TREEHOUSE

Learn DeFi

Why Are There So Many Stablecoins?

@0xshyu and @adityadotb
April 22, 2022

This article discusses the role of stablecoins in the cryptocurrency system today.

The Vision of Cryptocurrencies

Bitcoin first came to life in 2008 when Satoshi Nakamoto published his famous white paper on a cryptography mailing list. He described a digital currency that would allow secure, peer-to-peer transactions without the involvement of any middleman, whether that be the government, financial system, or a company.

Since then, cryptocurrency has come a long way, with many describing Bitcoin (BTC) as "digital gold" and looking to it as a replacement for gold as a store-of-value asset. Satoshi's vision has also since been further enhanced with innovations in the crypto space, such as the development of the Ethereum network.

Despite their relative volatility, cryptocurrencies have been around for over a decade viewed as a potential disruptor of traditional financial systems.

TREEHOUSE

the price of BTC from around $68,800 in November 2021 to $32,980 in January 2022. There is stability needed within the crypto space, where stablecoins enter the stage.

In short, a stablecoin is a cryptocurrency designed to peg its value to a stable external asset such as the U.S. dollar or Gold. A reliable stablecoin enables many use cases than we would otherwise see on the blockchain.

No longer do people have to worry about the daily fluctuations of their cryptocurrency when deciding to make a purchase. In the short-term, stability allows people to transact practically, and long-term stability enables other essential financial functions such as loans and credit to be utilized.

The Risks

There are dozens of stablecoins in use today, with a combined market value exceeding $185 billion at the time of writing. Most of those with large followings are tied to the U.S. dollar, backed by traditional currencies, other cryptocurrencies, precious metals, and even algorithmic functions.

Tether Holdings Ltd issues the largest stablecoin (USDT), with more than 82 billion in circulation.

That said, stablecoins are still a form of digital currency and are exposed to all sorts of risks. For instance, a stablecoin's backing source can impact its risk level: A fiat-backed stablecoin, for example, can be more stable because it is linked to a centralized financial system, which has an authority figure (like a central bank) that can step in and control prices when valuations are volatile.

On the other hand, stablecoins that are not linked to centralized financial systems, like a Bitcoin-backed stablecoin, may experience quick and drastic changes to their value since no one regulating body controls what the stablecoin pegging.

Apart from just looking at the asset backing stablecoins, the market capitalization of each stablecoin can give you a peek into how widely adopted each stablecoin is. As a rule of thumb, the higher the market capitalization, the more widely adopted the stablecoin is, and hence, the more stable and safe it is for use.

So, Why Are There So Many Stablecoins?

In short, people are looking for the best way to create a stablecoin, resulting in many different stablecoins, each reliable in its unique way.

While **USDT** is the most popular stablecoin today, the company behind USDT is somewhat controversial and has been under regulatory scrutiny due to its lack of transparency regarding asset reserves. Due to regulatory constraints, other stablecoins like USD C (USDC) have been gaining popularity due to it being managed by some of the most w trusted cryptocurrency companies in the world like Circle and Coinbase.

TREEHOUSE

collateralization means that instead of having a 1-to-1 ratio with the underlying assets, the ratio is slightly greater, resulting in having more reserves than is necessary for every DAI equivalent (US$1). This results in a comfortable buffer of reserves for when cryptocurrencies enter a volatile period.

UST (TerraUST) has been a rising star amongst the stablecoin ecosystem in recent times, having overtaken the overall market capitalisation of **BUSD** (Binance USD), a stable coin which has been around a year longer. Despite boasting over $17 billion in market capitalization, the crypto community has been quick to point out that **UST** trading volume pales in comparison to **BUSD**, with around $4.5 billion **BUSD** traded in the last 24 hours as compared to **UST** trading volume coming in at just over $542 million. The popularity of **UST** has been linked to various factors, with the most significant one being its backing by the Luna Foundation Guard (LFG), which has managed to steadily increase its reserves through adding significant amounts of BTC, LUNA and AVAX. The LFG's wallet currently holds more than $2 billion in assets with the reserve's majority holding being in BTC.

The Future of Stablecoins

With the rising popularity, and unique ways in which each protocol maintains its stability, what does the future have in store for this unique subset of cryptocurrencies? Will all stablecoins find a harmonious way to co-exist with one another, or will there ultimately only be one winner?

Security and credibility are the key factors on which cryptocurrency enthusiasts adopt stablecoins. As the saying goes, if enough people believe in the value of something, then it could get too large to fail.

On the contrary, when we're all living in the metaverse, perhaps the real need for a 'stablecoin' will finally cease to exist. However, this would only be a reality when the entire world shares the common belief in an agreed underlying asset more valuable and stable than fiat currency or gold.

If you're interested in reading a more thorough analysis of the role of stablecoins in crypto, read our Insights piece, "The Evolution of Stablecoins: A Vital Cog in DeFi" here.

New to DeFi? If you found this useful, check out our other Learn DeFi articles to dive deeper into the wonderful world of DeFi! Alternatively, browse our Insights section to read more in-depth analyses on the DeFi space. You can also try out our flagship product, Harvest, to get a comprehensive analysis of your DeFi assets. Lastly, subscribe to newsletter updates in the box below!

TREEHOUSE

Subscribe

Our Analytics App: Harvest

Track your DeFi positions with the most comprehensive portfolio tracker ever built!

Try Now

TREEHOUSE

We help everyday investors and institutions confidently navigate DeFi.

Harvest

Company

About Us

Blog

Press

Documentation

Careers

Product

Harvest

Learn DeFi

Insights

Help Center

Protocols

Request Protocol

Report Bug

FAQ

TREEHOUSE

Privacy Policy | Terms of Use