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MARKET INSIGHTS

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THE DIGITAL GOLD RUSH:

How Bitcoin Became America's Unlikely Saviour

In our fast-paced world, we often overlook the long arc of evolution. With a new administration set to take control in Washington, it's timely to reflect on the evolution of the U.S. dollar.

The journey of the U.S. dollar as a global reserve currency is marked by economic innovation and geopolitical strategy, beginning with the introduction of greenbacks during the Civil War. This groundbreaking move financed the Union's efforts through unbacked fiat currency, paving the way for the dollar's central role in the global economy, which was further solidified at the 1944 Bretton Woods Conference[1]. English economist John Maynard Keynes voiced concerns about the dollar's dominance at this pivotal meeting, foreshadowing challenges that would emerge in subsequent decades.

> "If you are going to put a legend on the greenbacks, I would suggest that of Peter and Paul, 'Silver and gold I have none, but such as I have I give to thee."
>
> - Abraham Lincoln[2]

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[1] Conference held in 1944 to determine a new international economic order and cooperation after the end of the Second World War.

[2] Remark by Abraham Lincoln during a cabinet meeting based on biblical verse 3:6 in the New Testament, highlighting the financial strain of the U.S. during the Civil War and the value of the greenback as a representation of the government's promise to the nation during a time of crisis.

In the 1960s, countries like France increased demands for the return of gold reserves, threatening dollar stability. This culminated in 1971 when President Nixon ended the gold standard, creating a dollar unbound by tangible assets. The U.S. then established the petrodollar system with Saudi Arabia to maintain global dominance, linking the currency's value to oil pricing.

Today, an unexpected alliance is forming around cryptocurrencies, underscored by president-elect Donald Trump's evolving stance and former Speaker of the U.S. House of Representatives Paul Ryan's support for stablecoins. This partnership highlights the urgent need to tackle national debt and fiscal crises, with digital assets like bitcoin potentially revolutionizing global finance—like oil in the past. The nomination of Scott Bessent as U.S. Treasury Secretary, along with other pro-crypto appointments, signals the growing influence of digital currencies in U.S. policy.

Historically, the U.S. has demonstrated resilience in adapting its currency to changing global realities. The potential integration of digital currencies could represent the next chapter in this ongoing evolution, challenging the established dollar-based system while addressing modern economic issues. Rather than threatening the U.S. dollar, bitcoin may actually help alleviate the unsustainable national debt and sustain demand for U.S. Treasuries (UST), reinforcing the dollar's position as a cornerstone of the global monetary system. We are on the verge of a new global monetary system, influenced by Trump's policies on bitcoin and stablecoins backed by UST.

This revolutionary system could integrate bitcoin as a strategic reserve asset, expand the use of stablecoins, transform the Treasury market, and provide unprecedented global access to U.S. dollars through these stablecoins. It resembles a modern take on the Bretton Woods monetary system, paving the way for a more interconnected financial landscape.

The bitcoin-dollar solution could emerge as an unlikely yet transformative development, reinforcing the idea that change is both possible and inevitable. As the new Treasury Secretary has suggested:

"We're also at a unique moment geopolitically, and I could see in the next few years that we are going to have to have some kind of a grand global economic reordering, something on the equivalent of a new Bretton Woods or if you want to go back like something back to the steel agreements or the Treaty of Versailles, there's a very good chance that we are going to have to have that over the next four years and I'd like to be a part of it."[3]

As the philosopher Heraclitus said, "The only constant in life is change."

Bitcoin: The New Oil Fuelling America's Gilded Age

In an unexpected twist, bitcoin, once seen as a nemesis to traditional finance, may become the force cementing America's financial supremacy in the digital age. This narrative gained traction following Trump's bold proclamation that the U.S. will become the "Bitcoin superpower of the word." Just as oil became the lifeblood of the global economy in the 20th century, bitcoin is positioned to become the digital gold of the 21st century, driving a new financial paradigm that could strengthen the U.S. dollar's global dominance.

The bitcoin standard posits that the cryptocurrency is a superior monetary system compared to traditional fiat currencies. Its fixed supply, decentralized nature, and digital properties make it an ideal form of "sound money" that could serve as a global reserve currency. Many wrongly conclude that bitcoin will replace the U.S. dollar. The opposite is true. As with oil, bitcoin will support the U.S. dollar and create demand for UST.

The petrodollar system established the U.S. dollar as the world's reserve currency after Nixon ended

[3] Scott Bessent, Manhattan Institute, June 6, 2024.

the gold standard. Today, we may be witnessing the emergence of the bitcoin standard. As more countries adopt the cryptocurrency, they create demand for stablecoins pegged to the U.S. dollar.

Stablecoins 101: Fiscal Stability

Stablecoins are cryptocurrencies designed to maintain a stable value by being pegged to a reserve of assets like UST bonds. For example, a stablecoin might be backed by a specific amount of UST for every token issued, helping to stabilize its value. If UST backs a stablecoin, demand for UST will also rise as the crypto market expands. As more governments, companies, and investors consider converting fiat money into bitcoin, stablecoins act as a vital link between traditional finance and the crypto world—becoming the preferred medium for bitcoin transactions. They allow investors to enter and exit bitcoin positions without facing the volatility of cryptocurrencies.

