Executive Summary

Many associate the financial market mostly with the equity market. The financial market is, of course, far broader, encompassing bonds, foreign exchange, real estate, commodities, and numerous other asset classes and financial instruments. A segment of the market has fast become its most important one: derivatives. The derivatives market has seen the highest growth of all financial market segments in recent years. It has become a central contributor to the stability of the financial system and an important factor in the functioning of the real economy.

Despite the importance of the derivatives market, few outsiders have a comprehensive perspective on its size, structure, role and segments and on how it works. The derivatives market has recently attracted more attention against the backdrop of the sub prime lending crisis, financial crisis, fraud cases and the near failure of some market participants. Although the financial crisis has primarily been caused by structured credit-linked securities that are not derivatives, policy makers and regulators have started to think about strengthening regulation to increase transparency and safety both for derivatives and other financial instruments.
The study is purely based on the secondary data for examining futures market in terms of relationship, modeling and forecasting volatility in India. The study period spanned from January 2003 to December 2008 with a sample of 25 stock futures contracts. For the purpose of evaluating stock futures, we used ARCH/GARCH family model to draw valid conclusion. Our findings suggest that, volatility is a part and parcel of capital market and have a major effect in derivative market fluctuations, it is due to the other key determining factors like inflow of foreign capital into the country like exchange rate, balance of payment, interest rate etc. Rise in market capitalization leads to rise in inflation rates, Industrial Production Index (IIP) and Gross Domestic Product (GDP). Overall, it is clearly desirable to preserve the environment that has contributed to the impressive development of the derivatives market and enhances the overall depth, increases market liquidity and compresses spot market volatility in the Indian economy. However, some aspects of the futures trading terminal can still be improved further. Safety and transparency, and operational efficiency could be enhanced along proven and successful models helping the Indian derivatives market to become even safer and more efficient.