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The Daily Dispatch

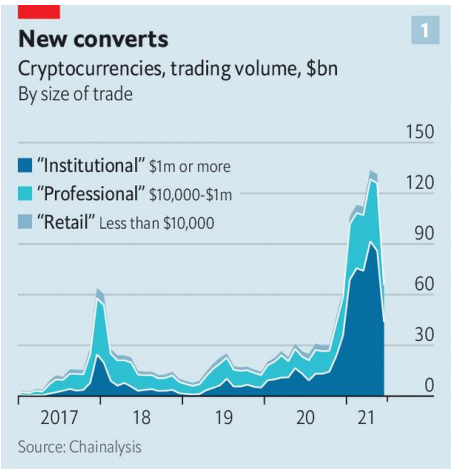
Weekly Special Feature

September 03, 2021

What if bitcoin went to zero?

By: The Economist *(Published on August 5, 2021)*

The recent expansion of the crypto-universe is a thing of wonder. Only a year ago there were about 6,000 currencies listed on CoinMarketCap, a website. Today there are 11,145. Their combined market capitalisation has exploded from $330bn to $1.6trn today—roughly equivalent to the nominal gdp of Canada. More than 100m unique digital wallets hold them, about three times the number in 2018.



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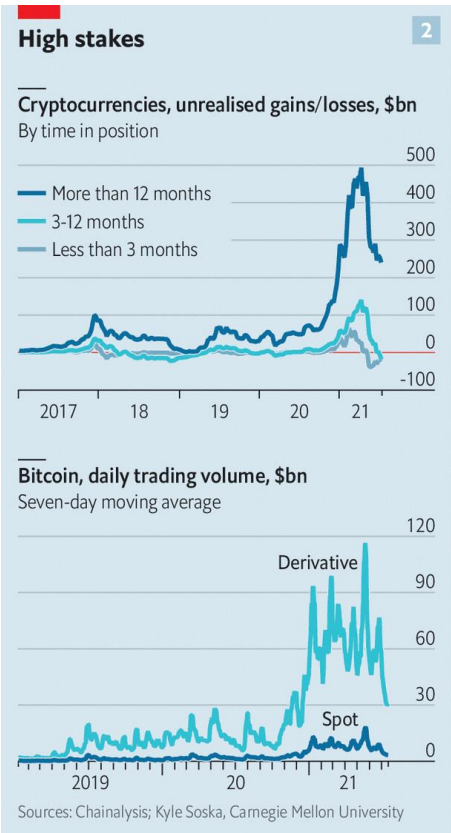
Holders have become more sophisticated and deep-pocketed, too. Institutions account for 63% of trading, up from 10% in 2017 (see chart 1). SkyBridge Capital, a hedge fund run by Anthony Scaramucci, provides an illustration. Its diversified $3.5bn fund began investing in crypto in November, and it launched a $500m bitcoin fund in January. The exposure of its 26,000 clients, which range from rich individuals to sovereign funds, is rising. Bitcoin now accounts for 9% of the value of its main vehicle, up from 5%, and the dedicated fund is worth around $700m.

This maturing, however, has failed to tame the wild gyrations that characterise crypto markets. Bitcoin sank from $64,000 in April to $30,000 in May. Today it hovers around $40,000, having dipped to $29,000 as recently as July 29th. Every downward lurch raises the question of how bad the fallout might be. Too much seems at stake for the cryptocurrency to collapse—and not just for the die-hards who see bitcoin as the future of finance. Algorithmic traders now conduct a hefty share of transactions and have automatic "buy" orders when bitcoin falls below certain thresholds. Still, in order to grasp the growing links between the crypto-sphere and mainstream markets, imagine that the price of bitcoin crashes all the way to zero.

A rout could be triggered either by shocks originating within the system, say through a technical failure, or a serious hack of a big cryptocurrency exchange. Or they could come from outside: a clampdown by regulators, for instance, or an abrupt end to the "everything rally" in markets, say in response to central banks raising interest rates.

There are three types of crypto investors, says Mohamed El-Erian of Allianz, an insurer and asset manager: "fundamentalists", who believe bitcoin will replace government-issued currencies one day; "tacticians", who reckon its value will rise as more people invest in it; and "speculators", who want to gamble. Though a crash would come as a monumental upset to the first group, it is least likely to sell out; the third, meanwhile, will flee at the first sign of trouble. To avoid a terminal stampede, the second group must be persuaded to stay. It is unlikely to do so if the price falls to zero.

