Bloomberg Intelligence: Crypto Outlook

The Buck, Bitcoin & Ethereum

- Bitcoin, Ethereum May Notch 2022 Win-Win vs. Crude's Lose-Lose
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Bitcoin, Ethereum May Notch 2022 Win-Win vs. Crude’s Lose-Lose

Performance: Bloomberg Galaxy Crypto Index (BGCI)
January -22%, One Year to Feb. 2: +28%
Bloomberg Galaxy DeFi Index (DeFi)
January -29%, One Year -39%
Bitcoin January -17%, One Year +3%
Ethereum January -27%, One Year +75%

(Bloomberg Intelligence) -- Crypto assets may have a lot going for them as U.S. midterm elections approach, notably vs. inflation-related commodities. Typical demand and supply elasticity, and crude prices buoyed by the risk of war in Ukraine, are strong catalysts to refresh oil’s enduring bear market. It’s the opposite for Bitcoin and Ethereum. In their early adoption days, supply elasticity is negative for the top two cryptos and prices have dipped within bull markets. Inflation is a top issue facing politicians under pressure to deliver, while plenty of potential U.S. commodity production is limited by regulation.

We expect U.S. policymakers will embrace cryptos with proper regulation and ETFs for these reasons: dollar dominance, jobs, votes, lots of revenue (tax) and -- most importantly -- it’ll run counter to China’s antipathy.

Digital Decarbonization

Cryptos and Digitalization vs. Commodities and Decarbonization. The Bloomberg Galaxy Crypto Index down about 20% in 2022 to Feb. 2 vs. the Bloomberg Commodity Index Total Return up about 10% may be a temporary blip within enduring trends the other way. Supply, demand, adoption, economics and advancing technology point to cryptos continuing to outperform commodities.

Supply vs. Demand Favor Cryptos Over Commodities. The bottom line for most commodities is that rising prices thwart demand and increase supply, while the opposite may be true in Bitcoin. Competition has inspired over 17,000 crypto wannabes, but only a few are sustainable and have practical use cases. Bitcoin, Ethereum and crypto dollars top the list. The first two share an attribute that sets them apart from commodities -- a lack of supply elasticity. Increasing Bitcoin and Ethereum demand, and adoption vs. diminishing supply, should follow the basic rule of economics and raise prices.

Trends That Favor Bitcoin, Ethereum vs. Crude Oil

Our graphic shows downward paths in Bitcoin and Ethereum supply juxtaposed with surplus North American crude oil and liquid-fuel production vs. consumption heading toward 13% in 2023. The U.S. -- former net importer turned rising exporter -- has been a top headwind for commodity prices.
Revolutionary Bitcoin

Bitcoin's Price-Appreciation Advantage and Early Adoption Days. Some purging of the speculative excesses of 2021 may mark much of 2022, but Bitcoin is poised to come out ahead. Early adoption days and limited supply of the nascent technology/asset are prime advantages for price appreciation of the benchmark crypto, which is well on its way to becoming global digital collateral.

Limited Bitcoin Supply vs. Unlimited Cryptos. Bitcoin may be uniquely situated for enduring price appreciation. Well on its way to becoming global digital collateral, the first-born crypto launched a revolution in the digitalization of finance, which appears in its early days. Our graphic depicts the upward trajectory of the total market cap of crypto assets from Coindance at about 1% vs. world equities. What's unique about Bitcoin is diminishing supply vs. the unlimited and rapidly increasing number of cryptos. Coinmarketcap shows about 17,000 crypto assets, about double from a year ago, many of which are highly speculative.

Rising Crypto Market Cap, Declining Bitcoin Supply

Bitcoin, Ethereum and crypto dollars comprise about 70% of the total crypto market cap. Purging 2021’s excesses may continue, but we expect the market cap of these three stalwarts to just keep going up.

Rising Bitcoin Adoption, Declining Risk Measures

Bitcoin’s path toward greater mainstream adoption may be unstoppable, with implications for prices. The launch of U.S. futures-based exchange-traded funds in 2021 appears as a baby step by regulators that we think culminates with ETFs tracking actual cryptos via broad indexes. Our graphic depicts the upward trajectory of Bitcoin futures open interest vs. the downward slope in the crypto’s volatility vs. the stock market. Bitcoin’s 260-day volatility at about 3x that of the Nasdaq 100 compares with closer to 8x when futures were launched in 2017.
Ethereum and Crypto Dollars

Bearish the Buck, Ethereum? Crypto Dollars Gaining Momentum. The three crypto asset stalwarts -- Bitcoin, Ethereum and the proliferation of crypto dollars -- may be gaining underpinnings with the purging of some speculative excesses at the start of 2022. The nascent technology allows the ability to transact dollars around the clock at little cost and earn interest, and is key part of the revolution in digital assets.

