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COMMODITY MARKET-CURRENT SCENARIO

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ABSTRACT

The history of organized commodity derivatives in India goes back to the nineteenth century when Cotton Trade Association started futures trading in 1875, about a decade after they started in Chicago. Over the time datives market developed in several commodities in India. Following Cotton, derivatives trading started in oilseed in Bombay (1900), raw jute and jute goods in Calcutta (1912), Wheat in Hapur (1913) and Bullion in Bombay (1920). However many feared that derivatives fuelled unnecessary speculation and were detrimental to the healthy functioning of the market for the underlying commodities, resulting in to banning of commodity options trading and cash settlement of commodities futures after independence in 1952. The parliament passed the Forward Contracts (Regulation) Act, 1952, which regulated contracts in Commodities all over the India. The act prohibited options trading in Goods along with cash settlement of forward trades, rendering a crushing blow to the commodity derivatives market. Under the act only those associations/exchanges, which are granted reorganization from the Government, are allowed to organize forward trading in regulated commodities. The act envisages three tire regulations: (i) Exchange which organizes forward trading in commodities can regulate trading on day-to-day basis; (ii) Forward Markets Commission provides regulatory oversight under the powers delegated to it by the central Government. (iii) The Central Government- Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution- is the ultimate regulatory authority.

KEYWORDS :

CURRENT SCENARIO IN INDIAN COMMODITY MARKET-INTRODUCTION

Need of Commodity Derivatives for India:-

India is among top 5 producers of most of the Commodities, in addition to being a major consumer of bullion and energy products. Agriculture contributes about 22% GDP of Indian economy. It employees around 57% of the labor force on total of 163 million hectors of land Agriculture sector is an important factor in achieving a GDP growth of 8-10%. All this indicates that India can be promoted as a major centre for trading of commodity derivatives.

Trends in volume contribution on the three National Exchanges:-

Pattern on Multi Commodity Exchange (MCX):-

MCX is currently largest commodity exchange in the country in terms of trade volumes, further it has even become the third largest in bullion and second largest in silver future trading in the world.

Coming to trade pattern, though there are about 100 commodities traded on MCX, only 3 or 4 commodities contribute for more than 80 percent of total trade volume. As per recent data the largely traded commodities are Gold, Silver, Energy and base Metals. Incidentally the futures' trends of these commodities are mainly driven by international futures prices rather than the changes in domestic demand-supply and hence, the price signals largely reflect international scenario.

Among Agricultural commodities major volume contributors include Gur, Urad, Mentha Oil etc. Whose market sizes are considerably small making then vulnerable to manipulations.

Pattern on National Commodity & Derivatives Exchange (NCDEX):-

NCDEX is the second largest commodity exchange in the country after MCX. However the major volume contributors on NCDEX are agricultural commodities. But, most of them have common inherent problem of small market size, which is making them vulnerable to market manipulations and over speculation. About 60 percent trade on NCDEX comes from guar seed, chana and Urad (narrow commodities as specified by FMC).

Pattern on National Multi Commodity Exchange (NMCE):-

NMCE is third national level futures exchange that has been largely trading in Agricultural Commodities. Trade on NMCE had considerable proportion of commodities with big market size as jute rubber etc. But, in subsequent period, the pattern has changed and slowly moved towards commodities with small market size or narrow commodities.

Analysis of volume contributions on three major national commodity exchanges reveled the following pattern,

Major volume contributors: -

Majority of trade has been concentrated in few commodities that are

- Non Agricultural Commodities (bullion, metals and energy)
- Agricultural commodities with small market size (or narrow commodities) like guar, Urad, Mentha etc.

Trade strategy:-

It appears that speculators or operators choose commodities or contracts where the market could be influenced and extreme speculations possible.

In view of extreme volatilities, the FMC directs the exchanges to impose restrictions on positions and raise margins on those commodities. Consequently, the operators/speculators chose another commodity and start operating in a similar pattern. When FMC brings restrictions on those commodities, the operators once again move to the other commodities. Likewise, the speculators are moving from one commodity to other (from methane to Urad to guar etc) where the market could be influenced either individually or with a group.

Beneficiaries: -

So far the beneficiaries from the current nature of trading are

Exchangers: - making profit from mounting volumes

Arbitragers

Operators

In order to understand the extent of progress the trading the trading in Commodity Derivatives has made towards its specified objectives (price discovery and price risk management), the current trends are juxtaposed against the specification

Specified and actual pattern of futures trade:-

Thus it is evident that the realization of specified objectives is still a distinct destination. It is further, evident from the nature of the commodities largely traded on national exchanges that the factors driving

the current pattern of futures trade are purely speculative.

Reasons for prevailing trade pattern:-

No wide spread participation of all stake holders of commodity markets. The actual benefits may be realized only when all the stake holders in commodity market including producers, traders, consumers etc trade actively in all major commodities like rice, wheat, cotton etc.

Some Suggestions to make futures market as a level playing field for all stake holders:-

- Creation of awareness among farmers and other rural participants to use the futures trading platform for risk mitigation.
- Contract specifications should have wider coverage, so that a large number of varieties produced across the country could be included.
- Development of warehousing and facilities to use the warehouse receipt as a financial instrument to encourage participation farmers.
- Development of physical market through uniform grading and standardization and more transparent price mechanisms.
- Delivery system of exchanges is not good enough to attract investors. E.g.- In many commodities NCDEX forces the delivery on people with long position and when they tend to give back the delivery in next month contract the exchange simply refuses to accept the delivery on pretext of quality difference and also auctions the product. The traders have to take a delivery or book losses at settlement as there are huge differences between two contracts and also sometimes few contracts are not available for trading for no reason at all.
- Contract sizes should have an adequate range so that smaller traders can participate and can avoid control of trading by few big parties.
- Setting of state level or district level commodities trading helpdesk run by independent organization such as reputed NGO for educating farmers.
- Warehousing and logistics management structure also needs to be created at state or area level whenever commodity production is above a certain share of national level.

