

Chapter 12

Stablecoins: Ensuring Stability in a Volatile Market

Ardit Vehapi

University “Ukshin Hoti” Prizren, Kosovo

Elhan Tafili

University “Ukshin Hoti” Prizren, Kosovo

ABSTRACT

This study explores Stablecoins, cryptocurrencies pegged to assets like the US dollar for price stability. It examines mechanisms achieving this stability and the role Stablecoins play in the market, highlighting their informative market capitalization despite low volatility and their surprising lack of correlation with other cryptocurrencies. The study then dives into challenges like transparency and trustless transactions before exploring the future potential of Stablecoins to revolutionize payments, financial access, and even create new financial products. Finally, it concludes by outlining different Stablecoin types categorized by their value-pegging methods.

INTRODUCTION

The world of finance is undergoing a digital revolution, with cryptocurrencies emerging as a prominent force. However, the inherent volatility of these currencies has limited their widespread adoption, particularly for everyday transactions. Stablecoins offer a potential solution. Designed to maintain a stable price by being pegged to a reliable asset like the US dollar, Stablecoins aim to bridge the gap between the innovative world of cryptocurrencies and the stability of traditional finance.

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This paper delves into the world of Stablecoins, exploring their mechanisms for achieving price stability, their role within the cryptocurrency market, and the challenges and opportunities they present. We will examine how Stablecoins, despite their low volatility, offer valuable insights through market capitalization data. We will also explore the surprisingly weak correlation between Stablecoins and other cryptocurrencies.

Furthermore, this paper will analyze the challenges associated with Stablecoin adoption, such as the need for robust security and transparency. We will then look towards the future, examining how Stablecoins have the potential to revolutionize payment systems, create a more inclusive financial landscape, and even lead to the development of entirely new financial products. Finally, the paper will conclude by categorizing different Stablecoin types based on their methods for maintaining a steady value.

Understanding Stablecoins

Over the past few decades, the finance industry has been heavily influenced by the increasing use of digital technologies and data analysis. This trend accelerated in the 2010s with the rise of powerful information and communication technologies (ICT). These advancements have impacted not only traditional financial services like payments, credit, and insurance, but even the fundamental concept of money itself. The Covid-19 pandemic further pushed the shift towards digital payments, as concerns about the spread of the virus through cash led to a significant increase in the use of digital payment methods. (Auer et al., 2020)

It's widely argued that technology is revolutionizing the realm of money and payment systems (Didenko et al., 2020) Governments worldwide are struggling with how to regulate new digital currencies and financial systems built on new technologies like blockchain, while also dealing with changes in traditional financial systems. (Arner et al., 2020)

Since the blockchain concept emerged in 2008, over 100 digital currencies, known as cryptocurrencies, have been created and traded online. In December 2017, the value of one bitcoin reached nearly \$20,000, pushing the total market value of cryptocurrencies to a staggering \$796 billion the following month. This market size would have placed cryptocurrencies second only to Apple Inc. at the time, which had a market capitalization of \$911 billion. Researchers have investigated blockchains as a potential solution for online payments, specifically their role as decentralized payment systems (DPSs) [16, 19]. These studies highlight the advantages of DPSs, including lower costs for international payments and remittances, as well as the ability to track all transactions, enabling automated

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