2023 Q2 Outlook Report

APRIL 2023

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About This Report

The first quarter of 2023 saw a challenging start from a macroeconomic perspective, but it was also marked by a significant increase in crypto asset prices and adoption. In this report, we cover the macroeconomic environment of Q1 2023 and look forward to how this might change in the new year. Off the back of this, we assess the developments in the centralised exchange sector, decentralised finance, and stablecoins & CBDCs, all while providing our view on trends to look out for in this subsector of the digital asset economy.

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Executive Summary

In the first quarter of the year, authorities stepped up their efforts to regulate the digital asset industry. This has resulted in lawsuits being filed against centralised exchanges and crypto leaders over products and conduct. Many crypto-native firms within the United States have also been left without banking options, following the closure of the Silvergate Exchange Network (SEN) and Signet in March. The Federal Reserve, FDIC and the OCC also issued a joint statement discouraging banks from accepting deposits from crypto companies, further exacerbating the situation.

Despite these challenges, digital assets have rallied in the first quarter and outperformed their traditional counterparts, defying expectations given the worsening macroeconomic environment. Uncertainty in the market has restored the 'safe haven' narrative for Bitcoin, while other factors such as the evolution of Layer 2 networks, Ethereum's Shanghai upgrade and continued DeFi growth, have contributed to what has been a strong start to the year for the industry.

The rise in the value of crypto assets has also sparked a surge in decentralised applications. As a result, decentralised exchanges have seen a surge in volumes, often outperforming their centralised counterparts, which have struggled with liquidity issues and outflows. Overall, the market has become more cautious this year, and speculation has declined, leading to an overall drop in trading volumes.

In this report, we provide readers with a comprehensive, data-driven analysis of the digital asset landscape, reflecting on the key events of the previous quarter while casting an eye towards the future, pinpointing emerging trends and potential developments in the coming months.

Key Expectation

Bitcoin Market Dominance On The Rise

In the early stages of previous market rallies, Bitcoin has typically led the market, as investors shift capital from altcoins and stablecoins into the largest digital asset. Recently, Bitcoin's market dominance has started to increase, rising to 45.2%, its highest level since April 2021. This is a substantial increase from ~36% market dominance, which it maintained during the collapse of FTX when its price dipped to a yearly low of $15,760.

Ethereum Continues to Dominate DeFi

Ethereum continues to be the dominant network for DeFi, with its total value locked (TVL) rising 52.0% to $76.8bn in Q1 2023, and its market share increasing to 72.0% from 68.6% in the previous quarter. The rise of liquid staking protocols, such as Lido Finance and Rocket Pool, have also contributed to Ethereum's increasing dominance in DeFi, with their TVL growing by 84.1% and 105%, respectively.

Centralised Exchange Volumes See Quarterly Rise

During the first quarter of 2023, market turbulence and loss of confidence impacted trading volumes. Monthly volumes averaged $932 billion, a 16.8% decline from the 2022 monthly average of $1.12 trillion. Despite the overall decline, when comparing Q1 2023 to Q4 2022, centralised exchange volumes have increased by 23.2%, from $7.57bn to $9.33bn.

Uniswap Sees Boost in Liquidity

When comparing the liquidity of ETH on Uniswap V3, the largest decentralised exchange, to Binance and Coinbase, we found that Uniswap V3's liquidity has grown substantially, registering an impressive 208% increase. In contrast, Coinbase and Binance have recorded declines of -6.35% and -13.4%, respectively. This boost in liquidity may be attributed to market participants attempting to capitalize on the USDC peg deviation and adding liquidity to pools such as ETH-USDC.

Decentralised Exchanges Gain Traction

Decentralised exchanges (DEXs) have witnessed a 27.6% increase in average monthly volumes (Up till the end of March) compared to 2022. By the end of March, Monthly volumes for DEXs reached an average of $97.0 billion, a substantial increase from the $76.1 billion observed in Q4 2022 average. Uniswap V3 has taken the lead in terms of trading volume, capturing 50.3% average monthly market share of the total decentralised exchange volume.

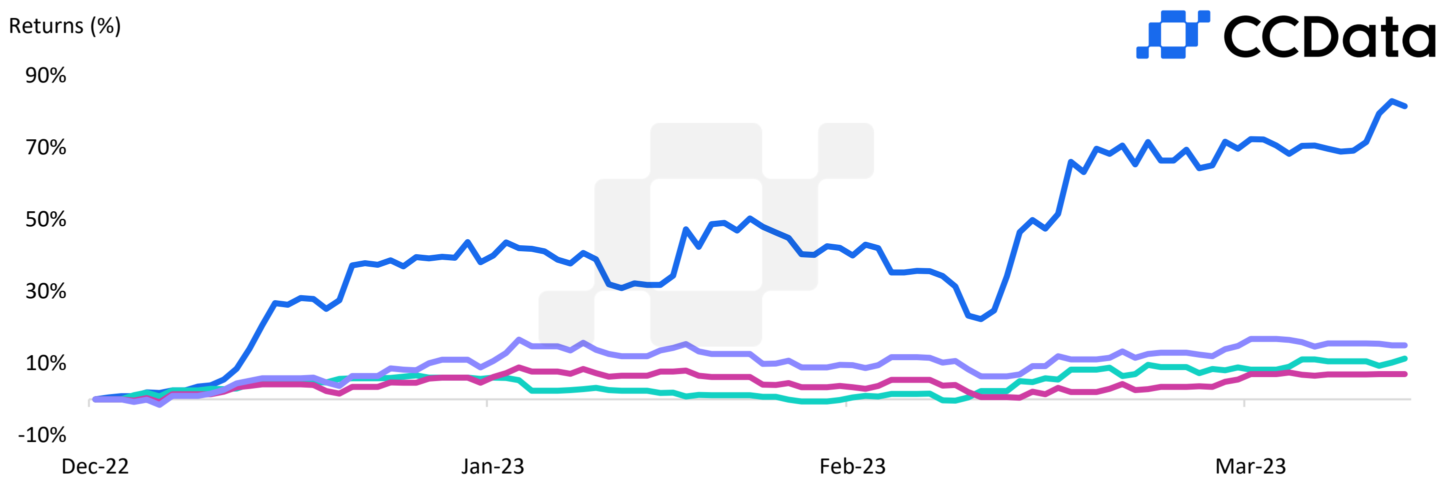
Introduction

In Q1 2023, the SEC issued a Wells Notice to Paxos, the company behind BinanceUSD, the third largest stablecoin. Additionally, Genesis, a leading market maker in the industry, filed for bankruptcy, succumbing to events of the past year. Centralised exchanges have also faced increased scrutiny in Q1, with the SEC closing Kraken's staking program, delivering a Wells Notice to Coinbase, and the CFTC filing a lawsuit against Binance.

Despite all of this, digital assets have rallied in the first quarter of 2023 with the price of Bitcoin and Ethereum rising 72.3% and 52.5% to $28,477 and $1,822 – levels not seen since June 2022. As a result, digital assets have been one of the best-performing asset classes when compared to their TradFi counterparts.

The current macroeconomic climate has created an environment in which Bitcoin could fulfil its role as an alternative asset class, amidst a stuttering banking sector and ineffective government policies - sharing similarities to the very economic climate in which it was born and created to be the solution.

Figure 1: Bitcoin Performance Against Traditional Asset Classes



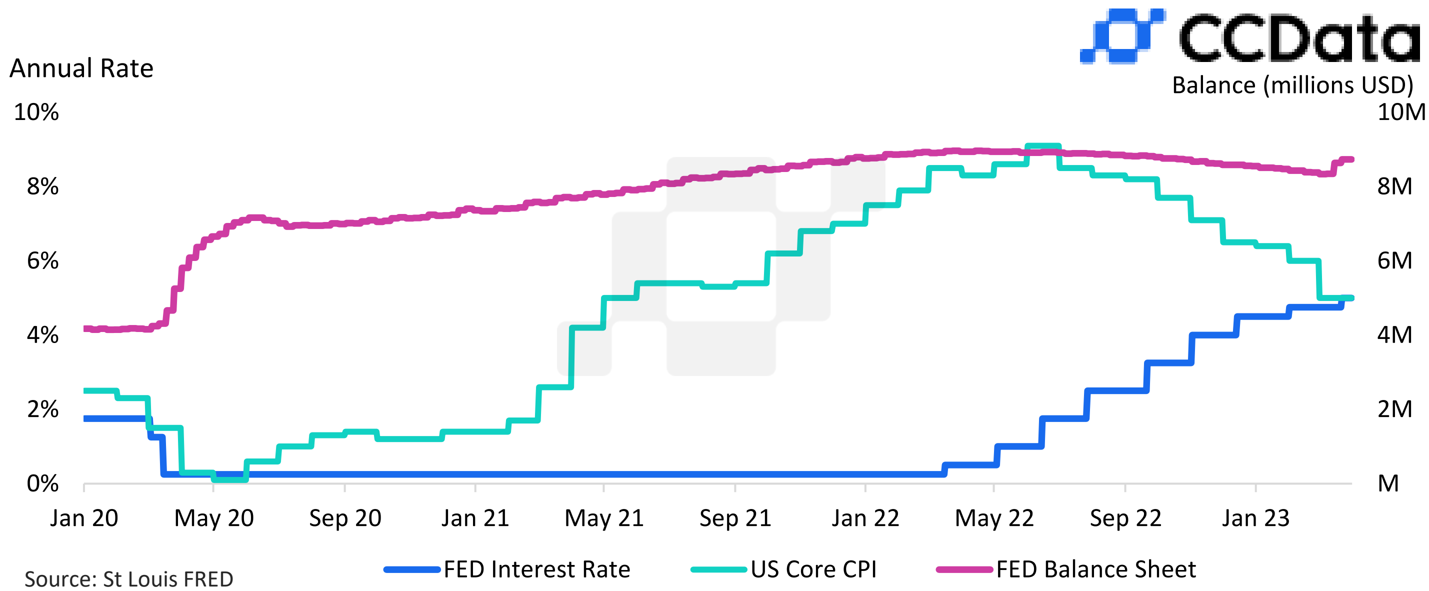
Source: CCData, Market Watch

Macroeconomic Outlook

Unprecedented Times

Following a quarter of record-breaking interest rate hikes, regional bank collapses and persistent inflation, uncertainty surrounds many global economies in the coming months. Post-COVID consumer demand, the Federal Reserve's loosening of its balance sheet, and increased GDP forecasts may, however, bring relief to risk assets.

