Stablecoins. What are they?

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Today's news channels are flooded with the news of how stable coins are behaving "not so stable". So, what are these stablecoins? How did we even come up with this terminology?

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In an ever changing and evolving economic situation, we are hearing a lot of new terms and concepts. Stablecoin is one such term. Ever since Crypto currency became more and more mainstream, it has given rise to newer concepts and needs.

A stablecoin is a cryptocurrency that derives its value from other underlying assets and is pegged to such an asset. For example, government currencies (legal tenders) or gold can

For example, one of the leading stablecoin, Tether (USDT) generally maintains a 1 to 1 ratio with the US dollar. On the other hand, Bitcoin is more volatile, and their market values keeps on fluctuating. Bitcoin or BTC was trading around $4,000 in March of 2020. In October 2021 it was trading around $62,000. Today it is trading around $30,000. Factors impacting its notorious price volatility are many and varied. Supply & demand (the maximum total supply of Bitcoin is 21 million BTC), government policy changes, mining difficulties and investment acceptance and attractiveness are just some of the factors.

Stablecoins do not have a fixed supply limit and are backed with collateral to safeguard investors from price fluctuations to some extent. They are of a few different types, Fiat – Collateralized, Centralized, Decentralized, Crypto – Collateralized and Algorithmic based stablecoins.

Let us get into a little more detail about some of these coins. Just as the name suggests, Fiat-Collateralized are backed by the country's currency. They are not issued by the government but rather a company issues these coins by depositing equal amount of fiat in its reserve as collateral. The most popular stablecoin in this category are Tether (USDT), USD coin (USDC). These are also considered as centralized stablecoins, wherein they are generally connected with a third-party custodian, achieving 1:1 backing of the underlying asset. What this means is that users can mint the coins by depositing equivalent fiat to the custodian and for redeeming coins for cash, the entity that manages the stablecoin, will withdraw

from the cash reserves and send it to the person's bank account. The equivalent coins are then burned or removed from the system.

The decentralized stablecoins that have peer to peer connection without the custodian. The funds are visible and traded on public blockchain technology. These are also Crypto – Collateralized and Algorithmic stablecoins. Crypto – Collateralized are backed by Cryptos. Cryptocurrencies are volatile hence they are over collateralized to accommodate the higher volatility. For example, DAI stablecoin is pegged to US dollar but runs on Ethereum blockchain and backed by cryptocurrencies ($1 stablecoin can be backed by $2 cryptocurrency due to the price fluctuations).

program adjusts the supply of the stablecoins as the demand for it fluctuates. The strategy allows the peg to remain intact, for example if the demand is high and the price of stablecoin increases (above $1) the algorithm will mint coins and increase the supply to bring the price back to $1. TerraUSD an algorithmic based stablecoin on May 9, 2022, made the news as it plummeted to 50-60 cents, the token fell from its 1 to 1 peg to the US dollar. The TerraUSD collapse created a mayhem in the crypto markets and across the board there were selloffs. Most of the other algorithmic stablecoins were also below their 1:1 ratio. Luna coin plunged 99%. Luna & TerraUSD tokens work on blockchain based technology made by Terra Labs.

Regulators globally are trying to establish some framework to regularized and scrutinize the crypto markets to avoid situations like TerraUSD mayhem.

"*Treasury Secretary Janet Yellen said the de-pegging of TerraUSD shows the urgency to have a regulatory framework on stablecoins*".

While the future is unknown, stablecoins that are backed by legal tender or fiat currency can possibly offer to bring some stability to the crypto markets. However, they will continue to receive pushbacks from the governments for the near future. While all of the above information sounds very convoluted, it is the future of currency. These new-age wealth avenues are very much here to stay. Hopefully governments and regulatory bodies across the globe team up and create solid frameworks around them to decrease their volatility.

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