

Destination *Viksit Bharat*: India’s Commodity Derivatives Market as a Vehicle to Reach There



Debojyoti Dey
Vice President and
Head-Research
Multi Commodity Exchange
of India Ltd.

The development paradigm contextualising the growth of the Indian economy in recent times has been underpinned on market-based institutions and rules-based market mechanisms for achieving the coveted objectives of equitable and participative growth. Perhaps very few market institutions qualify as an enabler of inclusive development, especially in a fast-growing emerging economy as ours, as that of the commodity derivatives market and the many sub-stratum of institutions that serve this market. As evidenced in several countries before and after being witnessed in India, the institution of commodity derivatives market has been an effective catalyst in bringing about a host of socio-economic changes at the grassroots level, thanks to the very nature of its operations. On one hand, it provides a transparent and well-established (and therefore, well-trusted) mechanism for price discovery of commodities, from where millions of producers, consumers and everyone in between them in the value chain, are able to take reference prices; on the other hand, the market institution also enables those exposed to the risks arising from volatility and uncertainty in commodity prices, to manage such risks.

The twin benefits of commodity derivatives – yielding more

The twin benefits of price discovery and risk management are associated with the unlocking of a host of other benefits brought in by the commodity derivatives market; not least of which is the impetus it provides to infrastructure creation, quality consciousness and market integration. The very operation of institutions like commodity exchanges necessitates creation of supporting institutions offering services such as warehousing, logistics, assaying, sorting & grading, financing, etc., in the process creating an entire ecosystem of supporting infrastructure. Over the years, this ecosystem has, in turn, led to the emergence of an efficient marketing channel that on one hand made the exchange-traded market an institution for ‘delivery of the last resort’, and on the other hand, supported the emergence of benchmarks for physical markets to take price cues from. The adage of ‘delivery of last resort’ was evident in the unprecedented disruptions witnessed in physical markets during the Covid pandemic, when only commodity exchanges stood ready to take/ give deliveries on their platforms, as long as they met the Exchange-defined specifications, thus fully honouring the commodity and payment obligations of all counterparties. The mechanism for price discovery, reflecting the dynamics of local market demand and supply, is strengthened when the derivatives market is anchored to the local physical markets through delivery of the commodity. For instance, the conversion of MCX’s base metals derivatives contracts to delivery-based contracts in 2019 has not only enabled discovery of ‘Indian’ metal prices on the Exchange, but also created a trusted marketing channel of base metals. Likewise, MCX Gold and Silver prices have emerged today as the benchmark for bullion transactions across the country. The trust of this marketing channel’s users is evidenced in the high volumes of delivery, as may be seen from Table 1, highlighting the efficiency of this marketing channel and faith of all stakeholders on it.

Table 1: Delivery of select commodities on MCX	
Commodity	Delivery since inception, till June 2024
Gold	142 tonnes
Silver	5230 tonnes
Base Metals	4,07,388 tonnes
Cotton	42,477 bales
Mentha Oil	46,509 tonnes