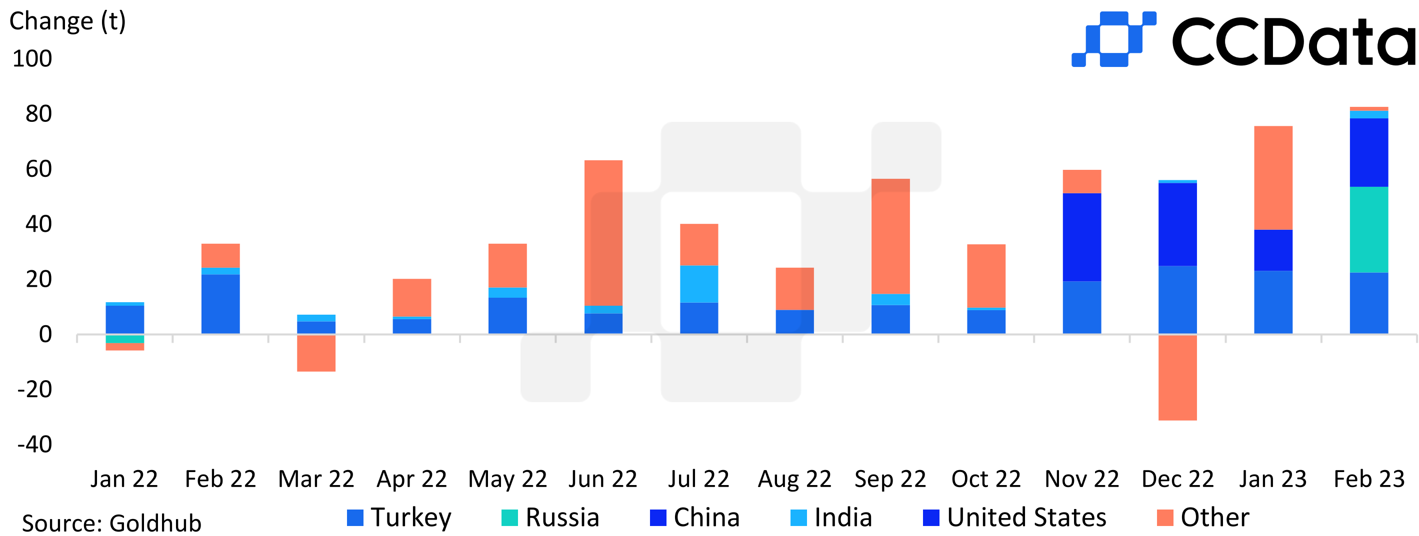
Figure 2: US Core Rates vs FED Balance Sheet



The Fed has continued to raise rates in the first quarter of the year which; until recently, had successfully removed almost $625 billion from its balance sheet and brought headline inflation down to 5.0% (as of March). However, in lieu of the current banking crisis brought about by these rapidly increasing rates, hundreds of billions of dollars were re-injected to bail out banks that had over-exposed themselves to long-term, fixed-rate, low-interest debt instruments. This undid four months of quantitative tightening, and the effects of this on core inflation are yet to be seen.

Core CPI fell from a peak of 9.1% in June 2022, to 6.5% by the end of the 2022. This downtrend has continued to bring current CPI down to its current level of 5.0% in March 2023. However, the confidence central banks have in their quantitative tightening efforts is uncertain, as the World Gold Council announced that there have been 11 straight months of net gold purchasing. In the first two months of 2023 alone, 125 tonnes of gold were purchased, the strongest start to the year since 2010.

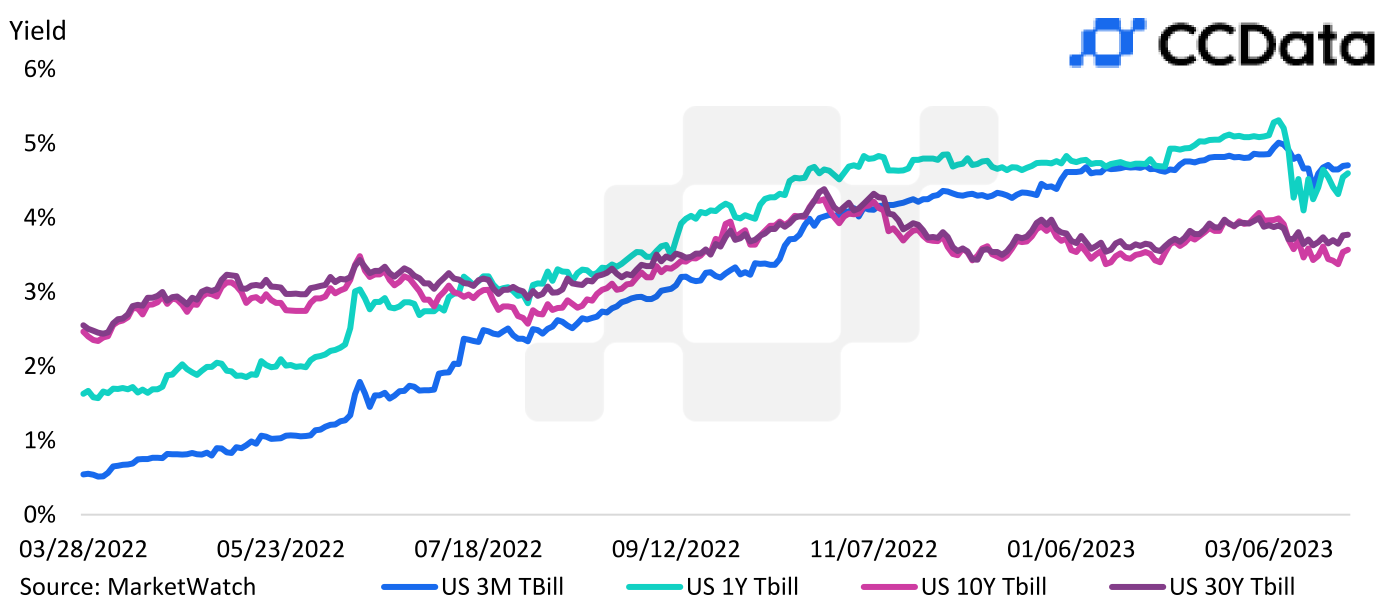
Figure 3: Reported Monthly Change in Central Bank Gold Reserves



Patterns of Bank Collapses

Short-term (3M T-Bill) yield surpassed longer-term yields (10Y T-Note and 30Y T-Bond) amid growing uncertainty at the end of October 2022, with yields converging at 4.1%. As this spread widened, the long-term, fixed-rate, low-yield portfolios of banks began to decline- leading us to the current banking environment we are experiencing. Short-term yields currently sit at 4.7% while longer-term yields are down at 3.6%.

Figure 4: US Treasury Yields by Duration, 2022 - 2023

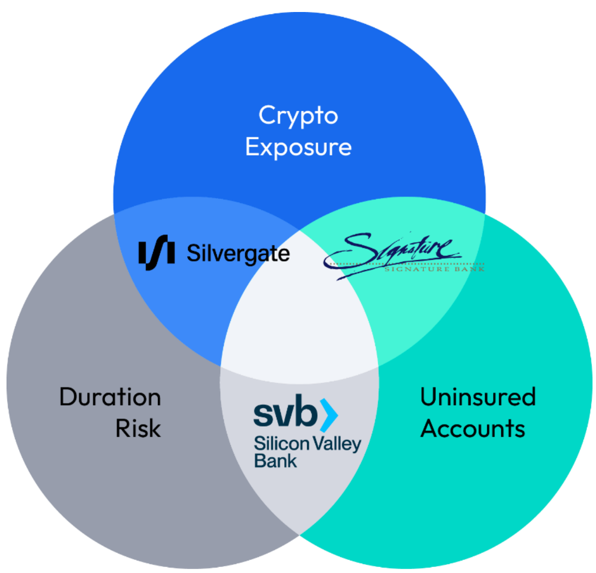


A Run on the Banks

Silvergate Bank - Large crypto-exposure led to depositors withdrawing $8.1B post-FTX-collapse, incurring the realisation of a $718M loss to meet liquidity requirements. These previously unrealised losses were a product of the bank's exposure to fixed-rate long-duration securities, whose mark-to-market value cratered amid record breaking interest rate hikes. Prolonged losses from sales of securities at mark-to-market price led to Silvergate undergoing voluntary liquidation.

Silicon Valley Bank (SVB) - Two days later SVB attempted to raise capital after they had been forced to sell almost $2B of securities at a loss to meet liquidity requirements. These losses were incurred again by over-exposure to low-rate long-duration debt instruments. This attempt to raise capital spooked investors, and triggered a run on the bank, with $42B in withdrawals the following day. First Citizens acquired $72B of SVB's assets at a $16.5B discount, while $90B in securities remain in receivership.

Signature Bank - 48 hours later, the two dangers exposed by the demise of Silvergate and SVB, led to the multi-billion-dollar bank run that led to Signature's decline - large amounts of crypto exposure, and a large portion of uninsured deposits. Cryptocurrency-related client deposits totalled $16.5B, including deposits from industry giants Coinbase and Circle (which saw 89.3% of their total $110B in deposits uninsured). Two days after the collapse of SVB, the New York State Department of Financial Services closed Signature Bank, due to it being unable to present capital to meet client withdrawals.

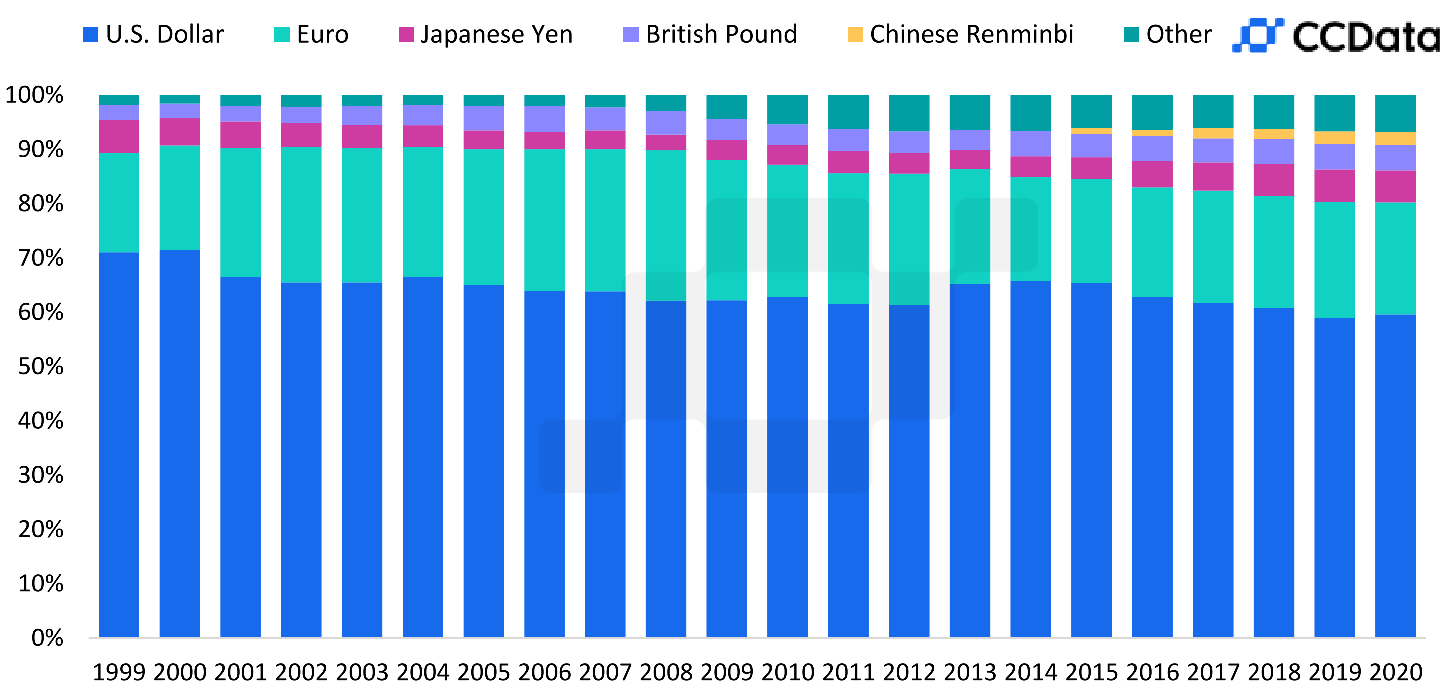


Dollar Dominance

For the last 80 years, the US dollar has been the global reserve currency and almost all trades have been based on the dollar. However, the invasion of Ukraine by Russia last year once again highlighted the weaponization of the dollar, allowing the US to heavily impact the economies of other countries via aggressive trade sanctions. In response to this, sanctioned countries will be forced to turn to other currencies to settle international trade. As a result, the Chinese Yuan overtook the US dollar in trading volume on the Moscow Exchange (MOEX), in February.

