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COMMODITY FUTURES MARKET IN INDIA – AN OVERVIEW

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ABSTRACT

The article is a descriptive paper about inception, history and renaissance of Commodity Futures Market in India. It outlines the differences between the spot and the futures market, important economic functions, regulation of commodity futures market, national and regional exchanges, the commodities traded on them and the growth of these markets over the years and also discuss the primary purpose for the existence of these markets.

KEYWORDS: *markets, Commodities, Spot Markets, Agricultural Markets*

INTRODUCTION

Commodities are marketable raw materials or agricultural products that are produced or manufactured to satisfy the needs of consumers. Commodities are fungible i.e. individual units of commodities can be mutually substituted. The characteristic of fungibility, render commodities the ability to be traded on exchanges like equity shares or funds. Commodities can be soft or hard; soft commodities are the agricultural products like wheat, jowar, turmeric etc whereas hard commodities are usually extracted from mines like oil, metals etc. Commodity markets are basically of two types, they are Spot Markets (Regular Mandi or Wholesale Market) and Derivative Markets. The spot markets or the wholesale market is the meeting place for buyers and sellers of commodities. The commodities are bought and sold with immediate delivery and after visual inspection of the specific commodity. Agricultural Markets are examples of Spot markets and are established in most parts of India and are regulated under the State Agricultural Produce Market Committee (APMC) Acts. Market Committees constituted by the State Governments manages the markets within the market area of a state. No agency or person is allowed to carry on freely wholesale marketing activities in a particular area if it is declared as a market area and falls under jurisdiction of the Market Committee. “Agricultural Produce Market Committee (APMC) is a statutory market committee constituted by a State Government in respect of trade in certain notified agricultural or horticultural or livestock products, under the Agricultural Produce Market Committee Act issued by that state government”.

‘Derivatives’ are financial instruments which ‘derive’ their value from an underlying asset. There are many types of derivatives such as, forwards, futures, options, swaps etc. The derivative markets are financial markets where financial instruments like futures or options contracts are traded. These financial instruments are called as derivative instruments because they derived their value from the underlying asset; here the underlying asset is 'Commodity' hence they are termed as commodity derivatives. Again, these commodity derivatives require the existence of regularized commodity exchanges where they can be bought and sold. This mechanism gives commodity derivative trading an edge over regular wholesale markets as they require standardized contracts and are traded over regularized exchanges, without any hassle of visual inspection. It is a sort of virtual market where trading of soft or hard commodities takes place. The delivery of the commodity is not immediate but in some certain future time. There are only two types of commodity derivatives in India, they are forwards and futures. Futures markets came into existence to overcome the problems that existed in forward markets. Futures Contracts are very similar to forward contracts but unlike forwards, futures are standardized contracts and are traded on regularized commodity exchanges giving them the advantage of mitigating the counterparty risk.

CHEQUERED HISTORY OF CFM

In India, commodities market had a long history of derivative trading in commodities (Vashishtha and Kumar, 2010). It is still in its nascency in India, when compared to other global commodity exchanges. According to, (Ramaswami and Singh, 2007) Commodities futures market in India predominantly remains underdeveloped. The Indian Commodities Future Market has a long and chequered history; it started with the establishment of Bombay Cotton Trade Association in 1875. This was just after a decade of inception of commodity trading in Chicago. Over time the derivative trading started in different parts of India. It started in oilseeds in Mumbai (1900), in Kolkata (1912) for jute goods and raw jute, in Hapur (1913) for wheat, in 1920 it started in Mumbai for bullion. There was an increased growth in futures trading in India between the First and Second World War.

DORMANT PERIOD IN INDIA

In 1939, Government of Bombay banned the derivative trading in Cotton because of the increased speculative activities. Later in due course forward trading was prohibited in oil seeds, sugar, vegetable oils, spices, food grains etc. After the Second World War, there was shortage in supply of major commodities, and in the back drop of war, the futures trading was prohibited under the Defence Act of India. After the Independence the commodity trading again started and was flourishing in early years of 1950 and 1960. But the future trading in commodities was banned in mid 1960's in India except in minor commodities like turmeric and pepper. This was because many blamed derivative trading for unnecessary speculation in essential commodities and also considered it deleterious to the normal and healthy functioning of markets. The commodities future market remained dormant for about forty years until the beginning of twenty first century.

Forward Contract Regulation Act (FCRA (1952)) and set up of Forward Market Commission (FMC)

In December 1952, Forward Contracts (Regulation) Act (1952) was enacted. This was an act to provide for the "regulation of certain matters relating to forward contracts, the prohibition of options in goods and for matters connected therewith".

