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Popular Article**A brief Overview of Commodity Trading in India****Jitendra Ojha and Sumit Kumar Shukla**

*Chhatrapati Sahu Ji Maharaj University, Kanpur, UP
Mahatma Gandhi Chitrakoot Gramodaya Vishwavidyalaya, Chitrakoot, Satna, MP*

**Corresponding author: ojhajitendra2014@gmail.com*

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Abstract

Commodity trading is referred as the buying and selling of raw materials or primary agricultural products in organized markets. It also includes trading of wide range of commodities, including energy resources, metals, agricultural products, and more, traded on organized exchanges worldwide. The commodities can be classified in Hard Commodity and Soft Commodity. Tangible goods that are typically mined or extracted from the earth such as metals, gold, silver, copper and energy resources such as crude oil, natural gas often are considered as Hard Commodities while agricultural products or natural resources that are grown rather than mined, including crops (e.g., wheat, corn, soybeans) and livestock (e.g., cattle, pork) considered as Soft Commodities. It's a complex and dynamic market which offers several advantages to various market participants, including traders, investors, producers, and consumers. Multi Commodity Exchange of India Limited (MCX), National Commodity & Derivatives Exchange Limited (NCDEX), National Multi Commodity Exchange of India Limited (NMCE), BSE Commodity Derivatives Limited are some common commodity trading platforms in India dealing with various agricultural products, including grains, pulses, oilseeds, spices, and more. Chicago Mercantile Exchange (CME Group), Intercontinental Exchange (ICE), New York Mercantile Exchange (NYMEX) etc. are some common commodity trading platform in worldwide.

Keywords: Commodity, Trading, Trading platforms, Stock Exchange

Introduction

Commodity trading has a long history that can be traced back to ancient civilizations. Egyptians traded commodities such as grain and precious metals. The Silk Road, a network of trade routes that connected Asia with the Middle East, Europe, and Africa, played important role in the exchange of commodities in ancient times. It facilitated the trade of silk, spices, precious metals, and other valuable goods. During the middle ages, European commodity markets established. Trading centres in Belgium became hubs for the exchange of goods, including wool, textiles, and spices. The Hanseatic League, a confederation of merchant guilds in northern Europe, also played a crucial role in medieval commodity trade. The Age of Exploration and European colonization of the Americas, Africa, and Asia led to the exchange of various commodities between continents. This era saw the introduction of commodities like coffee, sugar, tobacco, and cotton to European markets.

The concept of commodity futures contracts emerged in the 17th century in Japan with the trading of rice futures in the Dojima Rice Exchange. In the 18th century, the Amsterdam Stock Exchange introduced futures contracts for various commodities. These contracts allowed traders to hedge against price fluctuations and speculate on future prices. Chicago Board of Trade (CBOT) founded in 1848, which is often considered as the birthplace of modern commodity futures trading in the United States. It initially focused on trading of agricultural commodities. The CBOT laid the foundation for organized and regulated commodity markets in the United States. In 19th century the establishment of the gold standard in various countries, linking the value of their currencies to a specific quantity of gold. This had a profound impact on the trading of gold and other precious metals as commodities. The 20th century witnessed significant developments in commodity trading, including the growth of futures markets for energy products, metals, and soft commodities. With the advent of modern transportation and communication, commodity trading became increasingly globalized. Commodities from around the world, such as oil, copper, and soybeans, could be traded on international exchanges.

Commodity Trading

Commodity trading can be defined as the buying and selling of raw materials or primary agricultural products, often referred to as commodities, in organized markets. These commodities can include things like oil, gold, grains, coffee, cotton, and many others. Commodity trading is a vital component of the global economy, with a wide range of commodities, including energy resources, metals, agricultural products, and more, traded on organized exchanges worldwide. These markets continue to evolve, driven by technological advancements, changes in global supply and demand, and regulatory developments.

Types of Commodities: Commodities can be broadly categorized into two groups:

Hard Commodities: Tangible goods that are typically mined or extracted from the earth, such as metals (e.g., gold, silver, copper) and energy resources (e.g., crude oil, natural gas).

Soft Commodities: These are agricultural products or natural resources that are grown rather than mined, including crops and livestock.

Key aspects of commodity trading:

Commodity Exchanges: Commodity trading often takes place on specialized commodity exchanges. These exchanges provide a platform for buyers and sellers to trade standardized contracts for various commodities.

Futures and Options: The most common instruments for commodity trading are futures contracts and options. A futures contract is an agreement to buy or sell a specific quantity of a commodity at a predetermined price on a future date. Options provide the holder with the right, but not the obligation, to buy or sell a commodity at a specified price.

