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EXECUTIVE SUMMARY

Markets were left reeling last week as Bitcoin plunged below the psychologically significant $25,000 mark. This recent downward spiral was accompanied by a hair-raising $1 billion in futures liquidations.

Before this tumble, Bitcoin had been enjoying an almost serene market period, with historically low volatility levels, with bulls looking for the next catalyst to take the market higher. But the winds were changing. A spike in Open Interest in the futures market was a signal that the market was poised for a sharp move. It seems many may have been positioned the wrong way, and by the time the storm passed, a staggering $3 billion in Open Interest had been obliterated.

Drivers included a combination of: concern about continued high interest rates, bankruptcy at one of China's largest property developers, and reports of Bitcoin sales by SpaceX. Those issues, combined with a highly leveraged market, provided a perfect recipe for a sharp price drop.

Yet, while historical volatility rocketed, it was the surge in implied volatility – the market's crystal ball – that should make investors take notice. This metric is still higher than historical volatility, and suggests traders are bracing for even more choppy waters ahead. The aftermath of this shakeout also reveals a rising trend in Bitcoin options open interest. This might be the market's hedge against more chaos or a savvy bet on continued volatility.

Parsing the July Fed minutes, it is clear that policymakers are grappling with the decision to implement further rate hikes as they acknowledge the threat of resurgent inflation. All eyes are now on Fed Chair Jerome Powell's upcoming Jackson Hole speech on the economic outlook.

Economic data continues to be mixed. The retail sector displayed unexpected exuberance, registering a sturdy 0.7 percent growth in July, suggesting consumers are yet undaunted by inflation's looming shadow. However, the housing arena offers a starker story; aspirations of homeownership are jeopardised by skyrocketing mortgages and spiralling prices, even as homebuilding surged 6.7 percent in July.

With builders slashing prices to attract potential buyers, the mortgage rate menace looms large. Manufacturing, another significant pillar, defied odds with a July rebound, especially in motor vehicles, surging 5.2 percent. Yet, the Leading Economic Index's 16-month decline, paints a tableau of contrasts.

In crypto news, London-based Jacobi Asset Management unveiled the Europe's first spot Bitcoin ETF on Euronext Amsterdam, putting it ahead of the US, where similar efforts have met regulatory pushback.

On the other side of the globe, the CME Group acknowledges Asia Pacific's rising crypto clout. Joining forces with CF Benchmarks, they're launching Bitcoin and Ether reference rates tailored for the region's bustling trading hours. Meanwhile, Ripple Labs fiercely countered the SEC's bid for an early appeal in the ongoing battle to determine whether Ripple's XRP is a security. Ripple argues the SEC's appeal is both premature and unfounded.

We also take a deep dive into China and show how its economy is showing increasingly widening cracks. Beneath its powerhouse status lurk tales of a real estate debacle, as seen in real-estate giant Evergrande's dramatic fall and threats of deflation in the economy. As factory prices plummet and Beijing navigates stormy waters with policy shifts, the world waits with bated breath. The dragon might be faltering, but it's far from its final act. From business discussions to markets, everyone is closely watching China's next steps.

Happy trading!

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WHAT'S ON-CHAIN THIS WEEK?

Bitcoin Crashes Below $25,000 with over $1 Billion in Liquidations

The Bitcoin price dropped to below the $25,000 level for the second time since March 2023 (refer to Figure 1 below). On August 17th, BTC recorded the largest daily red candle in percentage terms of -7.3 percent since it crashed below $16,000 following the collapse of FTX in November 2022.

Figure 1. BTC/USD Daily Chart. (source: Bitfinex)

One of the major recent bullish catalysts for price expansion was the news that major TradFi players like Blackrock, were pushing for spot Bitcoin ETF approvals. This all came undone last week. In an extremely volatile and perpetuals driven move, BTC crashed to sub-$25,000 levels before it found support, and settled at $25,200, which is the exact level from which the price had previously bounced on June 14th, before its rally past $30,000.

The downward move was accompanied by a major open interest (OI) wipeout, and one of the largest daily liquidation figures in the history of the asset class, which at over $1 billion (refer Figure below), was larger than the FTX collapse in November 2022. At one point, there were a total of $720 million in long liquidations in just one hour.

Figure 2. Total Liquidations Across Centralised Exchanges vs BTC price. (source: coinglass)

Prior to the collapse to $25,000, the price had been hovering around the local range low of around $29,000 with some of the lowest volatility figures in Bitcoin's history. However, most of the market moves had recently been increasingly perp driven. This is evident from the fact that there was an Open Interest (OI) ramp up in the BTC futures markets prior to the crash to over $14 billion (refer to Figure 3 below). OI has increased gradually throughout this year, almost to the 2021 bull market average after reaching values as low as $9.5 billion at the beginning of the current calendar year.

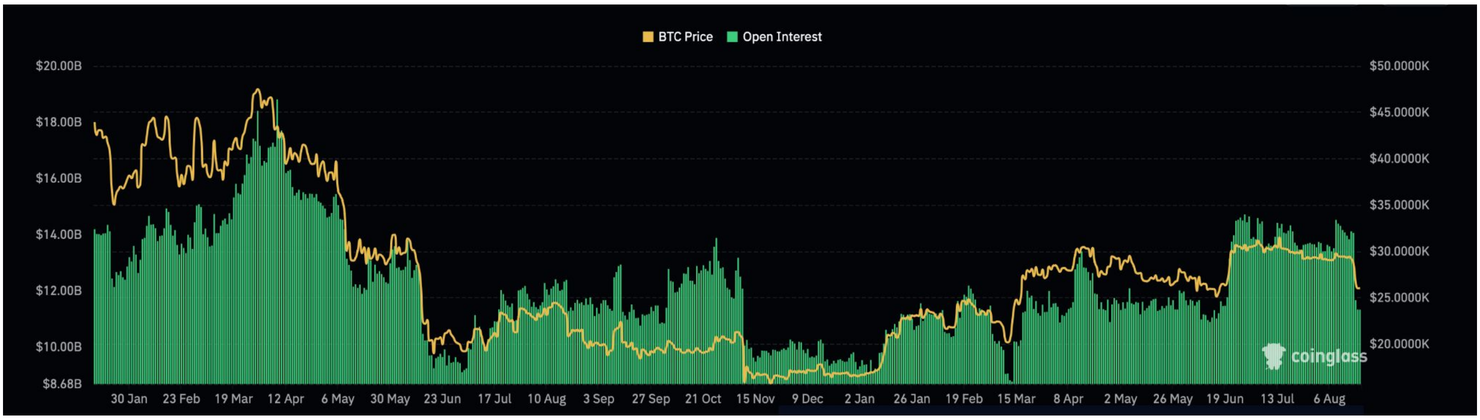


Figure 3. BTC price vs Open Interest Daily Chart. (source: coinglass)

This was one of the largest OI wipeouts in a single day in US dollar notional terms. Almost $3 billion in OI was wiped out in the span of a few hours of the crash, and it saw one of the largest reductions in day-to-day OI since December 2021, when BTC posted its all-time high above $69,000.

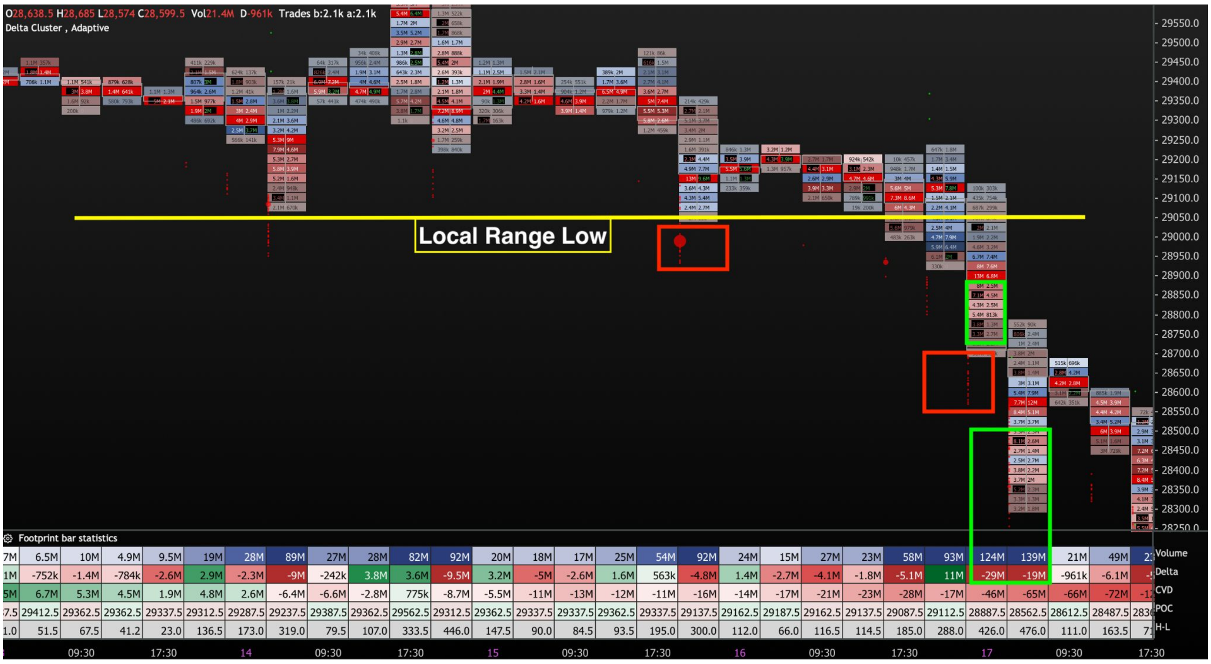


Figure 4. BTC/USD perpetual 2H chart. (source: exocharts)

Before the collapse, BTC was ranging on the lower time frames with very low historical volatility metrics. The local range low was $29,000. As is evident from the green boxes in the Figure above, there was negative perp sell delta. This means that the price was being driven down on August 16th and 17th with only minor bounces amid net market shorting. There was also a decent number of long liquidations whenever price wicked below the local range low (refer to red box, Figure 4).

Negative Delta is when there's higher market selling volume compared to buying volume. Negative Delta at the bottom (local range low on August 16th-17th) shows that the selling was absorbed by Limit orders set by bigger traders on the spot markets. Orderflow data showed that most of the selling delta was from perps. In addition to this, there were larger spot bidders, who were probably dollar-cost-averaging spot positions down to the $27,800 level or hedging their futures positions from earlier when the BTC price broke below its July range.

The major price dip to $25,000 was catalysed in a single -8.1 percent five-minute candle on Coinbase (refer to Figure 5 below) as bids till $27,800 were filled as stated earlier but increasing selling pressure (negative delta imbalance) on perpetuals pushed the price lower to a point where a large trader was likely forced to market sell their spot position, perhaps to meet a margin call, although at this stage, this is at best speculation.

Figure 5. BTC/USD 5 minute chart from August 17th. (source: coinalyze)

The spot cumulative volume delta (CVD) and the buy/sell volume indicators show how spot positions were immediately market sold, this is made apparent by the lack of buying volume on that particular candle before an immediate lower timeframe buy-back which was probably a result of algorithmic trading systems rebalancing the BTC price across exchanges via arbitrage. During such scenarios where the price has a flash crash due to large market sells on one exchange, the price falls immediately on that exchange before others, thus creating an arbitrage opportunity for quick-to-respond high frequency algorithms to buy BTC for cheap there and sell elsewhere for a quick profit.

