THE FALL OF THE CRYPTOCURRENCY MARKET

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Abstract:

Started following the financial crisis of 2008 with the launch of the first virtual currency - bitcoin (launched in 2009), which was followed by the subsequent launch of hundreds and then thousands of other virtual currencies, the value of the crypto currency market has constantly developed attracting an increasing number of participants and which required the development of an increasing number of trading platforms. Cryptocurrency markets are made up of companies that launch virtual currencies, those that trade these currencies and trading platforms. Virtual currency exchanges are similar to stock exchanges, only that they exist exclusively in the online environment and being still at the beginning, they have a relatively short existence time, they are less regulated. Even if the desire of those active in the crypto market "to buy coffee with bitcoin" is far from being achieved because the number of commercial agents that accept payment with cryptocurrencies is limited, most new participants were attracted by the potential quick earnings that the companies launching different virtual currencies promised them, the crypto market grew rapidly reaching a capitalization of almost 3 trillion uds at the end of 2021 and investors' hopes had taken wings, followed by a sudden fall in the markets, in a few months the capitalization reached at less than one trillion usd. The paper aims to analyze what are the main factors that influence the evolution of cryptocurrencies and to explain what was the sum of factors that led to the collapse of the cryptocurrency market in 2022.

Keywords*: cryptocurrency; cryptocurrency market;*

JEL Classification*: E42, G23, O23;*

Introduction

Virtual currencies have often been compared with fiat currencies issued by the national banks of different states, being considered a possible alternative to them, with private currencies, with gold (especially bitcoin because it has a finite amount and is obtained through a process called "mining "), with the shares of existing companies on the stock exchanges, with gambling, or with Ponzi-type pyramid schemes. Given the degree of novelty brought by the appearance of virtual currencies and the rapid evolution through the integration of innovative ideas in the mode of encryption, issuance, transaction, use, in order to be able to explain the evolution of crypto markets it is important to analyze their "currency" characteristics, especially by comparing with fiat currency and private currencies. Then we will see what were the conditions and factors that triggered the sudden fall of the cryptocurrency market in 2022.To be considered currency, a form of money (eg digital currencies) must be able to be used as a unit of account, store of value and medium of exchange.

Characteristics of virtual currencies

Cryptocurrencies are used as a means of saving (with much higher volatility than traditional currencies), but they largely fall short of the other two criteria.

Cryptocurrencies have no intrinsic value. Although limited as a resource - bitcoin and other cryptocurrencies have a finite supply - investors trade them in hopes of higher value in the future,

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rather than the ability to purchase other goods and services. However, use for other initial coin offerings is growing.

As a medium of exchange, cryptocurrencies are only used to a limited extent for the purchase of goods and services, with a limited number of economic agents using them.

In addition, virtual currencies are generally converted into sovereign currencies after transfer. Therefore, cryptocurrencies are not used for accounting purposes, (they do not satisfy the characteristics of the unit of account).

Volatility is an obstacle to the acceptance of cryptocurrencies for making payments, being a unit of account and a store of value. Digital currencies exhibit extreme volatility with a purchasing power that changes continuously and rapidly.

Price stability is essential for currencies to be a reliable medium of exchange. If the value of the digital currency goes down, it encourages consumers to get rid of it as quickly as possible, and if it is rising, to buy it.

Despite the technological novelty, cryptocurrencies are a contemporary form of private money. Private currency is a unit of value issued by a private business entity, (private bank, financial or non-financial institution, or a natural person), which is accepted as a means of payment by other economic agents [30].

However, this term is also sometimes applied to similar liabilities issued by local public authorities or municipalities, or by public banks. In such broader interpretations, we are talking about decentralized money rather than private money.

In economic history, private money was a popular phenomenon between the late 18th and early 20th centuries, and was associated with the era of "free banking" - when banks they were subject to relatively little regulation and had the right to issue notes that served as a means of payment for the general public.

Private money existed in parallel with sovereign money, such as coins minted by the government or notes from government banks that gradually assumed the role of the central bank. Private money emerged in the early industrial era as a necessity to the rapidly growing demand for money and credit that could not be met by traditional means of payment.

In the mid-19th century, the opposite trend began, countries established their central banks and gradually gave them regulatory powers over private commercial banks, the role of lender of last resort and the central monetary authority with dominant rights or even exclusive rights to issue national currencies.