According to Forward Contracts (Regulation) Act, commodities are divided into 3 categories with reference to extent of regulation, viz

- Commodities in which futures trading can be organized under the auspices of recognized association.
- Commodities in which futures trading is prohibited.
- Commodities which are neither regulated nor prohibited for being traded. These are referred as 'Free Commodities'.

FMC

It is a statutory body set up under Forward Contracts (Regulation) Act 1952. "The Central Government may, by notification in the official Gazette, establish a Commission to be called the Forward Markets Commission for the purpose of exercising such functions and discharging such duties as may be assigned to the Commission by or under this Act."

Forward Markets Commission (FMC) has its headquarters at Mumbai. It is a regulatory authority for commodity futures market in India. The Commission functioned under the administrative control of the Ministry of Consumer Affairs, Food & Public Distribution, Department of Consumer Affairs, Government of India till 5th September 2013. Thereafter the Commission has been functioning under the Ministry of Finance, Department of Economic Affairs, Government of India. The objectives of regulation of CFM are to ensure that markets efficiently and effectively perform the economic functions of Price discovery and Price Risk management, to maintain financial integrity (Capital Adequacy and Payment of Margins) and market integrity (Audit, Surveillance and Monitoring) across the Exchanges, the market and the intermediaries (brokers, assayers, warehouses etc.), to ensure alignment of spot and future prices, Investor Protection and Transparency, fairness in trading, clearing and settlement process.

RENAISSANCE OF COMMODITY FUTURES TRADING IN INDIA

The Khusro Committee was constituted in June, 1980. This committee had recommended reintroduction of futures trading in most of the major commodities. Accordingly, the future trading was initiated in Potato during the latter half of 1980 in quite a few markets in Uttar Pradesh and Punjab.

In 1990, there was the Liberalization, Privatisation and Globalization of Indian economy in trade and industry. This resulted in major policy shifts in India. During the latter half of the nineties values and volumes of trading in some of the exchanges have reached reasonable levels. The summary position is as displayed in the below table :-

Table: Summary Position of Trading Volumes

Year	Value of Trading (Rs billion)
1996-97	313.56
1997-98	314.79
1998-99	326.50
1999-00	228.59 *
2000-01	273.80

*** The drastic decline in value of trading in 1999-2000 is mainly on account of the reduced trading at the Jute Exchange at Calcutta (from R 5022 to Rs 1234) and castorseed exchange at Ahmedabad (from Rs 6854 to Rs 5220 mn)**

The Government of India established a committee under the chairmanship of Prof. K.N. Kabra in 1993 to examine the role of futures trading over the past years, and then began to encourage commodity markets on the recommendations of Kabra committee submitted in 1994. It strongly recommended the opening of futures trading in select commodities.

In pursuance of the National Agricultural Policy 2000 of the Government of India, an Expert Committee was set up in December 2000 by the Department of Agriculture and Cooperation to recommend various reforms in agricultural marketing; whose recommendations (submitted Report in June, 2001) include the following relating to forward and futures markets in commodities: "More commodities should be permitted for forward and futures trading to facilitate competitive and free marketing system. Govt. has to continue its efforts to strengthen the commodity exchanges and to instill confidence and awareness among market players". As proposed in the National Agricultural Policy, 2000 more agro commodities were identified and added to the list of permitted commodities for futures trading. Finally, the year 2003 proved to be a landmark in the history of commodity futures market, witnessing the establishment and recognition of three new national exchanges [National Commodity and Derivatives Exchange of India Ltd. (NCDEX), Multi Commodity Exchange of India Ltd (MCX) and National Multi Commodity Exchange of India Ltd. (NMCE)] with on-line trading and professional management. Since the advent of 1990, concerted efforts have been made by the government in expanding the scope of futures trading, along with general economic reforms. The renewed interest among the stake-holders, have resulted in several institutional reforms. Among the reforms, the regulatory framework has been strengthened, exchanges have been exposed to the best practices from across the world, institutional interface between the various related agencies have been strengthened.

The efforts by the Government, recommendations of Khusro and Kabra Committees, recommendation of National Agricultural policy, Strengthening of regulatory framework, establishment of National Commodity Exchanges actually have made ways for the commodities future markets to witness phenomenal growth in due time.

