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## Decentralised exchanges see volume rise but are not without risk

In recent weeks, as multiple centralised exchanges have experienced liquidity issues, traders have flocked to DEXs to push volumes to levels not seen since May. Decentralised exchanges (DEX) are smart-contract applications that facilitate peer-to-peer trading through the use of liquidity pools and automated market-makers (AMMs).

In the week beginning 6th November, a total of \$46bn was traded on DEXs across the DeFi ecosystem. The last time this level was broken was the week beginning 8th May when total DEX volumes hit \$55.5bn; just before the cascade of events over the summer led to the market conditions we see today.

Centralised exchanges manage a traditional order book, matching market makers (those providing liquidity and adding orders to the book) with takers (those executing orders against the book and removing liquidity). Using this model, all funds must be under the custody of the exchange, opening participants up to high levels of counterparty risk in the event of liquidity issues or insolvency. Simply put, to trade on a centralised exchange you must transfer custody of your assets to the platform.

When trading on a DEX, you can use a web wallet to interact directly with the smart contract and execute trades. Participants (Makers) can delegate assets to a "liquidity pool" (smart contracts that pool assets together) in exchange for a portion of the transaction fee, and participants can trustlessly execute trades against the pool.

AMM algorithms are based on a mathematical formula that seeks to ensure a constant value is maintained based on the liquidity for each token the pool supports. Assuming this is a two-sided pool, WBTC/ETH for example, the price of each side is moved in accordance.

Trading on decentralised venues is not without risk, however. Liquidity levels tend to be lower than those found on a centralised exchange's order book and prices can be susceptible to higher levels of volatility. This is amplified by the frequent creation of new DEXs across different blockchains, resulting in fragmented and thinly spread liquidity. Solutions to this, such as 1Inch on Ethereum, are aggregators that search across multiple DEXs to find the best possible option for trade execution to reduce slippage.

Using a non-custodial, or hot wallet, also carries risk as there is a single-point of failure that a malicious smart-contract could potentially compromise. CopperConnect, Copper's institutional-grade web wallet, allows clients to deploy capital into smart contracts using MPC protected wallets, reducing single-point-of-failure risks in private key management.

As market participants become increasingly conscious of security and asset custody, we may see the volume on DEXs continue to rise, leading to increased liquidity and therefore efficiency across DeFi ecosystems. Although AMMs and DEXs are still in their infancy, they are continuing to advance. New concepts, such as DEXs that specialise in fulfilling perpetual futures contracts, are beginning to enter the space to advance decentralised trading solutions.

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Source: [DefiLlama](#)



## The stable side of the market

When markets go through periods of high volatility, a flight to safety in the form of cash is expected. Likewise, for digital assets an uptick in stablecoin usage is one of the few predictable outcomes of market turbulence. Stablecoins, however, carry inherent risks — with market participants forced to choose between protocol-native stablecoins, such as DAI (MakerDAO), or centralised market leaders, such as USDC (Circle) and USDT (Tether).

The number of addresses across all USDC balance thresholds have been on the rise. Addresses holding over 1,000 USDC are up from 168,000 on the 1st November, up to 194,000 by the 24th. Those that hold over 10,000 USDC have reached 86,000 — a 14% rise from 75,500 on the 1st November.

This trend can be seen across all address sizes, with larger USDC balances having increased too. Addresses holding over 100,000, 1 million, and 10 million USDC are up 13%, 17%, and 9% this month respectively. This recent jump in USDC addresses has not been mimicked by USDT addresses, however. The surge for USDC is not unexpected, as converting assets into stablecoins is a way to hedge as prices start to fall and FTX contagion spreads. In times like these, the data is proving what the market deems the safest options for conserving capital and waiting out the storm.

Binance has also been gaining stablecoin market share. Back in September, Binance announced plans to convert all their USDC holdings, along with other stablecoins, into BUSD, effectively making a small dent in USDC dominance.

Poloniex recently announced they have halted support for stablecoins from the BNB Chain, most notably BUSD as of the 24th November. With the Tron Network founder, Justin Sun, at the helm of Poloniex, we could see a similar move to convert other stablecoins into USDD, potentially prompting further selloffs of stablecoins by exchanges.

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Source: [Dune Analytics](#)

## CBDC pilots gather pace

Despite the turmoil currently playing out in the digital asset space, governments across the world continue to experiment with central bank digital currency (CBDC) initiatives, with a number of trials announced over the last few weeks.

