Voyager had rejected FTX's earlier offer for the company, calling it a “low-ball” offer. According to the filing, Voyager has several offers on the table that are "higher and better than AlamedaFTX's proposal."

As a result, the struggling crypto lender sent AlamedaFTX a letter requesting it to put a stop to making inaccurate offer claims.

Florida Man Pleads Guilty for Participating In $100M Crypto Investment Ponzi Scheme

Figure 11. Joshua David Nicholas persuaded investors that a trading bot was assisting them in earning daily returns.

The U.S. Department of Justice (DOJ) announced Friday, September 9, 2022, that a Florida man pleaded guilty in a federal district court on Thursday to defrauding investors of approximately $100 million in a cryptocurrency-based Ponzi scheme .

According to the department, Joshua David Nicholas from Stuart, Florida, served as the “Head Trader” of EmpiresX, a cryptocurrency investment platform that guaranteed investors daily profits of one per cent generated by state-of-the-art “trading bot” and Nicholas' manual trading skills.

Nicholas and EmpiresX co-founders Emerson Sousa Pires & Flavio Mendes Goncalves frivolously spent the majority of investor funds to lease a Lamborghini, purchase numerous Tiffany & Co. items, and make payments on a second home.

The DOJ claims that the small number of user funds Nicholas traded in cryptocurrency resulted in significant losses.Nicholas could face up to five years in federal prison.

He was initially charged in June with conspiracy to commit wire fraud, though those charges appear to have been dropped.

“Our office is committed to protecting investors from sophisticated scammers seeking to capitalise on the relative novelty of digital currency,” said U.S Attorney Gonzalez. “As with any emerging technology, those who invest in cryptocurrency must beware of profit-making opportunities that appear too good to be true.”

In addition to the criminal charges filed by the DOJ, the Securities and Exchange Commission (SEC) also filed a civil complaint against Nicholas, Pires, and Goncalves in June. It claimed that the defendants violated the Securities Act of 1933 and the Securities Exchange Act of 1934, partly by defrauding customers and partly by failing to register EmpiresX as security.

White House Says Bitcoin Mining Must Be Greener Or U.S. Could Ban It Entirely

Figure 12. The Biden administration encourages cryptocurrency miners to look into greener alternatives.

The White House on Friday, September 9, 2022, suggested that U.S. lawmakers and regulators could crack down on cryptocurrency mining due to its large carbon footprint.

In Thursday's report, mandated by President Biden in an executive order in March, the White House Office of Science and Technology Policy said crypto miners should reduce greenhouse gas emissions with help from the Environmental Protection Agency (EPA) and the Department of Energy.

The White House Office of Science and Technology Policy stated in Thursday's report, mandated by President Biden in an executive order in March, that cryptocurrency miners should reduce greenhouse gas emissions with assistance from the Environmental Protection Agency (EPA) and the Department of Energy.

It proposes that the government collect more data from industry on power usage, advance energy efficiency standards and promote the "use of environmentally responsible crypto-asset technologies."

The White House even went on to say that if measures to make mining greener fail, energy-intensive crypto mining, such as Bitcoin, should be banned entirely.

The report also notes the differences between proof-of-work (PoW) and proof-of-stake (PoS) blockchains and mentions Ethereum's long-awaited upgrade, known as "The Merge."

Nike minted $11 million in NFTs in a week despite NFT Market Downturn

Figure 13. Nike generated more than $11 million revenue from NFT mints amidst NFT market decline

Over the last seven days, Nike's NFT project RTFKT has raised more than $11 million through NFT mints. The major sportswear brand's web3 business continues to operate successfully even in the middle of an NFT market decline.

Nike released the Clone X NFT Forging collection on August 30, with minting continuing until September 7. NFT forging occurs soon after the minting process is completed. According to the transaction data, the number of mints was high at the start of the process and surged again at the end as more users rushed in for their final chance, according to Noah Levine's on-chain dashboard on Dune Analytics.

Nike-owned RTFKT's NFT Clone X Forging Collection includes special apparel for Clone X holders. The 74-piece collection includes sneakers, hoodies, T-shirts, jerseys, vests, and socks. According to Noah's Dune Analytics dashboard, shoes made up 64.7% of sales, hoodies 12.8%, and T-shirts 8.7%.

If you add the revenue from the Clone X Forge to the $185 million announced by NFTgators last month, Nike's NFT projects have earned about $200 million to date.