The dominance of the US dollar has been steadily declining over the past twenty years. The share of USD reserves held by central banks fell to 59.8%, the lowest in 25 years during 20Q4, with other currency reserves at: Euro (19.7%), Yen (5.3%), Pound (4.6%), and Yuan (2.8%). As well as this, the GDP of BRICS nations (Brazil, Russia, India, China, and South Africa), has now surpassed that of the G7 (31.5% of the total, vs 30.7%).

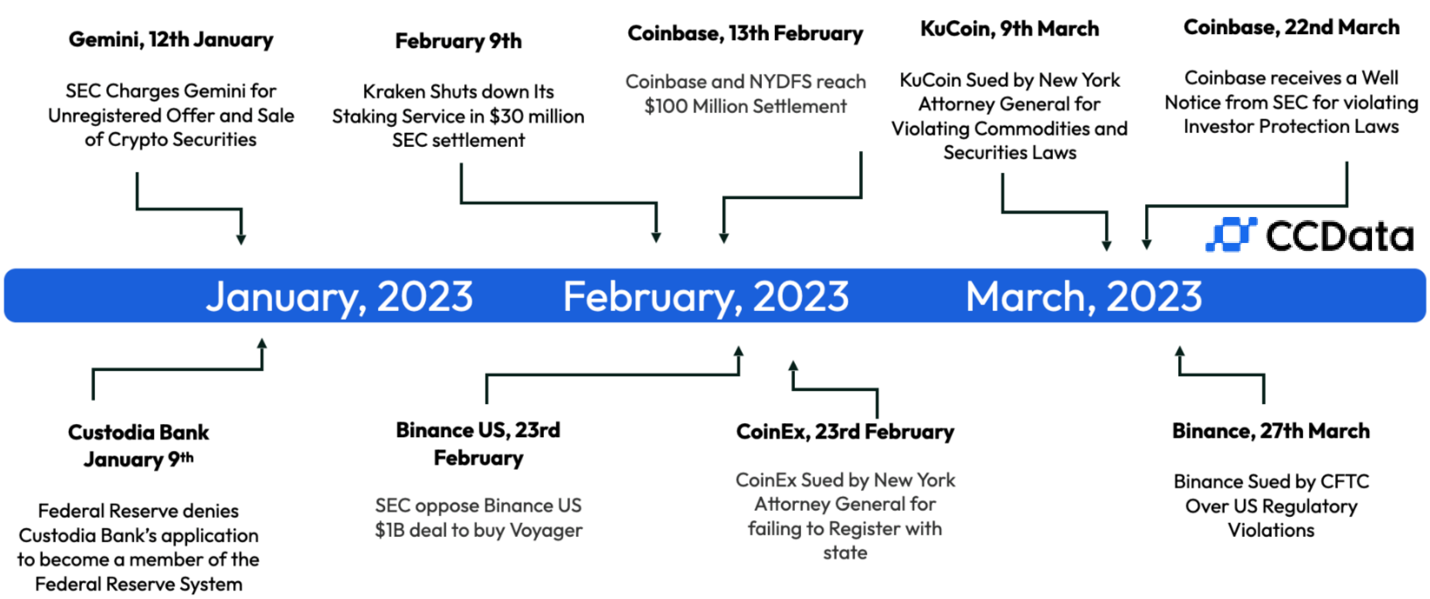
Figure 5: Composition of Globally Disclosed Foreign Exchange Reserves



Centralised Exchange Outlook

The decline of FTX in November 2023, and traditional finance failures, have underscored the need for transparency within the centralised exchange sector and resulted in heightened regulatory pressure, which is expected to be the dominant trend for centralised exchanges in 2023. This narrative has been instrumental in shaping the centralised exchange industry in the past couple of months and has had a notable impact on both the exchanges and the broader cryptocurrency industry; with volumes and liquidity witnessing a sharp decline.

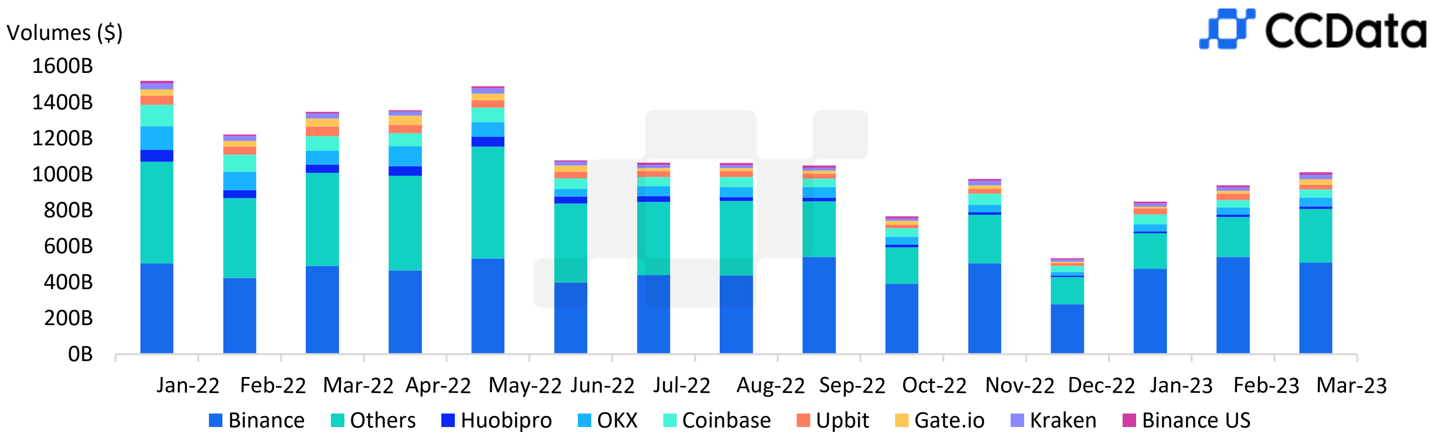
Figure 6: Highlights of Regulatory Stringency, 2023



Exchange Volumes

During the first three months of this year, monthly volumes averaged $932 billion, 16.8% lower than the 2022 average of $1.12 trillion. Furthermore, there has been a consolidation of volumes, with the top 8 exchanges accounting for a higher percentage (70.5%) of total volumes compared to January 2022 (Only 62.7%). This consolidation was expected and has been advantageous for larger exchanges. For example, Binance's market share increased significantly from 33.2% in January 2022 to 50.3% in March 2023. Although average yearly volumes have decreased, when comparing Q1 2023 with Q4 2022, we see that centralised exchange monthly volumes have increased by 23.2%, from an average of $7.57bn to $9.33bn.

Figure 7: Centralized Exchanges Volumes, 2022 - 2023



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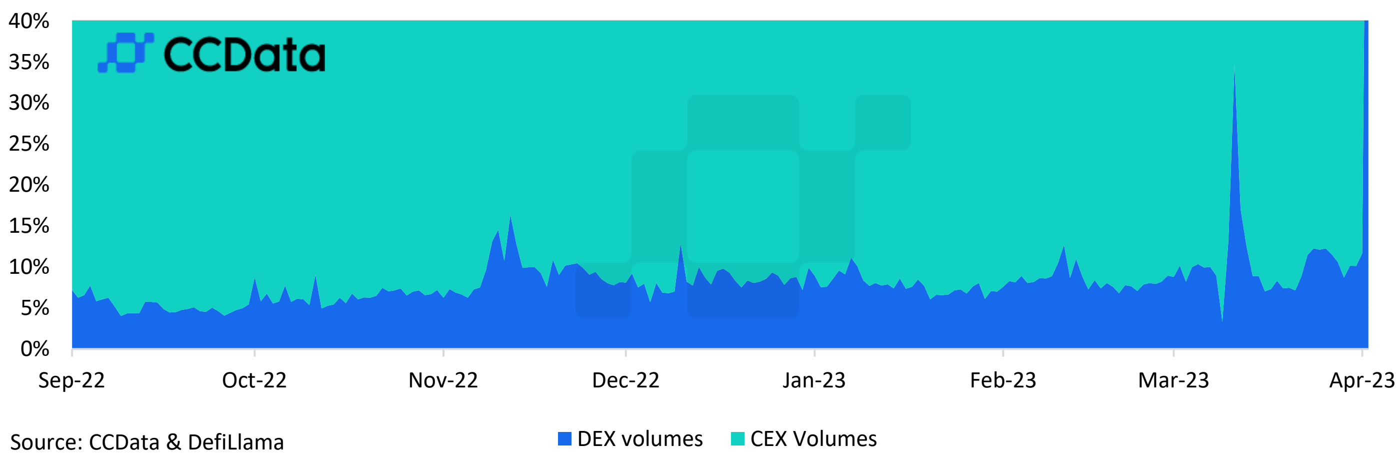
Decentralised Exchanges (DEXs) have experienced a similar trend with a slight positive increase compared to centralised exchanges. As of the end of March, DEXs have recorded an average monthly volume of $97.0 billion, compared to $76.1 billion in Q4 2022, a 27.6% increase. Notably, Uniswap V3 has been the leader in terms of volume, accounting for an average monthly market share of 50.3% of total decentralised exchange volumes.

