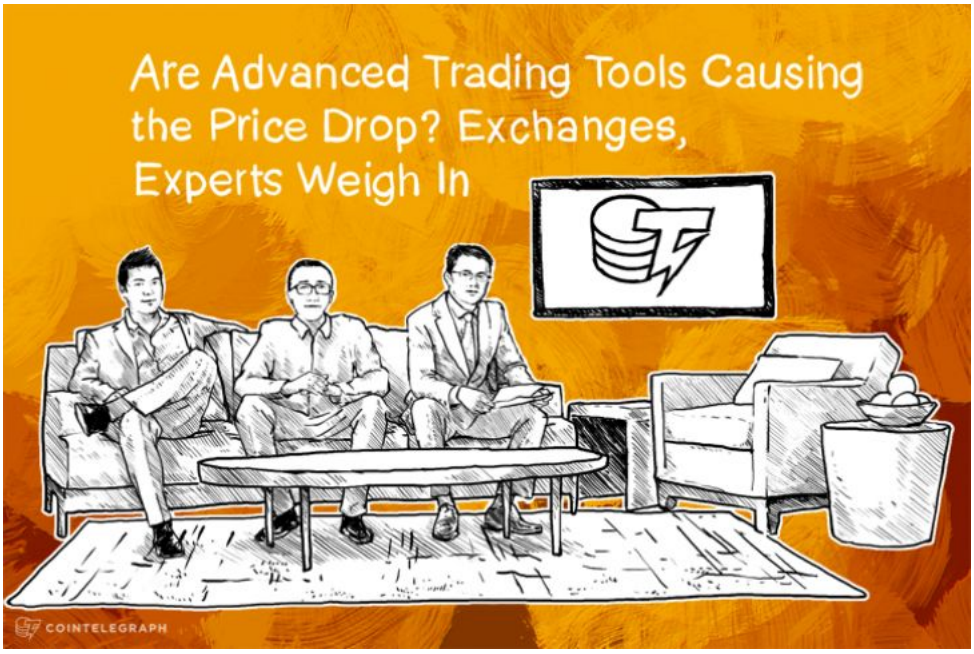
Author **Allen Scott** Tip 57 tips 2014-09-29 11:09 AM

Are Advanced Trading Tools Causing the Bitcoin Price Drop? Exchanges, Experts Weigh In



Among the many theories (http://cointelegraph.com/news/112323/btc-price-flash-crash-manipulation-or-growing-pains) behind Bitcoin's recent price cold streak (http://cointelegraph.com/news/112562/bitcoin-analysis-mid-week-update-dont-panic), one of the most prominent speculations is that of emerging trading tools causing downward pressure on the market.

More and more exchanges have been adding value to their services by introducing such trading tools as futures (http://blog.bitmex.com/?tag=futures-contract), derivatives (http://cointelegraph.com/news/112513/bitcoin-derivatives-exchange-teraexchange-receives-approval-from-us-federal-regulator), leverage (https://www.bitfinex.com/pages/howitworks) etc. - similar to the instruments used in traditional finance. Many argue that these tools are geared towards high-volume markets and, therefore, can prove too powerful for a relatively small Bitcoin market with a capitalization of under US$6 billion compared to the daily average of US$4 trillion flowing through traditional financial markets.

"Many sharp declines in financial markets were largely attributed to the leverage involved, especially for cryptocurrencies," stated Thomas Xie (http://cointelegraph.com/news/112112/a-ban-should-target-risky-products-and-foul-players-not-bitcoin-itself-lakebtc-ceo-thomas-xie), CEO of LakeBTC via email to CoinTelegraph. "The entire Bitcoin capitalization is still very tiny, the number of Bitcoin in circulation is even smaller, and the market is quite illiquid compared to most of other traditional financial assets."

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But while some exchanges such as Shanghai-based LakeBTC have not yet rolled out such features, others like OKcoin with their recent Maker Taker (http://blog.okcoin.com/2014/09/23/okcoins-new-maker-taker-fee-model-illustrated/) offering, along with BitMEX and Bitfinex are in a race to offer the "most comprehensive financial products" such as futures and margin trading, respectively.

