National Insurance Alliance Limited

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Macroeconomic Factors and Bitcoin: How Correlated are Cryptocurrencies to Capital Markets

Bitcoin's Relationship with Interest Rates, Inflation, The US Dollar, and Volatility
Generally, the monetary policy decisions from the Federal Reserve (Fed) affect and influence global markets with no exception to cryptocurrencies. Interest rates have had an inverse relationship with Bitcoin prices, with Bitcoin prices surging in times of low interest rates as the risk appetites of investors seeking riskier investments in exchange for higher returns increase. The inverse is true as risk appetite for riskier assets tend to decrease in periods of elevated interest rates. Some experts though have argued that demand for cryptocurrencies should surge in periods of high interest rates as it provides a store of value. However, a study conducted by S&P Global has revealed that according to a study conducted by S&P Global which analysed the correlation between inflation and Bitcoin prices, the study found that Bitcoin and inflation do not track each other and found that gold was a better hedge against inflation. This can be attributed mainly to a lack in track record for Bitcoin as well as the perception that Bitcoin is a riskier asset.

Comparing the US dollar against a basket of major global currencies, investors usually favour other currencies when the US dollar is projected to weaken. Conversely, investors should prefer the US dollar over other foreign currencies if the US dollar is projected to strengthen. However, the idiosyncratic trends between Bitcoin and the US dollar mean that investors will not be able to predict Bitcoin prices based on the US dollar. Conversely, Bitcoin prices are inversely related to the Volatility Index (VIX) where a predicted increased volatility in global markets causes Bitcoin prices to fall. Heightened volatility sparks fear and increases the pressure on financial markets, reducing investors' confidence and spiking liquidity premiums. Arguably, Bitcoin will experience more volatility in line with the wider market and thus experience a drop in price levels as investors move towards safer assets.

How the Upcoming Federal Reserve Quantitative Easing will Affect Cryptocurrency Market
With the looming Fed meeting and interest rate decisions set to be announced soon, analysts are predicting a rate cut of 0.25% to 5% which is more gradual as compared to bond market expectations. This is largely due to sticky inflation and a relatively resilient economy. However, market analysts do expect a rate further 0.5% rate cut sometime down the line in November or December as the United States nears a highly watched presidential election between Donald Trump who is widely regarded as pro-cryptocurrency and Kamala Harris who is perceived to be more anti-cryptocurrency. Successive rate cuts could help to boost Bitcoin prices as interest rates ease as the appetite for riskier assets generally increases with lower interest rates. Additionally, Trump's triumph in the elections could add further momentum to Bitcoin as BlackRock has predicted that Trump's victory and successive albeit gradual rate cuts before the turn of next year could drive Bitcoin prices to $90k a coin. However, it also warned that a combination of pre-election jitters and the persistent fears of a recession coupled with a victory for Harris could send Bitcoin prices tumbling by as much as 50% to just $30k coin. This could be a tumultuous next few months for cryptocurrency bulls as the market awaits some key macroeconomic events and data.

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Central Banks from the Rest of the World Following Suit

As the world awaits to learn the stance of the Fed on interest rates, other countries are sure to follow suit as interest rates set by the US Central Bank are often thought to be the global benchmark. However, Asian markets will be keeping an eye out on the interest rate decisions of the Bank of Japan (BoJ) as well.

Just last month, the BoJ for the second time in 17 years announced an interest rate hike due to a stronger-than-expected Japanese economy which caused a sell-off reminiscent to Black Monday. A hawkish BoJ has also expressed willingness to raise interest rates should inflation in the Japanese economy continue to hold steady and experts believe another rate hike is imminent before the end of the year. Cryptocurrency holders will want to keep an eye out on developments on the BoJ as a stronger Yen and higher interest rates in Japan could see some fund inflows into cryptocurrencies against the backdrop of lower anticipated interest rates in the rest of the world. Traditionally, lower interest rates usually signal a higher risk appetite but with renewed fears of a global recession, investors would be cautious about portfolio allocation which signals a rather uncertain coming months for the global economy as well as the cryptocurrency market.

NIACE will continue to monitor the developments in the cryptocurrency space as a slew of key market developments will be taking place over the next few months. We remain cautious but optimistic on Bitcoin as it is a high risk asset and recommend our clients invest with caution.

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