

# Behind the Markets Podcast Special: Ethereum, The Triple Halving

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## WisdomTree

Contributor

Jeremy Schwartz, Global Head of Research at WisdomTree and regular host of the Behind the Markets Podcast was joined by Guest Host Corey Hoffstein, Co-Founder and CIO of Newfound Research to talk to Nikhil Shamapant (@squishchaos) about a new research paper he wrote about Ethereum, specifically a series of events that he views as a 'Triple-Halving.'

### What is 'Halving?'

The cryptocurrency world was introduced to the concept of 'halving' as part of the bitcoin protocol. It is well known from the bitcoin whitepaper that there will be a limited supply of 21 million bitcoins. The mechanics of how this is achieved comes through a consistent reduction in the reward paid to bitcoin miners over time. At rough intervals of four years, the rewards paid to miners for securing the network with proof-of-work to verify transactions, the specific reward paid to miners is cut in half.

Even though the halving is known well ahead of time, there are interesting supply-demand dynamics that tend to play out in real time within the bitcoin marketplace. Mining bitcoin is very cash intensive, meaning that the computing hardware is expensive, the electricity is expensive, and there isn't a high profit margin left after all these activities. To continually pay for these activities, miners will tend to sell most of the bitcoin that they earn from the mining process. The day after the halving compared to the day before halving, miners will be selling less bitcoin than they otherwise would have if there had been no halving. While demand on those exact days may fluctuate, over time, if demand is staying even close to stable, an important source of supply from miners is reducing, price should be pushed more in an upward direction. The most recent halving occurred in May of 2020.

So the bottom line is that 'halving' is a way to think about a reduction of selling relative to buying demand that could, all other things being equal, create an upward pressure on price.

### Upcoming Events on the Ethereum Network

Different upcoming events on the Ethereum Network could be interpreted in the same way as 'halving' even if there is no finite set supply of ether and the Ethereum Protocol does not have the same provisions as the bitcoin protocol. Thinking of these events, the way to conceive the risk is less about interpreting the impact and more about whether the events will occur in the form currently thought in the market. With the Ethereum Network, it is not guaranteed that proposed events will occur.

### **Event 1: EIP 1559**

While it would be difficult to have an event sound more technical than this, the bottom line is that it would impact the way in which transaction fees would be earned. Pre-EIP 1559 sees transaction fees going to the miners. Post-EIP 1559 sees only 30% of the transaction fees going to the miners, with the other 70% ceasing to exist. It is estimated that this will lead to a 30% reduction in selling pressure coming from the daily transactions of miners.

Remember—a key feature of halving leads to a reduction of selling, so even though EIP 1559 is not exactly the same as ‘halving’, the end effect in the supply/demand dynamics may be very similar.

### **Event 2: Proof of Work to Proof of Stake**

Within the bitcoin protocol, miners are solving cryptographic problems that require a lot of electricity and computing power to secure the network. Currently, the Ethereum network is also using proof of work. However, Ethereum could move to a different setup in the future. Instead of miners needing to secure expensive compute resources and burn lots of electricity to solve problems, the proof-of-stake approach could mean that people could shift to using regular, even inexpensive computers to secure the network. If a user wanted to participate in proof of stake, the individual could put an amount of ether at risk (possibly 32 units), and then they could verify transactions. Instead of solving the difficult cryptographic problem with lots of electricity, the miners who are doing the staking are incentivised to simply do things properly because if they do not, the ether they have at risk would be reduced. Any attacker would tend to see the ether they have at risk reduced, such that it would be harder and more costly to continue to try to act in a malicious way.

The bottom line here is that one would need less of these proof of stake nodes to properly secure the network, and less nodes means less miners, less transaction fees being collected, miners selling less of their ether into the market, and therefore being lower in overall supply in the face of similar demand dynamics.

Again—a similar impact to ‘halving.’

### **Event 3: The Rise of Decentralised Finance Applications (DeFi)**

Developers are creating more and more applications on the Ethereum Network. Some of these are in the Finance Space. As there are more of these applications and each one becomes more popular, more and more ether will be used in a way to secure the collateral within the applications. Currently, roughly 9% of the market cap of ether is used to secure collateral in the DeFi space.

What’s even more interesting is when you combine the impact of this amount of ether going out of typical circulation alongside the amount that is being used for proof of stake going out of circulation to be used for staking purposes. It is estimated that within the next 18 months, roughly 30% of the ether market cap could exist but be used in a way that would not be considered liquid and traded regularly.

Yet another impact similar to halving.

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