Thus, as we are starting to see the price slip below the US$400 mark, "correcting" the surge after the big announcement (http://cointelegraph.com/news/112593/us-paypal-merchants-can-accept-bitcoin-starting-today) from PayPal on September 23, we decided to ask the some of the biggest exchanges as well as a few financial experts in the Bitcoin space to share their thoughts on the aforementioned theory.

Are trading tools causing downward pressure on the Bitcoin Price?

Arthur Hayes (http://cointelegraph.com/news/111988/arthur-hayes) (CEO, BitMEX):

> *"No I don't think so, what is negatively affecting the price is the supply of mined Bitcoin and merchant adoption."*

Joseph Lee (http://cointelegraph.com/news/112105/joseph-lee) (CEO, BTC.sx):

> *"Trading tools by nature do not drive the price down. Their value to Bitcoin's economy is that more liquidity is given to the market. In other words, they may appear to control the market price, however in a free floating currency market (such as Bitcoin), supply and demand simply dictate the price.*
>
> *One threat to Bitcoin is if business owners start running in a fractional reserve manner, whereby bitcoins held do not account for 100% of what should exist on their customer accounts. MtGox's demise was ultimately caused by a hack which caused a balance mismatch of this type. Regardless of the trading tool or business, whether it is a synthetic derivative or an exchange, the threat of immoral business practices will far outweigh affects of individual traders.*
>
> *Bitcoin as an asset type is not shielded from the basics of economics 101, that is, that supply and demand dictates price movements. The market cap of Bitcoin is currently ~$5.5 bn. As an asset type this is tiny and large Bitcoin holders and high net worth individuals will have a far greater effect in controlling the (still small) market. In comparison the daily FX turnover in the wider world of finance averages $4 trillion USD.*
>
> *My bottom line? Trading tools may appear to be a convenient scapegoat, however wider adoption as well as macro economic factors will dictate price movements far more then anything else. The most recent announcement from BitPay and Paypal highlights this fact very clearly."*

Changpeng Zhao (http://cointelegraph.com/news/112544/as-much-as-we-compete-when-it-makes-sense-to-cooperate-we-do-changpeng-zhao-cto-okcoin)(CTO, OKcoin):

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> *"The recent price decline has led to people grasping at straws for the causes. The conclusion that it is due to the futures trading is absurd.*
>
> *The basis of this conclusion is that by providing an avenue for traders to short Bitcoin on leverage is harmful as it adds downward pressure to the price. However, they are neglecting that these leverage tools are also present when the price is moving upwards, which happens very frequently; daily, hourly, and even every minute.*
>
> *Furthermore, futures have been available for 166 years since it was introduced in Chicago in 1848. This is a very mature tool in established financial markets. There is never a saying that having futures will drive the stock market price down.*
>
> *I believe that the highest risk of these tools isn't pushing the price of Bitcoin down, but rather ordinary users getting burned trying to trade with tools they don't have sufficient knowledge of. With this in mind, OKCoin will be releasing guides and video tutorials explaining just how these tools work and how everyone can use them to their benefit."*

Thomas Xie (http://cointelegraph.com/news/112112/a-ban-should-target-risky-products-and-foul-players-not-bitcoin-itself-lakebtc-ceo-thomas-xie)(CEO, LakeBTC):

> *"There are a number of reasons but the most popular ones are leverage, price manipulation, and trader mistakes. Often these factors stack on each other to further worsen the situation, very quickly.*
>
> *[..] It might not be the right time to introduce leverage trading, be it margin/short trading or P2P lending, to the Bitcoin world. Don't get me wrong - leverages, futures, options, plain vanilla or exotic, and all varieties of other derivatives and structured products are useful financial instruments, and LakeBTC will introduce them sooner or later. The thing is, market needs to be ready, and more importantly, the exchange itself needs to be ready.*
>
> *Leverage is a weapon of massive destruction, just like CDO (collateralized debt obligation) and CDS (credit default swap) in the '08 financial tsunami. If not used properly, it's a disaster to everybody onboard. There are enough bad examples in the traditional capital markets that are supposed to be mature, liquid, and robust. Even the fixed-income and foreign exchange markets, which are well known for their unlimited liquidity and endless depth, are not immune to crashes.*
>
> *Arming Bitcoin exchanges run by a bunch of geeks and technologists with financial WMDs? Not a good idea. It is always easy to copy something from the traditional markets. Running it right with appropriate risk management is what really matters here."*