Nike is an outstanding example of how mainstream businesses capitalise on the NFT craze to generate new and viable income streams. Although profile pictures (PFPs) have been their most popular use case, companies view NFTs as a way to build deeper ties with their customers through digital products and regular NFT drops.

WHAT'S ON-CHAIN THIS WEEK?

Ethereum Merge Causing Volatility

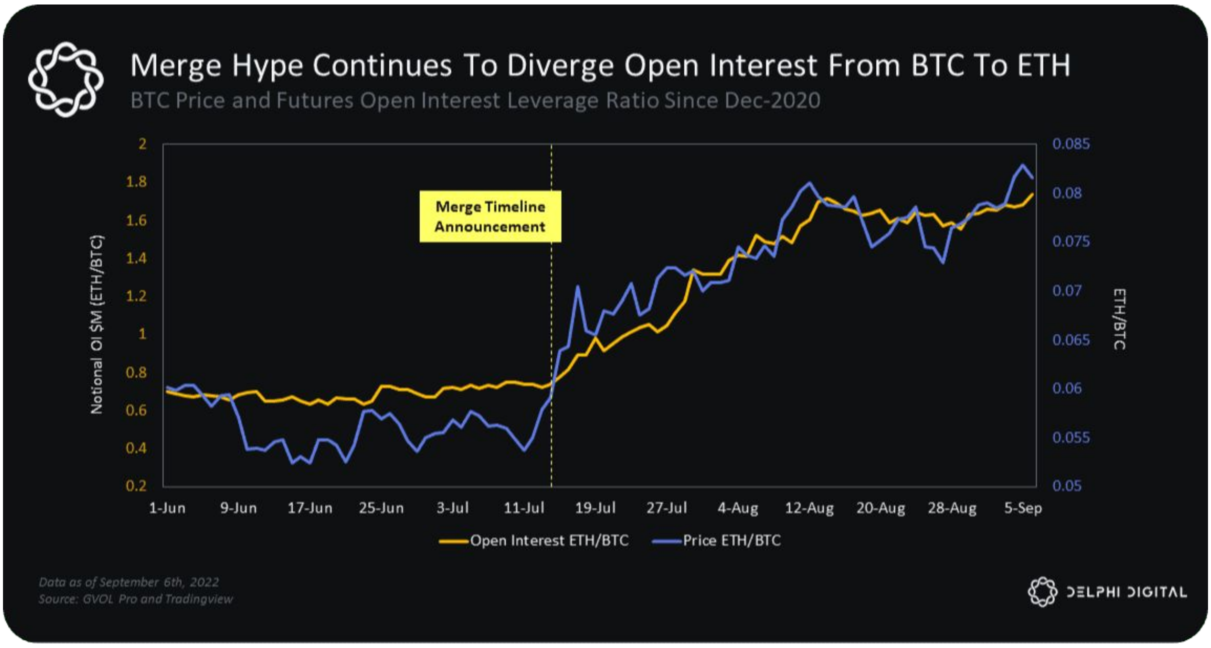


Figure14. ETH/BTC ratioed Open Interest and Price comparison (source: Delphi Digital)

Total futures market Open Interest (OI) for Ethereum moved past $9 billion again last week and is currently at $9.22B *(at the time of writing)*. This is equivalent to the OI highs reached on April 2, 2022, when the ETH price was over $3500. We have experienced a 73 per cent drawdown from the highs in price since. The current Ether price is also trading at a 53 per cent discount from April highs. Ether Open Interest has been ahead of BTC numerous times since the phenomenon first occurred in August. The primary driver for this magnitude of speculation on the asset, especially in bearish conditions, is the Merge.

Figure15. Ethereum Open Interest across major exchanges. (source: coinglass)

The plot thickens; on one hand, the Merge represents the Ethereum network's shift to PoS (Proof of Stake). On the other, the new asset on the horizon is an ETH PoW (Proof of Work) hard fork. If this is successful there could be ETH PoW tokens being airdropped to ETH holders by miners who continue to mine ETH post-Merge. The incentive for the airdrop on this new asset might also be a primary driver for the Ether price surging.

An interesting measure to analyse is the Ether flows metric. This helps us better assimilate the data from the spot and futures markets. These flows show the overall level of asset use and how assets flow between use cases. Most flows on the blockchain are assets in transit between services, moving via entities, whose ownership is unknown.