Figure 8: Centralised Exchanges vs. Decentralised Exchanges, 2022-2023



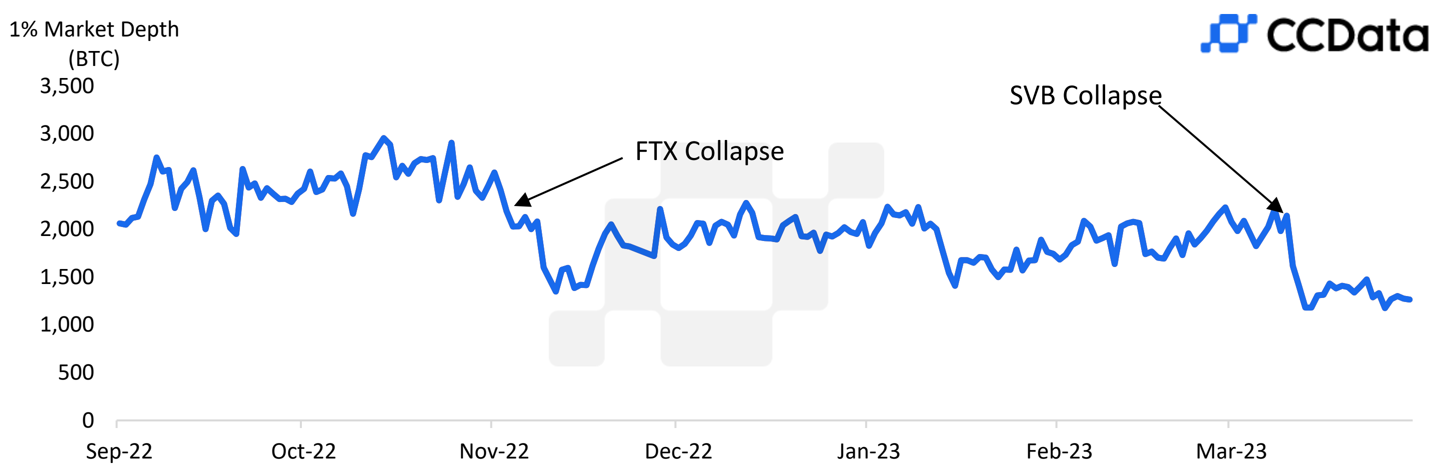
Source: CCData & DefiLlama

"We expect regulatory enforcement on centralised exchanges to further intensify, impacting volumes more on centralized exchanges and creating more opportunities for decentralized applications to expand and prosper. Furthermore, we expect the consolidation trend in centralised exchanges to increase, with the top 10 exchanges accounting for more market share."

Exchange Liquidity & Reserves

The impact of regulatory pressure on market liquidity has been noteworthy, particularly during times of uncertainty, such as the depegging of USDC. The exchanges that were analysed in the following charts indicate a significant drop in 1% Market Depth for BTC-USD and BTC-USDT pairs, with Liquidity reaching its lowest point for USD and USDT during the SVB Collapse on the 26th of March.

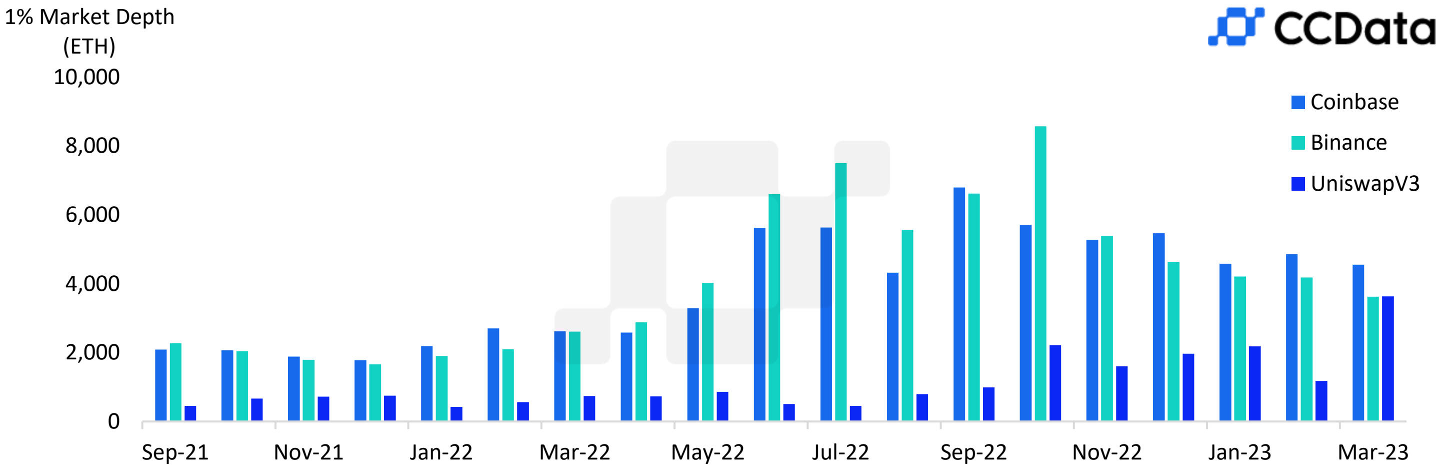
Figure 9: Liquidity Drop on Centralised Exchanges, 2022-2023



Exchanges: Binance, Coinbase, Binance US, Kraken, Bitfinex, OKX

On the contrary, the liquidity of decentralised exchanges has experienced a notable surge, resulting in a significant market share shift from centralised exchanges. When examining the liquidity of ETH on Uniswap V3, the largest decentralised exchange, and comparing it to Binance and Coinbase, we discovered that Uniswap V3's liquidity has significantly and substantially grown, registering an impressive 208% increase, whereas Coinbase and Binance have recorded a decline of -6.35% and -13.4%, respectively. The boost in liquidity could be attributed to market participants attempting to capitalise on the depeg of USDC and adding liquidity to pools such as ETH-USDC.

Figure 10: Liquidity Increase on UniswapV3, 2023



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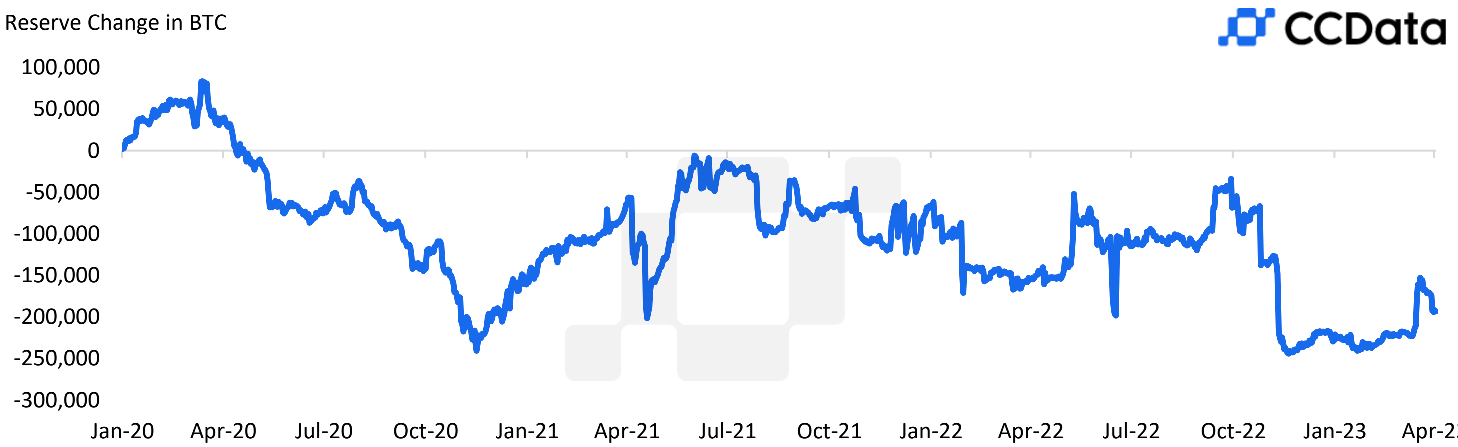
Low liquidity and trading volumes have significantly impacted the reserves of centralised exchanges, with exchange reserves hitting their lowest levels since 2020. Upon analysing net flows, we observed a slight improvement in March, which was fuelled by the narrative of Bitcoin being a safe haven after the recent banking collapses. However, when considering a longer timeframe, we notice a significant decline in reserves, which is a clear indicator of the growing uncertainty in the digital asset markets and the influence of regulatory stringency.

Figure 11: Centralised Exchanges Reserves, 2020-2023



Data from Binance, Coinbase, Bitfinex, OKX, Bitstamp, Huobi and Luno

"In the near future, we anticipate a decrease in liquidity and an increase in outflows for exchanges due to the rising enforcement actions taken by SEC against centralized exchanges and the growing concerns surrounding exchange compliance and security. "

Derivatives Are Leading the Narrative

Historically, derivatives activity has been a significant contributing factor to recent market rallies. However, the leverage ratio, which measures the significance of open interest compared to market capitalization, suggests that market participants are becoming increasingly concerned about the future and are using less leverage in the crypto market. This narrative has also been reflected in volumes, which despite seeing a slight increase of 18.1% from $1.94bn last quarter of 2022 to $ 2.30bn in this quarter, is retracing back from $2.95bn; the average of 2022.

Figure 12: Leverage Ratio Plummets - 2022-2023

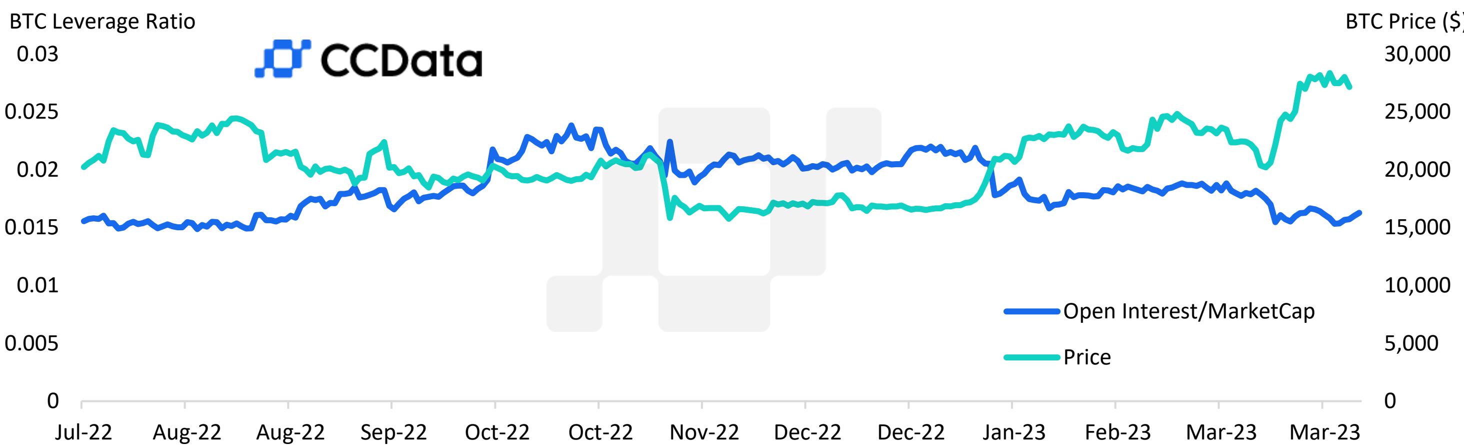
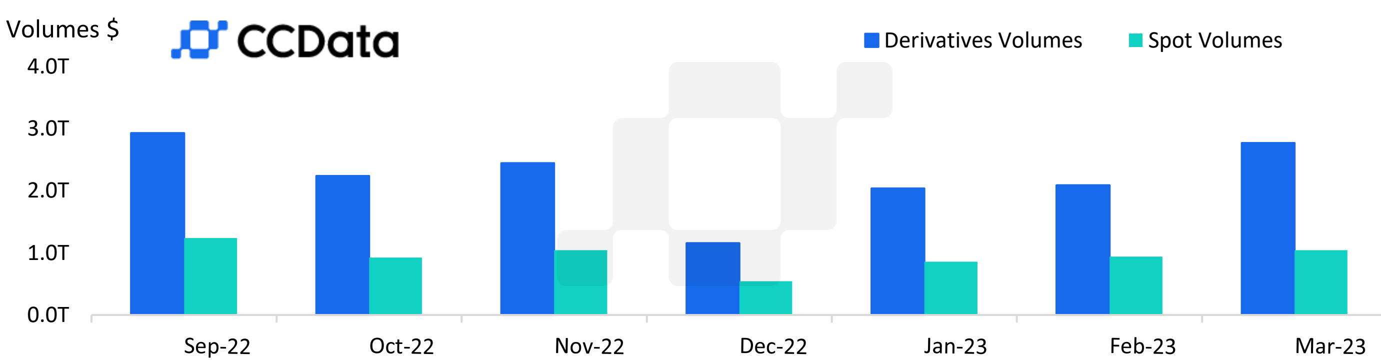


