What is Tokenomics?

One factor you'd probably consider in thinking about whether a cryptocurrency's price makes sense is the usefulness — or utility — of that cryptocurrency. A token might be used to pay the gas fees required to execute smart contracts on a blockchain network, or provide the owner with a say in the future of a protocol, among countless other functions. But utility is just one aspect that influences a token's price. Among a huge range of other factors are some basic attributes baked into each cryptocurrencies' design, like token supply (both how much of it there is currently and how much there will be in the future). If you're pondering where to look to understand the bigger picture of factors that impact token price, the answer lies in each project's' "token economics," commonly referred to as tokenomics.

Every cryptocurrency has a unique tokenomic structure, which plays a key role in determining its market price. Understanding the factors that make up a cryptocurrency's tokenomic structure is essential to understanding the fundamental value of any crypto — and thus is fundamental to making smart trades. Fortunately, we have you covered.

A cryptocurrency's supply is a powerful factor that can influence token price, especially over time. Some cryptocurrencies — like Bitcoin — have a maximum, fixed supply. Other cryptocurrencies have an unlimited supply.

The initial circulating supply, upon the token's launch, varies greatly among cryptocurrencies. Once the initial token supply is circulating, the inflation rate (or rate of supply distribution) may remain linear or vary over time. Beyond miner and staking rewards driving supply inflation, there may be a token unlock schedule that determines when eligible investors receive tokens in exchange for their initial investment. Other supply inflation factors include distribution of tokens used as incentives to grow the cryptocurrency's ecosystem. The most important takeaway here is that supply inflation rates vary greatly among cryptocurrencies, as all cryptocurrencies have different initial supplies and factors driving inflation to various degrees.

Beyond supply inflation, some cryptocurrencies have a burning mechanism, where a portion of the token's supply is removed from circulation. Burning mechanisms have the opposite effect of inflation, as they are used by cryptocurrencies to reduce total token supply over time, otherwise known as a deflationary cryptocurrency. Avalanche (AVAX) is an example of a deflationary cryptocurrency, as it has a maximum supply of 720 million AVAX tokens, and each AVAX transaction burns a portion of a supply.