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EXECUTIVE SUMMARY

Unclear economic picture, but watch out for China

In what is becoming a customary story, we saw another week of data providing a mixed picture for the economy and hence a still unclear prognosis on inflation.

US manufacturing continues to decline, with layoffs and contraction in the sector observed for the eighth consecutive month, indicating a struggling economy - at least for this sector. While there are pockets of growth in certain industries - such as transportation- concerns remain about declining sales and potential inventory buildup.

The construction industry however, has experienced moderate growth, buoyed by increased public and private sector spending. Notably, construction spending in May edged up 0.9 percent to a total of $1.925 trillion, surpassing consensus forecasts.

The service sector too, continues to thrive, with new orders pushing the ISM's business conditions index to 53.9 percent, above expectations and well into the expansionary zone. This growth was driven by a surge in employment across 15 out of 18 industries. The US job market in contrast, reported its slowest growth in 30 months, but despite this, wage growth remains resilient, underscoring labour market strength.

While we believe this points to stickier inflation, the market view does not seem to support this. While rates are expected to rise again this year, there is still a broad expectation that inflation will begin to subside in 2024 and rates will come down. However, in our view, this underestimates a number of important inflationary factors and we look in particular at China.

While investors are showing renewed enthusiasm for sectors like tech hardware, software services, and semiconductors, supporting a view that business and consumer spending will remain buoyant - and unconstrained by high long term rates - we believe that sectors such as energy and utilities, which can leverage the inflationary environment should drive investor focus. Why? China's gradual re-opening post-Covid, will fuel renewed inflationary pressures.

As China starts to stimulate its economy, we should see a surge in activity as students resume studying abroad, tourists start travelling, and business executives re-start international travel. Concurrently, China's recovering housing market will also further boost consumer spending, creating a significant economic resurgence.

US inflation is historically closely tied to China's recovery, and a rising China Producer Price Index (PPI) will push up the US Consumer Price Index (CPI), and in turn keep the Fed's hopes of reaching its two percent target inflation rate, a distant dream.

The extent and timing of China's reopening in the coming year, for sure remains uncertain. However, it is evident that a pivot is underway. To ignore the potential impact of China on inflation, and therefore interest rate trajectory, is misguided in our view.

We see some institutional investors recognising this, with a growing number increasing their exposure to Bitcoin, with a correspondingly positive impact on the price.

Bitcoin indicators decidedly bullish

This comes against the backdrop of Bitcoin's unmoved supply reaching a new peak with data from Ark Invest revealing that approximately 70 percent of the circulating Bitcoin supply has remained static for at least a year, a clear indication of a solidifying holder base and a vote of confidence from long-term Bitcoin investors.

Meanwhile, the narrowing discount of the Grayscale Bitcoin Trust signals renewed institutional optimism for the leading cryptocurrency. Since BlackRock's spot Bitcoin ETF filing, GBTC's discount to NAV has reduced from 42 to 26.7 percent, indicating market expectation of Blackrock's ETF getting approved.

Furthermore, the balance of Bitcoin held on over-the-counter (OTC) desks reached a one-year high in June, suggesting increasing interest from institutional players and large capital allocators. However, the escalating open interest since BlackRock's first ETF filing points towards a dominance of derivatives traders, a trend worth monitoring due to potential for short-term price movements.

Meanwhile, there has been a significant surge in USDt (Tether) reserves on exchanges, indicating an increase in liquidity from the most sizable stablecoin within the cryptocurrency markets. This suggests a growing demand for stable assets, possibly driven by an uncertain economic climate and trust in crypto as an easily fungible safe haven. However, exchange reserves for all stablecoins have witnessed a 52 percent decrease this year, an effect possibly influenced by Binance's legal challenges and the subsequent outflow from the BNB chain and the BUSD stablecoin.

Bitcoin liquidity has also seen a decrease, possibly due to the trend of long-term holding among investors, indicating confidence in Bitcoin's enduring value despite market volatility.

We welcome the unmoved supply of Bitcoin and growing institutional interest as a bullish indicator, potential economic challenges coupled with a shift from spot to futures trading in the past few weeks could introduce short-term volatility in the global crypto landscape.

Happy trading!

INDEX

1. GENERAL MARKET UPDATE 6-26

- US Manufacturing Slumps to Pandemic-Era Lows While Inflation Eases 7-9
- Construction Industry Shows Moderate Growth in May 10-11
- FOMC Meeting Minutes Reveal Division Among Fed Officials on Rate Hikes 12-15
- US service sector picks up in June with inflation slowing 16-18
- US Job Growth Slows in June, Wage Growth Remains Strong 19-20
- Contrarian Inflation Outlook Amidst Anticipation of China's Reopening 21-26

2. WHAT'S ON-CHAIN THIS WEEK? 27-35

- Bitcoin's Unmoved Supply Peaks Amid Heightened Institutional Interest 28-31
- Liquidity of Largest Stablecoin Increases While That of Bitcoin Decreases 32-35
-

3. NEWS FROM THE CRYPTO-SPHERE 31-45

- BlackRock CEO Larry Fink Embraces Bitcoin as BlackRock's Bitcoin ETF Application Receives Attention 37-38
- Gemini Co-Founder Demands Repayment of $1.47 Billion from Digital Currency Group in Ultimatum 39-42
- South Korea Passes Virtual Asset User Protection Act 43
- Thailand's SEC Introduces New Rules for Digital Asset Service Providers 44-45
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GENERAL MARKET UPDATE

US Manufacturing Slumps to Pandemic-Era Lows While Inflation Eases

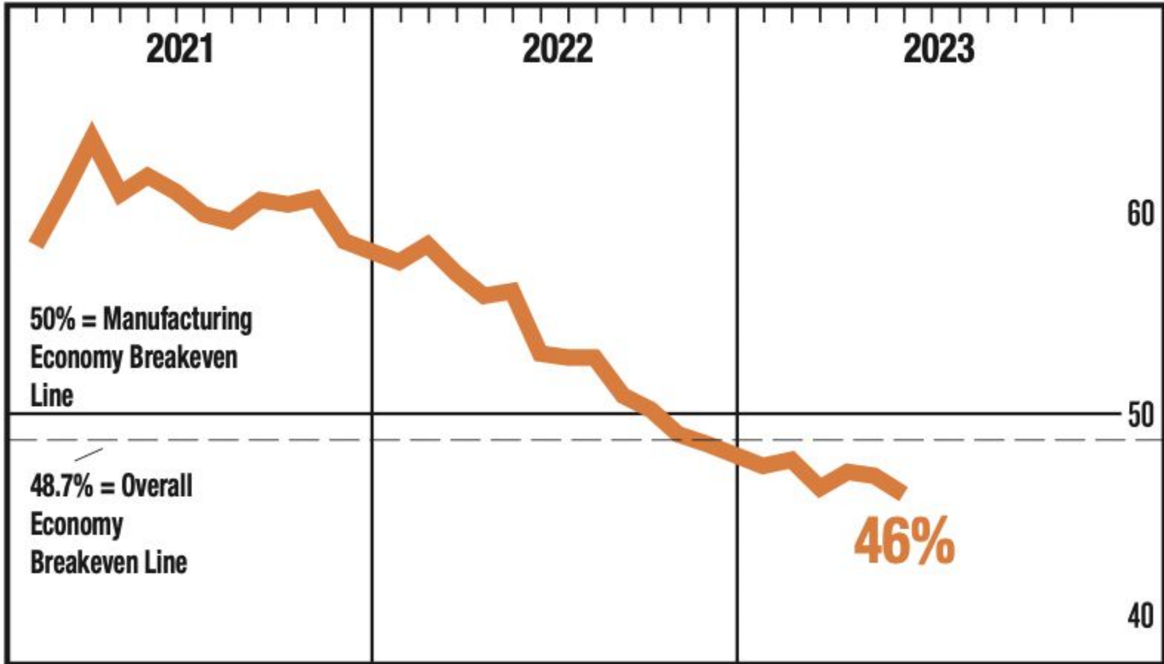


Figure 1. US ISM Manufacturing Index (Source: Institute of Supply Management)

US manufacturing has continued to decline, reaching levels last observed during the initial wave of the COVID-19 pandemic. However, there is a silver lining as price pressures at the factory gate have deflated, offering a glimmer of hope for the economy.

The Institute for Supply Management (ISM) survey, released last Monday, July 3, revealed that shrinking activity has forced factories to resort to layoffs, with Timothy Fiore, Chair of the ISM Manufacturing Business Survey Committee, stating that this trend is more pronounced than in previous months.

Although the data, at first glance, suggests an economy on the verge of recession, other indicators such as nonfarm payrolls, unemployment benefit applications, and housing starts paint a picture of a more 'slow-grinding' economy. A slow-grinding economy is one which has very little or no clear indication of either growth or a downturn, with indicators showing mixed sentiment across different measures.

In this case, we think the risk is to the downside, due to the Federal Reserve's aggressive monetary policy tightening campaign, which has seen 500 basis points worth of interest rate increases since March 2022.

Manufacturing at a Glance

INDEX	Jun Index	May Index	% Point Change	Direction	Rate of Change	Trend* (months)
Manufacturing PMI®	46.0	46.9	-0.9	Contracting	Faster	8
New Orders	45.6	42.6	+3.0	Contracting	Slower	10
Production	46.7	51.1	-4.4	Contracting	From Growing	1
Employment	48.1	51.4	-3.3	Contracting	From Growing	1
Supplier Deliveries	45.7	43.5	+2.2	Faster	Slower	9
Inventories	44.0	45.8	-1.8	Contracting	Faster	4
Customers' Inventories	46.2	51.4	-5.2	Too Low	From Too High	1
Prices	41.8	44.2	-2.4	Decreasing	Faster	2
Backlog of Orders	38.7	37.5	+1.2	Contracting	Slower	9
New Export Orders	47.3	50.0	-2.7	Contracting	From Unchanged	1
Imports	49.3	47.3	+2.0	Contracting	Slower	8
Overall Economy				**Contracting**	**Faster**	**7**
Manufacturing Sector				**Contracting**	**Faster**	**8**

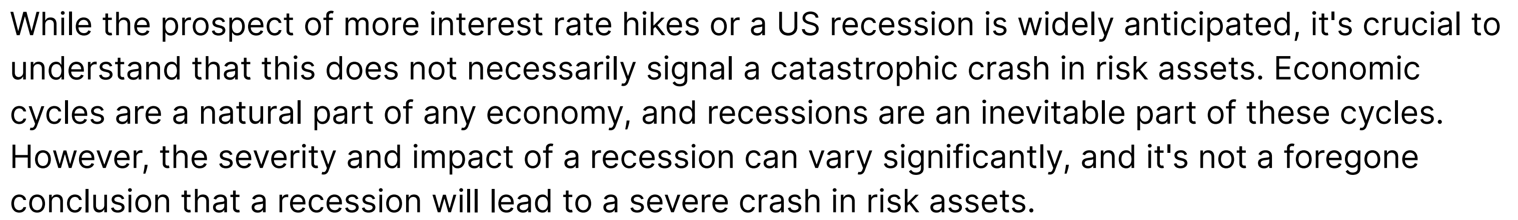
*Number of months moving in current direction. Manufacturing ISM® *Report On Business®* data has been seasonally adjusted for the New Orders, Production, Employment and Inventories indexes.

Figure 2. ISM Manufacturing Index Components (Source: Institute of Supply Management)

The ISM's manufacturing Purchasing Managers' Index (PMI) dropped to 46.0 for June, the lowest reading since May 2020, continuing the eighth consecutive month of contraction in manufacturing. This extended period of contraction is the longest since the Great Recession that started in 2007. The number was also lower than consensus forecasts, which had anticipated a reading of 47.3. Government data from last week revealed that manufacturing contracted at an annualised rate of 5.3 percent in the first quarter, making up 11.1 percent of the economy.

While there are pockets of strength in certain sectors such as transportation equipment (as reported in last week's *Bitfinex Alpha*), concerns remain. Manufacturers in the transportation equipment industry worry that second-quarter sales could decline, potentially increasing inventory levels. They project that total end-of-year sales will remain at similar levels to the previous year.

