Container freight derivatives trading gathers momentum

Clearing houses enter market as industry group prepares for first forum

Michelle Wiese Bockmann

THE nascent market for container freight derivatives has taken a further step forward with trades cleared via clearing houses by July, and a newly formed industry association to hold its first forum in September.

The Container Freight Derivatives Association will meet in Shanghai on September 14 to introduce the contract to potential traders, including influential executives from global shipping lines and freight forwarders in Asia.

About 50 Container Swap Agreement trades have been brokered by Clarkson Securities, the derivatives branch of London brokers Clarksons, since the first deal in January, with hopes that 2m teu will be traded within five years.

"We're really in experimental territory for most people," said Clarkson Securities chief executive Alex Gray, citing "slow but steady growth".

The over the counter container swaps will be cleared by clearing house LCH.Clearnet within weeks, and a forward curve developed for two years. Mr Gray said the credit risk perceived from OTC bilateral contracts available until now "had held up progress".

"We've had good feedback from the retail sector, both large and small, the freight forwarding community and logistics providers for whom this is a very good way of passing on benefits to their customers, as well as the shipping container lines themselves," Mr Gray said.

"The market has been quite volatile in the last couple of months and given plenty of people a really good reason to look at this product very seriously."

Clarkson Securities developed the financial instrument to hedge container freight rates, working with Morgan Stanley. Trades are settled against the Shanghai Containerised Freight Index, although there had been feedback for expanding the indices, Mr Gray said.

Morgan Stanley was a counterparty for the first trade, with executives travelling to visit lines and owners in Europe over the last three months to widely promote the contract. Morgan Stanley executive director Brian Nixon has been appointed the association's first president.

"(Container derivatives trades) are at what I would call the nurturing stage of the business," Mr Nixon said.

"(Container) lines have had huge financial issues in the last year and having spoken to the users of container freight, we've also seen huge budgeting issues, where people have been forecasting one (freight) level and the rates have doubled or tripled in a year. This has created a huge concern in the boardrooms, and also for people like me and you — for the end users — it's creating an inflationary environment."

There was the potential to grow volumes traded to 20m teu each year, he said, just under 20% of the underlying physical global container trades.

"I would (personally) hope that we would see in five years 2m teu trading a year, " he said. "There's certainly a willingness from the users of freight — the retailers and the freight forwarders — to embrace the use of freight derivatives not only as a tool for risk management, but also for price discovery. The lines are taking a bit more time to embrace the product. The lines that we have spoken to are keen to be involved, but are less keen to be seen to be the first to get involved."

The association's vice-president is Brian Dempsey, from UK-based freight forwarder Kerry Logistics, which trades mostly on routes from China to the UK.

He said there was wide interest throughout the transportation and cargo chain in using hedging, as freight rates had been on a "roller coaster ride" — fluctuating from $300 per teu to over $2,000 teu over the last 18 months from Asia to Europe.

"Somebody who's selling bins (from China) to (UK department chain) Marks and Spencer wants to make sure they can crystallise their margins throughout the process," he said.

"They would look to try to fix a (freight) price forward that reflected when they were going to move it and they could budget that into their selling prices and fix their margins that way.

"The shipping lines, when the rates would be high, particularly the forward rates, would be trying to secure their revenues by selling (swaps) at that rate.

Mr Dempsey said the shift to clearing — which also allows anonymous trading — as well as the September conference was vital to growing container derivatives, along with liner companies endorsement.

"The key is liquidity, and that liquidity is going to be delivered in big numbers when the shipping lines start trading in the market against the consumers," he said.

"My personal view is that once we get shipping lines thinking that it would be great to sell the space (on ships) for January for the prices in the market at the moment, and the importers might want to buy that space to secure their prices, then it will start rolling, and I think it will be quite quick."

The container sector is the last in the maritime industry to embrace derivatives, partly because it lacked a global freight index against which to settle contracts, until the Shanghai-based index was developed last year.

It is difficult to get precise figures for the underlying size of the physical market of containers shipped from Asia to Europe. But according to Containerisation International, total trade shipped between northern Europe and east of the Bay of Bengal in 2009 was 10.9m teu.

That breaks down as 7.2m teu westbound, a fall of over 19% on 2008's level, while eastbound volumes were 3.7m teu, up 13%.

Germany-based containership owners had tried for several years to develop a product, before the launch of the Clarkson Securities product, settled against the German shipbrokers association Contex index, developed in 2008.

However, the Contex was based on time charter rates for vessels, rather than freight rates, which limited participation as there was little appeal for the freight forwarding and logistics sector. ■

Boxed in: Interest has been growing in using derivatives to hedge against volatile freight costs in the container trade.

SHANGHAI CONTAINERISED FREIGHT INDEX

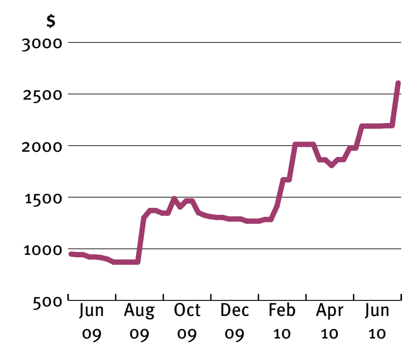
Departing from Shanghai to following destinations:	Weighting	Weekly Index $ 18/6/2010	Change on Last Week $
Comprehensive Index		1,569.04	+25.32
Line Service			
Europe (base port)	20%	1,868	-6
Mediterranean (base port)	10%	1,908	+2
United States West Coast (base port)	20%	2,810*	+67*
United States East Coast (base port)	7.50%	3,897*	+75*
Persian Gulf and Red Sea (Dubai)	7.50%	1,303	+33
Australian/New Zealand (Melbourne)	5%	1,056	-50
East/West Africa (Lagos)	2.50%	2,511	+13
South Africa (Durban)	2.50%	1,591	0
South America (Santos)	2.50%	2,181	-35
West Japan (base port)	5%	323	-1
East Japan (base port)s	5%	323	-1
Southeast Asia (Singapore)	5%	428	-15
Korea (Pusan)	2.50%	212	-3
Taiwan (Kaohsiung)	2.50%	322	-15
Hong Kong	2.50%	145	+22

Price is US$/teu except * which are US$/feu

Source: Shanghai Shipping Exchange

DREWRY FREIGHT RATE BENCHMARK

Hong Kong-Los Angeles



■ Week 24, 2010 — $2,607 (18.9% change on week)
■ Week 24, 2009 — $921 (182.9% change over year)

For full container loads per 40 ft box, excluding THC at port of origin.

Source: www.drewry.co.uk

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