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ON TRADE FINANCE

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD



SESSION ON TRADE FINANCE

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Institutional Cooperation Framework Active for Trade Finance

- ❑ Asian Exim Banks working closely under the Asian Exim Banks' Forum for trade finance cooperation
- ❑ Global Network of Exim Banks and Development Financial Institutions (G-NEXID), under the auspices of UNCTAD
- ❑ ECAs signing Bilateral / Multilateral L/C confirmation facilities
- ❑ Developmental banks from BRICS signing arrangement for local currency financing
- ❑ Exim Bank of India is also working closely under these arrangements
 - ❑ Technical Assistance to other developing countries – sharing of knowledge and experiences in structuring trade finance products
 - ❑ Working with Regional Development Banks in Africa and Latin America
 - ❑ Afreximbank
 - ❑ PTA Bank
 - ❑ BOAD
 - ❑ ECOWAS Bank
 - ❑ East African Dev. Bank
 - ❑ ANDEAN Dev. Corpn.
 - ❑ CABI
 - ❑ CDB

Cooperation at National level too exists

- ❑ **National level cooperation to facilitate trade settlement:**
 - ❑ **Asian Clearing Union**
 - ❑ **Chiang Mai Initiative of ASEAN**
 - ❑ **Argentina – Brazil Bilateral Currency Settlement Agreement**
 - ❑ **China's Yuan based credit line agreements**

South-South Trade has been growing

Increasing influence of developing regions in global trade

Exports of Developing Countries to	2000	2010	CAGR (2000-10)
World	2418.2	7254.1	11.61
Industrialized Countries	1169.7	2859.6	9.35
<i>Share (%)</i>	<i>48.4</i>	<i>39.4</i>	
Developing Countries	1248.5	4394.5	13.41
<i>Share of Africa's exports to devpg. countries</i>	<i>30.3</i>	<i>43.2</i>	
<i>Share of Asia's exports to devpg. countries</i>	<i>55.2</i>	<i>64.5</i>	
<i>Share of CIS's exports to devpg. countries</i>	<i>41.1</i>	<i>39.4</i>	
<i>Share of Middle East's exports to devpg. countries</i>	<i>56.5</i>	<i>67.1</i>	
<i>Share of LAC's exports to devpg. countries</i>	<i>38.7</i>	<i>55.4</i>	

Source: WTO.

Existing Cooperation Framework Inadequate

Developing countries need Trade Finance support

- ❑ South-South trade amounts to USD 4.4 trillion in 2010
- ❑ Assuming 20% of this volume requires trade finance support, around USD 900 billion trade is required to be supported
- ❑ This level of Trade Finance demand is much more than what regional development banks and MDBs can offer cumulatively

Mainline commercial banks represent the major source for trade finance support for developing countries.

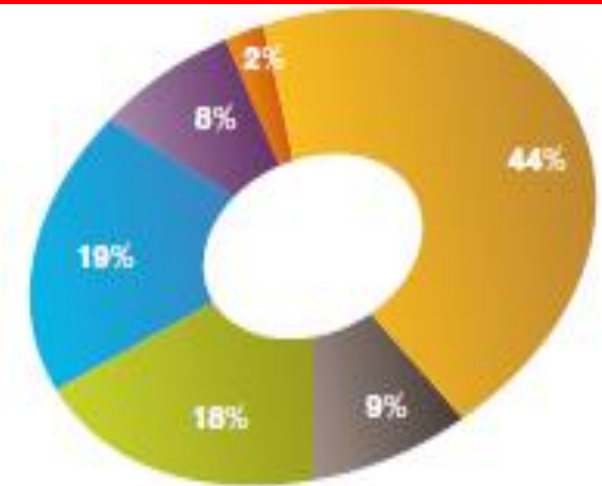
Current Trends in Trade Finance

ICC Survey on Trade Finance (2012)

- ❑ Trade Finance scenario improved a bit in 2011 as compared to the crisis period of 2008 and 2009.
- ❑ However, the improvement is insufficient to cater to the growing volume of trade finance requirements.
- ❑ Risk aversion, higher risk premiums still persist in trade finance market leading cost escalations.

