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Wall Street Sees Bitcoin's Legacy as Payment System: Currencies

By John Detrixhe - Jan 16, 2014

While a Texas Senate candidate is accepting Bitcoin campaign donations, and Overstock.com customers can use the technology to buy engagement [rings](#), [Wall Street](#) sees its future more as a payment system than a currency.

Either way, it's been a profitable investment. Created in 2008, Bitcoin's value took off last year, leaping about 60-fold in the past 12 months to \$936.51 yesterday, with prices ranging from \$16 to more than \$1,200, according to [bitcoincharts.com](#). Gold plunged 26 percent in the same period, while the second best-performing major currency, the 18-nation euro, [climbed](#) 7.3 percent versus a basket of its major peers.

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While its supporters have embraced Bitcoin as an alternative to currencies vulnerable to sovereign debasement, [China](#)'s central bank has banned lenders from handling the virtual money and [Finland](#)'s authorities said it lacks the characteristics of a real currency. Citigroup Inc., the second-largest foreign-exchange trader, said Bitcoin could benefit society if it eases transactions, even though about 1 percent of owners hold some 80 percent of the digital money.

"Bitcoin, in essence, is just an evolution of a payment system," [Sebastien Galy](#), a New York-based senior foreign-exchange strategist at Societe Generale SA, said by phone Jan. 14. "The ultimate concept of transaction, the innovation, is certainly progress in the means of transaction."

Anonymous Network

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Bitcoin was introduced by Satoshi Nakamoto, which may be a pseudonym for one or more programmers. The anonymous network is protected by cryptographic codes and works outside the banking system, allowing users to transact with one another directly. It doesn't exist in physical form and has no coins or bills.

"The original Bitcoin was designed to operate outside the financial system," Steven Englander, the head of [currency trading](#) for major industrialized nations at Citigroup in [New York](#), said by e-mail Jan. 13. "There is nothing to stop existing payments processors from adopting generic Bitcoin payments technology."

Bitcoin's market value has expanded to about \$10.6 billion. The supply will be capped at 21 million, with about half of that already in circulation, according to [Bitcoin.org](#), a repository for information on the system. The price of an individual Bitcoin jumped from \$100 in July, to \$200 in October and more than \$1,000 this month.

For Offit Capital Advisors LLC, this volatility could be its fatal flaw.

'Fails Miserably'

"Saying that a currency is a store of value implies that it is a relatively stable value," the New York-based private wealth-management firm wrote last month in a report. "Without that stability, the costs of normal commerce far outstrip any credit-card or bank transaction fees. Bitcoin fails miserably on this important measure."

Bitcoin is less a currency than a virtual commodity, Sheng Songcheng, the head of the People's Bank of China's statistics department, told reporters at a briefing this week in Beijing. The Bank of Finland said on its website yesterday that the virtual money doesn't fulfill official definitions of a currency.

The U.S. [Internal Revenue Service](#) hasn't offered guidance on Bitcoin beyond saying it's working on the issue and that it has been monitoring digital currencies and transactions since 2007. The IRS should give taxpayers clear rules on how it will handle transactions involving digital currencies, [Nina Olson](#), the National Taxpayer Advocate, said Jan. 9.

Senate Candidate

Bitcoin is gaining traction in the face of the official criticism. The virtual money is being accepted for donations by Texas Senate [candidate](#) Steve Stockman. Online retailer Overstock.com's Chief Executive Office Patrick Byrne said in a Jan. 9 [statement](#) that he finds the virtual currency appealing to him because "no government mandarin can will it into existence."

The value of the world's reserve currencies has been called into question since the 2008 financial crisis, spurring demand for everything from gold and art to digital money. The response of central banks of flooding the financial system with unprecedented amounts of cheap funding debased their currencies, helping send the Bloomberg Dollar Spot Index tumbling 20 percent from March 2009 to August 2011.

Limited Supply

“There is definitely a temptation to find assets that are in limited supply,” [Eswar Prasad](#), a professor at [Cornell University](#) in Ithaca, New York, and former International Monetary Fund economist, said Jan. 14 in a phone interview. Investors have sought Bitcoin “on the belief that assets in limited supply are likely to maintain their value more than assets that can be produced at the whim of a central authority.”

The [Federal Reserve's](#) [balance sheet](#) has quadrupled to more than \$4 trillion since 2008 as it sought to drive down [interest rates](#) and prop up asset prices. [Japan](#) is doubling its [money supply](#) to ward off 15 years of deflation. The [European Central Bank holds](#) 2.2 trillion euros (\$3 trillion) of assets, down from a peak of 3.1 trillion euros in June 2012.

As recently as 2012, ECB President [Mario Draghi](#) was forced to battle speculation that the currency union would unravel. He warned markets that July that he'd do “whatever it takes” to protect the euro, which survived to welcome [Latvia](#) as its 18th member on Jan. 1.

Avoiding Volatility

Some companies that accept Bitcoin for payment have avoided price volatility by using a third party. Consumers can buy a \$58.49 Beautyrest [mattress topper](#) from Overstock.com using the digital payment system. The payment is processed by Coinbase, which eliminates foreign-exchange risk for the retailer and provides local currency to Overstock.

“Most businesses that accept Bitcoin do not hold it,” Citigroup's Englander said. “So they're now using it simply for transactions and not as an asset.”

Bitcoin the currency can't be separated from Bitcoin the payment system, [Barry Silbert](#), the founder and head of SecondMarket Inc., a New York brokerage that runs a virtual currency fund, said Jan. 14 in a phone interview. Without having the virtual currency as an asset, the system would be reliant on trust in a third-party, he said. His fund invests in Bitcoin.

“There is very little debate, I think now in Wall Street, and certainly as it relates to Silicon Valley and venture capital, that Bitcoin technology, Bitcoin the protocol, has the potential to radically disrupt and transform the financial-services space,” Silbert said.

Retaining Trust

Trust in traditional currencies hasn't evaporated yet, if their performance since the height of the financial crisis is anything to go by.

The euro has gained 12 percent against the 10 developed-nation currencies tracked by Bloomberg Correlation-Weighted Indexes since Draghi's 2012 pledge. In the past year, it has trailed only the Swiss franc, which strengthened 7.6 percent.

The Bloomberg Dollar Spot Index, which measures the U.S. currency against 10 major counterparts, has also recovered from its decline two years ago. The gauge rose 3.5 percent in 2013, touching a three-year high of 1,056.33 in July, before climbing 1 percent this year to 1,030.76 as of 1:07 p.m. in New York.

“The crisis has paradoxically shown that it's those assets that can be produced in very large quantities in a short period that are the ones that continue to retain the trust of the broad majority of investors,” Cornell's Prasad said.

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