II. Commodity futures market

4.25 As compared to 59 in January 2005, 94 commodities were traded in the commodities futures market as of December 2006, and these included major agricultural commodities (rice, wheat, jute, gur, cotton, coffee, major pulses like urad, arahar, chana, edible oilseeds like mustard seed, coconut oil, groundnut oil and sunflower), spices (pepper, chillies, cumin seed and turmeric), metals (aluminium, tin, nickel and, copper), bullion (gold and silver), crude oil, natural gas and polymer, among others. Gold accounted for the largest share (31 per cent) of trade in terms of value, followed by silver (19 per cent), guar seed (11 per cent) and chana (10 per cent). A temporary ban was imposed on futures trading in urad and tur dal in January 2007 to ensure orderly market conditions. An efficient and well-organised commodities futures market is generally acknowledged to be helpful in price discovery for the traded commodities (Box 4.5).

4.26 The growth in the commodity derivative trading witnessed in 2005-06 continued during 2006-07. Total volume of trade rose sharply from Rs. 1.29 lakh crore in 2003-04 to Rs. 27.39 lakh crore in 2006-07 (till December 2006) (Table 4.15). In the first nine months of 2006-07, the volume of trade was already more than Rs. 21.55 lakh crore achieved in the twelve months of 2005-06. Turnover as a proportion of GDP increased from only 4.7 per cent in 2003-04 to 18.3 per cent in 2004-05 and further to 76.8 per cent in 2005-06. The growth in the volume of trading has been primarily propelled by Multi Commodity Exchange, Mumbai (MCX) and National Commodity Derivatives Exchange, Mumbai (NCDEX) (Figure 4.1), with these two exchanges also accounting for a large share of the number of contracts traded on the exchanges (Table 4.16).

Fig. 4.1 **Indian commodity exchange market share (in terms of turn-over) in 2006-07 (till December 2006)**

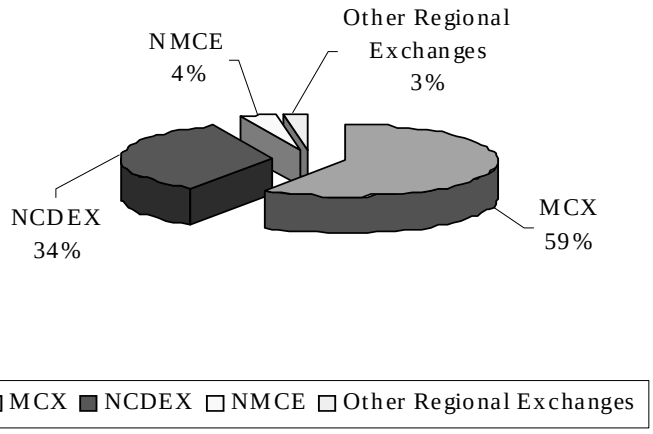

Table 4.15 : Turnover on commodity futures markets

(Rs. Crore)

Exchanges	2004-05	2005-06	2006-07*
Multi Commodity Exchange, Mumbai (MCX)	165,147	961,633	1,621,803
National Commodity Derivatives Exchange, Mumbai (NCDEX)	266,338	1,066,686	944,066
National Multi Commodity Exchange, Ahmedabad (NMCE)	13,988	18,385	101,731
National Board of Trade, Indore (NBOT)	58,463	53,683	57,149
Others	67,823	54,735	14,591
All Exchanges	**571,759**	**2,155,122**	**2,739,340**

*** Till December 31, 2006**
Source: Forward Markets Commission.

Table 4.16: Number of contracts traded in national exchanges

(in lakh)

Exchange/ Year	2004-05	2005-06	2006-07*
MCX, Mumbai	33.38	152.45	255.26
NCDEX, Mumbai	109.95	274.17	236.55
NMCEX, Ahmedabad	9.56	9.95	28.51

*** Till December 31, 2006**
Source: Forward Markets Commission

4.27 The daily average volume of trade in the commodity exchanges in December 2006 was Rs. 12,000 crore. In the fortnight ending on December 31, 2006, gold, silver and copper recorded the highest volumes of trade in MCX, while in NMCEX, pepper, rubber and raw jute, and in NCDEX, guar seed, chana and soy oil had the highest volumes of trade. MCX emerged as the largest commodity futures exchange during 2006-07 both in terms of turnover and number of contracts. The growth of MCX during 2006-07 is comparable with some of the international commodity futures exchanges like Goldman Sachs Commodity Index (GSCI), Dow Jones AIG Commodity Index Cash Index (DJAIG) and Reuters/Jefferies Commodity Research Bureau (RJCRB) (Figure 4.2).

Box 4.5 : What commodity futures markets do?

A well-developed and effective commodity futures market, unlike physical market, facilitates offsetting the transactions without impacting on physical goods until the expiry of a contract. Futures market attracts hedgers who minimise their risks, and encourages competition from other traders who possess market information and price judgment. While hedgers have long-term perspective of the market, the traders, or arbitragers as they are often called, hold an immediate view of the market. A large number of different market players participate in buying and selling activities in the market based on diverse domestic and global information, such as price, demand and supply, climatic conditions and other market related information. All these factors put together result in efficient *price discovery* as a result of large number of buyers and sellers transacting in the futures market.

Futures market, as observed from the cross-country experience of active commodity futures markets, helps in efficient price discovery of the respective commodities and does not impair the long-run equilibrium price of commodities. At times, however, price behaviour of a commodity in the futures market might show some aberrations reacting to the element of speculation and 'bandwagon effect' inherent in any market, but it quickly reverts to long-run equilibrium price, as information flows in, reflecting fundamentals of the respective commodity. In futures market, speculators play a role in providing liquidity to the markets and may sometimes benefit from price movements, but do not have a systematic causal influence on prices.

An effective architecture for regulation of trading and for ensuring transparency as well as timely flow of information to the market participants would enhance the utility of commodity exchanges in efficient price discovery and minimise price shocks triggered by unanticipated supply demand mismatches.

References:

1.Ghosh, S. et.al, 1987, "Stabilising Speculative Commodity Markets", New York, Oxford University Press
2. International Monetary Fund, "World Economic Outlook", September 2006

Fig. 4.2

MCX COMDEX vs Other Global Indices
(Base unit, days & major unit, months on X-axis)