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Market Insights: The changing shape of the Iron Ore trading day

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The changing shape of the Iron Ore trading day

How a decade's worth of jetlag finally caught up with Asia's key commodity

In 2009 and 2010 the iron ore derivatives market was still nascent. Trading was focused around a limited group of banks, commodity traders and miners - organised mainly by inter-dealer brokers based in London. In addition, the price which these trades were settled against, The Steel Index (TSI) benchmark was published at 1200 GMT. This combination of London market opening and the index at lunchtime effectively created a time bound European 'session' in which virtually all volumes were traded.

Fast forward 8 years and the contrast is remarkable. Iron ore is now one of the world's most liquid commodities. It is traded by a large array of organisations and dominated by participants who are based in Asia. Used as a proxy hedge for everything from car production to currency and widely viewed as a key indicator of macro-economic conditions in China; iron ore derivatives have quickly caught the fancy of a broad range of users. What facilitated this shift?

China has been the largest consumer of iron ore for decades, with annual import volumes exceeding one billion metric tonnes in both 2016 and 2017, mostly originating from Australia and Brazil. Contrary to the derivatives markets, the physical market has long reflected Asia's dominant role as a trading hub for iron ore, with most major market participants already present in the region. However, given the initial typical Euro-centric market design for iron ore, early liquidity in swaps, futures and options was concentrated during London trading hours. In 2009-10, the vast majority of all daily volumes (approx. 80%) were transacted between the hours of 0800 and 1200 GMT (1600 – 1900 SGT).

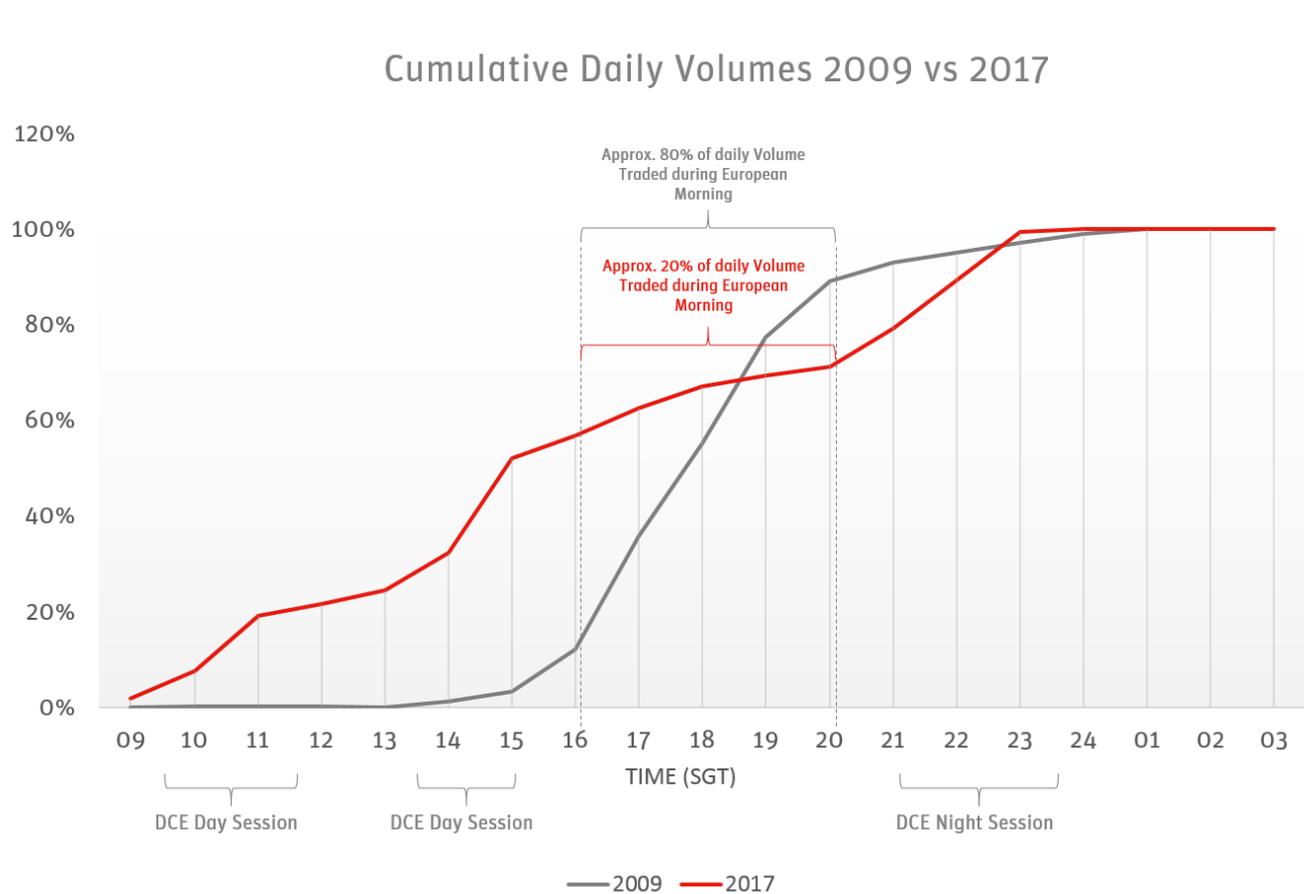
Adoption of iron ore derivatives increased quickly in the years that followed, trading volumes more than doubled for 4 years in a row and as a result, volumes for 2014 were 26 times larger than they were in 2010. Much of this growth came from an ever-increasing number of counterparties based in Asia, prompting a large shift in activity to the East with organisations setting up or moving their trading and broking desks to Singapore.