Hedging and Speculation: Hedging is a strategy or action taken to reduce or mitigate risk, uncertainty, or potential losses in a particular context. It involves creating a protective or compensatory measure to offset the negative impacts of an adverse event or situation.

Speculation is a financial or investment activity where individuals or entities make educated guesses or bets on the future price movements of assets, such as stocks, bonds, commodities, currencies, or real estate, with the aim of earning a profit.

Global Impact: Commodity prices can have a significant impact on various sectors of the economy, including agriculture, energy, and manufacturing. Changes in commodity prices can affect the cost of production, inflation rates, and the profitability of companies involved in these industries.

Commodity Trading Advisors (CTAs): CTAs are investment professionals or firms that manage commodity trading on behalf of clients, often within managed futures funds. They use various trading strategies to try to generate returns from commodity price movements.

Regulation: Commodity markets are typically subject to government regulations to ensure fair trading practices and prevent market manipulation. Regulatory bodies may vary from country to country.

Risks: Commodity trading can be highly volatile and carries various risks, including price fluctuations, geopolitical events, supply and demand imbalances, and weather-related factors (for agricultural commodities). Traders and investors in this market need to be aware of and manage these risks effectively.

Advantage of commodity trading:

Commodity trading plays a critical role in the global economy by providing a means for producers to sell their products and for consumers and businesses to secure the resources they need.

- It's a complex and dynamic market that requires a good understanding of the specific commodities being traded and the factors that influence their prices.
- Commodities provide a diversification opportunity for investors. Unlike traditional asset classes like stocks and bonds, commodities often have a low correlation with these assets.
- Many commodities, especially hard commodities like gold and oil, have historically served as effective hedges against inflation.
- When the value of currency decreases due to inflation, the prices of commodities often rise, preserving purchasing power.
- Commodity markets are known for their volatility, which can present speculative trading opportunities. Traders can profit from price fluctuations by buying low and selling high or selling short when they expect prices to decline.
- For producers and consumers of commodities, futures contracts provide a means of managing price risk.
- Major commodity markets offer high liquidity, making it relatively easy to enter and exit positions without significant price impact.

- Commodity markets are global, which means that traders and investors can gain exposure to various regions and economies. This can be especially valuable for portfolio diversification and taking advantage of international economic trends.
- Commodity markets are often highly regulated, and price information is widely available in real-time.
- Commodities are influenced by fundamental factors such as supply and demand, weather conditions, geopolitical events, and technological advancements. These factors can create trading opportunities for those who can analyze and anticipate them.
- Investing in commodities allows individuals and institutions to gain exposure to essential natural resources, such as energy, metals, and agricultural products, which are critical to global economic growth.

Disadvantage of commodity trading:

- Commodity markets are known for their price volatility. This volatility can lead to significant gains but also substantial losses.
- Commodity trading often involves the use of leverage, which means traders can control a large position with a relatively small amount of capital.
- Commodity markets can be complex, with various factors affecting prices.
- Commodity markets are generally liquid, some less-traded or niche commodities may have lower liquidity. Illiquid markets can make it challenging to enter or exit positions without significantly affecting prices.
- When using leverage, traders are required to maintain a margin account, which means they may receive margin calls if their positions move against them. Failing to meet margin requirements can result in forced liquidation of positions and losses.
- Commodity markets are subject to government regulations, and changes in regulations can impact trading practices and costs. It's essential to stay informed about regulatory developments.
- Many commodities, particularly agricultural products, are affected by seasonal factors. This seasonality can lead to predictable price patterns but can also result in losses if not properly anticipated.
- Some futures contracts in commodity markets require physical delivery of the underlying commodity. Traders who hold positions until expiration may need to manage logistics and storage, which can be costly and inconvenient.
- Commodity prices are sensitive to geopolitical events, such as conflicts, sanctions, and trade disputes. Sudden geopolitical developments can lead to price spikes or disruptions in supply chains.

Major Commodity Trading Platform in India:

Multi Commodity Exchange of India Limited (MCX):

India has a well-developed commodity trading ecosystem, and several commodity exchanges operate in the country. MCX is one of the largest and most prominent commodity futures exchanges in India. MCX was established in 2003 and is headquartered in Mumbai, India. It offers a wide range of commodity futures and options contracts, including metals, energy products and agriculture commodities. MCX operates under the regulatory framework of the Securities and Exchange Board of India (SEBI), which oversees commodity derivatives markets in India. SEBI is responsible for regulating and



Fig 1: Web portal of MCX

ensuring the integrity of the Indian commodity markets

National Commodity & Derivatives Exchange Limited (NCDEX):

NCDEX specializes in agricultural commodity trading. It offers futures and options contracts for various agricultural products, including grains, pulses, oilseeds, spices, and more.