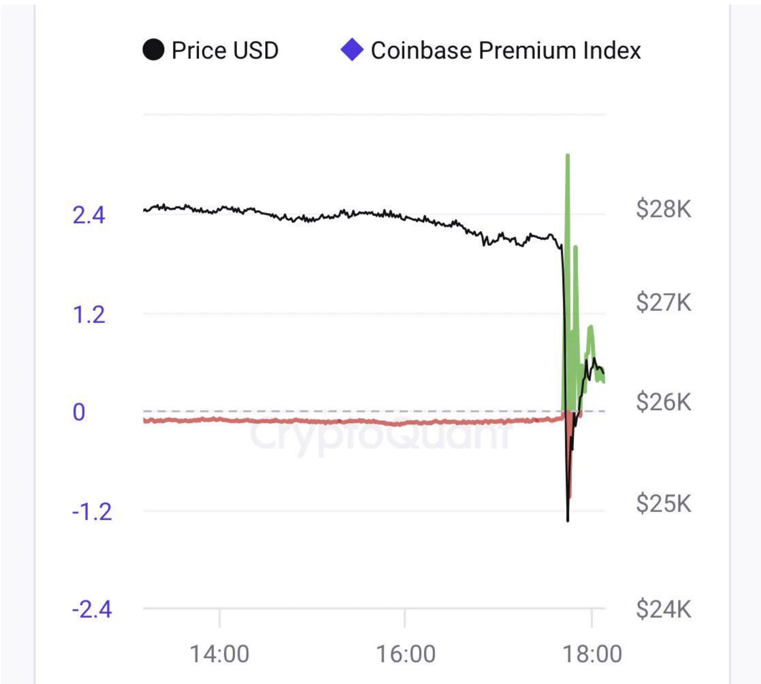


Figure 6. Coinbase Premium Percentage. (source: CryptoQuant)

Following this move, the Coinbase spot price was in fact moving at a premium to other exchanges. This could potentially indicate that whales bought the dip to take the price back above $25,000, which is a crucial psychological support level, given it is where Blackrock announced its application for a spot BTC ETF.

Volatility Uptick as Expected

On August 18th, Bitcoin's daily historical volatility metric BVOL24H increased by 5.82 (refer green box in Figure below). This is the largest increase in volatility in absolute terms since November 2022 following the FTX collapse.

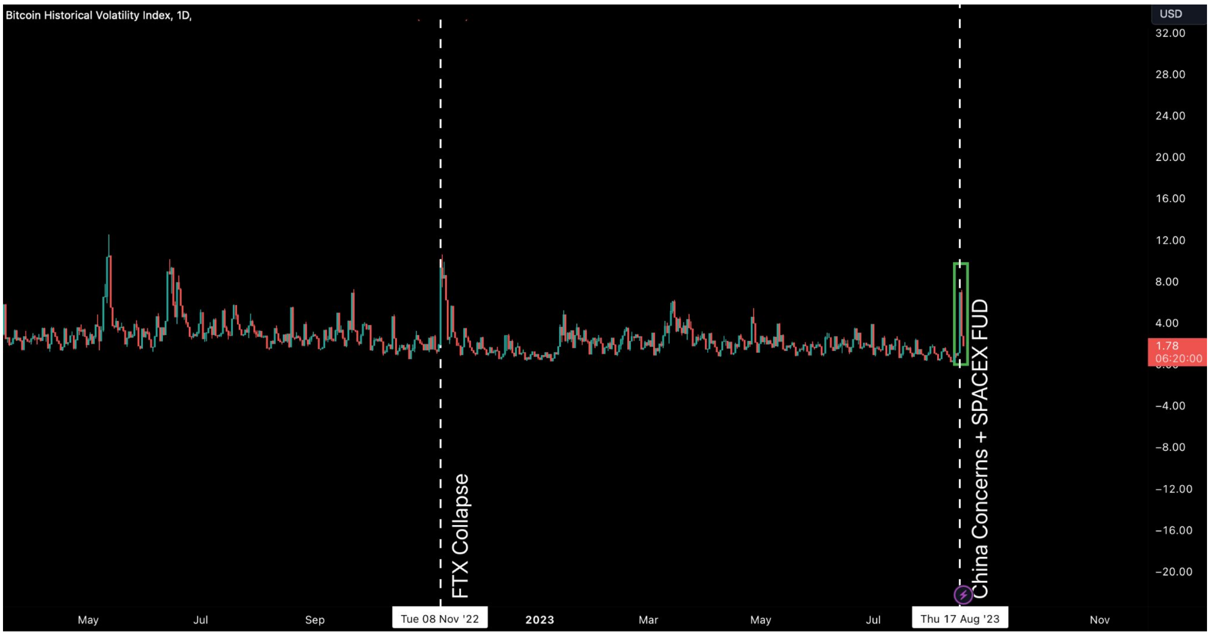


Figure 7. Bitcoin Daily Historical Volatility. (source: Tradingview)

In previous editions of [Bitfinex Alpha,]() we have discussed how , whenever historical volatility has been at or near all-time lows, alongside low implied volatility, there is usually a violent move brewing in the market. Such was the case on August 18th. Below we re-evaluate correlated metrics to ascertain whether volatility is here to stay and make a sustained comeback.

Historical Volatility (HV) reflects the actual past movement or fluctuation of an asset price, giving a quantitative measure of past volatility. It is based on historical data, such as stock prices from the previous days, weeks, or months. HV is typically calculated using the standard deviation of the log returns of the asset over a specified period of time. It is a backward-looking metric, meaning it is derived from actual past price changes.

Implied Volatility (IV), on the other hand, is a forward-looking measure and reflects the market's expectations about the future volatility of an asset. Unlike HV, IV is not based on the past price data of the underlying asset itself, but rather is inferred from the prices of options on that asset. It is a critical component of options pricing models, such as the Black-Scholes model. IV can be thought of as the market's forecast of a likely range for an asset's price in the future, and it is often used by traders to assess potential future price risks.

The Current Market Scenario:

- The Bitcoin market has experienced a significant drop in price.
- Liquidations, especially long positions, are nearing record levels.
- A significant amount of open interest has been wiped out from the market.
- There has been notable spot selling.

When HV jumped to 32 percent on August 17th (refer to Figure 7 below), it signalled a pronounced shift in market dynamics. Historically, Bitcoin's price had been somewhat predictable, but this change in HV pointed to a newfound turbulence. More interestingly, the subsequent plateauing or flatlining of HV suggests a market acceptance of this elevated volatility, hinting that traders have adjusted their strategies to this "new normal" of heightened price fluctuations.

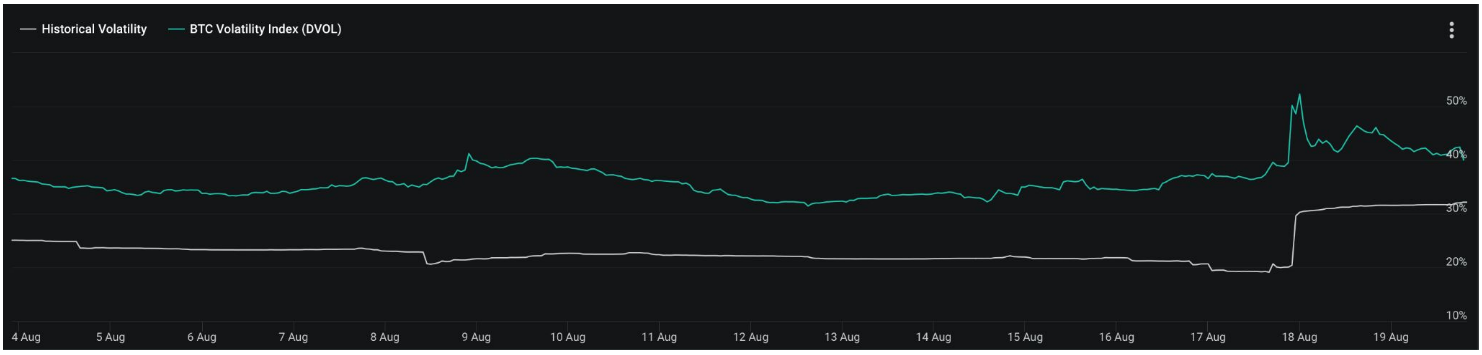


Figure 7. Bitcoin Historical vs Implied Volatility. (source: Deribit)

A more striking development was the surge in Implied Volatility (IV) to 40 percent. Unlike HV, which reflects past price movements, IV gives us a window into the future, or at least the market's expectations of it. The fact that IV outpaced HV indicates that traders, especially those dealing in options, foresee even wilder price swings ahead. This anticipation could stem from various factors, from macroeconomic shifts to regulatory changes, but the underlying message is clear: brace for even stormier seas ahead in the crypto market.

With the open interest wipeout however, it is estimated that another highly volatile move could be slightly further away in the short term. There are multiple reasons for this, one is the estimated leverage ratio.

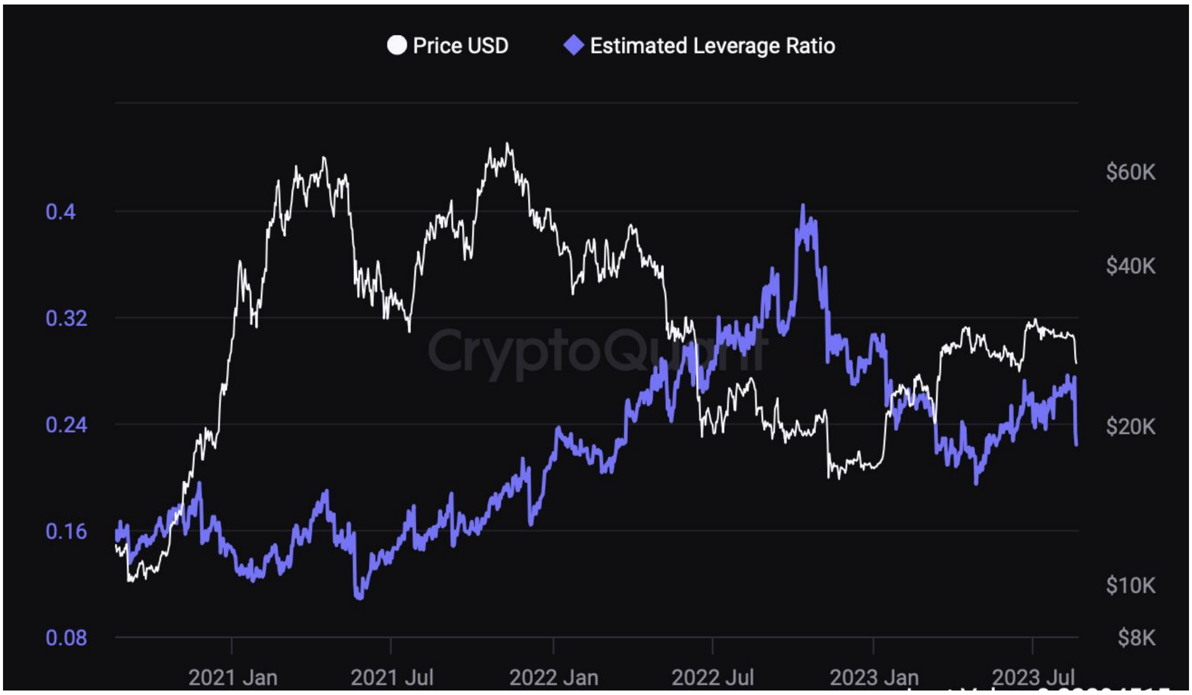


Figure 8. Estimated Leverage Ratio vs BTC price. (source: CryptoQuant)

The above metric is a representative of the open interest divided by the Bitcoin reserve ratio for exchanges, aggregated market wide. This is a representative of increasing leverage in the Bitcoin markets which is usually a precursor to increased volatility as seen in the chart recently.

