The Economist

Freight derivatives

Boxing clever

Are container derivatives poised for bumper growth?

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Crate expectations

FORGET civil rights, sexual liberation and pop music. The swinging sixties also saw the advent of containerisation in shipping. Some 140m containers now carry around half of the world's exports by value (see chart). And according to the brokers that are starting to offer container-freight derivatives, contracts based on the future price of renting containers, the way these boxes are financed is about to undergo another revolution.

Clarksons, the world's biggest shipbroker, which pioneered derivatives for dry-bulk cargoes like iron ore and coal in the early 1990s, made its first container-derivative trade in January this year. Since then two other London-based brokers, ICAP and Freight Investor Services, have also started to offer derivatives settled against the Shanghai Containerised freight index, which is based on per-box rates on the world's busiest container routes. Alex Gray of Clarksons admits that the market is tiny at the moment. But he reckons that container derivatives may be worth 5-10% of the physical market by the end of 2011.

The dry-bulk market was also tiny until 2003, when rates took off as China began to import huge volumes of raw materials and rising freight costs became a bigger slice of commodity prices. That prompted shippers and producers to use derivatives to hedge against volatile costs. Forward freight agreements are now worth 40% of the physical market.

Volatility is also a feature of the container market. Half the container fleet runs like a bus network with regular sailings at set times. With these ships, prices are set under long-term contracts. But the spot market, where vessels are chartered for specific trips or time periods, is very unpredictable, particularly since regulators put a stop two years ago to an arrangement between shipping lines (the top 15 of which control 80% of the market) to manage overcapacity by co-operating on routes and rates.

On August 5th Chile's CSAV, which runs the world's eighth-largest container fleet, became the first shipper to make a container-derivative trade (with Morgan Stanley). A couple of other big shipping lines are said to be ready to test the water.

Customers may also want protection from the ebb and flow of prices. Manufacturers of small high-tech electronics goods, where freight costs account for a tiny fraction of the retail price, may not be that bothered about hedging freight rates. But for makers of bulky lower-value goods such as furniture, toys and machinery, the ability to hedge shipping costs should prove a boon. Betting on container rates, which are a proxy for economic activity, may also appeal to speculators. If so, the market could soon become as liquid as the ocean waves.

Finance and Economics