

Analysis on the Current State of Stablecoins

Didem Demirag

Seyedehmahsa Moosavi

Jeremy Clark

1 Introduction

1.1 Motivation

In this section we talk about volatility and what does stability mean, and we make argument that we're not economist and everything is explained in our own language Cryptocurrencies have gained a wide application after Bitcoin was first introduced in Satoshi Nakamoto's (pseudonymous) 2008 whitepaper [7]. For Bitcoin and any other cyptocurrency to function as money, they need to fulfill a set of properties that determine the strength and adoption of them *i.e.*, they are expected to serve as a medium of exchange, a unit of account, and a store of value. However, due to high fluctuations in their prices, majority of the cryptocurrencies do not meet these properties and hence they cannot be adopted as money [4].

Having said that, the volatile nature of cryptocurrencies (*e.g.*, Ether, Bitcoin) has raised the interest into what is known as stablecoin. Stablecoins (*i.e.*, cryptocurrencies with stable price) ensure that the fluctuation in the value remains low. Figure 1 illustrates the volatility of Bitcoin's value, when compared to fiat currencies, and the change of values of EUR, GBP, CAD, and BTC with respect to USD over time. Monthly values between January 2016 and November 2018 are shown. According the figures, while fiat currencies show stable behaviour, Bitcoin's value changes drastically over time, which makes it a non-stable cryptocurrency.

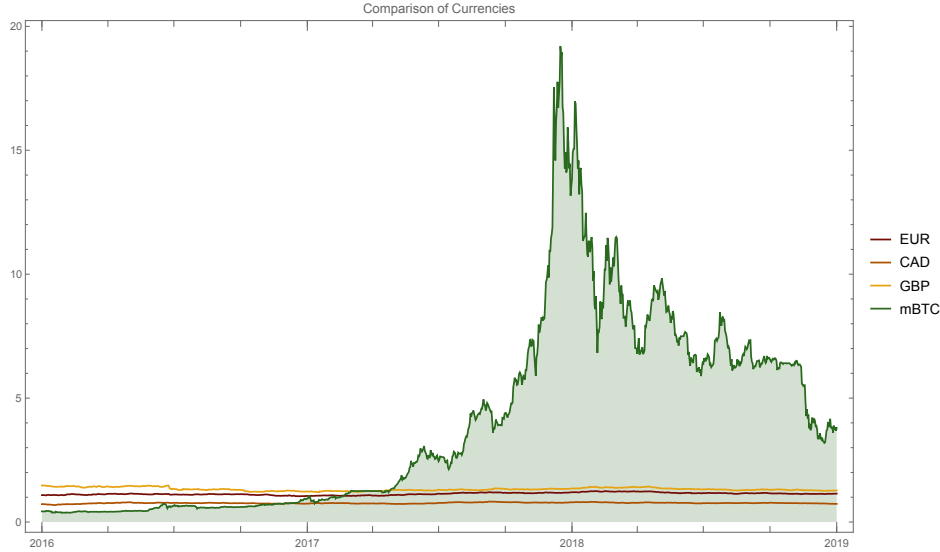


Figure 1: Comparison among fiat currencies and Bitcoin: The values are retrieved daily between 01-01-2016 and 01-01-2019.

Figure 2a shows the change of value of Bitcoin with respect to USD and gold. The value changes happen in directions 2 and 6 (Figure 2b). The part of plot in direction 2 means that Bitcoin is gaining value against

