Twitter Thread by jonwu.eth



jonwu.eth
@jonwu_

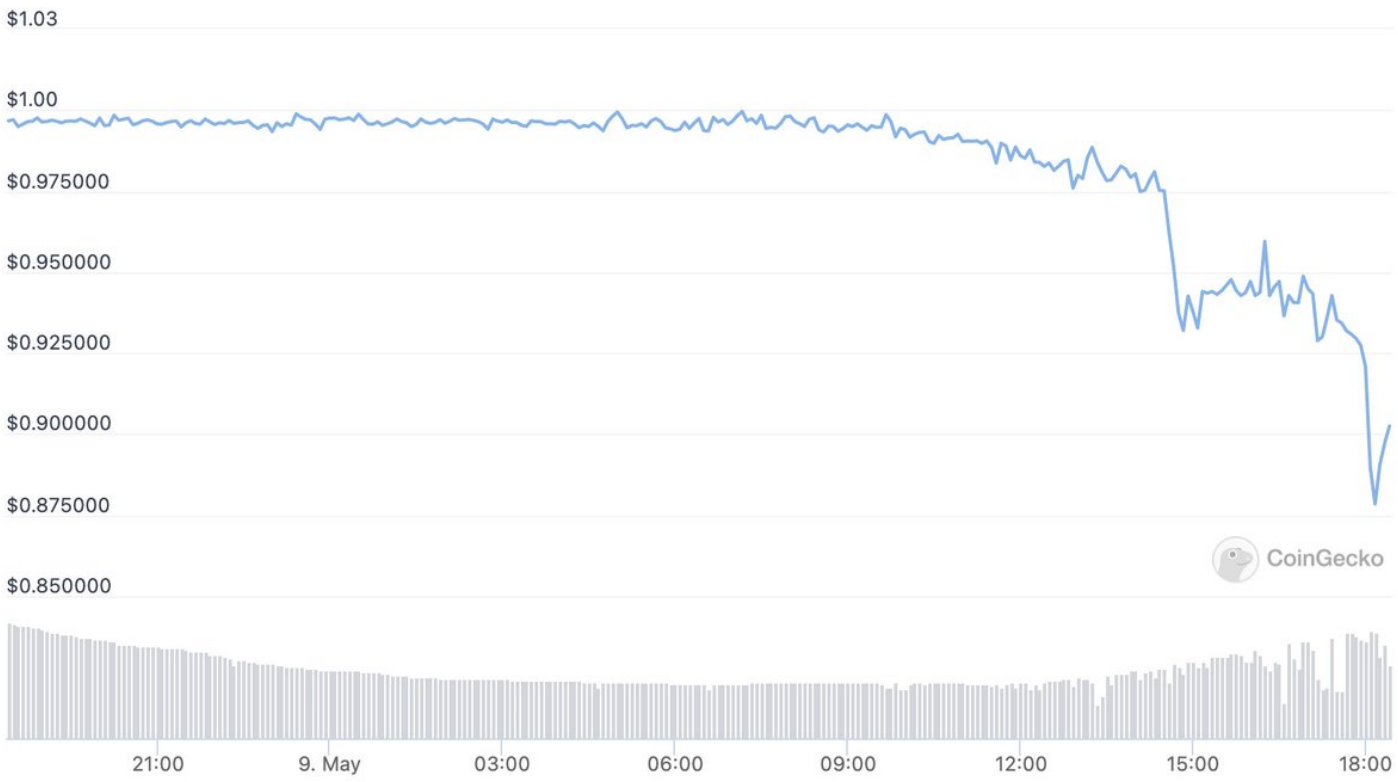
An $18 billion stablecoin is losing its dollar peg with all the magical chaos of algorithmic stables, with a dash of Bitcoin systemic risk drama.

Here's everything you need to know.

The $UST Depeg Thread:

■

$UST is a dollar-pegged stablecoin that has depegged twice in the last few days, now hovering around $0.90 to the dollar.



Just a reminder on how $UST works:

You can always redeem $LUNA for $UST dollar-for-dollar, and vice versa.

If $LUNA is at $50, you can redeem it for 50 $UST.