The moment this continues to increase again above the 0.24 pivotal level, it could signal another volatile move on the horizon. Even after one of the largest OI wipeouts in the asset classes history, the metric remains significantly above historical ratios, and in tandem with the IV readings, it suggests that volatility will continue to increase over the next month at least.

The peculiar trend since the sell-off has also been the increasing options OI, which is also trending higher consistently despite the perpetuals market OI wipeout. (refer to Figure 9 below)

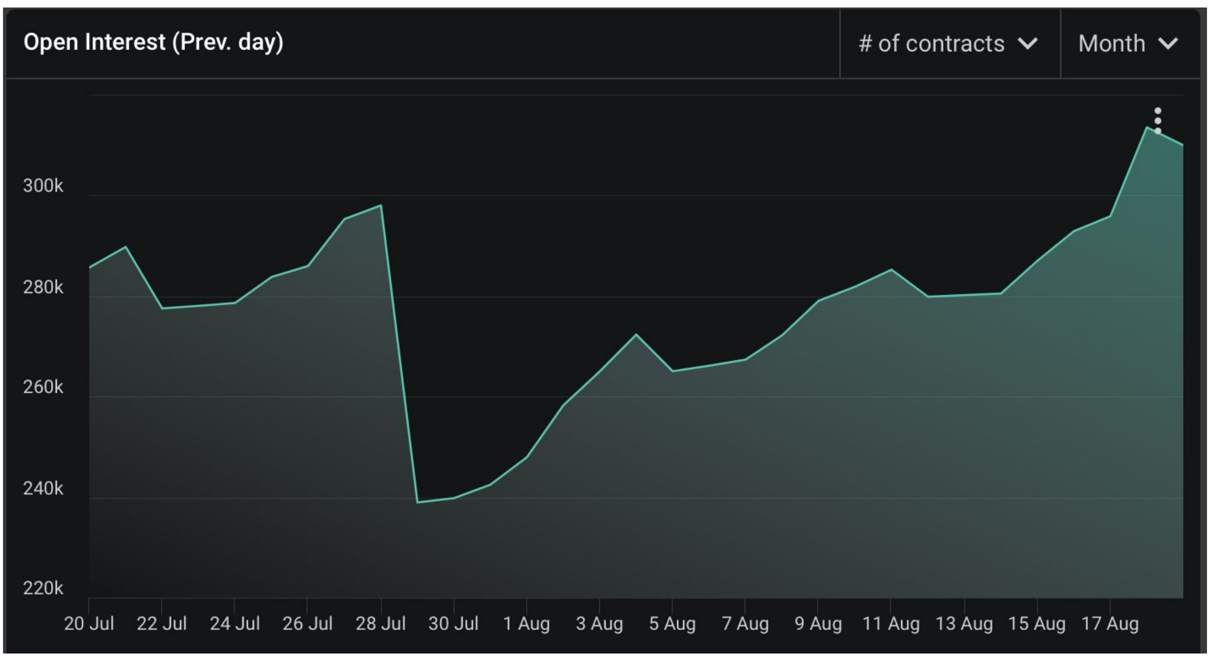


Figure 9. Bitcoin Options Open Interest. (source: Deribit Metrics)

This increase can be attributed to two different scenarios: hedging and long/short volatility strategies. In a volatile market, traders and investors may seek options as a tool to hedge against further adverse price movements. Buying put options, for example, can provide insurance against further declines in the underlying asset. In terms of long/short volatility strategies, options are a way to bet on volatility itself, not just price movements. In turbulent times, traders might expect high volatility to continue and use options strategies (like straddles or strangles) to profit from this. Data suggests that long volatility strategies have been deployed extensively over the weekend after the price crashed below the $25,000 level.

GENERAL MARKET UPDATE

FOMC Meeting Minutes: Federal Reserve Divided on Interest Rate Hikes

Federal Reserve officials are continuing to grapple with the pivotal decision of whether to implement further interest rate hikes as they confront the looming threat of resurgent inflation, according to minutes from the Federal Open Market Committee's (FOMC) meeting in July, which were released last Thursday, August 17th.

The minutes shed light on the internal divisions within the committee regarding the appropriate course of action to address inflation while maintaining economic stability. The central bank is walking a fine line, aiming to balance the objective of curbing inflationary pressures without stifling the ongoing economic recovery.

During the July meeting, the FOMC voted unanimously to raise interest rates by a quarter of a percentage point, pushing the benchmark fed funds rate to a range of 5.25 percent to 5.50 percent. However, the minutes revealed that despite the unanimous vote, at least two committee members expressed reservations about the timing of the rate hike, suggesting that keeping rates steady might have been more appropriate. This faction within the Federal Reserve holds the belief that maintaining the status quo could be the optimal strategy to foster progress toward the committee's dual mandate of stable prices and maximum sustainable employment. This would also allow for a more thorough assessment of the economic ramifications of previous rate increases.

Of the "almost all participants" who favoured raising rates to counter inflationary pressures and restore price stability, this action was seen as a step toward balancing supply and demand imbalances in the economy. The minutes underscored the ongoing concern regarding the risk of inflation, with most committee members viewing the inflation risk as "significant" and indicating that further interest rate hikes might be necessary to address it effectively.

Despite acknowledging some positive indicators in the economy, including moderate economic expansion and stronger-than-anticipated real economic activity, the committee is still grappling with the uncertainty surrounding the economic outlook. The tightening of financial conditions since the previous year and the potential for economic weakening and rising unemployment were highlighted as potential challenges.

In Federal Reserve Chairman Jerome Powell's press conference, he emphasised the data-dependent approach that the Fed would take in making future rate decisions. Powell noted that while progress is being made, the desired effects of the policy might not have fully materialised yet.

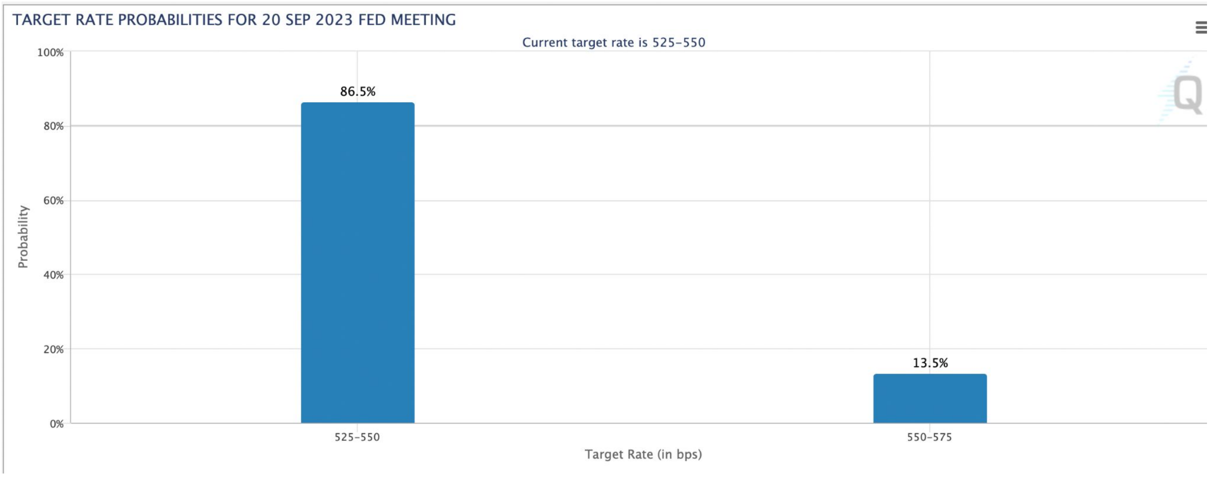


Figure 10. Target Rate Probabilities for September, As of August 17th 2023 (Source: CME FedWatch Tool)

Market sentiment suggests that the Fed might pause its rate increases in the near term, with the CME FedWatch Tool indicating an 88.5 percent likelihood of the benchmark rate remaining steady in September (refer to Figure 10 above).

The minutes also set the stage for the upcoming Jackson Hole conference, where Chair Powell is expected to reiterate the Fed's data-dependent approach and address the mixed views within the committee. The conference may provide further insights into the Fed's stance on interest rates and its strategies to navigate the economic challenges posed by inflation and other uncertainties.

Strong Resilience in US Retail Sales for July, Surpassing Expectations

In a surprising turn of events, US retail sales for July surpassed expectations, demonstrating the robust spending behaviour of American consumers. The Commerce Department's report released on Tuesday, August 15, revealed a 0.7 percent increase in retail sales for July (refer to Figure 11 below), outpacing the consensus forecast of 0.4 percent growth.

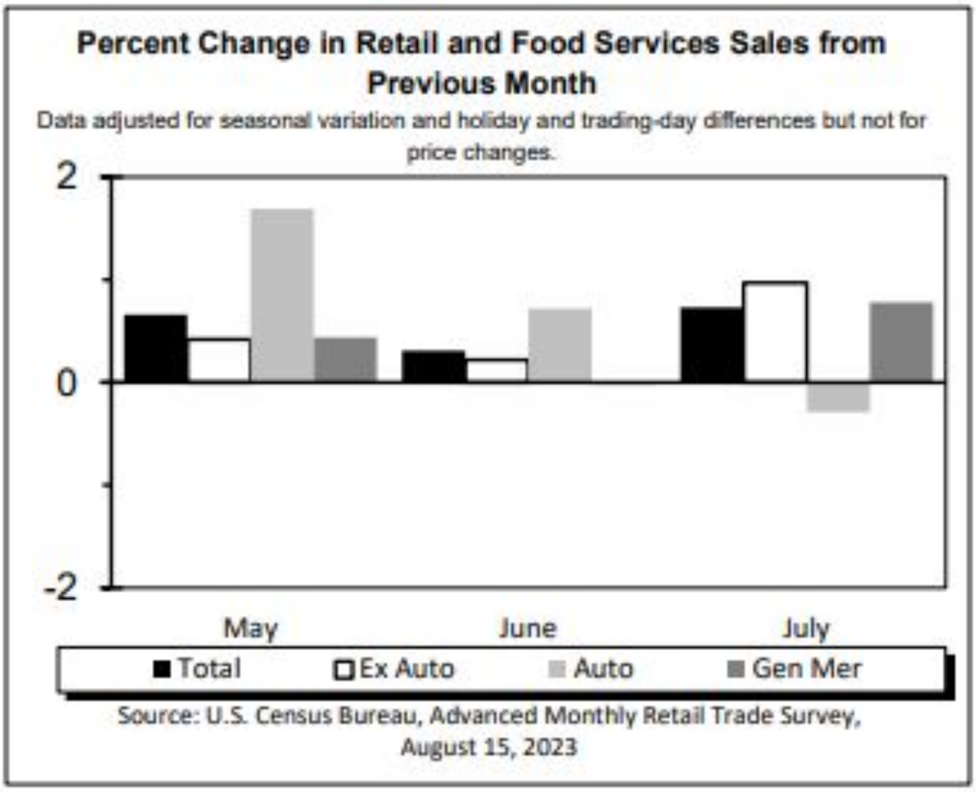


Figure 11. Month-over-Month (MoM) percentage change in US Retail Sales. (source: US Census Bureau)

Consumer spending has continued to thrive, supported by strong wage gains attributed to a tight labour market. The resilience exhibited by consumers is noteworthy, especially in light of the Federal Reserve's assessment of “significant” inflation risk.