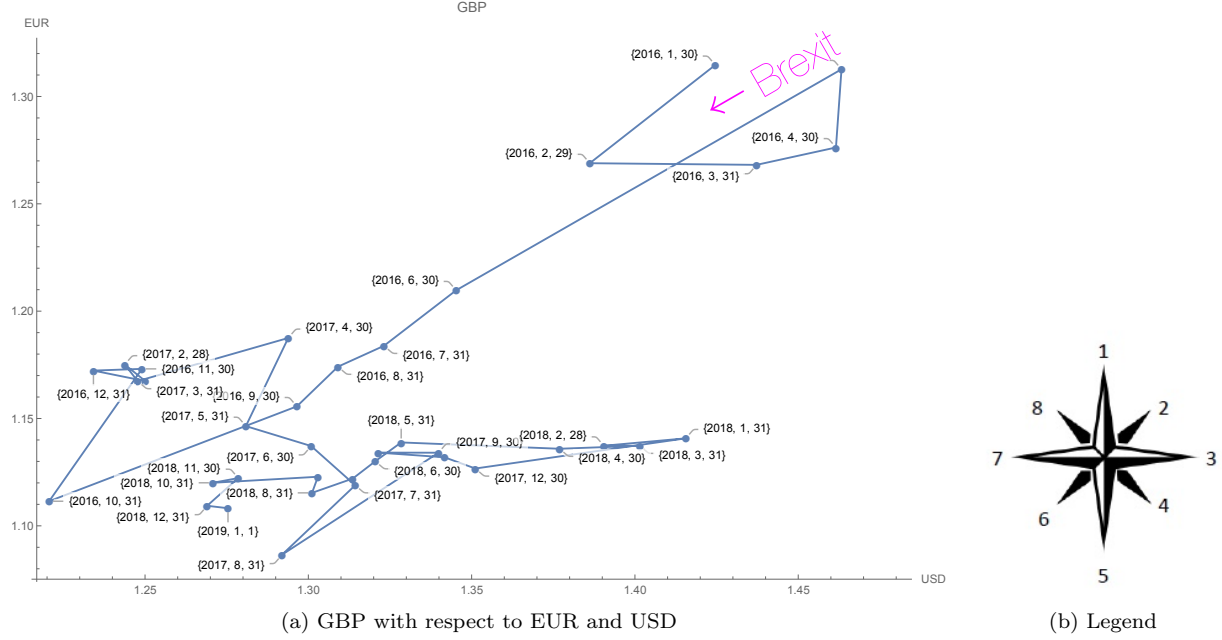


Figure 2: BTC

gold and USD. This can also be interpreted as both gold and USD are losing value relative to Bitcoin. Also, the fact that the plot is located on the diagonal shows that Bitcoin gains/loses value against both USD and Gold at the same time. This indicates that the changes in the values of USD and gold are highly correlated.

Considering these facts, there is a desire to design stablecoins with the stable nature of the fiat currencies together with the decentralized nature of the blockchain which is the underlying technology of cryptocurrencies.

2 Preliminaries

2.1 Valuation

2.2 Exchange

Direction	Interpretation
1/5	Y is losing (1) / gaining (5) value
2/6	Plotted asset is gaining (2) / losing (6) value
3/7	X is losing (3) / gaining (7) value
4/8	Plotted asset is gaining (4) / losing (8) value against X , while losing (4) / gaining (8) value against Y

Table 1: The interpretation of the plots.

2.3 No-Seignorage Theory of Money

To explain Bitcoin’s exchange rate with fiat currencies, an oft-repeated theory has emerged that attributes Bitcoin’s value to the hydro consumed by blockchain mining. While imprecise, the theory suggests that if a valuable resource x is consumed to produce y , the value of x is imparted into y . Setting aside the nuance that the hydro contributed to the Bitcoin system only indirectly produces new coins (it produces blocks, and blocks produce coins only for now), there is no economic principle underlying this transfer of value.

If Alice goes to Peter Luger’s in Brooklyn, consumes a \$100 ribeye, and mints a literal shitcoin out of the result — is that coin worth \$100 because it is “backed” by \$100 worth of steak?

2.4 plot explanations

3 Systemization of stablecoins and Justification

4 Backed

4.1 Redeemable and Directly-Backed.

4.2 Non-Redeemable and Directly-Backed.

4.3 Non-Redeemable and indirectly-Backed.

4.4 Redeemable and indirectly-Backed.

5 Intervention-based

5.1 Currency Board

5.2 Algorithmic with subjective external information

5.3 Algorithmic with objective external information

5.4 Algorithmic with only internal information

We performed a search query on `coindesk.com` and found the following projects which are mostly used in every articles published about stablecoins until January 11, 2019. ¹ Table 2 represents these projects and the methods they apply to achieve stability. (we should mention the search term that we used to extract our resources from coindesk)

Distribution of articles speaking about stablecoin: 2014: 2, 2017: 4, 2018: 112, 2019 (up to Jan 11): 4.

¹<https://www.coindesk.com/>

Category	Sub-Category	Examples	Rank
Backed	Directly-Backed & Redeemable	USDC	20
		TrueUSD	26
		Paxos	38
		Gemini Dollar	52
		StableUSD (USDS)	685
		Stronghold USD	891
		Petro	1210
		Ekon, WBTC, emparta	⊥
	Directly-Backed	Tether	6
		EURSToken	95
		BitCNY	304
		Terracoin	1280
		Saga	1495
		GJY, Novatti AUD, UPUSD	⊥
	Indirectly-Backed	Dai	57
		BitUSD	398
Intervention	Market	Nubits	892
	Algorithmic with subjective external information	Nomin*	⊥
	Algorithmic with objective external information	CarbonUSD*	1262
		Ampleforth*	⊥
	Algorithmic with only internal information	Basis	⊥

Table 2: Systemization the current stablecoin projects on January 11, 2019. The Projects that are in bold are discussed in this paper.

