Volume of FFA trades to double

Off with a bang: dry bulk FFA rates got off to a flying start this year, with transactions expected to total $60bn. Bloomberg

FIS forecasts 2m lots will be sold in 2010 as market stages recovery

Liz McCarthy and **Steve Matthews**

THE volume of dry bulk forward freight agreements traded this year is set to double compared with 2009 levels, according to Freight Investor Services.

A combination of firm underlying raw materials demand in Asia and strong volatility has rekindled the interest of banks and trading houses in freight as an investment opportunity, FIS managing director John Banaszkiewicz said on Friday.

"We are off to a flying start on freight in 2010 with firecrackers going off ahead of Chinese New Year. There is a lot of buzz in the market and we think that means a very interesting year ahead," he said.

Mr Banaszkiewicz's views matched those of Duncan Dunn, senior director of SSY Futures, who also said last week that FFA volumes were expected to recover strongly this year.

SSY Futures reported that 2009 paper contract volumes had fallen sharply, though numbers picked up during the fourth quarter when physical spot prices reached a 14-month high.

The total number of dry bulk lots traded last year was 1,178,575, a reduction of 47% from 2008, but in line with expectations in a difficult market, SSY Futures reported.

However, the fourth quarter saw 338,991 lots traded, which was almost 16% more than in the first quarter.

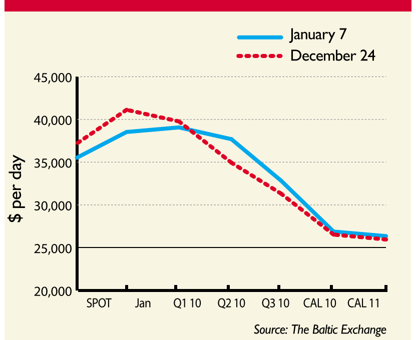
Mr Dunn told Lloyd's List that he expected the number of traded lots to recover towards 2m this year. By comparison, in 2008 about 2.2m dry bulk FFA lots were traded — a record high.

SSY also estimated the total market value of 2009 FFA transactions was about $35bn and this was also expected to rise strongly this year.

Mr Banaszkiewicz predicted that potential dry FFA lot volumes of 2m this year would imply a market value of around $60bn. "Volatility is going to drive the FFA market in 2010 and the iron ore market could accelerate the process," he said.

"The banks and trading houses see freight and commodity volatility as an opportunity to derive new value and there is plenty to play with.

FFA capesize forward curve

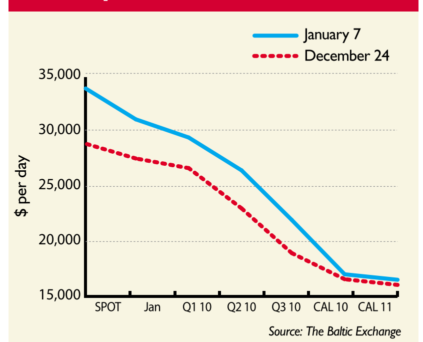


"The implied volatility for Q1 capes is at 115%. The realised, or historical volatility for Q1 capes in the last 30 days is 111.4%, much higher than oil, copper and equities so the opportunity is clear."

Although the total volume of cleared business in 2009 was down by 15% from the previous year the share of cleared business continued to rise strongly and reached about 93%, compared with just 68% in 2008, SSY reported.

LCH dominated clearing with a market share of more than 80% with the large majority of FFA transactions in 2010 expected to be cleared.

FFA panamax forward curve



The volatility of the capesize market through 2009 contributed to its popularity for FFA trading and this sector accounted for 48.5% of the total market and saw a continuation of the trend for capesizes to increase market share at the expense of panamax trades, according to SSY.

Panamax trades contributed a 41% share. This trend was expected to continue, but Mr Dunn suggested that there was potential for an increase in activity in the supramax and handysize segments, which are relatively lightly traded in FFAs.

Mr Dunn also identified a trend towards smaller lot sizes: "This has enabled smaller counterparties to cover their freight market exposure and is a welcome feature of an evolving market."

In the first week back to office of 2010, the dry paper market has been "topsy-turvy", with capesize contracts and panamaxes subject to strong volatility, FIS said.

Market players appeared to lose confidence in paper's value, only to then step in with support when contracts traded far enough down. One FIS broker said: "It has been very choppy. The market is volatile in short ranges with the trading volume stronger on the way up than the way down. Traders are mostly interested in the widening Q2 capesize/panamax ratio, with rises in the capes seeming to increase the panamax offer."

At the end of last week, second-quarter 2010 panamax contracts were being traded at an average of $26,200 per day, around $7,000 less than the average panamax spot rate.

In contrast, second-quarter capesize contracts were trading at around $37,700 at the end of last week, which was higher than the average spot rate, which fell to around $35,000 per day.

"The capesize/panamax ratio across the curve has approached significantly important low levels that could imply in the short term further weakness in the capesize sector," French broker Barry Rogliano Salles said on Friday.

"In this regard, we could witness going forward a decoupling of the momentum of price levels sustainability between capesizes and panamaxes, with the latter sustaining gains whereas capesizes continue to suffer."