

Quarterly iron ore price enters force

Freight rate volatility forecast to increase as miners end benchmark

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VALE and BHP Billiton have agreed quarterly iron ore prices for Asian steelmakers from April 1, signalling the demise of the 40-year-old annual contract benchmark system and potentially injecting further volatility into the dry bulk freight market.

The pair are the largest and third-biggest iron ore producers and along with the second-largest, Rio Tinto, control about two thirds of annual seaborne trade, expected to hit one billion tonnes this year.

Vale's increase puts the price of ore at around \$105 per tonne (assuming 62% fe content) for Japan's Nippon Steel and South Korea's Posco against the current benchmark, which expired on March 31, of around \$62 per tonne.

Adding in capesize freight costs at today's rate, that takes the landed cost of iron ore from Brazil to China to \$129.19 per tonne.

The landed cost from Australia would be cheaper at \$115.13, representing a sub-



Vale and BHP Billiton have moved iron ore pricing to shorter contracts. Bloomberg

stantial advantage for Rio Tinto and BHP Billiton. The majority of Australian iron ore exports are shipped to China.

Yesterday's spot market price was \$153 per tonne for iron ore with a 62% fe content landed in China, almost double the price six months ago, and still 15.6%

higher than the agreed quarterly contract price.

BHP Billiton said on Tuesday it had agreed with Asian customers to shift pricing for most of its iron ore to shorter-term contracts based on market-cleared prices and on a landed basis, but did not specify

any price. The world's second-largest producer, Rio Tinto, also aims to ditch annual prices this year.

For four decades miners and mills have agreed on a single annual price, but an estimated 30%-40% is now sold on the spot market, leading to higher levels of volatility in freight rates.

"What is extremely interesting and incredibly important for dry bulk rates is that in December of every year up until April, China imports a very large amount of iron ore from India rather than Brazil. This is the time period when contract talks with Brazil and Australia are in effect and become very tense," said Jeffrey Landsberg, from US-based Commodore Research & Consultancy.

"The shorter distance of India-China vs Brazil-China affects the market and puts a great deal of pressure on cape rates, as does the greater amount of panamax and supramax vessels used to haul Indian iron ore imports.

"Now that long-term contract pricing looks like it will no longer exist, the tradition of China sourcing a great deal of it's iron ore from India from November to April — and the negative effect that has on the capesize market — will likely come to an end."

Mr Landsberg added: "This will significantly affect dry bulk freight rates. Novem-

ber to April will no longer be a traditional time where capesize rates come under pressure and panamax and supramax rates receive a boost."

Last week one of the world's top dry bulk charterers, Louis Dreyfus Commodities, warned that rising raw materials prices could kill demand, and hurt the freight market.

"You cannot price a billion tonnes of iron ore at spot prices and not expect to have a significant impact on what demand does," said director of ocean freight strategy Peter Sandler.

John Banaszkiwicz, managing director of Freight Investor Services, which has traded in iron ore swaps for nearly a year, suggested the move signalled major changes in how the commodity was traded.

"We think 2010 is the last year there will even be a conversation about the iron ore benchmark. Next year it will be all about what quantity of product, for which period and which index you are pricing against for physical and swaps," he said.

BRAZILIAN FOB IRON ORE PRICES

2008	2009	2010
\$83.33	\$61.69	\$105f

* based on 62% fe content