Similarly you can redeem 50 $UST for 1 $LUNA.

https://t.co/DAGmnXrdM4

> A thread about all the opportunities in the Terra $LUNA ecosystem:
>
> In this thread, I'll focus on the nr. 2 biggest ecosystem in terms of TVL in DeFi ($16.8b).
>
> There are plenty of opportunities in crypto to earn yield.
>
> Let's look at how you can make it with Terra $LUNA
>
> /THREAD pic.twitter.com/SKmEY3cBOT
>
> — Route 2 FI (@Route2FI) January 7, 2022

It's worth noting you can always redeem 1 $UST for $1 worth of $LUNA, even if $UST is worth <$1.

It's meant to be a stabilizing mechanism:

If $UST is trading at $0.99, arbitrageurs can buy it and redeem it for $1 of $LUNA.

We all know Stablecoins Require Utility™ to maintain demand and defend their peg.

So where does $UST get utility?

Simple, Anchor Protocol.

Anchor Protocol is (nominally) a money market, but the important tl;dr is it pays you 19.5% to stake $UST.

A huge proportion of $UST's circulating supply is in Anchor.

Right now, it's only ~40%, but it's been as high as 70%+ historically.

So, why hold $UST?

Easy: because they're paying you 20% per year to hold it.

Two obvious questions:

1) if something is paying you 20% risk-free, why not just borrow a ton of money and make it pay you like, 100%+?

Oh uhm, that's exactly what Abracadabra / $MIM's degenbox did:

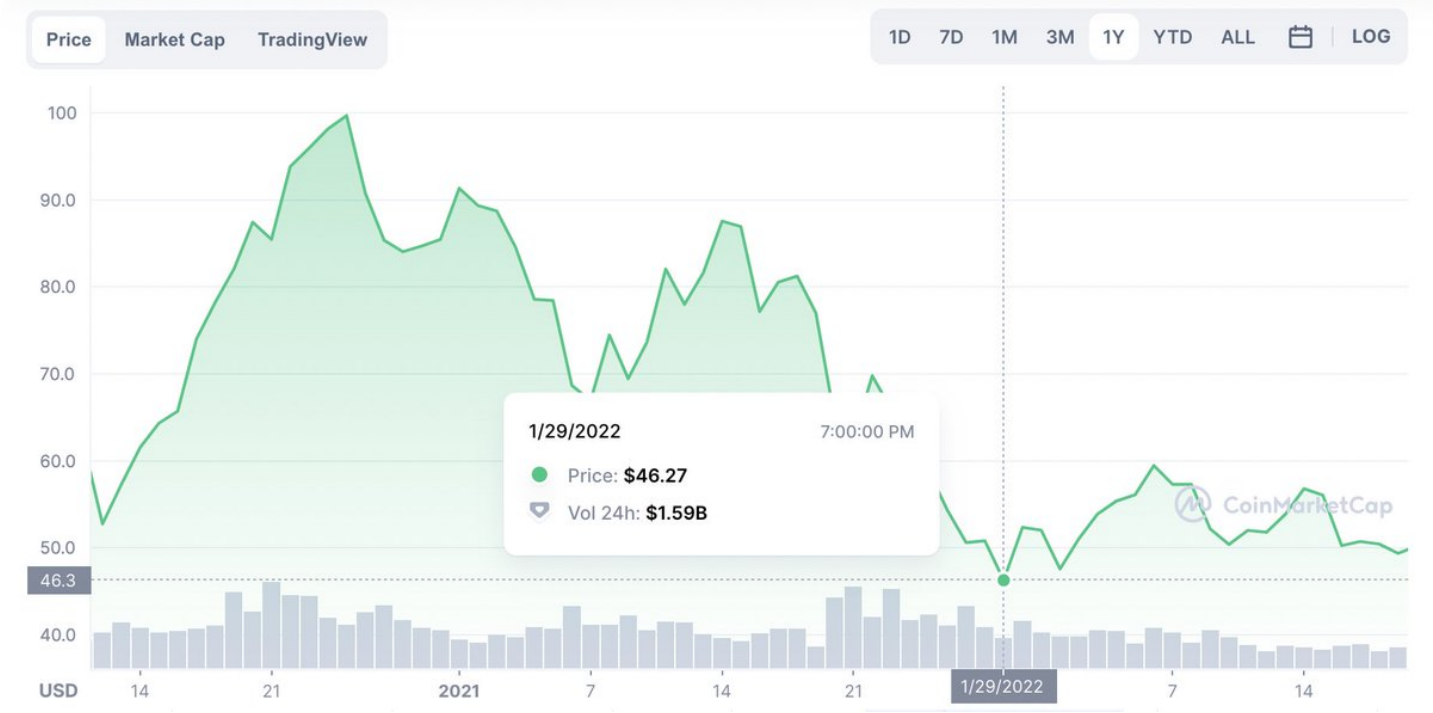
https://t.co/2MUoAvjFiI

> Our $UST Strategy! The first application of the magic potentialities of Degenbox by Abracadabra Money https://t.co/xCWIh8JYwj
>
> — Jason Wang \U0001f316 (@jwang815) November 3, 2021

Degenbox and the rest of the Frog Nation DeFi ecosystem unwound in January, depegging $UST and sending $LUNA from $100 down to $46.

