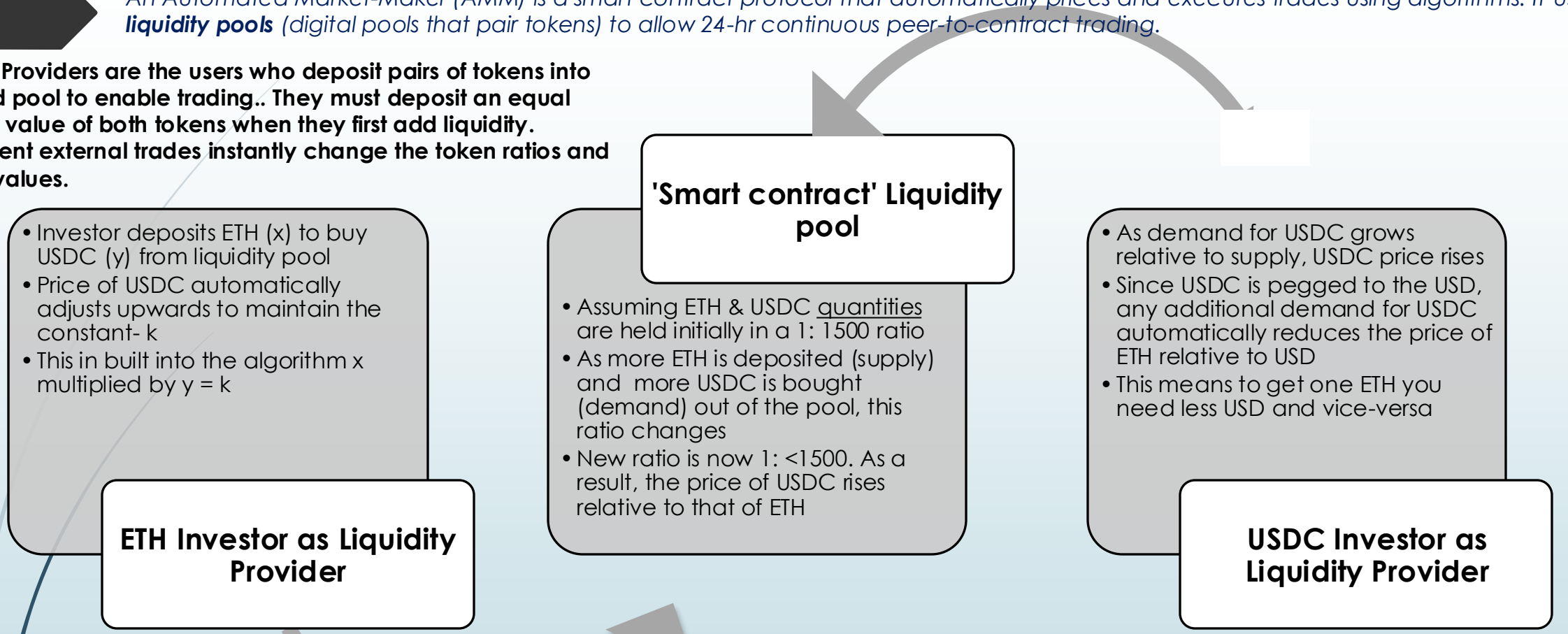
Understanding Automated Market-Makers (AMMs) in DeFi

An Automated Market-Maker (AMM) is a smart contract protocol that automatically prices and executes trades using algorithms. It uses ***liquidity pools*** *(digital pools that pair tokens) to allow 24-hr continuous peer-to-contract trading.*

Liquidity Providers are the users who deposit pairs of tokens into the liquid pool to enable trading.. They must deposit an equal financial value of both tokens when they first add liquidity. Subsequent external trades instantly change the token ratios and relative values.



The price of an asset is calculated algorithmically based on the ratio of the paired tokens currently available in that specific pool. The most common mathematical model used is the "constant product formula'- x × y = k. Here the quantities of ETH and USDC when multiplied must always equal a contant number k.

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