Figure 13: Spot Exchange vs. Derivatives Exchanges Volumes - 2022-2023



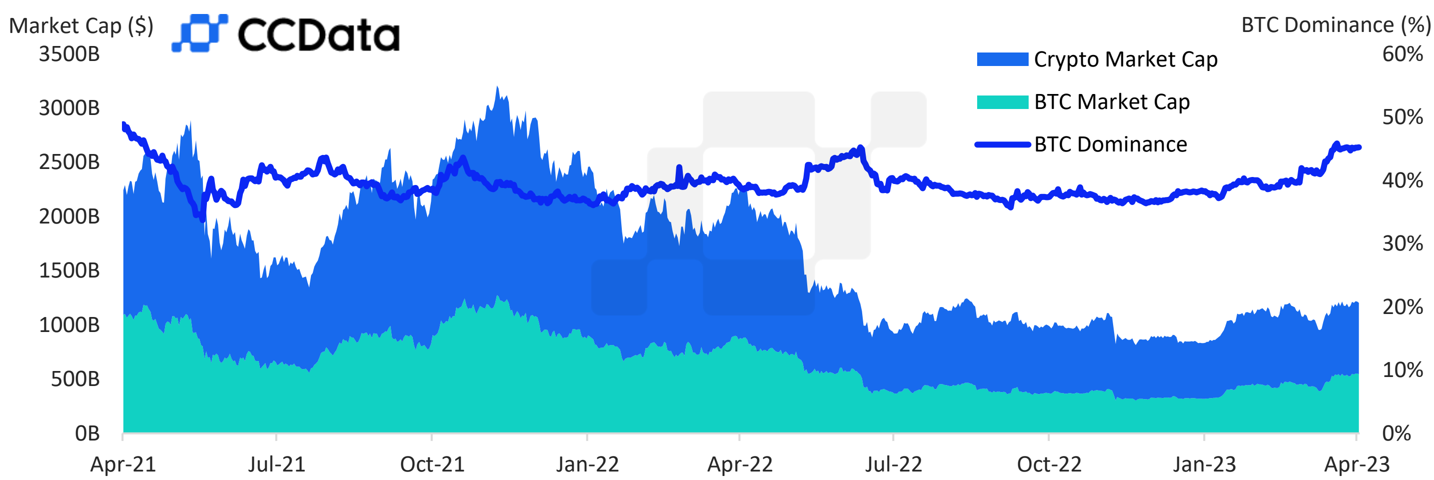
Asset Outlook: Bitcoin, DeFi and Stablecoins

Bitcoin to Lead the Market

Examining Previous Market Cycles

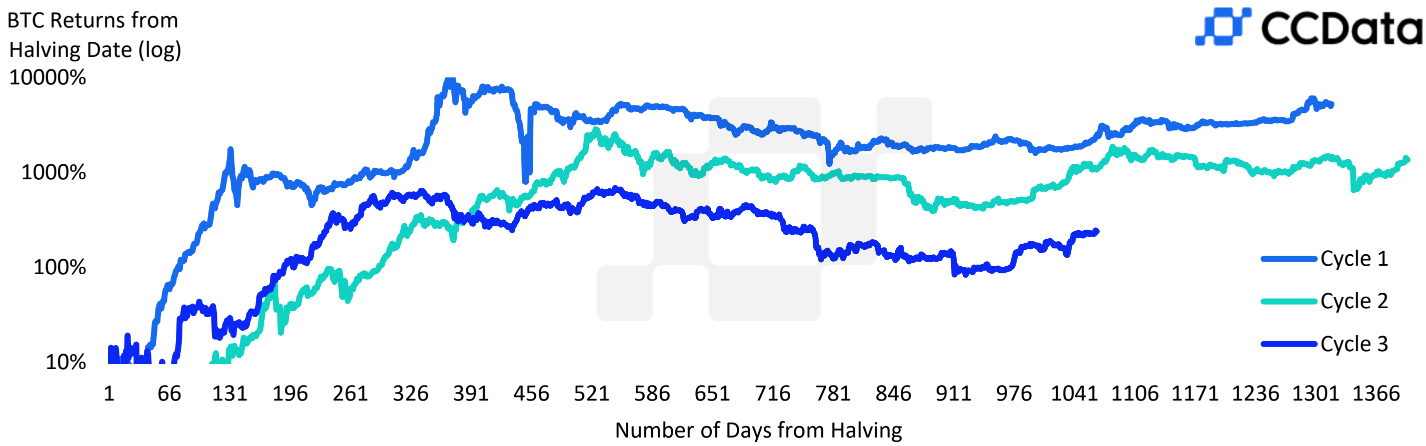
In the early stages of previous market rallies, Bitcoin has typically led the market, as investors shift capital from altcoins and stablecoins into Bitcoin, perceiving it as a safer asset. Recently, Bitcoin's market dominance has started to increase, rising to 45.2%, its highest level since April 2021. This is a substantial increase from ~36% market dominance, which it maintained during the collapse of FTX when its price dipped to a yearly low of $15,760.

Figure 14: Bitcoin Market Cap and Dominance, April 2021 - Present



To better understand Bitcoin's current performance, it is helpful to examine its behaviour in previous market cycles. In the previous two cycles, the accumulation period from the market bottom after the breakout to the halving date spanned at least 500 days. This would mean, if we were to assume that the market bottom for this cycle was in November last year (when Bitcoin hit a yearly low of $15,760), then we are only 129 days into the current cycle as of March 30th. This would also be confluent with the next Bitcoin halving date, expected to be in May 2024, which is another ~400 days ahead.

Figure 15: Halving Influence on Bitcoin Price

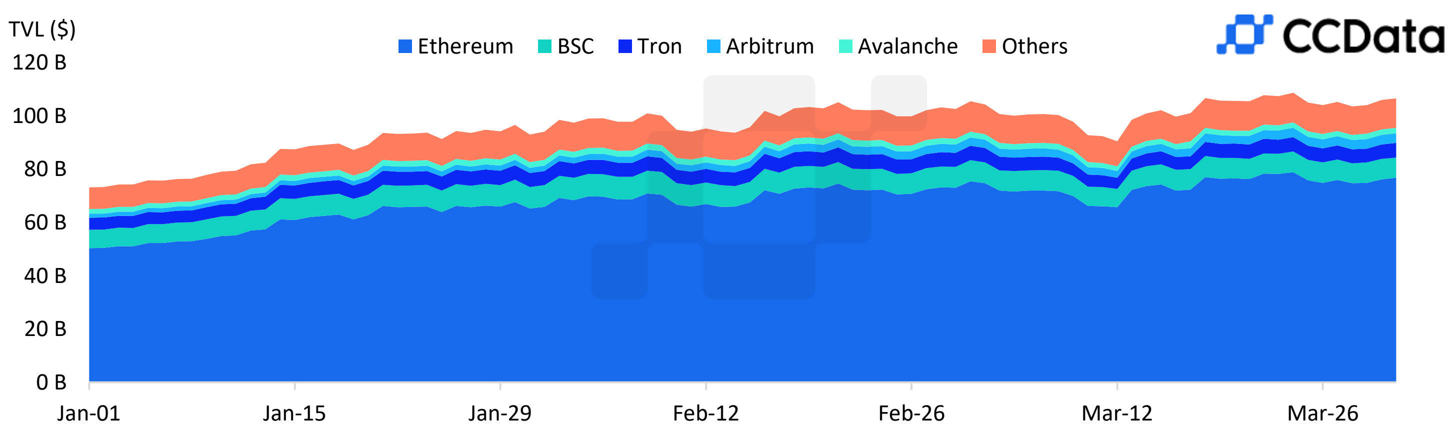


DeFi Recap

Ethereum Dominance in DeFi Continues to Rise

The digital asset markets witnessed a surprising uptrend in Q1, with the TVL in DeFi rising 44.8% to $107bn in Q1 of 2023. Ethereum remains the dominant chain in DeFi, with its TVL rising 52.0% to $76.8bn in Q1 and its market share rising to 72.0% from 68.6% in the last quarter. This is the highest market dominance of the network since September 2021. The rise of Liquid Staking Protocols, including Lido Finance and Rocket Pool, which saw their TVL rise 84.1% and 105%, respectively, played a big contribution to Ethereum's rising dominance. Ethereum scaling solutions, including Arbitrum and Optimism, also recorded notable growth in TVL, rising 138% and 76.7% to $3.69bn and $1.25bn, respectively - ranking 4th and 7th highest in the chains by TVL. The growth of other chains in the top 5 pales in comparison, with BNB chain, Tron, and Avalanche rising 10.3%, 18.8%, and 11.1%, respectively.

