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Freight costs ignored as ore cash price rockets

Freight costs have become a far-less important element in the delivered cost of iron ore to China.

Despite last week's surge in bulker rates, the cost of hauling ore has been left on the "backburner", while the cash price of ore delivered to the world's largest consumer has recently been at its highest for more than a year.

Freight Investor Services (FIS)'s Shanghai-based strategy director, Michael Gaylard, says iron ore has been in such demand that people are content paying freight levels 50% lower than at the peak 18 months ago.

And when the delivered price into China was not so long ago around \$135 per tonne, similar to now, freight accounted for around \$46 per tonne on the Tubarao, Brazil-China route. Today, it is closer to \$26 per tonne.

The spot price of iron ore has at least doubled since its 2009 low last March.

Nevertheless, said Gaylard: "I think the demand for iron ore is keeping freight at the relatively strong and comfortable levels we are seeing at the moment." However, a feature of the market has been a greater reliance by the steel mills on smaller, piecemeal iron-ore cargoes from India whenever the standard capesize trades from Brazil and Australia to China slip.

Chinese steel mills have been operating on a more "hand to mouth" basis, he says, taking smaller cargo sizes in supramaxes from India and the spot market.

At a time of uncertainty over pricing, it reduces their credit exposure, adds Gaylard. It has resulted in a "see-saw" effect with freight clearly dependent on iron-ore demand patterns.

The capesize market remains quite strong for periods but as the steel mills struggle to make decent margins and iron-ore demand relaxes, the supramax market benefits.

The ratio between capesizes and supramaxes has been changing a lot more than in previous months, says Gaylard.

Commodore Research says iron-ore stockpiles at Chinese ports have grown to 70.82 million tonnes, rising faster in a week than for almost a year. Steel factory closures during the Lunar New Year may be the cause but if not, iron-ore imports may be set to decline.

Gaylard says the correlation between iron-ore prices and freight rates is a lot less than one might imagine at around 83% or 84%.

Iron-ore prices increased for around six or seven weeks prior to the early-March freight jump, while freight had been softening. During the first quarter of 2010, the markets "moved in divergence more often than not", says the strategy boss.

On the Tubarao-China route, freight is currently around \$26 per tonne, as against an iron-ore spot-market rate of \$132 per tonne, equivalent to roughly 20% of delivered cost. At the start of the year, it was closer to 36%.

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