Indian Economy · GS - III

Evaluate the role of a well-regulated derivatives market in improving price discovery and risk management in India's commodity economy.

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 25/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
15	~250 words

Answer Hint

Price discovery, hedging, market liquidity, FPI participation, clearing corporations, margin requirements, systemic risk

Model Answer

Commodity derivatives are financial contracts whose value is linked to underlying commodities such as agricultural products, metals and energy resources. A well-regulated derivatives market can strengthen India's commodity economy by facilitating price discovery and managing price uncertainty.

Economic significance

1. **Price discovery:** Futures prices reflect market expectations regarding demand, supply, inventories and global developments, providing useful signals to producers and consumers.
2. **Risk management:** Farmers, traders, processors and manufacturers can hedge against adverse price movements, improving income and business planning.
3. **Capital mobilisation:** Participation by institutional investors can deepen markets and improve trading liquidity.
4. **Efficient allocation:** Transparent market prices help businesses make informed decisions regarding production, procurement and storage.

Challenges and risks

1. Excessive speculation can increase short-term volatility and distort price signals.
2. Inadequate market liquidity may create difficulties in entering or exiting positions.
3. Counterparty defaults and insufficient margins can threaten settlement stability.
4. Complex derivative products may expose less-informed participants to substantial losses.

Regulatory priorities

SEBI's proposed early release of sale proceeds to FPIs illustrates efforts to improve capital efficiency and market participation. However, faster settlement must be supported by appropriate margins, collateral requirements, position limits and robust clearing mechanisms.

Regulators must also strengthen surveillance, disclosure standards and investor awareness to prevent market manipulation.

Conclusion: A deeper commodity derivatives market can complement physical markets by improving transparency and managing price risks. Its effectiveness ultimately depends on balancing liquidity and innovation with financial stability and investor protection.

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