market notes: Where Are "Real" Transactions? Trust the Hype

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5/10/24 - Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. The wow factor: Bitcoin has processed more than one billion transactions and enjoys 99.99% uptime. Its success walks the thin emotional line between love and hate. The focused attention from industrialists, financiers, lawmakers, and regulators speaks to the rising relevance of crypto technologies, despite the love-hate relationship. Ironically, there's a race to harness the properties behind Bitcoin's value proposition that many profess to despise. The future of finance is onchain.

2. Eighteen months into this bull cycle, the performance of cryptocurrencies differs significantly from past cycles. The unique features put a spotlight on how investors see their future utility. Meme coins are experiencing yet another surge in popularity. But the combined crypto market share of Bitcoin and Ethereum has increased to 70%, unlike declines in previous bullish cycles. The market is shifting focus from competing with these leaders to building value within them.

3. How do investors distinguish between those leaders? Crypto fundamentals paint a clear picture. Take our Digital Pulse and the performance of its "velocity" factor – the rate of token turnover. Bitcoin scores zero, indicating that holders are, well, "hodling" – retaining their investments longer term. In reverse, Ethereum scores a high 65. It speaks to increasingly-entrenched investor sentiment – Bitcoin is seen as the digital equivalent of gold and Ethereum as oil.

4. Various data reinforce this message. There is $54 billion of value locked in the Ethereum protocol, far greater than the next largest at $8 billion. Fees paid for Ethereum services are tracking over $4 billion annualized this year alone, dwarfing other protocols and startups. Success is an inviting self-reinforcing mechanism, too. Ethereum's ecosystem has more than 2,000 active developers, working on upgrades that aim to widen its lead.

5. But the activity on Ethereum in this cycle is also narrow, leaving it ripe for disruption. Of the top ten tools built on Ethereum, 52% are tied to services employed to validate Ethereum transactions – Lido "staking" at $28 billion and EigenLayer "re-staking" at $15 billion. These are hardly the killer applications that will capture user imagination. If anything, Lido demonstrates a tendency for users to migrate to centralized services, with a 28% market share.

6. So, where are the "real" transactions? New protocols have to prove themselves before the big financial players engage. And they are engaging. Walmart, IBM, JP Morgan,

Blackrock, Swift, the Bank of International Settlements are all testing or deploying Ethereum for blockchain solutions, either directly or indirectly, through permissioned layers that are rebranded like JP Morgan's Onyx. As the opportunities grow, so too does Ethereum's competition.

7. For one, past Bitcoin upgrades are bearing fruit, opening the door to multi-asset activity that would compete directly. Taproot Assets, built by Lightning Labs, did its first transaction this month. The introduction of Bitcoin-based stablecoin is also imminent. It's a critical reminder to those building blockchain solutions – crypto is dynamic and their "do-nothing" base-layer tokens like Bitcoin act as a future reserve asset for the digital economy.

8. Existing financial intermediaries are also testing real-world asset and cross-border currency payments with a shared blockchain. This approach competes with decentralized tools. The Regulated Settlements Network will work on a feasibility trial across ten enterprises to bring 24/7/365 settlement to payments and assets. Of course, the emergence of these trials validates the value proposition of crypto – the evolution started with Bitcoin, after all.

9. The competitive friction across public and private blockchains is unlikely to be winner-takes-all. Like the excitement about real-world assets migrating onchain, and the dynamism of smart contracts, so too will identity and parametric policy move to smart contract solutions. Naturally, policymakers will seek permissioned guardrails. But there is also an inherent legacy disadvantage. The banking system is plagued with unresolved stability issues dating back to 2008.

10. Financial stability is about balance sheets. They are infinitely lived, a cumulative history of good and bad decisions. Central banks are confronting great tension in their policy objectives. Keep rates too low and risk inflation, too high and risk instability. This tension constrains the ability for legacy operators to innovate, periodically distracted by intense instability like 2023. It gives the advantage to innovators in permissionless finance. It keeps progressing – guard rails and all.

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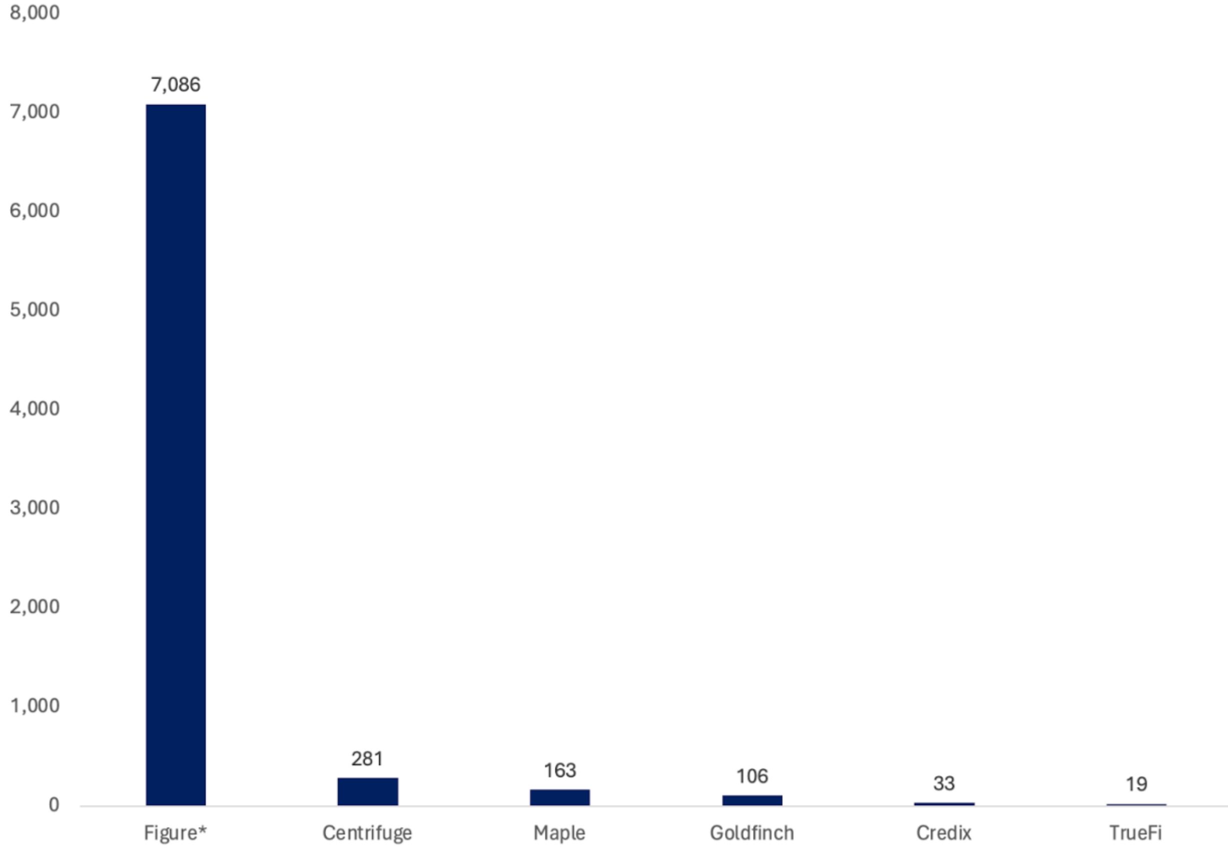
Figure 1: Real World Assets – Active Loans Onchain (MN USD)



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