For instance, someone might convert fiat currency into UST-backed stablecoins before buying bitcoin. If bitcoin's market cap approaches US$20 trillion, this would boost demand for UST as stablecoin issuers back their tokens with these securities, potentially alleviating concerns about failed bond auctions and helping to address the fiscal debt crisis.

Ryan and Trump understand this nuance, with Ryan arguing that stablecoins could help mitigate the impending fiscal crisis in the U.S. by becoming significant buyers of U.S. government debt. The question remains: When will Wall Street catch on? In summary, the growth of stablecoins, especially those backed by UST, could drive greater adoption of bitcoin and other cryptocurrencies, offering a stable way to transact, invest, and store value in the evolving financial landscape.

The Digital Transformation Process

The digital transformation of money is a crucial process that many overlook. It isn't just about cryptocurrencies; it's about the entire journey of capital from traditional fiat currencies to the digital realm.

Steps in the digital transformation include:

1. Cash to stablecoins: Converting physical cash or traditional bank deposits into stablecoins like Tether (USDT) allows users to benefit from digital transactions while maintaining a stable value.

2. Stablecoins to crypto: Users can transition from stablecoins to cryptocurrencies like bitcoin, exposing themselves to the potential benefits of the crypto market.

3. Implications of the digital transformation: As more capital undergoes this transformation, the demand for stablecoins will likely increase significantly, impacting the underlying assets backing them, particularly UST bills. This process resembles the petrodollar system, increasing global demand for U.S. dollars and creating a new source of demand for UST.

Bitcoin: A Complement, Not Substitute to the U.S. Dollar and U.S. Treasury

Contrary to some beliefs, digital transformation suggests that bitcoin and other cryptocurrencies complement the U.S. dollar rather than replace it. As a gateway to the crypto world, stablecoins create an ecosystem where traditional and digital currencies coexist, supporting each other's value propositions. Bitcoin rivals the UST as a store of value, while stablecoins serve as a bridge between the analogue and digital worlds.

This transformation isn't about replacing one system but about creating a more integrated, efficient, and accessible global financial ecosystem leveraging the strengths of both traditional and digital finance. Bitcoin actively supports the U.S. dollar and UST, generating demand through this digital process. Indeed, the world is gradually evolving from the petrodollar system to a bitcoin-dollar system.

Stablecoins: The New Petrodollars

Just as petrodollars were recycled into UST in the 1970s, stablecoin issuers have become significant buyers of short-term U.S. government debt. The stablecoin market has surged to nearly US$200 billion, with approximately US$120 billion invested in Treasury bills, accounting for about 2.5 per cent of the T-bill market. As the cryptocurrency landscape evolves, this presents a unique opportunity for UST bonds to attract new buyers, potentially alleviating concerns about failed bond auctions. A new buyer for UST has emerged, reminiscent of the petrodollar era.

This interplay between bitcoin, stablecoins, and UST reinforces America's role as the world's financial anchor in the digital age. Just as the petrodollar system extended U.S. financial influence globally, the "bitcoin-stablecoin-Treasury" ecosystem solidifies the dollar's supremacy in the evolving digital finance landscape.

The Role of U.S. Treasuries in Proposed Stablecoin Legislation

The Lummis-Gillibrand Payment Stablecoin Act introduces significant provisions regarding the backing of stablecoins with UST. This legislation proposes that stablecoin issuers maintain one-to-one reserves using high-quality, liquid assets, particularly UST bills, bonds, or notes with maturities of 90 days or less. This requirement aims to enhance the stability and reliability of stablecoins by anchoring them to one of the most secure assets in the global financial system.

Including UST as a primary backing for stablecoins serves multiple purposes. It enhances the trustworthiness of stablecoins, potentially increasing their adoption and utility in the broader financial ecosystem. Additionally, it aims to maintain the U.S. dollar's prominence in the digital asset space while providing a clear operational framework for stablecoin issuers, balancing innovation and consumer protection. As this legislation progresses, monitoring its impact on the stablecoin market and cryptocurrency industry will be crucial.

The Digital Treasury Boom

The implications of this new system are profound. While exact figures are challenging to predict, significant growth in bitcoin's market cap could impact the stablecoin ecosystem. However, the relationship between the two is complex and influenced by various factors. As bitcoin adoption increases, we may see a corresponding rise in stablecoin usage for trading and as a store of value, which would boost demand for the assets backing these stablecoins, particularly UST.

For instance, Tether (USDT), which dominates the stablecoin market with about 72 per cent market share, has a market capitalization of over US$133 billion. As the crypto market expands, stablecoins like Tether could see substantial growth, potentially increasing their holdings of U.S. government securities.

This potential growth in demand for UST, driven by the expansion of the crypto ecosystem, could have far-reaching implications for U.S. fiscal policy and international financial markets, representing a new mechanism through which the digital asset space could reinforce the U.S. dollar's global position.

