A Plethora Of Positives For Commodity Markets

P. K. Singhal, Jt MD of MCX claims some changes in the tax structure in India's gold market will be quite beneficial for the stakeholders of this market



The slew of announcements made by the Union Finance Minister while presenting the Annual Budget for 2016-17 bodes well for the commodity market in India. One of the most positive announcements is that new derivative products will be developed by SEBI in the commodity derivatives market. This will pave the way for introduction of products such as options; and trading in indices and intangibles, which have long been in demand in the Indian commodity markets. SEBI has already indicated that subject to their satisfaction of the robustness of the risk management systems in commodity exchanges, they will allow the launch of new derivative products like commodity options.

We are hopeful that initially Options in

Bullion, Base Metals and Energy may be introduced as there is good market depth and healthy participation in these commodities.

Another major decision announced in the Union Budget is the increase in the investment limit for foreign entities in Indian stock exchanges to 15%, as is being allowed for domestic entities currently. With a higher stake in the stock exchanges, foreign investors will be incentivised to not just bring in a higher quantum of capital, but also their world-class technology and superior products, processes and practices as prevalent in the global exchanges. We hope the increase in investment limit, covers not just stock exchanges, but also support institutions such as clearing corporations, depositories, etc.

The Finance Minister had announced the setting up of an International Financial Services Center (IFSC) in India in the budget last year, which he has met with announcement on specific fiscal incentives in the current budget. By exempting trade in commodity derivatives from the Commodity Transaction Tax (CTT), an important impediment which inhibits the growth of the exchange-traded commodity derivatives market, has been removed and we hope that within the next one year, India's first IFSC at GIFT City, Gujarat, becomes operational.

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Secondly, the Finance Minister has also removed an anomaly by increasing concessional CVD on Gold dore bar and concessional excise duty on refined gold bars manufactured from such gold dore or gold ore/concentrate. This would help bring in rationalisation and uniformity in gold pricing in India. With the uniformity in prices, price risk management platforms such as the gold futures market can now attract a larger number of hedgers.

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The policy announcements for agricultural development are noteworthy. The government's intent on creating a common e-market platform in order to implement the Unified Agricultural Marketing Scheme can provide the much-needed transparent and participative platform for agricultural commodities. A robust spot market is a key enabler of the derivatives market, the development towards a common e-market platform will go a long way in evolving not only in the physical market segment of commodities but also in the derivatives market.

The strong emphasis on risk management in agriculture through the announcement of path breaking initiatives like strengthening the Minimum Support Programme through three specific initiatives; and implementation of a crop insurance scheme, i.e. the Prime Minister's Fasal Bima Yojana, underlines the need for price risk management in agriculture. Such price risk management can be further strengthened and made more effective by promoting the commodity derivatives market and propagating its benefits among large sections of India's rural population. Additionally when the intangible products such as weather derivatives are allowed, they will aid the insurance companies to offer weather related insurance products to the millions of farmers at very competitive rates.

While the Union Budget has been progressive and growth-oriented, we had hoped that government would lower the import duty on gold. High import duty is encouraging gold smuggling and further encouraging 'Dabba' trading noted above. The proposal to levy an excise duty on gold jewellery will increase the cost of business, including the compliance cost, for millions of small jewelers.

The commodity derivatives market needs more depth and breadth, which can be made possible if financial institutional investors such as banks and mutual funds are allowed to participate in this market. Since the commodity derivatives market is now under the regulatory oversight of a powerful regulator, SEBI, there is little apprehension about institutional participation in this market. Belying our expectations, no such announcement was made in the Union Budget.

Overall, however, the Budget has the potential to bring in a lot of positive effects in the Indian economy, including the commodity market. With an estimated outlay of more than ₹2.21 lakh crore in the infrastructure sector, this very crucial sector will get the much needed push. As infrastructure is built, there is going to be an enhanced demand for commodities, particularly metals and energy, and an associated need for risk management. This is an opportunity for MCX which it is ready to capture with open arms. Besides, MCX is ready with new derivative products like options, and whenever SEBI approves of the same, the exchange can launch them, serving the needs of hedgers. The National e-market for agricultural commodities will lead to the emergence of a transparent spot market for such commodities, which can be the backbone of an equally robust derivatives market. This opens up a lot of opportunities for MCX to provide many derivative contracts on agricultural commodities.