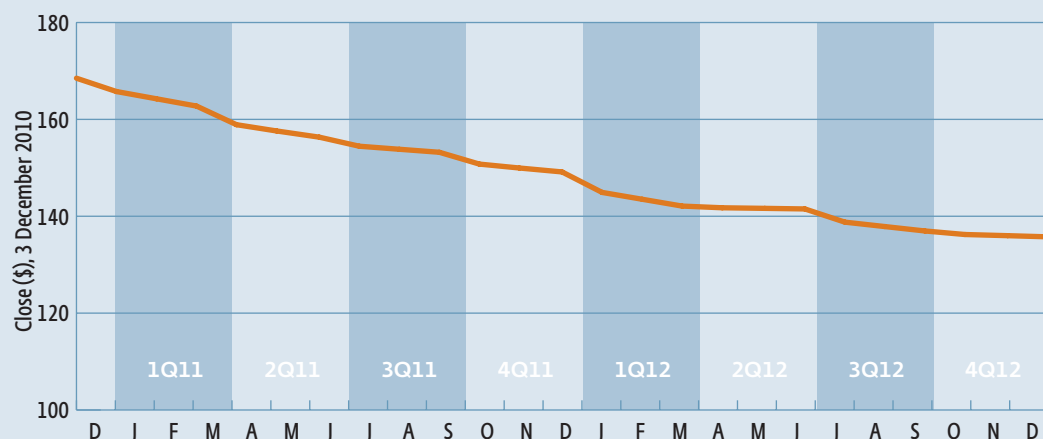


## Iron ore settlements

[ Source: Iron Ore and Steel Derivatives Association ]



## Iron ore swaps help Capesize fixtures

Iron ore swaps, which include delivery, are gaining in popularity but need to overcome a number of challenges

Shipping connections to iron ore swaps, which were launched in late 2008 by well-known freight derivatives brokers, abound.

Following the October 2010 London conference of the Iron Ore and Steel Derivatives Association (IOSDA), a representative said: "The number of companies on the sidelines studying the market has increased sharply. Market volatility is certainly an extra push on players to adapt quickly to the new system."

Unlike exchange-traded contracts in finished steel reinforcing bars and billets, which have gained traction, traded swaps on iron ore have faced considerable headwinds. Much like FFAs, the cash-settled deals, involving no physical delivery, are done through a network of brokers such as FIS (Freight

Investors Services) and London Dry Bulk – a broker tied to Deutsche Bank (DB).

These deals are then placed with strong financial 'clearers' in most cases, also analogous to shipping FFAs. Market sources suggest that financial players (rather than big miners and big mills) have been the main source of the trading activity.

### Big players

Big financial houses such as DB, Credit Suisse, JP Morgan and Morgan Stanley are said to be active in the market, which is transacted both over the counter and through exchanges.

Through November and into early December 2010, weekly volumes of cleared swaps reported by the IOSDA varied between 400,000 and 500,000 tonnes, worth between \$60M and \$70M.

SGX Asia Clear is handling the lion's share of the cleared swaps. Its presentation showed a rising trend from 2Q09 (when less than 1M tonnes cleared) to 2Q10, when 5M tonnes cleared.

Still, an annual cleared rate of about 20M tonnes pales in

comparison with total seaborne iron ore shipments estimated to exceed 1Bn tonnes in 2010.

China's huge demand growth is the focus of the market and multiple indices are used to settle swaps, each representing daily pricing for ore delivered into China, traded on multiple venues, or over the counter.

The Intercontinental Exchange (ICE), a venue that is well-known to traders of financial swaps on coal, has offered cleared swaps based on an index, with delivery of 62% Fe content at Qingdao, provided by Platts.

Another pair of markers, produced by specialist pricing service The Steel Index (TSI), are based on either 58% or 62% Fe content delivered into Tianjin.

## 'The number of companies on the sidelines studying the market has increased sharply'

The TSI indices have been used to price swaps traded and/or cleared through the Chicago Mercantile Exchange, LCH

Clearnet (another FFA crossover) and the Singapore Exchange. The IOSDA provides forward curves against the TSI measures, going out two years. Recent pricing, in the 62% grade, shown in the graph, shows a forward discount – downward slope for spot ore, which recently closed at \$170/tonne and softens to \$135/tonne for end 2012 delivery.

Among the challenges facing the iron ore swap markets is the near-monopoly enjoyed by the three largest suppliers – Vale, BHP Billiton and Rio Tinto, and the highly-concentrated nature of the buy-side.

Over time, the shift from iron ore priced annually (with a spot market at the fringe) to quarterly pricing, and ultimately, to an arena with true spot pricing, will be mirrored in the shipping markets. These have already seen a growth in spot Capesize ore fixtures as the spot share of ore sales has grown.

SGX's roster of inter-dealer brokers (IDBs) seeking to transact ore business includes a number of well-known names such as GFI, Clarkson Securities, ICAP, SSI, and a host of other crossovers. Some of the finance houses and brokers have worked to explicitly link their new ore desks with existing freight businesses.

The delivered pricing on ore – with an implicit shipping component – means brokers and traders will increasingly

be looking towards the Capesize sector of the dry bulk market to optimise their pricing on ore purchases. ■