Why cryptocurrencies have gone from the next hot thing to a full-on meltdown

By | June 17, 2022
The cryptocurrency world is in chaos.

Just months ago, crypto companies were advertising heavily during the Super Bowl after virtual currencies enjoyed a dizzying rally in 2021.

Today, Bitcoin and other cryptos are plunging, and companies such as Coinbase, which runs the largest crypto exchange in the U.S., are announcing layoffs.

“The crypto house is on fire, and everyone is just rushing to the exits because there is a complete loss of confidence in the space,” says Ed Moya, a senior markets strategist at financial firm Oanda.

Here’s what’s going on.

**Why are cryptos falling so sharply?**

Because they are being hit by the same factors impacting stocks and other assets.

Consumer prices are surging at the fastest annual pace in over four decades, and the Federal Reserve is hiking interest rates aggressively to bring down inflation.

On Thursday, the Fed raised rates by three-quarters of a percentage point and indicated it could raise them again by the same amount at its next meeting in July if needed to cool down prices.

Higher interest rates make borrowing costs more expensive for people and companies, and that’s raising concerns about an economic recession.

Stocks have fallen dramatically from records set in January, with the broad S&P 500 index entering a bear market this week (when an index falls 20% or more from its recent high).

Cryptocurrencies have hardly been immune. Since Bitcoin hit an all-time high in November, the value of the world’s most popular digital currency has fallen by about 70%, and its rivals are also suffering. Ether is down by around 70% this year, and so is Dogecoin.

Bitcoin’s backers have always claimed the digital currency would be an “inflation hedge,” but in fact, it hasn’t behaved that way.

As shares of tech companies have plummeted, so has Bitcoin’s value.

“What this episode, this crash in crypto prices, shows is that cryptocurrencies are by and large speculative financial assets that are subject to macroeconomic forces, such as changes in interest rates,” says Eswar Prasad, an economics professor at Cornell University.

**So what does this mean for cryptocurrency companies?**

The sharp falls in cryptocurrencies are driving some companies into problems.

Celsius, which takes cryptocurrency deposits from individuals and lends them out, stopped withdrawals because it’s facing financial trouble. Binance, a cryptocurrency exchange, halted Bitcoin withdrawals for several hours on Monday.

The problems at Celsius are undermining confidence in the broader cryptocurrency space just weeks after the collapse of a stablecoin called TerraUSD.

Crypto companies are responding by re-evaluating their plans for the future.

Coinbase, a cryptocurrency exchange platform, reduced its staff by almost a fifth.
In a memo to staff (https://blog.coinbase.com/a-message-from-coinbase-ceo-and-cofounder-brian-armstrong-578d75edf812), the company's CEO said Coinbase "grew too quickly."

“We appear to be entering a recession,” Brian Armstrong wrote.

Some backers of cryptocurrencies still believe a “crypto winter” could lead to a “crypto spring.” In the past, deep downturns have led to strong rebounds.

But according to Moya, the analyst at Oanda, the economic landscape is different now, and so is crypto's outlook.

In fact, with the Fed continuing to raise interest rates aggressively and with inflation still high, there is likely to be more pain ahead across all markets, including cryptocurrencies.

What does this mean for those who got into cryptos?

It’s been a rude awakening for the millions of people who bought cryptocurrencies, especially if they got into the craze last year.

Prasad says 2021 was “the height of crypto mania.”

The total value of all the digital currencies in the world swelled to $3 trillion. Crypto companies inked sponsorship deals with professional sports teams, and Coinbase, Crypto.com, eToro, and FTX shelled out millions of dollars to buy ads during the Super Bowl (https://www.npr.org/2022/02/14/108027871/superbowl-ads-cryptocurrency).

Crypto.com hired actor Matt Damon as a spokesman, and an FTX ad featured the curmudgeonly comedian Larry David.

The message from these companies was that crypto represents the future of finance and it was best not to miss out.

“The technological razzle-dazzle of cryptocurrency swept in a lot of retail investors who didn’t realize the sort of risks they were taking on,” Prasad says.

Today, the total value of crypto market has been shaved to about $1 trillion. And if you bought Bitcoin on Feb. 14, the day after that Super Bowl ad bonanza, it is now worth about half of what you paid for it.

What will this mean for regulations on the sector?

The increase in amateur investors, combined with the growing complexity of some of the cryptocurrency products, are worrying regulators.

Crypto markets are still fairly new, and there’s a lack of clarity even about the most basic things, like who is in charge of overseeing the space.

Right now, both the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) claim oversight of parts of the crypto market.

“If there is no guidance whatsoever, people will be taken advantage of, and we want to prevent that” says Cam Harvey, a finance professor at Duke University. “Right now, we have basically nothing.”

The SEC is stepping up enforcement actions against crypto companies and considering new rules. Meanwhile, in an executive order, President Biden asked government agencies to make policy recommendations.

And in Congress, Sen. Cynthia Lummis (R-WY) has teamed up with Sen. Kirsten Gillibrand (D-NY), on the first comprehensive crypto legislation (https://www.npr.org/2022/06/14/110430182/crypto-bitcoin-stablecoin-regulation-senate). The bill would give more regulatory authority to the Commodity Futures Trading Commission.

Still, for now, many analysts don’t think the broader financial system is at risk. The total value of the cryptocurrency market is still less than the total market value of a big company like Apple.

But this recent downturn has raised some serious concerns.

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