Ethereum, the Triple Halving

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On May 7, 2021, 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 on Ethereum, specifically a series of events that he views as a "Triple-Halving."

What is "Halving"?

The Guests noted that the cryptocurrency world was introduced to the concept of "'halving"' as part of the bitcoin protocol. It is well known from the bitcoin white paper 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. What is "Halving"?

Even though the halving is known well ahead of time, Nikhil noted a belief that there are interesting supply–demand dynamics that tend to play out in real time in the bitcoin marketplace. Mining bitcoin is very cash intensive—the computing hardware is expensive, the electricity is expensive, and there is not a high profit margin left after mining is complete. To pay for these activities, Nikhil expects that miners will tend to sell most of the bitcoin they earn from the mining process. On the day after the halving, miners may sell less bitcoin on the market than on the day before. While demand on those exact days may fluctuate, if demand stays even close to stable, but the supply from miners is reducing, Nikhil indicated that prices may be pushed upward. The most recent halving occurred in May 2020.

Upcoming Events on the Ethereum Network

Nikhil also discussed how different upcoming events on the Ethereum network could be interpreted in the same way as "halving," even if there is no finite supply of ether and the Ethereum protocol does not have the same provisions as the bitcoin protocol. With the Ethereum network, it is not guaranteed that such events will actually occur.

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 POW, but Nikhil indicated that the Ethereum network is being positioned to potentially transition to a proof of stake (POS) model in the future.

As described by Nikhil, instead of miners needing to secure expensive computer resources and burn lots of electricity to solve problems, the POS approach could mean that users could shift to using regular, even inexpensive computers to secure the network. If a user wanted to participate in POS, they could put an amount of ether at risk in order to gain the ability to potentially verify transactions. Instead of solving the difficult cryptographic problem with lots of electricity under the POW model, the miners who are doing the staking are incentivized to simply do things properly because if they do not, the ether they have at risk would be reduced. Nikhil noted that an attacker would tend to see the ether they have at risk reduced, such that it would potentially be harder and more costly to continue to try to act in a malicious way.

The Rise of Decentralized 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, the Guests theorized that more ether will be used.

Building an Ether Thesis

Nikhil noted a belief that over time, there are certain aspects that could make ether particularly interesting and more usable:

1. Ether could be a store of value: The Guests noted that certain predictions indicate that the peak supply of ether, even though it is not precisely defined as is the case with bitcoin, will be 120 million units, and then from there will drop roughly 2% per year, leading to a deflationary supply.
2. Ether may be viewed a consumable commodity in and of itself within different decentralized applications and smart contracts.

For full context, please listen to the conversation below.

Important Risks Related to this Article

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