Effect of Stagflation on Crypto

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An old word is coming back to haunt the US economy. It may also haunt a new word which is cryptocurrencies. The old word is stagflation which plagued the US economy in the 1970s. Stagflation is when inflation is high and persists. It is coupled with stagnant economic demand and high unemployment. As the US Federal Reserve raises interest rates it risks causing a recession. There are calls for the Fed to back off on interest rate increases but, if it does, persistent inflation, **stagflation**, could be the result. Our concern is the effect of stagflation on crypto and crypto businesses.

What Is Stagflation?

Stagflation is an economic situation that defies common thinking about economics. High unemployment generally reduces the demand for goods which should, in turn, drive prices down. People who need work should be willing to work for less. Thus, we should not see high inflation in a weak economy. In the 1970s oil prices soared as OPEC came into being and controlled oil production and also prices. In the wake of the Covid Pandemic and now with the Russian invasion of Ukraine we are seeing supply disruptions of commodities and manufactured goods. This, like the oil situation in the 1970s, tends to create persistent inflation even as the US Federal Reserve and other central banks raise interest rates. What broke the back of stagflation at the end of the 1970s was a monumental increase in interest rates by the Federal Reserve. The result was a recession and higher unemployment that lasted for seven years.

Stagflation and Investing

During the 1970s era of persistent stagflation, stocks did not do well but anyone who invested in gold or real estate did exceptionally well, until they didn’t. After President Nixon took the US off of the gold standard in 1971, gold soared from its fixed price of $32 an ounce. It traded for about $125 an ounce in 1975 and as high as $843 an ounce by 1980. That was when the Fed raised rates and by 1982 gold traded as low as $297 an ounce. Stocks did poorly during the 1970s due to low earnings. Real estate soared in price like gold and then corrected sharply when interest rates went up sufficiently to kill inflation. Cryptocurrencies did not exist back in the 1970s so they have no track record during the worst period of stagflation in memory. But we do know how crypto responds to dramatically higher interest rates.

Cryptocurrencies When Interest Rates Rise

Crypto winter happened when inflation got to the point where the US Federal Reserve and other central banks started to raise interest rates. This is when we learned that contrary to years of hype, cryptocurrencies were not a world apart from the larger financial system. Bitcoin tracked up and down with the Nasdaq stock market. When higher interest rates drove the dollar up against foreign currencies, Bitcoin did not follow along but headed the other way. The rise of Bitcoin from the end of 2022 well into 2023 came with market expectations that the Fed was done raising interest rates or even lower them. That has not happened and the Bitcoin surge has paused.

Bitcoin When There Is a Recession

Will Bitcoin and the rest of the crypto herd continue to follow the Nasdaq stock market up and down? If so, we would expect to see crypto fade again as the Fed fails to achieve their soft landing. The economy will slide into a recession. This happens more often than not when the Federal Reserve raises interest rates to stem inflation. The longer it lasts **crypto during a recession** will likely be suppressed in price along with the stock market. When stagflation, recession, and economic problems relent we would expect to see crypto rally along with the stock market.

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