Press Release

Irrational demand by few value chain participants for suspension of Cotton futures

Mumbai, January 11, 2022: In the recent past, there has been a clamour demanding suspension of derivative contracts on agricultural commodities by a section of value chain participants who do not want transparent pricing and thrive from price opacity. Their arguments are devoid of any merit and do not have any empirical evidence. In the instant case of Cotton contract on MCX, the pressure groups are lobbying for its suspension at the cost of farmers who are major beneficiaries of higher cotton prices after many years.

The commodity exchanges across the world function on the principles of efficient market conduct, which enables every participant to take informed decisions with all publicly available data/information. Such information is assimilated, which could be as frequent as daily updates or weekly/monthly data estimates issued by various state, central government authorities, international newswires, and other sources. An efficient market, where price being a signal, ensures most optimal allocation of scarce resources. At MCX, we are mindful of our responsibilities in ensuring free, transparent and efficient price discovery on the exchange with all its attending risk management measures. In these circumstances, we are surprised to know that certain pressure groups are working for suspension of the Cotton contract on the exchange. We, therefore, thought it appropriate to place before all stakeholders the demand and supply fundamentals of Cotton, various myths and realities, and rationale as to why contracts should not be suspended at this critical juncture of India's growth and development.

A. COTTON FUNDAMENTALS

1. Domestic Supply Concerns

- *Unseasonal rainfall: Adverse impact on the harvest*

Cotton Association of India (CAI) estimated cotton crop for the year 2021-22 beginning from 1st October 2021 at 360.13 lakh bales coupled with lower opening stock of 75 lakh bales of 170 kgs each as on November 30, 2021. However, due to unseasonal rainfall during October – November in major producing areas, market participants are expecting the actual cotton production for 2021-22 to be in the range of 330-335 lakh bales.

Indian Cotton Balance Sheet for the Season 2020-21 and 2021-22 (Estimated as on 30th November 2021)		
(in lakh bales)		
Details	**2021-22**	**2020-21**
Supply		
Opening Stock	75.00	125.00
Crop	360.13	353.00
Imports	10.00	10.00
Total Supply	**445.13**	**488.00**
Demand		
Mill Consumption	292.00	292.00
Consumption by SSI Units	25.00	25.00
Non- Mill Consumption	18.00	18.00
Total Domestic Demand	**335.00**	**335.00**
Available Surplus	110.13	153.00
Exports	48.00	78.00
Closing Stock	62.13	75.00
Source: CAI		

- *Quality concerns*

Besides harvest, the unseasonal rains also raised quality concerns, which is driving up demand for quality cotton. The farmers are also reported to be holding on to good quality cotton in anticipation of better prices for their produce.

- *Lower opening stock*

The supply is also adversely affected due to lower opening stock which fell sharply to 75 lakh bales for 2021-22 against 125 lakh bales for 2020-21 following export demand on account of increasing global consumption.

- *Cotton sowing acreage shrinkage*

As per the Committee on Cotton Production and Consumption (COCPC) in November, Cotton sowing acreage (provisional) for CY2021-22 was down by 7.2% to 120.69 lakh hectares compared to 130.07 lakh hectares the previous year.

- *Lower arrivals in mandis*

Arrivals during Oct-Dec of current crop year was down by 37%. However, prices started cooling off since November 2021, as arrivals in mandis improved.

Year 2020		**Year 2021**			
Month	**Lakh Bales**	**Month**	**Lakh Bales**	**Change**	**Change %**
Dec-20	106.28	Dec-21	47.24*	-59.04	-56
Nov-20	64.41	Nov-21	46.64	-17.77	-28
Oct-20	27.16	Oct-21	31.12	3.96	15
Total	**197.85**	**Total**	**125.00**	**-72.85**	**-37**
Sep-20	6.10	Sep-21	0.94	-5.16	-85
Aug-20	8.50*	Aug-21	3.45	-5.05	-59
Total	**14.60**	**Total**	**4.39**	**-10.21**	**-70**
*Source: Cotton Association of India (CAI), * Trade estimates; 1 bale = 170 kg.*					

2. Global and Domestic Demand Scenario

- *Improved Global demand*

As per United States Department of Agriculture (USDA) estimates, compared to the previous season, the global demand for cotton in current year has increased. USDA's estimates for global Cotton demand and supply for the season 2020-21 and 2021-22 are as mentioned below:

Unit in '000' MT	2020-21	2021-22	% Change	Effect
India's Production	6,009	6,096	1.4	Higher production
India's Consumption	5,443	5,617	3.2	Higher consumption
India's ending Stock	2,926	2,360	-19.3	Lower ending stock
Global Production	24,321	26,468	8.8	Higher production
Global Consumption	26,328	27,057	2.8	Higher consumption
Global Ending Stock	19,286	18,666	-3.2	Lower ending stock
Source: USDA, December 9, 2021 estimates				

- *Higher Polyester yarn prices*

The prices of Polyester yarn, which is a by-product of crude oil and a near substitute to Cotton has gone up in the recent past with increase of crude oil prices. The absence of a cheaper alternative to Cotton supported global cotton prices.

- *Increased Cotton exports*

India's export of textiles, covering cotton yarn/fabrics/made-ups, handloom products, etc. increased by a substantial 40.72 per cent to $1.227 billion in November 2021, compared to $872.55 million in the same month of the previous year, according to the preliminary data on merchandise trade released by the Ministry of Commerce and Industry, Government of India.

B. MYTHS & REALITIES

MYTH 1: Exchange Traded Commodity Derivatives (ETCD) are driven by excessive speculation

Reality: MCX Cotton contract is a compulsory delivery contract ever since inception and market participants depending on their physical market needs either take or give delivery on the Exchange or prefer to look at physical market depending on the prevailing spot prices and logistics and transaction costs. In fact this ensures spot and futures convergence at expiry.

- *Active participation from Hedgers*

A large section of stakeholders in the value chain such as producers, ginners, millers, exporters, etc. actively trade and participate in the price discovery process on the Exchange for their hedging requirements.

Fiscal Year	Open Interest (in Bales)	Category wise OI in Cotton futures	
		% FPOs*/VCPs**/ Hedgers	
		Buy	Sell
FY 2020-21#	1,10,735.46	40.91	53.11
FY 2021-22##	1,51,571.62	40.80	52.00

Note:
Average from daily disclosure for FY20-21 (since Jun ’20)
Average from daily disclosure for FY21-22 (Apr ’21 till Jan 6, 2022)
Based on the classification provided by the Exchange members from time to time pertaining to farmers/FPOs, VCPs/Hedgers for the aforesaid period.
*Farmer Producer Organisations
**Value Chain Participants

- *Efficient Delivery Mechanism*

Over the years, the Exchange has been witnessing significant deliveries, which is a testimony of its efficient delivery mechanism. During the previous crop year, despite COVID-19 lockdown restrictions, the Exchange witnessed significant volumes and deliveries in MCX Cotton futures contracts and provided an efficient trading/ delivery platform for VCPs. The current season (Oct 21-Sep 22) also witnessed robust deliveries on the Exchange in the first three expiries.

MCX Cotton Delivery (in bales) (Oct-Sept Season)	
2016-17	96,200
2017-18	1,86,600
2018-19	3,98,600
2019-20	2,31,975
2020-21	3,13,450
2021-22*	63,225
* till December'21 *Source: MCXCCL*	

MCX Cotton Delivery (in bales)			
	2019-20	**2020-21**	**2021-22**
October	100	2,475	8,425
November	3,900	20,675	23,550
December	14,400	31,325	31,250
Source: MCXCCL			

