

Different digital assets, different monetary policies

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Monetary policy varies across different digital asset networks (e.g. Bitcoin, Ethereum, etc). This feeds into the value proposition presented by different networks. How and why do they differ and what does this mean for investors?

The Bank of England considers the term 'monetary policy' to mean, "the action a central bank or a government can take to influence how much money is in a country's economy and how much it costs to borrow." Transposing this concept onto digital asset networks, like Bitcoin or Ethereum, one can think of digital asset monetary policy as the means by which the amount of coins (cryptocurrencies) or tokens is determined over time in/by/for the digital asset network. This determination is written in software code but might be determined by a company or a group of network users or some other party. This variation helps differentiate digital asset networks from one another – helps frame value propositions - and ultimately provides a basis to inform investment allocations.

How does monetary policy differ across digital asset networks?

Bitcoin's monetary policy does not change. There is a limit on the total supply of bitcoins: there will only ever be 21 million bitcoins created¹. For this limit to be changed would require agreement² from a majority of the 10,000 plus bitcoin nodes³ that run the open source software. In the past there has been disagreement about how many bitcoins should be created, which has caused 'hard forked' bitcoin variants (e.g. Bitcoin Cash). The amount of new bitcoins created decreases over time. Every four years the amount of bitcoins is reduced by 50% ('the halvening'⁴). The final bitcoin will be mined in approximately 2140. In this sense bitcoin is inflationary (i.e. more bitcoin is created each day up to 2140) but the amount created decreases over time (deflationary). This leads some to liken bitcoin to 'digital gold', which makes some sense until one considers that the amount of new gold mined increases/decreases in response to the price of gold at any point in time. This does not happen with bitcoin – the number of bitcoins created increases at a fixed emission schedule.

Source: <https://www.bitcoinblockhalf.com/>

Ethereum's monetary policy can and has changed in the past. Each year 18 million new ether are created. There is no cap on the total supply of ether that can be created. This leads some to term its monetary policy as inflationary. Recent changes to the Ethereum source code were adopted by a sufficient number of nodes to result in a change to the monetary policy. This was called the 'London Hard Fork'⁵ brought about due to the implementation of Ethereum Improvement Proposal 1559. Now and into the future, whenever

someone uses the Ethereum network a proportion of the fee paid to miners is 'burned' (i.e. taken out of supply and destroyed). This has led to a situation where some days there is more ether burned than new ether created, which one might term 'deflationary'.

Source: Token Terminal.

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There are a multitude of different digital asset networks - each with their own monetary policies calibrated to their functional needs. Tether (USDT), for instance, is a token that corresponds to USD\$1. Tether's issuer claims that USDT is backed by bank reserves and loans which match or exceed the value of USDT in circulation⁶. These representative tokens are distributed via many different digital asset networks (e.g. Ethereum, Tron, Algorand, etc). By contrast the BNB token, which is issued by digital asset exchange Binance, can be created or burnt⁷ as the Binance company wishes. In fact a certain amount of BNB tokens are burnt each quarter.

How can digital asset monetary policy inform investment allocations?

Stepping back, the monetary policy for different digital asset networks can have an impact on the expected market price of the coins or tokens in question. Think about it in terms of demand and supply. In a situation where less and less of the coin/token is created (deflationary), coupled with increased demand for said coin/token, one would expect the price to rise. For a coin/token where the supply is not capped (inflationary), demand needs to be sufficient to absorb the increasing supply over time for prices to remain stable or rise.

Some investors might be more comfortable with a monetary policy that cannot change over time. Others might prefer a situation where the monetary policy can change in response to changing needs or conditions (e.g. network scaling, increased profitability, etc). This can come with risks though depending on the (corporate) governance of the organisation that has the capability to change monetary policy.

Finally, the digital asset space can be characterised as inflationary in the sense that new coins and tokens can be created by whoever possesses the technical ability to do so. Its potential to grow is only capped by the extent to which people have new needs that need satisfying over time, which as any economist will tell you, is infinite.

1 <https://www.miamigov.com/files/sharedassets/public/bitcoin.pdf>

2 <https://river.com/learn/can-bitcoins-hard-cap-of-21-million-be-changed/>

3 <https://bitnodes.io/>. A Bitcoin node is any computer that runs a Bitcoin implementation and stores the entire blockchain.

4 <https://www.bitcoinblockhalf.com/>

5 <https://www.gemini.com/cryptopedia/ethereum-improvement-proposal-ETH-gas-fee>

6 Tether's issuer claims that USDT is backed by bank reserves and loans which match or exceed the value of USDT in circulation

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<https://www.gfinityesports.com/cryptocurrency/bnb-burn-schedule-next-binance-coin-burn-date-how-much-bnb-burned-meaning/>

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