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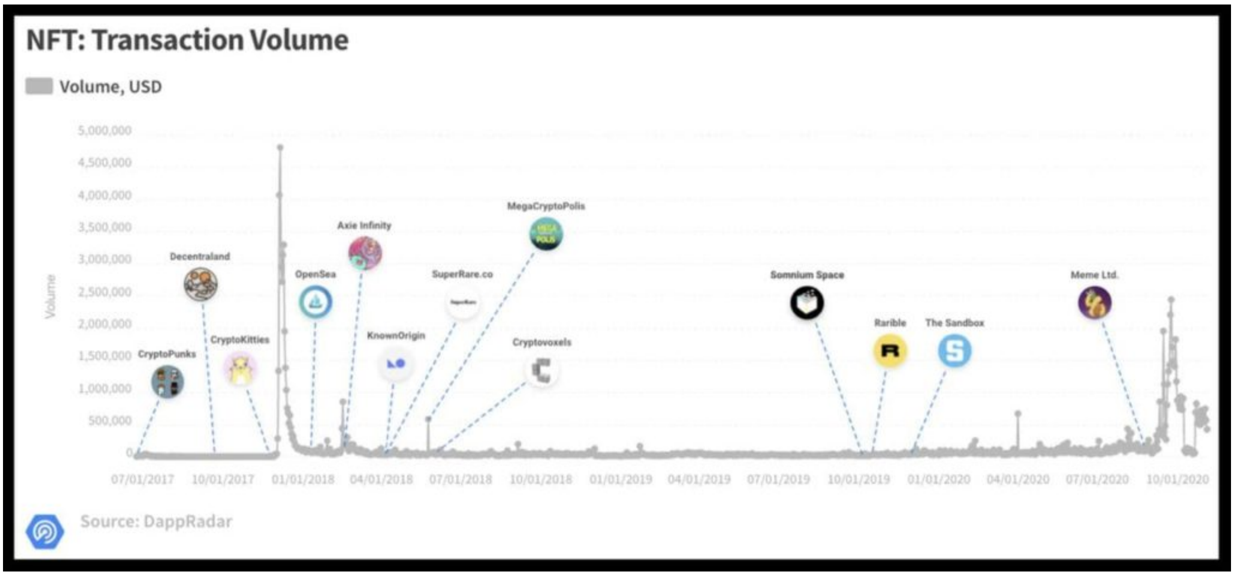
The DeFi – NFT Symbiosis

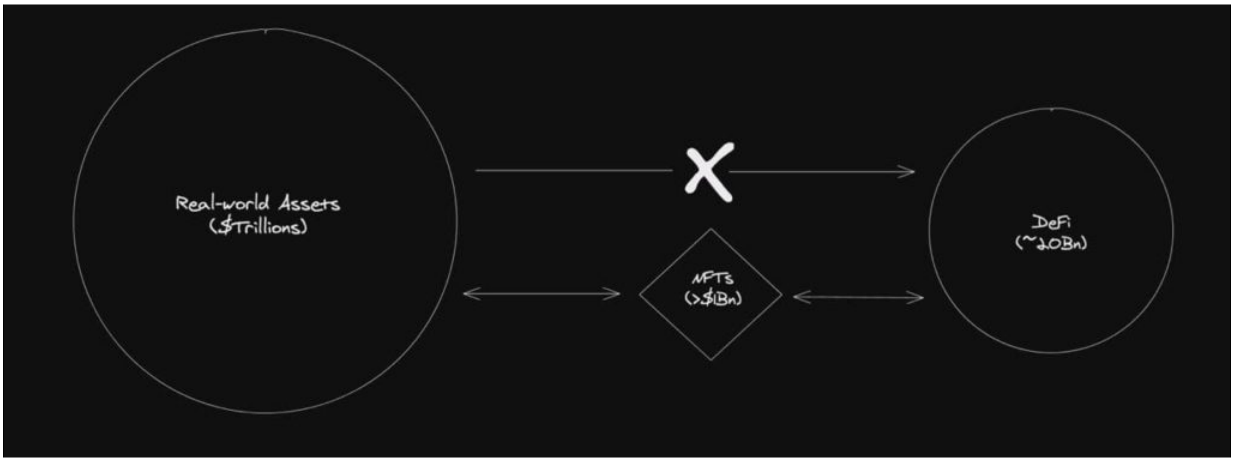
Piers Kicks · Friday, January 8th, 2021

In 2020, the worlds of decentralized finance and NFTs collided dramatically as the DeFi Summer drove gas fees on Ethereum to intolerable levels for many NFT activities. Whilst many participants in the NFT space initially saw this detriment as a curse, **it can certainly be argued that residual liquidity from such a frothy market is what allowed the NFT sector to have its moment in the sun as money began to spill across sectors.** As the DeFi boom subsided towards the end of summer, the NFT space began to see its highest volumes since late 2017 before ending the year with a bang fueled by historic crypto art sales.



What became clear last year is that there is an exciting natural synergy between the two. On the one hand, **DeFi can provide a dramatic expansion of utility, functionality, and access to more complex financial infrastructure through fractionalization for the NFT ecosystem.** And on the other, **NFTs provide DeFi with an expansion of the universe of collateral,** and may ultimately prove to be the primary mechanism through which real-world assets can enter this new land.

Whilst description of real world assets via NFTs along with the corresponding legal enforcement mechanisms remain relatively undeveloped, there are projects such as Tinlake looking to tackle exactly that with a few live early instances. Large scale successful implementations will open up huge untapped potential and undoubtedly serve as additional DeFi propellant.