Top Digital-Asset Bull Market: Crypto Dollars. The fact that Ethereum made crypto dollars possible, and the escalating use of the technology to transact greenbacks, support the No. 2 crypto's price. Approaching $170 billion on Feb. 2, the market cap of the top six crypto dollars listed on Coinmarketcap is up about 5x from the start of 2021. That pace may slow, but we see little to stop what is billions of dollars of market cap from reaching trillions. Our graphic depicts the strong companionship between the Ethereum price and proliferation of crypto dollars.

Trend’s Your Friend - Crypto Dollars and Ethereum

Crypto dollar issuers are a prime target of U.S. regulation in 2022. Increasing dollar dominance through digital tokens, jobs, votes, plenty of tax revenue and risks of falling behind are the top reasons we expect the U.S. will embrace crypto assets with proper regulation.

The Triple Treat: Bitcoin, Ethereum, Crypto Dollars. The proliferation of crypto dollars is an indication of the increasing dominance of digital assets, with bullish implications for the greenback, Bitcoin and Ethereum. Among the top five cryptos listed on Coinmarketcap on Feb. 2, two are crypto dollars. Tether, the No. 3 crypto after Bitcoin and Ethereum, is the primary so-called stablecoin and not without controversy, but there are well over a dozen tokens with significant market caps tracking the dollar. We view stablecoins as misnamed, as virtually all are linked to the greenback.

Ethereum is the primary platform for crypto dollars and nonfungible tokens (NFTs), and a key support for Ether’s price. We believe expunging some of the speculative excesses of 2021 is accelerating the maturation of Bitcoin, Ethereum and crypto dollars into the mainstream.

What Stops the Dominating Dollar? The dollar may be entering a potential win-win scenario, if cryptos are a guide. The U.S. raising interest rates in 2022, compared with No. 2 China cutting in what appears to be a response to economic stress, should provide solid underpinnings for the buck. Our graphic depicts the U.S. Treasury two-year yield rising above 1%. Juxtaposed is the downward slope of China’s two-year, which appears to be accelerating. It's little surprise that the trade-weighted broad dollar has been rising since China’s yield peaked in 2013.

Solid Underpinnings - Dollar Digital Dominance

We see little to stop the buck’s upward trajectory, which appears to have found a bottom in 2021 akin to 2018. The proliferation of crypto dollars (and free markets going for the greenback via digital tokens) vs. all others is a show of dollar confidence.
Range Traders Delight - Bitcoin, Ethereum Eye Upside

What Ends Bitcoin, Ethereum Range Trade? Bullish Fundamentals. By the rules of economics, a market with rising demand and declining supply will go up over time, suggesting that Bitcoin may be forming a bottom again around $30,000 as $60,000 resistance ages. Ethereum’s fundamentals are similar, with straightforward technical guidance and buyers prevailing at about $2,000 and sellers around $4,000.

Next Key Bitcoin Threshold May Be $100,000. Bitcoin is more likely forming a floor than a ceiling, which means range traders accustomed to $30,000-$60,000 may be disappointed. Since the start of 2021, the more tactically oriented had opportunities near the lower end twice and to sell for double around the upper end. Our graphic shows this consolidation period may be ending, with the path of least resistance pointing higher. About 30% below the 52-week moving average has proven to be a good support reading. Bitcoin revisited this potential bottom in January for the first time since the 2020 trough.

Top of Bitcoin Range Moving Toward $100,000

Range traders often provide market liquidity but can aggravate extremes. Short holders seeking to cover or new long positions expecting $30,000 may be disappointed, and $60,000 resistance appears less enduring than in November.

Ethereum Nearing Lower End of $2,000-$4,000 Range. Rising demand vs. declining supply dynamics are similar for Ethereum, with related upward price inferences. Bullish fundamentals are intact, and technical guidance has been straightforward, with buyers benefiting around $2,000 and sellers at about $4,000. It’s a question of the duration of a consolidation period within an enduring bull market. Our graphic depicts Ethereum moving toward the bottom of the range and nearing the support threshold about 30% below its 52-week moving average.

The End of a Trend or Consolidating Bull Market?

