CAB Training Cards

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Eight Things About Agriculture Commodity Futures You May Want to Know

1. Commodity is a product having commercial value, which can be produced, bought, sold and consumed. A commodity exchange is a formal place, whether physical or virtual, where trading of commodities and its derivative products happens.

2. Broadly, the commodities market exists in two distinct forms—the Over-The-Counter (OTC) market and the Exchange based derivatives market. Spot markets are essentially OTC markets and participation is restricted to those who are involved with that commodity.

3. Commodity trading in various commodities like agricultural products, metals and energy products has existed from the start of human civilization. With times, it has progressed from barter system to spot market to futures market.

4. Bombay Cotton Trade Association, India's first commodity exchange, was established in 1875. Presently, there are six national level electronic multi-commodity exchanges, viz., NMCE, MCX, NCDEX, ICEX, ACE and UCX, besides 16 smaller commodity exchanges.

5. Commodity Futures contract is a standardized agreement between two parties to buy or sell a commodity of a specified quantity and quality for a price agreed upon on a particular day with settlement occurring at a specified time in future.

6. The players in the Agricultural Commodity Futures markets are Hedgers, Farmers and Hedgers, Farmers and Producers, Intermediaries, Importers, Exporters or Speculators and Arbitrageurs.

Building Capacity for Inclusive Finance

7. The major agricultural commodities traded at the exchanges are soya oil, mentha oil, guar seed, guar gum, gram, rubber, potato, chillies, cumin seed, cardamom, pepper, turmeric, wheat, maize, cotton, etc.

8. The primary objective of exchange-traded agriculture commodity futures is establishment of efficient and transparent agricultural markets through:

a. **Price Discovery:** Regular trading which happens at futures exchanges based on various inputs like market information, demand and supply, weather forecasts, expert opinions, inflation rates, government policies, market dynamics, etc. translates into continuous price discovery mechanism, leading to assessment of fair value of a particular commodity;

b. **Risk Mitigation:** Hedging is the most common method of price risk management wherein, for the price risk inherent in spot market, an equal but opposite position is taken in the futures market. Hedging through futures protects various agri-value chain players from adverse price change;

c. **Benefits for farmers:** Trading in futures can provide reliable price signals to farmers about the likely prices of their crops in the months ahead and potentially lower the volatility along with increased market stability;

d. **Credit accessibility:** Lending to commodity traders is risky because of price volatility and banks, therefore, charge higher interest rate along with stringent terms and conditions. Hedging, through futures markets, can cut down the interest rate in commodity lending and improve product quality. The warehouses with grading facilities for facilitating delivery provide a reason to upgrade and enhance the quality of the commodity.

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