6 Investigation of gas volatility

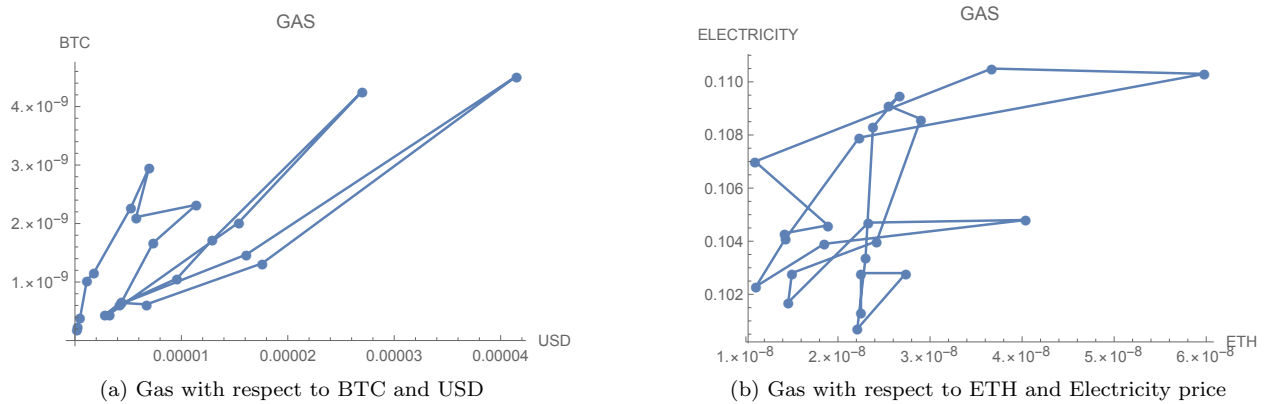


Figure 3: Ethereum average GasPrice chart. The two spikes correspond to (i) January 2018 when Cryptokitties² was launched for the first time and (ii) the Fcoin³ was launched and required a lot of on-chain voting. Both these events have resulted the Gasprice to go up as Ethereum users had to pay more Gas for their transactions to go through.

it would be nice to have a chart : Ether, Electricity (Global energy index), and Gas

Our analysis in Section 1 shows that cryptocurrencies exhibit less stable behavior compared to fiat currencies. Hence, we aim to analyze the price stability of *Gas*. In Ethereum blockchain, every transaction contains a number of operations and there is a precise amount of gas unit associated with each.⁴ Since Ether is volatile, this concept is introduced to have fixed cost for operations. Thus, even though the price of Ether changes, the amount of Ether corresponding to a unit of gas decreases; so that users pay the same price for the transactions on the Ethereum blockchain. Hence, the notion of gas is yet to be investigated to find out whether it exhibits behavior similar to fiat currencies or cryptocurrencies.

Figures 5b- ?? illustrate how the values of EUR, ETH and Gas change with respect to BTC and gold. EUR plot in Figure 5b tends to have more movements in the directions 1-5 and 3-7 suggesting that while the value of EUR stays the same according to one axis, it changes according to the other. For instance, between June 2018 and August 2018, the value of EUR increased with respect to BTC, while it stayed the same according to USD. This type of movement suggests that EUR-USD exchange rate is going under less change, whereas BTC-EUR rate is subject to high volatility. On the other hand, in the first half of 2017, while EUR retained its value against BTC, EUR to USD rate went under change.

ETH plot in Figure ?? illustrates more volatility against BTC and gold, as there are horizontal, vertical and diagonal changes. The fact that the points are spread in a large range of values indicates drastic changes in ETH price with respect to BTC and Gold.

Compared to Figure 5b and Figure ??, gas plot (Figure ??) has mostly diagonal changes, spread over a smaller range. There are less number of changes compared to ETH. Except from the changes between May 2018-July 2018 and January 2018-March 2018, the gas price changes in a smaller range. Even though there are fluctuations in the gas price, it can be inferred that gas price is less volatile than ETH. Also, it worths mentioning that gas is changing over a small scale in x-axis (USD), when compared to Ether's plot over the same axis in a larger interval.

