

FIS predicts volumes in iron ore swaps to double

Liz McCarthy

MONTHLY trading volumes in the iron ore swaps market could double this year to hit a new high of 2.5m-3m tonnes as the evolving derivatives trade expands and attracts more participants.

Liquidity is expected to continue growing at a fast pace as 2010 progresses, making this target feasible, according to Michael Gaylard, strategic director of Freight Investor Services.

"I think the biggest month in terms of iron ore swaps volumes this year will be at least double the volume from last year's monthly high on cleared products," he told *Lloyd's List*.

"The largest month in 2009 was 1.6m tonnes and so I would expect the top month of this year to be closer to 2.5-3m tonnes traded."

Mr Gaylard added that on a global scale the iron ore swaps market was attracting on average at least one new counterparty each week to sign up and prepare themselves for trading.

"That doesn't mean that they're stepping in to trade, but they have all their admin and protocols in place to trade. Of that I would probably say about 30 would be Asian-based, so about two thirds."

However, many new Asian counterparties from major steel-making nations were only entering the market on a speculative or 'fact-finding' level at the moment, whereby they "dip their toes in with small volumes", he said.

"Asia is very much the home of steel-making, and in Japan and Korea they have

consolidated a lot of their industry and have big steel mills that have to take in a lot of iron ore. The liquidity pool in the swaps market is nowhere near what they need to manage their risk."

This liquidity pool was still the biggest obstacle facing the iron ore swaps industry, and was likely to affect the market for at least another 12 months, as it was not deep enough to service participants who have a "reasonable amount of cargo," Mr

Banks to lose market share by next year

THE proportion of banks and funds participating in the iron ore swaps industry is set to shrink significantly in 2011 as a wider range of counterparties enter the market, writes Liz McCarthy.

In 2011, financial entities such as banks and funds are estimated to hold a 30% share in the iron ore swaps market, down from 70% in 2009 and around 45% this year, according to Freight Investor Services.

However, this will still leave them as the largest participant by sector, followed closely by traders and end-users.

Speaking at a Singapore-based iron

Gaylard said. "But then you get to this double-edged sword that people really do want to hedge but they're not going to come into the market because there's not enough liquidity.

"But if they don't at least come in and start in the market then the liquidity isn't going to build."

The same was said about the forward freight derivatives market when it was starting out, with the value of trades peak-

ing in 2008 at \$155bn, before falling to around \$35bn in 2009.

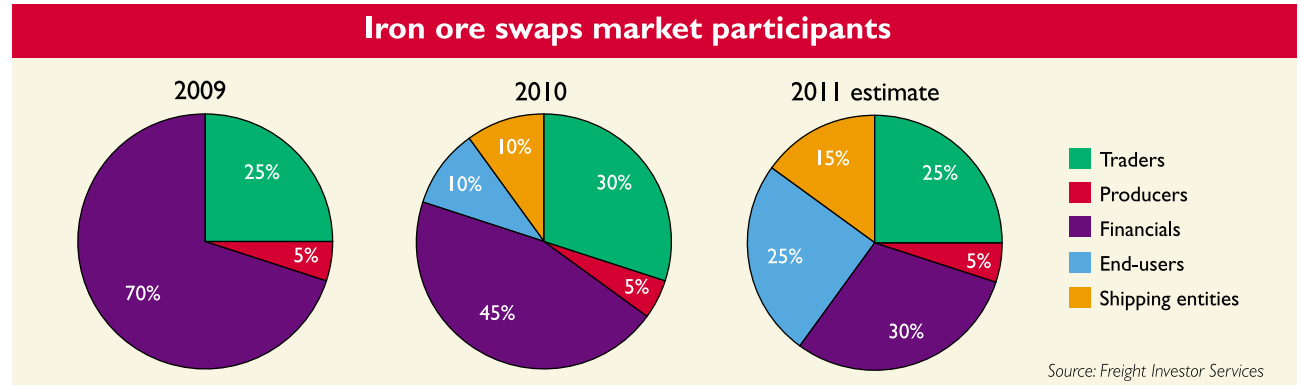
"So this is a really key period in terms of getting the liquidity to a place where the market can function properly and attract the big players," said Mr Gaylard.

"But the big question mark hanging over the market is the issue in China with regard to how the spot market is perceived, how cash-settled derivatives are looked upon from the perspective of

mainland China and whether state-owned companies are allowed to trade or are not allowed to trade. What they don't want to have is wild Western-style speculating."

The shift in physical trading dynamics for the iron ore industry has seen a swing from benchmark prices to sales on the volatile spot market.

This volatility has supported sharp growth in trading volumes of cleared, over-the-counter iron ore swaps.



ore conference last week, FIS' Michael Gaylard presented forecast trading dynamic estimates for the iron ore swaps market in 2010 and 2011.

With a limited pool of iron ore producers, counterparties from this area of the business are expected to stay low, at 5% of market share.

In contrast, end-users such as steel

mills and traders are expected to rapidly increase their share of the market from 10% this year to 25% in 2011. The number of counterparties from the shipping sector is also forecast to climb to 15% of the iron ore swaps market next year. Many began trading in 2010.

The FIS presentation also showed that although Asian and European

counterparties were actively trading iron ore swaps in 2009, the market is expected to spread globally by 2012 and attract participants from India, reflecting its expanding presence in the iron ore export market.

South America and a small proportion of US-based counterparties are also estimated to be active by 2012.