- *Significant Open Interest*

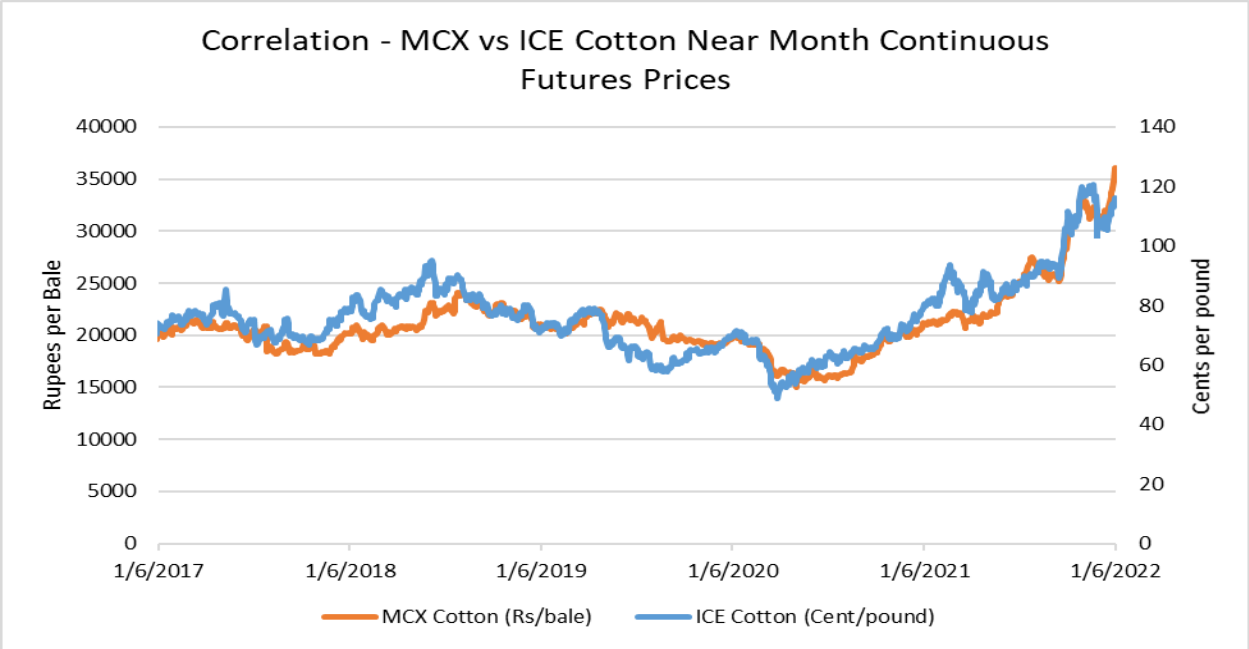
The significant open interest as shown below against volumes on the exchange also exemplify the hedging interest in the Cotton contract.

MCX Cotton Turnover, Volume & Open Interest (Average)			
Month	**ADTV (lots)**	**AOI (lots)**	**ADTV (Rs. Cr)**
Apr' 21	2,245	9,011	121.66
May'21	1,886	8,889	105.38
June'21	1,775	7,656	107.32
Jul-21	1,583	6,769	102.91
Aug'21	985	3,683	64.88
Sept'21	644	2,169	42.77
Oct'21	2,140	4,917	163.54
Nov'21	2,326	5,321	187.38
Dec'21	2,341	6,093	188.33
1 lot = 25 bales; Source: MCX			

MYTH 2: Domestic prices are decoupled from international prices

REALITY: The prices of Cotton not only increased in India, but also they moved in conjunction with global prices, reflecting the international supply and demand fundamentals. The high degree of price correlation of MCX Cotton contracts of around 90% with ICE (US) prices signifies our linkages with global markets as a price taker. This is clearly evident from the prices in domestic market vis-à-vis prices in global market as provided in the table below.

Month/ Year	Average MCX futures prices (29 mm staple length)		Average ICE US (parity) futures prices (27.4 mm staple length	
	Rs per bale	Price Change (%)	Rs. Per bale	Price Change (%)
Dec '17	19,518		18,820	
Dec '18	21,565	10.49	21,036	11.77
Dec '19	19,201	-10.96	18,407	-12.50
Dec '20	20,202	5.21	21,266	15.54
Dec '21	32,015	58.47	31,585	48.52
Source: MCX Research				



MYTH 3: Futures trading is leading to price rise

REALITY: Cotton is a global commodity. It is produced, traded and consumed across several countries of the world. Cotton derivatives viz. futures and options are widely traded in global benchmark commodity exchanges such as ICE (US), Zhengzhou Commodity Exchange, China, etc. India is a leading producer and exporter of Cotton. Despite such a predominant position as a large producer, India holds an insignificant share in the global derivatives market. Although Indian market fundamentals impact global prices, India is actually a price taker in the global market for cotton.

Commodity Exchange	**CY 2019 (in MT)**	**CY 2020 (in MT)**	**CY 2021 (in MT)**
ZCE, China	3,19,856	5,41,692	5,67,113
ICE, US	1,91,906	1,88,794	1,92,816
MCX, India	3,593	1,360	2,066
India's Share	**0.70%**	**0.19%**	**0.27%**
Source: Futures Industry Association & websites			

MYTH 4: Lower Margins in the domestic market.

