Role of Commodity Market in Price Discovery Mechanism in India: A Study of Silver

Vandana Dangi1

Abstract

Price discovery is the important function of the commodity derivative market. The long run and causal relationship between two variables establish the price discovery mechanism between the two variables. The present treatise studied the price discovery by statistically testing the cointegration and causality between the spot returns and future returns of silver. The present study is based on the spot and future prices of silver for a period of five years starting from 1 January 2008 and up to 31 December 2012. Data was studied for stationarity, cointegration and causality by applying Augmented Dickey–Fuller test, Johansen cointegration test and Granger causality test respectively. The silver price series were found non stationary; and these series were transformed to stationary series by estimating their differentiated log. The results of Johansen cointegration test indicate that the cointegration exists between the spot returns and future returns of silver. The result of Granger causality test is unidirectional. The future market leads spot market but the spot market does not lead future market. So, the long run and causal relationship between the spot returns and future returns of silver indicates the virtuous performance of commodity market in the price discovery of silver.

Key words

Causality, cointegration, price discovery, stationarity

1 Vandana Dangi, Government College for Women, Rohtak, Haryana, vandanashoora@gmail.com