National Multi Commodity Exchange of India Limited (NMCE):

NMCE is commodity exchange in India that deals primarily with agricultural



Fig 2: Web portal of NCDEX

commodities. It offers futures contracts for commodities like castor seed, cotton, and soybean.

Indian Commodity Exchange Limited (ICEX): ICEX primarily focuses on trading in commodities related to the diamond industry, including diamond futures contracts. It is known for its unique offering in the Indian commodity market.

ACE Derivatives & Commodity Exchange Limited (ACE): ACE is a relatively newer commodity exchange in India, offering futures contracts for various agricultural commodities.

Universal Commodity Exchange (UCX): UCX specializes in trading in various agricultural and non-agricultural commodities. It offers futures contracts for commodities like black pepper, cardamom, and rubber, among others.

BSE Commodity Derivatives Limited: BSE offers commodity futures and options contracts for various commodities, including precious metals and agricultural products.

Indian Energy Exchange (IEX): IEX is a specialized power and electricity trading platform in India. It enables participants to trade electricity and power derivatives

International Commodity Trading:

Commodity trading often takes place on specialized commodity exchanges or futures exchanges, where standardized contracts for various commodities are bought and sold. These exchanges provide a platform for market participants to trade commodities in a regulated and transparent manner. Some of the well-known commodity exchanges around the world include:

Chicago Mercantile Exchange (CME Group):

The CME Group is one of the largest and most prominent commodity futures exchanges in the world. It offers a wide range of commodity futures contracts, including those for energy products, agricultural commodities, metals, and more. Notable contracts include WTI crude oil, gold, and corn futures.

Intercontinental Exchange (ICE): ICE operates several commodity exchanges, including ICE Futures US and ICE Futures Europe. It provides futures and options contracts for commodities such as oil, natural gas, coffee, sugar, and cotton, among others.

London Metal Exchange (LME): LME is the world's primary exchange for trading base metals. It offers futures and options contracts for metals like copper, aluminum, nickel, and zinc.

New York Mercantile Exchange (NYMEX): NYMEX, part of the CME Group, focuses on energy and metal contracts. It is known for its oil and natural gas futures contracts.

Shanghai Futures Exchange (SHFE): SHFE is one of China's leading commodity futures exchanges, where contracts for various metals, energy products, and agricultural commodities are traded.

Tokyo Commodity Exchange (TOCOM): TOCOM is Japan's primary commodity futures exchange, focusing on contracts for precious metals, energy products, and agricultural commodities.

Euronext: Euronext operates commodity futures markets in Europe, including futures and options contracts for products like milling wheat, rapeseed, and dairy.

Brazilian Mercantile and Futures Exchange (BM&FBOVESPA): BM&FBOVESPA, now part of B3, is the primary commodities exchange in Brazil, offering contracts for various agricultural products, including soybeans, coffee, and sugar.

Dubai Mercantile Exchange (DME): DME specializes in energy contracts, particularly the Oman Crude Oil Futures Contract, which is a benchmark for crude oil pricing in the Middle East.

Summary:

Commodity futures contracts emerged in the 17th century in Japan with the trading of rice futures in the Dojima Rice Exchange. Commodity trading can be defined as the buying and selling of raw materials or primary agricultural products, often referred to as commodities, in organized markets. India has a well-developed commodity trading ecosystem, and several commodity exchanges operate in the country. MCX is one of the largest and most prominent commodity futures exchanges in India. There are different platform for future trading India which are dealing with various agricultural products, including grains, pulses, oilseeds, spices etc. Over the years, there has been an improvement in the commodity trading. Trading in agricultural commodity serves as a reliable method of price discovery that gives buyers and sellers an indication of future prices.

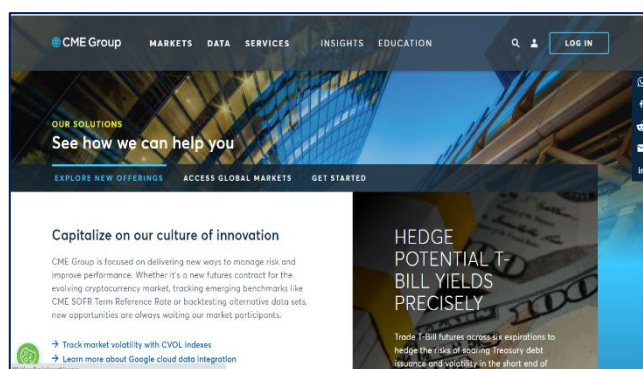


Fig 3: Web portal of CME