It should be remembered that various money surrogates, such as promissory notes, barter transactions, clearing accounts, were designed to avoid liquidity constraints. They were and are used in special circumstances, such as doing business in remote locations, closing banks in times of financial crisis, wars and other conflicts, conducting business operations in the absence of currency convertibility, or circumventing harsh budget constraints by state-owned enterprises in the first stages of the post-communist transition. However, money surrogates cannot be considered as full-fledged money and do not provide a benchmark for comparison with cryptocurrencies.

Private money has failed to compete against sovereign currencies. There are two major advantages of sovereign currencies: network externalities and the potential ability to address the problems of information asymmetry and adverse selection.

Network externality means that a given currency is widely accepted by other economic agents in a given market and performs all the functions of money. This allows the creation of a sufficiently extensive and liquid financial market for various instruments. This was not possible in the environment where several private currencies circulated in parallel and competed with each other.

The existence of several private currencies in a certain territory meant an increase in transaction costs for all economic agents. Even though they were denominated in the same currency, they were traded at different rates depending on the reputation and reliability of their issuers – with volatile and unpredictable exchange rates. Sovereign currencies eliminated this competition between currencies and helped create single internal markets for goods and services in individual currency jurisdictions.

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[30] https://www.investopedia.com/terms/p/private-currency.asp

This was an important expansion of the network for all economic agents - using the same currency as buyers, suppliers, creditors, debtors and tax authorities.

The problem of information asymmetry (ie the informational advantage of the financial service provider over its customers and its inability to fully assess the quality of the purchased product, including private currency) is inherently present in financial intermediation. This creates the possibility for the issuer to take excessive risks at the cost of customers and even the risk of intentional abuse or fraud.

Free banking competition does not always lead to the choice of the best products (in this case, private money) and the best providers. Therefore, the need to address the problem of information asymmetry and adverse selection serves as the main argument in favor of government regulation of financial services.

The need to have stable and reliable money for the proper functioning of the market economy forced most countries to adopt the gold standard in the second half of the 19th century, which largely eliminated the monetary discretion of governments. In the early 1970s after a period of higher inflation, the role of the stabilization mechanism was taken over by central banks that set strict monetary policy rules.

Compared to private currencies, cryptocurrencies differ in particular by their global or "non-local" characteristic, as well as their "virtual" character (there was no attempt to launch physical tokens). On the other hand, private currencies fulfilled the characteristics of currency, cryptocurrencies did not reach this "performance".

Looking at the technological features of cryptocurrencies at least some of them (such as bitcoin) offer a chance to eliminate at least some of the disadvantages of private money mentioned above. The transparency of their operation and the predetermined algorithm of their creation reduce information asymmetry.

However, their exclusively digital form, the rather complicated mechanism of their creation and the lack of political will to accept them as official legal tender in any jurisdiction (at least for the foreseeable future) limits their circulation and use and will make them unlikely to be competitors sovereign money. (See also the study "Virtual currencies and central banks monetary policy challenges ahead" [31])

2022- Cryptocurrency crush

The evolution of bitcoin:

- In 2009, bitcoin, the first virtual currency, appeared.
- Until 2011, it has a price with evolution from $0.3/bitcoin to $11
- In 2013 the price jumps from $14 to $1000 based on the economic crisis in Cyprus which led to the blocking of the bank accounts of many depositors.
- Since 2014, bitcoin miners and investors have appeared, which will take the crypto market to another level.
- In the first two weeks of March 2020, bitcoin fell by more than 40% due to concerns about Covid-19, investors sold everything in panic
- In 2021, the price rose more than 700% in 12 months to a record $69,000 in November
- In June 2022, it fell below $18,000.
    - In February 2023 the price is around $22,000.

[31] http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/619009/IPOL_IDA(2018)619009_EN.pdf