Figure 16: DeFi Total Value Locked (TVL), Q1 2023



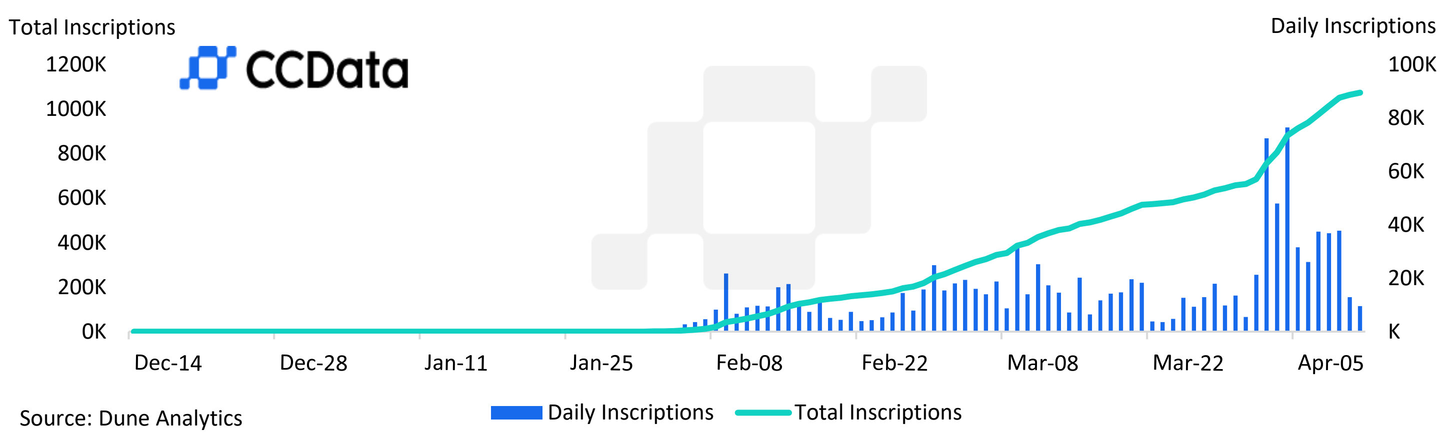
Source: DefiLlama

Bitcoin Ordinals: A New Boom

The launch of Ordinals inscriptions was one of the highly debated topics in Q1 2023. Using a design quirk in the Taproot upgrade, Ordinals allows digital assets such as images and video games to be inscribed on Satoshis on the Bitcoin blockchain. Critics have argued that these inscriptions could delay the confirmation of other financial transactions as they occupy large Bitcoin block space. Meanwhile, proponents of Bitcoin NFTs believe that the new trend can change the narrative of Bitcoin, enabling Decentralised Finance protocols and NFTs to launch on the network. A budding ecosystem has been created around Ordinals and Bitcoin NFTs, with several marketplaces launching, including Gamma and Ordswap. Bitcoin NFTs have also brought attention to tokens associated with Bitcoin, such as Stacks, Sovryn, and Threshold, which have all outperformed the rest of the Bitcoin ecosystem in Q1.

"We expect the protocols associated with Bitcoin and its growing ecosystem to gain traction with Bitcoin likely to lead the market next quarter."

Figure 17: Bitcoin Ordinals: Daily Inscriptions and Total Inscriptions, Dec 2022 – Apr 2023



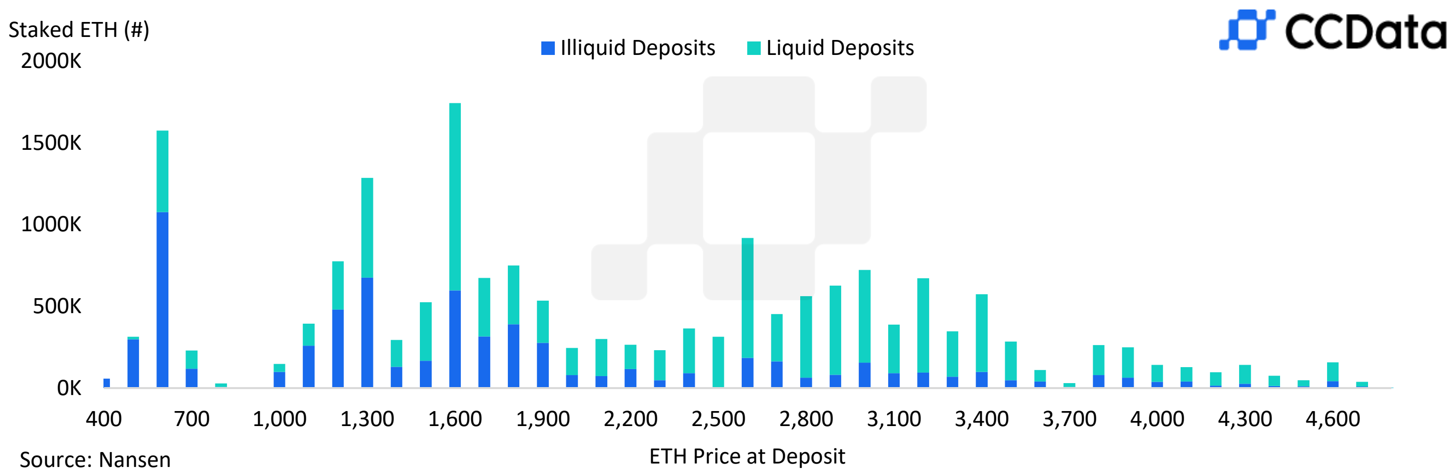
Source: Dune Analytics

Ethereum Shanghai Outlook

Looking forward, it is hard not to overlook one of the most important events that is happening in the next quarter - the Ethereum Shanghai upgrade. Ethereum introduced the Beacon Chain in 2020 which operated in parallel with the PoW Ethereum chain. Validators were allowed to deposit ETH with a minimum requirement of 32 ETH, however, were unable to withdraw it. The EIP-4895 proposal which is set to be executed with the Shanghai upgrade will allow validators to withdraw their staked Ethereum and rewards. On-chain data shows that more than half of the ETH holders who staked are at profit at the time of writing.

As mentioned in the previous outlook report, liquid staking protocols (e.g. Lido Finance, Rocket Pool, and FXS) that allow users to use their staked Ethereum within other DeFi operations, have been one of the asset sectors that outperformed the market in Q1.

Figure 18: Staked ETH Profits & Price at Deposits



Source: Nansen

With the uncertainty around the macroeconomic climate and increasing regulatory oversight, it is likely that a small part of staked Ethereum - which represents 15.6% of all Ethereum - will act as a potential selling pressure. Selling pressure may also come from recently charged centralised staking services like Kraken, however, any sell-off is not going to be imminent post-upgrade as partial and full withdrawals will take place via an exit queue.

This system prevents investors from selling all their ETH at once, leading to an estimated 5-20 days waiting period. In the long run, more investors should begin to stake their Ether, adding to the security of the underlying blockchain. Liquid Staking Protocols should also perform well, especially if regulatory pressure on centralised staking services continues to escalate, resulting in the shutdown of centralised staking services.

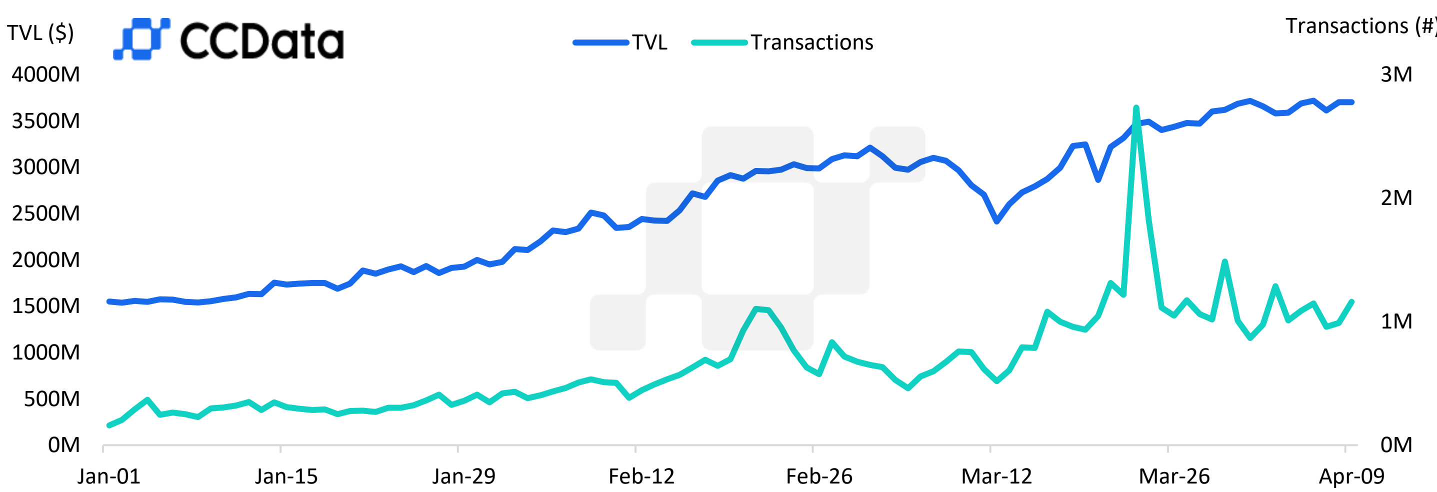
"We expect Ethereum and the Liquid Staking Protocols to face a mild drawdown in the short-term following the Shanghai upgrade with the entry of new selling pressure in the market."

Arbitrum to Zero Knowledge Proofs: Tracing Capital Flow

One of the many ways decentralised finance stands out from its traditional counterparts is how they reward active participation in protocols and blockchain via airdrops. Airdrops have always had a historical significance in DeFi, with SushiSwap's vampire attack on Uniswap, and the subsequent Uniswap airdrop being important moments in DeFi.

The Arbitrum airdrop on March 23rd has many similarities to Uniswap, with Arbitrum being the most popular Layer 2 blockchain in terms of user activity, and Uniswap being the dominant DEX in the space. Although most capital flows into an ecosystem before the airdrop, as investors utilise the network to qualify for rewards, there is a good chance that the additional $1bn liquidity is likely to stay within the Arbitrum ecosystem. Arbitrum is currently one of the most used layer-2 scaling solutions for Ethereum, with the low gas fees and the popularity of Arbitrum native protocols attracting new users to the ecosystem.

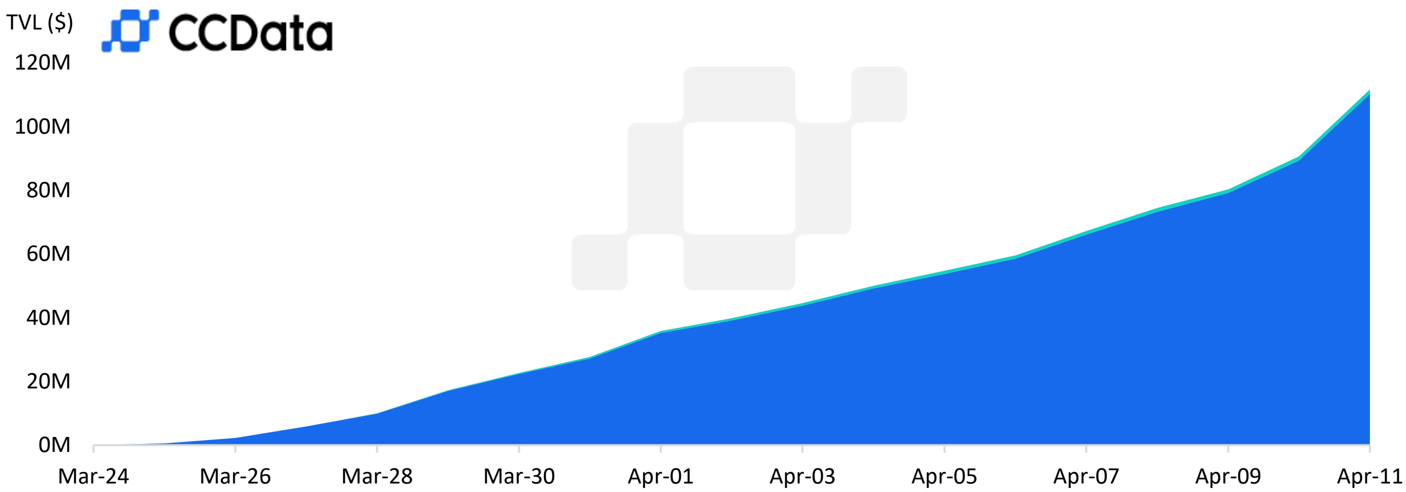
Figure 19: Arbitrum TVL & Number of Transactions, 2023



Source: DeFiLlama BlockExplorer

Many networks and protocols utilise airdrops as a bootstrapping mechanism to incentivise user activity and bring additional capital to the ecosystem. Following the launch of Arbitrum, Zero Knowledge projects seem to be the next trend to catch investors' attention, with zkSync seeing its TVL grow to over $100m in a matter of weeks.