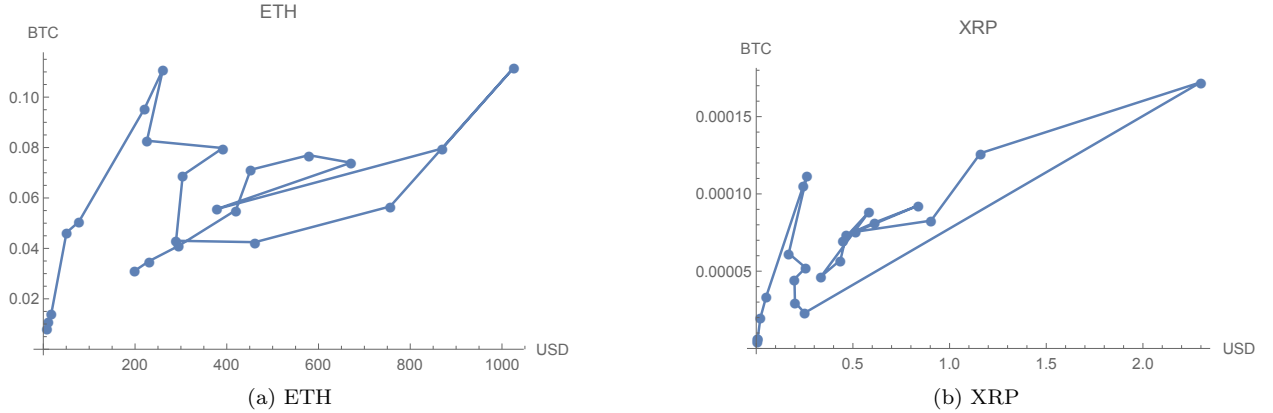


Figure 4: CAPTION

7 Conclusion and Discussion

In this paper, we analyze the current state of stablecoins with the various options that have been so far proposed to achieve price stability. We also discuss various issues that stablecoins would address. According to the charts represented in the paper, gas is relatively stable in price, while Bitcoin and Ether show volatile behavior. The reason could be the fact that how users interact with the interface to set the gas price when sending transactions to the Ethereum. By analyzing the properties of gas together with the existing methods to create stablecoin, we can later propose what properties stablecoins should attain.

⁴<http://ethdocs.org/en/latest/contracts-and-transactions/account-types-gas-and-transactions.html#what-is-gas>