REALITY: Margins levied in domestic exchanges are typically higher as compared to their global counterparts. Currently, the applicable margin at MCX is ~11.5% (14.5% w.e.f. Jan 12, 2022) as against around 6% at ICE US and 10% at Zhengzhou Commodity Exchange (ZCE).

MYTH 5: The futures contracts serve only few

REALITY: The contracts are reviewed before launch every season and the Product Advisory Committee, comprising of experts from the industry and representatives from all sections of the value chain, meets at least twice or more in a year to discuss various issues relating to the cotton futures contract. Recently, effective from Nov 2021, MCX cotton contract was modified to introduce RD value for colour grade among others. The encouraging response to such modifications is evident from the robust deliveries, as shown above, during this season.

C. WHY SUSPENSION OF COTTON FUTURES IS DETRIMENTAL

- *Farmers, the losers*

After many years, farmers have benefited for the first time due to higher prices, which are being driven by fundamentals. It is significant to note that for more than five years cotton prices remained almost stagnant, which had been adversely affecting farmers. Sadly, continued subdued prices, and therefore depressed incomes and debt burdens, forced many farmers to resort to drastic measures, including committing suicide. In its 2020 report, National Crime Records Bureau (NCRB), Ministry of Home Affairs reported 5,957 and 5,579 no. of farmers' suicide during 2019 and 2020 respectively.

Month, Year	**Average Spot Prices, Rajkot (Rs per Bale)**
Jan '17	19,947.62
Jan '18	19,796.82
Jan '19	20,830.87
Jan '20	19,234.78
Jan '21	20,863.50
Jan '22*	35,132.00
* till Jan 7, '22 *Source: MCXCCL*	

- *Cotton is not an essential commodity*

India is a net exporter of Cotton and the prices are moving in tandem with international prices. Further, Cotton is not in the list of essential commodities and any suspension in the commodity may lead to undesirable economic outcomes.

- *Shooting the messenger; destroys price transparency and favors only few vested interests*

Exchange is only an efficient price discovery platform that provides an opportunity for hedging and disseminates continuous transparent prices for the benefit of market participants. The futures market is like a messenger. Therefore, there is no point in shooting the messenger.

By not allowing markets to function, the objective of such groups is to make transparent prices unavailable to farmers and reap benefits out of the opacity that would result from dysfunctional markets. The unhedged are the ones who are actually getting exposed to higher price risk. The squeezing profit margins of these participants has led them to clamour for suspension.

It is ironical that very purpose of derivative contracts is to protect from price volatility and those very groups who ought to have hedged their risk on the exchange are clamouring for suspension of the Cotton contract, which is a protective financial instrument.

- *Uninterrupted global markets*

India is only a price taker and represent only a small fraction (< 1%) of the global derivatives market. The trading in global markets would continue as usual even if Indian markets are shut. As a result, suspension of Cotton futures in India only deprives domestic participants especially small and medium VCPs and producers from taking part in global price discovery process and makes them totally exposed to price risks. On the other hand, many of the large domestic entities who are hedging in global markets gain a competitive edge over small and medium players.

D. FOR CONSIDERATION OF ALL STAKEHOLDERS

As India desires to be a price setter ('make in India') in global market in many of the commodities where India is either a major producer or consumer, we need to nurture the growth and development of a free market with minimum interference by adhering to the principle of "minimum government and maximum governance". Moreover, any interference in a free market is not seen as a good governance practice by the international forums. Therefore, any such measure of suspension without a strong substantiating reason and wide consultation will shake the confidence of the market participants in the system.

In the light of the above, the discerning authorities should able to appreciate the above facts and decide further course of action in the best interest of all stakeholders in the Cotton eco-system.

About MCX:

Having commenced operations on November 10, 2003, Multi Commodity Exchange of India Limited (MCX) is India's first listed, national-level, electronic exchange. It is also the first exchange to introduce commodity options in India. In the financial year H1 2021-22, the market share of MCX stood at 92.57% in commodity futures segment. MCX offers the benefits of fair price discovery and price risk management to the Indian commodity market ecosystem. Various commodities across segments are traded on the Exchange platform. These include bullion, energy, metals and agri commodities as well as indices. The exchange has forged strategic alliances with various international exchanges, as well as Indian and international trade associations. For more information, about MCX and its products visit www.mcxindia.com.

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