

FRONT PAGE - FIRST SECTION: China factor helps drive freight futures market towards \$150bn

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Bankers and hedge fund managers are increasingly turning to the nascent world of freight derivatives to make money, as figures to be published today show that the market is on course to hit a record \$150bn in value - a 200 per cent increase on last year.

With volumes in many other derivatives markets, such as credit default swaps, hit by the liquidity crunch, freight derivatives have, by contrast, experienced a big surge in business as a result of the booming Chinese manufacturing sector, which requires raw materials.

This China factor has been the big driver behind the expansion of freight derivatives, forcing up prices because of the country's demand for ships to import iron ore from places such as Brazil and Australia.

The volatility of the market has also attracted banks and hedge funds, while the growing number of clearing houses, which log the trades, have reassured these banks and funds that deals will be transacted in an orderly and cost-efficient way.

John Banaszkiwicz, managing director of Freight Investor Services, the freight derivatives broker, said: "We have seen a whole new influx of players in the past year. The banks have been setting up proprietary desks and new funds have set up to speculate and make money in this market." Citigroup, Merrill Lynch and Macquarie Bank have set up proprietary trading desks in the past few months.

Freight derivatives are forward contracts that were once used almost entirely by ship owners and manufacturing companies to lock in a fee for renting a ship, but now banks and hedge funds are making speculative bets on the market's direction.

Big sums can be made as the forward market is extremely volatile because it is difficult to determine weather conditions. Port congestion and lack of ships have also created uncertainty.

Today, figures from the Baltic Exchange will show last week's volumes hit about \$3bn in value to establish a \$150bn market by the end of the year, according to FIS.

This is a dramatic rise compared with the estimated value of \$57bn at the end of last year and the meagre \$3bn in 2000. It also means that derivatives will grow larger than the physical market, which is forecast to reach about \$140bn by the end of the year, compared with \$110bn at the end of last year.

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