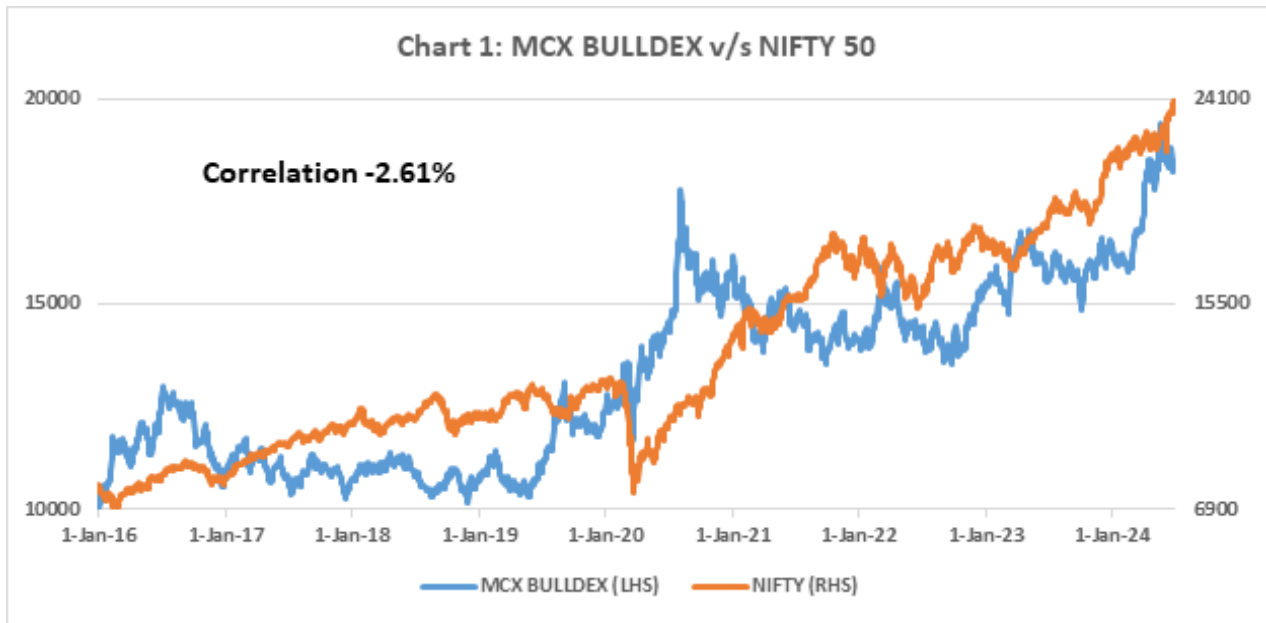
Note: Figures include all variants of the commodity

To further entrench the derivatives market in the economics of physical commodity markets, commodity exchanges have been facilitating delivery of widely-used commodities across multiple delivery centres across the country. Moreover, even in commodities (such as gold and lead) for which Indians frequently consider international standards as the benchmark for quality, Indian exchanges have been creating and popularising domestic standards and empanelling Indian brands for good delivery after facilitating necessary warehouse and quality assessment infrastructure to instil trust in the markets for these commodities. The result has been the slow but sure emergence of India’s own quality

standards, as an alternative to the international standards, acceptable to the entire ecosystem of these commodities. This emergence of India’s own quality standards for commodities - leading to associated benefits such as enhanced quality consciousness among producers, incentivisation for production of better quality of the commodity, greater recognition of Indian brands, possibility of producers moving up the value chain and expansion of their markets in India and abroad - are all in alignment to the broader national goal of achieving an *Atmanirbhar Bharat*, i.e. a self-reliant India.

An alternative asset class, as well

Another mechanism in which India’s commodity derivatives market is helping unlock value is by providing an alternative investible asset class. Commodity investment offers the benefits of diversification, high risk-adjusted returns, a shield against inflation, etc. The diversification benefit is displayed in the low correlation between MCX BULDEX, an index consisting of gold and silver futures, and NIFTY50 as seen in Chart 1:



To the extent that exchange-traded commodity futures and options offer a safe and regulated (and often, the only) mechanism for investment in commodities, the availability of this alternative asset class to the investor community is closely linked to the growth of this market.

Commodity derivatives as agent of economic transformation

The above evidences point towards the huge transformational potential held by the institutions of India’s commodity derivatives market, making these institutions essential cogs in the wheel of the nation’s journey towards attaining ‘developed country’ status – a dream of every Indian. Economic history of India and several countries point towards the significant role played by commodity derivatives markets in catalysing sustained economic growth in those countries. Take the U.S., for instance. The rise of Chicago as an economic powerhouse, rivalling financial centres like New York, was closely associated with the role played by the Chicago Board of Trade (CBOT) in providing price discovery and risk management services to the commodity producers and traders of U.S. Midwest, financialising their commodity trades and linking large swathes of the region’s commodity markets to the U.S. financial markets. The rise of London as the global price setter of commodities like gold (*a’ la* LBMA) and industrial metals (*a’ la* LME), despite U.K. not being a major producer or consumer in most of these commodities, point to the role of a vibrant commodity derivatives market in creating a hub for commodities.