Global and Indian Scenario: -

The world wheat production in the recent years has been observed to be hovering between 555 million tons to 625 million tons a year. The biggest cultivators of wheat are EU 25, China, India, USA, Russia, Australia, Canada, Pakistan, Turkey and Argentina. EU 25, China, India and US are the four largest producers account for around 60% of total global production.

World's wheat consumption is continuously growing with growth in a population, as it is one of the major staple foods across the world. The major consuming countries of wheat are EU, China, India, Russia, USA and Pakistan. India has largest area in the world under wheat. However, in terms of production, India is second largest behind China. In India, Wheat is sown during October to December and harvested during March to May. The wheat marketing season in India is assumed to begin from April every year.

There are around 1000 large flourmills in India, with a milling capacity of around 15 million tons. The total procurement of wheat by Government agencies during last 15 years from 8 to 20 million tons, accounting for only 15-20% of the total production. India exported around 5 m illion tons subsidized by Government in 2004-05, as a result of surplus stock. Recently Govt. took decision to import wheat in view of, declining stocks and increasing demand.

Key market moving Factors: -

Price tends to be lower as harvesting progresses and produce starts coming in to the market. At the time sowing and before harvesting price tend to rise in a view of tight supply situation. Weather has profound influence on wheat production. Temperature plays crucial role towards maturity of wheat and productivity.

Change in Minimum Support Price (MSP) by Govt. and the stock available with Food corporation of India and the release from official stock influence of the price. Though, international trade is limited, the ups and downs in the production and consumption at all the major/minor producing and consuming nation dose influence the long term price trend.

Contract specifications of Wheat	
Contract Period	Five Months
Trading Period	Mondays through Saturdays
Trading session	Monday to Friday: 10.00 am to 5.00 pm Saturday: 10.00 am to 2.00 pm
Trading	
Trading unit	10 MT
Quotation based value	1 Quintal
Maximum order size	500 MT
Tick size (minimum Price movement)	10 Paise
Price Quotation	Ex-warehouse Delhi (including all taxes, levies and sales tax/ VAT, as the case may be)
Daily price limits	4%
Initial margin	5%
Special margin	In case of additional volatility, a special margin at such other percentage, as deemed fit will be imposed immediately on, both buy and sale side in respect of all outstanding position, which will remain in force of next 2 days, after which the special margin will be relaxed.
Maximum Allowable Open Position	Clientwise- 20000 MT, Member wise- 80000 MT or 20% of open position, which ever is higher.
Delivery	
Delivery unit	10 MT with tolerance limit of 5%
Delivery Margin	25%
Delivery Center(s)	Warehouses at Delhi
Quality Specifications	
Wheat of Standard Mill variety confirming to the following quality standerds will be delieverable. The material will be tested using a 3mm sieve.	

Defects	
(a) Foreign Matter (organic/inorganic)	2.0% (Max)
(b) Damaged Kernels	2.00 (Max) provided that infestation damaged not to exceed 1 per 100 kernels.
(c) Shrunken Shriveled & broken grains	3.00% (Max)
Total defects (a+b+c) Acceptable up to Rejected total defect is	Below 6% 8% With rebate on 1:1 basis Above 8%
Teat weight up to 76 kg/hl	76kg/hl. Min. acceptable with rebate of 150 grams per kg/hl or pro-rata variance in hector liter weight deducted per quintal Below 74 kg/hl
Rejected	Below 74 kg/hl
Moisture Acceptable Reject able	11% (Max)13% With rebate 1:1 Above 13%

Quality Specifications: -

Wheat of Standard Mill variety conforming to the following quality standards will be deliverable; The material will be tested by using 3 mm sieve.

Defects: - 1. Foreign Matter (organic/ inorganic) 2. Damaged Kernel 3. Sunken, Shriveled and Broken grains Total Defects (a+b+c) Acceptable Rejected if total defects	 2.0% (maximum) 2.0% (maximum) provided that infestation damaged not exceed 1 Per 100 kernels. 3.00% (maximum) Below 6% Up to 8% with rebate on 1:1 basis Above 8%
Total Weight Up to 74 kg/hl Below 74 kg/hl	76 kg/hl. (minimum) Acceptable with rebate of 150 grams per kg/hl or pro-rata variance in hector liter weight deducted per quintal weight delivered. Rejected
Moisture Acceptable Reject able	11% (maximum) Up to 13% with rebate 1:1 Above 135
Packing	Packing should be in B Twill once used 100kg jute bags, the tare weight deduction per bag for net weight calculation shall be 1 kg per quintal of gross weight.

CONCLUSION:

As majority of Indian investors are not aware of organized commodity market; their perception about is of risky to very risky investment. Many of them have wrong impression about commodity market in their minds. It makes them specious towards commodity market. Concerned authorities have to take initiative to make commodity trading process easy and simple. Along with Government efforts NGO's should come forward to educate the people about commodity markets and to encourage them to invest in to it. There is no doubt that in near future commodity market will become Hot spot for Indian farmers rather than spot market. And producers, traders as well as consumers will be benefited from it. But for this to happen one has to take initiative to standardize and popularize the Commodity Market.

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