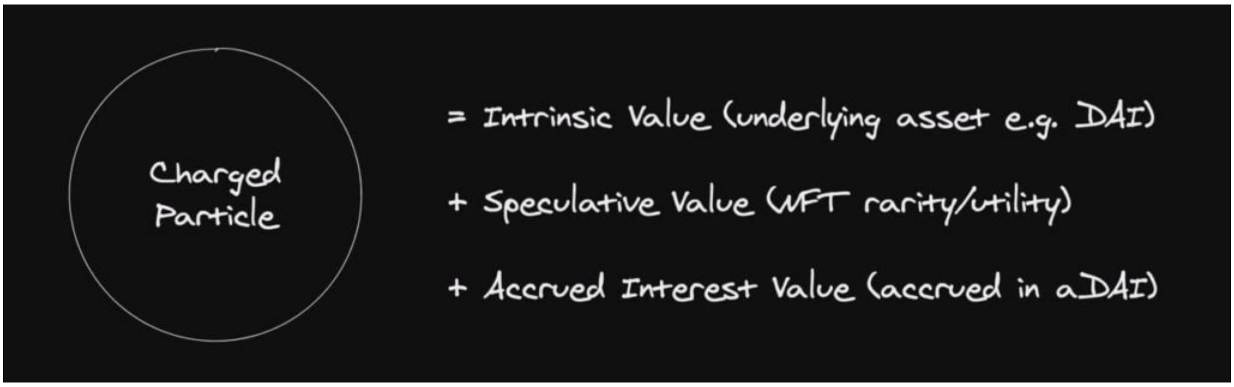
Aside from that exciting prospect, **NFTs can also be used to represent financial products in an intuitive way.** We have already seen this with yInsure, but it's my view that this will extend well beyond insurance into options, bonds, and other more complex financial products. One of the major frictions for integrating NFTs with traditional lending protocols is the lack of reliable pricing data. Whereas in DeFi oracles can be used, no such thing exists for NFTs. At an extreme push you might be able to assume that the NFT is worth at least as much as its last sale price, but that's not a very robust assumption. As a result, most NFT-collateralized loan activity happens in a P2P fashion. With the rise of individual NFT fractionalization as well as indexing through projects like NFTX (see yesterday's launch), this is changing.

#	Name	Market Cap	Liquidity	Price	ROI	Total Supply
1	The MetaONEz NIFTEX Uniswap	$211,494	$23,178	$2.11	2.46%	100,000 META
2	The Nifty ONEz NIFTEX Uniswap	$129,409	$17,047	$1.29	50.47%	100,000 ONEZ
3	APE Punk NIFTEX Uniswap	$104,093	$38,261	$10.41	-48.13%	10,000 APES
4	Cream City Brick NIFTEX Uniswap	$89,086	$8,496	$0.89	-22.31%	100,000 CREAM
5	Almace Shards NIFTEX Uniswap	$88,672	$31,931	$8.87	93.32%	10,000 ALMX

Source: ShardMarketCap

As we see NFT make their way into DeFi, concepts native to the latter are beginning to seep back into the NFT space too. From marketplace governance tokens like $RARI, to "NFT mining" in projects like Meme, to the emergence of "voting NFTs" that are actually imbued with voting power within a heavily redesigned Compound/Uniswap DAO. Already there exist multiple projects where mechanics from both sides are intimately intertwined. I covered Aavegotchi's interesting approach in a previous Delphi Daily last summer, but a number of other projects are beginning to explore other angles.

An interesting example which predates Aavegotchi that I am yet to touch upon is Charged Particles. Essentially, **the protocol aims to let you bind interest-bearing assets such as aDAI with *any* NFT.** Over time, as that NFT earns yield, its "charge" increases. That charge can be left to compound, programmed so that a portion of it heads elsewhere (e.g. a friend or the original creator), or "discharged" by a future owner who can withdraw any accrued interest. Conceptually this is a really interesting idea, and we can begin to speculate upon how this might be used. Their documentation alludes to a hypothetical gaming use case in which we can imagine that an NFT represents a sword, whose power is dependent on the amount of "charge" it has. This could ultimately add an interesting dimension to in-game staking, whereby there is a strong time component to the items you risk losing in a duel. Not only might the original sword NFT be costly to acquire, but so is the *time* that was sunk into letting it reach a certain level of charge. Interestingly, these elements could actually be used to combat "pay to win" environments. By having to charge (even cheap) items over time, early adopters could actually wield greater power than latecomers no matter how deep their pockets. As mentioned, this can be applied to any NFT so I'm excited to see how something like this is experimented with across other major categories such as art, virtual real estate, and collectibles.



As we head into 2021, I am confident we are going to see significantly more experimentation at the intersection of these two sectors throughout the year. In particular, the concept of NFT farming feels relatively unexplored. It has clearly shown merit in the Meme instance, but strikes me as an elegant way for projects to bridge activity across both fungible and non-fungible tokens. Needless to say, the relative sizes of both sectors are far from alignment and NFTs are definitely fighting the uphill battle in terms of both users and size. **That being said, NFTs potentially have a broader retail appeal that could draw new entrants into the space through actual products and experiences faster than DeFi.** Content is much more intuitively understood by most whether it's a video game, art, music, or writing. Crypto Art has already demonstrated just how infectious this can be across creative spaces. In time, as models are tested, both DeFi and NFTs should eventually harmonize and become mutually beneficial. Regardless of the manner and order in which growth happens, both DeFi and NFTs especially (due to lower transaction values) are going to require scaling solutions to meet demand.