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Stablecoins: How They Hold Their Price, and When They Don't

The four main kinds of stablecoins, the mechanism that keeps them at one dollar, what actually backs USDT, and the famous times the peg broke

11 min read 8 quiz questions with answer key

CRYPTO · BEGINNER · LESSON 6 OF 15

Stablecoins: How They Hold Their Price, and When They Don't

IN ONE SENTENCE

Stablecoins are tokens designed to stay at a fixed value, usually one US dollar, and how safe each one is depends entirely on what backs it and whether holders can redeem it.

Why crypto needs stable money

Lesson 1 showed that bitcoin is a poor unit of account because its price moves so much. Traders, businesses and everyday users still need something on the blockchain that stays put: a way to hold dollars without leaving crypto, to price trades, and to send money across borders in minutes.

That is the job of **stablecoins**: tokens designed to keep a steady value, almost always one US dollar. They have become one of the largest parts of crypto. In May 2026 the total value of all stablecoins reached a record of about **$322 billion**, according to DefiLlama data. Two coins dominate: **USDT**, issued by Tether, with about 59% of the market, and **USDC**, issued by Circle, with about 24%.

A stablecoin only stays stable if something holds it there. The rest of this lesson is about that something.

The four kinds of stablecoins

- **Fiat-backed:** for every token, the issuer holds about one dollar in cash, bank deposits or short-term government bonds. USDT and USDC work this way. They are simple and by far the largest, but you have to trust the issuer and its banks.
- **Crypto-backed:** users lock crypto such as ETH in a smart contract and borrow stablecoins against it. Because crypto prices swing, the system demands more collateral than the loan, for example $150 of ETH for 100 stablecoins. DAI and its successor USDS work this way. No company holds the reserves, but a fast crash in the collateral is a risk.
- **Algorithmic:** no real reserves, just a mechanism that creates or destroys tokens to push the price back to one dollar. The best known, TerraUSD, collapsed in 2022, as you will see below.
- **Commodity-backed:** tokens backed by a physical asset such as gold. Tether Gold (XAUT) and PAX Gold (PAXG) each represent one troy ounce of gold held in a vault. They are stable in gold,

not in dollars, so their dollar price moves with the gold price.

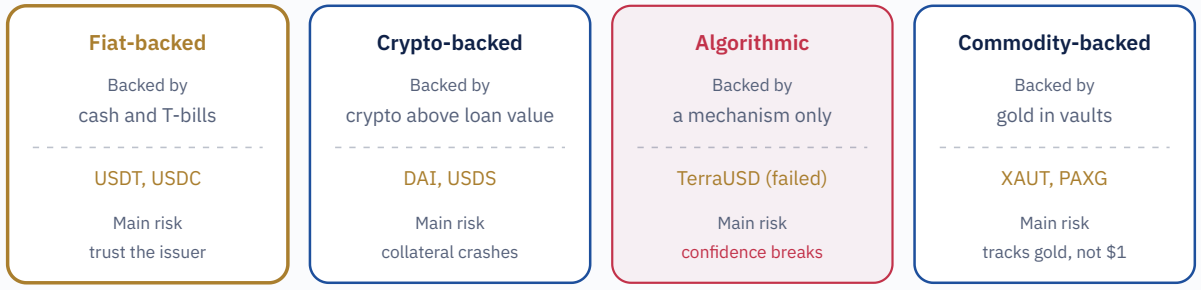


Figure 1. The four kinds of stablecoins, what backs each one, and its main risk.

EXAMPLE: BORROWING 100 DAI

Lisa locks ETH worth $150 in a lending contract and borrows 100 DAI. If ETH falls so far that her collateral is worth only a little more than the loan, the contract automatically sells her ETH to repay the DAI. The DAI in circulation stays fully covered, but Lisa loses her ETH. That forced sale is called a liquidation, and you will meet it again in the lesson on derivatives.

How the peg holds: mint, redeem and arbitrage

A fiat-backed stablecoin stays near one dollar because large, approved customers can always swap with the issuer at exactly one dollar:

- **Minting:** send the issuer $1 and receive 1 new token.
- **Redeeming:** return 1 token to the issuer and receive $1 back. The token is destroyed.

Now imagine the price on exchanges drops to $0.99. A trader buys tokens cheaply on the market and redeems them with the issuer for $1 each, making a small profit. That buying pushes the price back up. If the price rises to $1.01, traders mint new tokens for $1 and sell them on the market, pushing the price back down. This is **arbitrage**, and it is the force that holds the **peg**.

