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Why SEBI suspended Futures Trading in Agri Products

What is the issue?

SEBI has issued directions to stock exchanges in the commodity derivatives segment for immediately suspending trading in derivative contracts in key farm commodities for a year.

What are derivative contracts?

- Derivative contracts are between two or more parties where the derivative value is based upon an underlying asset, in this case agri commodities.
- The prices of the derivatives are established by the price fluctuations of the underlying assets.
- Derivatives can be traded on an exchange or over the counter (OTC).
- Derivatives trading take place when traders speculate on the future price of an asset through buying or selling of derivative contracts to maximise profit, as compared to buying the underlying asset outright.
- Traders also use derivatives for hedging to minimise risk against an existing position.
- Agri futures and options play a critical role in helping farmers sell the agricultural produce and in hedging against adverse price movement.
- Exchange traded contracts can play a useful role in discovering price in a transparent manner.

What is the SEBI's direction about?

- The Securities and Exchange Board of India (Sebi) has suspended futures and options trading in 7 commodities including paddy (non-basmati), wheat, channa, mustard seeds and their derivatives, soybean and its derivatives, crude palm oil, and moong for one year.
- The finance ministry had directed the SEBI to suspend futures trading in the seven commodities amid concerns about high food prices, which are at the heart of the country's elevated inflation.
- It is believed that speculators have a role in increasing the prices and this need to be discouraged to curb inflation and support growth.
- Following the SEBI directive, the country's leading commodities exchanges MCX and NCDEX told members they have suspended fresh positions on the seven products.

How alarming is inflation?

- As per the RBI governor's recent monetary policy statement, CPI inflation went up in October to 4.5% from 4.3% in September.
- The persistence of high core inflation (i.e., CPI inflation excluding food and fuel) since June 2020 has been an area of policy concern as input cost pressures could rapidly be transmitted to retail inflation.

- RBI has projected CPI inflation at 5.3% for FY22.
- **Interventions to curb the rising inflation**
  - As prices of edible oil hit near record highs, the Union Government substantially reduced taxes on imports of palm, soy and sunflower oil.
  - The Union and State Governments had recently reduced excise duty and VAT on petrol and diesel, which was aimed at bringing down inflation through fuel and transportation costs.

What does the SEBI order mean?

- No new contract will be introduced until further orders.
- In respect of running contracts, no new position will be allowed to be taken and only squaring up of position has been allowed.
- This enables market regulator to take away an effective tool to shield users from price volatility and inflation.
- The imports in such commodities, especially edible oils, would reduce in the short term leading to the release of blocked local produce supplies into the market, which will cool the prices.
- The trading suspensions enforced in the past have deterred large institutional investors from participating in these contracts.
- With the commodities banned by SEBI being among the most traded, volumes and liquidity on exchanges are bound to drop sharply

The share of agri commodities has been declining to just 4.7% of overall commodity derivatives turnover in 2020-21.

The trading is concentrated in a handful of agri commodities, with the top 10 most-traded contracts accounting for around 94% of the volume.

What is the need of the hour?

- The suspension should be withdrawn at the earliest along with a promise from the Centre that they will not be re-imposed in order to create a vibrant derivative market for agricultural commodities.
- If the Centre is worried about speculation, prices can be curbed through other means such as imposing tighter daily limits on sensitive commodities or by increasing trading margins very steeply.
- The regulator should also speed up efforts to increase trading volumes and participation on exchanges through creation of higher awareness among the users and farming community.
- A liquid market has in-built checks that prevent excessive speculation and trading suspensions are dangerous to free markets.

References

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