NAVIGATING THE VOLATILITY: RUSSIA, UKRAINE AND BITCOIN

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After heavy price drops to start 2022, the crypto market stabilised for some time until it was shaken by a sudden spike which saw overall market capitalisation rise over 10% on Monday 28 February. Bitcoin is currently trading around $42k, which is still down from its all-time high price of $68k in November 2021, but well above its recent lows of $35k.

The precipitating event for the spike was the imposition of economic sanctions on the Russian Federation as a consequence of the outbreak of conflict with Ukraine. Imposed by the US, UK, many European nations and Canada, part of these sanctions includes blocking a number of Russian banks from the use of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging network. The Russian Central Bank has also had its assets frozen abroad to prevent it from liquidating its assets[1].

In the face of these events, Bitcoin outperformed assets like oil, gold and US dollars.

This might lead some to claim that Bitcoin is a safe haven asset, which is an asset that can hold or appreciate in value during an economic downturn. Here some nuance is required.

At a global level, Bitcoin's price has become more correlated with equities during acute moments of market shock and its volatility has made it a poor candidate for safe haven status at many points in time. Rather than a safe haven asset, the behaviour Bitcoin, as shown during the events in Russia/Ukraine, may indicate that it can perform the role of a hedge against political risk. This is similar to the way oil behaves at a global level. In moments of macro-economic shock, like the covid crisis in March 2020, oil tends to fall sharply. By contrast, in times of heightened political risk, which create fears of shortages and disruptions, the price of oil typically goes up.

For those in Russia during these past week, by contrast, Bitcoin has served as a safe asset. For these people perhaps it is more useful then to think of Bitcoin as a digital currency of last resort. Bitcoin does not require physical storage, has a fixed monetary policy and highly divisible. In places where US dollars, US treasuries or gold are not available, but the local economic system and/or currency is collapsing, Bitcoin becomes an attractive alternative. More traditional safe haven options are not available to a large proportion of citizens in Ukraine and the Russian Federation - even before the conflict and subsequent sanctions – but Bitcoin is available to anyone with a cell phone.

This increased demand for Bitcoin in both Russia and Ukraine can be seen in higher trading volumes in their respective fiat currencies on exchanges[2]. The spike is anomalous in two countries where crypto adoption is high. For some time Russia and Ukraine have seen relatively high peer-to-peer Bitcoin exchange for their region, ranking number one and two respectively[3]. Use of digital assets is not just something confined to a tiny segment of the population – one rough estimate suggests that the two highest ranked countries by crypto ownership are again Ukraine (12.7%) and Russia (11.9%)[4].

Bitcoin and digital assets more generally, such as ether and US-dollar pegged 'stablecoins', are likely to receive increased attention in the context of the conflict. The Ukraine government has solicited donations via digital asset networks[5]. A US Senator and the President of the ECB have both pointed at the risk that economic sanctions could be weakened by these networks[6,7]. A large proportion of Bitcoin mining occurs in Siberia[8]. Either way, all signs point to increased demand for and wider use of digital assets like Bitcoin 'on the ground' in places that fall victim to economic and/or political instability.

Sources

1 https://www.bbc.co.uk/news/world-60542433

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8 https://ccaf.io/cbeci/mining_map

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