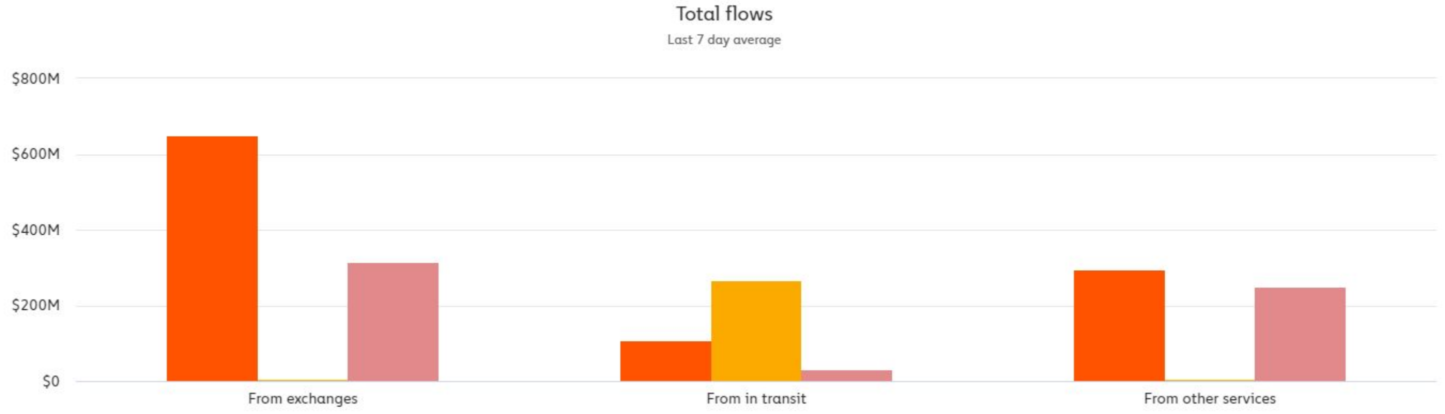


Figure16. Ether Flows through various mediums. (source: chainalysis)

ETH flows to other services (disregarding exchanges) as of 11th September are 538.88k ETH, which is the highest level in 56 days. This allows us to draw a conclusion that various staking protocols that have offered services dedicated to the Merge and ETH 2.0 narrative could develop a demand shock heading into the Merge with a complete lack of liquidity, as most of the asset is held instead in liquid positions on private or exchange wallets.

It is essential to note that ETH exchange outflows have outweighed inflows in anticipation of the Merge. Despite the declining ETH price, large amounts of ETH continue to leave exchange wallets.

On September 4, exchanges saw an outflow of over 476k ETH. This has been the third largest outflow of ETH since March. The largest outflow occurred when over 555k ETH was transferred out on July 7.

