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Price Discovery of Indian Equity Futures

JYOTHI MARIA JOHNY*
G. RAJU**

Abstract

Price discovery being related with the informational efficiency of futures market, the study examined long run and short run relationship between spot and futures market of Indian equity futures using data from the beginning of trading of equity futures in NSE which is from November 9th 2001 to July 31st 2019 and the lead lag relationship between spot and future returns was also determined using Vector Error Correction Model. The short run and long run relationship between spot and futures markets were identified and the cases of unidirectional, bidirectional and no directional relationship were found in short run and the conditions of spot leading futures and futures leading spot were found on individual stocks. The results of companies with leading futures can be used to forecast effect of futures on the spot market and policy makers can stabilize futures market through ensuring smooth run of price discovery process to avoid supernormal profit from arbitraging on price differences.

JEL Code : E3, E64, G13
Keywords : Price Discovery, Equity, Futures, Industry, India

I. Introduction

INDIAN CAPITAL MARKET is a thriving sector with different investment options for its participants. Along with the popularity of equities traded in capital market, different means of managing risk involved in its nature paved way for the segment called derivatives market. Derivatives are instruments whose value derives from an underlying asset which may be securities, gold, stock or other commodities. Basically, derivatives are classified into forward, futures, options and swaps. One of the most actively traded derivates is futures with its various roles such as price discovery, hedging, arbitrage and speculation.

* M.Phil Research Scholar, The University of Kerala, The Department of Commerce, Karyavattom, Thiruvananthapuram, Kerela 695581, INDIA
** Head and Professor, The University of Kerala, The Department of Commerce, Karyavattom, Thiruvananthapuram, Kerela 695581, INDIA

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CIPLA, TATAMOTORS, DRREDDY, M&M ,TATASTEEL and HINDUNILVR spot lead futures and for BPCL and INFY futures lead spot market. The findings of the study are useful in such a way that, traders can use the results of companies with leading futures to forecast effect of futures on the spot market and policy makers can stabilize futures market through ensuring smooth run of price discovery process to avoid supernormal profit from arbitraging on price differences.

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