Efficiency of Indian Commodity Futures Market: An Empirical Examination

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Abstract

The present paper examines the efficiency of Commodity futures market in India. The futures price and spot price are related by cost of carry relationship. If there is deviation from cost of carry relationship, arbitrage and reverse arbitrage will bring equilibrium between spot and futures prices. We have taken the commodity futures index and commodity spot index in our study, and have employed Dickey Fuller Test and ADF, KPSS test to evaluate for non-stationarity in the data. We also employed the multiple hypothesis test to examine the strong form of efficiency. Our sample period is from January 2009 to June 2011. The study finds that the spot and futures prices are integration of order one. This implies that the commodity futures market is weakly efficient.

1. Introduction

Futures commodity trading started in India in 2003. Over the period of eight years, Indian commodity futures grew at a very high rate. Despite such a high growth, the role of future markets has been met with much scepticism and a lot of questions are being raised regarding the possible gains and negative effects of the commodity futures on its underlying assets in India. Not much study has been done in the field of Indian commodity future market. This study is an attempt to examine whether the futures market is efficient or not.

For proper working of the futures markets, efficient market institutions were needed. Therefore, the Government of India established numerous institutions. On the suggestions of the forward market commission, Government of India established National exchanges such as Multi Commodity Exchange, Ahmedabad; Multi Commodity Exchange, Mumbai (MCX); National Commodity and Derivative Exchange, Mumbai (NCDEX). By November 2003, trading has begun at MCX and by December 2003, trading also got under way at NCDEX.