Staked Ether at Massive Amounts

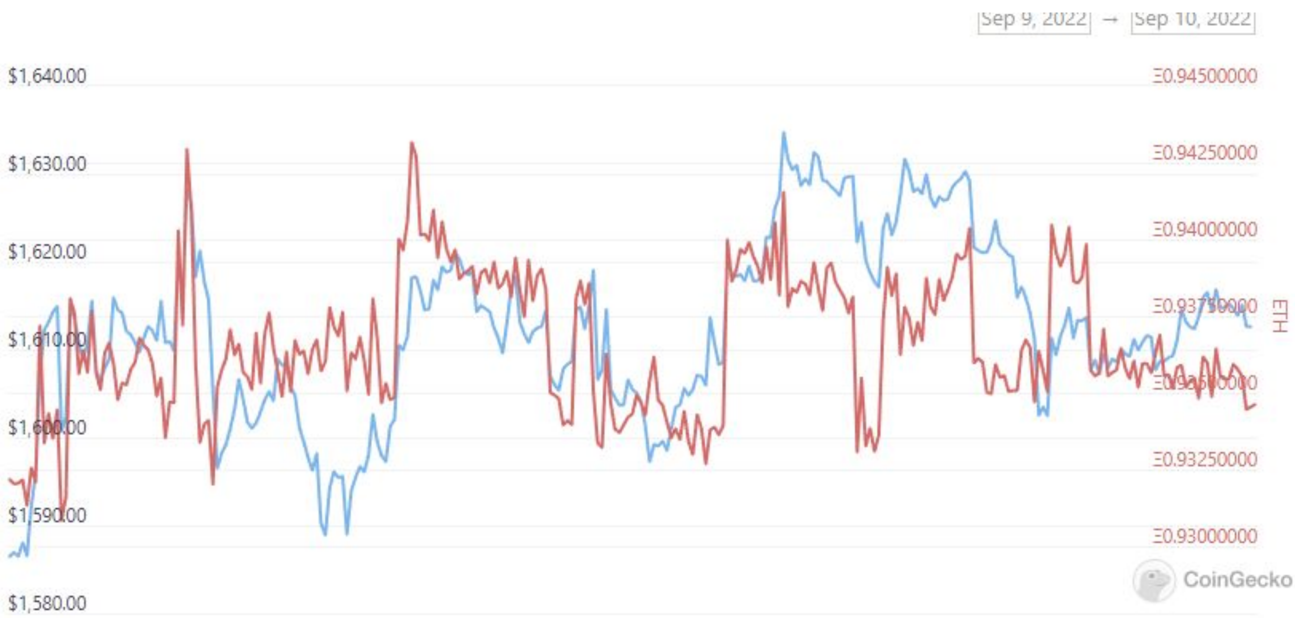


Figure 17. Coinbase Staked ETH (blue) vs Ether (red) price comparison. (source: coingecko)

Coinbase Staked ETH traded at a price of 0.91 ETH per token on September 7th. This indicates a discount of almost 10% from a price of 0.97 ETH per token when it was initially launched on August 25.

Coinbase Staked ETH or cbETH is a liquid staking derivative representing ETH staked through Coinbase. This ERC-20 token allows users to transfer or trade staked ETH, which would otherwise be locked until a future upgrade to Ethereum.

The 10% discount to ETH may indicate that users are accounting for risks arising from staking ETH with a centralised entity. This can include the potential risk of being slashed if Coinbase begins censoring transactions at the protocol level. Alternatively, this can also indicate that users are selling liquid staking derivatives to accumulate spot ETH and maximise the amount of any airdropped token from a potential proof-of-work hard fork as discussed above.

Discounts among pegged assets can also persist due to low liquidity. However, the cbETH/ETH pool on Curve has $1.5 million of liquidity with almost a 50-50 split among the two tokens, indicating that we do not have a liquidity crisis currently. However, the volatility in the pool composition suggests we might be on the brink of one.

Other popular alternatives to cbETH that are also trading at a discount include stETH from Lido trading at 0.96 ETH per token and aETHc from Ankr trading at 0.93 ETH per token.

Available Supply on Bitcoin

A significant amount of on-chain movement for Bitcoin occurs for three specific reasons.

1) Whale Profit Taking
2) Retail Euphoria
3) Capitulation (whale, retail and miner alike)

In our previous editions, we have covered why we like to categorise entities holding BTC into the three separate sections as mentioned in point 3. (link - https://bit.ly/3RCxdQy)

The figure below shows an example of each phase of euphoria, profit taking and capitulation. When a portion of the entities holding BTC reach a certain level of returns on their initial investments (for retail) or employ educated hedging mechanisms/ profit-taking in liquid favourable conditions (by whales), they feel the need to liquidate some of their holdings and diversify their portfolio, this is known as euphoria and profit-taking.

