Bit of a bubble? — on bitcoins and cryptocurrencies

One lakh rupees invested in bitcoin in 2010 would be worth a few hundred crore rupees today. That is the kind of extraordinary return the digital currency has given investors as its price has witnessed a meteoric rise, from just a few cents in 2010 to hit a lifetime high of over $11,000 last week. In 2017 alone, bitcoin price has increased by over 1000%. In fact, all it took for the currency to reach $11,000 after breaching the $10,000 mark was a single day. True to its nature, however, soon after hitting $11,000, bitcoin witnessed a sharp drop of 20% before recovering some of its losses to close the day almost flat. Other cryptocurrencies like Ethereum too have shown equally impressive gains and falls, particularly over the last year. Enthusiasts argue that cryptocurrencies like bitcoin are rapidly transforming into mainstream money that will offer serious competition to national currencies issued by central banks. Therefore they see bitcoin's current price rise as merely a reflection of its bright future as a stateless currency. Its limited supply and the blockchain technology on which it functions, they say, have also added to its exotic appeal. Sceptics, however, have pointed to the Tulip Bubble of the 17th century and Internet stocks of the late 1990s as cautionary examples. The most notable among the critics has been J.P.Morgan chief executive officer Jamie Dimon who called bitcoin a "fraud" that will make its investors poor.

Whether bitcoin holds huge fundamental value as a medium of exchange, as many of its supporters claim, is yet to be seen. The blockchain technology may well have some merits, as shown by increasing interest in it even among central banks and other financial institutions. Many have even started offering financial products and services centred around bitcoin. Yet the fundamental value of any currency is based not on its underlying technology but on its general acceptability as money for the purpose of commerce. Bitcoin, or any other cryptocurrency, is nowhere close to widespread use as a medium that helps in the exchange of goods and services. Earlier this year, a Morgan Stanley research note concluded that bitcoin's acceptance "is virtually zero". In fact, it found that the acceptance of bitcoin among the top 500 online retailers actually dropped in the last year. What then explains bitcoin's huge price rise? The fear of missing out on extraordinary gains, achievable within extremely short periods of time in the case of bitcoin, has likely pulled people from all walks of life into the digital currency. This is typical of bubbles that are driven by emotion rather than value. It is also a telling sign of the times where easy monetary policy has pushed investors starved of yield in traditional assets into highly risky assets like bitcoin.

Revving up infrastructure spending is necessary, but not sufficient

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