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CRYPTOCURRENCY. WHAT IS ITS RETURN?

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According to Canaccord Genuity, the market for cryptocurrencies is likely to experience explosive growth in the next decade. They have forecast that cryptocurrencies will grow from a present value of US$117 billion to US$1,131 billion in 2025. However to put this in context, currently daily turnover in national currencies is around US$5,100 billion.

Cryptocurrencies do not pay interest. The values of cryptocurrencies are extremely variable so the return on a cryptocurrency is uncertain.

There are three elements which might provide returns on a cryptocurrency. Mining for new currency, movement in the value of the currency and transaction costs in verifying transactions or making cross currency movements.

There are three principal uses of a currency:

- a medium of exchange,
- a unit for accounting value and
- as a store of value.

Currency failures occur when their population of users lose faith in the currency's ability to meet the above needs. Two common causes are:

- capital controls – which limit the ability to freely use a currency as a medium of exchange and
- hyper-inflation – where the material erosion of future purchasing power sees the currency losing is ability to store value.

Cryptocurrency has emerged with blockchain technology. Blockchain technology provides a rigorous platform for transactions with multiple parties being integrated in a transparent secure system. The system is so rigid any unintended transactions are irreversible. For electronic transactions, this replaces a fragmented medium of exchange system involving multiple intermediary parties, principally banks and merchants, each vulnerable to security breaches to their databases.

As a medium of exchange blockchain systems are an enhancement of current national currency systems, but it is worth noting that current blockchain systems are limited by the number of transactions they can handle. Bitcoin is capable of processing 3-4 tps (transactions per second) compared to Visa at 1,667 tps.

As a means of payment, national currencies are generally accepted, although the U.S. dollar as the international reserve currency is pre-eminent in the payment system for international transactions. Cryptocurrencies must achieve wider acceptance by parties involved in transactions to improve their utility.

Some national governments, which are responsible for the stability of market systems including the monetary base, have a poor record in maintaining the store of value of their national currency. Governments have repeatedly through history undermined the real value of currencies through capital controls and persistent inflation. Whether cryptocurrencies can achieve a better outcome is uncertain. Supply constraints are managed by individual systems. There is no restraint on new providers so supply could overwhelm value.

Current cryptocurrencies are particularly susceptible to being superseded by the next generation of cryptocurrencies. Given they are decentralised, and therefore not mandated by national authorities, a cryptocurrency will lose its relative usefulness if a new cryptocurrency is perceived to provide an enhanced medium of exchange or store of value.