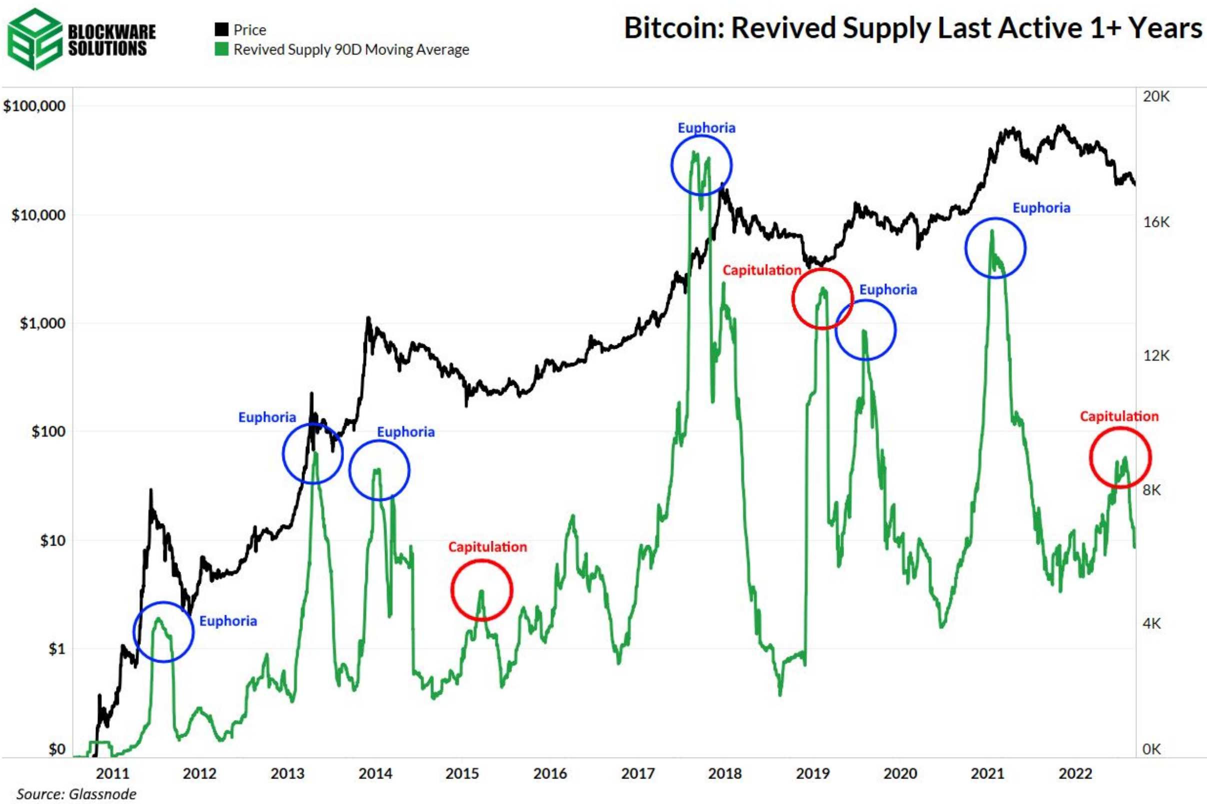


Figure 18. Bitcoin Revived Supply compared with price. (source: glassnode, blockware intelligence)

Capitulation results from stronger hands that are put under extreme strain and some of them giving in. The only users left beyond this phase are the extremely strong hands. This traditionally indicates a bottom.

