Sharp fall in bitcoin price a sign of growing financial turbulence

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The plunge in the value of the cryptocurrency bitcoin over two days this week to below $10,000—half the level reached in December—and the fall in other cryptocurrencies is another sign of growing turbulence throughout the financial markets.

The sudden fall came a week after significant tremors rippled through bond markets, prompting predictions that the rise in yields could be the start of a bear market, reversing a more than 30-year trend.

Some observers described the situation in the bitcoin market as one of "panic" as investors sought to exit.

Other cryptocurrencies were caught in the downdraft, with Ethereum falling from a high of $1,400 to just over $800 and the Ripple XRP coin halving its value from $2.02 to 93 cents. The founder of Ripple was reported to have suffered a paper loss of $44 billion since the coin reached an all-time high at the beginning of the month.

The value of bitcoin has steadied since Wednesday's sharp decline and moved back to over $11,000, still well below the level of $20,000 reached last month. But it could well plunge again.

The immediate cause of the sell-off appears to have been the news that South Korea and China were moving to introduce restrictions on cryptocurrency trading, if not banning it altogether.

In South Korea, the third largest market, Finance Minister Kim Dong-Yeon said shutting down cryptocurrency exchanges was an option. In an interview, he said he hoped things would not go that far, but irrational speculation needed rational regulation.

China, which has moved in this direction, is reported to be considering a further clampdown on cryptocurrency trading, particularly with regard to online platforms and mobile phone apps that offer exchange-like services.

A note by the British-based organisation Capital Economics, cited by the *Guardian*, said bitcoin's latest price fall suggested the "bubble is bursting." Yet, with the price still ten times higher than it was a year ago, it had a long way to go. The note claimed that when the bubble did collapse it would not have a major impact because the amount of money involved was relatively small at $200 billion.

It should be recalled, however, that in 2007, the then chairman of the US Federal Reserve, Ben Bernanke, said the emerging sub-prime crisis would not be a problem for broader markets because it only involved investments of $50 billion.

Capital Economics said the bitcoin price surge had been driven by the belief that it would continue to rise in value. In other words, the speculation was a kind of pyramid scheme in which the price continued to rise as long as money kept flowing in.

Such a description could equally well be applied to the current surge in stock markets, which saw the Dow Jones reach 26,000 this week after passing through the 25,000 mark a few days before.

The rise and rise in the markets is beginning to bring warnings that it is preparing the conditions for a collapse, with far-reaching consequences.

Writing in the *Wall Street Journal* this week, Martin Feldstein, chairman of the Council of Economic Advisers under the Reagan administration, warned that stocks were headed for a fall, with the escalation of stock prices far in excess of the rise in profits. The price/earnings ratio for the S&P 500 index was now 26.8, higher than at any time in the 100 years before 1998 and 70 percent higher than its historical average, he noted.

With an expected increase in interest rates from the historically low levels set by the US Federal Reserve, share prices were also likely to return to their previous norms. If the price earnings ratio declined to its historical average then the value of equities would fall by $10 trillion.

Feldstein did not spell out the implications of such a decline but it would result in a financial meltdown far beyond that of 2008. He did point to the “excessively easy monetary policy” that had “led to overvalued equities and a precarious financial situation.”

In another warning, the global bond trader Pimco said the very fact that investors had been ploughing money into ever-riskier assets, with no fears and amid expectations that they would keep on rising, was a cause for concern.

Speaking to Bloomberg TV on Wednesday, Pimco global economic adviser Joachim Fels said: “The fact that fear is gone is the main reason why we should be worried. That means most investors are now pretty fully invested and that means they will want to get out if the markets start to correct—exacerbating the downdraft.”

In other words, in the expectation that markets are on the rise, and seeking to take advantage of profitable opportunities, large investors have no cash reserves. They will have to liquidate their holdings if there is a fall— creating a rush for the exits that further accelerates the process.

An even more severe scenario was spelled out in the Global Risks Report prepared by the World Economic Forum for its Davos summit of the world political and financial elites to be held later this month.

While rising share prices had delivered “positive returns”—billions of dollars transferred to the ultra-wealthy—there were “underlying concerns,” most notably the weakest post-recession recovery in record and low productivity growth.

With asset prices at “unsustainable levels” and “continuing strains in the financial system,” a systemic collapse “could push countries, regions or even the whole world over the edge and into a period of chaos.”

The turmoil surrounding bitcoin has to be placed within this context. While cryptocurrencies occupy a very small portion of the financial system, their speculative rise over the past year and the plunges in recent days are symptomatic of much broader processes.