The commodity futures market witnessed a spectacular growth till the first ban was imposed on tur and urad towards the end of January 2007, and subsequently the ban of wheat and rice in the next month. In 2008, Forward Markets Commission, as a cautionary measure, suspended futures trading in Potato, Chana, Rubber and Soya. Trading in these commodities was resumed in 2008 with the ease of inflationary pressures.

Later on futures trading in wheat was re-introduced in 2009. These bans shattered participants' confidence. The commodity trading in India has become very popular among the traders and retail investors in the recent times. The commodity derivatives constitute an important part of the commodity futures trading in the Indian financial market. The commodity derivatives are preferred for the reason that they provide the investors with a better opportunity of diversifying their portfolios in addition to what the bonds, shares, and real estates offer.

Commodity Futures Trading Value since 2002-03							
Year	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2010-11
Value of trading (Rs in crore)	66,530	1,29,363	5,71,759	21,55,122	36,76,926	40,65,989	11948942

COMMODITY FUTURES MARKETS IN INDIA: AN OVERVIEW

Indian Commodity Exchanges In India, at present there are twelve recognised future exchanges, of which there are six national level multi-commodity exchanges and six regional exchanges. The table below displays the list of exchanges in India.

Table: List of the Exchanges

Sr. No.	Name of the Exchanges
A.	**National Multi Commodity Exchanges**
1	Multi Commodity Exchange of India Ltd., Mumbai (MCX)
2	National Commodity & Derivatives Exchange Ltd., Mumbai (NCDEX)
3	ACE Derivatives and Commodity Exchange, Mumbai. (ACE)
4	National Multi Commodity Exchange of India Ltd., Ahmedabad (NMCE)
5	Indian Commodity Exchange Ltd., Mumbai (ICEX)
6	Universal Commodity Exchange Ltd, Navi Mumbai (UCX)
B.	**Commodity Specific Regional Exchanges**
7	The Chamber of Commerce, Hapur
8	Rajkot Commodity Exchange Ltd., Rajkot
9	India Pepper & Spice Trade Association, Kochi
10	Bombay Commodity Exchange Ltd, Mumbai
11	Spices & Oilseeds Exchange Ltd, Sangli
12	Cotton Association of India, Mumbai

(Source: FMC Bulletin, April 2015 – June 2015)

DISTINGUISHING FEATURES OF NATIONAL AND REGIONAL EXCHANGES

The following are the distinguishing features of the commodity futures exchanges:

National Exchanges	Regional Exchanges
Compulsory online trading	Online trading is not compulsory
National Exchanges are de-mutualised	De-mutualisation not mandatory
National Exchanges are recognised on permanent basis.	Recognition given for fixed period after which it could be given for re-regulation
They are multi commodity exchange i.e., they can trade in many commodities.	Generally, these are single commodity exchanges. Exchanges have to apply for trading more than one commodity.
Large expanding volumes.	Low volumes in niche markets.

As already stated, the national exchanges can deal in multiple commodities, whereas the regional exchanges can trade in one or more commodities. The above table shows the commodities traded in each of these exchanges

Name of Exchange	Volume of Trade (In lakh tons)	Value (in crore)	% share (In value terms)
Multi Commodity Exchange of India Ltd., Mumbai (MCX)	1758.38	1357877.23	80.55
National Commodity & Derivatives Exchange Ltd., Mumbai (NCDEX)	632.050	316099.20	18.75
National Multi Commodity Exchange of India Ltd., Ahmedabad (NMCE)	19.44	8906.09	0.53
ACE Derivatives & Commodity Exchange Ltd., Mumbai (ACE)	0.28	261.81	0.02
Total of National Exchanges	**2410.14**	**1683144.33**	**99.84**
Regional Exchanges	**6.44**	**2656.28**	**0.16**
Grand total	**2416.58**	**1685800.61**	**100**

(Source: FMC Bulletin, April 2015 – June 2015)

CONCLUSION

The two most important functions of these markets are price discovery i.e. the information is reflected first in futures market and risk mitigation through hedging i.e. offsetting the risk by taking an equal and opposite position. Commodity futures market, besides providing hedging, also provides for efficient portfolio management because it acts as portfolio diversifier. Diversification benefits help investors in improved returns. For smooth and efficient functioning of the commodity futures market, it requires certain prerequisites like, good liquidity in the market, future and spot price should move in tandem, strengthened regulatory framework, well developed commodity exchanges etc., for the functions to be most effective, the markets should reach to all the target groups. It should be advantageous to all the segments of the economy, then only it can fulfill the basic purpose of it's existence.

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