The positive retail sales figures has however also contributed to increased optimism that the US economy could achieve a "soft landing" instead of plunging into a feared recession: consumers have persevered and managed to sustain their spending habits.

The report showcased diverse spending patterns among different categories. Online retail sales led the growth with a substantial 1.9 percent surge. Purchases in sporting goods, hobbies, books, musical instruments, and dining out at food service and drinking establishments also experienced notable gains of 1.5 percent and 14 percent, respectively.

The overall strength in retail sales is seen as a reflection of consumer confidence, however while the momentum appears strong, there is reasonable concern that slowing job growth and increased credit card balances could eventually impact spending patterns.

As the labour market continues to play a pivotal role in consumer spending, many experts remain watchful for any signs of significant labour market changes that could influence consumer habits. Despite this, the solid performance of core retail sales, which closely aligns with the consumer spending component of GDP, suggests that consumer spending is off to a promising start in the third quarter of the year.

With retail sales exceeding expectations and demonstrating consumers' resilience, the possibility of a "soft landing" for the US economy gains traction. As the year unfolds, we will continue to monitor consumer behaviour and its potential impact on the nation's economic trajectory.

US Home Builder Confidence Dips Amidst Soaring Mortgage Rates and Housing Prices

Home builder confidence in the United States experienced a decline in August, marking the first downturn this year. The latest report, released Tuesday, August 15th, revealed that the National Association of Home Builders (NAHB) /Wells Fargo Housing Market Index retreated from a peak of 56 in July to 50 (refer to Figure 12 below) in August, highlighting a waning optimism among builders. This downturn in confidence comes as prospective buyers grapple with record-breaking mortgage rates and persistently high housing prices.

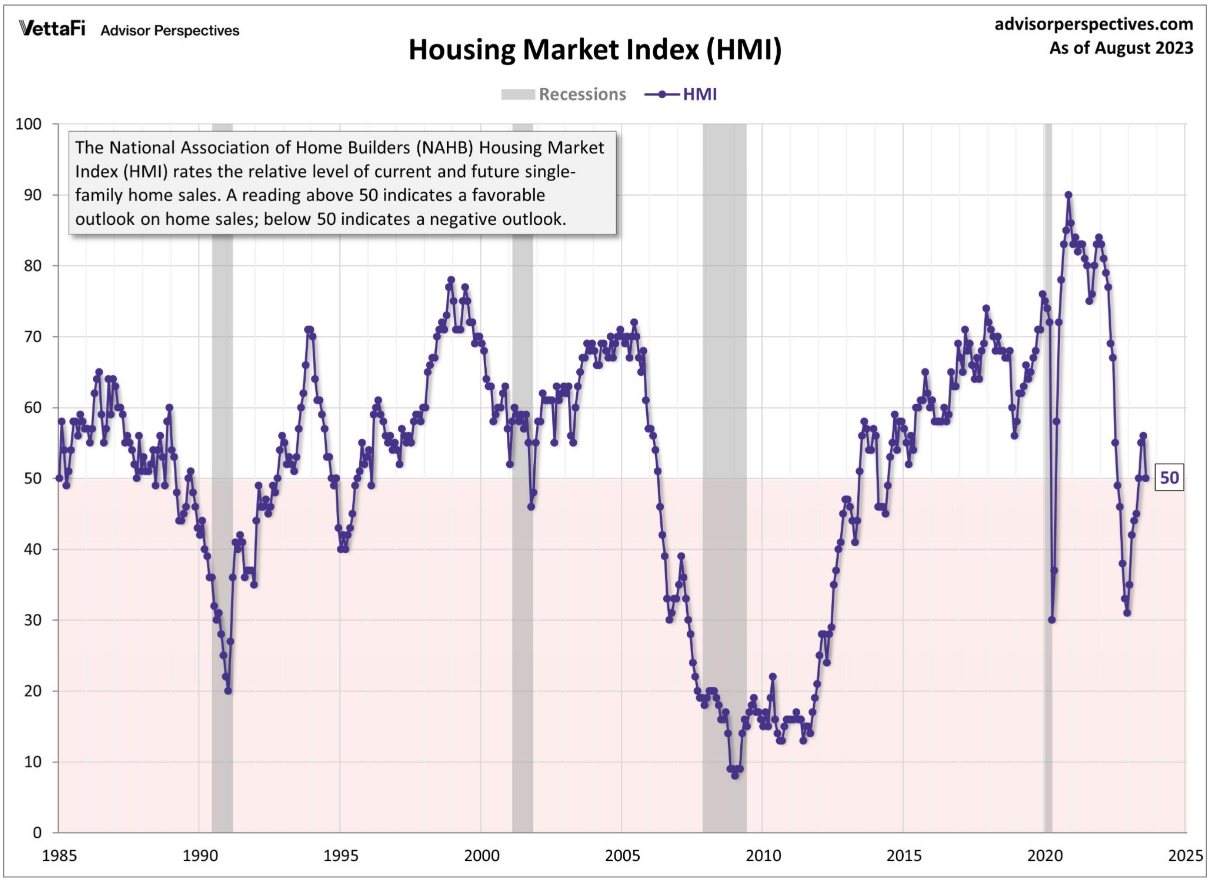


Figure 12. Housing Market Index (Source: NAHB, Chart from Advisor Perspectives)

A significant contributing factor to the diminished builder confidence was the drop in prospective buyer traffic. The figure fell to 34 in August from a year-long high of 40 recorded in July. The consensus forecast was a steady builder confidence level of 56.

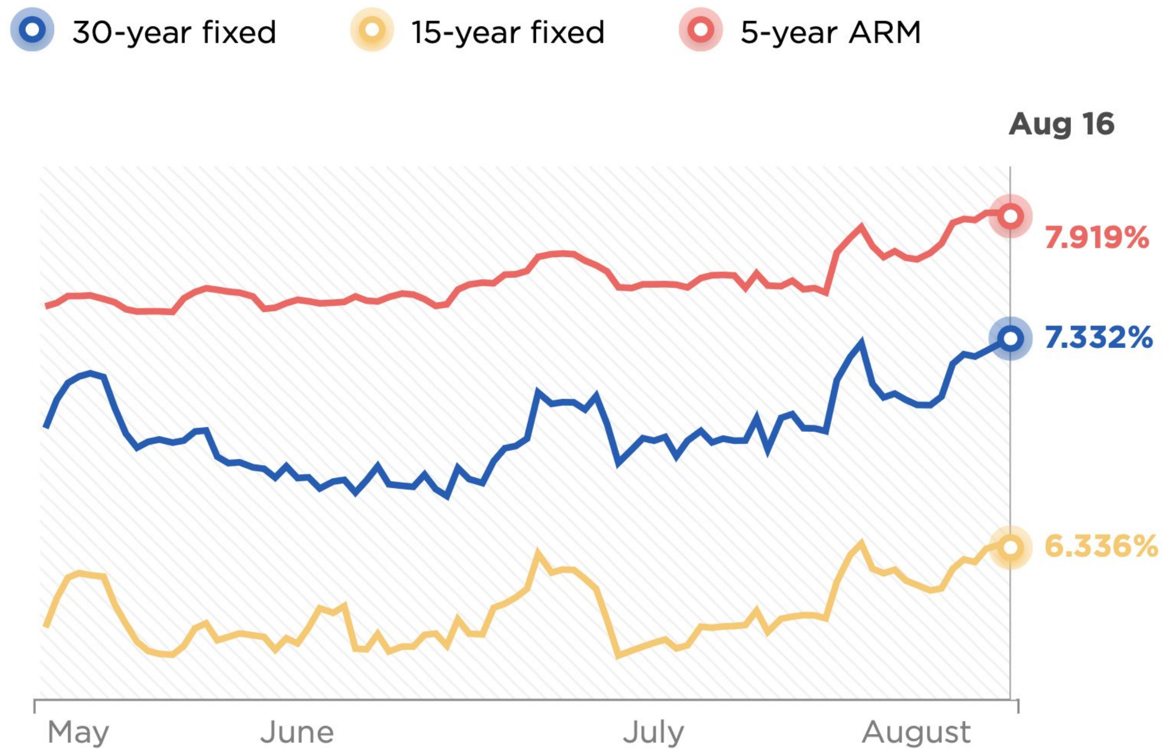


Figure 13. US Mortgage Rates, as of August 16 2023 (Source:Nerdwallet.com)

The surge in builder confidence observed during the first half of the year was largely attributed to robust demand for new homes. This demand was a direct consequence of the limited availability of existing homes on the market.

However, with the most aggressive interest rate hiking cycle by the Fed in history, mortgage rates have continually increased and surged past the seven percent mark last month (refer Figure above). This rise in mortgage rates has prompted a reluctance among many existing homeowners to put their properties up for sale, further exacerbating the shortage of available homes.

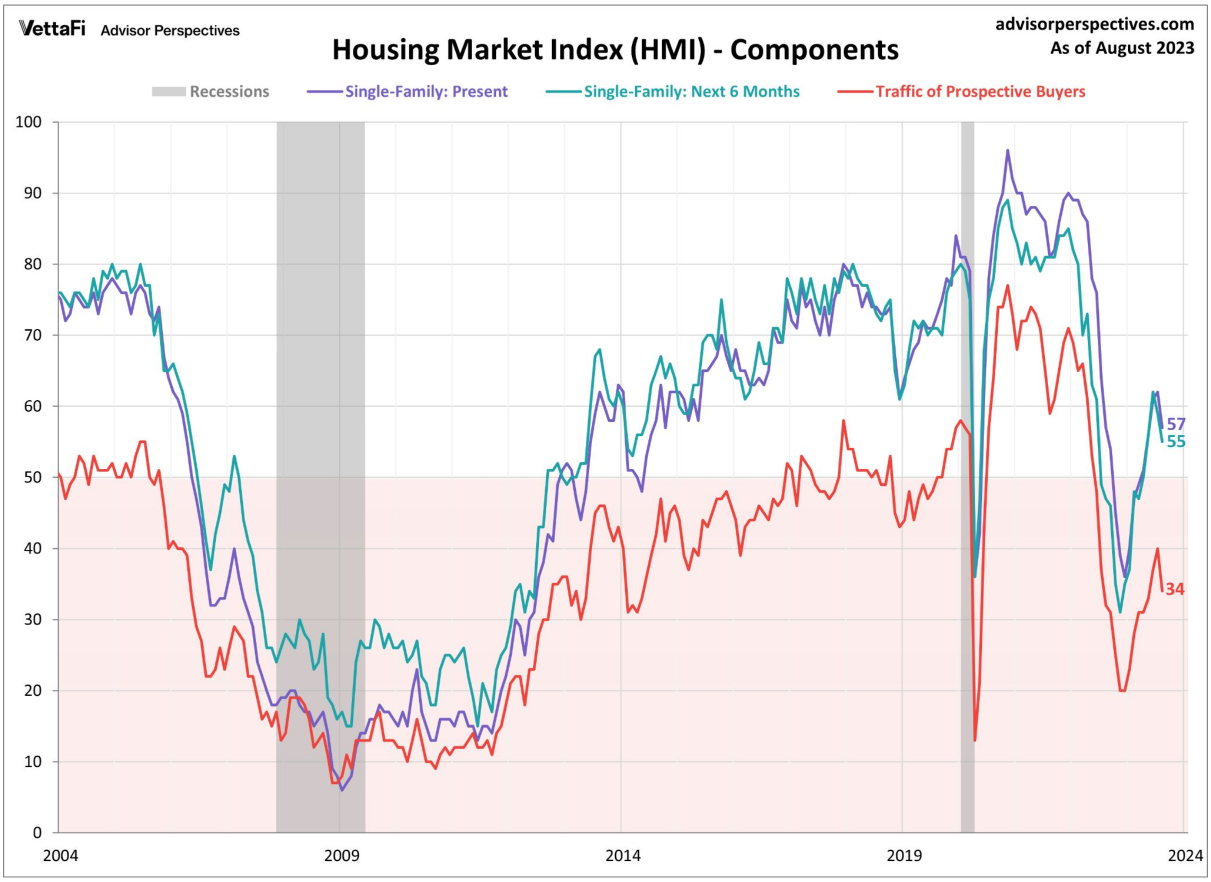


Figure 14. Housing Market Index (HMI) - Components (Source: NAHB, chart from Advisor Perspectives)

In a noteworthy shift within the housing market, August saw a significant 25 percent of total builders implementing price cuts to stimulate sales, marking the first instance of such reductions since March. Furthermore, builders' sales expectations for the upcoming six months have cooled, sliding from a reading of 59 in July to 55, as indicated in Figure 14 above. This suggests that the proportion of builders resorting to price reductions might increase further in an effort to entice potential buyers. These broader price cuts could potentially aid the US central bank's ongoing battle against inflation.