Figure 20: Total Value Locked in zk Protocols, March 2023



Source: DeFiLlama

In the digital asset space, anything that creates a headline can be spun into a potential narrative. With Polygon and zkSync launching their main nets, Polygon zkEVM and zkSync Era in March, the attention of airdrop hunters has turned to these networks. Other zK projects, such as Scroll and Starknet, which are still in their testnet phase, are also a potential opportunity for users and are likely to see an inflow of capital from users chasing potential airdrops. Although Matter Labs, has confirmed that zkSync's token will be launched in a year's time, the efforts of airdrop hunters have already started to take place on the respective chains.

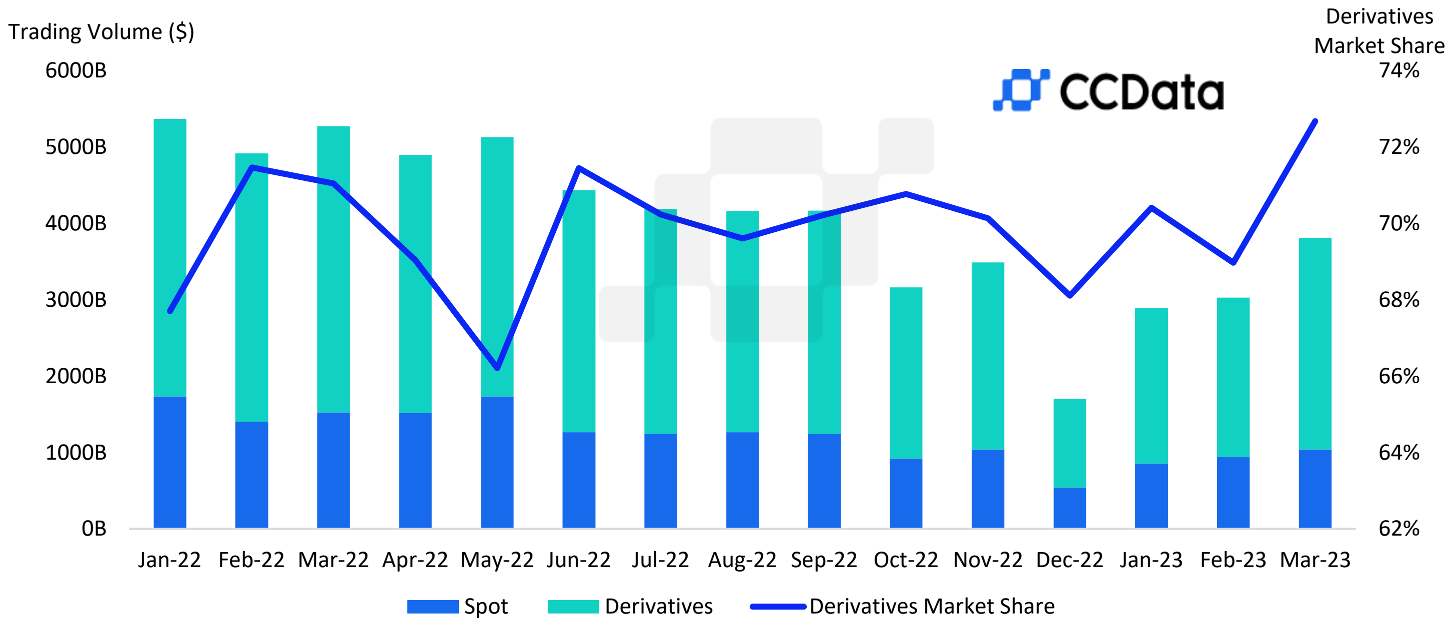
"We expect tokens in the Arbitrum ecosystem to benefit from the additional liquidity from the airdrop and new capital inflow to zk ecosystems."

Derivative DEXs

Since its infancy, speculation has been a consistent theme in the crypto industry. For an asset class that is so ingrained in speculation, it is hard to find a better product-market fit for DeFi than decentralised derivative exchanges.

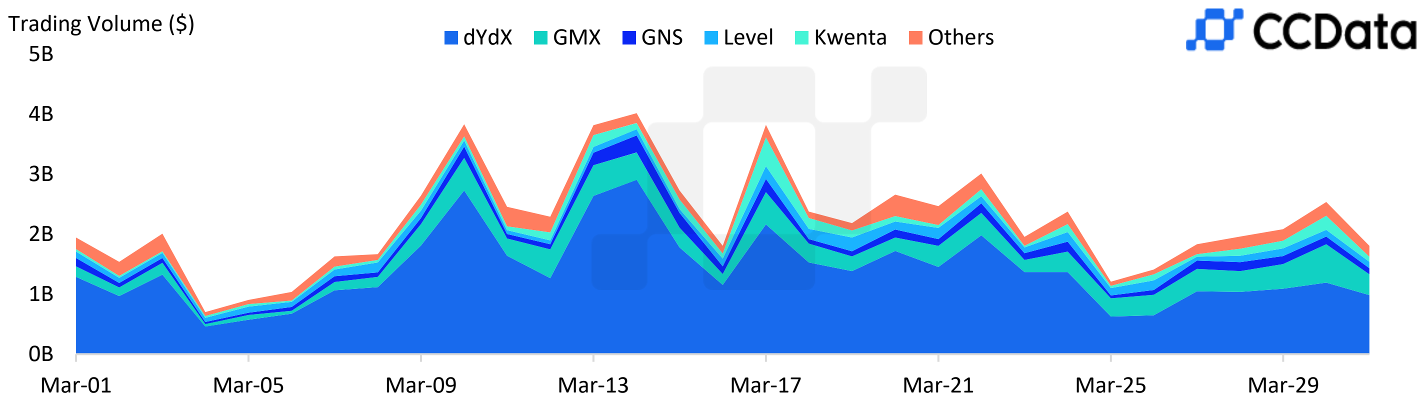
Over the years, the digital asset industry has been labelled as both a casino and the ‘wild west’, with derivative markets accounting for an all-time high of 72.7% of total centralised market volumes, trading $2.77tn in March, and highlighting the prominence of speculation rather than the fundamental value of assets.

Figure 21: Derivatives Volume and Market Share, 2022 - 2023



It is no surprise that the collapse of FTX has put the spotlight on decentralised solutions. In recent months, decentralised derivatives exchanges seeing an uptick in trading activity, trading $68.7bn in March, with dYdX accounting for 62.6% of the market share.

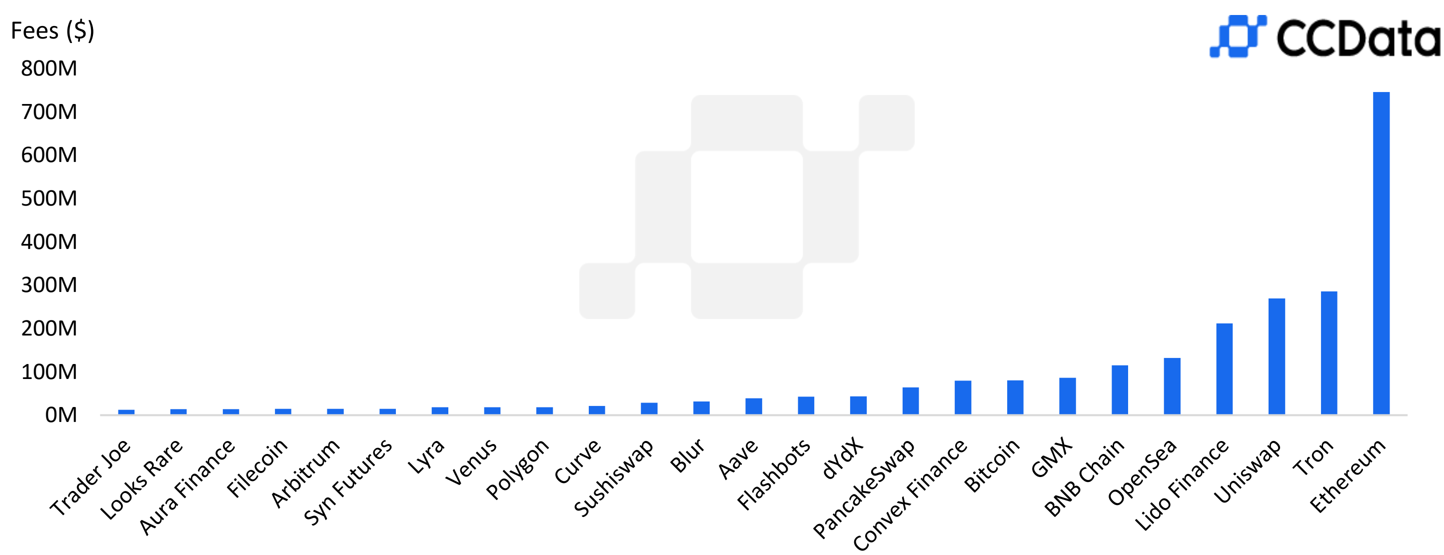
Figure 22: Trading Volumes: Decentralised Derivatives Protocols, March 2023



Source: Dune Analytics, dYdX

Unlike many crypto projects, certain derivative DEXs have found a product-market fit, combining utility with a sustainable revenue model in accruing trading fees which are redistributed to stakers. Despite generating significant revenue, these projects rank far below the top tokens in terms of market capitalisation, residing far below meme coins such as Dogecoin and Shiba Inu.

