The bubble bursts on e-currency Bitcoin

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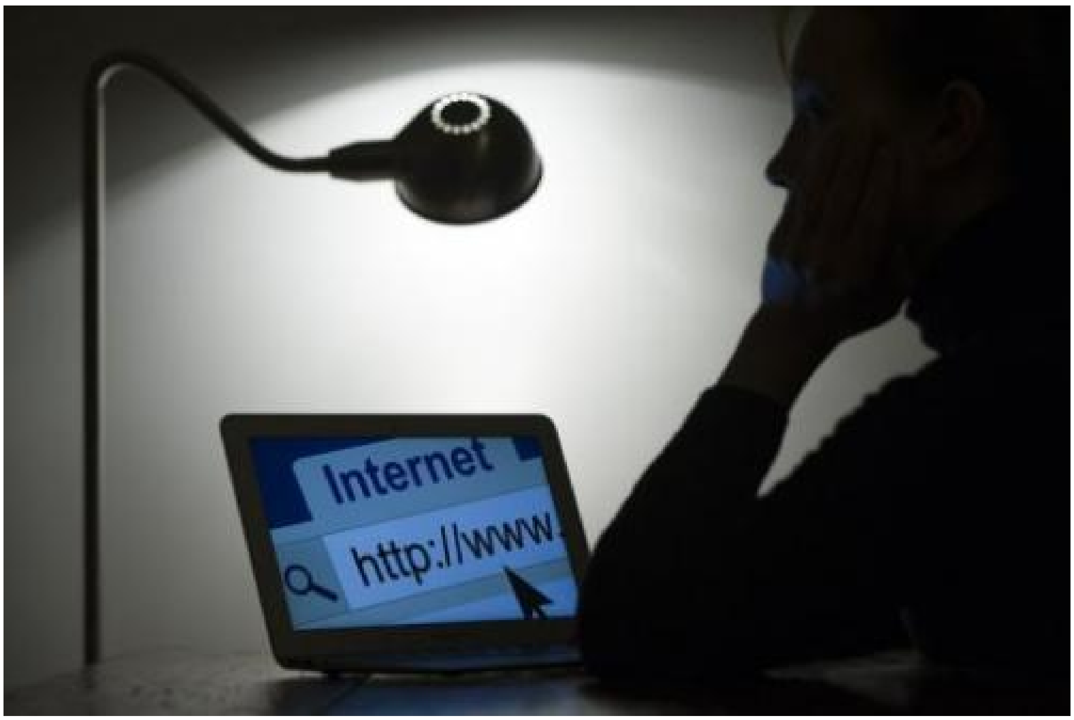

Many saw it coming, but that didn't stop the Bitcoin bubble from bursting: after rising to dizzying heights, the digital currency suffered its first true crash this week. File picture for illustration only shows a user connecting to the internet

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The price of the virtual "geek" currency had soared through the stratosphere in recent weeks, trading for a high of $266 on

Wednesday—only to come hurtling back to Earth in just three days.

By Friday, a single Bitcoin was worth just $54, according to the Mt. Gox platform, which manages 80 percent of the Bitcoin transactions and had to briefly shut down trading Thursday.

"There was a LOT of short-term speculation happening" from people who wanted to earn a buck from the soaring prices and cash out before the fall, Bitcoin Foundation chief scientist Gavin Andresen told AFP.

"Wild price swings are not good for Bitcoin."

But Andresen predicted the crash would not spell the end of the Internet-era currency, which was created in 2009 in the wake of the global financial crisis by an anonymous programmer who wanted a currency independent of any central bank or financial institution.

"We believe that as the value of Bitcoin grows, and the infrastructure around it grows and matures, the price relative to other currencies will get more stable," he said.

"That will take a few years," he cautioned, "and I expect continued chaos and drama in the meantime."

Some analysts have said the volatility of Bitcoin might have been fueled by Cypriots and Russians seeking to invest their euros elsewhere during Cyprus's banking crisis.

But economics professor Steve Hanke of Johns Hopkins University said the Bitcoin bubble burst under pressure from investors, most of whom are American.

Either way, he said, Bitcoin remains "a very uncertain, speculative venture," because it is not backed by a commodity.

As far back as August 2011, James Surowiecki was pointing to the risks of investing in Bitcoin, in a Massachusetts Institute of Technology review.

"With ordinary currencies, there is a limit to how far down the spiral can go, since people still need to eat, pay their bills," and otherwise spend money, Surowiecki explained.

"But these things aren't true of Bitcoins: you can get along perfectly well without ever spending them."

The system is also very complex.

A form of "e-money," Bitcoin is made of strings of dazzlingly complex code created by raw computing power—a process called "mining" that can in theory be carried out by anyone with a computer.

The software is written in such a way that it becomes increasingly difficult to generate new Bitcoins, with the number in circulation designed to eventually top out at 21 million.

Once mined, Bitcoins are stored on a user's hard drive in a virtual wallet, and can be sent directly to another person, bypassing banks and remaining largely anonymous.

In addition to the risks, made evident this week after the crash, this "high degree of anonymity" could lead Bitcoin to become a "monetary alternative for drug dealing and money laundering," warned the European Central Bank, in a report published in October.

The central bank also highlighted the risk of a so-called Ponzi scheme, in which early investors earn returns paid by the later investors. Indeed, Bitcoin users can only cash out their money if other people want to buy their Bitcoins.

Also worrying, the central bank noted, is that the virtual currency has been vulnerable to cyber attacks, including in June 2011, when hackers targeted virtual wallets and wiped some people's accounts clean.

But that risk has failed to sway many.

For one, Hanke was not entirely convinced by the European Central Bank's critiques. "If private money starts to become a threat for governments, they come up with many reasons why this is a bad idea," he said.

And the currency appeared to have at least two high-level champions: the Winklevoss brothers, known in part for accusing Facebook founder Mark Zuckerberg of having stolen the idea for the social network from them.

On Thursday, they told The New York Times that they had bought $11 million worth of Bitcoins—that value assessed before the crash—praising it as a mathematical system "free of politics and human error."

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