A Beginner's Guide to Avalanche (AVAX) Staking

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Do you have some AVAX in your wallet? Why not stake these tokens to earn some passive income? Here's a guide to the best platforms to stake Avalanche (AVAX) for maximum returns and how to stake it!

Avalanche is a high-speed, scalable blockchain that offers near-instantaneous transaction speeds at a low cost. Despite its recent popularity, Avalanche already boasts a $4.4 billion TVL and ranks fourth among other blockchains in the metric. Much of its value comes from Trader Joe – the trading platform on Avalanche, classified as a one-stop decentralized trading platform.

In this article, we will discuss this go-to protocol for DeFi enthusiasts with a special focus on staking AVAX tokens and generating yield. To understand how we can stake our AVAX through different ways, it is crucial to deep-dive into the consensus mechanism that the protocol uses and figure out how yields are generated on staked AVAX.

A Brief Glance at AVAX Staking

Staking AVAX implies locking it in a staking pool so the assets can earn some yield. In most Proof-of-Stake (PoS) blockchains, staking is the process of participating in the network consensus. Unlike Proof-of-Work (PoW) blockchains protocols, the decentralized systems that utilize PoS as their major consensus mechanism do not need users to put up computational resources at stake to validate transactions on the network.

In PoW, miners, who responsible for validating transactions on the network, need to perform complicated calculations to participate in the consensus algorithms. The specialized hardware is computing an "unknown" random number that is almost impossible to discover manually. This scheme is the core mechanics of PoW. When the number is found by the hardware, the given transaction associated with it is validated and added to the block. Only those who have access to this sophisticated hardware or, to be more specific, can afford its prohibitive price can participate in the

network consensus and get rewarded for doing so.

In PoS chains, on the other hand, delegators do not need any hardware to validate transactions on the network. Instead, they are just required to hold their capital within the network. Starting from a particular amount of tokens locked in the blockchain, you gain your right to validate transactions, participate in votings on major decisions, etc.

Capital lock-ups can be risky due to the extreme market volatility. Recall at least the recent collapse of Terra that wiped out at least $200 billion from crypto space. Moreover, the opportunity cost that is incurred by capital lock-ups can also be a challenge. If a delegator is seeking a profit, sometimes it is more reasonable to put the capital in a De-Fi protocol where there is more control and higher returns.

Therefore, staking rewards are crucial to incentivize users to hold their capital in a particular network. We refer to a special bonus that is paid out to those who stake some amount of coins within the blockchain. And this interest is what you get when you stake your AVAX within the network.

How AVAX Staking Works?

Staking AVAX is similar to any other token in a PoS-based blockchain. When a validator locks up their stake, their chances to get selected to validate the next block are proportional to the amount of their capital locked within the network. The rewards that are accumulated by the validator also hinge on this amount.

The remunerations are more based on the validator’s uptime and correctness in validating transactions. This avoids the rich-gets-richer effect that PoS blockchains are accused of. As long as the participant is validating the right transactions and has their resources available for the network 80% of the time, the reward will be granted.

In addition to this, there are several conditions to becoming a validator or a delegator in the network. A validator must stake at least 2,000 AVAX to participate in the network consensus, while to become a delegator, you must hold 25 AVAX. The minimum period for staking is two weeks and the maximum period is one year for both validators and delegators.

These conditions ensure that the network is always able to process transactions and keep the network live and running. If validators and/or delegators are allowed to stake and unstake whenever they want, then the network becomes much more susceptible to attacks. It is therefore a mutually beneficial relationship. As the network becomes secure with the stake that users deposit/commit, they get the staking rewards in return. Several new solutions help remove the illiquidity of staked

assets by issuing synthetic derivatives. This process is known as liquid staking, which we discussed in this article.

What's the Difference Between Validator and Delegator?

A delegator in any PoS network is the one that delegates their capital to a validator so the latter can use it to participate in the network consensus. A validator can be a staking pool or simply an individual who has set up a node. Delegators are generally individuals who are not able to deploy their node because of a lack of technical knowledge, resources, or even time. Validators are those who have those resources and are willing to spend additional time in setting up nodes.