The manufacturing sector is also facing challenges beyond high borrowing costs. The shift in consumer spending from goods to services typically purchased on credit is undermining manufacturing, and businesses are carefully managing inventories in anticipation of weak demand. Economists suggest that the sector has yet to experience the full consequences of credit tightening following earlier financial market turbulence this year.



While the prospect of more interest rate hikes or a US recession is widely anticipated, it's crucial to understand that this does not necessarily signal a catastrophic crash in risk assets. Economic cycles are a natural part of any economy, and recessions are an inevitable part of these cycles. However, the severity and impact of a recession can vary significantly, and it's not a foregone conclusion that a recession will lead to a severe crash in risk assets.

The current economic indicators do suggest a potential slowdown in the US economy. For instance, the Purchasing Managers' Index (PMI) has shown a decline in new orders, and the US Gross Domestic Income (GDI) is contracting sequentially. These indicators suggest a possible recession on the horizon.

The impact on risk assets will depend on a variety of factors, including the severity of the recession, the response of policymakers, and the resilience of the financial system. In fact, there are several reasons to believe that a potential US recession may not lead to a severe crash in risk assets. The potential recession of 2023, if it occurs, has been widely anticipated, making it one of the most predicted recessions in history. Both markets and economic actors have taken preemptive measures to mitigate its impact, thereby reducing the probability and potential severity of the recession. This front-running is not limited to the US; for instance, Germany's DAX index (The Deutscher Aktienindex, the main stock market index of Germany) has been hitting all-time highs despite the country being in recession, challenging the notion that risk assets must bottom out in a recession.

The primary cause for the crash of risk assets in 2022 was the Federal Reserve's aggressive tightening cycle, which saw 20 rate hikes of 25 basis points each. However, it's believed that the Fed is nearing the end of its hiking cycle. This could stabilise the market and further reduce the risk of a recession, demonstrating how the potential economic downturn has been front-run.

Construction Industry Shows Moderate Growth in May Amid Increased Spending

CONSTRUCTION SPENDING

MAY 2023	$1,925.6 billion
APRIL 2023 (revised)	$1,909.0 billion

Next release: August 1, 2023

Seasonally Adjusted Annual Rate (SAAR)
Source: U.S. Census Bureau, July 3, 2023

Figure 3 Construction Spending Month-Over-Month Change. (Source:, US Census Bureau)

According to the monthly construction spending report from the US Commerce Department last Monday, July 3, the construction industry experienced a modest upswing in May, with both private companies and the government ramping up spending on various projects. On dissecting the data, it seems that the housing sector in the US is finally stabilising. Construction spending rose by 0.9 percent to reach $1.925 trillion during the month (refer Figure 3 above), surpassing Wall Street's expectations of a 0.5 percent increase from April.

Construction spending is a key indicator of economic activity, reflecting the amount invested by private entities and the government in projects ranging from housing to infrastructure development. In April, the initial reading indicated a 1.2 percent increase in construction spending, but the figure was later revised to 0.4 percent.

Over the past year, construction spending has seen a positive trend, rising by 2.4 percent. However, the residential real estate sector showed mixed results. Private residential construction experienced a decline of 11.6 percent in May compared to the previous year, but it did witness a 2.2 percent increase from April. Single-family construction displayed a month-over-month increase of 1.7 percent, although it plummeted by 25 percent when compared to the same period last year. On the other hand, multifamily construction decreased slightly by 0.1 percent in May but showed significant growth of 20.4 percent over the past year.

Public residential construction spending exhibited a slight rise of 0.1 percent from the previous month and a substantial increase of 12.3 percent from the same period last year. The overall spending on public residential construction by the U.S. increased by 1.1 percent from the previous month and 8.3 percent over the past year.

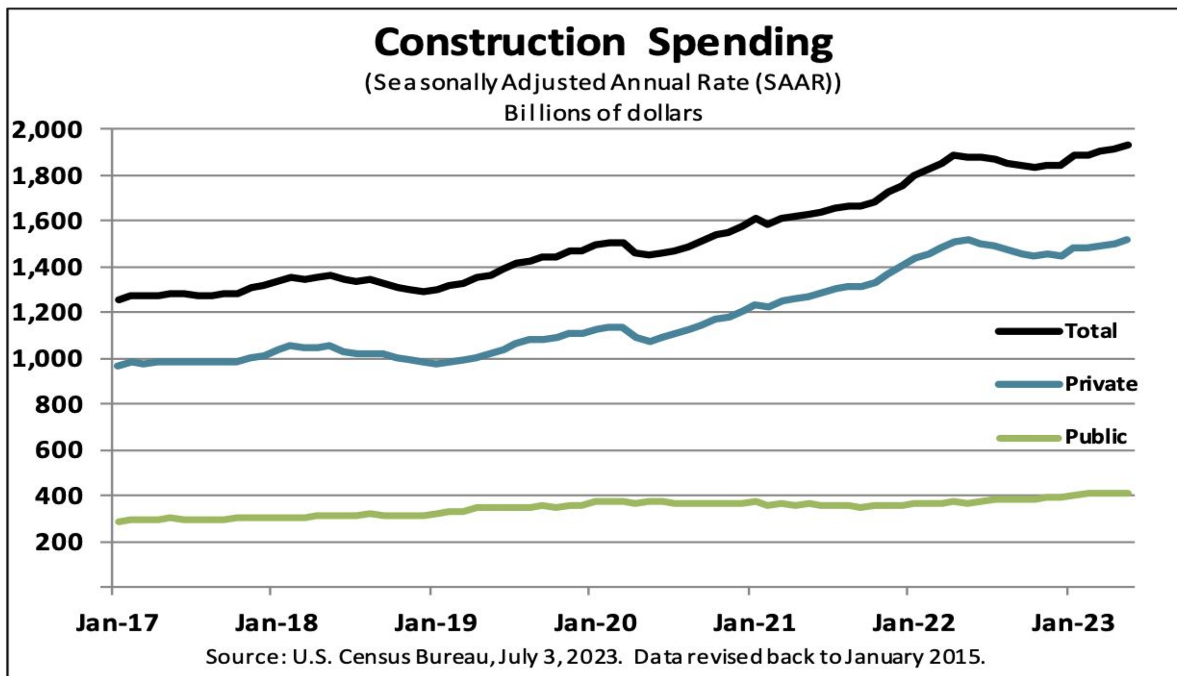


Figure 4. Construction Spending For Private vs Public Section in the US. (source: Census Bureau)

The rise in expenditure can be succinctly described as 'robust'. Of particular note is the resurgence in new residential activity, effectively reversing the cumulative downtrend observed over the past three months. We posit that this positive development is in harmony with the notable expansion in housing starts witnessed in May, which insinuates a stabilisation within the housing sector.

The rise in construction spending in May was largely attributed to the scarcity of homes available for sale, particularly in the single-family housing market. The acute shortage has spurred increased investment in single-family homebuilding. Notably, housing starts soared during the same month.

The report also revealed that spending on private non-residential structures, including gas and oil well drilling, declined by 0.3 percent. However, spending on public construction projects edged up by 0.1 percent in May, following a 0.5 percent increase in April. While state and local government spending experienced a growth of 0.4 percent, outlays on federal government projects witnessed a decline of 2.5 percent.

Overall, the construction industry's growth in May indicates a positive trajectory for the U.S. economy. The combination of increased private and public investment, coupled with the rebound in residential construction, suggests a potential recovery and stabilisation of the housing sector.

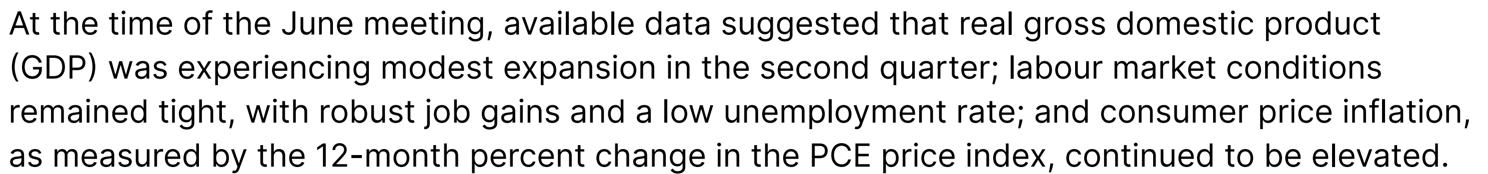
FOMC Meeting Minutes Reveal Division Among Fed Officials on Rate Hikes

The FOMC minutes revealed that a majority of respondents from the Open Market Desk's Surveys of Primary Dealers and Market Participants expected no change in rates during the June meeting. The survey is conducted by the Fed to gather insights and expectations from primary dealers (financial institutions authorised to transact directly with the Fed). While the survey's median path indicated no rate changes until early 2024, this is misleading as there was significant dispersion among respondents, with a clear expectation of additional tightening.

Figure 5. Almost All Fed Officials Opted For a June Rate Pause But A July Increase Is On The Table.

The release of the Federal Open Market Committee (FOMC) meeting minutes had investors and economists eagerly awaiting insights into the future course of rate hikes. The FOMC minutes, closely monitored by global investors, provide valuable information on the perspectives of Fed members regarding the terminal rate and the potential direction of the Federal Funds Rate. The minutes of the June 13th-14th FOMC meeting were made public on July 5th.

Respondents to the survey still view a near-term recession as quite likely, although the expected timing was pushed out further due to the continued resilience of economic activity. The overall expectation was that any downturn would not be severe or prolonged. In terms of inflation projections, respondents increased their expectations for core Personal Consumption Expenditures (PCE) inflation in the second and third quarters of the year, while projections for later quarters remained relatively stable.



At the time of the June meeting, available data suggested that real gross domestic product (GDP) was experiencing modest expansion in the second quarter; labour market conditions remained tight, with robust job gains and a low unemployment rate; and consumer price inflation, as measured by the 12-month percent change in the PCE price index, continued to be elevated.

For April and May, there have been substantial increases in total nonfarm payroll employment, although the unemployment rate slightly increased, albeit to a relatively low level of 3.7 percent in May. However, there were variations among different demographic groups, with African Americans experiencing an increase in the jobless rate while Hispanics saw a decline. Labour force participation rate remains steady, while the employment-to-population ratio decreased slightly. The private-sector job openings rate in April remained unchanged from the relatively high first-quarter average but was lower than the previous year.

Recent indicators pointed to continued expansion of economic activity at a modest pace, with robust job gains and a low unemployment rate. However, inflation remains elevated.

The Fed also emphasised the soundness and resilience of the U.S. banking system. While tighter credit conditions for households and businesses were expected to affect economic activity, hiring, and inflation, the exact extent of these effects remained uncertain. The Committee remained highly attentive to inflation risks.

The FOMC's objective is to achieve maximum employment and maintain inflation at a rate of two percent over the longer run. In line with these goals, the Committee decided to maintain the target range for the federal funds rate at 5.0 to 5.25 percent during the June meeting. By holding the target range steady, the FOMC wants to assess additional information and its implications for monetary policy. It said that in determining the appropriate extent of further policy firming to achieve the desired inflation rate, it needs to consider the cumulative tightening of monetary policy, the time lags in which policy affects economic activity and inflation, as well as economic and financial developments.

Although the Fed met market expectations in June, it hinted at more increases in the future, given the hawkish economic forecast. The median predictions from FOMC members indicated a final rate of 5.6 percent after at least two additional predicted rate increases.

The markets anticipate future rate increases in July and September, and it is now expected that interest rates will remain higher for a longer period than initially anticipated.

The Fed's dot plot is a chart that records each Fed official's projection for the central bank's key short-term interest rate. The dots reflect what each U.S. central banker thinks will be the appropriate midpoint of the fed funds rate at the end of each calendar year three years into the future, should the economy evolve as they expect. In the "dot plot" (refer Figure 6 below), the projections by 18 FOMC members of the Fed Funds Rate by the end of 2024, show that one-third expect it will be 5.125 percent, the current rate. The median estimate is 4.6 percent, with only one among the 18 members projecting that the Fed Funds rate will be below four percent by December 2024.