Among developing and emerging markets, the influence wielded by China in global commodity dynamics is partly on account of the sheer size and growth of its commodity derivatives market (China’s commodity derivatives exchanges are the world’s largest), which the country is leveraging as a strategic tool to assert its dominance in East Asia and beyond. The Ethiopian Exchange, started in 2008, has been instrumental in tackling the country’s chronic resource curse, making it one of the faster growing countries in Africa.

Given India’s long history in commodity trade and the commodity intensity of India’s economic growth, it is only imperative that the commodity market institutions can and should be weighed on for achieving the national goal of *Viksit Bharat* by 2047, coinciding with the country’s centenary anniversary of independence. India’s commodity market institutions have already shown the potential for creating positive socio-economic changes, as noted above. A number of these changes have been studied and documented by independent research studies too.

An agenda towards *Viksit Bharat*

To enable India’s commodity market institutions become the pillars of *Viksit Bharat*, they need to be carefully nurtured.

For instance, participation in the commodity derivatives market should be broad-based, with minimal restrictions in participation by any group. Today, banks, arguably the most important class of financial institutions in India, are not allowed to participate in this market, as aren't insurance companies or pension funds. Other financial institutions which are allowed, including Foreign Portfolio Investors, Mutual Funds and Alternate Investment Funds, operate under considerably restrictive regulatory frameworks. To the extent these institutions are known to participate with research-based entry and exit strategies, and also are a useful conduit for channelizing the investible surplus of retail investors, these restrictions need to be removed for India's commodity derivatives market to attain its true potential and reach.

A second way that India's commodity derivatives market can both be a contributor as well as a hallmark of *Viksit Bharat* would be when the arms of the state start to use and mandate the use of exchange-discovered prices as references for market transactions. Thus, tenders floated by public sector bodies can use Indian exchange-discovered metals prices for referencing, rather than prices of LME; and financial instruments ranging from Sovereign Gold Bonds to ETFs can use the Indian exchange-discovered prices of gold, discovered in a well-regulated environment and transparent manner, for referencing during redemption or otherwise. This will further encourage market participants to refer to Indian prices in their physical market transactions, lowering dependence on offshore prices.

There are several other mechanisms to make Indian commodity derivatives market an enabler for *Viksit Bharat*, of which the above are just two. But just as favourable policy actions can lay the path towards this goal, avoidance of some policy actions can equally enable this market to play a bigger role in nation-building. In particular, eschewing arbitrary suspension and bans on commodity derivatives contracts can go a long way in building trust of stakeholders on the sustenance of the contracts, their usefulness and thereby in the market institutions themselves. The Economic Survey 2023-24, presented in the parliament on 22 July 2024, notes "The commodity futures market can effectively contribute to price discovery only when many consumers, producers, traders, and aggregators use these markets to hedge their risk. The interplay of these participants, speculators, and arbitrageurs provides liquidity and helps price discovery for longer periods.Once the regulators provide clear direction regarding the choice of commodities, they must stay the course by adopting a stable policy with minimal interventions....." (Ref. Chapter 9, Economic Survey 2023-24)

Destination *Viksit Bharat*

The NITI Aayog, in an Approach Paper, envisions '*Viksit Bharat*' as a "Bharat which will have all the attributes of a developed country with a per capita income that is comparable to the high-income countries of the world today. It is a Bharat whose social, cultural, technological, and institutional features will mark it out as a developed nation with a rich heritage and one that is capable of functioning at the frontiers of knowledge."

The history of some of the developed countries and rapidly-growing emerging nations, as noted earlier, teach us that a socio-economic leap forward to a level that characterises the above description of *Viksit Bharat*, is almost always associated with strengthening and leveraging of institutions that eventually herald such transformations. India is no different. Taking a leaf out of the experience already witnessed in the Indian commodity ecosystem, it is only apposite that the institutions of this market are treated as vehicles for socio-economic transformation, rather than mere commercial entities, and actions are taken for making them vibrant and participative, in order to enable them play their rightful role in achieving *Viksit Bharat*.