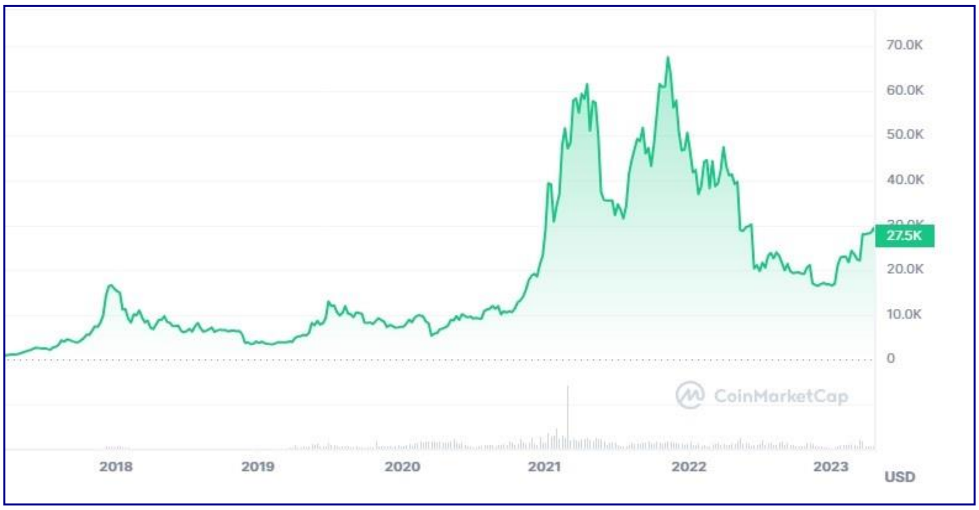

Figure 1. Historical bitcoin price (2017-2023)

Source: https://coinmarketcap.com/

It appears that the bitcoin bubble has burst as investors have lost faith in the crypto sector. Uncertainty about bitcoin's future caused prices to crash. Although there are signs of recovery, it is still far from record highs.

There were also big falls in the crypto market in other years (2013, 2014, 2017), but on a different scale because there was less interest in the field, there were fewer investors and investments in cryptocurrencies were smaller. For the first time, the total number of virtual coins was decreasing for a long period, approximately one year. On the other hand, the crypto crush of 2022 surprised even by the fact that currencies considered stable, called "stablecoin", created precisely to be less volatile and whose value is directly linked to asset reserves such as US federal bonds, small amounts of cash and corporate debt. The most famous stablecoin is Theter. The same dramatic loss of value was recorded by the stablecoin Terra (from the Luna-TerraUSD crypto binomial), which is not directly linked to the dollar, but is supported by an algorithm that adjusts the offer of Terra through the other currency, Luna, so that Terra maintains its parity with the dollar.

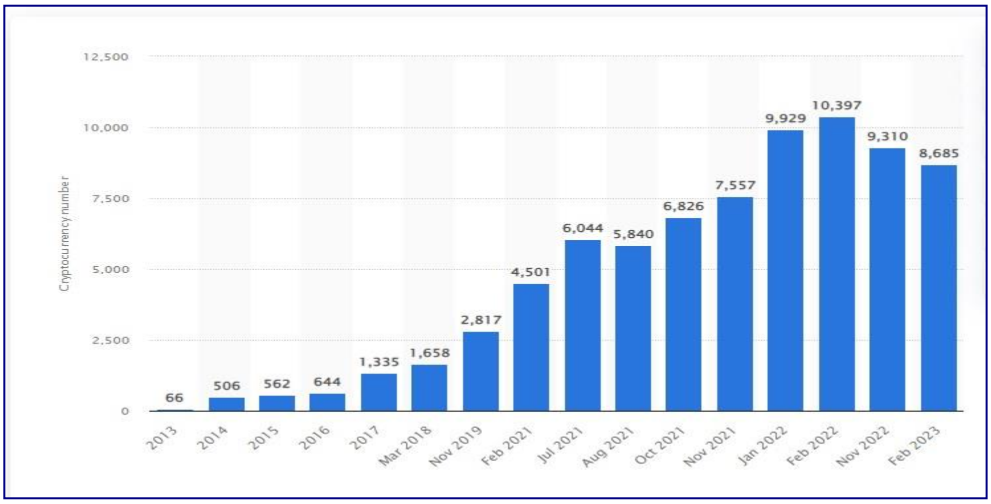

Figure 2. Number of cryptocurrencies worldwide from 2013 to 2023

Source: https://www.statista.com

Cryptocurrency Market Component (February 2023):

Total capitalization approximately 920 billion dollars, of which:

- The top 50 cryptocurrencies with a capitalization of more than $1 billion each;
- Top 10 cryptocurrencies by market capitalization with capitalization over $10 billion each;
- The top three virtual currencies: bitcoin $420 billion (45.6% of the total cryptocurrency market), ethereum $185 billion (20% of the crypto market) and tether $69 billion (7.5% of the crypto market)

The cryptocurrency market went into a decline as a result of the general conditions at the global level generated by the war in Ukraine which led to a state of uncertainty and stress at the level of the population, inflationary fears as a result of extremely large and rapid increases in the price of gas . natural resources and the price of energy, the decrease in the value of real interest rates in conditions where interest rates have increased at a lower rate than inflation rates in various countries, bans on mining or trading in various countries such as China, regulatory trends around the globe (but especially in the USA and the EU), environmental concern in the conditions of the energy crisis, the level of consumption for a bitcoin minar equals the consumption of a medium-sized country, security problems, many frauds and shows that the dark web works through crypto payments due to. the fact that the participants in the transaction remain anonymous.