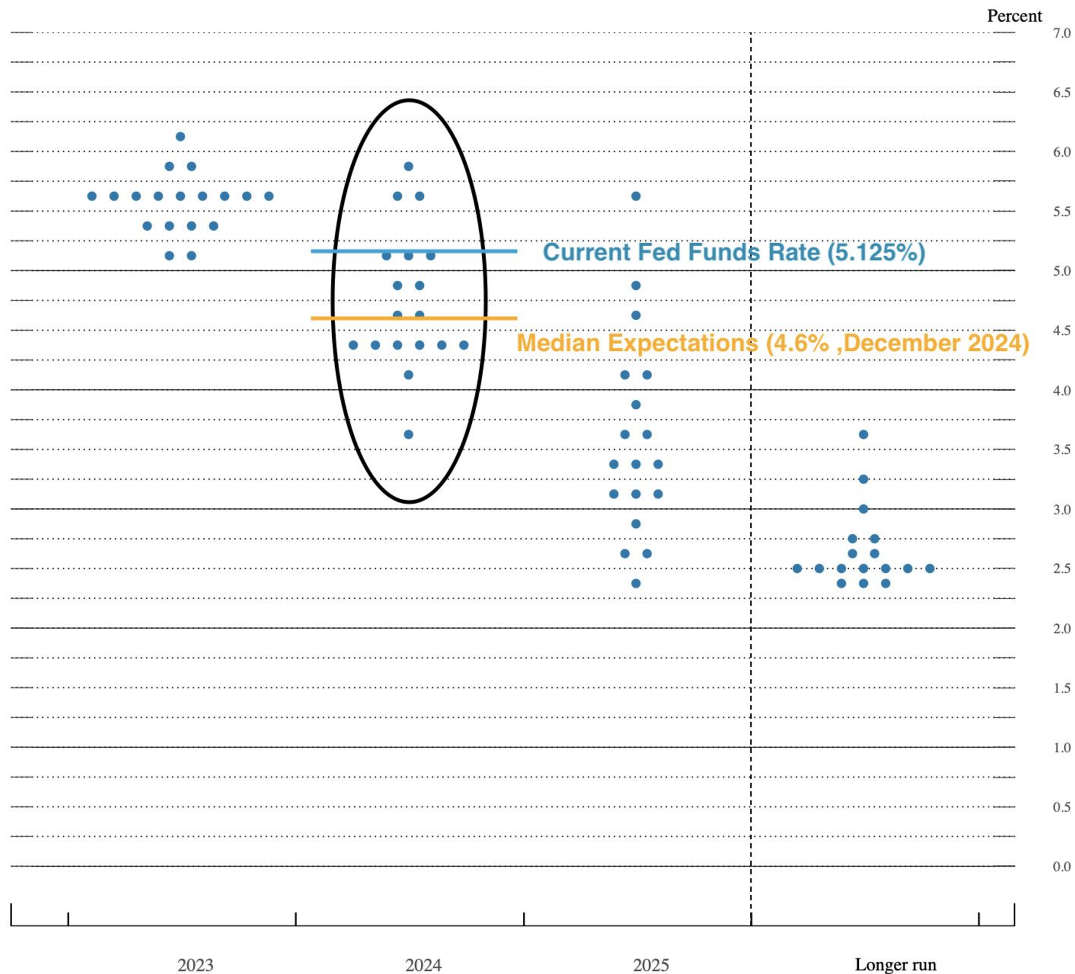
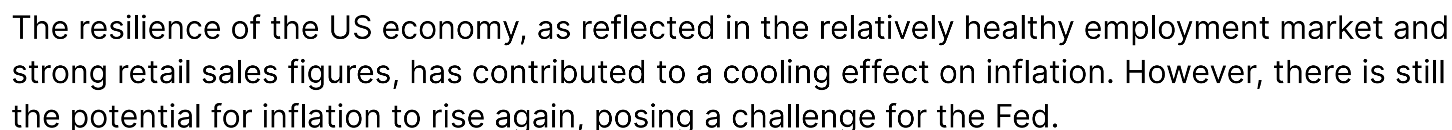


Figure 6. US Fed's Dot Plot. (Source: US Federal Reserve)



The resilience of the US economy, as reflected in the relatively healthy employment market and strong retail sales figures, has contributed to a cooling effect on inflation. However, there is still the potential for inflation to rise again, posing a challenge for the Fed.

As the markets await further signals from the economy, the central bank, as well as from corporate results, there is a crucial decision to be made regarding the next phase of the bull run. Any unexpected negative news could shock the markets, while unexpected positive news could prolong the upward trend into the latter part of the year.

In conclusion, the FOMC meeting minutes revealed a division among Fed officials regarding rate hikes. While the majority favoured maintaining the current interest rate, there were some who supported a rate increase due to the tight labour market and stronger-than-anticipated economic momentum. The minutes also highlighted the uncertainty surrounding the economic outlook and inflation, emphasising the importance of additional information in determining the appropriate monetary policy stance.

US service sector picks up in June with inflation slowing

The US services sector demonstrated stronger-than-expected growth in June, driven by increased new orders, according to reports from the Institute for Supply Management (ISM) and S&P Global, last Thursday, July 6. The ISM's barometer of business conditions at service sector companies, including restaurants and hotels, rose to 53.9 percent in June, surpassing consensus forecast of a rise to 51.3 percent. This marks the sixth consecutive month that the index has remained above the 50 percent threshold for expansion.

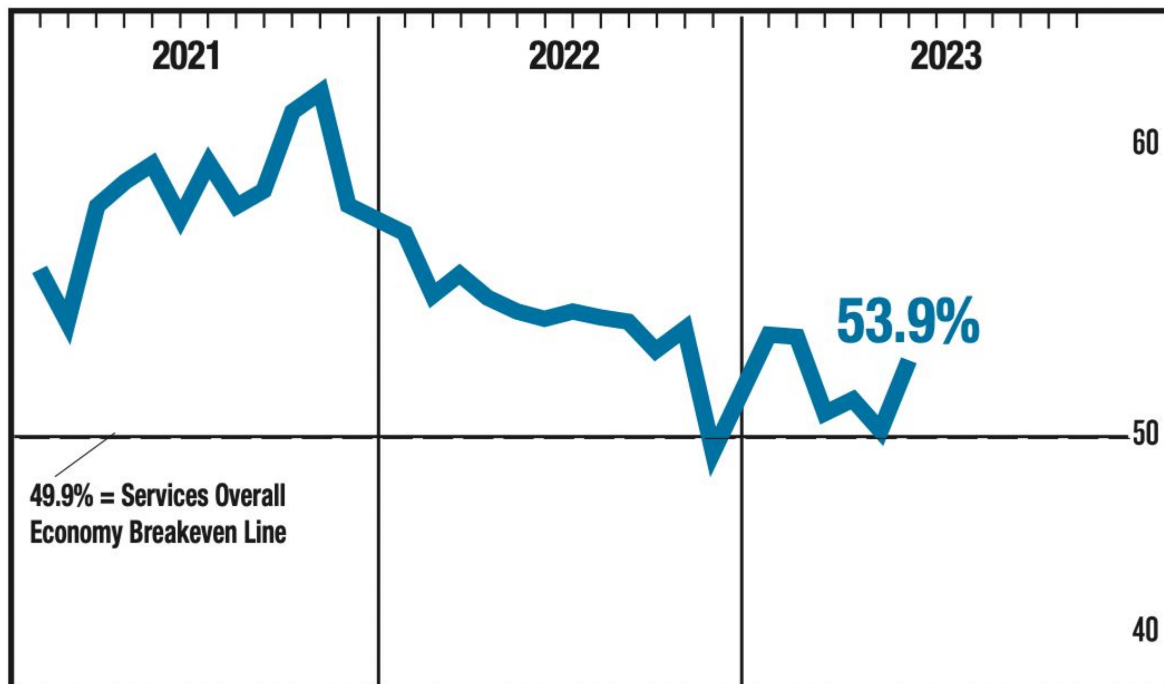


Figure 7. ISM Service Index (Source: Institute for Supply Management)

Key details from the ISM report reveal that 15 out of 18 industries reported growth in June, with new orders, activity, and employment all experiencing increases. While most respondents expressed stability in business conditions, there was cautiousness regarding inflation and the future outlook. Notably, the employment index rose by 3.9 points to 53.1, indicating a rebound in services sector employment. However, the prices component slowed down to 54.1 percent in June from 56.2 percent in May (refer to Figure 8). Economists view the ISM services prices paid measure as a reliable predictor of personal consumption expenditures (PCE) inflation, which the Fed monitors for its monetary policy decisions.

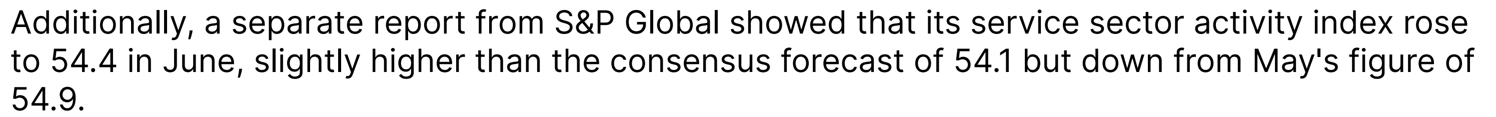
Services at a Glance

INDEX	Jun Index	May Index	% Point Change	Direction	Rate of Change	Trend* (months)
Services PMI®	53.9	50.3	+3.6	Growing	Faster	6
Business Activity	59.2	51.5	+7.7	Growing	Faster	37
New Orders	55.5	52.9	+2.6	Growing	Faster	6
Employment	53.1	49.2	+3.9	Growing	From Contracting	1
Supplier Deliveries	47.6	47.7	-0.1	Faster	Faster	5
Inventories	55.9	58.3	-2.4	Growing	Slower	2
Prices	54.1	56.2	-2.1	Increasing	Slower	73
Backlog of Orders	43.9	40.9	+3.0	Contracting	Slower	4
New Export Orders	61.5	59.0	+2.5	Growing	Faster	3
Imports	54.6	50.0	+4.6	Growing	From Unchanged	1
Inventory Sentiment	54.0	61.0	-7.0	Too High	Slower	2
Overall Economy				**Growing**	**Faster**	**6**
Services Sector				**Growing**	**Faster**	**6**

*Number of months moving in current direction. Services ISM® *Report On Business®* data has been seasonally adjusted for the Business Activity, New Orders, Employment and Prices indexes.

Figure 8. ISM Service Index Components (Source: Institute of Supply Management)

Figure 9. S&P GLobal US Service Business Activity Index (Source: S&P Global)



Additionally, a separate report from S&P Global showed that its service sector activity index rose to 54.4 in June, slightly higher than the consensus forecast of 54.1 but down from May's figure of 54.9.

The service sector and consumer spending have been driving the US economy this year, and the June data does not suggest any signs of a slowdown.

Overall, the growth in the US services sector and the moderation of prices paid by services businesses reflect a resilient economy, despite potential risks arising from increased interest rates. With solid job growth and ongoing efforts to manage inflation, expectations remain positive for the coming months.