The recent data coincided with the significant rise in shelter inflation which has accounted for a substantial 90 percent of the Consumer Price Index move last month. The dynamics of the US housing market continue to be influenced by a delicate interplay of factors, including mortgage rate fluctuations, housing prices, and builder sentiment. As the housing industry grapples with the challenges of balancing affordability and demand, policymakers and market participants alike face the task of finding sustainable solutions to ensure a healthy housing market for all stakeholders.

US Factory Production Rebounds Unexpectedly in July, Driven by Motor Vehicles

Seasonally adjusted

Industrial production	2017=100						Percent change						
	2023 Feb. r	Mar. r	Apr. r	May r	June r	July p	2023 Feb. r	Mar. r	Apr. r	May r	June r	July p	July '22 to July '23
Total index	102.6	102.6	103.1	102.7	101.9	102.9	.0	.1	.5	-.4	-.8	1.0	-.2
Previous estimates	102.6	102.7	103.3	102.8	102.2		.0	.1	.6	-.5	-.5		
Major market groups													
Final Products	101.2	101.2	102.4	101.8	100.7	101.9	-.2	.0	1.2	-.6	-1.1	1.2	.2
Consumer goods	102.2	102.4	103.8	103.0	101.5	102.9	.0	.2	1.3	-.7	-1.5	1.4	.2
Business equipment	96.5	95.4	96.5	96.0	95.7	96.6	-.7	-1.1	1.2	-.6	-.3	1.0	-.2
Nonindustrial supplies	100.9	100.5	100.0	99.9	99.4	99.6	-.2	-.4	-.5	-.1	-.4	.2	-2.6
Construction	102.8	100.9	101.7	101.5	101.2	101.0	-1.0	-1.8	.7	-.1	-.3	-.2	-2.7
Materials	104.2	104.6	104.8	104.5	103.7	104.8	.3	.3	.2	-.3	-.8	1.1	.3
Major industry groups													
Manufacturing (see note below)	99.9	99.0	99.8	99.6	99.0	99.5	.3	-.8	.8	-.3	-.5	.5	-.7
Previous estimates	99.9	99.1	100.1	99.9	99.6		.4	-.8	1.0	-.2	-.3		
Mining	117.5	118.1	119.2	118.4	117.3	117.9	-1.0	.5	.9	-.7	-.9	.5	2.0
Utilities	100.5	106.8	104.3	103.6	100.5	105.9	-.8	6.2	-2.3	-.7	-3.0	5.4	-.9

Figure 15. Industrial Production in the United States (Source: The Federal Reserve)

Industrial production in the United States experienced an unexpected rebound during the month of July. The Federal Reserve's recent report released last Wednesday, August 16, shed light on the dynamics at play, with manufacturing output increasing by 0.5 percent (refer Figure 15 above, yellow box). This reverses the previous month's decline of 0.5 percent, which had been revised downward from the initially reported 0.3 percent. The consensus forecast was for manufacturing output to remain unchanged.

The U.S. manufacturing sector, a substantial component of GDP accounting for 11.1 percent of total output, has found itself navigating turbulent waters in recent months. This is largely due to escalating borrowing costs triggered by the Fed's assertive monetary policy stance. Since March 2022, the central bank has implemented a series of interest rate hikes, cumulatively raising its benchmark overnight rate by 525 basis points.

These higher rates, aimed at reining in inflation, has had manufacturing feeling the pinch acutely. For an industry reliant on financing for operations, expansion, and capital expenditure, the increased cost of borrowing can squeeze margins, dampen investment appetites, and slow overall activity. The manufacturing sector’s performance will be a critical barometer for assessing the broader impact of the tightening cycle. These elements mean that year-on-year industrial production is still down 0.7 percent.

Nonetheless, glimmers of stabilisation appear on the horizon for the manufacturing industry. The Institute for Supply Management (ISM) noted that while its measure of national factory activity contracted for the seventh consecutive month in July, the pace of contraction had slowed.

The robust demand for goods also played a role in the unexpected rebound and in particular the resurgence in the motor vehicle sector, which saw a remarkable 5.2 percent rise in output in July. This followed a 3.9 percent decline in June, reflecting seasonal fluctuations and possible difficulties in data adjustment.

Typically, July sees a drop in production due to plant retooling in the automotive industry. However, these seasonal plant closures do not always materialise, which can complicate data interpretation and analysis. Beyond motor vehicles, the durable manufacturing sector experienced increases in output for machinery and computer and electronic products. Conversely, there were declines in electrical equipment, appliances, primary metals, and furniture production.

Mining output, which had faced a 0.9 percent dip in June, rebounded with a 0.5 percent increase in July. The utility sector saw a significant surge of 5.4 percent in production, driven by high temperatures across the country that escalated demand for air conditioning (refer to Figure 15, redbox)

When considering the broader industrial picture, including mining and utilities, overall industrial production shot up by 1.0 percent in July, rebounding from the 0.8 percent drop observed in June (refer to Figure X, green box)

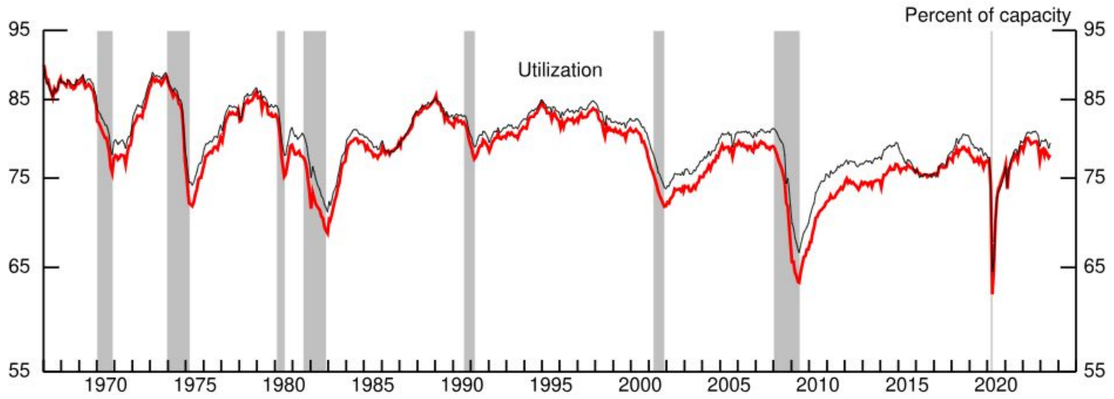


Figure 16. Capacity utilisation in the US (Source: The Federal Reserve)

Capacity utilisation, a key metric, gauges the extent to which industries are employing their productive resources. It serves as a significant indicator of the health of the manufacturing sector and provides insights into potential inflationary pressures.

In July, capacity utilisation for the industrial sector climbed to 79.3 percent, marking an appreciable increase from the 78.6 percent reported in June. Despite this upward movement, the July figure still sits 0.4 percentage points shy of the long-run average, as highlighted by the Federal Reserve's report.

While the challenges of higher borrowing costs and fluctuating production patterns persist, the unexpected rebound in factory production, particularly in the motor vehicle sector, provides a glimmer of hope for a more stable manufacturing landscape in the months ahead. As economists and analysts closely monitor these trends, industrial production and capacity utilisation reports continue to offer valuable insights into the state of the US economy.

US Homebuilding Surges Despite Mortgage Rate Concerns

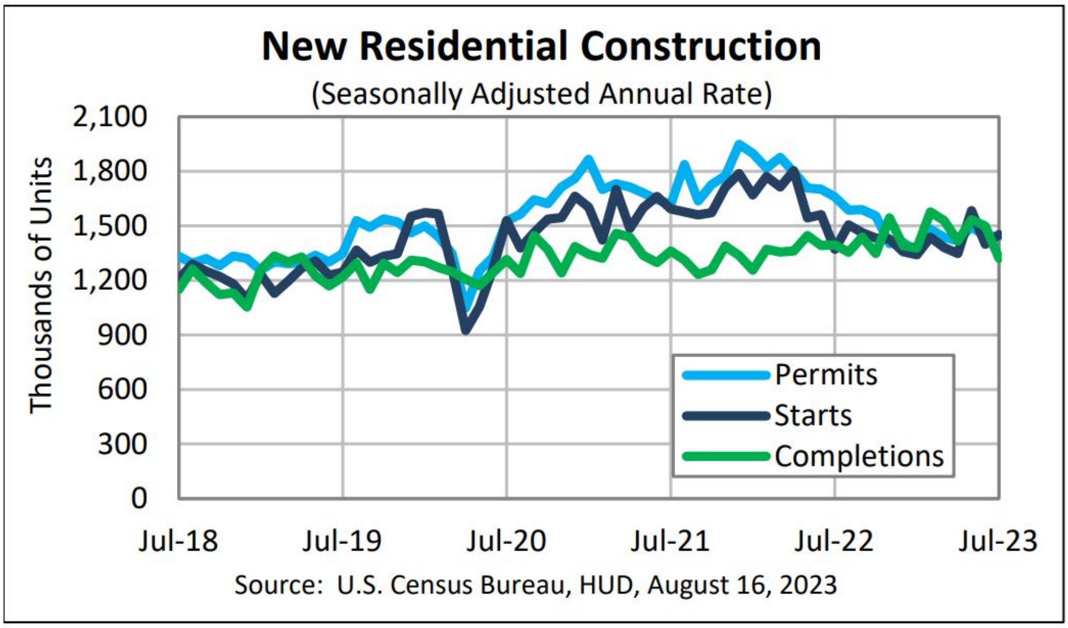


Figure 17. New Residential Construction (Source: US Census Bureau)

Amidst a climate of economic resilience, the US economy has once again defied predictions of a downturn as single-family homebuilding saw notable growth in July. The Census Bureau's latest report revealed a rebound in the construction of single-family housing units, offering a glimmer of hope in a housing market plagued by an acute shortage of existing homes. However, concerns loom as mortgage rates near two-decade highs could potentially slow down the positive momentum.

The increase in single-family housing starts, a significant component of overall homebuilding, painted a positive picture for the economy. The Census Bureau's data released last Wednesday, August 16th, revealed that single-family housing starts surged by 6.7 percent, reaching a seasonally adjusted annual rate of 983,000 units. This encouraging uptick in home construction was particularly driven by strong activity in the West, where single-family starts skyrocketed by 28.5 percent.