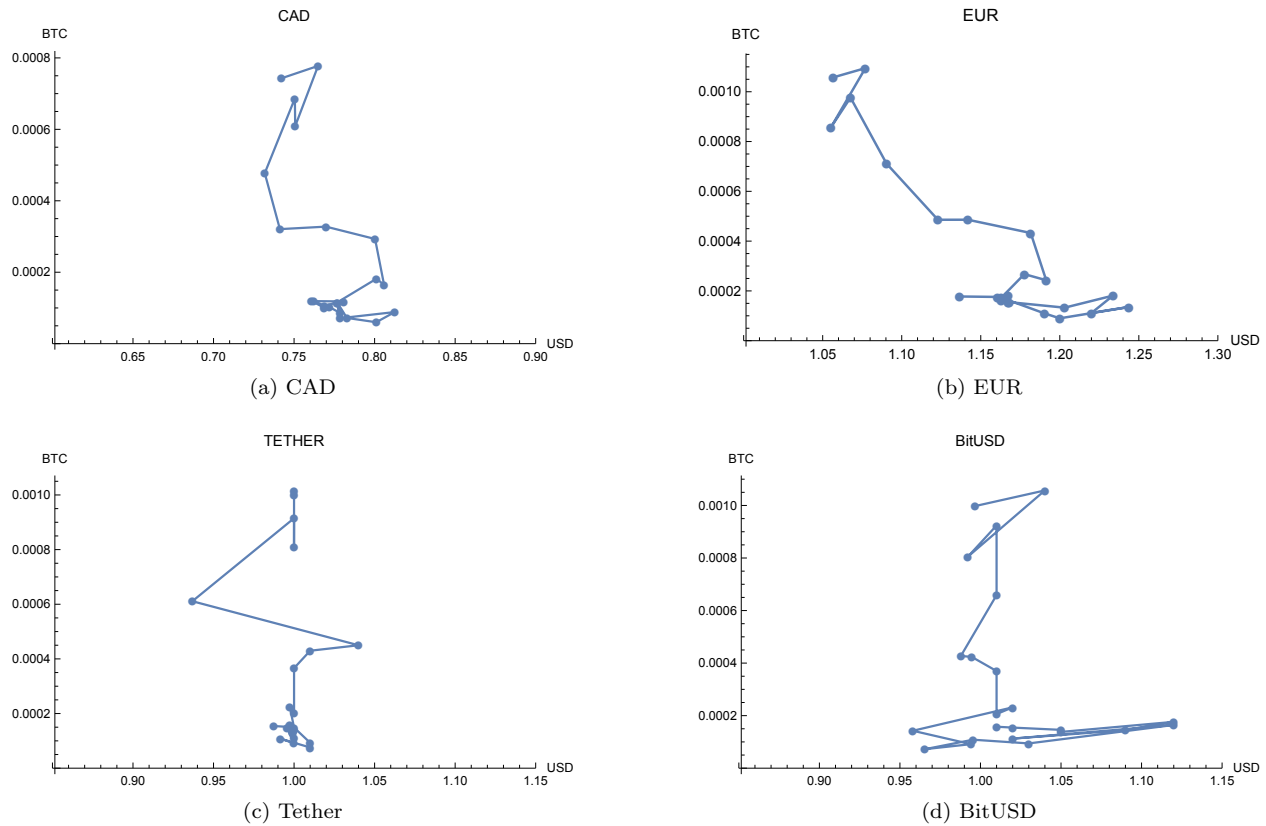


Figure 5: CAPTION

References

- [1] Black swan. <https://www.investopedia.com/terms/b/blackswan.asp>, 2008.
- [2] Blockchain. The state of stablecoins. 2018.
- [3] S. Dhillon. Stablecoins vs. govtcoins: The race to solve cryptocurrencies price volatility problems. <https://www.linkedin.com/pulse/stablecoins-vs-govtcoins-race-solve-cryptocurrencies-price-dhillon>, 2018. Accessed: 2018-10-29.
- [4] C. Durr. Overview of stablecoins. <https://hackernoon.com/overview-of-stablecoins-2e4ffef82a73>, 2018. Accessed: 2018-01-15.
- [5] M. Huillet. Ibm backs new us dollar-pegged stablecoin that runs on stellar network. <https://cointelegraph.com/news/ibm-backs-new-us-dollar-pegged-stablecoin-that-runs-on-stellar-network>, 2018. Accessed: 2018-07-17.
- [6] P. Lee. Forget bitcoin: stablecoins will change how money works. <https://www.euromoney.com/article/b1bbk5rb8gp227/forget-bitcoin-stablecoins-will-change-how-money-works?copyrightInfo=true>, 2018. Accessed: 2018-10-29.
- [7] S. Nakamoto. Bitcoin: A peer-to-peer electronic cash system, 2008.
- [8] C. O'Higgins. Stablecoins - everything you need to know. <https://cryptoinsider.21mil.com/stablecoins-everything-need-know/>, 2018. Accessed: 2018-07-09.

- [9] M. C. Okoye and J. Clark. Toward cryptocurrency lending.
- [10] M. Orcutt. "stablecoins" are trending, but they may ignore basic economics. <https://www.technologyreview.com/s/611370/stablecoins-are-trending-but-they-may-ignore-basic-economics/>, 2018. Accessed: 2018-07-06.
- [11] L. Schor. Stablecoins explained. <https://medium.com/@argongroup/stablecoins-explained-206466da5e61>, 2018. Accessed: 2018-10-29.
- [12] J. Smithin. What is money? introduction. In *What is Money?*, pages 11–25. Routledge, 2002.

8 Appendix

A The current state of stablecoins (might be needed for the paper)

Stablecoins have a market value of \$3 billion and this corresponds to the 1.5% of the total market value of the cryptoassets [2]. Each proposing different properties, stablecoins can be categorized into three groups based on the way they achieve stability: fiat-collateralized, crypto-collateralized, and non-collateralized.

1) Fiat-collateralized stablecoins: These types of stablecoins are backed by fiat currency. Generally, there is a 1:1 peg between the fiat currency and the stablecoin that indicates a convergence between their values [3]. While USD is currently the most common choice to back the stablecoin, IBM states that they are also interested in projects that use other national fiat currencies, as they will be helpful for their blockchain integration [5]. Tether and TrueUSD are prominent examples of USD pegged tokens.

Discussion about centralization: In order to back up with stablecoins with fiat, one needs to place trust on a third party. Centralization ensures that the amount of money to back the stablecoin with, is held in an account [10] and the peg is attained. However, involvement of a third party causes controversy, as the third party can deny giving money to the users. Tether explains this point as follows [8]:

“Redemptions will not be unreasonably denied, but we reserve the right to selectively deny redemption and creation of Tethers on a case-by-case basis.”