A crash would puncture the crypto economy. Bitcoin miners—who compete to validate transactions and are rewarded with new coins—would have less incentive to carry on, bringing the verification process, and the supply of bitcoin, to a halt. Investors would probably also dump other cryptocurrencies. Recent tantrums have shown that where bitcoin goes, other digital monies follow, says Philip Gradwell of Chainalysis, a data firm.



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The result would be the destruction of a significant amount of wealth. Long-term holders would suffer small losses relative to the price they paid, but cede huge unrealised gains (see chart 2). The biggest losses relative to the purchase price would fall on those who bought less than a year ago, at an average price of $37,000. That would include most institutional investors exposed to crypto, including hedge funds, university funds, university endowments, mutual funds and some companies.

The total value erased would go beyond the market capitalisation of digital assets. A crash would also wipe out private investments in crypto firms such as exchanges ($37bn since 2010, reckons PitchBook, a data provider) as well as the value of listed crypto firms (worth about $90bn). Payments companies like PayPal, Revolut and Visa would lose a chunk of growing, juicy business, which would dent their valuations. Others that have ridden the crypto boom, such as Nvidia, a microchip-maker, would also take a hit. All in all, perhaps $2trn might be lost from this first shockwave, a little more than the market capitalisation of Amazon.

Contagion could spread through several channels to other assets, both crypto and mainstream. One channel is leverage. Fully 90% of the money invested in bitcoin is spent on derivatives like "perpetual" swaps—bets on future price fluctuations that never expire. Most of these are traded on unregulated exchanges, such as ftx and Binance, from which customers borrow to make bets even bigger. Modest price swings can trigger big margin calls; when they are not met, the exchanges are quick to liquidate their customers' holdings, turbocharging falls in crypto prices. Exchanges would have to swallow big losses on defaulted debt.

The rush to meet margin calls in cryptocurrency—the collateral of choice for leveraged derivatives—could force punters to dump conventional assets to free up cash. Alternatively, they might give up trying to meet those calls since their crypto holdings would no longer be worth much, triggering liquidations. Meanwhile, other types of leverage exist, where regulated exchanges or even banks have lent dollars to investors who then bought bitcoin. Some have lent dollars against crypto collateral. In both cases borrowers nearing default might seek to liquidate other assets.

The extent of leverage in the system is hard to gauge; the dozen exchanges that list perpetual swaps are all unregulated. But "open interest", the total amount in derivatives contracts outstanding at any one time, provides an idea of the direction of travel, says Kyle Soska of Carnegie Mellon University. It has grown from $1.6bn in March 2020 to $24bn today. This is not a perfect proxy for total leverage, as it is not clear how much collateral stands behind the various contracts. But forced liquidations of leveraged positions in past downturns give a sense of how much is at risk. On May 18th alone, as bitcoin lost nearly a third of its value, they came to $9bn.

A second channel of transmission comes from the "stablecoins" that oil the wheels of crypto trading. Because changing dollars for bitcoin is slow and costly, traders wanting to realise gains and reinvest proceeds often transact in stablecoins, which are pegged to the dollar or the euro. Such coins, the largest of which are Tether and usd coin, are now worth more than $100bn. On some crypto platforms they are the main means of exchange.

Issuers back their stablecoins with piles of assets, rather like money-market funds. But these are not solely, or even mainly, held in cash. Tether, for instance, says 50% of its assets were held in commercial paper, 12% in secured loans and 10% in corporate bonds, funds and precious metals at the end of March. A cryptocrash could lead to a run on

stablecoins, forcing issuers to dump their assets to make redemptions. In July Fitch, a rating agency, warned that a sudden mass redemption of tethers could "affect the stability of short-term credit markets". Officials from America's Securities and Exchange Commission and the Federal Reserve are paying closer attention to the risks from cryptocurrencies, and stablecoins in particular.

A cryptocalypse could affect broader sentiment even beyond fire sales. The extent of this is unclear: more entities are now exposed to cryptocurrencies, but few have staked big shares of their wealth on them, so losses would be widespread but shallow. Crucially, banks are immune; and most will not rush to hold bitcoin on their balance-sheets any time soon. The Basel club of supervisors recently proposed making banks fund their bitcoin holdings with only capital, not debt.

But a worse case is not hard to imagine. Low interest rates have led investors to take more risk. A crypto collapse could cause them to cool on other exotic assets. In recent months the correlation between bitcoin prices and meme stocks, and even stocks at large, has risen. That is partly because punters reinvest gains made on faddish stocks into crypto, and vice versa.

