

## Chinese moving into iron ore swaps

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Chinese companies have started trading iron ore in the nascent derivatives market in a further sign that Beijing could be laying the ground to move away from the benchmark system of annual iron ore prices.

The iron ore swaps allow participants to hedge exposure to the physical iron ore spot market. The derivatives could gain importance if miners and Chinese steelmakers fail to reach an agreement over 2009-10 benchmark prices.

Traders and brokers told the Financial Times that up to seven Chinese trading companies were participating in the swaps market and that at least one China-based steelmaker was likely to join the market before the end of the month.

The arrival of Chinese companies comes after the Singapore Exchange and LCH.Clearnet, Europe's largest independent clearing house, started clearing iron ore swaps a month ago.

Central clearing is important because until now, buyers and sellers of the private, bilateral over-the-counter swaps bore the risk of their counterparties defaulting, deterring many from dealing with China.

"More than a handful of Chinese counterparties have come to the market in the last month," said Michael Gaylard, an iron ore broker at Freight Investor Services in London.

Clive Murray, head of London Dry Bulk, the iron ore brokers, added that the entry into the iron ore swaps market of Chinese companies linked to the steel industry was "a fantastic development and signals that they are moving forward with the times and embracing the concept of risk management further".

The likelihood of a structural change to price iron ore sales based on spot prices rather than annual benchmark settlements comes a year after the launch of the first cash-settled ore swap by Credit Suisse and Deutsche Bank. Other banks, including Morgan Stanley and Barclays Capital have since joined. Others, such as Goldman Sachs, aim to start trading iron ore swaps.

Benchmark negotiations between Chinese steelmakers, led by the China Iron and Steel Association, and miners Rio Tinto, BHP Billiton and Vale, have been particularly tortuous this year and remain deadlocked ahead of a potential deadline on June 30.

There are signs that BHP Billiton is pushing for a move to quarterly pricing, based on the spot market, and away from the traditional benchmark system, which has been the cornerstone of the industry for the past 40 years.

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