The key point: the peg is only as strong as the promise to redeem. If people start to doubt that the issuer can pay back every token, the arbitrage stops working, and the price can fall.

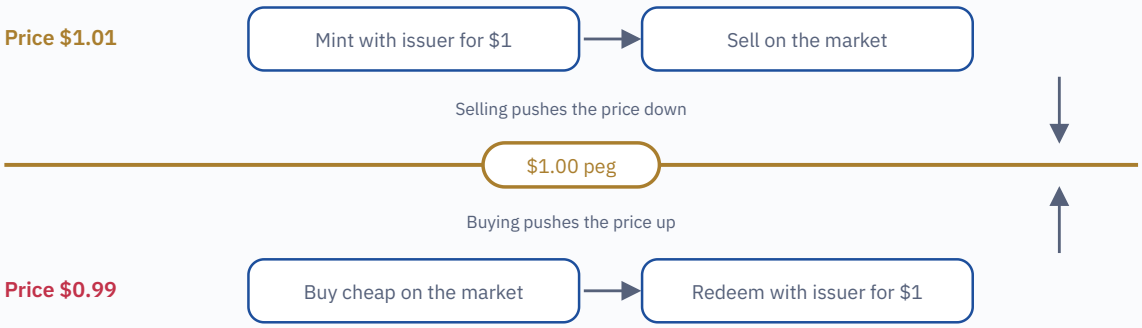


Figure 2. Arbitrage keeps a fiat-backed stablecoin near $1. Below the peg traders buy and redeem; above it they mint and sell.

What actually backs USDT?

Fiat-backed issuers publish regular reports, checked by an accounting firm, showing what they hold. Tether's report for 30 September 2026, reviewed by BDO, showed about **$191.5 billion** of assets against about **$183.5 billion** of USDT in circulation. The difference, about $8 billion, is a buffer that Tether calls excess reserves.

About 73% of the assets were cash-like: mainly short-term US Treasury bills, plus repurchase agreements. The rest included gold (about 10%), bitcoin (about 4%), secured loans and other investments. Critics point out that gold, bitcoin and loans can lose value or be hard to sell quickly. Tether points to its large buffer.

USDC has followed a narrower approach, keeping its reserves in cash and short-term US government securities. In the United States, the **GENIUS Act**, signed into law on 18 July 2025, now requires payment stablecoins to be backed at least one to one by safe assets such as cash, insured deposits and short-term Treasury bills, with regular public reports. The European Union has its own stablecoin rules under its MiCA regulation.

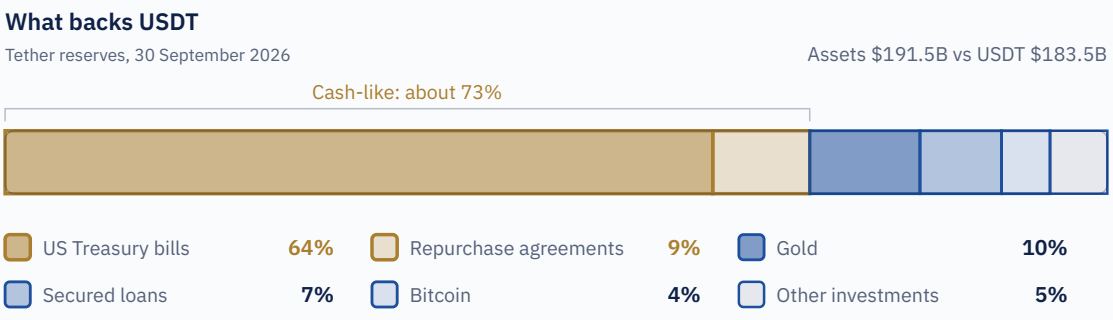


Figure 3. What backed USDT on 30 September 2026, as shares of total assets, rounded. About 73% was cash-like. Source: Tether attestation reviewed by BDO.

When the peg breaks

Two events show the two main ways a stablecoin can fail.