A closer examination of the housing market reveals that despite the growth in housing starts, supply remains constrained. The number of approved houses for construction yet to be initiated saw a slight dip of 0.4 percent in July. The inventory of single-family housing under construction also fell by 0.7 percent to a rate of 678,000 units. Meanwhile, multi-family housing under construction reached its highest level since 1970, registering a 1.1 percent increase to 986,000 units.

The rebound in the housing market is not without its challenges, primarily stemming from climbing mortgage rates. These elevated rates have triggered a decline in confidence among homebuilders, as previously reported above. The US housing market is currently presenting a complex narrative with conflicting signals, as two recent reports shed light on divergent trends in builder confidence and single-family homebuilding. These reports reflect the intricate interplay between market conditions, economic factors, and consumer sentiment.

One prominent factor influencing the downturn in builder confidence is the current state of mortgage rates, which are contributing to buyer hesitancy. These elevated rates are impacting the affordability of homes for potential buyers, potentially deterring demand and affecting the profitability of builders.

Moreover, the rise in mortgage rates could potentially curtail the momentum seen in single-family homebuilding. As these rates influence the affordability of homes, prospective buyers might face challenges in entering the market, which could ultimately affect the demand for newly constructed homes. The divergent trends in these reports reflect the complexity of the current housing market landscape. Builder confidence is a reflection of how industry professionals perceive the market's trajectory, while single-family homebuilding numbers provide a tangible measure of construction activity. The surge in homebuilding could be influenced by a range of factors, including pent-up demand, government policies, and localised market dynamics. The question of sustainability and the potential effects of external factors, such as the Fed's monetary policy decisions, remain crucial to understanding the long-term trajectory of the housing market.

Economic Landscape Presents Divergent Signals Amidst Growth and Caution

The Conference Board Leading Economic Index (LEI) for the U.S. declined by 0.4 in July 2023, marking a 16-month consecutive decrease, according to the latest [Leading Economic Index (LEI) report](), released last Thursday, August 18th. The LEI, which anticipates economic trends, fell due to weak new orders, high-interest rates, and reduced manufacturing hours (see Figure 18 below).

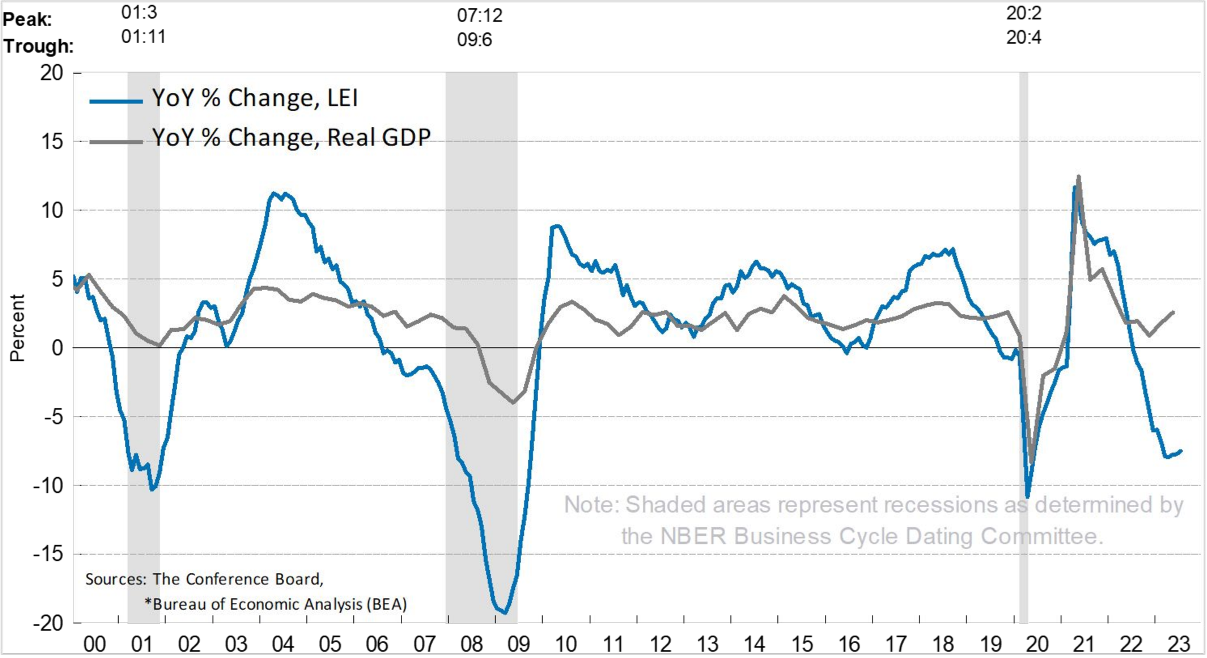


Figure 18. Leading Economic Index (Source: Bureau of Economic Analysis)

The economic arena finds itself entangled in a tale of contrasts, as various indicators offer contradictory narratives surrounding the trajectory of US economic growth. While retail spending basks in promising trends, a steadfast labour market stands resilient, home construction sees robust activity, and the manufacturing sector remains buoyant, a shadow of caution looms large with the revelation of a persistent decline in the leading economic index.

The leading economic index, which is a compilation of ten indicators aimed at gauging the economy's overall health, registered a decline of 0.4 percent in July. Traditionally, such a trend has been associated with imminent recessions. However, the current scenario challenges conventional wisdom as other indicators counter this apprehension.

Intriguingly, the coincident index, assessing present conditions, defies the leading indicator's sombre tone, as it posted a 0.4 percent rise in July. This variance underscores the complexities of the economic landscape, where seemingly opposing trends coexist.

Amidst these mixed signals, market participants grapple with the question of whether the leading indicator's predictive power remains steadfast or has been muddled by the economy's resilience. Officials at the Conference Board, acknowledge the challenging landscape, and that the resiliency of the economy might be altering the conventional relationship between leading indicators and recessions.

Nonetheless, the Conference Board says it remains cautious. The prediction of a potential short and shallow recession, as the LEI is indicating, in the latter part of 2023 and early 2024 hints at the underlying uncertainty in the economy's trajectory.

Given the rapid increase in interest rates, the potential for damper economic growth remains very real.

Case Study

Case Study: China's Current Economic Challenges and Real Estate Crisis

Figure 19. People's Republic of China, the second largest global economy has faced severe economic challenges in 2023.

China, a global economic powerhouse, has long been a subject of intrigue and admiration for its remarkable growth story. However, recent events have illuminated a more complex tale of economic challenges and structural shifts. This past week in particular, worsening unemployment and property market issues have proven to have global repercussions.

A Bumpy Road To Recovery

China's economy has faced a series of challenges in recent years, resulting in slower-than-expected growth and concerns about deflation. After implementing a strict "zero-COVID" policy for three years, there were expectations that the Chinese economy would recover in 2023. However, various metrics have indicated differently. Key economic indicators such as retail sales, industrial output, and investment all grew at a pace slower than anticipated in July. These challenges have put deflationary pressure on the world's second-largest economy with imports and exports both falling to multi-month lows.

The initial expectation for recovery was driven by a rebound in consumption, which was to be supported by the normalisation of economic activities, a resurgence in employment rates, and stability in the property sector. The economy did rebound as projected in the first quarter, particularly in property and exports.

Figure 20. China Retail Sales and Industrial Production (Soure: Tradingeconomics)

However, the second quarter witnessed stumbling blocks. The property sector's recovery faltered, accompanied by declining housing sales and starts. Moreover, local governments faced financial constraints due to increasing local debt, leading to tightened fiscal spending, which further hindered growth. Consequently, the industrial sector began destocking, and the consumption-driven recovery decelerated, resulting in a notable economic growth slowdown in the second quarter.

It was a domino effect which is still in play, borne of a housing downturn, initially through deliberate government measures to reduce debt in the economy and now an uncontrolled contagion scenario with Evergrande, a large Chinese property developer, declaring bankruptcy, with another, Country Garden, on the same path as its competitor.

Policy Shifts and Anticipated Measures: Navigating the Storm

China's senior leadership acknowledged the difficulties facing the economy during a Politburo meeting in late July. They pledged to step up stimulus measures to stabilise the economy as it faced “new” difficulties and a “torturous recovery”, including an easing of fiscal policy, increased credit support for infrastructure investment, and a modest easing of property policies. The goal was to achieve a quarter-on-quarter growth rate of 4-4.5 percent in the third and fourth quarters, aiming for an annual GDP growth of approximately five percent in 2023, in line with the government's target.

Unveiling the Real Estate Crisis

One significant factor affecting China's economy however, is the real estate market. Several major property developers, such as Evergrande, Sino Ocean, Country Garden, SUNAC, and R&F Properties, have been grappling with a substantial debt crisis. On August 17th, Evergrande Group, formerly China's second-largest real estate developer, initiated bankruptcy proceedings in New York. This move falls under Chapter 15 bankruptcy protection, enabling a U.S. bankruptcy court to intervene when a bankruptcy case spans international borders.

The government's tightening measures on the property market in previous years, combined with shifts in long-term real estate demand and supply, have led to a deep downturn in the sector. This downturn has not only affected property prices but has also raised concerns about the financial stability of property developers and the broader economy.

Real estate investment in China witnessed a substantial decline, plummeting 10 percent in 2022 and a further eight percent in the first half of 2023. Private companies had fueled real estate investment before the correction. With private real estate enterprises now engaging in deleveraging and focusing on completing pre-sold but unfinished projects, the real estate sector is poised to exert a drag on the pace of private investment growth, signifying a lingering challenge.

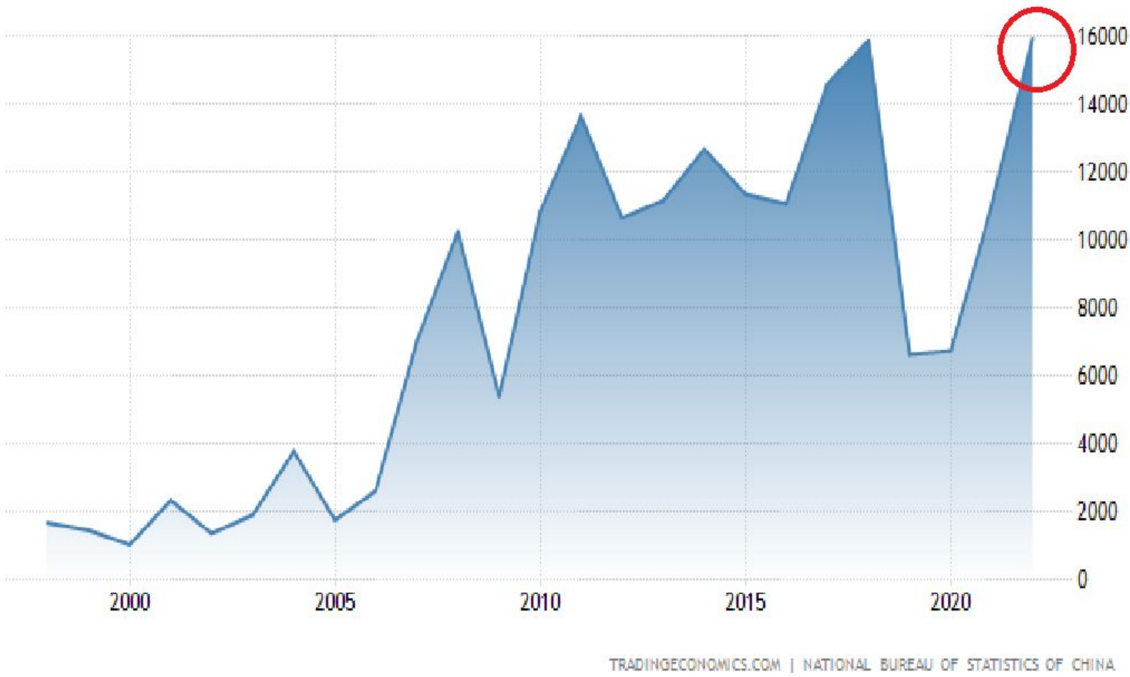


Figure 21. China Changes in Inventory (Source: Trading Economics, National Bureau of Statistics of China)

Challenges in Private Investments

Compounding the existing challenges in private investment growth in the real estate sector, industrial firms with bloated inventories added to the challenges. China's approach during the pandemic was to reduce business taxes and discourage layoffs, to indirectly support household income. This approach, while maintaining production continuity, inevitably led to a surge in inventories as sales dwindled.

