Bubbling Over the Top? DeFi Sector Heats Up in June, Raising Concerns

The DeFi sector is seeing rapid growth in use and volume. Some appear concerned about a bursting bubble, but could it be natural growth?

Decentralized finance is all about cutting out traditional financial intermediaries such as banks. Through the use of blockchain technology, DeFi platforms allow individuals to generate money against their own assets, becoming their own bank, as it were.

As an exciting new business paradigm, the DeFi sector has been warming up for some time. But during this past week, it got downright hot, and the current euphoria has some worried that a
Exhibit A: Compound Governance Token (COMP), the governance token for DeFi protocol Compound, rose in value from $64 on June 18 to $352 on June 21 following the launch of the ERC-20 altcoin on United States exchange Coinbase Pro. It eventually soared as high as $427 on Coinbase Pro before settling down — somewhat — at $255 on June 27 — but still up 298% compared with the price from June 18.

![Compound Governance Token (COMP) price since June 18](https://cointelegraph.com)

Exhibit B: On June 23, decentralized cryptocurrency exchange Balancer announced that its protocol governance token, BAL, was live on the Ethereum mainnet. Within 12 hours, BAL’s price jumped from $6.65 to $22.28.

Exhibit C: The total value of U.S. dollars locked in the DeFi industry sector over the past 30 days has increased by 80%. Compound’s share of total value locked was 38% as of June 26.
The recent turn of events clearly had Sasha Ivanov, the founder and CEO of the Waves Association, worried. “Future inevitable volatility and price crashes can severely harm DeFi mass adoption perspectives, which would be very bright otherwise,” he said.

**A speculative mania?**

So, it seems reasonable to ask: Is the DeFi sector approaching “bubble” territory? This isn’t always easy to determine. As Mati Greenspan, the founder of Quantum Economics, told Cointelegraph: “Bubbles often occur in financial markets, but the thing is: when you’re in one, it’s very difficult to tell if it’s about to pop or just get bigger.”

“It seems like it is undergoing some kind of surge in price akin to the speculative bubble in Bitcoin around 2013,” Jeremy Cheah, an associate professor at the business school of Nottingham Trent University in the United Kingdom, informed Cointelegraph. He wasn't
particularly alarmed though, adding: “Blockchain is here to stay. Short-run disruptions are to be expected, but its trend is upward given the benefits of blockchain.”

Campbell Harvey, a professor of international business at Duke University, explained to Cointelegraph that what is happening now in DeFi is different than the 2017 speculative craze in Bitcoin (BTC) and other cryptocurrencies — i.e., the so-called “ICO bubble” — in which “bandwagon investors were buying because the price was increasing.” Something more substantial is happening here, according to him:

“DeFi is poised to disrupt traditional borrowing and lending/investing which is an existing market that is massive in size. It is reasonable to expect that DeFi will cannibalize a good deal of the tangible, measurable market and the two questions are: how much of a share and how long will it take?”

Just because the total value locked in DeFi has increased by 80% in the past 30 days does not mean it is a bubble, added Harvey. “Indeed, it is not unusual to see growth like this in the startup space when a product idea catches on.”

**Being paid to take out a loan?**

Still, some strange things are happening. DeFi tokens are being “gamed,” behavior that wouldn’t be inconsistent with a bubble. A video analysis making the rounds last week, “Ridiculous DeFi: Compound (COMP) Finance Explained” by YouTube channel Boxmining, raised some questions about Compound’s business model.

Compound’s platform makes money on the spread between deposits and loans — i.e., savings accounts and borrowing accounts — like a bank does, but some users have reportedly “managed to find ways to exploit the system” to obtain COMP tokens that make continued user cycles of borrowing and lending profitable — despite a negative net interest.

As explained by the video’s host, Michael Gu, a user can be “literally [...] paid to take out, to borrow out a loan.” This doesn't work in any traditional banking context. It only works now “because the speculation on COMP is so high, and the value of COMP tokens is also through the roof.” Greenspan further explained this gaming process in a June 22 post on the website Bitcoin Market Journal: “Many users are then taking the USDT that they’ve borrowed, converting it to USDC, and then lending it back to the platform in order to earn even more COMP, which might explain why the system’s smart contracts now have $600 million in them.” This doesn’t make
much sense to Greenspan, as he told Cointelegraph:

“Borrowing one digital asset using another as collateral is a rather funky use case. Unfortunately it seems to be a theme among DeFi projects, but if you have one and want another, why not just swap them outright? If the purpose of the transaction is just to get the additional COMP, then we’re back into the realm of magical internet money.”

**Differences from 2017**

There is some danger in all this, acknowledged Duke University’s Harvey, especially if utility tokens rise beyond their reasonable fundamental value because investors keep buying, not wanting to miss out on the next big thing. But there are two key differences between this situation and the ICO bubble of 2017, as he shared with Cointelegraph:

“First, investors know a lot more about the cryptocurrency space than they did in December 2017. Second, DeFi has already demonstrated ‘Proof of Concept,’ and the market it is targeting is vast. In December 2017, Bitcoin was being treated purely as a speculative asset.”

