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Why do Stablecoins Losing Their Peg? Here's the Reason

Original:

<https://www.btcc.com/en-US/academy/crypto-basics/why-do-stablecoins-losing-their-peg-heres-the-reason>

This year was one of the toughest years for the crypto market. The bear market managed to hit even the stablecoins that could not stay pegged to the U.S. dollar.

USTC, formerly Terraform Labs' stablecoin, for example, lost its peg with the U.S. currency in May, putting heavy downward pressure on other blockchain assets.

Another algorithmic stablecoin that has been struggling to stay paired with the dollar is USDD, Tron's stablecoin. On June 19, 2022, the altcoin fell to \$0.93, and since Nov. 27, it has failed to return to trading at \$1.

Moreover, it is not just algorithmic stablecoins that are being negatively impacted this year. USDT, citing an analogous case, despite being the main stablecoin asset on the crypto market, has also had its down days in 2022, moving away from the \$1 mark at times.

The trajectory of the giants USDC and BUSD has been no different. Even at the time of writing, Circle's stablecoin is trading at \$0.99.

Why does stablecoin lose their peg?

First, it is necessary to analyze the decline of algorithmic stablecoins. They are the most troublemakers on the crypto market. These stablecoins do not use an asset as collateral to maintain their parity with the dollar.

In this sense, they are controlled by algorithms. They are designed to expand or contract their total

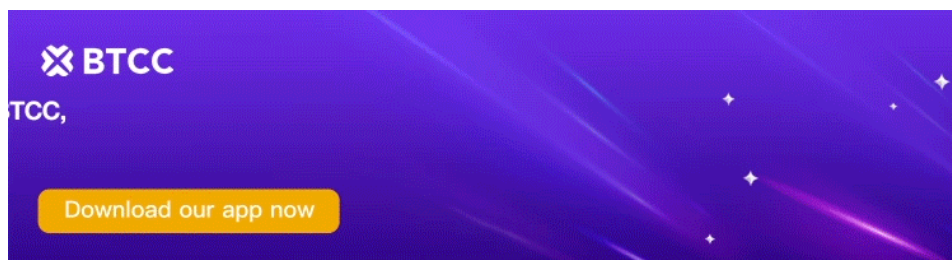
circulating supply, while maintaining their stability, according to market conditions.

The big problem is that sometimes the algorithm is faulty or misconfigured. This causes conditions other than what was planned to take away a stablecoin's parity with the dollar.

In the case of USTC, for example, the Terraform Labs ecosystem had flaws that allowed the exploitation of arbitrage opportunities due to the low liquidity of Curve (CRV) that underpinned the stablecoin's parity.

Also, in May, the DeFi Anchor project, a protocol that allowed users to deposit USTC to earn rewards, reduced its yield from 20% to just 4%. This took many investors by surprise, and they decided to take UST out of Anchor and sell it on the market.

As a result, in a brief time, USTC lost its peg, fell to pennies on the dollar, and took the economy of many people who believe in the stablecoin to zero.



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Mismanagement also leads to the decline of stablecoins

You read that right. Stablecoins like Dai, USDT, USDC and BUSD need to be professionally managed so that they do not lose their peg with the dollar.

Dai, MakerDAO's stablecoin, for example, has a particularly good proposition of being decentralized and having its parity guaranteed with cryptocurrencies.

However, in times of market crisis, with the price of cryptos falling, if Dai does not have a good reserve, it might lose its peg with the dollar. That is happening at the time of writing.

Centralized stablecoins, on the other hand, such as USDC and USDT, should have a calculated reserve, for times in which the crypto market may experience distrust and including stablecoins in uncertain market moments.

During the collapse of the Terra ecosystem and FTX, two major crypto scandals of 2022, USDT failed to hold steady, and the sale of the stablecoin on the market caused it to lose its parity with the dollar.

In theory, this should not happen at all, as stablecoins arose precisely to bring security in times of panic and no more fear to investors.

In practice, however, it is possible to observe that everything is completely different and that stable assets are simply less volatile than Bitcoin and do not realize their value proposition.

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