The significant accumulation of inventories dampened the incentive to invest in manufacturing production capacity in the first half of 2023. Throughout the pandemic, private investment displayed growth, albeit at a pace lagging behind the expansion rate of state investment, however in the first half of 2023, there was an unprecedented contraction of 0.2 percent.

Another factor contributing to the slowdown in private investment was the increased control placed on Internet companies. The sudden and rushed crackdown on these online platforms, which are mostly owned by private entities, starting in late 2020, had a strong negative impact on their earnings, investment plans, and hiring activities. It is worth noting however that this is now changing. In July 2023, regulatory authorities signalled that they had addressed the financial issues within these internet firms. This has already led to a positive reaction from companies like Alibaba, ByteDance, and Meituan. They have collectively ramped up their efforts to hire new employees, reversing the trend of layoffs that affected the private tech sector in 2022. Going forward, as these companies operate under the new "normalised supervision" approach, their profitability is expected to be less robust compared to the period of less strict regulations that existed before the crackdown.

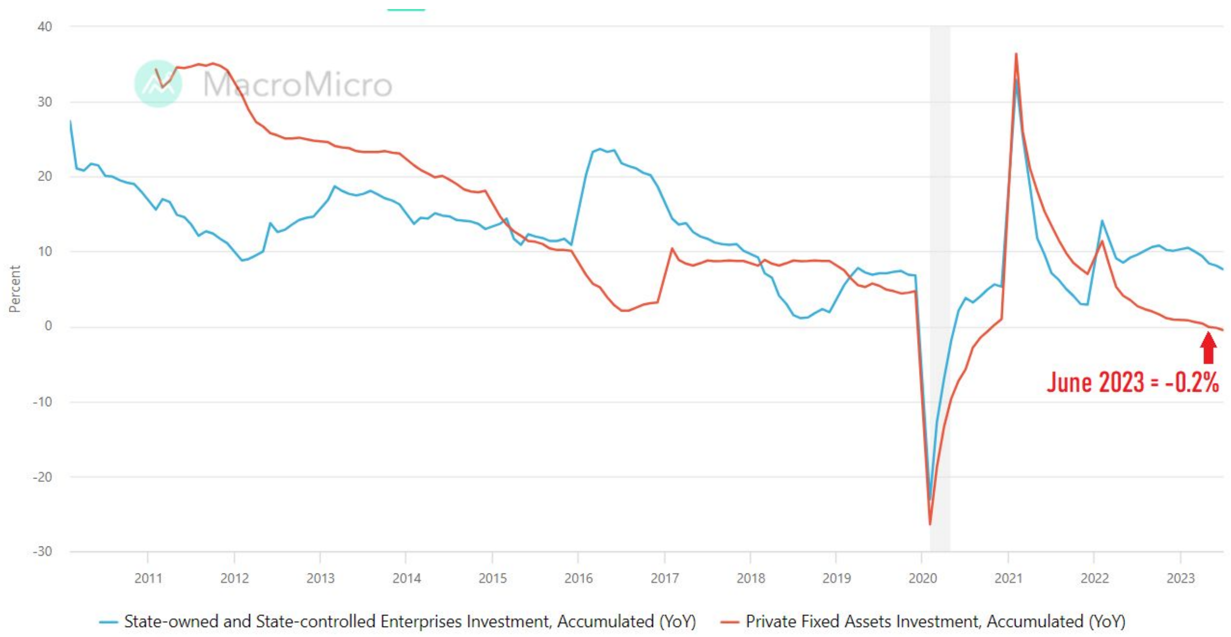


Figure 22. Private Fixed Assets Investment, Accumulated (Source: Macro Micro)

Deflation: The Looming Threat

Inflation, characterised by rising prices over time, starkly contrasts with deflation, where prices steadily decline. Recent data indicates that China's economy has fallen into deflation with a headline figure of -0.3 percent fall in consumer prices year-on-year for the first time in more than two years. Despite the People's Bank of China (PBOC) cutting interest rates and pumping liquidity into the economy, prices are stagnating or falling in China.

After a global period of high inflation since 2021, deflation might seem positive as it implies that the purchasing power of consumers is rising after an extended period of expensive cost of living. Interest rates are usually cut to combat deflation as they have in China, which makes borrowing cheaper for businesses. However, despite this, retail sales numbers in China continue to be dismal and even with already low interest rates, no one wants to borrow. New lending by banks has fallen to its lowest levels since 2009 (refer to Figure 23 below).

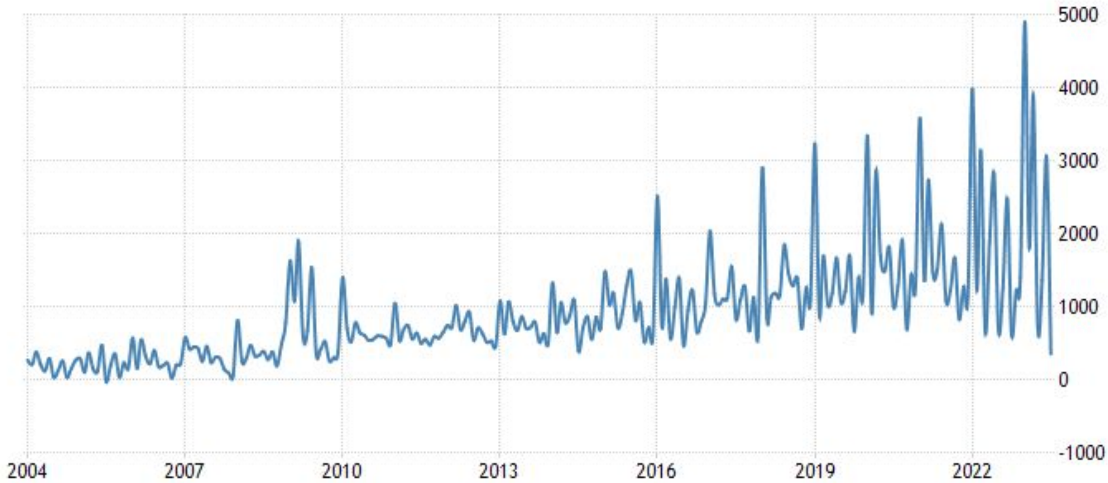


Figure 23. China New Yuan Loans (in billion CNY terms). (source: tradingeconomics)

Deflation, often perceived as a harbinger of economic stagnation, brings forth a series of economic quandaries. One of its foremost effects is the amplification of the real value of debt. As prices deflate, the value of outstanding debt increases, potentially placing immense financial strain on firms and consumers. This shift diminishes the spending power of these entities, which in turn can dampen economic activity. The reluctance of consumers to spend, coupled with deferred purchases as a result of falling prices, compounds the issue further.

China, having set a target inflation rate of three percent, embarked on a journey towards economic revitalisation when it eased its lockdowns in late 2022. Expectations were high for an economic boom, with analysts predicting an upswing in business activity and growth. The early months of 2023 witnessed a rise in inflation, from December's 1.8 percent to January's 2.1 percent. Projections indicated that China was on track to achieve its inflation target over the course of 2023.

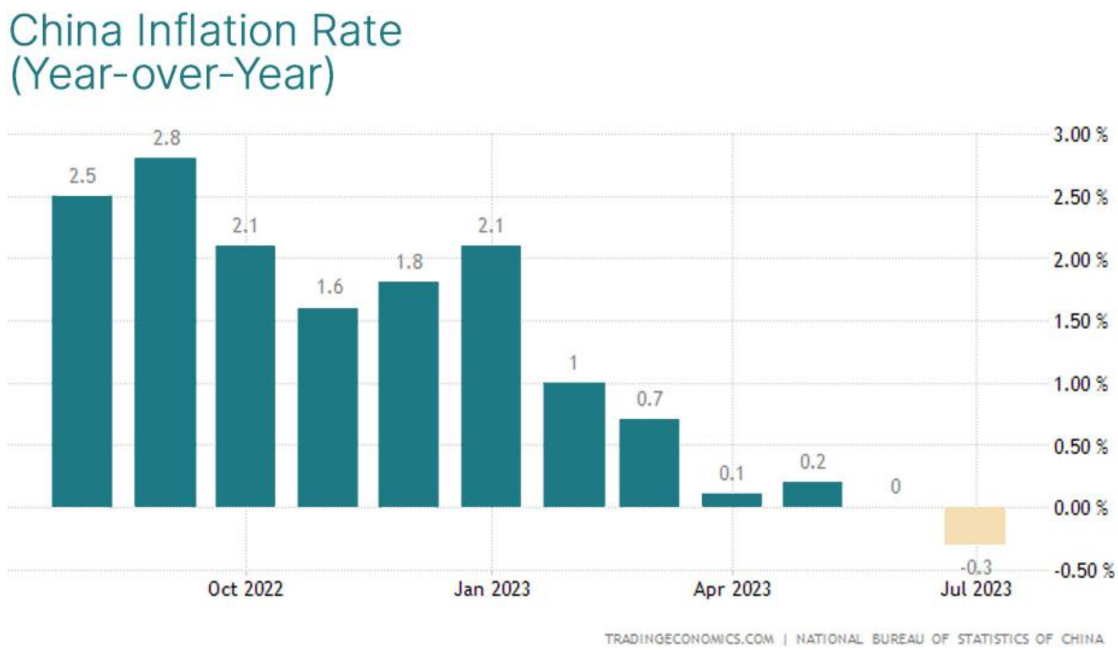


Figure 24 China Year-over-Year Inflation Rate (Source: Tradingeconomics, Bureau of Statistics of China)

However, this optimism was short-lived. In February, inflation plummeted to one percent, further descending to 0.7 percent in March and reaching a mere 0.1 percent in April (refer to Figure 24 above). A marginal increase to 0.2 percent in May was swiftly negated by June's drop to 0 percent. The blow came in July, with a startling -0.3 percent deflation rate. Scrutinising the data reveals a disconcerting trend, such as the food prices contracting by -1.7 percent in July while business operating costs surged significantly. This dissonance has grave repercussions, leading to businesses facing financial distress and unemployment escalating.

Factory prices, an essential barometer of economic health, have shown a consistent decline over the past 10 months, with July's figures plummeting to -4.4 percent. This downward spiral in factory prices paints a sombre outlook for the months ahead, suggesting that deflation could persist well into 2023 and beyond. A conventional central bank strategy in the face of deflation involves interest rate reductions to stimulate borrowing and spending. However, China's current interest rates remain relatively high, sitting at 3.5 percent in July 2023, in stark contrast to the deflation rate of -0.3 percent

A prevailing viewpoint has gained traction among numerous economists, reporters, and various experts concerning China's ongoing economic deceleration. Their argument suggests that China's setbacks in the spring of 2023 indicate a deeper and enduring challenge arising from misguided, inward-looking, and Communist Party-managed policy responses to COVID and its aftermath. This narrative is expectedly widespread, yet this is most likely premature. Despite China’s economic challenges, the risk of a full-blown debt crisis or financial crisis in China remains relatively small. The government's substantial assets, state ownership of banks, and guarantees on deposits help prevent severe credit crunches or bank failures. However, the high and rising debt levels are a concern due to their potential to lead to misallocation of resources, lower corporate profitability, and depressed long-term growth.

