A Study of Long Run Relationship Between Spot and Futures Values of Metal Index

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Abstract

This paper investigates the long-term relationship between spot and futures values of metal index. Metal futures index and corresponding underlying spot index of Multi-Commodity Exchange (MCX), Mumbai, have been used to undertake the econometric study. The cost of carry model provides the relationship between the futures price and spot price. The magnitude to which the contracts returns of a product is in excess of the cash returns of the same commodity is provided by cost of carry. This manuscript has employed the 632 observation of day-to-day data points for the period January 2009 to June 2011. Econometric model of DF, ADF, Phillips Perron Test and Engle-Granger co-integration test have been used in the analysis. The cash and contracts data sequences are non-stationary, which implies that the markets are efficient. The results suggest that there is the presence of long-term cointegrating association between cash and contracts metal data sequences.

1. Introduction

Since 1875 commodity futures trading have its existence in India. Due to Government curbs, the commodity futures have been in hibernation for the past 125 years. After liberalisation of the economy in 1991, the need for future market was felt by Indian policy makers. Therefore, in 2003-04 the Government of India took some significant decisions related to commodity futures. A notification was circulated by Government of India on 01 April 2003, allowing futures trading in large number of commodities. Further, In May 2003, Government of India also repealed prohibition on non-transferable specific delivery forward contracts. Given that the Government of India is giving due importance to the futures markets, this study attempts to examine