If left unattended could cause damage to trade growth

Export Transactions Volume Break-up



Source: ICC Global Survey 2012

Impact of Eurozone Crisis

Market Conditions are Grim following Euro Crisis

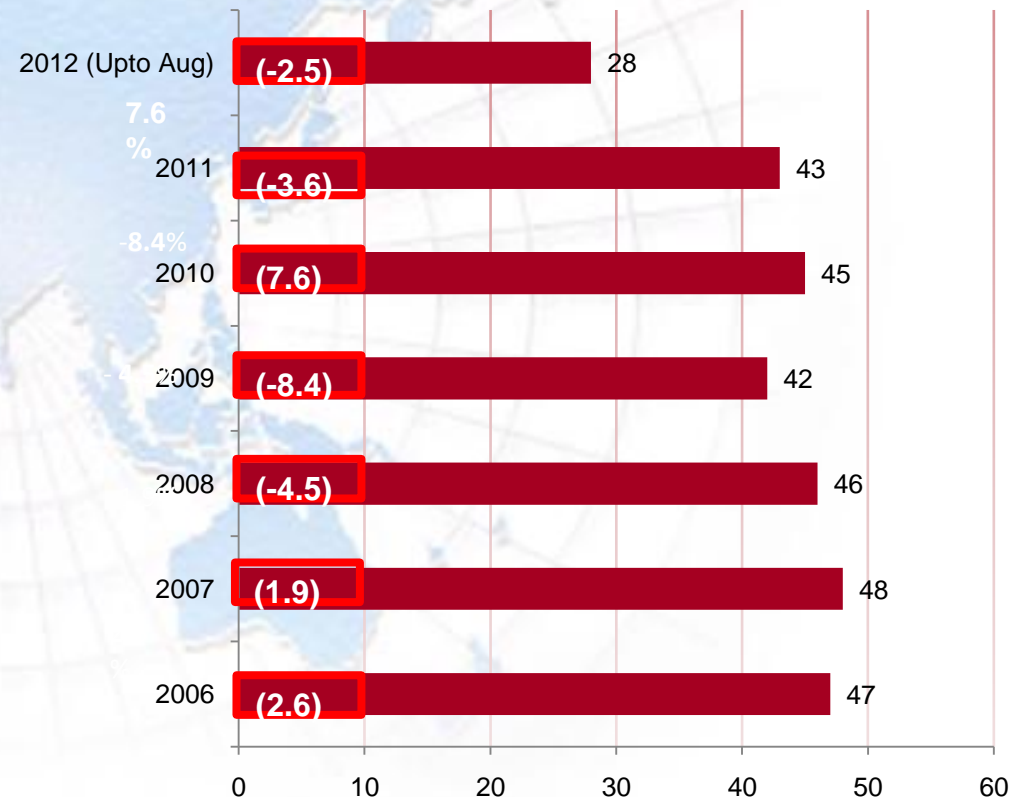
- ❑ Feeble global recovery, already witnessing rapid deceleration
- ❑ Deleveraging by Eurozone banks lead to demand-supply mismatch
- ❑ Prices for Trade Finance transactions for developing countries are impacted by events that are occurring outside the region.
- ❑ Though the trade finance prices are moderating now, still the traders' confidence is again in the grip of volatile markets leading to possibilities of future supply side constraints

Trade Finance Trends

SWIFT Trade Messages

- Annual SWIFT Review reveals that decline in trade messages witnessed in 2008 and 2009 has reemerged in 2011, and continued for the period upto August 2012.

Trade messages in million (growth in %)