US Job Growth Slows in June, Wage Growth Remains Strong

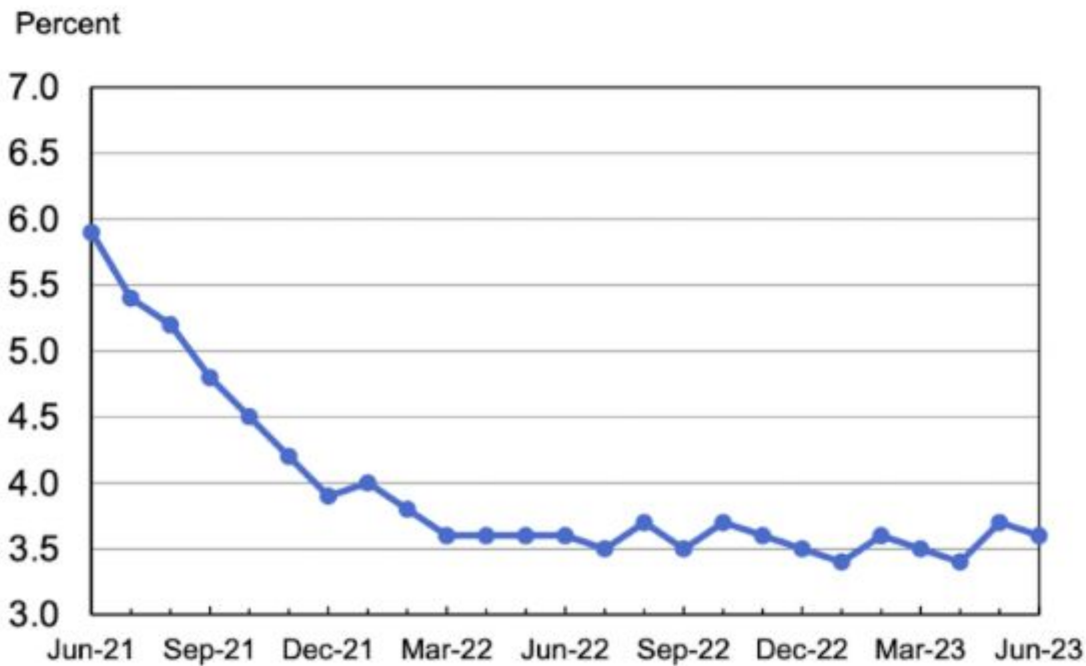


Figure 10. Seasonally Adjusted Unemployment Rate Month-over-Month. (source:)

The latest employment report released by the US Labor Department on Friday, July 7th revealed that the US economy has added the lowest number of jobs for a 30 month period in the past two and a half years. However, robust wage growth indicated ongoing tight labour market conditions, suggesting that the Federal Reserve is likely to continue raising interest rates later this month. Unemployment is at 3.6 percent, significantly lower than the average 5.72 percent rate from 1948 until 2023.

The report revealed that nonfarm payrolls increased by 209,000 jobs in June, marking the smallest gain since December 2020 (refer to Figure 11 below) and I short of the consensus forecast of a rise of 225,000 jobs. Additionally, the report revised down job numbers for April and May, indicating that higher borrowing costs were starting to dampen businesses' enthusiasm for expanding their headcount.

Despite the slowdown, we note that the pace of job growth remains strong by historical standards, providing further evidence that the economy is far from a recession. The employment report also indicated a rise in part-time employment for economic reasons, possibly due to reduced hours resulting from work slack or business conditions.

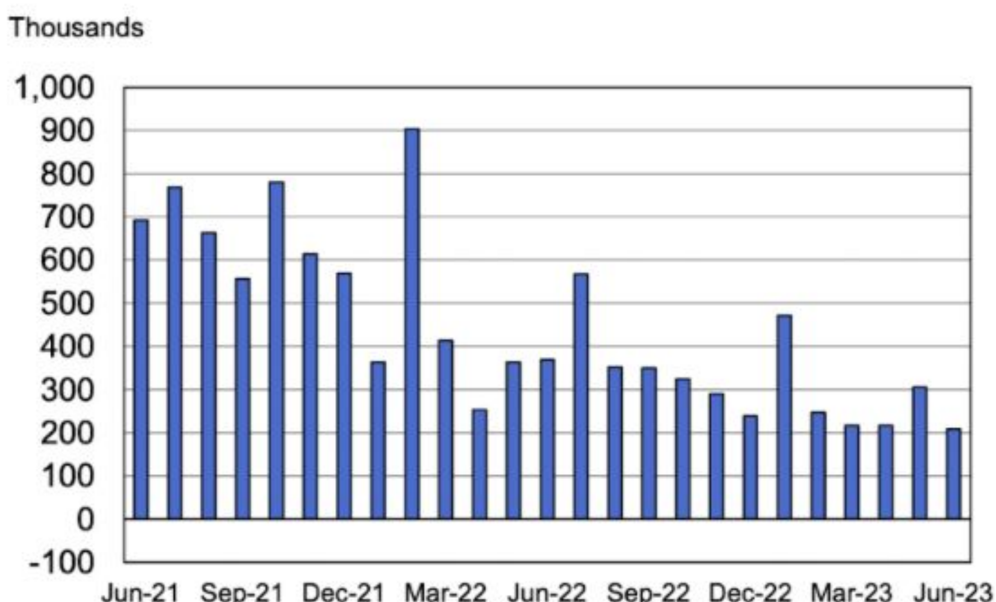


Figure 11. Seasonally Adjusted Nonfarm Payrolls Month-over-Month change. (source:)

While certain higher-paying industries, such as technology and finance, are shedding workers, sectors like leisure and hospitality, as well as local government and education, are still in the process of recovering after experiencing employee losses and accelerated retirements during the COVID-19 pandemic.

On a positive note, government employment saw an increase of 60,000 jobs, with a rise of 59,000 in state and local government payrolls. Healthcare payrolls rose by 41,000 jobs, primarily driven by hiring in hospitals, nursing and residential care facilities, and home health care services. Construction employment also saw a significant jump of 23,000 jobs, indicating a revival in the housing market after being impacted by a surge in mortgage rates.

Furthermore, average hourly earnings rose by 0.4 percent in June, following a similar increase in May. Over the past 12 months, wages have increased by 4.4 percent, consistent with the high wage growth that exceeds the Federal Reserve's 2 percent inflation target.

While the job growth slowdown may influence the Federal Reserve's decision to raise interest rates at its upcoming meeting, market expectations already suggest a high likelihood of a rate hike. Investors closely monitored the jobs data as an indicator of the Fed's next move to curb inflation.

In summary, the June employment report revealed a moderation in job growth but highlighted ongoing wage growth and a resilient labour market. While job numbers fell short of expectations, the overall economy remains on a positive trajectory, and the Federal Reserve is expected to take further action to manage inflation.

Contrarian Inflation Outlook Amidst Anticipation of China’s Reopening

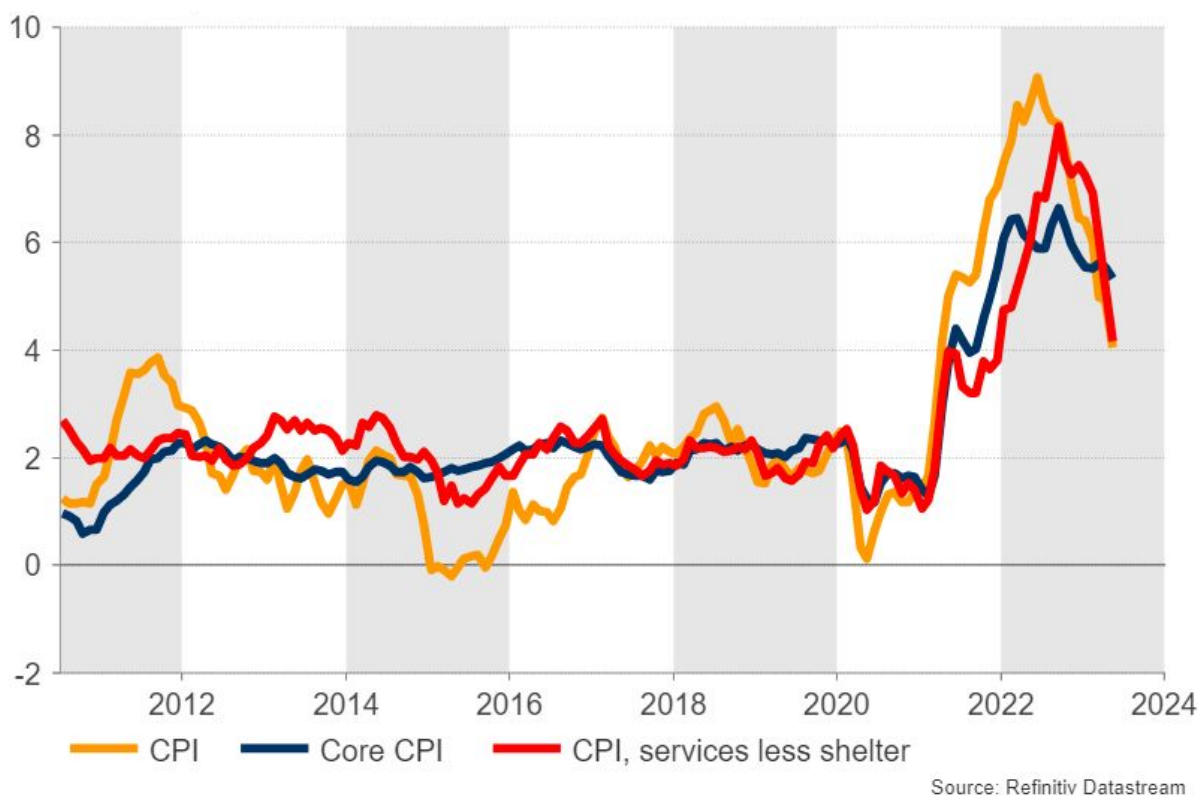


Figure 12. A Decline in US Inflation after it peaked in June 2022 (Source: Refinitiv Datastream, US Bureau of Labor Statistics)

Amidst broad projections of a global slowdown in inflation due to rising interest rates and reduced consumer spending, the anticipated reopening of China's borders has emerged as a potential game-changer.

Global inflation is expected to decelerate next year due to rising interest rates, an impending recession, and reduced consumer spending. Easing prices for commodities, food, and energy, should contribute to this trend.

However, the contrarian view is that the broadview of economic recovery and market's apparent lack of concern about inflation in 2024, may be misguided. Despite a brief period of unease surrounding rising price growth in 2021 and the first half of 2022, the market has embraced higher-duration stocks as if inflation were a thing of the past. When investors believe that the economy is moving towards sustained growth and recovery, investors tend to focus on companies that generate strong earnings and revenue growth, so-called higher-duration stocks. Through this, the market is indicating that it is confident in central banks' ability to manage inflationary pressures and stabilise the economy.

However we believe this is complacent, and that there is real risk of a re-acceleration in inflation, this year or early next year, as China's monetary and fiscal engines gradually regain momentum.

A revitalised domestic economy in China would mean students will resume studying abroad, tourists start travelling, and business executives re-start international travel. Concurrently, China's recovering housing market will also further boost consumer spending, creating a significant economic resurgence.

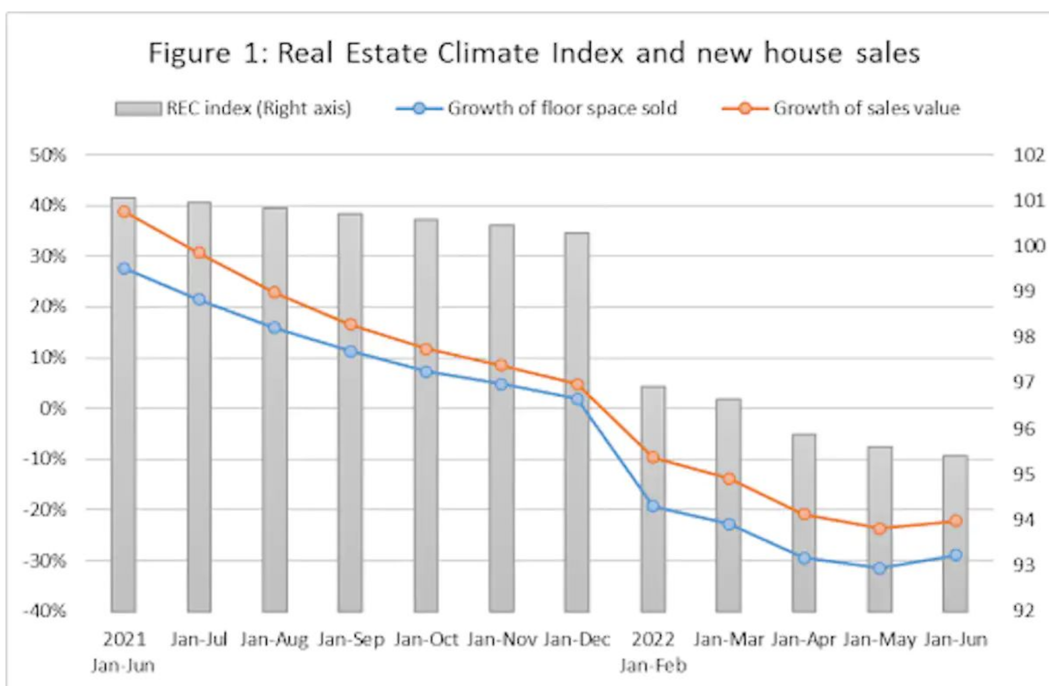


Figure 13. Real Estate Climate Index and New House Sales in China (Source: National Bureau of Statistics, China)

The market's increased exposure to duration risk in recent quarters could prove to be burdensome. There is a growing possibility that interest rates may not return to their longer-term average as quickly as expected. Consequently, sectors with lower durations, such as energy and utilities, which have fallen out of favour, could outperform higher-duration sectors during the resurgence of inflation.

