Cryptocurrency returns are immune to monetary policy spillovers

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Cryptocurrency returns are immune to spillovers caused by changing international monetary policies, according to new research from Durham University Business School. The researchers state that cryptocurrencies may offer diversification benefits as a digital asset.

The study also found that interconnectedness between cryptocurrency returns and monetary policy spillovers were particularly large when shadow policy rates became negative, moderated during the Fed's "tapering process", and sharpened again more recently as cryptocurrency buoyancy returned.

This research was conducted by Dr Ahmed Elsayed, Professor in Economics and Finance at Durham University Business School, alongside his colleague, Ricardo Sousa, a Professor at the University of Minho, Braga .

The researchers were interested in understanding the dynamic and spillover effects of leading countries' international monetary policies on the cryptocurrency market, and whether or not they were affected in the same way as other financial traditional assets.

To do so, the researchers used daily data on shadow policy rates – which are indicators of monetary policy actions - for four major economies; the Eurozone, Japan, the UK and the US.

The researchers then used daily closing price data on three key cryptocurrencies; Bitcoin, Litecoin and Ripple, to determine whether these monetary policy changes had an impact on cryptocurrency returns.

Their investigations revealed strong interconnectedness between cryptocurrencies, with returns correlating as both high and positive for all cryptocurrencies reviewed.

The researchers also found that shadow short-rates and cryptocurrency returns typically have a low correlation, which tends to be negative, suggesting that monetary policy tightening has a negative effect on cryptocurrency returns. In a low interest rate environment, investors tend to 'search-for-yield' which again reinforces the view of some diversification gains provided by cryptocurrencies in addition to portfolios consisting of alternative and conventional assets.

Professor Ahmed Elsayed says,

"In the aftermath of the global financial crisis, central banks in both developed countries and emerging market economies have deployed a series of unconventional monetary policies. Not surprisingly, international monetary policy spillovers became particularly relevant, posing challenges for policymakers. However, our research suggests cryptocurrencies are a less volatile asset when it comes to these spillovers."

This research supports the view of a somewhat low monetary policy synchronisation in recent years, as economic growth geared at different speeds across jurisdictions. Thus, the US is generally a net transmitter of shocks, while the Eurozone and the UK are both net transmitters and receivers. As for cryptocurrencies, Bitcoin and Litecoin are net transmitters of shocks, while Ripple is a net receiver.

These findings of strong international monetary spillovers pose challenges for national authorities, reinforcing the importance of policy coordination. The researchers suggest setting up a global level playing field to avoid regulatory arbitrage and deter any potential financial instability that might be attributed to sharp shifts in capital flows associated with portfolio reallocations into and away from the cryptocurrency space.

If you would be interested in speaking with the researchers, or receiving the full research paper, please contact Peter Remon at BlueSky Education – peter@bluesky-pr.com +44 (0) 77 235 228 30.