A sell-off would begin with the most leveraged punters—typically individuals and hedge funds—in high-risk areas: meme stocks, junk bonds, special-purpose acquisition vehicles. Investors exposed to these, facing questions from their investment committees, would follow in turn, making risky assets less liquid, and perhaps provoking a general slump. If that sounds improbable, remember that the s&p 500, America's main stock index, fell by 2.5% in a day after retail punters' infatuation with GameStop, a video-game retailer, wrong-footed a few hedge funds.

For general market turmoil to ensue, then, you would need a lot of things to go wrong, including the price of bitcoin to fall all the way to zero. Still, our extreme scenario suggests that leverage, stablecoins, and sentiment are the main channels through which any crypto-downturn, big or small, will spread more widely. And crypto is only becoming more entwined with conventional finance. Goldman Sachs plans to launch a crypto exchange-traded fund; Visa now offers a debit card that pays customer rewards in bitcoin. As the crypto-sphere expands, so too will its potential to cause wider market disruption.

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TODAY'S TOP NEWS

Medilines seeks clearance to conduct P2bn IPO

Medilines Distributors Inc., a leading distributor of medical equipment to public and private healthcare facilities, seeks to raise P2 billion from an initial public offering in November. MDI disclosed with the Securities and Exchange Commission it would sell up to 825 million common shares at an offer price of P2.45 each.

Discovery taps Globe as PH streaming partner

"The launch of discovery+ in the Philippines represents another step forward in the platform's global expansion and further strengthens our direct-to-consumer proposition across Asia Pacific," said Simon Robinson, president of Discovery Inc. in Asia Pacific.

AMLC files cases worth over P3.3B in H1

The Anti-Money Laundering Council (AMLC) filed a total of 63 cases involving dirty money, terrorism financing, civil forfeiture and even administrative issues during the period, central bank Governor Benjamin Diokno said on Thursday.

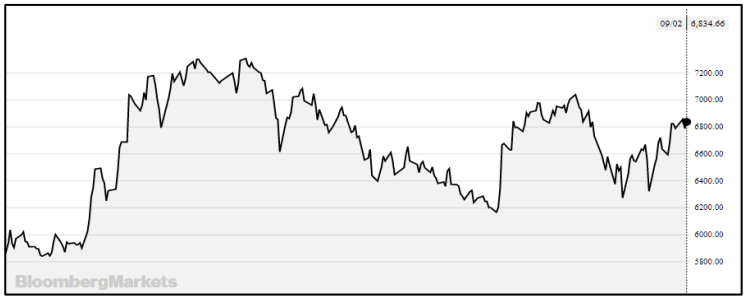
Covid resurgence poses risks for PH construction

THE Philippine construction sector remains headed for a bounceback this year but downside risks are increasing given a surge in Covid-19 infections, a Fitch Group unit said. While a 25.7 percent year-on-year gain in the second quarter was mostly due to low base effects, it also implied a very robust recovery.

Megaworld books 415K sq m of office leases

Megaworld Corp., the property development arm of businessman Andrew Tan, on Thursday said it booked around 415,000 square meters of office leases since the start of the pandemic. The company said around 60 percent of these lease contracts booked since last year were renewals while the remaining 40 percent were new leases.

Philippine Stock Market Update



Previous Close: 6,834.66

1 Yr Return: 20.87%

Open: 6,841.13

YTD Return: -4.00%

52-Week Range: 5,695.78 - 7,432.40

Source: Bloomberg

Foreign Exchange

As of Sept. 2, 2021

US Dollar	Philippine Peso
1	49.83

BVAL Reference Rates

As of Sept. 2, 2021

Tenor	Rate
1Y	1.631
3Y	2.300
5Y	2.957
7Y	3.595
10Y	4.125
20Y	4.969

Daily Quote

"What we achieve inwardly
will change outer reality."
--Plutarch

MORE LOCAL NEWS

SMC's MRT-7 train cars to start arriving next week

SAN Miguel Corp. (SMC) announced on Wednesday that the first batch of train cars for the Metro Rail Transit (MRT) Line-7 project, which is targeted for completion next year, will arrive in the Philippines next week.

2GO cancels 86 voyages for Sept. due to MECQ

2GO Group, Inc. (2GO) has canceled 86 voyages to and from Manila from Sept. 1 to 30 due to the travel restrictions imposed by the government to contain the coronavirus pandemic.

Local printer market almost triples

THE Philippine printer market almost tripled in the second quarter compared to the same period last year after factory production capacity improved. The Philippine hardcopy peripherals (HCP) market, including inkjet, laser, and SDM or serial dot matrix printers, went up 195.7% year on year, the International Data Corp. said.