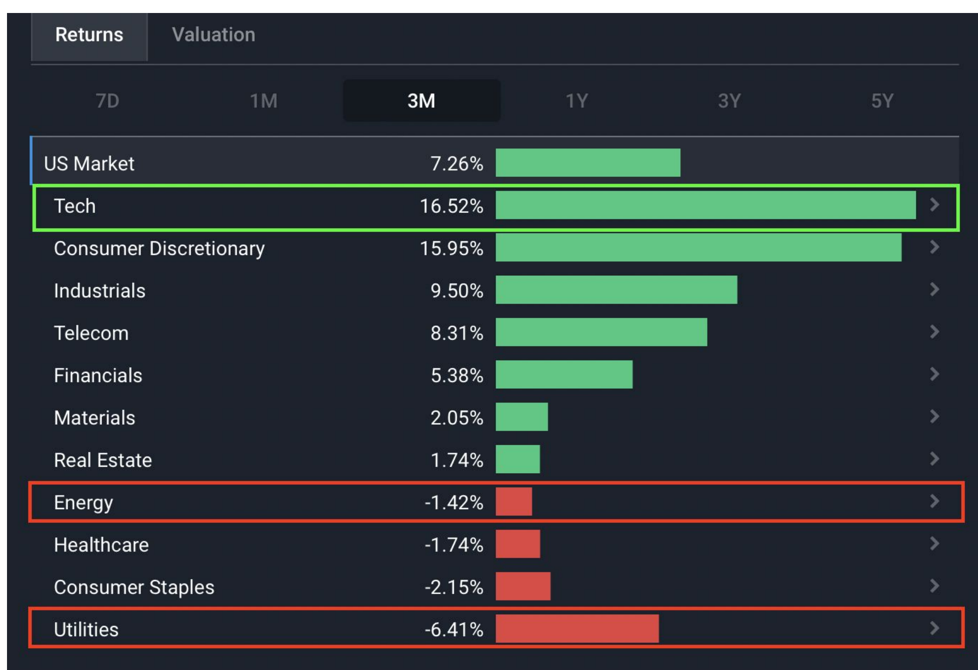


Figure 14. Sector Trends in the US Market (Source: Simply Wall St.)

It is worth noting that sectors like tech hardware, software services, and semiconductors have thrived this year. These sectors tend to have higher durations, indicated by their relatively lower dividend yields. Conversely, lower-duration sectors, such as telecoms and energy, have underperformed. This reversal in sector performance occurred after the peak of the year-on-year headline Consumer Price Index (CPI) in the United States last June. Since then, inflation has declined, prompting profit-taking in energy sectors initially, followed by a renewed focus on tech stocks.

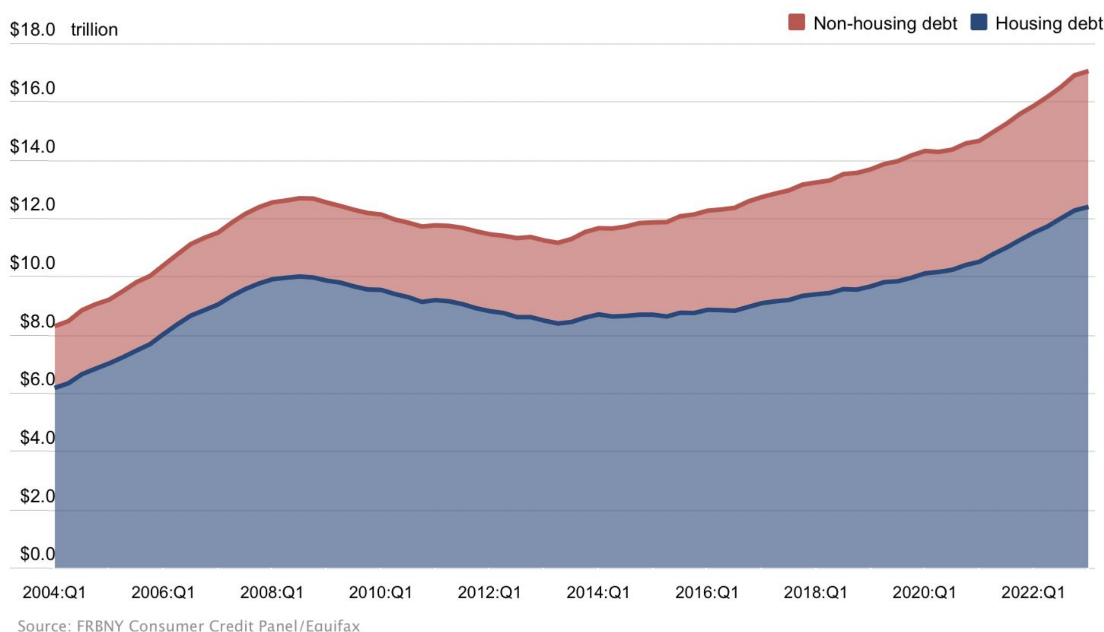


Figure 15. Household Total Debt Balance: New York Fed Household Debt and Credit Report (Source: New York Fed, FRBNY Consumer Credit Panel)

Household Debt and Credit Developments as of Q1 2023

CATEGORY	QUARTERLY CHANGE * (BILLIONS $)	ANNUAL CHANGE** (BILLIONS $)	TOTAL AS OF Q1 2023 (TRILLIONS $)
MORTGAGE DEBT	(+) $121	(+) $864	$12.04
HOME EQUITY LINE OF CREDIT	(+) $3	(+) $22	$0.34
STUDENT DEBT	(+) $9	(+) $14	$1.60
AUTO DEBT	(+) $10	(+) $93	$1.56
CREDIT CARD DEBT	(+) $0	(+) $145	$0.99
OTHER	(+) $5	(+) $67	$0.51
TOTAL DEBT	(+) $148	(+) $1205	$17.05

Figure 16. Household Debt and Credit Development as of Q1 of 2023 (Source: NewYork Fed)

It is not only equity markets that face rising duration risk; the bond market is also impacted. The household and corporate sectors are absorbing the increasing bond duration risk, with households being the principal absorber. Analysis of household debt levels can provide insights into the extent to which households are taking on bond duration risk. High levels of household debt, especially in the form of mortgages or long-term loans, indicate that households are absorbing longer-term financial obligations and potentially taking on bond duration risk. In a regime of low and stable price growth, this broad-based rise in duration risk might not pose significant problems. However, the argument posits that inflation is not yet done with us.

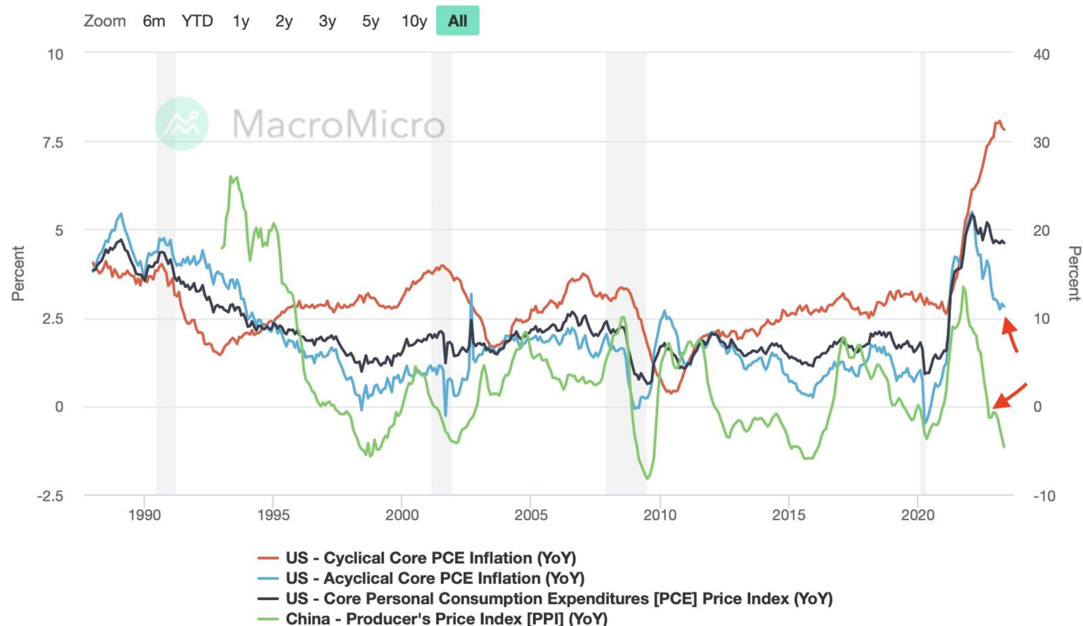


Figure 17. Cyclical, Acyclical Core PCE, China's Producer's Price Index. (Source: Macromicro)

The primary driver behind the expectations of a decline in US inflation has been China's hesitant recovery. A breakdown of the US Personal Consumption Expenditures (PCE) into cyclical and acyclical components reveals that cyclical inflation remains near its peak, while the decline in inflation is solely driven by the acyclical component. Cyclical inflation represents the portion of inflation that is influenced by the business cycle and economic conditions.On the other hand, acyclical inflation refers to inflationary pressures that are not directly influenced by the business cycle. Unlike cyclical inflation, the acyclical component is less dependent on the immediate state of the economy and can persist even during periods of economic slowdown or recession.

Notably, acyclical inflation highly correlates with producer inflation in China. Thus, China's ongoing struggle to achieve a sustainable recovery has been the key factor influencing disinflation in the US. As China incrementally eases its monetary and fiscal policies to address the current economic slowdown, its rising Producer Price Index (PPI) is expected to feed into US CPI, halting its decline and pushing it higher.

Figure 18. China's Producer Price Index and its Effect on US Consumer Price Index (Source: OECD.org , Bureau of Labour Statistics)

Although the exact timing of this shift is uncertain, a window of opportunity potentially arises for portfolio reallocation towards lower-duration sectors. Currently, sectors like tech are overcrowded, according to BofA's Global Fund Manager Survey. Energy, in particular, stands out as on a valuation basis. Not only is the sector currently less preferred, but it also ranks as the cheapest in terms of relative price-to-earnings and price-to-book ratios. Additionally, historical data indicates that energy tends to perform well during periods of elevated inflation.