TerraUSD, May 2022: a design failure. UST was an algorithmic stablecoin. It held its peg by letting users swap 1 UST for $1 worth of a sister token, LUNA, which was created on the spot. When large holders started selling UST on 7 May 2022, people rushed to swap UST for newly created LUNA and sell it. LUNA's supply exploded and its price collapsed, which made the promise of "$1 of LUNA" worthless. Within days UST fell as low as $0.22, LUNA went almost to zero, and more than $40 billion of value disappeared from the Terra ecosystem.

USDC, March 2023: a bank failure. On 10 March 2023 Silicon Valley Bank collapsed. Circle revealed that $3.3 billion of USDC's reserves, about 8%, was held there. Panic followed, and on 11 March USDC fell below $0.87. It recovered within days, after US authorities announced that all of the bank's depositors would be protected.

The lesson from both: a stablecoin is not the same as a dollar in your bank account. It is a promise, and you should know who is making it and what stands behind it.

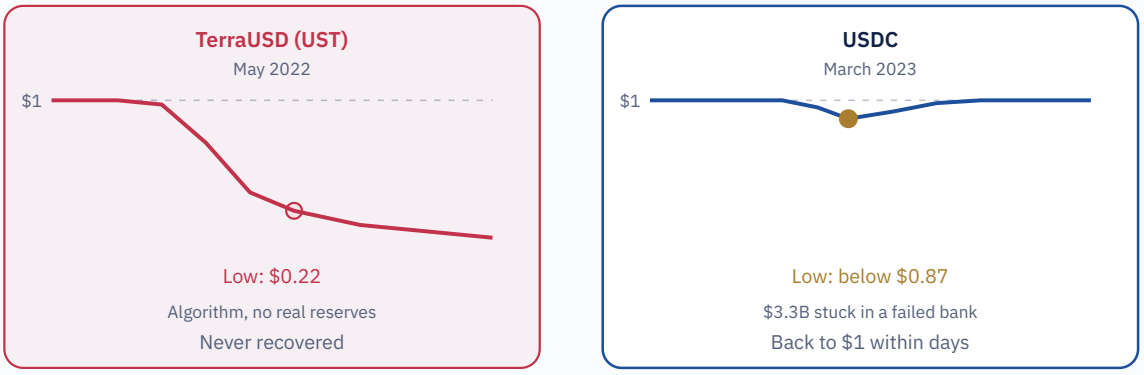


Figure 4. Two famous depegs. TerraUSD failed because of its design and never recovered. USDC fell because of a bank failure and recovered within days. The price lines are simplified shapes, not exact charts.

Comparing the risks

Type	Backed by	Main risks	Examples
Fiat-backed	Cash, bank deposits, short-term government bonds	Issuer, banks, regulation, freezing of addresses	USDT, USDC
Crypto-backed	Crypto locked in smart contracts, above the loan value	Sharp crashes in the collateral, smart contract bugs	DAI, USDS
Algorithmic	A mechanism, not real reserves	Collapse when confidence breaks	TerraUSD (failed)
Commodity-backed	Physical gold in vaults	Custodian, and the gold price itself	XAUT, PAXG

Remember from Lesson 4 that fiat-backed issuers can also freeze tokens at specific addresses. And remember from Lesson 5 that the same stablecoin lives on several networks, so always check the network before sending.

Why this matters for traders

- **Stablecoins are the base currency of crypto trading.** Most pairs on crypto exchanges are quoted against USDT or USDC, and the profit and loss on many perpetual futures is settled in them. When you are "in cash" on an exchange, you are usually holding a stablecoin, with that issuer's risk.
- **Stablecoin supply is a measure of liquidity.** Growing stablecoin supply often means new money waiting on the sidelines to buy crypto. Shrinking supply can mean money is leaving. Many traders follow total stablecoin supply for this reason.
- **USDT dominance rises in sell-offs.** When traders flee to safety, the share of the crypto market held in USDT tends to jump. Charts of USDT dominance are often read as a mirror image of crypto risk appetite.
- **Small depegs are trading events.** A stablecoin trading at $0.997 or $1.003 is normal noise. A fall below about $0.98 usually means real stress, and large depegs have triggered sharp moves across the whole crypto market, as in May 2022.

