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Bitcoin as a safe haven in the banking crisis

The high inflation and rapid rise in interest rates in the US have plunged the global banking sector into a crisis. Some respected financial institutions have already filed for bankruptcy and requested bailout packages from central banks. Notably, Bitcoin's price has risen during the current crisis. Will this lead to recognition of the original purpose for which the cryptocurrency was created?

The recent bank collapses have shaken the financial world and led to drastic measures by policymakers. In response to the first US bank insolvencies, the US Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Treasury Department have announced steps to ensure the deposit insurance of the affected banks.

The Fed has also established an emergency facility to prevent other US financial institutions from facing liquidity shortages. According to JPMorgan analysts, the US Federal Reserve Bank is expected to provide up to $2 trillion, which some market participants refer to as stealth Quantitative Easing (QE).

The Swiss National Bank (SNB) also has to support the new owner of Credit Suisse with loans of up to CHF 100 billion, thereby preventing the insolvency of the former traditional Swiss bank.

Bank failures highlight fragility of the sector

A few weeks ago, the Federal Deposit Insurance Corporation (FDIC) took over the deposits of Silicon Valley Bank (SVB), and the financial institution was closed by regulators citing inadequate liquidity. The collapse of SVB represented the largest bank failure in terms of assets since the 2007-2008 financial crisis. The institution's downfall was the result of a mismatch of assets and liabilities, which led to the bank's fall after aggressive interest rate hikes by the US Federal Reserve. Despite a bailout, the crisis spilled over to other banks and forced half a dozen billion-dollar US financial institutions to their knees.

Although financial regulators claim to have contained the "contagion" effect, the loss of confidence spread internationally. The next financial institution to experience a run on its deposits was the Swiss banking giant Credit Suisse. An initial injection of liquidity from the Swiss National Bank was not enough and ultimately led to a regulatory takeover by UBS, creating one of the largest systemically relevant financial institutions in Europe.

Systemic weaknesses of the banking sector

In our prevailing fractional reserve banking system, banks only need to hold a portion of customer deposits as a permanent reserve. A "bank run" is therefore not necessarily the result of pure mismanagement, but primarily follows a loss of confidence in a specific institution.

The repeal of the Glass-Steagall Act in 1999 also led to an expansion of risk in the US banking system. The legislative reform eliminated the separation between commercial and investment banks, allowing banks to operate in both areas simultaneously. This enabled banks to expand their business with customer funds and take on greater risks.

The gold of the digital era: Bitcoin

When investors lose confidence in the banking system and the value of paper currencies, they often seek refuge in debt-free assets that are not arbitrarily inflatable. Gold has been considered a safe haven for decades due to its properties, and is perceived as a stable store of value that is not affected by economic or political events.

The digital age brought forth another alternative to escape turbulence in the traditional financial system: Bitcoin. The transaction network has its own

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currency, and its decentralized, protocol-based structure ensures unrestricted functionality according to the predetermined rules. The system, based on blockchain technology, can also demonstrate unprecedented transparency and a well-defined monetary policy for the native currency. In contrast to our fiat currency system, the maximum supply and inflation rate are clearly defined.

Bitcoin does not require intermediaries such as banks or payment processors, eliminating the risk of intermediaries going bankrupt and losing customer funds, as has happened in the past with traditional financial institutions.

The fact that Bitcoin was created during the 2008 financial crisis is no coincidence. Two main problems of today's financial system were to be eliminated: reliance and trust in counterparties, as well as inflation-based depreciation of the purchasing power of our fiat currencies.

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Figure 1: Satoshi's message in the first Bitcoin block | Source: Bitcoin blockchain

In the first block of the decentralized Bitcoin ledger, the pseudonymous founder Satoshi Nakamoto added a message that is more relevant today than ever before. The note referred to an article in the English Times titled "Chancellor on brink of second bailout for banks," which referred to a government bank bailout taking place at the time. Satoshi took this opportunity to point out the weaknesses of the traditional banking system and to show that a blockchain-based, decentralized system can provide an alternative to centralized financial institutions.

Bitcoin's legitimacy confirmed

The extraordinary adoption progress of Bitcoin since its introduction is undisputed. With the price increase since the outbreak of the banking crisis, there are initial signs that Bitcoin's purpose as an alternative to centralized financial institutions is increasingly being recognized.

In the current banking crisis, the end consumer hopes that their deposits will be secured in the event of their institution's insolvency due to its systemic importance, while their purchasing power continues to decline due to the unrestricted creation of currency. The "digital gold" was created to offer a way out.