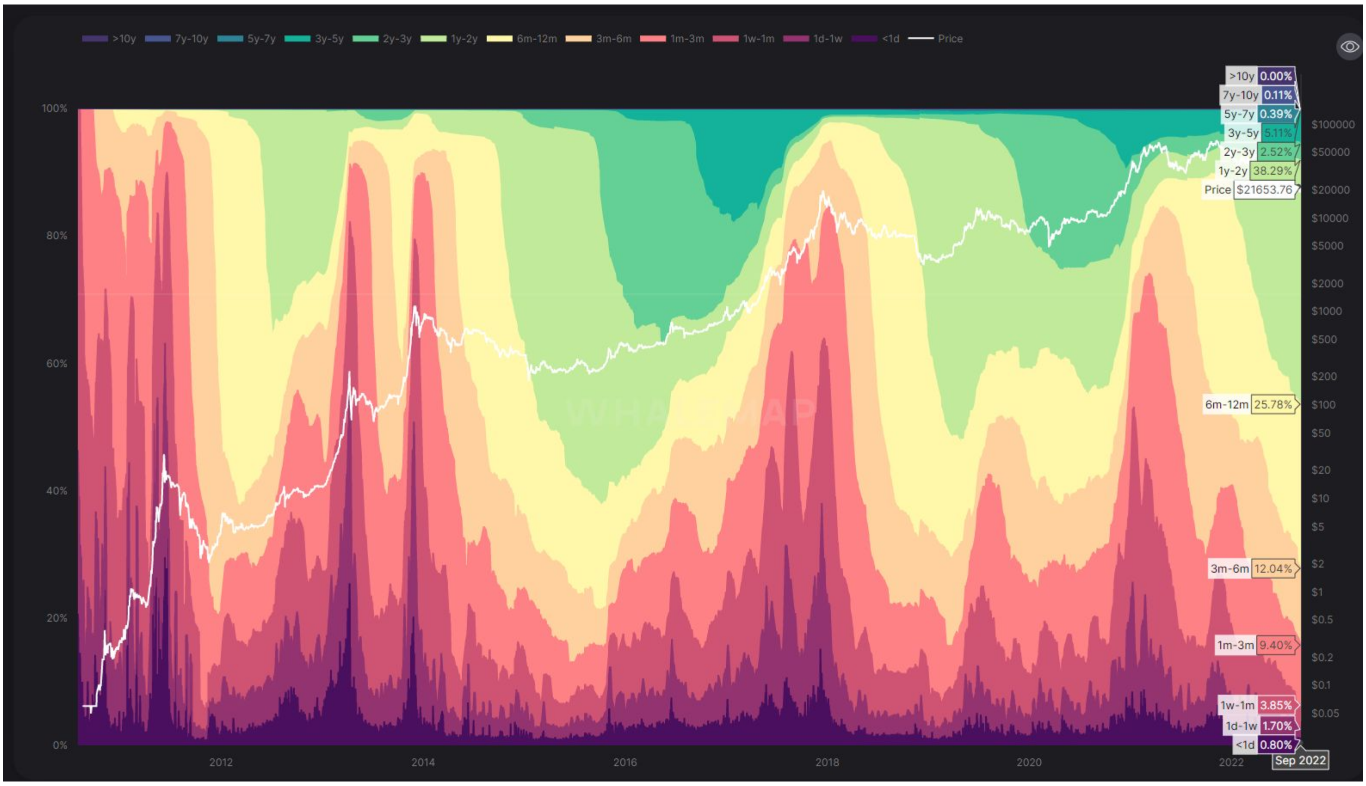


Figure 19. Realised cap HODL waves. (source: Whalemaps)

A lucid visualisation of the supply held by various entities is through the realised cap HODL waves, which is an improvement on the regular HODL waves as it focuses entirely on the asset supply rather than the USD supply.

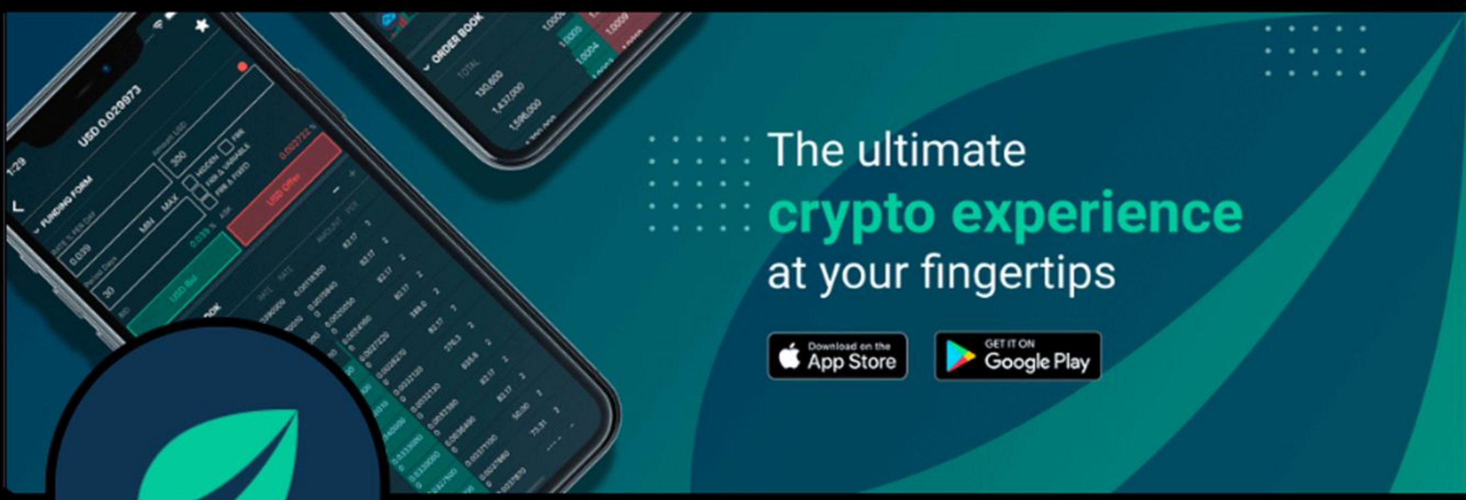
The metric provides data on the percentage of realised capitalisation belonging to holders of different types. Currently, more than 15 per cent of the supply is held by entities less than three months old. This is a sign of accumulation, but we would need more data to accurately assess if this recent accumulation would stand the test of time and active whale supply if that were to occur.

Accumulation patterns for Bitcoin in bearish macro conditions resemble gold. Commodities like gold and silver have long been acquired by TradFi institutions in bearish macro trends to hedge against their short exposure or lack of long exposure in the equities market. The characteristics that we base this thesis on are:

1. Medium of exchange: Both gold and bitcoin are mediums of exchange, because we can trade them for goods and services.

2. Store of value: This refers to an asset you rush to during economic turmoil because it has intrinsic value.

Store of value is debatable as Bitcoin has been correlated with the stock markets. But on-chain activity, especially whale behaviour in the current economic downturn resembles institutional behaviour surrounding previous recessions/crises.



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