Key terms

Stablecoin	A token designed to keep a steady value, usually one US dollar.
Peg	The fixed value a stablecoin aims to hold, such as $1. Losing it is called a depeg.
Mint and redeem	Creating new stablecoins by depositing dollars with the issuer, and destroying them by returning them for dollars.
Arbitrage	Buying where something is cheap and selling where it is expensive. For stablecoins, it pushes the price back to the peg.
Reserves	The assets an issuer holds to back its stablecoins, such as cash and short-term government bonds.
Overcollateralized	Backed by collateral worth more than the loan, as with crypto-backed stablecoins.
Algorithmic stablecoin	A stablecoin that relies on a mechanism instead of real reserves to hold its peg.
Liquidation	The automatic sale of a borrower's collateral when its value falls too close to the loan.

Key takeaways

1. Stablecoins aim to stay at one dollar. The total market reached about $322 billion in May 2026, led by USDT and USDC.
2. There are four kinds: fiat-backed, crypto-backed, algorithmic and commodity-backed. Each has different risks.
3. The peg holds because traders can mint and redeem at $1 and profit from any gap. It is only as strong as the promise to redeem.
4. USDT's September 2026 report showed about $191.5 billion of assets for $183.5 billion of tokens, mostly in US Treasury bills, plus gold, bitcoin and loans.
5. TerraUSD collapsed in 2022 because its algorithm had no real reserves. USDC briefly fell to $0.87 in 2023 because of a bank failure.
6. A stablecoin is a promise from an issuer or a system, not a dollar in a bank. Know what backs it.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. Why do crypto markets need stablecoins?

A. To make bitcoin's supply fixed
B. To hold a steady value on the blockchain for trading, saving and payments
C. To replace mining
D. To make transactions anonymous

2. What backs a fiat-backed stablecoin such as USDC?

A. Nothing, just an algorithm
B. ETH locked in smart contracts
C. Reserves such as cash and short-term government bonds held by the issuer
D. Bitcoin mining machines

3. Why do crypto-backed stablecoins require more collateral than the loan, for example $150 of ETH for 100 DAI?

A. To pay the founders
B. Because crypto prices can fall quickly, so a cushion keeps every coin covered
C. Because the law requires 150%
D. To make the stablecoin worth more than $1

4. A fiat-backed stablecoin trades at $0.99 on exchanges. What do arbitrage traders do?

A. Buy it on the market and redeem it with the issuer for $1
B. Mint new tokens and sell them
C. Nothing, the price stays at $0.99
D. Ask the issuer to change the peg

5. According to Tether's September 2026 report, what made up most of USDT's reserves?

A Bitcoin
B Gold
C Cash-like assets, mainly US Treasury bills
D Shares in tech companies

6. What caused TerraUSD (UST) to collapse in May 2022?

A A bank failure
B A hack of its smart contract
C Its algorithmic design had no real reserves, so selling triggered a spiral with its sister token LUNA
D A government ban

7. Why did USDC fall below $0.87 in March 2023?

A Circle was hacked
B $3.3 billion of its reserves was stuck at the failed Silicon Valley Bank
C It switched to an algorithm
D Ethereum stopped working

8. What is Tether Gold (XAUT) designed to track?

A One US dollar
B The price of one troy ounce of gold
C The price of bitcoin
D The average of all stablecoins

Answer key

1 B

To hold a steady value on the blockchain for trading, saving and payments

Stablecoins give users a dollar-like asset on the blockchain, so they can price trades and move money without leaving crypto.

2 C

Reserves such as cash and short-term government bonds held by the issuer

The issuer holds roughly one dollar of reserves for each token. You rely on the issuer and its banks.

3 B

Because crypto prices can fall quickly, so a cushion keeps every coin covered

The extra collateral absorbs price drops. If it shrinks too much, the collateral is sold automatically to repay the loan.

4 A

Buy it on the market and redeem it with the issuer for $1

Buying cheap tokens and redeeming them for $1 earns a profit, and that buying pushes the price back up to the peg.

5 C

Cash-like assets, mainly US Treasury bills

About 73% was cash-like, mostly short-term Treasury bills. Gold was about 10% and bitcoin about 4%.

6 C

Its algorithmic design had no real reserves, so selling triggered a spiral with its sister token LUNA

Redeeming UST created ever more LUNA, which crashed LUNA's price and destroyed the backing. More than $40 billion disappeared.

7 B

$3.3 billion of its reserves was stuck at the failed Silicon Valley Bank

About 8% of its reserves was at the bank. USDC recovered within days, after US authorities protected all of the bank's depositors.

8 B

The price of one troy ounce of gold

Commodity-backed tokens are stable in gold, not in dollars. Their dollar value moves with the gold price.

SOURCES

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