

Bitcoin: The Mother of all Bubbles

News:

Bloomberg reported a remarkably conservative headline today, 13th December, 2017: "Bitcoin's 8.7% Decline Pales in Comparison to Record Run" and noted that now bitcoin was moving "closer to the mainstream through the introduction of futures." From the same day, other headlines focused on either the risks of bitcoin: "Bitcoin Is History's Biggest Bubble, Turkey's Simsek says", or the huge investment potential: "Bitcoin Price Will Hit \$1 Million, says Social Capital Founder". So what is all the hype about, and what will it mean for banking and the world economy?

Comment:

Bitcoin is a digital currency, also called a cryptocurrency, which was created privately in 2009 as a peer-to-peer system of exchange based upon a novel 'blockchain' algorithm by an unknown individual or group under the name of Satoshi Nakamoto. At the time, a pizza was bought and sold for 2 bitcoins, while those two coins today would be worth \$33,000 with the dollar price still climbing. In fact, the 8.7% loss reported earlier in the day by Bloomberg has already been recovered! The price has almost tripled in 3 months, and the buying frenzy has been so great that the online exchanges that handle transactions have been crashing periodically. People are remortgaging their houses, cashing in their life's savings and today a new way to trade bitcoin with futures is giving added volume to the market. Futures are basically a bet on what the value of a trade will be at a future time.

Bitcoin is a means of exchange and can be used to buy some goods and services. Libertarians hope that bitcoin will cause the corrupt banking system to collapse and offer an escape from the grip of fiat currencies whose value is manipulated by politicians directly or indirectly via 'independent' central banks. While the cryptocurrencies, of which bitcoin is currently the most highly valued, have the potential to undermine the corrupt capitalist banking systems, governments have powerful ways to assert control. The US Federal Reserve has forced the major bitcoin exchange (coinbase) to give up the names of all bitcoin sellers for tax purposes and is thinking about inventing its own cryptocurrency to compete with the others. For all the flaws of fiat currencies governments have huge means at their disposal to maintain the value in exchange of their national currencies, but that cannot be said for private cryptocurrencies. The identity of bitcoin's founder, Satoshi Nakamoto, is a mystery and nothing but the hope of getting rich quickly is driving the meteoric rise in value of bitcoin. Many have called bitcoin a 'bubble' waiting to burst very painfully for those who do not get their money out in time.

Most people who buy bitcoin are buying it to sell at a huge profit, and while this is a powerful upwards driver, there is nothing to support its value when confidence is challenged or when there are not enough buyers left to keep fuelling new purchases.

The fiat currencies are always at risk of collapse because of national debt, but yet central banks do hold reserves that can at least partially cover the value of the currency. Not so bitcoin. Gold experienced a frenzy of buying that drove its price up to \$1900 in 2011 and was described as a bubble, which burst in 2012, but the price remained above \$1000 with trading over a relatively narrow range since then. Gold is valued as jewelry throughout the world and is further supported at lower prices as an industrial commodity. Bitcoin, on the other hand has no such value, and its price could rise to any figure, even a million dollars, or it could just as easily plummet to a few cents. This huge volatility makes it a very poor currency and a very dangerous investment.

For those seeking to escape the control of capitalist banks that are licensed to print money, the answer is not bitcoin, but the Islamic currency system that is based on gold and silver. Those who think that bitcoin could undermine the current fiat currency system might, however, be correct, but not through the success of bitcoin; rather through its failure. As more and more people become intoxicated with 100% profits on a monthly basis, and jump into bitcoin, the price could be inflated far more than any bubble in the history of capitalism, and when such a bubble as that bursts, the effects on the world economy could be substantial. Stock market bubbles, housing and real estate bubbles and commodity bubbles have crashed before bringing ruin and collapse throughout the world, but in those cases there was a floor, as stocks represent real businesses that have value and income generation potential, and real estate has income generating potential and commodities have industrial and social utility; so while the value of these things was inflated grossly till the bubble burst, some value remained, but not bitcoin. If the bitcoin bubble continues to grow and then burst, nothing will remain!

**Written for the Central Media Office of Hizb ut Tahrir by
Dr. Abdullah Robin**