Bitcoin

A bit on the side

Bitcoin is a speculative asset but not yet a systemic risk

FINANCIAL markets rarely miss opportunities to make money. That is as true of cryptocurrencies as anything else. Trading in bitcoin futures began on the Chicago Board Options Exchange this week; CME Group will launch its own futures on December 18th (see page 65). That has given a further boost to the digital currency's price, which is up by 1,550% this year. Such phenomenal returns are drawing in waves of speculative money. But is there a fundamental case to invest in bitcoin?

The usual tools of finance are no guide. An equity is a claim on the assets and the profits of a firm; a bond entitles the investor to a series of interest payments and repayment on maturity. Bitcoin brings no cashflows to the owner; the only return will come via a rise in price. When there is no obvious way of valuing an asset, it is hard to say that one target price is less likely than another. Bitcoin could be worth $10 or $100,000.

Instead, investors must weigh the scenarios that enthusiasts posit: what if, say, every pension fund invested 1% of its portfolio in the cryptocurrency? One argument made by bitcoinnoisseurs is that it is a type of "digital gold". Stores of value are supposed to keep their value; bitcoin, by contrast, is extremely volatile. Its code ensures that no more than 21m coins can ever be created; that sets bitcoin apart from fiat money, which central banks can create at will. Yet being limited in supply is a necessary, but not sufficient, condition for having value; signed photographs of *Economist* journalists are rare but, sadly, of negligible worth. Nor is supply really limited. Plenty of other cryptocurrencies exist.

Might bitcoin replace ordinary currencies in everyday transactions? Not soon. Who wants to part with (or accept in exchange) a currency that can rise or fall by 20% in an hour? And true currencies are used to denominate liabilities as well as assets; imagine the ruin faced by those who had taken out a bitcoin mortgage or business loan earlier this year.

Bitcoin might triumph if currencies like the dollar and the euro succumb to hyperinflation, but there is no sign of that. A more likely scenario is that the technology that underpins bitcoin—a distributed ledger called the blockchain—proves so useful that it becomes widely adopted. If so, bitcoin would become a vehicle for other services, and people would need to own some, or a fraction of one, to use them. But the original appeal of bitcoin was to the libertarian fringe and those who wanted to trade illegal commodities, like drugs, out of sight of the authorities. Bitcoin's anonymity and opacity do not much appeal to big banks (or to their regulators). They are developing their own blockchains.

Hysteria on all fronts

If the bitcoin boom looks like a mania, calls for it to be banned are also over the top. Regulators are right to watch "initial coin offerings"—attempts by companies to raise money by issuing digital tokens of their own. They are right, too, to warn retail investors about the dangers of a thinly traded market for an asset with no inherent value and scant recourse if things go wrong. But it is hard to see how the currency is a source of systemic risk; by one measure, the value of bitcoin is less than half that of Apple's market capitalisation. Real economic damage occurs when a plunge in asset prices is combined with the widespread use of money that has been borrowed, particularly by banks. These elements are not yet present.

For those who believe that cryptocurrencies could be the next big thing, buying bitcoin is like an option contract: it might just pay off. For everyone else, the wise course is to watch. Investors have had a lot of fun piling into bitcoin; the real test will come when they suddenly need to get out again. ■

Energy subsidies in America

Abuse of power

Regulators should reject Rick Perry's plan to subsidise coal-fired and nuclear plants

WINTER is coming to America. That simple statement of fact ought not to send shivers down policymakers' spines. But Rick Perry, the energy secretary, sees it as a call to arms. To defend Americans from blizzards, polar vortices and other treacherous weather which, he says, threatens the country's electricity grid, he proposes throwing a multi-billion-dollar lifeline to struggling coal-fired and nuclear plants if they can keep emergency fuel on standby for 90 days.

On December 8th the Federal Energy Regulatory Commission (FERC) was given a 30-day grace period to decide whether to support Mr Perry's plan. It should refuse to do so, or substantially amend it. His scheme is a confection of bad policy, faulty economics and thinly disguised patronage. But it also raises a genuinely difficult question: how to keep grids working smoothly in an era of cheap natural gas, which is hard for baseload power plants to compete with, and renewable energy, which is dependent on the vagaries of the wind and sun?

The FERC's decision, by contrast, ought to be an easy one. The rationale behind Mr Perry's proposal is weak; just 0.00007% of power cuts in 2012-16 were caused by problems with fuel. In emergencies the biggest risk to grids is not power generation at all, but the poles and wires along which electric- ▸▸