Figures on the bar are % growth over the previous year

Source: www.swift.com

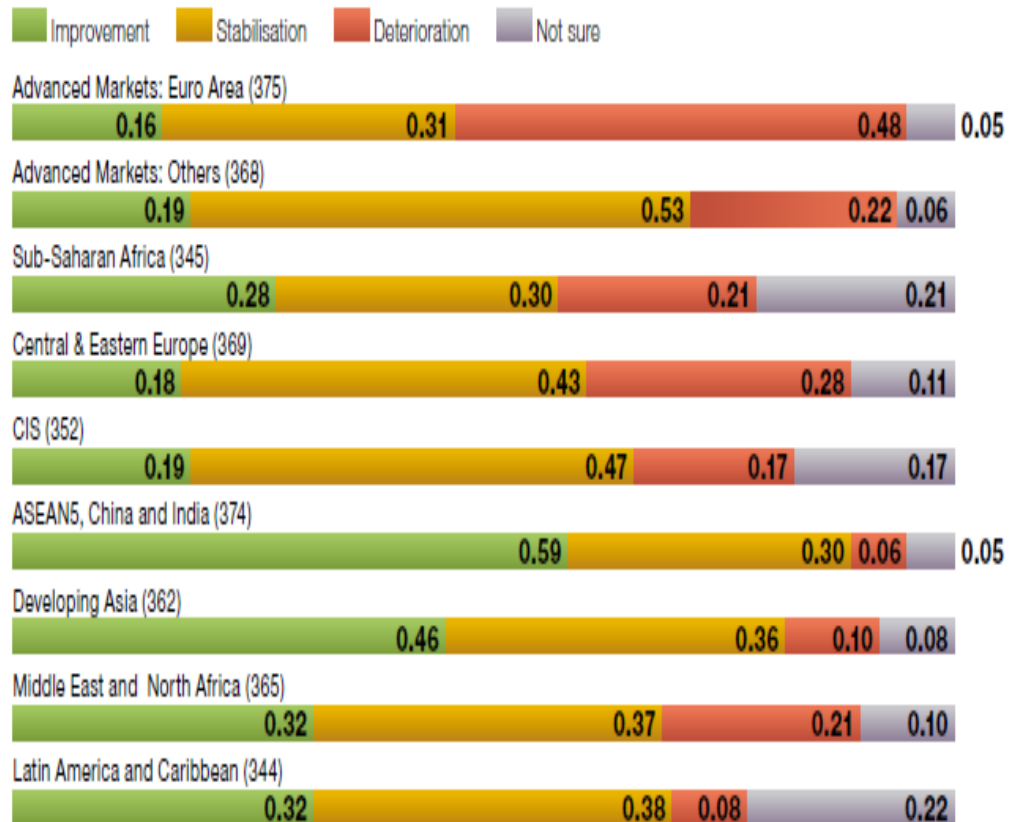
Trade Finance Trends

IMF-ICC Market Snapshot (2012)

- Market developments in Europe led to tighter trade finance lending and low credit / liquidity availability

Implementation of BASEL – III will add pressure on cost of funds and availability of liquidity

Trade Finance Outlook for 2012 (Full sample)



Share of respondents answering each question

BASEL – I Framework and Trade Finance

Recognised the low risk profile of Trade Finance

- ❑ **Special dispensation for Trade Finance by way of low Credit Conversion Factor (CCF)**
- ❑ **CCF was kept as 20% to 50% based on original maturity.**
- ❑ **Short-term self-liquidating trade finance products were given 20% CCF**

BASEL – II Framework and Trade Finance

Superimposed concept of external credit rating

- ❑ Special dispensation for Trade Finance given by BASEL – I was diluted with the condition of obtaining external credit rating.
- ❑ The debatable external credit rating structure put developing countries with high risk perception:
 - ❑ During downturn or economic crisis, mainline commercial banks reduce their trade finance exposures especially to developing countries..

BASEL – III Framework and Trade Finance

The standards set a more restrictive interpretation in terms of quality of counterparty risk

❑ Direct proposals and implications

- ❑ Correlation multiplier of 1.25% to the Asset Value Creation of exposures to regulated financial entities with assets of at least USD 100 mn.
- ❑ Leverage ratio – which would require the banks to set aside 100% of capital for any off-balance sheet, including trade finance instruments
- ❑ Higher liquidity standards for transaction banking

❑ Indirect implications

- ❑ Indirectly the new capital requirements would enhance the cost of operations of the banks, as also the cost of trade finance;
- ❑ Banks have to create a cyclical buffers on top of existing equity.

Experts are of the opinion that the proposals could increase the pricing for trade finance products upto 35%, which could in turn shrink global trade finance capacity by as much as 6%.

Trade Finance: Low level of default risk

ICC – ADB Trade Finance Register

- A joint study by ICC and ADB on trade finance default has concluded that only negligible volume of transactions defaulted during the five year period of 2005-2009.

The average default rate within each of the product type over the analysed period was:

- Import L/Cs 0.06%;
- standbys and guarantees 0.1%;
- export loans 0.17%.
- export confirmed L/Cs 0.28%,
- import loans 0.12%, and

Trade Finance : Structurally Low Risk Transactions

Trade financing transactions are structured under UCP which are well-established in the settlement system

- ☐ Transactions are short-term in nature, self-liquidating, and are backed by L/Cs and Guarantees by banks**
- ☐ Interagency Country Exposure Review Committee of USA has often cited trade finance credits granted by US banks to entities in foreign countries have a low risk of default.**
- ☐ BASEL – I recognised the low risk level of trade finance products**

Experiences during the global financial crisis of 2008-2009, as also the current Eurozone crisis suggest lacunae in the credit rating methodology and model , both for sovereign rating and corporate rating.

**Is it not important to recognise the low risk
and low default rate of trade finance transactions?**

Multilateral agencies like UNCTAD have a role to play

THANK YOU

Website

www.eximbankindia.in