Ethereum could repeat last summer and revisit about $1,700. Once the weaker leveraged long positions were purged, the resolution was a new high around $4,800 in November. Ethereum approaching the lower end of its range has greater risks for shorts than longs.

Declining Supply vs. Increasing Adoption. Bitcoin and Ethereum remain in early adoption days, with increasing demand vs. declining supply and related price implications. Our bias is why complicate it — unless something unlikely reverses the proliferation of the nascent technology, prices should rise. As coded, Bitcoin’s supply is straightforward. Only 900 coins can be mined a day until 2024, then the daily discovery limit halves. Our graphic shows Bitcoin production dropping to less than 1% of the total by 2025.

In Decline, by Code - Bitcoin, Ethereum Supply

Ethereum supply is less defined, but clearly in a downward trajectory, notably due to a protocol change in 2021 that burns coins. Ethereum is the foundation for revolutionary technologies like non-fungible tokens and crypto dollars. Bitcoin is well on its way to becoming the benchmark global digital collateral.
Cryptos Gone to the Dogs? Bitcoin Value

Cryptos Gone to the Dogs? Bitcoin Set to Shine vs. the Gaggle. Price reversion in cryptos is likely to spread in 2022, after the assets were a poster child of speculative inflationary excess in 2021, but Bitcoin stands to come out ahead. With correlations heading toward 1-to-1, we expect history to look at 2022 as expunging some of last year’s excesses. Dogecoin and Shiba Inu may have parallels with AOL and Pets.com.

Leading, Lagging or Leaning Toward Risk-Off? Bitcoin is a nascent asset/technology facing another maturation test in 2022 vs. risk-asset deflation, and we expect the benchmark crypto will prevail. There’s a good chance that this year in cryptos will remind us of the 2000-01 internet purge, which helped form the foundation for the revolutionary technology. We see parallels in crypto assets, with stalwarts Bitcoin, Ethereum and the proliferation of crypto dollars maintaining the upper hand. At about 30% below its 200-day moving average on Jan. 24, Bitcoin isn’t far from the 50% discount that marked lows in 2018 and 2020.

Bitcoin Nearing Too-Cold Support vs. Stock Market

Our graphic shows how most correlations approach 1-to-1 when the stock market declines, yet Bitcoin has been acting as a leading indicator. At about a 2% discount to its 200-day mean, the S&P 500 is far from similar 2018 and 2020 lows.

Bitcoin Bumping Into Levels Not Favoring Shorts. The fact that Bitcoin is an up-and-coming asset (with less than $1 trillion market cap vs. about $100 trillion of global equities) that got a bit extended may give the crypto an advantage in 2022. Our graphic depicts a good bottoming indicator for Bitcoin -- when it dips about 30% below its 20-week moving average. Troughs in 2020 and 2021 roughly matched the relative discount reached on Jan. 24. We see $30,000 as key support this year. This level has held a floor under the market since the initial breach of what was resistance at the start of 2021.

More institutional-based, less-leveraged and responsive buyers seem to buoy Bitcoin around $30,000. When the world’s most significant risk-asset measure -- the S&P 500 -- breaks down, all correlations move toward one, but early adoption may help Bitcoin come out ahead.

Broad Crypto-Market Pressures. Bullish Bitcoin fundamentals -- limited supply vs. increasing demand and adoption -- are juxtaposed with the unlimited amount and ease-of-entry of other crypto-assets, with implications for prices. The roughly 17,000 so-called crypto currencies listed on Coinmarketcap compares with about 8,000 at the start of 2021 and 5,000 in 2020. Basic economics doesn’t favor broad price appreciation when supply is growing that rapidly, and we see the 2021 pumps (looking at you Dogecoin and Shiba Inu) indicating market excesses ripe for purging.

This process appears to have started with the November peak in the MVIS CryptoCompare Digital Assets 100 Small-Cap index, which was below the 2018 high. What’s notable from our graphic is the price of Bitcoin divided by the number of cryptocurrencies is nearing a support zone.
BI Litigation Watch: Crypto Tax Data Capture Overreach

Crypto Investor May Win Tax Appeal, Stifle IRS Data Capture Bids. Contributing Analysts Andrew Silverman (Government)

The IRS may lose its appeal of a trial court ruling over the issuance of anonymous summonses to capture taxpayer data, we believe, putting one of its primary enforcement initiatives in jeopardy. Quashing anonymous tax summonses could stop the tax agency from addressing tax abuses tied to crypto currency until a better compliance regime is established. An unrelated 2021 Supreme Court ruling may be pivotal for the case going in crypto investors’ favor.