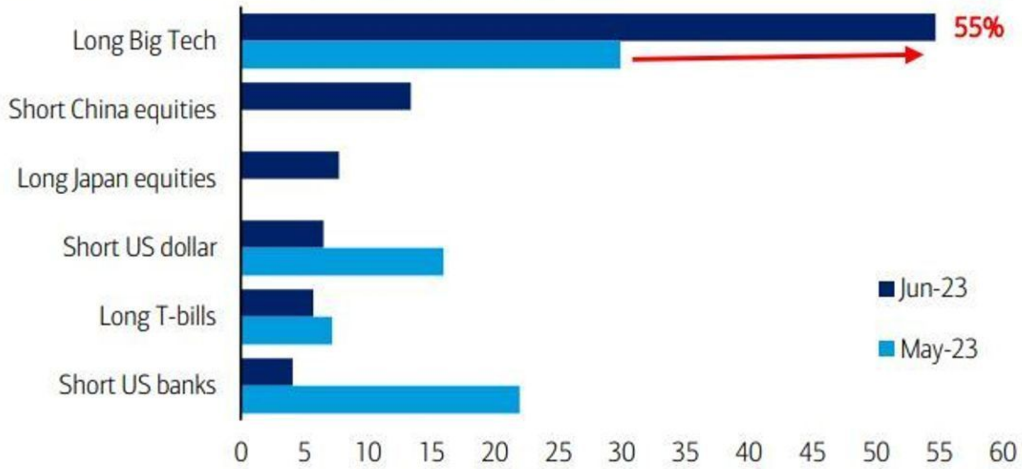


Figure 19. Long Big Tech Showing the most crowded trade (Source: Bank of America Global Research)

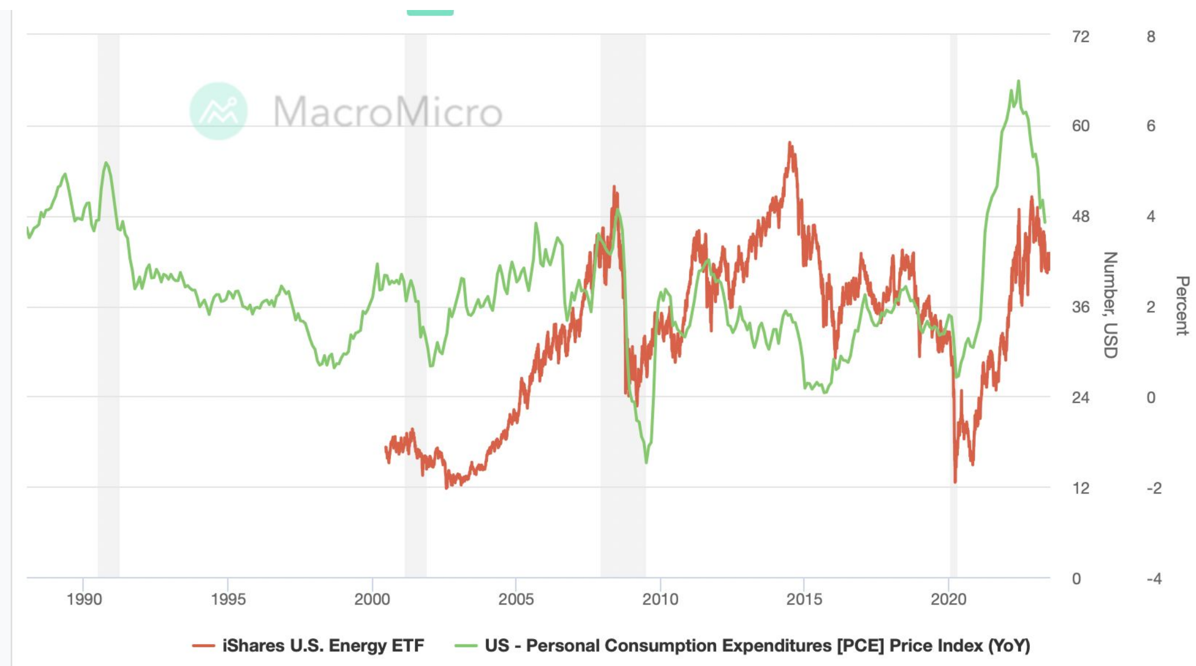


Figure 20. Historical Behavior of Energy Stocks Against US Inflation (Chart Source: Macromicro)

The extent and timing of China's reopening in the coming year remain uncertain. However, it is evident that a pivot is underway. Market participants should recognise the potential for China's actions to disrupt prevailing inflation expectations and alter the global economic landscape. Given the evolving global economic landscape, monitoring inflationary trends and understanding their underlying causes will remain essential for policymakers, investors, and individuals alike.

WHAT’S ON-CHAIN THIS WEEK?

Bitcoin's Unmoved Supply Peaks Amid Heightened Institutional Interest

Against the backdrop of clear growing institutional interest, Bitcoin's unmoved supply has hit an all-time high. According to *Ark Invest* data, approximately 70 percent of the circulating Bitcoin supply has remained untouched for at least a year (refer Figure 21 below). This trend, indicative of a strengthening holder base, underscores the confidence of long-term Bitcoin investors.

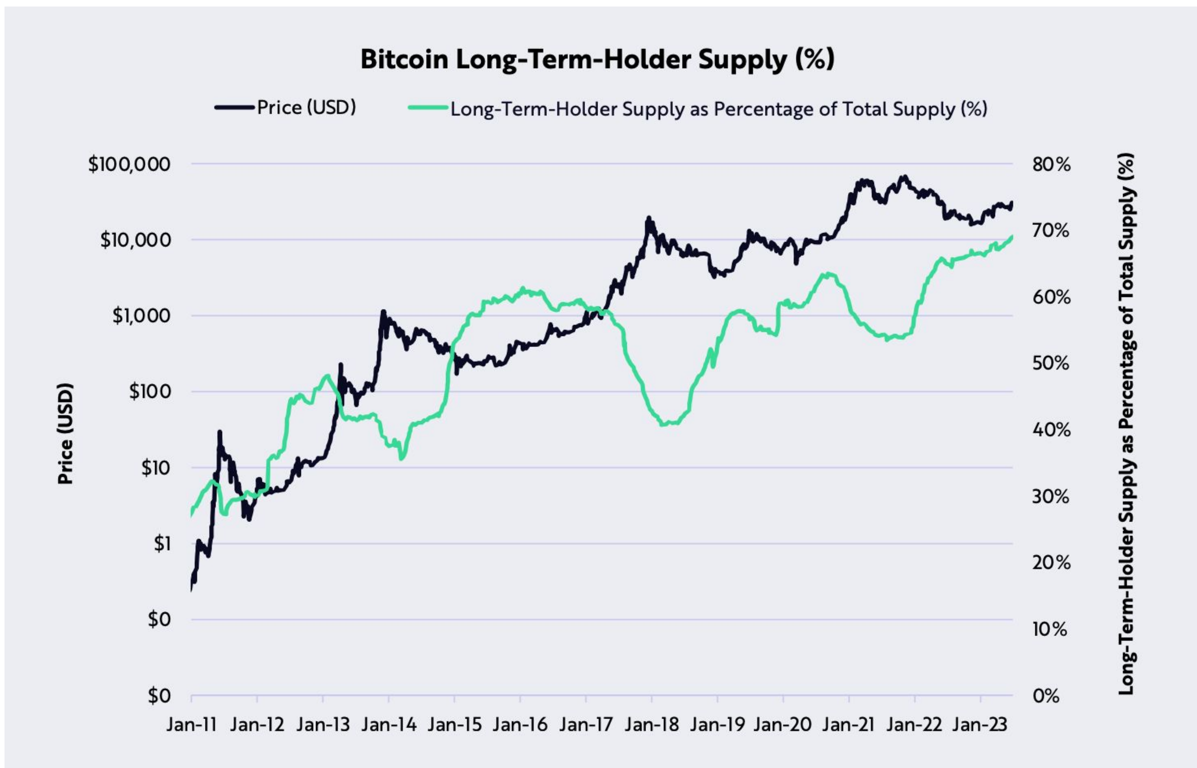


Figure 21. Bitcoin Long-Term Holder Supply As Percentage Of Total Supply. (source: Ark Invest)

In particular, the steadily rising share of the circulating BTC supply that is in the hands of long-term holders confirms that the holder base is "strengthening," according to the firm.

With BTC closing at $30,500, marking a 12.05 percent increase for the month (refer to Figure 22 below), we note that this is still below the all-important range high at $31,500 (as discussed in the previous edition of the *Bitfinex Alpha*). It is nonetheless a fairly significant milestone for Bitcoin Bulls as long-term holder supply has reached an all-time high, and the price is still above the important psychological level of $30,000. This was also a green monthly candle after the first red monthly candle of the year in May and a subsequent lower timeframe continuation with prices decreasing even further in the beginning of the month of June.

Figure 22. BTC/USD Monthly Chart. (source: Bitfinex)

This positive price action, coupled with the narrowing discount of the Grayscale Bitcoin Trust (GBTC) to its Net Asset Value, signals improved institutional sentiment towards the leading cryptocurrency.

Since BlackRock filed for its spot Bitcoin ETF on June 15th, the GBTC's discount to NAV has reduced from 42 percent to 26.7 percent — a one-year low (refer Figure 23 below).

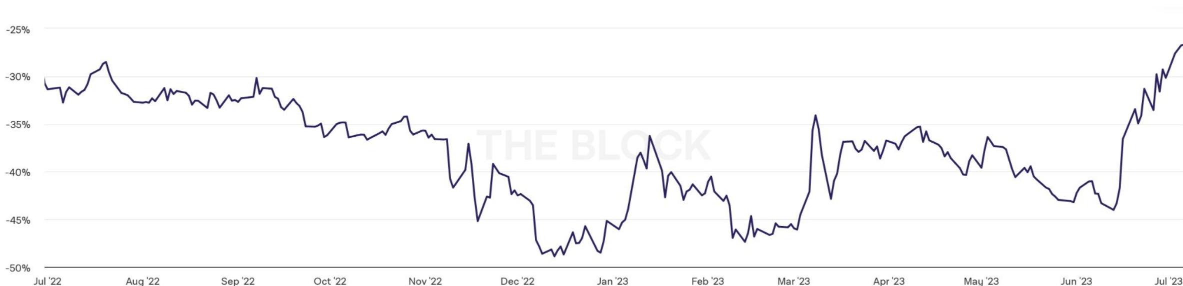


Figure 23. GBTC Discount to NAV Daily Chart. (source: The Block)

This narrowing discount potentially indicates the market's anticipation of a Bitcoin spot ETF approval, thereby increasing the odds of GBTC's long-running quest to be an ETF itself. And while this is one of the most accessible arbitrage opportunities, it is also a gauge of investor sentiment depending on how crowded this arbitrage opportunity becomes.

Moreover, the balance of Bitcoin held on over-the-counter (OTC) desks, serving as a proxy for institutional activity, reached a one-year high in June. The OTC Bitcoin balance increased by 60 percent by the end of the quarter, suggesting that institutions and large capital allocators are increasingly focusing on Bitcoin as an investment option.

Figure 24. Bitcoin Fund Holdings and Volume. (source: CyrptoQuant)

Fund holdings refer to the cryptocurrency holdings of institutional investors, including hedge funds, investment firms, and cryptocurrency private funds. Analysing the holdings of these funds provides valuable insights into the market dynamics and investor sentiment.

By closely observing fund holdings, we can identify a significant upward trend in the accumulation of BTC by these institutional entities (refer to Figure 24 above). This exponential increase in holdings indicates a strong interest among institutional investors to acquire Bitcoin, even at its current price level.

It's worth noting however, that Bitcoin Open Interest has risen by more than 38 percent since BlackRock's first ETF filing (refer to Figure 25 below).

Figure 25. BTC/USD Daily chart with aggregated open interest. (source: coinalyze)

This suggests that derivatives traders may be dominating the current market momentum after a period of spot dominance. Increased positions in futures contracts usually negatively affect the price of BTC in the short term, which is something to keep an eye on.

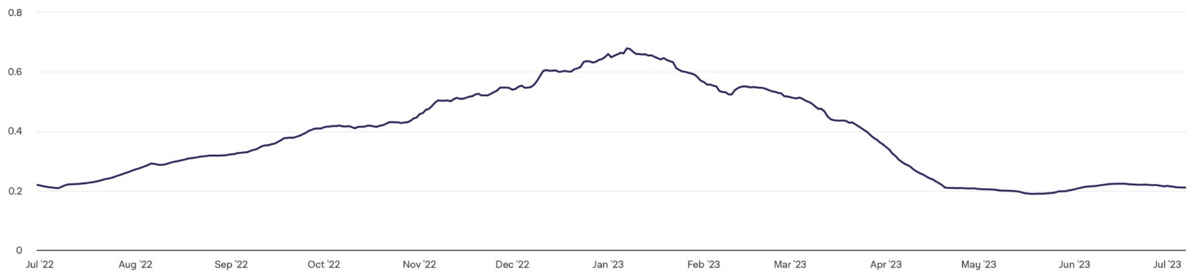


Figure 26. BTC Spot To Futures Trading Volume 30 Day-Moving Average. (source: The Block)

The spot volume in comparison to the derivatives volume has subsided recently after dominating the move up from sub $16,000 BTC during the bear market bottom (refer to Figure 26 above). BTC's monthly candle failing to close above the range high and the increased derivatives activity could be bearish in the short term. Derivatives traders may currently be exerting a commanding influence on market momentum, following a period of spot market preponderance. Could this mark the advent of a new Fear Of Missing Out (FOMO) trend?