Waves CEO Ivanov agreed that “DeFi products are more sophisticated in nature than simple ICO tokens, which probably will limit the influx of non-qualified investors.” Additionally, Ruaridh O’Donnell, the co-founder and director of information systems of Kava — a DeFi lending platform — told Cointelegraph that it is wrong to call what is happening a speculative bubble, as DeFi firms such as Compound are developing new incentive programs to drive user adoption. He clarified for Cointelegraph:

“Much like how Uber, AirBnb, and other tech companies have subsidized the initial supply and demand side of their platforms, we are now seeing decentralized protocols like Kava and Compound do the same to bootstrap early adoption until a sufficient network effect is built.”

Token assets such as COMP are seeing a great amount of speculation due to the growth of their platforms, O’Donnell added, which can cause a localized bubble for COMP in the markets. But this is different from a general market bubble.
On the issue of volatility, Giuseppe Ateniese, a professor at the Stevens Institute of Technology, told Cointelegraph that he can name “hundreds of companies whose stock price behaves with the same volatility [as COMP], particularly during the first days on the market.” The critical difference here is that the assets are digital. It isn’t like a traditional car loan, where if the borrower defaults, the bank goes after the car seeking repossession. Ateniese continued:

“With DeFi, assets are digital and locked/committed through smart contracts. If done correctly (and this is still a big IF), there is no or little risk for creditors. If I don’t pay the loan back, the digital asset that I used as collateral is taken, and there is nothing I can do about it.”

This is the reason the “interests” being paid on DeFi platforms such as Compound are so high, in Ateniese’s view. For example, if one deposits the stablecoin Tether with Compound this week, a 6.75% annualized rate in interest will be earned — at a time when the federal discount rate is 0.25%. “The best part of all is that anyone can be a creditor under these terms. Banks are warned,” according to Ateniese.

A game-changer?

“I’m more optimistic about DeFi” than some of the more recent naysayers, Ateniese told Cointelegraph. “I think it’s a game-changer.” As he said recently, “With decentralized finance, there’s no human in the loop, no server, no organization. There’s no bias. [...] Once the code has been analyzed and set in stone, it runs, and that’s it. You can rely on it almost 100 percent.”

O’Donnell added to this by saying that “recent events further galvanize [belief] that DeFi is a true use case for crypto.” His firm remains very bullish on DeFi, and he expects the industry will grow further as it opens up to non-Ethereum assets such as Bitcoin, Ripple (XRP) and Binance Coin (BNB).

Irrational exuberance?

Meanwhile, the DeFi sector’s market capitalization stands at just over $6.6 billion on June 27, according to DeFi Market Cap. Compared with the $2 billion reported on June 12, there has been a roughly three-fold increase in some two weeks. New asset growth was recently described by Evgeny Yurtaev, the founder of DeFi project Zerion, as “exponential.”

What about the gaming of DeFi tokens and seemingly pointless swapping of crypto coins? Is that
a sign of "irrational exuberance" — an indication that the market might be overvalued — and if so, should users be concerned? Regarding this, Greenspan said:

“Most people understand that the golden rule of crypto is not to invest more than you can afford to lose. In the meantime, new economic models are being tested. And that's pretty exciting.”

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Bitcoin Price Touted to End Stagnation in Style, Surging to New High

While Bitcoin's value seems to have stagnated over the past few months, some believe that a price surge is just around the corner.

As the global economic engine continues to reel from the effects of the slowdown induced by the novel coronavirus, it's still not clear how much devastation the pandemic has actually caused. For example, due to the restrictions imposed by governments all over the world such as border lockdowns, trade limitations and import/export reductions, economic movement has
almost ceased, causing many businesses, both large and small, to either face up to the losses or shut down completely.

Furthermore, traditional financial offerings such as stocks, bonds and equities have also been on the receiving end of a beating since mid-February, with many well-respected economists warning that the global economy is once again heading in the direction of a major recession — the effects of which will most likely be more profound than any of the other slowdowns witnessed in the past.

To put things into perspective, the FTSE 100, Dow Jones Industrial Average and Nikkei 225 have all witnessed value drops of unprecedented proportions over the past four months. In fact, the Dow and the FTSE saw their biggest quarterly falls in more than three decades during the start of the year.

The impact of coronavirus on stock markets since the start of the outbreak

As a result of these developments, central banks all over the world have proceeded to slash interest rates to help boost consumer confidence, primarily by making borrowing easier. However, with a second coronavirus wave expected to sweep the planet by the end of the year, fears of further increased volatility still loom large on the horizon.
Bitcoin’s ongoing stability is redefining market perception

Despite the disorder that seems to have engulfed the global financial sector, it’s worth pointing out that since May, Bitcoin’s (BTC) value has not strayed beyond the $9,000-$10,000 range, barring a few short-lived exceptions.