By the end of this growth period, the UK morning (0800 – 1200 GMT) time slot was no longer the most important time of the trading day, in fact by the end of 2013, 50% of all daily volume was transacted by 1600 SGT (0800 GMT), before traditional London opening. Index publication had also been moved an hour earlier.

In October 2013 the influence of China on this market further intensified. Dalian Commodity Exchange (DCE) launched a physically delivered Chinese Iron Ore futures contract traded during 2 sessions: morning (0900 – 1130 SGT) and afternoon (1330 – 1500 SGT). Adoption of the product was swift and the volumes transacted, enormous; in its first year of trading over 6 billion metric tons were traded in comparison to approx. 400 million metric tons outside China. Dalian's market was not directly accessible to international participants and the majority of the volume was considered to be

speculative, however the launch provided much needed price discovery in Asian hours, and was a key factor in aligning derivatives trading with the established realities in the physical market.

The shift to Asian trading hours moved volume from London mornings to Singapore days, but the cross over with Europe remained important. The net effect of this is that the iron ore trading day became longer. In 2009 over 80% of all volumes were traded in a period of 5 hours, in 2013 this period had grown to 10 hours.



The addition of a new trading session at the DCE in July 2014 helped to continue this process. The DCE night session (2100 – 2330 SGT), became established just as quickly as the exchange’s previous day session had. Until now, the volume traded during this window was small, the early London market had mostly ended by midday and since then trading had only been moving earlier. The effect of the DCE on the market though was inexorable. In the years between 2009 and 2013 only around 10% of daily volumes were executed during the ‘night session’, by the end of 2017 this figure had tripled.

Access model, market participants and even price formation are completely different for the international and Chinese domestic iron ore markets but despite this, the DCE’s contracts have helped to create one of the first global commodity markets with a truly liquid Asian trading day. When the market first started, 80% of all trading happened when Europe opened, 8 years on and this session is now the least liquid of all.

What lessons can we take from the example of iron ore?

As physical trade flows for many products move east, the role of Asian counterparties, Asia trading hours and particularly onshore Chinese contracts may force other financial markets to follow. In the case of iron ore, price discovery, even when coming from a different market has clearly been a catalyst for growth. Exchanges, in partnership with their stakeholders, need to position themselves ahead of this growth to provide effective solutions for a group of commodity markets that are increasingly moving to the east.