It is plausible that we are observing the initial indicators of widespread FOMO amongst both institutional and retail participants. Historically, leverage dominated price movements have been known to be less trustworthy and whenever the derivatives market has been dominant over the spot markets.

In conclusion, while the unmoved supply of Bitcoin and the growing institutional interest paint a positive picture, the potential economic challenges and the shift from spot to futures trading could introduce volatility in the short term.

Liquidity of Largest Stablecoin Increases While That of Bitcoin Decreases

USDt (Tether) reserves on exchanges have reached an unprecedented level relative to other stables, specifically for ERC20 tokens (refer to Figure 27 below). This surge indicates an amplification in liquidity from the most sizable stablecoin within crypto markets.

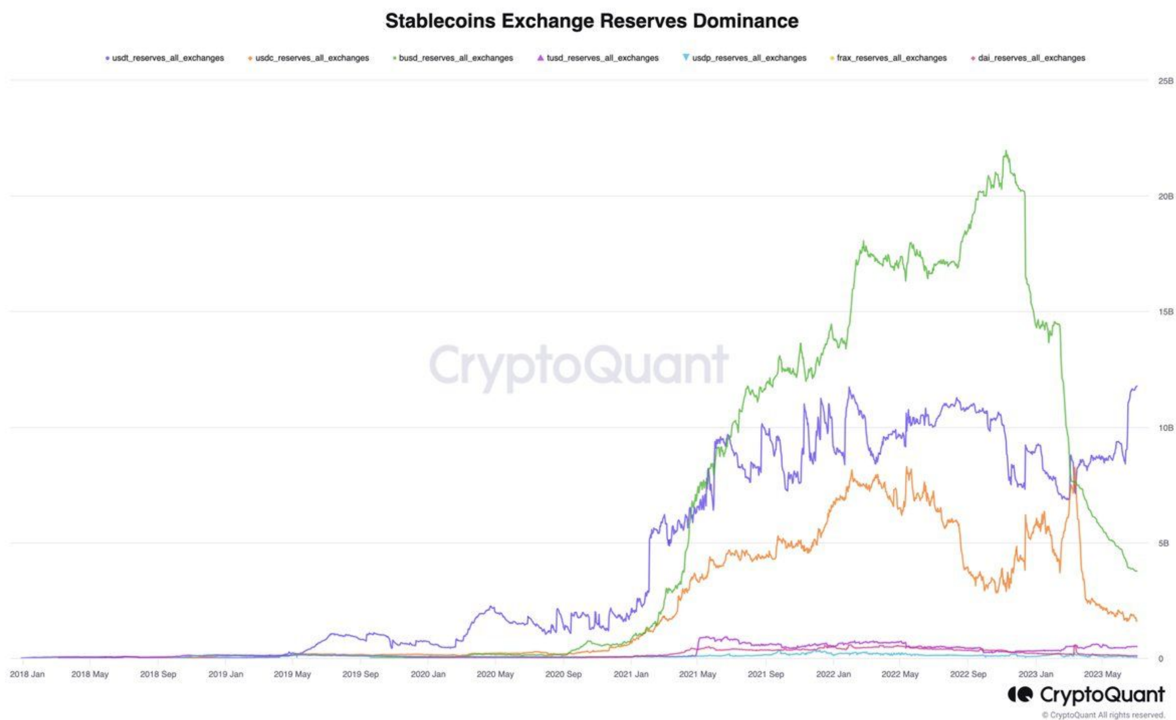


Figure 27. Stablecoins Exchange Reserves Dominance. (source: CryptoQuant)

The liquidity of the largest stable coin has seen a significant increase, while that of Bitcoin, the leading cryptocurrency, has experienced a decrease. This shift in liquidity dynamics could potentially have far-reaching implications.

The increase in stablecoin liquidity suggests a growing demand for stable assets, possibly driven by the uncertain economic climate and faith in crypto as a safe haven asset. Tether is also by far the easiest method globally to gain exposure to the US dollar. Historical trends between stablecoins exchange balances and BTC/Ether prices have shown that when stablecoin supply on exchanges increases, there is a higher probability of prices bottoming out.

Data also suggests that newly issued USDt is predominantly received by exchanges, currently 100 percent of newly issued assets. This has increased from 83.33 percent in the last 90 days. (refer Figure 28 below)

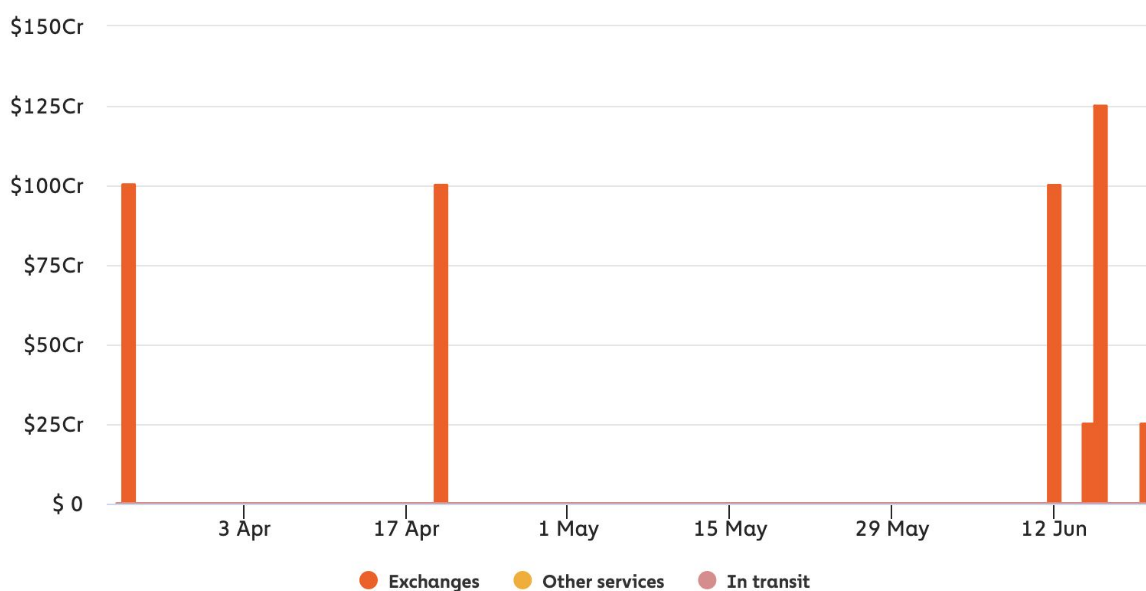


Figure 28. USDt destination for freshly issued coins. (source: Chainalysis)

However, exchange reserves for all stablecoins are down 52 percent for the year. (refer to Figure 29 below) This could be primarily because of Binance's legal troubles spilling over to an exodus away from the BNB chain and the BUSD stablecoin.

Figure 29. Total Stablecoin Exchange Reserves. (source: CryptoQuant)

We also note the decrease in Bitcoin liquidity, which likely reflects the growing trend of long-term holding of the asset by Bitcoin investors as discussed earlier.

Figure 30. Bitcoin Exchange Reserves vs Price. (source: CryptoQuant)

As more investors hold onto their Bitcoin, less of it is available for trading, leading to decreased liquidity. This trend of 'HODLing' is often seen as a sign of confidence in the long-term value of Bitcoin, despite short-term market fluctuations. Based on *chainalysis* data, Illiquid BTC held has increased by 73.09k BTC which is a 1.5 percent increase month-over-month on average in the last month, the largest rise in 31 weeks. (refer Figure 31 below)

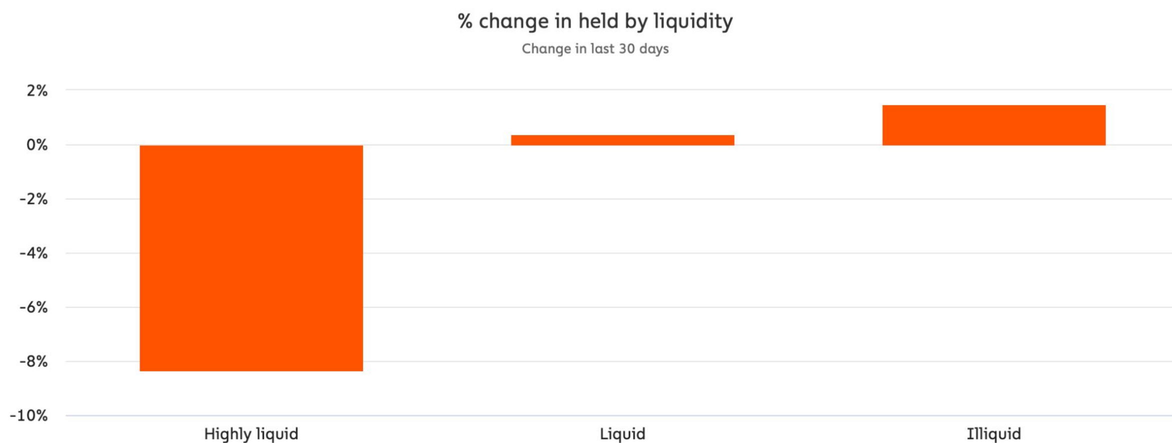
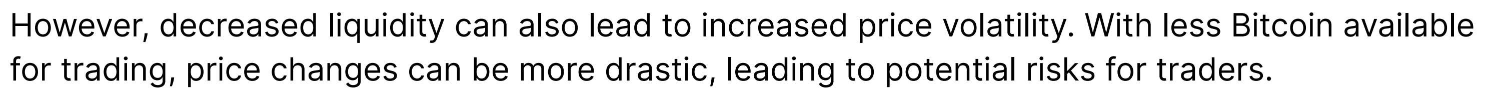


Figure 31. Percentage change by liquidity cohorts of Bitcoin. (source: Chainalysis)



However, decreased liquidity can also lead to increased price volatility. With less Bitcoin available for trading, price changes can be more drastic, leading to potential risks for traders.

The contrasting trends in the liquidity of USDt and Bitcoin highlight the diverse dynamics at play in the crypto market. While the decrease in overall stablecoin liquidity suggests a cautious sentiment, that can be due to the regulatory crackdown against certain exchanges. The decrease in Bitcoin liquidity could signal confidence in its long-term value, despite potential short-term risks.

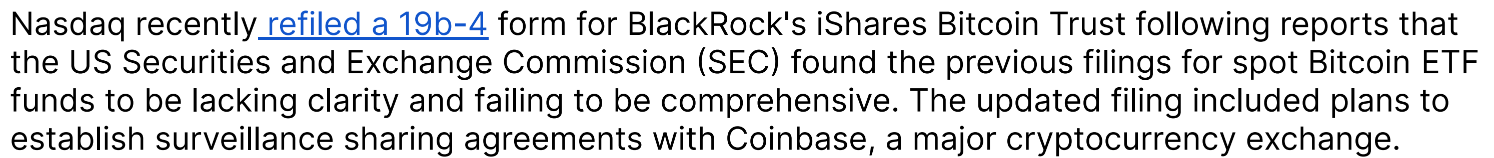
NEWS FROM THE CRYPTO-SPHERE

BlackRock CEO Larry Fink Embraces Bitcoin as BlackRock's Bitcoin ETF Application Receives Attention

Figure 32. BlackRock CEO Larry Fink Embraces Crypto as BlackRock's Bitcoin ETF Application Receives Attention

- **BlackRock CEO Larry Fink is open to collaborating with regulators regarding BlackRock's Bitcoin ETF filing and emphasizes the importance of working closely with them.**
- **Nasdaq refilled a form for BlackRock's Bitcoin Trust, including plans to establish surveillance sharing agreements with Coinbase, as the approval of a spot Bitcoin ETF by the SEC remains pending.**

BlackRock CEO Larry Fink expressed his willingness to collaborate with regulators and address any concerns they may have regarding BlackRock's recent filing for a spot Bitcoin exchange-traded fund (ETF). In an interview with Fox Business, Fink emphasised the importance of working closely with regulators and stated that he wanted to get their input into Blackrock's application. He said he viewed Bitcoin as a means of "digitising gold" and believed in the democratisation and cost-effectiveness that crypto could bring to investors. However, Fink clarified that he personally did not own any Bitcoin.