Sudden and severe sell-offs in major cryptocurrencies that triggered panic and subsequent cascading sales once consumer confidence was damaged.

There were a series of incidents that determined the price fluctuation (in reverse chronological order, considering that the closer they are to the current moment, the more obvious the effects are):

- 2023, the US Federal Reserve, the ECB, and other national banks consider launching their own "central bank digital currency" (CBDC).

- November 2022, cryptocurrency trading platform FTX went bankrupt after its rival Binance pulled out of a deal to buy it

- June 2022, Celsius Network, a major US cryptocurrency lending company, froze withdrawals and transfers, citing "extreme" conditions.

- June 2022 Binance, one of the world's largest cryptocurrency exchanges, halted bitcoin withdrawals, (blaming a "blocked transaction" that caused a backlog).

- February 2022, it was reported that Russia may ban cryptocurrency operations.

- after the invasion of Ukraine, cryptocurrency trading platforms were called upon to ban Russian transactions.

- March 2022, President Joe Biden issued an executive order proposing to coordinate the actions of the US government on the regulation of digital assets.

- May 2021 ElonMusk said electric car maker Tesla will no longer accept digital payments due to concerns about the environmental impact of cryptocurrency mining.

- June 2021, banks and payment institutions in China were forced to stop allowing crypto transactions and the Chinese government banned cryptocurrency mining. Then, in September 2021, all crypto transactions were declared illegal.

- June 2021 President Donald Trump described bitcoin as a "scam" competing with the dollar to be "the world's currency".

- August 2021, the Financial Conduct Authority, the UK regulator, blacklisted Binance, one of the largest cryptocurrency trading platforms. Big banks HSBC and have followed Santander's lead as well as how to make payments to Binance.

- August 2021, the International Monetary Fund issued a warning on countries using cryptocurrencies as legal tender, saying that their widespread use would threaten "macroeconomic stability" and could compromise financial integrity.

- August 2021, Cryptocurrency Theft: Last August, a hacker stole $600 million in a cyber attack from the PolyNetwork crypto platform,

Conclusions

Unlike traditional investments such as a company's stock, where price movements are influenced by the performance of the business, cryptocurrencies do not have an underlying asset. This means that its price movements are based solely on expectations among investors about future price developments. Therefore, there can be sudden and large amplitude fluctuations in the price of cryptocurrencies, in very short periods of time, even less than a day. Right now, high inflation and the cost of living crisis are causing people to reduce their investment risk by selling cryptocurrencies.

On the other hand when assets rise very quickly in price and reach a record high, this makes a crash much more likely - or at least a correction, which lowers the price to a more "normal" level.

What was the main cause of the fall of the crypto market in 2023? It is not possible to speak of a specific factor, but of an accumulation of factors that include both existing global conditions and certain "incidents" regarding the crypto field, together they formed a perfect storm in which investors on an emotional basis sold excessively many crypto assets.

What will happen in the crypto market? As in the previous cases, the crypto market will recover after a period, it will have ups and downs, but overall the capitalization value will tend to increase. And this will happen related to economic developments at the global level but also to the possible regulations that may appear and can boost the crypto field or stop it.

The qualities of virtual currencies characterized by simple and cheap transactions by eliminating intermediaries, new technology that can revolutionize transactions and global trade, because, a non-fiat currency, it does not raise problems regarding exchange rates, confidentiality of transactions, deposits of safe value, in the meaning that it cannot be printed or confiscated, and in certain situations they can be a hedge against inflation, and last but not least the fact that there are investors who consider cryptocurrencies as a diversifier in balanced portfolios to which is added technological innovation and the generation of new solutions that to adapt to the challenges of the crypto market but also of the banking and financial market can lead the entire crypto environment (cryptoassets and related technologies) to spectacular yet unsuspected developments.

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