Sound kinda familiar?

Something something history may not repeat itself but it can rhyme.



2) How does one give out 20% in free money every year?

Well that's also easy, the LFG (Luna Foundation Guard), overseers of Terra's multi-billion dollar ecosystem fund.

We'll come back to that.

First we need to figure out what the $LUNA token does:

I'm not going to focus on what drives its fundamental value and focus instead narrative:

~Every $UST in circulation reduces the circulation of $LUNA~

The win scenario is every single $LUNA on earth gets burned for $UST.

You can see the basic appeal:

The more $UST, the less $LUNA.

Holders should want to diamond-hands $LUNA:

If there's unstoppable demand for $UST and you're the last $LUNA holder on earth, you have immense redemption power.

It's right on their site:

https://t.co/afSOcN3aJs

That's kind of why the $LUNA mcap < the $UST mcap is FUD.

It doesn't matter what the total implied value of $LUNA is.

What matters is the marginal value of each $LUNA that is redeemed for $UST, or vice versa, aka $LUNA's price.

https://t.co/29oAXB98s5

> is there a problem if UST mcap is larger than LUNA mcap https://t.co/24z3kPMpNv
>
> — \ucc0c G \u8dfb \u3058 Goblin King of the scam bots (@DegenSpartan) May 9, 2022

But what's even MORE important is the directionality and stability of $LUNA's price.

It's a Big Motherfucking Problem if the average redemption price of $LUNA for $UST is high relative to $LUNA's current price.

Let me slow that one down:

- $LUNA price high
- $LUNA burned, many $UST minted
- $LUNA's price fall
- $UST redeemed for many $LUNA

■ That is bad mmkay?

It's useful to illustrate using extremes.

Say the price of $LUNA is $1 billion.

Then someone could mint 1 billion $UST by burning a single $LUNA.

Then let's say the price of $LUNA falls to $1 for no good reason.

That person could redeem their UST for 1 billion $LUNA.

So suddenly--again, for no good reason at all--there's a shit-ton more $LUNA in circulation being dumped on the open market.

This is--in essence--what's happening today.

So now back to the Luna Foundation Guard:

$UST has the same dynamics as many other algo-stables, except in addition to the "algo" part they also have LFG.

In other words, UST is stabilized by:

1) Contracts.
2) The gigantic gravity well created by the size of Do Kwon's nuts.

Previously the LFG was in charge of the Anchor bootstrapping strategy:

Take treasury $LUNA, sell it, and fill up the Anchor Protocol Reserve (the big slush fund that pays $UST stakers 20%).

Every other L1 eco fund does shit like this, just less directly.

Don't @ me.

The bet?

- $UST burned for staking
- $LUNA price goes up
- Sell more $LUNA to fund the Protocol Reserve

And, longer term:

- $UST takes off as a widely-used stable before LFG runs out of money
- $LUNA goes to the moon
- Everyone happy

Hence this tweet:

https://t.co/kQ9oEN7xd2

> Don\u2019t wanna get another DM about the @anchor_protocol yield reserve. What do you want?
>
> — Do Kwon \U0001f315 (@stablekwon) January 25, 2022

This was all challenged in January when Degenbox collapsed.

That implosion took down a big push for $UST to be used in a 10-figure cross-chain ecosystem headed by Daniele Sesta.

That's when Jump, 3AC, and others piled into the $1 billion Luna OTC deal to buy Bitcoin.

The story there?

