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# *Veblen Goods In The Metaverse?*

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*"I can only show you the door, you're the one that has to walk through it"*
*Quote by Morpheus from The Matrix (1999)*

Economics is in many ways like physics, it is a collection of observable "laws" that govern what happens when certain conditions are met. Demand and supply are amongst the more well-known of these laws, the equivalent of, say, the laws of gravity in physics. In its most basic form, the laws of demand and supply state that the demand of a good or service will drop in an almost linear fashion as the price of that good or service increases and vice versa, whilst the supply of that same good or service will tend to increase in response to a ramping up in prices. These tendencies are observable in almost all conditions with the exception of specific cases where there are certain interferences such as substitution effects[1] and collusions.



Just as in physics, however, generalization is not the same as universality, which is another way of saying that not all laws in economics are immutable: some of them tend to break down under specific conditions, although it should be said that this does not necessarily invalidate those laws in the first place. Veblen goods[2] are an example of a specific type of good that seems to defy the "laws of gravity" (no pun intended). With Veblen goods, an increase in the price of the said good will actually make it more desirable, increasing the demand for it, which is the exact opposite of what one would expect or observe with most other goods.

Luxury items such as high-end mechanical watches, works of art or anything else that can enhance one's "status symbol" tend to exhibit Veblen-like pricing, which means that they depend negatively on the consumption of the same good by others. Scarcity can enhance the Veblen effect, but it is not a necessary condition. Even though Veblen goods have been around since pretty much the dawn of capitalism, the Covid pandemic appears to have pushed its effects to a whole new level, just as it has been accelerating the development of new technologies and the digital transformation of most industries.

2021 was certainly a record year for major auction houses as a surge in global wealth and the emergence of inflation prompted a growing subset of investors to pour lots of money into an asset class of "collectables"[3]. Even more

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[1] https://en.wikipedia.org/wiki/Substitution_effect
[2] https://brandmarketingblog.com/articles/branding-definitions/veblen-good/
[3] https://www.cnbc.com/2021/12/20/auction-sales-hit-record-15-billion-fueled-by-younger-collectors.html

intriguing, however, is the potential of Veblen goods to transcend from the realm of the “physical” world to that of the “virtual”. Witness the emergence of the metaverse, a virtual universe where it is possible to purchase all kinds of virtual items including “parcels of land” on which to build “homes” or anything else. Huge amounts of money is being channeled into the various metaverse platforms as investors, guided by similar economic principals as in the real world, are looking into making acquisitions of digital land, properties and all kinds of other items[4].

The rapid advancements for a whole range of technologies, especially in the last two years, have created a momentum that promise to increasingly blur the lines between the physical and the virtual. This, together with the advent of non-fungible tokens (NFT’s) which, unlike blockchain, are non-interchangeable and uniquely identifiable, is part of what makes the metaverse so appealing to investors. It also sets the stage for Veblen type goods to potentially thrive in the metaverse. Adidas, the sports shoemaker recently sold more than $22 million in NFTs in just a couple of hours, whilst archrival Nike bought a virtual shoe company that makes sneakers for the metaverse.

All these recent developments combined with a few classic telltale signs (novelty effect, massive growth potential, inherently high risk) would suggest that the metaverse might very well be the next “emerging frontier market” for investors and may even turn into an asset class in its own right. The appearance of metaverse tracking ETFs is a testament to its rapid rise in popularity[5], giving it more substance and legitimacy, although there are a few major “hurdles” that need to addressed. One of these is that unlike in the physical world, scarcity isn’t technically a real thing in the metaverse, which means that price behavior might end up being very different from what we are accustomed to in the real world[6].



### *Where Do We Go From Here?*

A confluence of events is affecting visibility on the economic front for at least the next couple of months, feeding into the market volatility that has been steadily surging in recent weeks. Higher inflation rates show few signs of abating in the near term as various supply chain bottlenecks continue to create disarray across industries. Most of these conditions continue to be fueled by the effects of an unrelenting pandemic, forcing the hand of Chinese authorities, for example, to impose short notice, ad hoc lockdowns on entire regions, causing further disruptions as they attempt to contain its spread in light of the looming Olympics.

The sudden surge in inflation is also limiting the options at the disposal of central banks, with the Fed in particular having to manage an increasingly delicate balancing act of ensuring inflation does not spiral out of control on the one hand, and maintaining just enough “stimulus” to keep the economy from tanking on the other. The ongoing supply constraints and demand that remains relatively strong for a number of goods is also raising the specter of stagflation, especially as Covid continues to create strong headwinds against the recovery.

These disruptions not only make it excessively challenging for businesses to plan ahead, the persistence of inflation is also increasing the likelihood of its being sustained well after the supply side bottlenecks have been resolved and demand has subsided to more “normal” levels. Same goes for output: the longer these tight supply conditions drag along, the more likely governments and businesses will spend time rethinking not only the whole “just in time” manufacturing process, but also look into relocating factories of goods deemed “sensitive” for strategic reasons closer to home[7].

[4] https://www.nytimes.com/2021/11/30/business/metaverse-real-estate.html
[5] https://www.roundhillinvestments.com/etf/meta/
[6] https://www.coindesk.com/layer2/2022/01/11/metaverse-scarcity-isnt-real/
[7] Vital industries, such as pharmaceuticals or medical supplies, may have no choice but to diversify production. There is mounting public pressure in the U.S. to move essential production of “sensitive” items closer to home, with several bipartisan bills already in play. Japan has also made moves in this direction, putting $2.2 billion of its COVID-19 economic stimulus package into supporting manufacturers who shift production away from China.

Whilst the convergence of cheap and plentiful labor were the main drivers for migrating production to China and its environs in the first place, the pandemic has led to a rethink of everything, with firms looking into ways of "future proofing" manufacturing and supply chains from the type of major disruptions they have been experiencing in these last two years. The other main contributor to the uncertainties on the horizon is geopolitical in nature. Tensions have been building up between Russia and the west over the last few weeks as Russia prepares for a possible invasion of the Ukraine, whilst the west scramble to come up with a credible way to dissuade them.

America's diminishing global presence over the last few years and growing perception that the Biden leadership is weak and unwilling to engage its adversaries, as it diverts more of its resources to tackle domestic issues like Covid, inflationary pressures and widening social discords, is creating a dangerous vacuum that autocrats are keen to exploit. There are plenty of reasons to fret about the outlook of both the global recovery and markets. If 2020 was somewhat of a "dress rehearsal" of what happened in 2021, this year looks set to be very different if only because the last two years were marked by the cumulation up of certain "pressures" (inflation, geopolitical tensions) on the one hand, and the relative softening of others (virulence of the pandemic).

Although the emergence and spread of new variants of Covid are likely to continue beyond this year, the damage they are likely to inflict on the major economies should lessen over time not only because we are reaching herd immunity levels but also thanks to the tremendous knowledge and experience acquired over these last two years. This means that the pandemic driven headwinds on the recovery should diminish in contrast to inflation, which is likely to stick around some more given that supply issues, especially within key sectors such as microchips, remain unresolved[8].



Portfolio diversification with maybe some exposure into inflation and market correction hedging instruments would make sense in light of the many challenges and uncertainties in the present. Expect volatility to persist at least over the next few months. Given the high multiples, geopolitical tensions coupled with resistant inflation and an ongoing pandemic, there is certainly enough out there to keep the boat rocking.

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[8] https://www.nytimes.com/2022/01/25/business/economy/chips-semiconductors-shortage.html