Nasdaq recently refiled a 19b-4 form for BlackRock's iShares Bitcoin Trust following reports that the US Securities and Exchange Commission (SEC) found the previous filings for spot Bitcoin ETF funds to be lacking clarity and failing to be comprehensive. The updated filing included plans to establish surveillance sharing agreements with Coinbase, a major cryptocurrency exchange.

Discussing Bitcoin more broadly, Fink expressed his belief in the increasing digitization of assets, and referred to Bitcoin as an alternative investment option. BlackRock initially filed for a Bitcoin ETF on June 15th, sparking a trend among other asset managers, including Fidelity, to follow suit. In the aftermath, Bitcoin's value surged by 19 percent over the past month.

However, the approval of a spot Bitcoin ETF by the SEC remains pending. The agency has previously cited concerns about fraud and potential market manipulation when assessing similar applications. The recent filings may face further challenges and scrutiny from the SEC.

While Fink acknowledged his previous scepticism about cryptocurrencies due to their association with illicit activities, he now sees their potential to revolutionise finance. He highlighted the opportunities created by the tokenization of assets and securities, with Bitcoin playing a pivotal role. Fink's positive outlook reflects a shift in his sentiment toward crypto, and a recognition of the asset as a potential digital gold.

Gemini Co-Founder Demands Repayment of $1.47 Billion from Digital Currency Group in Ultimatum

Figure 33. Gemini Co-Founder Demands Repayment of $1.47 Billion from Digital Currency Group in Ultimatum

- **Gemini co-founder Cameron Winklevoss issues a final offer demanding repayment of $1.47 billion from Digital Currency Group (DCG) or face a potential lawsuit, due to over $1.2 billion of assets stuck in Genesis Global.**
- **The proposal requires DCG to make payments totaling $1.465 billion, with an initial payment of $275 million by July 21st.**

Gemini co-founder, Cameron Winklevoss, has issued a final offer to Barry Silbert, founder of Digital Currency Group (DCG), demanding the repayment of a total debt of $1.47 billion or face a potential lawsuit. In an open letter, Winklevoss expressed frustration over the delay in resolving the issue concerning Gemini Earn users, who have over $1.2 billion of assets stuck in Genesis Global, a subsidiary of DCG, which Gemini worked with.

Best and Final Offer - July 3, 2023	
Forbearance Payment	**$275 million** due on Plan Support Agreement (PSA) Effective Date. • **PSA Effective Date** on or before **July 21st** • Denominated in **4,632 BTC** and **USD** • **BTC valued** on PSA Effective Date
Debt - Tranche 1	**$355 million** due in 2 years from PSA Effective Date. • Denominated in **40% USD** | **40% BTC** | **20% ETH*** • **BTC** and **ETH valued** on PSA Effective Date • **First Lien** • DGC to pay down using 100% of excess cash > $40 million • Interest rate & prepayment penalties consistent with par trading on Amended Plan Effective Date. *Tranche 1 + Forbearance Payment = $630 million due since May 9-11.*
Debt - Tranche 2	**$835 million** due in 5 years from PSA Effective Date. • Denominated in **40% USD** | **40% BTC** | **20% ETH*** • **BTC** and **ETH valued** on PSA Effective Date • **Second Lien** (converts to First Lien upon maturity of Tranche 1) • DGC to pay down using 60% of excess cash > $40 million • Interest rate & prepayment penalties consistent with par trading on Amended Plan Effective Date. **BTC price is capped at $100K, ETH price is capped at $10K.* *Tranche 2 reflects the restructuring of the $1.1 billion 10-year promissory note.*
Total	**$1.465 billion**
Sale Proceeds	DCG retains all proceeds from the sale of Genesis Global Trading. Creditors retain all proceeds from the sale of all other Genesis companies.
3AC	All parties reserve their rights with respect to Three Arrows Capital (3AC) and all 3AC recoveries.
Luno Setoff	Tranche 2 has been lowered by $25 million.
FTX / Alameda	DCG will absorb any payouts to the FTX and Alameda bankruptcy estates that exceed $300 million in the aggregate.
Other	DCG will contribute $100 million to the Genesis bankruptcy estate once it receives the AVAX / NEAR tokens from the 3AC bankruptcy estate.

Figure 34. Cameron Winklevoss' "Best and Final Offer" for DCG

The proposal presented by Winklevoss includes a demand for DCG to make payments amounting to $1.465 billion, which encompasses a missed $630 million payment due in May. The payment terms span five years, with an initial payment of $275 million required by July 21st. Winklevoss emphasised that the offer represents the minimum acceptable to creditors.

Figure 35. Cameron Winklevoss threatened legal action against DCG on Twitter

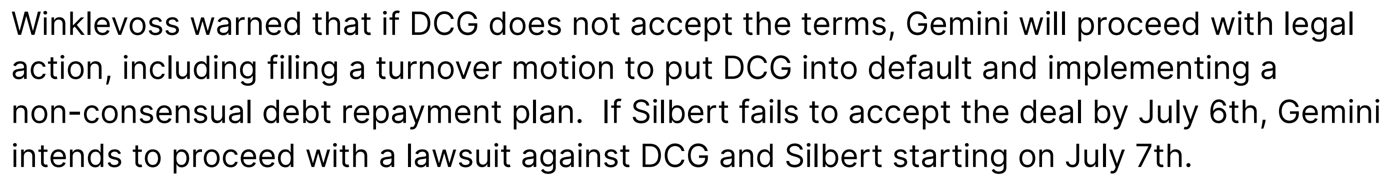
Gemini had previously threatened legal action against DCG and Silbert after Genesis Global filed for Chapter 11 bankruptcy protection in January. DCG, which faced credit issues during the crypto credit crisis, has been in negotiations with Genesis creditors but failed to make a $630 million payment to Genesis in May.

Gemini provided an update on June 30th, stating that the mediation period had been extended to July 5th to determine the contribution to be made by DCG. Gemini expressed disappointment over the delay in negotiating a DCG contribution and reaffirmed its commitment to pressuring DCG to repay what it owes to Genesis and compensate the Earn lenders affected by Genesis's failure to return assets.

In his letter, Winklevoss alleged Silbert had committed fraud and deception, and had knowingly misled creditors about DCG absorbing losses amounting to $1.2 billion. Winklevoss asserted that DCG only provided a "long-dated promissory note" to offset the losses and has since made no significant progress.

> In closing, I've seen a lot of bad behavior from you and your colleagues over the last 9 months, but perhaps the most disturbing part is something you said to me this Fall — that you're a victim in all of this. It takes a special kind of person to owe $3.3 billion dollars to hundreds of thousands of people and believe, or at least pretend to believe, that they are some kind of victim. Not even Sam Bankman-Friend was capable of such delusion. In the end, he at least recognized how his actions had hurt others and attempted to make things right. I can say confidently that I speak for all Earn users when I say, it's time for you to do the right thing.
>
> Sincerely,
>
> Cameron Winklevoss

Figure 36. Excerpt from the Open Letter of Cameron Winklevoss to Barry Silbert



Winklevoss warned that if DCG does not accept the terms, Gemini will proceed with legal action, including filing a turnover motion to put DCG into default and implementing a non-consensual debt repayment plan. If Silbert fails to accept the deal by July 6th, Gemini intends to proceed with a lawsuit against DCG and Silbert starting on July 7th.

On July 7th, Gemini filed a lawsuit against DCG and its CEO after DCG failed to meet the exchange's deadline for accepting a restructuring deal for their troubled unit.

According to a DCG spokesperson, they anticipate resolving the Genesis bankruptcy case in the near future.

The spokesperson stated, "Any allegations of misconduct against DCG or its employees are unfounded, libelous, and completely untrue. From the beginning, DCG has been committed to finding a mutually agreeable resolution for all parties involved in the Genesis bankruptcy."

Despite the lending unit of Genesis initially outlining a plan to emerge from bankruptcy by May, it has not yet reached a consensus on a restructuring proposal with its creditors, who are owed more than $3 billion, as stated in court documents.

South Korea Passes Virtual Asset User Protection Act, Establishing Legal Framework for Digital Assets

Figure 37. South Korea Passes Virtual Asset User Protection Act, Establishing Legal Framework for Digital Assets

- **South Korea's National Assembly approves the Virtual Asset User Protection Act, marking the country's first step in creating a legal framework for virtual assets.**
- **The legislation defines digital assets, introduces penalties for unfair transactions, and imposes requirements on service providers to ensure user protection.**

South Korea's National Assembly has successfully passed the Virtual Asset User Protection Act, signalling the country's initial move towards establishing a legal framework for virtual assets.

Consisting of 19 proposals put forth by lawmakers, the legislation will come into effect in the following year. It provides definitions for digital assets and outlines penalties for unfair transactions. Service providers will be required to separate user assets, obtain insurance coverage, hold a portion of reserves in cold wallets, and maintain transaction records.

Under the new law, the Financial Services Commission will be granted authority to oversee and inspect service providers, while the Bank of Korea will have the right to request data from these providers.

Increased scrutiny surrounding virtual assets in South Korea has been prompted by an investigation into a local legislator's cryptocurrency holdings and the collapse of Terraform Labs last year.

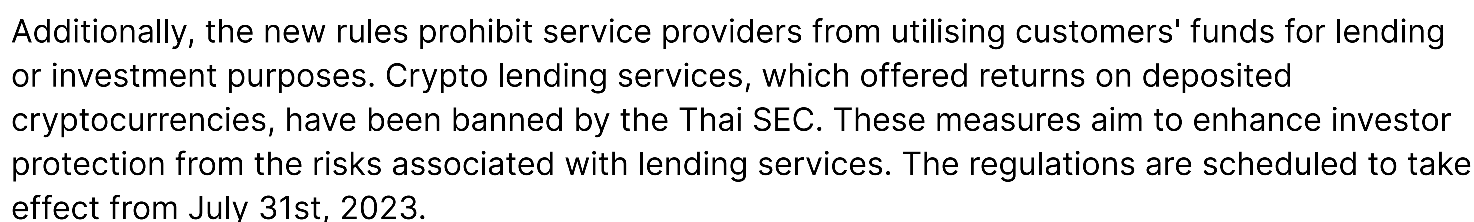
Thailand's SEC Introduces New Rules for Digital Asset Service Providers to Enhance Investor Protection

Figure 38. Thailand's SEC Introduces New Rules for Digital Asset Service Providers to Enhance Investor Protection

- **Thailand's SEC introduces new regulations requiring digital asset service providers to display prominent warnings about the high risks of cryptocurrency trading.**
- **The rules also ban crypto lending services and prohibit service providers from using customers' funds for lending or investment, aiming to enhance investor protection and prevent similar incidents seen during the 2022 bear market.**

In a move to safeguard investors, Thailand's Securities and Exchange Commission (SEC) has implemented new regulations for digital asset service providers, focusing on the disclosure of risks associated with cryptocurrency trading.

Under the guidelines, digital asset service providers are required to prominently display a warning message that emphasises the high risks involved in cryptocurrency investments. The message must read, "Cryptocurrencies are high risk. Please study and understand the risks of cryptocurrencies thoroughly because you may lose the entire investment amount." Prior to utilising the services, customers must give their consent and acknowledge these risks.



Additionally, the new rules prohibit service providers from utilising customers' funds for lending or investment purposes. Crypto lending services, which offered returns on deposited cryptocurrencies, have been banned by the Thai SEC. These measures aim to enhance investor protection from the risks associated with lending services. The regulations are scheduled to take effect from July 31st, 2023.

Discussions regarding investor protection regulations began on September 1, 2022, when the SEC approved the inclusion of security warnings for cryptocurrency business operators to disclose the risks involved in crypto trading. Further discussions held on December 1st, 2022, and May 11th, 2023, resulted in the formulation of rules prohibiting digital asset business operators from providing deposit-taking and lending services.

These new investor protection rules stem from a significant crypto lending crisis that occurred during the 2022 bear market. Numerous crypto lending firms, which attracted billions in customer deposits by promising substantial returns, collapsed during the market downturn. Prominent lending companies like Celsius and BlockFi filed for bankruptcy, leaving investors with their funds stuck in bankruptcy proceedings. The implementation of the new regulations aims to prevent such incidents and bolster investor confidence in the digital asset market.

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