BTC price chart since mid-May

As a result of this newfound, albeit possibly temporary, stability, a lot of casual investors have started to give more credence to the notion that Bitcoin may finally be morphing into the stable asset class that many had initially envisioned it to be.

Furthermore, this theory has gained even more ground since March’s “Black Thursday” crash that saw Bitcoin and gold — another well-regarded traditional store of value — exhibiting a stronger correlation following the event. Providing his insights on the matter to Cointelegraph, Jeffery Liu Xun, CEO of XanPool — a peer-to-peer fiat gateway — stated:
“No one will dispute the strengthening of Bitcoin’s perception among the traditional finance class. This is in part due to Bitcoin’s continuous market performance and resilience, but also largely due to traditional hedge fund managers like Paul Jones openly promoting Bitcoin, positioning Bitcoin as a hedge against the inflationary global financial policy.”

Additionally, according to crypto data analytics firm Coin Metrics, the above-mentioned correlation has never been observed historically and seems to suggest that more people are beginning to view Bitcoin as a digital safe haven. However, when it comes to comparing the price action of the two assets, BTC seems to have outperformed gold.

With that being said, prior to Bitcoin’s current stable position, the currency was very recently faced with periods of unprecedented volatility. Throughout the last couple of years, drops of $2,000 to $4,000 could be seen happening on a near-weekly basis — so much so that throughout the course of 2018, BTC’s value dropped from a relative high of around $14,300 to a shade under $4,000. In this regard, during the exact same time period, the value of gold showcased a staggeringly low level of volatility, sticking to a price range of roughly $1,200 to $1,360 for the entire year.

Lastly, even though many are gushing about the renewed market confidence in Bitcoin, it is worth remembering that following the flagship crypto’s much-hyped halving event that took place in May, the currency’s value remained almost flat, and its volatility levels are now seeing record lows.

**Why hasn’t Bitcoin’s price skyrocketed?**

When examining the issue of BTC’s current lack of price action, it is worth pointing out that if one were to look at the currency’s value movements at this exact point following its 2016 halving cycle, it would become quite apparent that the asset was behaving pretty much in the same way as it is now. In fact, it was a year and a half after its 2016 halving, around mid-December 2017, that BTC proceeded to reach its all-time high value of around $20,000.

Additionally, the volatility and uncertainty surrounding traditional financial markets have failed to translate into a direct increase in demand for Bitcoin because the coronavirus-induced panic has seemingly highlighted the need for alternative monetary systems rather than push Bitcoin to the center of the global finance stage. For example, when the coronavirus began to grip the world at the start of the year, BTC fell from almost $8,000 to around $3,600 on some exchanges, much like how the dollar has risen in recent months. 

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all in a span of less than three days between March 11 and 13, placing its safe-haven status under question.

Similarly, when stock markets all over the world were fluctuating wildly all throughout May, BTC also followed suit by mirroring the value drops being showcased by many traditional assets and commodities across the board, thereby worsening its perceived stability in front of investors all over the globe. On top of all this, the currency's poor usability also seems to have limited its potential for widespread adoption at the time when it counted. On the subject, Nischal Shetty, CEO of WazirX — an India-based crypto trading platform — commented:

“Let's also not forget, this is the first time that we're experiencing a global economic meltdown of this magnitude. Considering the global economic situation, it's great to see Bitcoin prices being stable and strong.”

Similarly, Ethan Taub, CEO of Loanry — a platform that connects people with lenders to source funds for their projects — believes that the Bitcoin market has been partially halted because of a lack of buying and selling. Though mostly dormant, he believes that after this period of stagnation, there may be a drop in value, following which BTC will experience a price surge.

Another potential cause for the ongoing stagnation could be due to many people recently losing their jobs and thus refraining from any risky trading activities. On the subject, the International Labor Organization has projected that during the second quarter of 2020 alone, more than 400 million people across the globe lost their jobs. To put things into perspective, the aforementioned job loss numbers are already ten times greater than what was observed after the 2008 recession.

**BTC’s future in the green?**

Despite Bitcoin struggling to break past the $10,000 barrier for a few months running, the market at large seems to be quite confident in the premier crypto asset’s long-term potential. For example, a new crypto outlook report released by Bloomberg earlier in July shows that the report’s analysts are optimistic regarding BTC and believe it could very well approach the $12,000 threshold in the coming weeks or months.

To back up their claims, the analysts stated that due to the current economic climate, more people are beginning to understand the utility of crypto and how it can act to alleviate inflation-related issues. Not only that, but they also highlighted BTC's recent low volatility in relation to
major stock indices, such as the Nasdaq, as being a clear indicator that the currency is primed for big things in the near future. The report reads as follows: “Unparalleled global central-bank easing and rising gold values are enduring trends favoring a higher Bitcoin price.”

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