market notes: It's All About the Base…and Bananas

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03/08/24 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. "Better, faster, cheaper" is the mantra underpinning innovation, even those we often take for granted – like bananas. No matter where I am in the world, the ubiquitous banana and its journey to my table sparks my curiosity. My latest feast traveled more than 22k kilometers from Ecuador at a bargain price. Impossibly delicious. But it's a banana in disguise. The economics tell me I'm eating oil used for transportation. Can innovation make it even better? Food companies think so!

2. Innovation, especially in sustainable food production like low-water bananas, remains latent without the right economic incentives to unlock it. Food companies will not invest in better banana production without an expectation of return. Economic planning matters. China's per-capita GDP was less than half of Lebanon in 2000 and is now triple the size. And if profit motives were removed from China or elsewhere, capital would leave and drive a march down the value curve.

3. Just as innovations in agriculture can bring a banana to my table more efficiently, financial innovations built on crypto technologies aim to simplify and secure our transactions. Innovation is inherently slower in finance. But even in banking, the principles apply. The internet killed stock certificates with electronic communication networks, the repository for ownership rights. A piece of paper was replaced with a bunch of numbers to document the financial asset and its ownership.

4. Why? It's a better user experience. When's the last time you looked up your ETF equity and bond holdings by CUSIP number? Probably never. It's also why investors are comfortable with trusted third parties – they make everything work. The tension in mainstreaming crypto technologies lies in balancing decentralization with regulatory and investor trust. Who's in charge? Decentralization is not only a difficult concept for regulators, sophisticated investors struggle to trust in math, too.

5. Investors want reliable bridges to new technologies. And exchange-traded funds are serving this role, offering a familiar gateway to the novel terrain of crypto. Investors are delivered the trust of third parties and familiar execution built on unconventional pipes and plumbing. Bitcoin ETFs unlocked pent-up demand based on this user experience, not its technology. In fact, the attributes of the ETF are lesser than its underlying asset. Users are voting for the experience, not philosophy.

6. What is the root of the pent-up demand? Let's listen to markets. They are moving in ways that they are not "supposed to." The Fed is reinforcing that real policy rates are too high, and that inflation is increasingly likely to stay low for long. Assets like bitcoin and gold that offer no yield should be suffering. Instead, they are racing to new highs. Both are reserve assets – there is no inherent yield and long-term holders don't trade it much. They are low-velocity assets.

7. It's about behavior, not the investment wrapper. Bitcoin and gold have a 62% correlation this year. Yet, market flows are clearing in very different ways. More than 49 tonnes of gold exited ETF coffers in February, a demand reduction of 1.6%. Bitcoin is playing the reserve asset for the masses while gold takes center stage for institutions like central banks. Institutions are crowding retail investors out of gold while retail investors are crowding institutions into bitcoin.

8. The digital economy has self-selected the US dollar as the high-velocity asset of choice. It's called stablecoin and it will also be unlocked when regulatory perimeters encourage its broader use because it's many times more efficient. Figure 1 shows the US monetary system versus the Crypto dollar regime. Roughly $5 trillion dollars of central bank money supports $28 trillion in nominal activity. Stablecoin velocity is nearly 50 times greater today – that's the efficiency improvement.

9. Efficiency is a double-edged sword. Yes, it reinforces the role of the US dollar as the dominant global currency. Investors are confident in the property rights of the assets backing stablecoins. It easily scales, so the world can converge to a common payment currency. But it also means users don't have to hold as much "cash." Excess cash holdings can instantaneously be swapped into assets, and assets can be converted to a means of payment, 24/7/365.

10. But what does that future innovation look like? Following the philosophy of learning by teaching, I showed a kid how it worked today. I took a fraction of an NFT on Base and sold it for $0.59 USDC, an impossible task only a year ago. It will only get cheaper and faster over time, a feature of Ethereum's expected upgrades next week. The kid immediately recognized the benefits – it's easy, it's (nearly) instant, and it's micropayments. Curiosity piqued, the conversation continued.

