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Market efficiency of commodity futures in India

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Abstract

This article aims to examine the market efficiency of the commodity futures market in India, which has been growing phenomenally over the last few years. We estimate the long-run equilibrium relationship between multi-commodity futures and spot prices and then test for weak-form market efficiency by applying both the dynamic ordinary least squares and fully modified ordinary least squares methods. The entire sample period is from 2 January 2006 to 31 March 2011. The results indicate that a cointegrating relationship exists between these indices and that the commodity futures market appears efficient during the more recent sub-sample period since July 2009 onwards.

Keywords:

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Notes

[1] The Indian Commodity Exchange and Ace Derivatives and Commodity Exchange were later recognized as the fourth and fifth national multi-commodity exchanges in India in 2009 and 2010, respectively.

[2] Fama (1970) classified market efficiency into three categories: weak-form efficiency, semi-strong-form efficiency and strong-form efficiency. As proposed by Fama (1970), we consider a market weak-form efficient if its futures prices reflect all the available information for predicting the futures spot prices but the participants are unable to consistently make profits. Unlike weak-form efficiency, semi-strong efficiency indicates that all public information is calculated into the current prices, while strong-form efficiency indicates that all information in a market, whether public or private, is accounted for in prices.

[3] The formal futures market was originated in the Osaka rice market during Japan's Tokugawa Era (see Schaede (1989) and Hamori et al. (2001)).

[4] Easwaran and Ramasundaram (2008) and Vishwanathan and Pillai (2010) examined the Indian commodity futures market by using techniques other than cointegration.

[5] We also divide sub-sample A into two sample periods: from the period 2 January 2006 to 30 June 2008 and from the period 1 July 2008 to 30 June 2009. However, we obtained similar results.

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