Greg Wolfson (Senior BD Manager, BTC China):

> *"I see new products like futures, short selling and margin trading as healthy developments in the maturation of our industry, and I am not very concerned if they negatively impact the Bitcoin price in the near term. Rather, in the long run, these products increase liquidity, expedite price discovery, reduce volatility and lay the groundwork for yet more products and a more robust Bitcoin marketplace. While perpetual price increase is the dream of those holding long positions, these new products are important for price stability and broader adoption of Bitcoin among businesses and consumers."*

Tone Vays (LibertyLifeTrail (http://libertylifetrail.com/), Trader):

> *"It's easy to blame tools people don't understand. Yes there will instances when an exchange or a trader is not properly using them and it results in a spice in prices on that exchange and a little panic might spread in this immature illiquid market. Hopefully in the near future there will be a general pool of liquidity so that a single exchange is not dependent only its members.*
>
> *Tools like short selling, margin trading and leverage trading are all independent, but people often combine all 3 when thinking about derivatives in a detrimental way. Had simple vanilla (non-leveraged) short selling was more wide spread, perhaps the price might not be down this much 10 months after the all-time high.*
>
> *Bitcioin trading definitely has a larger influence than it should, but the greater macro trend is what drives the price, not traders who can only affect something short term and usually in the direction of the general trend. Supply is way larger than demand because it's not just miners adding bitcoin to the ecosystem, it is also all the merchants that don't care about bitcoin and just place a Coinbase or BitPay button on their websites (PayPal will also increase supply).*
>
> *Demand on the other hand, is all the new users of bitcoin that are willing to hold it in their personal wallets and they are few and far between. The equation will be balanced once there is another "Cyprus Event" where a European bank decides to confiscate people's money and law abiding citizens will realize the advantages of holding their wealth in bitcoins."*

Jeffrey Smith (http://cointelegraph.com/news/111744/jeffrey_smith) (CIO, CEX.io):

> *"The introduction of these trading instruments will result in the increase of the 'trading' audience, which will benefit the Bitcoin economy in the long run. There will be no negative impact on the Bitcoin price."*

Nelson Yu (CEO, 796 (http://796.com)):

> *"We've been running 796 for more than a year. In terms of our trading volume and liquidity of Bitcoin futures, we are the world's biggest exchange. By our experience and evidence of empirical data, we do not see much correlation between our short orders and the lowering price of Bitcoin. However, it is known that a large portion of bitcoins is owned by a few addresses (http://bitcoinrichlist.com/charts/percent-bitcoins-owned-by-richest). That gives the chance to major investors in Bitcoin to "maybe" exert their greater influence on fiat exchanges to their advantage. I would personally believe this is a more probable cause for mid-term price direction."*

Conclusion

There seem to be opposing views among various exchanges and traders when it comes to the question of these newly introduced tools affecting BTC price. The ratio between mined bitcoins and merchant adoption, as highlighted by Arthur Hayes and Tone Vays, is another interesting theory regarding the effect on the exchange rate, but one that we will save for a later time.

All in all, one of the biggest threats to Bitcoin as well as traditional markets is that of the disparity between expectations and reality, which can lead to the creation of a market bubble like we saw during the dot-com boom of the late 90's.

Undoubtedly, actual demand for mined bitcoins is the single most important factor when it comes to price discovery.

So while things like bot-trading, peer-to-peer lending and leveraging can sometimes blur the perception of actual market conditions, perhaps the long-term benefits of implementing such tools can indeed justify these tradeoffs. And while it's still hard to say just how much impact they have on the price, it seems like the best thing for Bitcoin growth for now focusing on increasing the number of actual users of Bitcoin.

> *"I think derivatives will allow the kind of contrarian speculation of shorts that are probably necessary to stop these lurches and create less volatility."*

- Andreas Antonopolous on The Keiser Report, Feb. 4, 2014

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