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No, Bitcoins Aren't In Danger From "Hyperdeflation"

By: Timothy B. Lee – April 1, 2013

My friend Joe Weisenthal argues that Bitcoin is "now in a terrible state of hyperdeflation," with the currency's value rising from $13.50 to $100 in just the last three months:

> So a few weeks ago, a pizza might have cost you one Bitcoin. Today it might only cost you a fifth of a Bitcoin, which sounds great, but then if you're looking at the above chart, why would you spend anything?
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> Why would you buy a pizza (or pot or anything else) when tomorrow your Bitcoin will be worth more? With this kind of chart, you'd be insane to do anything but horde your coins.

Deflation is harmful for conventional currencies because, in economist jargon, Bitcoins are a unit of account as well as a medium of exchange. When you buy a house, your mortgage is likely to be denominated in dollars. So if the value of a dollar doubles, you might find yourself unable to make your mortgage payments. Similarly, because most wages are denominated in dollars and workers resist nominal wage cuts, deflation can force employers to lay off employees.

But Bitcoin is rarely, if ever, used as a unit of account. If you go to a website like Silk Road that sells stuff for Bitcoins, you'll generally find the prices listed in both Bitcoins and a conventional currency. The Bitcoin price is automatically adjusted as the value of Bitcoin rises or falls against dollars or euros.

Similarly, no one has Bitcoin-denominated salaries, borrows money in Bitcoins, or pays Bitcoin-denominated rent every month. So the rapidly rising value of Bitcoin isn't going to cause the kind of economic dislocations that dollar deflation would cause.

Also, "hyperdeflation" is another word for "investment opportunity." If Joe really thinks the price of Bitcoins is going to continue rising rapidly, he should put his money where his mouth is and buy some.

Disclosure: I own some Bitcoins.