

Cryptocurrency Questions, part 3

What's the true value of Bitcoin? Anything at all, as it compares to nothing in particular.

The Bitcoin rollercoaster has been running for over 9 years now and the familiar patterns seem to be repeating. A prolonged period of stagnation, cries of "Bitcoin is dead", a flurry of activity, an astonishing surge in value, a falter, another peak, a crash and finally consolidation at 10 times its previous value. It has risen over a billion percent since it was created.

After starting 2017 at \$1k, hitting \$20k in December and falling back to a low of \$6k early in February, the price of a Bitcoin had doubled again by the end of the month. Even for medium-term investors, Bitcoin is fickle. Someone who bought a Bitcoin near the end of 2013 and held for 2 years would have made a loss of 70%. The person who bought that same Bitcoin and held for 2 years would have made a 3,000% profit.

There is no central owner, no interest payable, no tax base and no one demanding payment in it, so there is no agreed way of valuing Bitcoin apart from the price its users drive it to. The first million coins are locked up in the Founder's wallet and a large proportion of the others are being held offline in 'cold wallets', so the limited tradeable supply is subject to intense periods of buying and selling, making the price highly volatile. As demand has risen quickly, the circulation has increased only slowly. Bitcoin is free to take on any valuation at all based on unfettered supply and demand.

In comparison, traditional currencies are normally valued by a combination of a country's wealth, the money supply, central bank interest rates, the amount of usage, international comparisons and the activity of currency traders, all fine-tuned by future predictions about the number of jobs, wealth creation and central bank policies.

Cryptocurrencies are valued mainly by opinions about their future use but there is some calculatable value in the predicted transaction fees and mining fees. Some cryptocurrencies have additional functionality (for instance digital rights, smart contracts or real-world asset backing). Some are platforms (eg. Ethereum or NEO) that allow private crypto 'utility tokens' to be built on top so the usage and fees are likely to be higher and more valuable, at least until the platform is superseded.

Currently, the price of thousands of these utility tokens is driven almost purely by speculation. For most, the price has very little connection with a realistic future revenue of the business that issued them. There is a widespread belief that most will fail but a small number will achieve ongoing use as the crypto space goes mainstream and becomes more stable and regulated.

Bitcoin has a special position as the first widespread cryptocurrency and the most secure. Over and above its use as a currency, it may have an additional advantage as a 'store of value', for example an alternative to gold. On the other hand, it is the least functional cryptocurrency and so may be superseded by more recent crypto coins with more innovative features.

With all this uncertainty, the price of Bitcoin is free to roam up and down depending on investor sentiment. Future predictions range from \$100k (or higher) to \$1k (or lower). Both may yet be right, but we cannot tell in which order! Meanwhile the other alternative coins follow in Bitcoin's dramatic wake.

Like a black hole at the centre of the financial system, Bitcoin could suck in more and more universal wealth or it could steadily evaporate and become an ever-glowing ember in crypto spacetime.

That is the mystery of Bitcoin. Its value could be anything at all because it can be compared to nothing in particular.