If you are a validator, you receive the bonus. In the case of delegation, once the staking reward is gained by a validator, it is redistributed proportionally amongst all delegators.

Annual Percentage Yield (APY) of Avalanche Staking

All PoS chains offer different APYs for their staking rewards. This depends on the amount of the native cryptocurrency kept aside for these bonuses. Avalanche offers about 9.41% staking APY for its users. Thus, when you deposit your AVAX, you can expect the rewards to accumulate in your wallet at the end of each time frame according to this APY.

Remember that as more validators and/or delegators join the network, it becomes more resilient to attacks, while your rewards get more sustainable. Unlike other DeFi protocols, you are more likely to get consistent rewards from staking your AVAX because it relies on network inflation (the number of validators on the network) more than on any other factor.

Staking Pools of Avalanche

Staking pools aggregate delegators' funds and then deposit them on the network through their validator nodes. They provide a much simpler form of staking. The only thing you need to do is to deposit your funds to the pool and then receive rewards from the stake that are proportionally distributed amongst all delegators.

The only challenge that users face with staking pools is that of validator uptime and performance. As we previously discussed, Avalanche requires validators to have an uptime and a network performance of at least 80%. This factor affects how often the validator is chosen to confirm transactions on the network.

Thus, before you decide to delegate your funds to any staking pool, you will have to check the node's

health. It’s crucial to find out whether the pool has any slashing history. Slashing in crypto is something similar to a fine in our mundane life. If a validator is suspected of any misbehavior, such as attacking the network or using the modified software, a part of their funds will be slashed. The slashing amount depends on the degree of dysfunction caused.

To check the validator’s health, you need their Node Id. Once you know it, you can head to AllNodes and review the past performance of a particular node.

Some staking pools on Avalanche like ITC provide their Node ID easily. For others, a thorough check will be required. You can even get in touch with the validators and request their Node Id.

There are some other staking pools on Avalanche to choose from, such as Staked. However, remember that you will have to perform your own due diligence on these staking pools before you actually delegate your funds. While it is very rare that a validator suffers so much downtime that the funds are slashed, in the crypto world nothing is impossible.

Avalanche Staking Challenges

Capital lockups are the fundamental challenge to PoS chains. When you delegate your funds to a staking pool or run a validator node, you are locking up your funds in the network. Therefore, the amount becomes illiquid and you are unable to use it elsewhere. As a result, you are essentially risking those funds getting devalued over time due to the prevailing market conditions. This implies that you are unable to hedge against that risk of opportunity cost.

This is a fundamental problem of PoS that has been discussed in several research papers. While some blockchains insist that the returns on staking are enough to offset that risk, it is practically untrue due to the market volatility.

As the APYs are usually low, ranging between 6% and 9% for most PoS chains, it does not make sense to stake funds for a short period of time. If you do that for a few weeks, then you are barely able to make any rewards. However, if you stake tokens for an entire year, then you get the total rewards. This means that to maximize the profit, you need to keep your funds staked for a much longer period than you would generally like to.

On such a long distance most native cryptocurrencies can either suffer from triple-digit devaluations or gain unbelievable profits. Can you imagine the huge opportunity cost that you have to pay in this case?

Liquid staking comes as a solution that helps unlock the liquidity of all the staked assets. Such protocols issue on-chain representatives of these staked assets (think cTokens in case of Compound, or aTokens in case of Aave). These representative tokens are pegged to the value of your underlying assets. You can then use these tokens across a variety of applications in DeFi and generate compounded yield. Moreover, you are able to generate returns from having your assets staked within the network while also using the new tokens in other DeFi projects.

Conclusion

Staking Avalanche is a reliable way of generating yields on your idle AVAX tokens. Thanks to the wallet integration, you can start delegating with just 25 AVAX on your account.

Staking is becoming more and more popular as we move into the world of PoS chains. staking rewards will play a key role in generating revenue for the network. As PoS networks become more resilient, staking rewards will become more sustainable and reliable as a way to generate revenue in DeFi.