



Crypto Crash: Can Terra Regain its Lost Glory?

Description

The last few days have shown investors the volatility associated with [cryptocurrencies](#). The **TerraUSD** (CRYPTO:UST), which is a stablecoin, lost its peg, driving the price of **Terra** ([CRYPTO:LUNA](#)) lower by 99.8% in recent trading sessions.

Several billions of dollars were lost by investors resulting in a broader market selloff. At the time of writing, the price of **Bitcoin** is down 56% from all-time highs. Similarly, other well-known cryptocurrencies such as **Ethereum** and **Solana** have also lost [significant momentum](#).

Let's see if investors should have any hope of a comeback by Terra.

What is Terra?

The Terra blockchain network is powered by cryptocurrencies such as LUNA and UST. Here, the UST is the stablecoin pegged to the U.S. dollar, and LUNA is used to stabilize the price of UST.

As a stablecoin, the UST should ideally maintain a price of \$1. So, if the UST moves to \$1.02 due to higher demand, traders burn \$1 worth of the LUNA token to mint a UST token and earn a profit of \$0.02. This mechanism also increases the supply of the UST bringing prices back to \$1. Alternatively, if the price of UST falls to \$0.98 traders burn the token and mint \$1 worth of LUNA.

Due to a selloff in TerraUSD, the [UST lost its peg](#), driving the stablecoin lower at an astonishing pace. It's imperative for the UST to be priced around \$1, but right now, it's trading at \$0.16. Investors then sold off their position in LUNA to distance themselves from the chaos.

Prior to the selloff, LUNA was one of the largest cryptocurrencies in the world, valued at US\$40 billion, by market cap. The UST was also the third-largest stablecoin and was gaining massive traction among investors.

Additionally, Terra also operated the second-largest DeFi (decentralized finance) ecosystem until last week. The [Anchor protocol](#) offered investors a tasty yield of 19.5%, and the total value locked on the

protocol has fallen from US\$17 billion on May 6 to just US\$400 million, at the time of writing.

Due to its algorithm, the demand for the UST depends on the Anchor protocol and other DeFi projects, which will lead to the burning of LUNA, thereby increasing the cryptocurrency's price. We can see why investors were extremely bullish on the long-term prospects of LUNA. In fact, LUNA had already surged by 13,000% in 2021, creating massive wealth before collapsing like a pack of cards this week.

Is it the end for algorithmic stablecoins?

The TerraUSD was an algorithmic stablecoin, which means its price was pegged to the U.S. dollar by computer code and an arbitrage mechanism. Most other stablecoins such as USD Coin are backed by cash, which is held in a reserve account.

The oversupply of UST led to a failure in the arbitrage mechanism of the blockchain network. Further, in the last two months, Terra disclosed it brought Bitcoin as a reserve to back its stablecoin, but the selling pressure was just too monumental for the strategy to have any kind of impact.

Several exchanges have now delisted the two Terra tokens, reducing liquidity in the process. Investors have clearly lost confidence in Terra, making it a high-risk bet at current prices.

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