On the 23rd November, the Bank of Japan (BoJ) announced its intention to work with three megabanks and regional banks from the spring of 2023 to issue and experiment with “digital yen”. The experiment is due to last for around two years ahead of a BoJ decision on whether to pursue a CBDC launch in 2026.

The Federal Reserve Bank of New York’s Innovation Centre (NYIC) announced it would also be launching a 12-week proof-of-concept pilot for a CBDC. In a 15th November announcement, the New York Fed said the program would explore the feasibility of an “interoperable network of central bank wholesale digital money and commercial bank digital money operating on a shared multi-entity distributed ledger” using a “regulated liability network”.



Banking giants, including BNY Mellon, Citi, HSBC, Mastercard and Wells Fargo, will be participating in the pilot by issuing tokens and settling transactions through simulated central bank reserves.

The majority of announced pilot schemes are solely focused on wholesale CBDC market practices, which is to say they are targeting ways to improve interbank transfers and wholesale transactions in central bank reserves. This compares to retail CBDCs, aimed at providing a digital alternative to everyday currency, promoting the ability to bank the unbanked and transmit monetary and fiscal policy in a more effective manner.

China's e-yuan and the Sand Dollar in the Bahamas stand out as two of the few digital currencies, or retail CBDC's that have made it into wider society thus far. The Reserve Bank of India is due to start a retail pilot of the digital rupee in December but more generally, scepticism over the value proposition and more importantly, global macro conditions, have diverted attention and resource elsewhere for now.

## Central Banks branch out into DeFi

While it's clear momentum is building for global central banks experimenting with CBDCs for wholesale banking practices, it's interesting to note that a subset has, alongside the Bank for International Settlements (BIS), begun exploring DeFi technology for more efficient FX and cross-border payment markets with Project Mariana.

Project Mariana is a joint project between the Switzerland, Singapore, and Eurosystem BIS Innovation Hub Centres, as well as the Bank of France, the Monetary Authority of Singapore and the Swiss National Bank.

The project is a study into how AMMs could be used for the cross-border exchange of hypothetical CBDCs for the Swiss franc, euro and Singapore dollar between financial institutions settling foreign exchange trades.

The project will explore the design and application of AMMs for wholesale CBDCs (wCBDCs), as well as investigate if a regional network could facilitate cross-border settlement. It will be interesting to see how this and any further DeFi experiments play out. Will G20 consensus around a solid DeFi use case be the catalyst that eventually brings all major Central Banks to the CBDC table?

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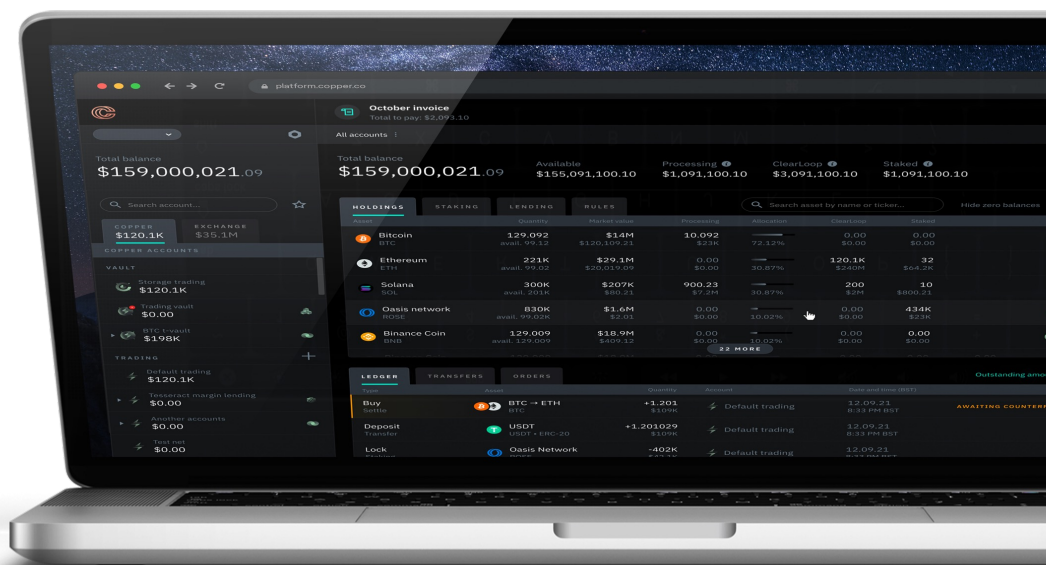
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