Figure 23: Top Protocols by Fees in the last 180 days, (as of 11th April 2023)

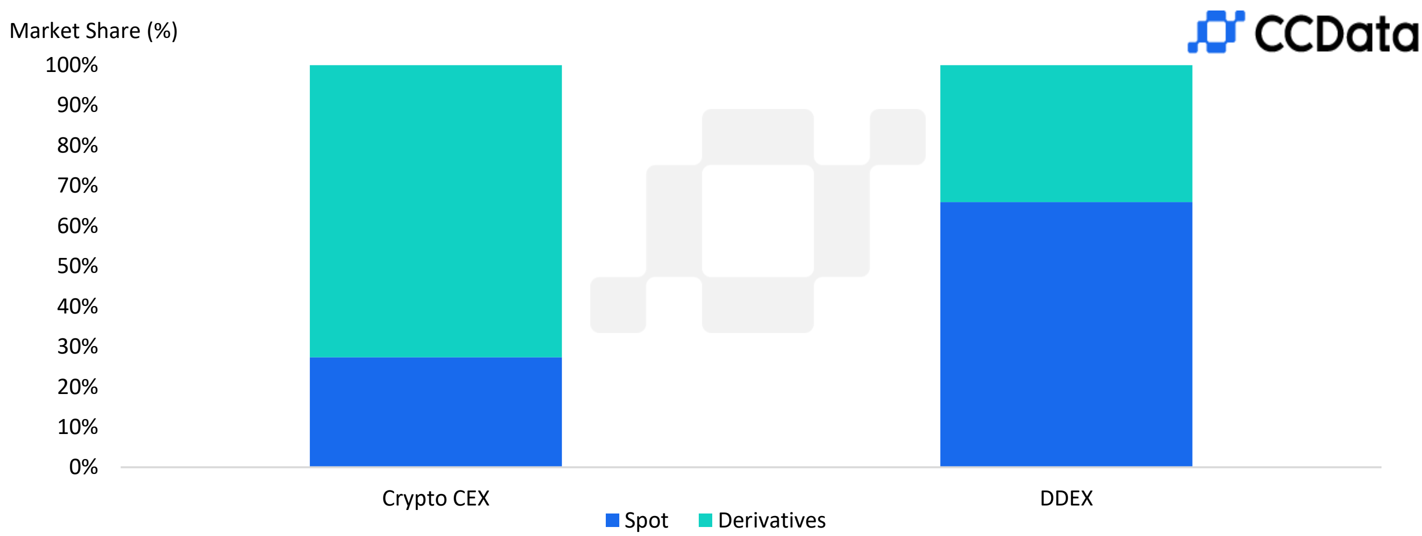


Source: Token Terminal

Having seen the potential of derivative DEXs, we have seen a rising trend where spot DEXs are starting to offer derivatives trading on their platform or via partner exchanges. PancakeSwap offers derivatives trading via Apollo Exchange. Meanwhile, Quickswap is launching its perpetual products soon and SushiSwap recently bought the derivatives protocol Vortex.

On-chain derivatives trading dominance pales in comparison to centralised crypto exchanges where derivative's trading volume is around 2.5x greater than spot trading volume. Based on the figures in March, trading volume on derivatives decentralised exchanges represented only half of the trading volume on spot decentralised exchanges, highlighting the nascent stage of derivatives trading in the on-chain world.

Figure 24: Market Share of Spot and Derivatives in Crypto CEXs, and DEXs

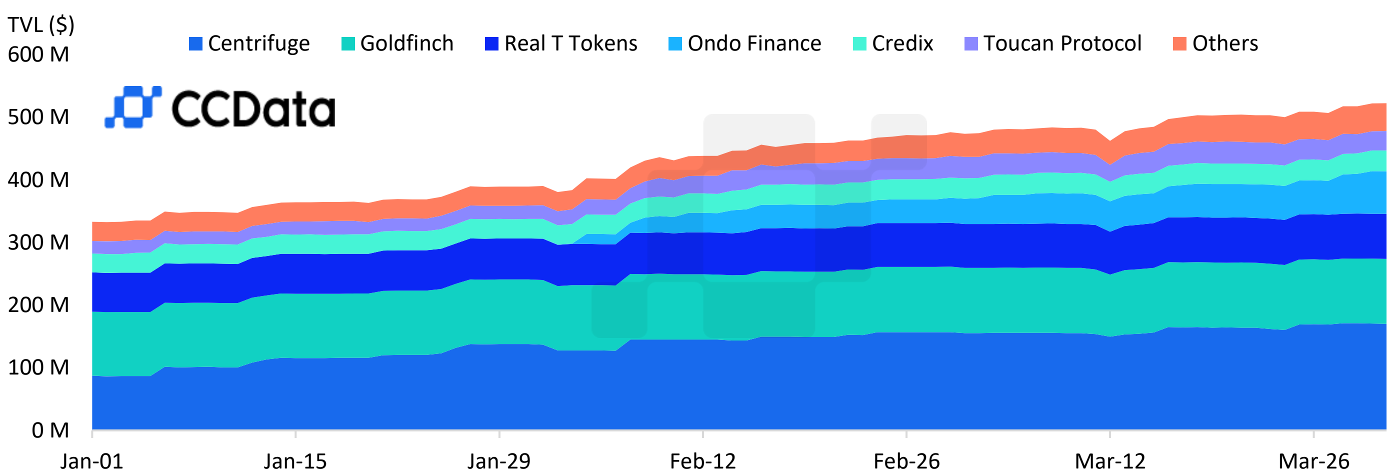


"We expect decentralised derivatives protocols to continue performing well and gain market share in the next quarter."

Real-World Assets

For now, DeFi remains a highly speculative space with most of the revenue coming from DeFi protocols that rely on fees generated from token swaps. However, there is a growing section of DeFi called 'Real World Asset' protocols, which aim to tokenise traditional financial assets. Consulting company BCG estimates that the tokenisation of global illiquid assets is a $16tn opportunity by the year 2030, with BlackRock CEO, Larry Fink, calling it the 'future of markets'.

Figure 25: Total Value Locked in Real World Asset Protocols, Q1 2023



Source: DeFiLlama

Real World Asset lending protocols, such as Centrifuge, Goldfinch, and Credix, enable users to convert tangible assets into digital assets. These tokenised real-world assets (RWAs) can include investments in businesses, loans, and physical assets. Once tokenised, these assets can be effortlessly transferred and employed across the extensive network of DeFi offerings.

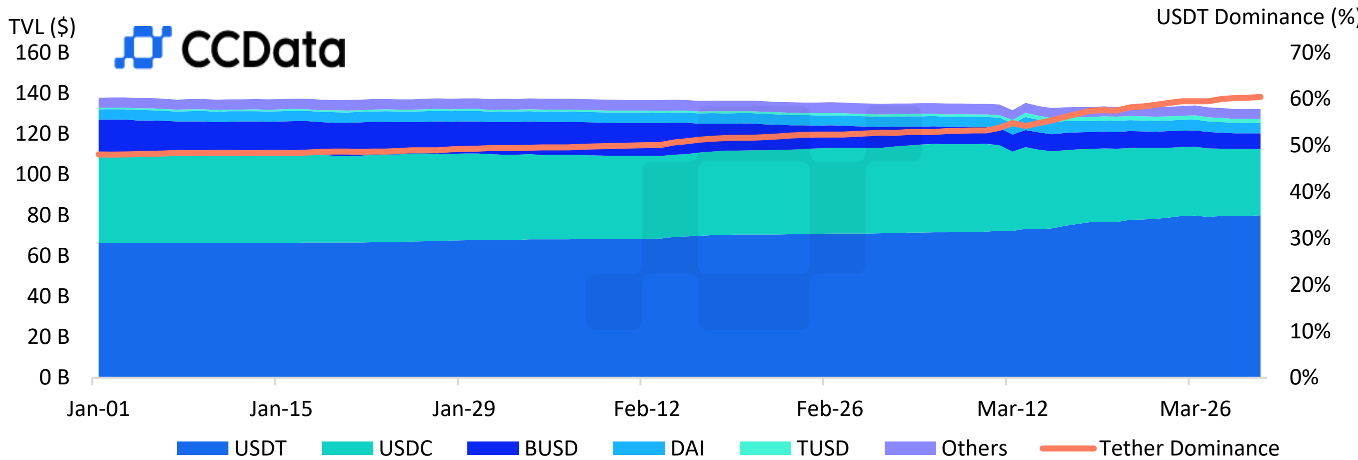
Other Real World Asset protocols, such as Onda Finance and BackendFi, allow DeFi users to invest in US Treasury Bills, which as reported in the previous Outlook Report, were able to provide a higher median yield than DeFi since Q23 2022. With regulatory scrutiny around DeFi at full force on the back of the bear market, it is exciting to see the rise of new protocols and initiatives that could help innovate and streamline access to global financial markets.

"We expect to see an increased focus on Real World Assets in the coming quarter as more DeFi protocols introduce legitimate use cases."

Stablecoins

Stablecoins are arguably the first off-chain real-world asset that has been tokenised and DeFi's first solution to the accessibility problem and financial inclusion. However, the asset class has run into problems in the last quarter with the SEC shutting down Paxos' BinanceUSD stablecoin (which was the third largest stablecoin at the time). The banking crisis in March, which led to USDC and other stablecoins momentarily losing their peg, also showed the drawbacks of stablecoins' reliance on centralised institutions. Despite all of this, Tether has continued to increase its market dominance to 60.4%, with users continuing to rack up the demand for the largest stablecoin by market capitalisation.

Figure 26: Stablecoins Market Capitalisation and Tether Dominance, Q1 2023



The total market capitalization of stablecoins has continued to decline for the 12th consecutive month, which is surprising considering the drawdown we have seen in crypto assets in the past year. Centralised stablecoins continue to dominate the sector, however, the upcoming launch of AAVE's GHO and Curve's crvUSD stablecoin might see that change and increase the usage of decentralised stablecoins.

Recently, we have also seen popular decentralised stablecoins, including DAI and FRAX, lose their peg (since they hold USDC as collateral). A solution is to get as close to the Federal Reserve as possible by having a Fed Master Account which would allow holding and transacting US Treasury bills without relying on a bank like USDC. FRAX is trying to resolve this by utilising a Federal Reserve Master Account, which would allow it to hold and transact US Treasury bills without relying on banks, to reduce its reliance on USDC.

"We expect Tether's dominance to continue to rise but at the same time an increased interest in decentralised stablecoins in the next quarter."

Conclusion

In conclusion, the digital asset industry has faced a series of challenges in the first quarter of 2023. The turbulence and loss of confidence in centralised exchanges, combined with regulatory pressures, have impacted trading volumes and liquidity. However, despite expectations, digital assets have seen their price rise considerably since the start of the year, with Bitcoin and Ethereum returning 72.3% and 52.5%, respectively.

The recent collapse of Credit Suisse and the near-collapse of First Republic Bank have highlighted the vulnerabilities inherent in traditional banking systems. Despite government intervention, the macroeconomic conditions remain uncertain, leading to expectations of a moderate performance for crypto assets in the upcoming quarter. However, it is crucial to recognize the significant progress that Bitcoin and the wider crypto industry have made over the years, growing to a market capitalization exceeding one trillion dollars.

The above challenges have also paved the way for decentralised exchanges (DEXs) to gain traction, with their average year-to-date (YTD) volume increasing by 27.6% compared to 2022. Uniswap V3, in particular, has emerged as the leader in the DEX space, accounting for an average monthly market share of 50.3% of the total decentralized exchange volume.

Overall, the value of Bitcoin and other digital asset infrastructure was exacerbated by the recent banking crisis. While banks were closed, Bitcoin settled nearly $33 billion and facilitated over 600k transactions over the weekend following Silicon Valley Bank’s collapse. During the week USDC depegged, Uniswap also recorded its highest volume to date, showcasing the robustness of this growing infrastructure. However, this same event also highlighted stablecoins' reliance on centralized institutions.

As we approach similar challenges and environments to those encountered fourteen years ago, it is important that we continue to look at and monitor alternative solutions like Bitcoin and decentralized finance, which are working to provide transparent and robust alternatives.