

Forbes

Nobody Knows If There's A Bitcoin Bubble

By: Timothy B. Lee – April 10, 2013

It has become almost obligatory for mainstream journalists writing about Bitcoin to describe the currency's current value as a bubble. It's widely assumed that the recent increase in the value of a bitcoin, from \$13.50 at the start of the year to more than \$250 today, must be the result of speculative excess.

But I have yet to see anyone actually make the argument for this point of view. Lots of people have made arguments that Bitcoin is nothing but a fad, and that its value will be \$0 in the long run. I think that view is incorrect but it's not a crazy view—it's one I held a couple of years ago. But I don't know of anyone who has made a convincing argument that Bitcoins are worth *something*, but that the current price is too high.

As I write this, the value of all outstanding Bitcoins is a bit less than \$3 billion. Is that a big number or a small number? It's a difficult question because the answer depends on what happens to the underlying Bitcoin economy in the coming years. The value of Bitcoin-denominated transactions has been rising steadily. If that process continues, the "Bitcoin economy" could be much larger in five or ten years than it is today.

To give just one example, Western Union has a market capitalization of \$8.5 billion and earned \$1.3 billion in *profit* in 2010. If you think Bitcoin will eventually become a popular way to transmit money internationally, it's not crazy to think Bitcoin's "market cap" will be in the same ballpark as Western Union's.

Obviously, that's just a rough back-of-the-envelope estimate. Maybe Bitcoins won't pose a competitive threat to Western Union. But the point is that at the scale of global financial networks, \$3 billion is a pretty small amount of money. If Bitcoin proves superior to conventional financial networks for at least one significant application, it's easy to imagine enough demand for the currency to justify the current valuation.

A lot of people seem to be comparing the current transaction volume to the current valuation. But that's a mistake. If you think the fundamentals of the Bitcoin economy will support a price of \$500 by 2018, it's rational to buy bitcoins at \$250 today even if today's fundamentals only support a price of \$50. So the recent rise in Bitcoin's price is a bet on the future size of the Bitcoin economy. That bet may turn out to have been mistaken, but we won't know until we see how people use Bitcoin in the coming decade.

Disclosure: I own some Bitcoins.