11. "Can you go buy something with 59 cents now? Oh, go buy a banana then I can tell my teachers blockchains are bananas…no, seriously." Just as blockages prevented investors from gaining their user experience of choice with bitcoin, so too are stablecoins precluded from the banking system. That is now, not forever. Seamless ramps between crypto wallets and the banking system are just a matter of when, not if. And when that happens, we'll be buying a bunch of bananas on Base.

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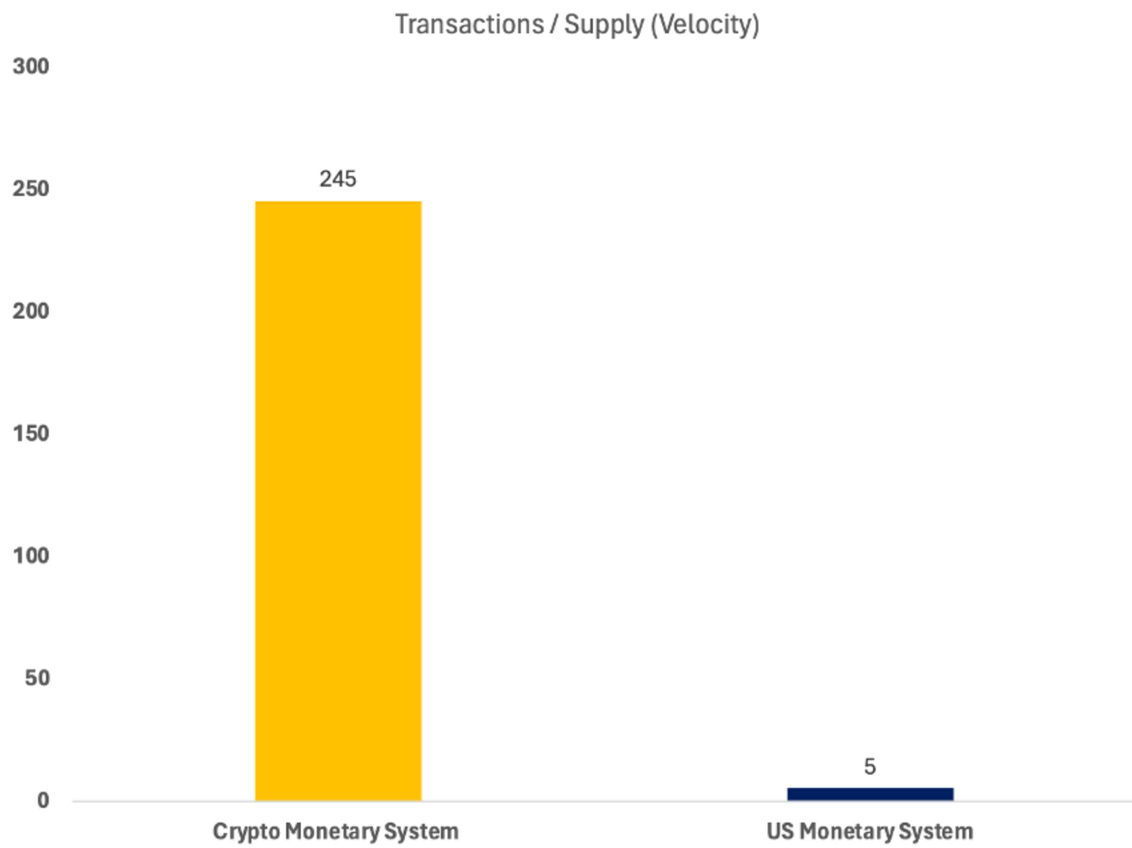
Figure 1: Digital Dollars – Better, Cheaper, Faster Money



Source: Messari. Federal Reserve Board of Governors. St. Louis Fed. CBAM Calculations. Crypto transactions are transaction volumes adjusted for double-counting (Messari) on the 24-hour period through October 8, 08:00ET at an annual rate.

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