Why I Hate Bitcoin (on the 50th anniversary of the Nixon Shock)

There are many reasons to hate Bitcoin. The biggest reason for me might be the fact that I didn't buy any when it was under $10 (it is now trading somewhere around $50 000 per coin), and so am not currently retired and living in splendour.

However, such personal reasons aside, I want to focus today on a broader issue with Bitcoin, which is its absolutely crucial role in keeping our current monetary system going.

Of course, such a critique is anathema to Bitcoin proponents, who correctly point out that the cryptocurrency was created in response to the astonishing pace of central bank money printing during and after the 2008 Global Financial Crisis. One of the key decisions made by the creator(s) of Bitcoin was to limit its issuance to 21 million coins. The thinking was that as governments continued to print more and more fiat money (which is backed by nothing but confidence in the government and assigned value only through its continued acceptance by others), the accelerating fall in its purchasing power would cause people to switch over to Bitcoin to protect their wealth.

Such a view makes sense if one remembers the immediate aftermath of the Nixon Shock of August 15th, 1971, when the U.S. Treasury "temporarily" suspended the exchange of dollars held by foreign governments for gold at the fixed price of $35/ounce. As inflation rates in the U.S. (and Canada) surged well above 10% p.a. savers lost confidence in the dollar as a store of value and shifted instead into gold (which hit $800 an ounce by 1980) and gold-backed currencies such as the Swiss franc.

This existential threat to the dollar was countered only by increasing interest rates to around 20%. Even today, countries with a history of high inflation need to offer savers a high rate of interest in order to persuade them to hold their currencies. For instance, Turkey's current interest rate of 19% reflects the fact that prices there are rising by at least 14% per year.

However, since the 1980s policymakers have been able to, almost counter-intuitively, keep dollar demand high even while pushing interest rates ever lower. While savings accounts have paid less and less interest, these same falling rates have driven the value of dollar-denominated assets such as stocks, bonds and real estate ever higher.

Interest rates matter. If I can only afford a $1000 monthly mortgage payment, and if mortgage rates are 10%, the most I can borrow and repay over 20 years is $100 000. However, if interest rates fall to 2% that amount rises to $200 000. Clearly, when interest rates fall, the amount people can afford to borrow, and therefore the price they are willing to pay for assets such as homes, rises.

Crucially, in order to best take advantage of these rising prices you have to borrow. As Robert Kiyosaki, the author of the bestselling personal finance book 'Rich Dad, Poor Dad' has said, you don't get rich by saving, you get rich by borrowing money.

The key is leverage. If you buy a house with cash, and it appreciates by 10%, you have gained 10%. However, if you borrow 90% of the purchase price, a 10% appreciation will result in a doubling of your original investment. Such rich rewards encourage further borrowing to purchase assets, driving prices ever higher. All this borrowing, of course, fuels demand for the dollars and other fiat currencies being feverishly printed by the world's central banks.

If interest rates are pushed too low for too long, though, they encourage speculative manias driven by buyers convinced that, even if they pay too much for an asset, a "greater fool" will pay them even more for it in the future. And so, in succession, we have had the junk bond mania of the 1980s, the Japanese and emerging market mania of the early- and mid-1990s, the technology stock (or 'Dot-Com') mania of the late 1990s and the housing and property mania of the 2000s.

As the satirical publication 'The Onion' put it perfectly in July 2008, just as the U.S. housing bubble was beginning to burst, "Recession-Plagued Nation Demands New Bubble To Invest In."

Fortunately for investors, politicians and policymakers heeded this call to action. Since 2009, we have entered what the author Graham Summers has called "The Everything Bubble." Stocks, bonds and real estate are at all-time highs, all fuelled by trillions of dollars of money printing and debt issuance.

Which is where Bitcoin and other cryptocurrencies enter the picture. Only in a monetary environment like this one could tokens with no intrinsic value (which, as they belong to a new asset class, are poorly understood and therefore difficult to price) trade for tens of thousands of dollars purely on the assumption that in the future they will trade for ever-larger sums of money.

Thus, instead of taking the place of government-issued fiat money, Bitcoin (alongside other cryptocurrencies) has evolved to become a perfect speculative asset. As people borrow dollars to speculate, Bitcoin is therefore supporting the demand for government-issued fiat currency and thereby supporting the current monetary system.

Which is a shame, because the promise of a transition to hard money that keeps its purchasing power, was and is much more appealing than remaining in our current monetary system which, by encouraging speculation at the expense of savings and productive investment, is leading us to a future of real poverty amidst paper plenty.