A New Era of U.S. Monetary Dominance

This scenario vividly illustrates a new era of U.S. monetary dominance, where bitcoin and cryptocurrencies, far from being threats, emerge as pillars supporting the U.S. dollar's global reign. This narrative challenges conventional wisdom, suggesting that the very technology once feared by traditional finance could become its strongest ally.

The U.S. Department of the Treasury is already taking notice. Recent reports indicate it is closely monitoring the growth of stablecoins and their impact on the Treasury market, suggesting policymakers recognize the potential of this new system.

Global Implications

The implications of this financial order extend far beyond America's borders. As more countries adopt bitcoin and engage with stablecoins, they inadvertently align themselves with the U.S. financial system, giving the U.S. greater leverage in global affairs—like the petrodollar system. This new arrangement could provide a fresh avenue for U.S. financial influence in an increasingly digital world. In response to nations like China advocating for de-dollarization, the bitcoin-stablecoin-Treasury ecosystem could serve as a counterbalance, ensuring the ongoing relevance of the U.S. dollar in global finance.

Recent statements from Russian president Vladimir Putin and Chinese leader Xi Jinping suggest a shift in their attitudes toward bitcoin, potentially influencing the global landscape. Putin now recognizes digital assets as legal property, while Xi's reconsideration of bitcoin indicates a warming attitude toward cryptocurrency, suggesting alternative paths to financial stability amidst rising economic tensions.

A new global monetary system is expected to emerge during Trump's second term, but regulatory concerns, technological hurdles, and geopolitical tensions could significantly impact the development of this new financial order. For instance, the need for robust regulation of stablecoins could lead to new frameworks that enhance the crypto market's stability and credibility. Such developments could attract more institutional investors, further fuelling the growth of the bitcoin-stablecoin-Treasury ecosystem.

The Petrodollar is Dead—Long Live the Bitcoin Dollar

As we look to the future, the relationship between bitcoin, stablecoins, and UST will play a crucial role in shaping global finance. Far from being a threat to the U.S. dollar, this emerging system could become its strongest bulwark in the digital age.

As we observe the unfolding of this new financial order, it becomes increasingly clear that bitcoin isn't just an asset class—it is the catalyst for a new financial system, with stablecoins and UST at its core. This system, echoing the petrodollar system of the past but adapted for the digital age, could ensure America's financial dominance well into the 21st century.

Understanding this paradigm shift will be essential for investors, policymakers, and anyone interested in the future of finance. The bitcoin standard, like the gold standard and the petrodollar system before it, could define the next chapter of global finance.

What Should Investors Do?

Investors need to embrace the new era emerging under the Trump administration. After four years of opposition from President Joe Biden's administration, a pro-crypto agenda is set to unfold. Ironically, bitcoin is now viewed as a key element in addressing the fiscal challenges facing the U.S. Both bitcoin and stablecoins could serve as crucial solutions, and investors should consider the potential for the bitcoin-dollar regime to replace the petrodollar. We may be witnessing the rewriting of the global monetary system, much like at Bretton Woods, with bitcoin playing a central role.

Looking ahead to 2025, we anticipate a slowdown in the real economy due to several factors. The effective federal funds rate (FFR) is expected to remain at five per cent throughout the year. Additionally, the extreme fiscal policies of the Biden administration are likely to cease following a presidential election loss, making way for Trump's economic efficiency program, which will emphasize tax cuts, deregulation, and pro-growth strategies. The U.S. Federal Reserve is projected to continue cutting rates toward a natural rate of 2.75 per cent.

Traditionally, elections trigger relief rallies; however, we foresee a shift towards secular growth names, which will drive the S&P 500 to 7,000. Bitcoin and gold are also expected to appreciate. Oil prices may correct to around US$50 as Trump's "Drill, Baby, Drill" program is implemented, while the Organization of the Petroleum Exporting Countries (OPEC+) may engage in a market share battle amid a slowing global economy.

The transition from a progressive, centrally planned economy to one driven by private sector and supply-side policies, rooted in the Chicago and Virginia schools of thought, suggests a potential growth scare. While this is not our base case, over US$1 trillion is earmarked for artificial intelligence (AI) infrastructure investments over the next few years, supporting a soft landing as the most likely scenario.

The Federal Reserve has maintained its restrictive stance for too long, and we anticipate interest rates will surprise the consensus by moving downward. With the dual mandate already achieved, the FFR should be below 2.75 per cent. As the economy slows in 2025, the appreciation of risk assets will rely heavily on liquidity.

We expect increased acceptance and pro-crypto legislation for bitcoin, potentially positioning it as a treasury asset. If our bitcoin-dollar thesis materializes, game theory suggests that countries and investors will quickly capitalize on this shift, leaving skeptics wondering what happened as they miss the opportunity.

To navigate this evolving landscape, investors should focus on growth-oriented assets, consider allocations to bitcoin and gold, and stay attuned to fiscal and monetary policy shifts that could impact risk assets.