1) Get the Bitcoin gang on board (every cycle needs one crazy billionaire to go hard for the King)

2) Give redemptions a $UST -> $BTC offramp in addition to the existing $UST -> $LUNA one.

https://t.co/hCI9I60TXt

> Today LFG announced they have raised $1 billion dollars to form $BTC reserve for Terra's $UST, lead by Jump Crypto and Three Arrows Capital.
>
> Here I explain why this deal is extremely important for Terra's stability, $LUNA's value capture, and future developments of LFG \U0001f9f5
>
> — Westie \U0001f316 \U0001f7ea (@WestieCapital) February 22, 2022

Now there's been a full weekend of gigantic, 9-figure moves market-selling $UST and pressuring the peg.

https://t.co/HJrfVj3PCj

> today's attack on Terra-Luna-UST was deliberate and coordinated. Massive 285m UST dump on Curve and Binance by a single player followed by massive shorts on Luna and hundreds of twitter posts. Pure staging. The project is bothering someone. \U0001f31d on the right path!
>
> — Caetano Manfrini \U0001f53a\U0001f316 (@CaetanoManfrini) May 8, 2022

As with all algo stables, the downside cycle is the opposite of the upside:

- $UST unstaked and dumped
- $UST depegs due to downward pressure
- $UST holders redeem for $1 of $LUNA
- Dump $LUNA

What complicates things is all the Bitcoin in the treasury.

Recall WHEN the LFG was buying Bitcoin.

Remember the $1 billion OTC news?

That triggered a massive run-up in $LUNA, which allowed for tons of high-basis $UST minting.

Simultaneously, the LFG DCA'd into Bitcoin at an average price north of $40K.



Now, Bitcoin is being driven lower due to macro and (ironically) expectations that LFG will be forced Bitcoin sellers due to $UST peg pressure.

Any redemptions of $UST -> $BTC now will essentially be booked losses for LFG, when they could have just sat on stables instead.

So now what's the plan?

As of this morning, commit $1.5B to defending the $UST peg, collateralized against Bitcoin reserves:

https://t.co/Fc5Nt6VaZn

> 4/ As a result, the LFG Council has voted to execute the following:
>
> - Loan $750M worth of BTC to OTC trading firms to help protect the UST peg.
>
> - Loan 750M UST to accumulate BTC as market conditions normalize.
>
> — LFG | Luna Foundation Guard (@LFG_org) May 9, 2022

Why?

The deeper the liquidity the harder it is for any one actor to "dig out" and move the price (even further) away from $1:

https://t.co/IQ9MO8Ck2Q

> The other way to visualize this is like a ravine or canyon surrounding the market-clearing price.
>
> The steeper the walls, the more market depth and liquidity around the spot price & the harder it is for market orders to "dig out" and move price. pic.twitter.com/d5tNhgT4Qp
>
> — jonwu.eth (@jonwu_) May 14, 2021

Liquidity, peg defense, market making?

That's why Jump Capital and 3AC are involved (they were part of the consortium that bought $1 billion of Luna OTC in February).

They're deep-pocketed, sophisticated traders willing to do whatever it takes to prevent a $UST death-spiral.

So what's next?

Friendly marketmakers go to work on deploying a piece of the $BTC treasury to market-buy $UST and keep the peg up.

Hope is there's more (falling-knife) $BTC collateral in LFG than there is bank-run pressure from people fudding $UST.

Possible outcomes:

1) The treasury gets drained, but $UST stabilizes.

For now, $BTC seems to have stopped dumping on liquidations and liquidation fears.



1a) The LFG also seems aware & intent on buying $BTC back at low basis.

There's a win where:

- $BTC gets pressured to $30K
- $UST peg restores
- LFG buys back into $BTC at lower basis

"Sell" BTC, restore peg, buy BTC.

Profit!

Better yet, $BTC somehow moons and we get a @feiprotocol situation where despite a difficult situation, the underlying collateral goes up in value and the protocol ends up fully collateralized.

And for completeness, since it would never happen:

2) Do Kwon and the LFG cease their $UST defense, annihilating Luna holders and allowing the $UST to settle at collateral value

https://t.co/eVzWMvQNaL

> In this situation, you have to sacrifice either LUNA or UST holders. As a stablecoin issuer, the moral choice should be easy. Defend UST by holding the treasury, even if it means LUNA going to zero
>
> — Hasu\u26a1\ufe0f\U0001f916 (@hasufl) May 9, 2022

tl;dr

$UST is 100 magic dollars backed by 20 bitcorns and 80 magic beans, but some people don't think it's worth 100 real dollars, so LFG is selling bitcorns to buy more magic dollars to convince people they're worth 100 real dollars, all so the magic bean holders don't get sad