What’s at Stake? Hundreds of billions of dollars of tax revenue.
IRS chief Charles Rettig estimates that the tax gap -- the difference between what the IRS should be collecting and what it actually collects -- may have risen to $1 trillion last year from $381 billion in 2013. Underreporting on crypto currency gains, he thinks, is a key factor in that increase. The IRS has issued anonymous “John Doe” summonses to exchanges like Coinbase and Kraken for the financial information of its customers which, the IRS hopes, will allow it to capture that lost revenue.

Tax Gap Has Gone From $630 Billion to $1 Trillion?

The appeals court, we believe, will agree that the IRS may have exceeded its power. The agency relies on the Anti-Injunction Act, which bars suits against the IRS that could restrain tax collection. The Supreme Court decided in May, however, that the AIA can’t bar a suit challenging the Treasury Department’s regulatory actions regardless of tax assessment. Beyond the AIA, another issue is the IRS’s power to issue anonymous summonses without knowing whether tax laws have actually been violated.
U.S. Crypto Ban Unlikely, CBDC Possible

Central-Bank Digital Dollar's Sure Possible But Not Anytime Soon.
Contributing Analysts Nathan R Dean (Government)
Momentum of using digital assets as currency is increasing both in the U.S. and around the globe, but the U.S. will likely continue to study - rather than launch - a central bank digital dollar over the next few years. A January white paper on the topic by the Federal Reserve explored both the risks and benefits of such a currency yet stopped short at endorsing the idea.

The Fed's January white paper is one of the first steps the U.S. will take in the creation of a central-bank digital currency (CBDC), but its conclusions stop well short of endorsing the idea. The Fed, which will receive comments through May 20, focused on both risks and benefits to using a digital currency. Yet in terms of next steps, we don’t believe the Fed will make moves anytime soon to begin creation of a CBDC. The report highlighted that it would not take any steps to do so without approval from Congress or the executive branch. We don’t anticipate either happening in the next few years.

Key Points:
We expect FinCEN and SEC enforcement will form a stopgap approach to digital assets in the coming years. The Fed is likely to adopt punitive capital rules proposed by the Bank for International Settlements, keeping bank crypto exposures to a minimum. Congress likely won’t act without cause.

Additional Reading:
Money and Payments: The U.S. Dollar in the Age of Digital Transformation, Federal Reserve, January 2022
“Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets,” FinCEN proposal, January 15, 2021

‘Studying’ Will Be the Game’s Name for 2022 and Beyond. With the Fed report punting on offering a conclusion on the future of a CBDC, U.S. regulators will instead continue to spend the next few years studying the subject, in our view. A key catalyst for when regulators’ mindset changes will be when the expected benefits of using a CBDC outweighs the potential of a systemic risk failure. In our view, that would mean the crypto industry in general would need to be under greater regulatory oversight before policy makers move forward with a CBDC. This includes exchanges and digital wallet providers. U.S. regulators are looking into both industries, but they’re only in the beginning stages of their review.

Congress Will Focus on Bills, Rhetoric with Little Outcomes. Broad legislation seeking to both embrace and restrict cryptocurrency usage will likely fail in 2022. With many policymakers still learning about the subject, regulators moving forward with their own oversight and an election later this year, there’s not much of a window for bipartisan legislation to come together. There are, however, several bills that are worth noting. One from GOP Rep. Tom Emmer of Minnesota, for example, would prohibit the Fed from issuing a CBDC directly to individuals.

Rep. Tom Emmer (Republican, Minnesota)

Bitcoin Market Risk, Money Laundering Threat Manageable. Though U.S. regulators likely have all the authority needed to keep big institutions at arms length from cryptocurrency exposure, only Congress can deem Bitcoin and other digital currencies unlawful, and no federal agency has primary control over Coinbase and other U.S. crypto marketplaces. We expect only an extreme event, like a terrorist attack financed by Bitcoin or a cyberattack worse than that on the Colonial pipeline, could drive a divided Congress toward restrictions or an outright ban.
Even though we don’t expect the U.S. to follow China with a ban on cryptocurrency, we note that regulation and enforcement globally are ramping up, with the Basel Committee proposing punitive dollar-for-dollar capital requirements for bank exposures and FinCEN and others ratcheting up seizures and reporting requirements.
### Cryptocurrency News

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**Bid/Ask Data**

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**Futures**

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**Certifications**

- [CRYP] Page on the Bloomberg Terminal
- Bloomberg Crypto Outlook
- February 2022 Edition

(2:30pm NY, February 2)
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