

## Freight volumes recover as industry realigns in post-credit crunch world

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London, 15 February 2010 - Dry bulk freight volumes so far this year signal a return the brighter days of 2008 even as the market battles with a new post-credit crunch landscape and the deployment of new vessels that could set back its fragile recovery, participants at a recent freight conference said.

At a conference in Hamburg on Thursday, industry members noted that freight volumes have set sail en route to recovery. Demand for bulk commodities such as coal or iron ore - mostly from China - has re-emerged after a protracted downturn since the onset of the credit crunch some 16 months ago.

But freight rates - the per-day cost of chartering a vessel - remain fragile and access to financing an issue. Rates are measured across four ship sizes; capesize with capacity of 172,000 dead weight tonnage (dwt), panamax at 74,000 dwt; supramax at 52,454 dwt; and handysize at 28,000 dwt.

After a major contraction during the last part of 2008 and across 2009, volumes have picked up significantly, managing director John Banaszekiewicz of broker Freight Investor Services (FIS) said.

Over the first month or so of the year, dry bulk freight volumes have jumped 55 percent to 137,000 lots from 88,000 dry freight lots for the equivalent 2008 period. A dry lot is defined as either one timecharter day or 1,000 tonnes of voyage-based ocean transportation.

"We might get close to 2008 figures, so that's good news," Banaszekiewicz said.

In 2009, total dry freight volumes dropped 45 percent to around 1.1 million lots from around 2.1 million lots in 2008, FIS said. This implies a market value of \$31.3 billion for freight forward agreements (FFAS) - a massive drop from \$146 billion in 2008.

Of the four ship sizes referenced by the Baltic Dry Index, the outlook for the handysize market is the brightest, Baltic Exchange chief executive Jeremy Penn told FastMarkets on the sidelines of the conference.

"The handysize market has a relatively aged fleet and not much new building coming on, so that's a contract that has made a new start over the last few years," he said.

But the emergence of new capacity, as freshly built ships reach harbours, will ripple into freight rates and the nascent derivatives markets.

"Ships that have been built over the last few years and are going into the market now are clearly already having an impact on rates," Penn said. "To what extent demand is out there to absorb that tonnage and the capacity that it represents is the question."

Should demand prompt the kind of shortages that have been prevalent in recent years, "the derivatives market could continue to be very exciting - but if not, you could certainly see less volatility, and therefore less activity in derivatives", he added.

Cleared options volume in recent months has averaged around 14,000 lots per months, up from around 10,000 lots per month when the options market emerged three or four years ago, Duncan Dunn, a senior director with broker Simpson Spence & Young (SSY), said. This is increasingly driving technological innovation - a fraught issue in the predominantly voice brokered market.

Demand for hedging is a leading factor here - despite the improving outlook for credit markets, the cost and availability of finance remains a major concern, Professor Wolfgang Drobetz of Hamburg University said.

"One of the key challenges this industry faces is the search for alternative ways of financing ships - presumably relying more on capital markets," he said.

Drobetz expects a strong increase in interest in freight rate derivatives "given the theoretical benefits of hedging and its potential influence on the cost of capital for industry", he added.

But the lack of liquidity in options markets has forced up prices, a situation that, while unlikely to change in the near term, has further-reaching implications, Clarkson Securities managing director Alex Gray said.

"Most people accept that if you are working in a physical but not a derivatives market you are missing something quite substantial and that will have a profound impact on volumes in the coming years," he said.

#### REGULATION AND DEVELOPMENT OF ELECTRONIC MARKETPLACE

The clampdown on derivatives activity has made trade in commodities derivatives markets more difficult, although for now the FFA market is "not on the major radar of Brussels by virtue of volumes going towards a cleared format and the fact it is an open marketplace", Gray of Clarkson Securities said.

"[But] we need to be very aware of the changing face of regulation in Europe," he said.

The growing transparency of this self-regulated market should encourage the entrance of new players.

"The increase in transparency, and volume reporting - whether we're going to do that daily and by contract... can only encourage people probably more from the financial sector rather than the shipping sector... to come in," Edward Radcliffe of broker GFI said.

Stefan Albertijn of Toepfer International - also chairman of the Freight Market Information Users Group (FMIUG) - issued a call for daily volumes reports by contract in addition to the current weekly volumes reports that comprise the Baltic Dry Index.

Conference participants also broached the controversial development of an electronic marketplace. The Baltic Exchange was given a mandate by members around the end of August to develop a centralised trading screen. The London Metal Exchange offered its assistance but has been broadly rebuffed; the Baltic is said to be working on its own broker-led solution.

"All the screens have different rule books and ways of trading... which can be a bit of a nuisance," Albertijn said. "What about doing something together? We have all read about the LME and others looking to our markets and how to push for a regulated investment exchange. Those are things that as FMIUG are a concern to us."

Technical innovation must also focus on clearing - the current process is more complicated than many would like.

"We need to look at straight-through processing between the screens we have and the trading houses," Albertijn said. "Do we have a deal, or do we not have a deal? If we push the button we hope that the trade has gone through but today that is not everywhere the case. We are making progress there but we still have some way to go."

(Editing by Mark Shaw)

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