News from the Crypto-Sphere

The First-Ever Spot Bitcoin ETF in Europe Is Now Listed on Euronext Amsterdam

Figure 25. Euronext Amsterdam (Source: Wikipedia)

- **Jacobi Asset Management introduces Europe's first spot Bitcoin exchange-traded fund (ETF) on Euronext Amsterdam after a two-year wait.**
- **The Jacobi FT Wilshere Bitcoin ETF, regulated by the Guernsey Financial Services Commission, offers ownership of underlying shares, differentiating it from traditional exchange-traded notes (ETNs),**

In a notable milestone for the European financial landscape, Jacobi Asset Management, headquartered in London, has successfully launched the continent's first-ever spot Bitcoin exchange-traded fund (ETF) on Euronext Amsterdam. This achievement follows nearly two years of anticipation since its initial regulatory approval.

Named the Jacobi FT Wilshere Bitcoin ETF, the fund operates under the jurisdiction of the Guernsey Financial Services Commission (GFSC) and will be traded using the "BCOIN" ticker. Custodial services for the ETF are provided by Fidelity Digital Assets, while market-making duties are undertaken by trading firm Flow Traders, as announced by Jacobi on Tuesday, August 15th.

Jacobi initially secured regulatory approval for its Bitcoin ETF in October 2021 intending to list it in 2022. However, the company opted to defer its plans due to adverse developments in the broader digital asset market, including the collapse of the Terra ecosystem and the insolvency of the crypto exchange FTX.

In contrast to commonplace exchange-traded notes (ETNs), Jacobi's offering stands out as the first ETF of its kind. Unlike ETN investors, ETF shareholders possess a stake in the underlying shares of the product. Notably, Jacobi's ETF is restricted from leveraging or utilising derivatives, setting it apart from ETNs.

Remarkably, Europe has managed to pave the way for a spot Bitcoin ETF to be traded before its counterpart in the United States, despite numerous applications submitted to the US Securities and Exchange Commission (SEC) over recent years, all of which have been met with delays or rejection.

Despite this there is still optimism that a spot Bitcoin fund will be approved by the SEC. Major asset management player BlackRock (BLK) spearheaded a wave of fresh applications featuring "surveillance-sharing" agreements designed to safeguard against potential market manipulation.

Jacobi Asset Management's successful ETF launch underscores the evolution of the European financial landscape in embracing innovative investment opportunities within the realm of digital assets, setting a precedent that could influence the global market's trajectory in the foreseeable future

Ripple Responds to SEC's Interlocutory Appeal Request in Ongoing Legal Battle

FIgure 26. Ripple Responds to SEC's Interlocutory Appeal Request in Ongoing Legal Battle

- **Ripple Labs strongly opposed the U.S. Securities and Exchange Commission's (SEC) attempt to file an interlocutory appeal in their ongoing legal dispute, arguing that the SEC's appeal lacks substantial legal grounds and departs from standard procedure.**

In the ongoing legal saga between Ripple Labs and the United States Securities and Exchange Commission (SEC), Ripple's chief legal officer has firmly opposed the SEC's move to file an interlocutory appeal in response to the recent partial judgement that found that in certain circumstances, Ripple's digital asset XRP, could not be classed as a security.

An interlocutory appeal refers to an appeal that takes place before a final judgement or decision is reached in a case. Court cases typically progress through various stages, including motions, hearings, and trials, before a final judgement is rendered. An interlocutory appeal departs from this usual sequence by allowing one of the parties to appeal a specific ruling or issue to a higher court before the entire case is concluded.

VIA ECF
Hon. Analisa Torres
United States District Court
Southern District of New York

Re: *SEC v. Ripple Labs Inc., et al.*, No. 20-cv-10832 (AT) (SN) (S.D.N.Y.)

Dear Judge Torres:

Defendants Ripple Labs Inc. ("Ripple"), Bradley Garlinghouse, and Christian Larsen ("Individual Defendants," collectively "Defendants") oppose the SEC's anticipated motion for leave to file an interlocutory appeal as to those portions of the Court's July 13, 2023 Order (ECF No. 874) ("Order") granting Defendants summary judgment.[1]

For years, the SEC has pursued a strategy of regulating the U.S. crypto industry through case-by-case enforcement. In keeping with that strategy, the SEC argued that the only question before the Court was the application of the *Howey* test to the specific circumstances of this case. Having failed to meet its burden to present facts that would support stretching *Howey* to cover all of Defendants' distributions of the digital asset XRP, the SEC now does an about-face and rushes to appeal what it claims (at 1) is a purely "legal question" affecting all other digital-asset cases. The Court should reject this gambit because the SEC raised no such question.[2] The SEC can appeal the Court's decision in the normal course after a final judgment with a full record.

Section 1292(b) is "a rare exception to the final judgment rule." *Koehler v. Bank of Bermuda Ltd.*, 101 F.3d 863, 865 (2d Cir. 1996). "[O]nly exceptional circumstances will justify a departure from the basic policy of postponing appellate review until after the entry of a final

Figure 27. Letter by the Ripple's Legal Team

Ripple's legal team, in a letter dated August 16th to US District Court Judge Analisa Torres of the Southern District of New York, articulated the company's objections to the SEC's appeal request. The SEC's interlocutory appeal would entail challenging the summary judgement laid down by Judge Torres last July 13. The SEC's stance, if accepted, would enable an appeal while other aspects of the case remain unresolved.

The crux of Ripple's opposition centres on the failure of the SEC to fulfil the Howey test criteria pertaining to Ripple's distribution of XRP. They argue that this inability to prove that certain distributions of XRP to meet the Howey test renders the SEC's appeal request invalid. According to the Howey test, the determination of whether a transaction qualifies as an investment contract depends on the presence of investment of money in a common enterprise with an expectation of profit solely from the efforts of others.

Ripple's lawyers presented three key arguments against the SEC's appeal. Firstly, they contended that the SEC's appeal does not raise new legal issues, a prerequisite for an interlocutory appeal. Secondly, Ripple's legal team refuted the SEC's claim of the court ruling being erroneous, asserting that the SEC should demonstrate clear conflict between courts on the matter, which it said is not the case here. Lastly, Ripple's lawyers maintained that an immediate appeal would not expedite the termination of litigation proceedings.

The initial victory for Ripple came on July 13, when Judge Torres ruled that the XRP token itself does not qualify as a security. However, she noted that under certain circumstances, such as sales to institutional investors, XRP transactions could be considered securities. This distinction has been at the heart of the Ripple-SEC legal dispute.

The SEC's attempt to initiate an interlocutory appeal stems from its desire to prevent extended litigation remedies. The regulatory body's argument implies that allowing the appeal to proceed would help prevent complications arising from the initial judgement in other pending cases involving crypto asset trading platforms or non-cash considerations.

CME Group Expands Crypto Reference Rates for Asia Pacific, Reflecting Rising Institutional Interest

Figure 28. CME Group Chicago Mercantile Exchange Center (Source: Wall Street Journal)

- **CME Group collaborates with CF Benchmarks to launch Bitcoin and Ether reference rates for Asia Pacific, addressing growing institutional interest in accurate crypto pricing during Asian trading hours.**

- **The APAC-specific rates, set to debut on September 11, aim to enhance risk management for regional market participants, aligning with around 11 percent of CME's crypto trading volume originating from the Asia Pacific region.**

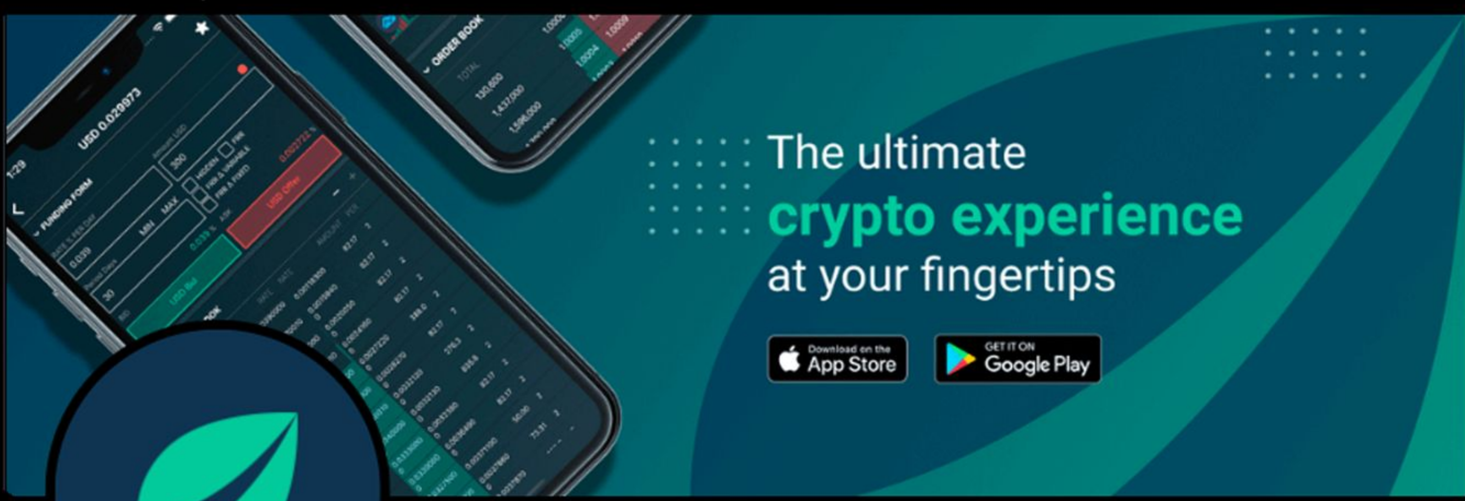
In a bid to cater to the escalating institutional interest in cryptocurrencies across the Asia Pacific region, derivatives marketplace CME Group has announced its collaboration with CF Benchmarks to introduce two new reference rates for Bitcoin and Ether. These reference rates, set to launch on September 11, will provide a daily valuation of these cryptocurrencies in U.S. dollars at 4 p.m. Hong Kong time, enabling market participants to manage price risks more precisely.

The partnership with CF Benchmarks aims to enhance the accuracy of cryptocurrency pricing during the Asia trading day, catering to the evolving requirements of global participants in the digital asset sphere. CME Group highlighted that approximately 37 percent of the total crypto volume at CME Group for the year has been traded during non-US hours, with around 11 percent originating from the Asia Pacific region.

The CME CF Bitcoin Reference Rate APAC and CME CF Ether-Dollar Reference Rate APAC will contribute to more effectively hedging cryptocurrency price risks for institutional clients. Notably, CME Group and CF Benchmarks already produce reference rates for Bitcoin and Ether that are published at 4 p.m. London time, as well as those released at 4 p.m. New York time.

The CME Group's initiative reflects heightened demand from institutions for precise cryptocurrency prices during Asia trading hours. The new APAC reference rates are expected to align more closely with the portfolios and investment strategies of market participants in the region.

CME Group's move comes as institutional interest in cryptocurrencies continues to grow, particularly in crypto-friendly jurisdictions such as Hong Kong and Singapore, which have been proactive in providing regulatory clarity to crypto businesses. The new reference rates are poised to contribute to the maturation of the digital asset space by facilitating more informed investment decisions and efficient risk management strategies for institutional players.



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