Strong metal prices fuel mining growth

THE country's metallic mineral industry grew by 24.50% in the first half due to higher metal prices, the Mines and Geosciences Bureau (MGB) said. In a report on Thursday, the MGB said metallic mineral production value stood at P68.63 billion in the January to June period, higher than the P55.13 billion posted a year ago.

New investment in RE tops P221 billion

NEW renewable energy (RE) investment between 2009 and 2020 amounted to P221.35 billion, the Department of Energy (DoE) said Wednesday, noting a growing interest in clean power since the enactment of the RE Law.

Carmen Copper reports higher output

Carmen Copper Corp., a subsidiary of Atlas Mining & Development Corp., on Wednesday reported higher copper production and shipments in the second quarter compared to the first quarter on improvements in metal grades and milling tonnage.

PCA updates coconut farmers' registry

The Philippine Coconut Authority (PCA) has updated around 84 percent of its old National Coconut Farmers Registry System (NCFRS), according to the head of the agency. In a virtual presser yesterday, PCA administrator Benjamin Madrigal Jr. said there are about three million coconut farmers listed in the NCFRS.

ACEN raises $400 million from green bonds

AC Energy Corp. (ACEN) has raised $400 million from the issuance of green bonds. In a disclosure to the Philippine Stock Exchange yesterday, ACEN said its wholly owned unit ACEN Finance Ltd. successfully issued 3.5-year senior guaranteed undated fixed-for-life (non-deferrable) green bonds.

DITO issues 35mshares to 'unrelated third party'

The PSE asked DITO CME [DITO 8.70 3.69%] to provide more information on the amended disclosure that DITO submitted earlier in the week that said the company had issued 35 million common shares to an "unrelated third party entity", which, according to DITO, "public ownership of Dito CME at 20.02% as of 27 August 2021".

Toktok draws interest from local, foreign inv.

A number of local and foreign investors are looking to ride on the growth of successful homegrown delivery service app Toktok. In a statement, Toktok said several local and foreign investors are in talks with the company to infuse additional investments and capitalize on its rapid growth.

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TODAY'S TOP ASIAN NEWS

SGX to be 1st major Asian bourse to offer Spac listing

The Singapore Exchange (SGX) will be the first major bourse in Asia to offer special purpose acquisition companies (Spac) listings, with new rules to take effect from Friday (Sept 3). The rules were finalised after an extensive public consultation exercise that found broad acceptance for the exchange's framework.

China orders firms to stop 'disorderly expansion'

Chinese regulators have summoned ride-hailing giant Didi Chuxing and ten other car platforms to demand they cease "disorderly expansion" and "vicious competition" tactics, the government said on Thursday (Sept 2), amid a growing national crackdown on the tech industry.

ByteDance to downsize fintech business

TikTok parent ByteDance said on Wednesday (Sept 1) that it would shrink its financial services unit and that it planned to sell its stock broking operations amid China's tightening grip on the financial technology (fintech) sector.

SG, AUS, Malaysia, S. Africa launch CBDC trial

Central banks in Singapore, Australia, Malaysia and South Africa will conduct a cross border payments trial using different central bank digital currencies (CBDC) to assess if this allows transactions to be settled more cheaply and easily, the banks said on Thursday (Sept 2).

Sim Leisure to raise S$3.6m via sale of new shares

THEME park operator and developer Sim Leisure Group on Wednesday said it plans to sell new ordinary shares to two of its controlling shareholders at a discount of 5.9 per cent, to raise S$3.6 million.

TODAY'S TOP GLOBAL NEWS

GM to cut vehicle production due to chip shortage

General Motors is once again significantly cutting production at its North American plants due to the semiconductor chip shortage, signaling the global parts problem remains a serious issue for the automotive industry.

Baxter to buy hospital-bed maker Hill-Rom for $10.5b

[BENGALURU] US medtech firm Baxter International said on Thursday it would buy rival Hill-Rom Holdings for about US$10.5 billion, adding smart hospital beds to its portfolio of patient monitoring and diagnostic products.

Amazon to roll out its own TV in US by October

[BENGALURU] Amazon.com Inc is planning to launch its Amazon-branded TV in the United States as soon as October, Business Insider reported on Thursday.

Apple offers concession in easing App Store rules

APPLE further loosened App Store rules on Wednesday, allowing some content companies like Netflix to provide links to their websites so that customers can sign up for paid accounts.

Oil rises on economic recovery hopes, weaker dollar

[NEW YORK] Oil prices rose more than US$1 a barrel on Thursday, rebounding on optimism about global economic growth despite the coronavirus pandemic, and after US crude inventories fell more than anticipated.