2) Crypto-collateralized stablecoins: These types of stablecoins use other cryptocurrencies as a back up value rather than fiat currency.

Over-collateralization is needed in this case as the underlying cryptocurrency is also volatile [3]. MakerDAO and Reserve use this approach – utilizing a smart contract to back the stablecoin with another cryptocurrency [5].

If there is a black swan event ⁵ where the underlying currency loses its value and does not worth anything, the stablecoin also loses its value [11]. Due to the over-collateralization in this type of stablecoins, the loss of value will be drastic. This is the reason that a group of experts strongly discourage this approach.

3) Non-collateralized stablecoins: Unlike the previous types, this group of stablecoins are not backed by fiat currencies or another cryptocurrency. Here, the stability is achieved algorithmically which helps to provide better scalability [2].

Basis is one of the first projects of this type that achieves price stability using the dual-token model [8]. In this method, there is dynamic adjustment of the existing supply of the stablecoin. While one token is stable, the other is used to achieve the stability of the value. If the value of Basis increases (an increase over \$1), more Basis tokens are produced to increase the supply which will lead to a decrease in the price and if there is a decrease in the price, a bond that is worth a Basis token is issued and some Basis tokens are bought to decrease the supply [6].

B Issues that stablecoins address

As mentioned in Section 1, currencies have to serve as a store of value, a unit of account, and a medium of exchange [12]. To do so, they have to denote a minimum level of value stability. In this regard, stablecoins are proposed to fulfill these properties, due to their non-fluctuating value compared to fiat currencies or any other alternative *e.g.*, commodity. In addition, they purport to solve a group of critical issues that were introduced by cryptocurrencies. In this section, we discuss these issues.

⁵A black swan event is characterized as being unexpected, random and having significant effects to the current situation. This type of an event is hard to predict [1].

B.1 Cryptocurrencies as Medium of Exchange

Despite the fast growth of the cryptocurrencies and decentral applications, there is still little deployment of them in the daily payment procedures of businesses. The main reason is that these assets are volatile in the price and hence highly risky to be deployed by merchants and retailers *i.e.*, it is impossible for a company employer to provide the employees' incomes in a volatile cryptocurrency *e.g.*, BTC that has a high level of future value and price uncertainty. On the other hand, having a stable price over the time, stablecoins can serve as a true medium of exchange, while they preserve all the advantages of using cryptocurrencies as opposed to fiat currencies.

B.2 Cryptocurrencies as Unit of Account

Money has to serve also as a unit of account– the common measure that sets price to goods and services. Fiat currencies *e.g.*, USD, EUR *etc.* serve this functionality correctly, so they are used as units of account in the US and Europe respectively. Unfortunately, cryptocurrencies such as BTC, not having a stable price, do not seem to be used as a unit of account, hence will not be able to serve as money. However, given the price stability that stablecoins offer, they have a higher chance to be used as a digital representation of a unit of account.

B.3 Cryptocurrencies as Store of Value

Any asset, commodity, or money that maintains its value is called a store of value. As mentioned in Section 1, highly volatile cryptocurrencies (*i.e.*, Bitcoin) cannot fulfill this property of money, as they cannot maintain their purchasing value for long-term. In contrast, stablecoins can be accepted as a store of value as their price remains stable over the time.

B.4 Lending with Cryptocurrencies

Despite quite a few blockchain applications in financial technologies, there has been little deployment of lending. Lending is difficult to be deployed on the blockchains, bdue to the monetary instability observed in the existing cryptocurrencies [9]. This volatility has led the cryptocurrencies to be used more as speculative investments instead of serving as store of value and unit of account. In a lending situation with volatile currencies, where their values are being depreciated or appreciated over time, the cash taker will eventually owe more than what he has borrowed or the vice versa. Therefore, the volatility in the value of cryptocurrencies causes serious concerns and difficulties both for cash takers and cash providers [9]. In contrast, lending perfectly works if a loan is done with a stable cryptocurrency, whose value remains stable over the time.

B.5 Remittance

Although cryptocurrencies, especially Bitcoin, play a revolutionary role in financial systems, they are yet not easy to transact with due to their volatile characteristics. Therefore with stablecoins, one can benefit from decentralized nature of the token, while there is no price volatility risk. In addition, stablecoins make the cross border payments, remittances, easier.