



## Iron ore goes financial - derivatives volumes grow 330% in one year

*Raw materials price has increased 137% in a year, creating knock-on to steel*

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London. After more than 40 years of painfully slow annual price negotiations for the supply of iron ore to the world's steel makers, this 1.3 billion tonne market - of which China absorbs the majority, is going financial.

As miners and steel producers are gearing up for quarterly spot market pricing of the commodity, financial hedging instruments such as swaps and futures are taking off, a leading commodity broker said today.

*"From 2009 until today, volumes in iron ore hedging instruments trading mainly in London and Singapore have grown 330% and show no signs of slowing down",* says John Banaszkiwicz, managing director of Freight Investor Services.

Traded between mining companies, merchant houses and steel-makers in Europe and Asia, financial iron ore contracts are quickly becoming the most efficient way to hedge against the volatility in prices which comes with a spot-driven market.

Known as Iron Ore Swaps, the contracts are simple 'plain vanilla' derivatives which settle in cash - not physical delivery of iron ore - against an industry standard daily index which reflects the actual cost of high quality grade iron ore delivered into North China.

Since the introduction of clearing in May 2009 until today, volumes of iron ore swaps have exploded as new participants entered the market, realising that without an effective way to trade the risk of huge price swings, they are left vulnerable to potentially devastating losses.

Banaszkiwicz, who is also chairman of the Iron Ore and Steel Derivatives Association (IOSDA), says: *"We are past the point of no return now - the massive global iron ore industry will never be quite the same - and that's not necessarily a bad thing."*

Iron ore, once the dull domain of far away mining companies, is the largest raw materials commodity market in which only the producers, their clients and the middle men could trade. It has been a closed market, not open for trading to users of steel and investors in the sector. That is changing rapidly.

Banaszkiwicz adds: *"With the emergence of financial iron ore contracts, key players in iron ore and steel as well as investors and end users can now trade iron ore without having piles of rock delivered to their back yards, just like they can in oil, wheat, soybeans, copper and gold. We are probably looking at one of the last great commodity stories to come out in decades."*

China is of course a key component in this story. The US\$600 billion infrastructure stimulus package announced by the Chinese government in 2009 has made iron ore one of the hottest commodities around. Importing over 700 million tonnes of iron ore in 2009, China creates huge demand as it builds airports, railways, factories and roads.

This in turn has caused prices of iron ore delivered into China from Brazil, Australia and India to soar as high as US\$150 per tonne - a full US\$90 per tonne more than the flat annual price agreed for 2009 at US\$60 per tonne. Clearly trading financial iron ore has big implications for hedgers who are active in the physical market and for investors who want to take part in the China story. *"Trading Chinese iron ore prices rather than just Chinese stocks and shares is like buying the milk without having to buy the whole cow,"* says Banaszkiwicz.

But, just as crude oil cannot be used until it is refined into fuels, iron ore is in itself of no use until it has been converted to steel. But with a 137% difference between May 2009 and Q1 2010, the steel industry has been left reeling as it scrambles to work out how to protect against price spikes in the cost of raw materials and the contagion effect this has on the price of steel. Steelmakers and their customers will face much higher costs as the iron ore market moves to quarterly prices linked to the spot market.

*"Look around and see how much of the things we use are made of steel"* says Banaszkiwicz, and adds: *"The steel makers and their customers also need a way to flatten out prices as iron ore goes financial - we believe this will quickly lead to a vibrant cash-settled steel swaps market too."*

Cleared through reputable exchanges like Singapore's SGX AsiaClear and London's LCH.Clearnet, iron ore swap contracts are - unlike many industrial commodities - free from counterparty risk as these exchanges guarantee payments to all participants.

*"2010 is the last year of the old pricing system for iron ore, and we are seeing the emergence of a whole new asset class for iron ore and steel. They have been the ugly twin sisters of global commodities but with China's growth roaring, these two are doing very well in the financial markets beauty parade,"* concludes Banaszkiwicz.

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Notes to Editors

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