ECONOMY

An Eye on Stablecoins

THINK STRATEGICALLY:

The Amalgam of Inflation, Rates and War

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Inflation Rises Price Pressures and Impacts Us All

For the past 10 months, most investors have been dealing with the rising inflation and Consumer Price Index (CPI) rates.

While in my point of view inflation would begin to come down slowly, when the CPI was announced, the reading exceeded the 7.3 percent estimate, rising to a 40-year-high of 7.5 percent compared with last year. As we look at specific items, the most significant gains include:

- Used cars: 40.5 percent
- Gasoline: 40 percent
- Energy: 37 percent
- Natural gas 23.9 percent
- Meats, fish, poultry, eggs: 12 percent
- Food at home: 7.4 percent.
- Transportation: 5.6 percent.
- Shelter: 4.4 percent.

Transportation 5.6 percent increase is concerning and impactful as it affects all products in the chain. The much-expected return to more accessible pricing will have to wait as the price pressures have also taken hold of the services sector.

Although inflation remains higher than the Fed's target of 2 percent, we continue to project that pricing increases will abate by March, with broader pricing decreases occurring through the second half of 2022. As supply chains normalize and inventories return to normal, the price of goods will decrease as a function of supply and demand. Another impact we shall see soon is the decrease in prices of both used and new cars.

The National Automobile Dealers Association stated that during 2021 its sales volume was a little more than 14.9 million vehicles, a 3.1 percent increase over 2020. NADA projects 15.4 million units will be sold this year, an 3.4 percent increase.

While sales have been hampered by microchip shortages and other supply chain disruptions, most automakers have said these issues will be resolved before the second quarter of 2022 (2Q22).

Another factor that impacts all products broadly is shipping costs. Since November, these have been on the decline, with faster delivery times, indicating that backlogs are starting to improve.

Last month, we estimated the basic food basket cost $161.26 per month in Puerto Rico, where the minimum wage totals $1,160, representing 13.9 percent of total income. With this latest increase, the basket increases to $173.32, or 14.94 percent, making it harder to make ends meet, a real impact on real people.

Interest Rates Must Increase Now

It has become quite clear that the Federal Reserve lost control of inflation and is now on an obligatory path to increase rates much faster than it usually would.

The jobs report and rising gross domestic product (GDP) tell us the U.S. economy is in great shape, and it no longer needs help; the time to begin raising rates is now, before inflation hits double digits.

Some Fed leaders have already begun publicly expressing their view, beginning with St. Louis Fed President James Bullard, who supports raising rates by 1 percent by July. The cure for out-of-control inflation is aggressive interest rate increases, which are on the horizon.

Is there a Ukraine-Russia War on the Horizon?

The administration of President Biden removed non-essential personnel from the U.S. embassy in Ukraine. It said that a Russian invasion of Ukraine could begin "at any moment's notice" and warned all U.S. citizens to leave. As fears rise over a potential invasion of Ukraine, U.S. Secretary of State Antony Blinken stated that diplomatic solutions remain open to end the potential crisis.

Blinken told reporters in Hawaii that he informed Russian Foreign Minister Sergey Lavrov during their phone call that their differences between his country and Ukraine could be better addressed diplomatically. Also, Biden and Russian President Vladimir Putin held an hours-long call on which Biden expressed a similar sentiment.

However, in an abundance of caution, U.S. Secretary of Defense Lloyd Austin ordered 160 U.S. troops to be repositioned in nearby areas following the U.S. and Russia's latest dialogue. The situation does not seem promising at all.

The Week in Markets: Inflation, Interest Rate Rise and Possible War in the Mix

The U.S. stock markets closed last week with losses as most investors are now concerned with three divergent issues. One is the Federal Reserve, due to the continued rise of inflation, there is a sentiment that the bank will raise interest rates by more than 1 percent in March. The second is the assertion by the Biden administration that a Russian invasion of Ukraine could begin at "any moment's notice" and has asked U.S. citizens to leave.

The third is the upcoming Federal Reserve Board's stress tests. All banks with $100 billion in assets must demonstrate they have the required capital to operate amid a dramatic recession. The Fed will test 34 large banks using a range of hypothetical scenarios. All these elements combined and the fact that consumer sentiment fell 8.18 percent last month to a low of 61.7, creates the foundation for increased volatility, rising asset rotation and a flight to safety by some investors.

Wall Street summary for the week ended Feb.11:

– Dow Jones Industrial Average closed at 34,738.06, down 351.68 points, or 1 percent, for a year-to-date (YTD) return of -4.4 percent.
– Standard & Poor's 500 closed at 4,418.64, down 81.89, or 1.82 percent, for a YTD return of -7.29 percent.
– Nasdaq Composite Index closed at 14,098.01, down 306.86 points, or 2.18 percent, for a YTD return of -11.85 percent.
– Birling Capital Puerto Rico Stock Index closed at 2,959.21, up 31.91 points, or 1.09 percent, for a YTD return of 2.78 percent
– The U.S. 10-year Treasury note closed at 1.92 percent.
– The U.S. 2-year Treasury note closed at 1.5 percent.

Weekly Market Close Comparison	2/11/22	2/4/22	Return	YTD
Dow Jones Industrial Average	34,738.06	35,089.74	-1.00%	-4.40%
Standard & Poor's 500	4,418.64	4,500.53	-1.82%	-7.29%
Nasdaq Composite	13,791.15	14,098.01	-2.18%	-11.85%
Birling Puerto Rico Stock Index	2,959.21	2,927.30	1.09%	2.78%
U.S. Treasury 10-Year Note	1.92%	1.93%	-0.52%	0.50%
U.S. Treasury 2-Year Note	1.50%	1.31%	14.50%	0.50%

The Final Word: What are Stablecoins?

Stablecoins are a class of cryptocurrencies that attempt to offer price stability while being backed by a reserve asset. These have gained popularity as they try to provide the best of both worlds—the instant processing and security and privacy of cryptocurrency payments and the volatility-free stable valuations of fiat currencies.

The House Financial Services Committee recently held a lengthy hearing on the regulation of stablecoins. A senior Treasury official discussed recommendations made in a stablecoin report issued by the department and other regulators at the hearing. To fill in regulatory gaps and address financial stability concerns, the regulators would like Congress to develop legislation regulating stablecoin issuers as banks. This point received pushback from some lawmakers.

Stablecoins are not the only area where regulators want Congress to act. The Federal Reserve recently issued a much-anticipated report on Central Bank Digital Currency, and it stated that it would like direction from Congress before proceeding with a CBDC. It will take time for lawmakers to digest the complexities of these issues and reconcile potentially divergent approaches to regulating digital assets. Knowing Congress, it will take a while for representatives to grasp the situation and issue the proper guidance.

More to come.

Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.