Crypto Coin Collapses (2022) and Rising Resiliency (2023)

Paul Gruenwald's Year-End Blog

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This report does not constitute a rating action

For the final edition of our Essential Economics newsletter this year, we asked each of our chief economist to share their insights on following questions:

- What was the biggest surprise for you in 2022 and what are the takeaways?
- What will you be watching most closely in 2023, and why?

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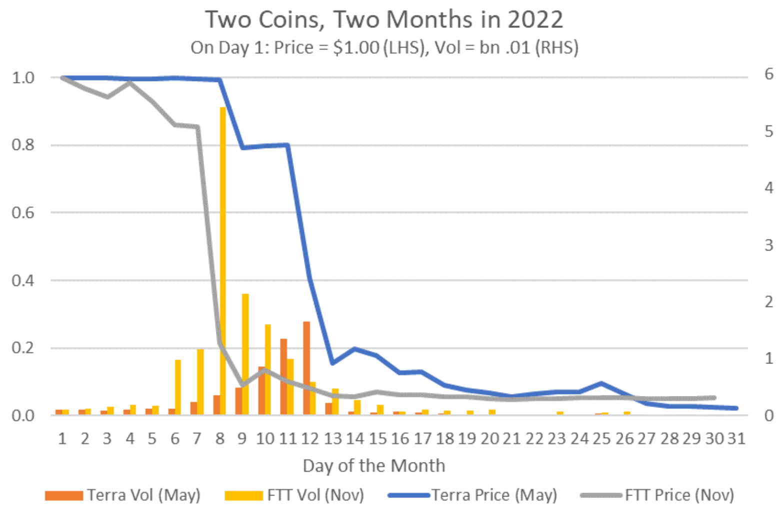
2022: The Swiftness of Crypto Collapses

The year started with swagger for the crypto world. Optimism around the growing applications of blockchain technology and the ecosystem's independence from – and superiority to – the "TradFi" world were growing. Business models were booming and revenues were rising. Optimism turned to "winter" when the Terra-Luna stablecoin blew up in May when it was discovered that it had no credible backing. The market's verdict was swift and brutal (see chart). But this was only the opening act. In November, the widely respected – and funded – FTX exchange collapsed. The revelation of astounding balance sheet holes from opaque intra-group transfers left investors burned and depositors holding the bag.



Source: Yahoo Finance, S&P Global Ratings Economics.

Takeaways. The promise and understandable hype of block chain technology do not imply that we can suspend of the laws of economics and finance. As a professional economist, I take some comfort from this fact: crypto coins that claim to be stable must be credibly backed by liquid and high-quality assets. Moreover, the use of anonymous technology does not obviate the need for transparency, disclosure and guardrails set by the authorities. DeFi will need to make peace with these realities if it is to truly go mainstream.

2023: After COVID and Russia-Ukraine, The Rise of Resiliency and Redundancy

Economies and markets continue to adjust and recover from the twin shocks of the COVID-19 pandemic and the Russia-Ukraine conflict. The former is hopefully behind us, particularly as China appears to finally be opening, while the latter is unfortunately ongoing. The big causality from these twin shocks has been the overwhelming pursuit of efficiency. Whether we think about the supply chains for medical goods or chips produced in Asia, or Europe's shockingly undiversified energy sup Source: Yahoo Finance. cy and cost minimization are the end-all has been shattered. Efficiency has spectacularly failed the resiliency test: it is simply too fragile.

What to watch. The transition from an efficient world to a more resilient and redundant world. This is not a "loss" – I would argue that on a risk-adjusted basis it is a gain. The reconfiguration of manufacturing (especially chip) and energy (especially gas) supply chains are the ones to watch. In terms of macro variables, this means it will be more expensive to produce, store and ship goods around the world. This will put some persistent upward price level impetus in the system. Not good in the short run as we battle inflation, but maybe not bad as we compare with the pre-shocks, too low inflation world.