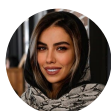


Stablecoins: The Bridge

How dollar-pegged tokens became crypto's most practical innovation — and the risks that come with them.



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8 min

The most useful innovation in cryptocurrency might be the least exciting one. While Bitcoin promises to revolutionise money and Ethereum aims to rebuild finance, stablecoins do something almost mundane: they stay the same price. One dollar in, one dollar out. It sounds trivial. It's anything but.

The Problem With Volatile Money

Imagine trying to run a business where your revenue could drop 20% overnight — not because of sales, but because the currency you're paid in collapsed over breakfast. This is the reality of accepting Bitcoin or Ethereum for actual commerce. Volatility that creates trading opportunities makes day-to-day business impossible.

The early crypto economy had a paradox: to be useful, crypto needed to be used for transactions. But rational actors don't spend an asset they expect to appreciate (why buy coffee with something that might double in value?) and merchants can't accept an asset that might halve before they pay suppliers.

Stablecoins solved this by doing something counterintuitive: creating crypto tokens that deliberately don't go up in value. A USDC is always worth approximately one dollar. A USDT is always worth approximately one dollar. That stability — that *boringness* — is precisely what makes them useful.

"Stablecoins aren't trying to replace the dollar. They're making dollars programmable, portable, and accessible 24/7."

How Stability Gets Made

There are several approaches to maintaining a stable value, each with distinct trade-offs:

Fiat-backed stablecoins are the simplest model. Circle (issuer of USDC) takes your dollar, puts it in a bank account or short-term Treasury bills, and issues you a token. Want your dollar back? Return the token, it gets burned, you get your dollar. The token's value is backed 1:1 by real assets. USDC and USDT dominate this category, representing over \$130 billion combined.

Overcollateralised stablecoins like DAI take a different approach. Instead of holding dollars, they hold crypto assets worth more than the stablecoins issued. You deposit \$150 of ETH to mint \$100 of DAI. If ETH's price drops, automatic liquidations ensure there's always sufficient collateral. No banks required — but capital efficiency suffers.

Algorithmic stablecoins attempted to maintain stability through pure supply and demand mechanics, without collateral. The theory was elegant. The practice was catastrophic. In May 2022, Terra's UST collapsed from \$18 billion to essentially zero in days, taking the broader market down with it. The lesson was clear: stability requires backing, not just algorithms.

KEY INSIGHT

Stablecoins aren't stable because of technology — they're stable because of reserves. The tokens are just representations of dollars (or dollar-equivalents) held somewhere. When you buy USDC, you're not trusting an algorithm. You're trusting Circle to actually hold the reserves they claim. This is old-fashioned counterparty risk dressed in new clothing.

Why This Actually Matters

Stablecoins have found genuine product-market fit in ways that other crypto applications haven't:

Trading infrastructure: Crypto exchanges operate 24/7, but banks don't. Stablecoins let traders stay in "dollar" positions without ever touching the banking system. Over 70% of all crypto trading volume now involves stablecoins as one side of the pair.

Cross-border payments: Sending dollars from the US to the Philippines through banks takes days and costs 5-7% in fees. Sending USDC takes minutes and costs cents. For remittances — the \$700 billion annual flow of money from migrants to their families — this is transformative.

Dollar access in restricted markets: In Argentina, Nigeria, and Turkey, where local currencies have collapsed and dollar access is restricted, stablecoins provide a lifeline. People aren't speculating on crypto's upside. They're preserving savings in the only stable currency they can access.

DeFi foundations: Nearly everything in decentralised finance — lending, borrowing, trading — requires a stable unit of account. Stablecoins are the base layer that makes DeFi functional.

The Risks You Should Know

Stablecoins are not risk-free. Understanding the risks is essential:

Counterparty risk: When you hold USDC, you're trusting Circle to maintain reserves and honour redemptions. When you hold USDT, you're trusting Tether. Tether's reserve composition has been questioned for years. They've paid fines for misrepresentations. The reserves now appear solid, but the history warrants caution. Your stablecoin is only as trustworthy as its issuer.

Regulatory risk: Governments have noticed \$150+ billion in private dollar-equivalents operating outside the banking system. The EU's MiCA regulation imposes strict requirements on stablecoin issuers. The US is actively debating stablecoin legislation. Regulatory changes could significantly impact the market.

De-peg risk: Stablecoins are supposed to trade at \$1, but supply and demand can push them off-peg. USDC briefly traded at \$0.87 in March 2023 when Silicon Valley Bank (where Circle held reserves) collapsed. The peg recovered once deposits were guaranteed, but the episode demonstrated that "stable" is a goal, not a guarantee.

Smart contract risk: Stablecoins exist as tokens on blockchains. If there's a bug in the contract, or if the blockchain itself has issues, your stablecoins could be affected. The code has been audited extensively, but "audited" doesn't mean "flawless."

The Institutional Perspective

For sophisticated investors, stablecoins occupy an interesting position:

As a tool: Stablecoins are infrastructure, not investments. They're useful for moving money into and out of crypto positions, for parking funds between trades, for accessing DeFi yields. The expected return on holding stablecoins long-term is approximately zero (minus any yield you might earn through lending).

As exposure: Holding significant funds in stablecoins means accepting counterparty risk on the issuer without compensation. If you're not actively using stablecoins, there's little reason to hold them versus actual dollars. The risk is real; the yield (on plain holdings) is not.

As a signal: Stablecoin supply and flows are useful market indicators. Rising stablecoin supplies often indicate capital waiting on the sidelines. Stablecoins flowing to exchanges may signal impending buying pressure. The data is public and informative.

THE RORY SUTHERLAND TAKE

The genius of stablecoins isn't financial — it's logistical. They took a 9-to-5, Monday-to-Friday system (banking) and made it 24/7/365. They took a system that charges 3% to cross a border and made it nearly free. The innovation isn't the "coin" part. It's the "stable access at any hour from anywhere" part. Sometimes the most valuable thing you can do is remove friction from something that already exists.

The Bridge in Both Directions

Stablecoins are often described as a bridge between traditional finance and crypto. This is accurate but incomplete. They're a bridge that works in both directions.

For crypto-native users, stablecoins provide a way to capture gains without exiting to the banking system. For traditional finance users, they provide a way to access crypto markets without committing to volatility. For the unbanked, they provide dollar access that was previously impossible. For regulators, they provide both concern (shadow banking) and opportunity (programmable compliance).

The \$150 billion stablecoin market exists because it solves real problems for real users. Whether that growth continues depends on regulatory decisions yet to be made. What's clear is that the demand for stable, programmable, globally accessible dollars isn't going away. If stablecoins didn't exist, someone would need to invent them.

And in a sense, that's exactly what happened.

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