Trade finance and the eurozone crisis: ripples across the Atlantic?

The global financial crisis and its repercussions continue to be felt in most parts of the world, the US continues to wrestle with deficit and unemployment issues, and the eurozone battles sovereign crises that threaten the fabric of partnership, and the future of the euro. Alexander Malaket explores the impact of the eurozone crisis on trade finance in the Americas.

Mike Quinn at JP Morgan in New York

Dyanne Carenza at Scotiabank in Toronto

The business of trade finance is, by its nature, fundamentally cross-border, and increasingly global in scope and influence. Just as the global crisis reminded importers and exporters, and their bankers, that risk remains an inescapable reality of international commerce, the current crisis in the eurozone reminds us all that country and sovereign risk are core to the risk equation.

European financial institutions have long been important players in the trade finance business; while the major providers of trade finance have remained largely committed to and active in the business, there have been some crisis-driven bank mergers and domestic retrenchments that have combined to reduce capacity and liquidity in global trade finance.

Regulatory pressures, including the need for banks to assess and prepare for the impact of Basel III, are also contributing to an overall contraction of liquidity in the trade finance space. While the euro had gained traction as a currency of international commerce, and the renminbi (RMB) is garnering significant attention, it remains a reality – and will in the medium term – that the US dollar occupies a unique position as the primary currency of global business.

The challenges faced by the biggest economy on the globe have impacted international trade in numerous ways, including the active search by exporters for alternate markets, and the need for banks and businesses alike, to address recurring issues around dollar liquidity. Large US institutions note that the demand for dollar liquidity remains consistent, at higher than pre-crisis levels. Trade finance pricing has not quite reached pre-crisis levels, but has largely normalised in comparison to its peak levels, and overall, it appears that the level of trade and financial supply chain finance available is sufficient to sustain current trade flows in most markets.

Crossing the pond?

But has the eurozone crisis traveled across the Atlantic, to materially impact trade finance in the Americas?

While there were reports of impact particularly seen in the last quarter of 2011, senior executives report that trade finance business, as reflected in unfunded activity (confirmed credit risk) and as can be observed through transactions in the secondary markets, are showing signs of normalising. While funded business has lagged, there are also reports that this type of business is returning to familiar ground.

Top US financial institutions perceive some opportunity as a result of the retrenchment of European institutions, several of which are politically driven to focus on supporting domestic financing requirements. One area where opportunity is being perceived, relates to commodity trade, where large US financial institutions have seen greater interest in non-letter of credit (LC) based financing, including straight loans in the commodity trade space.

By several reports, it appears the eurozone crisis has had limited negative knock-on impact in the Americas, given the relatively limited trade flows, and significant offsetting focus on Asia and other markets. Per-

Angela Martins at Banco Pine in Sao Paulo

Bruce Proctor at Bank of America Merrill Lynch in New York

haps paradoxically, bankers in the US, Canada and Latin America see the eurozone crisis, at this moment, as having marginal impact, if anything, presenting opportunity for the more robust financial institutions to step in and fill gaps left by retreating European institutions.

Mike Quinn, managing director at JP Morgan treasury services in New York, observes: "The situation in Europe is not driving a fundamental change in our strategy, which has been carefully developed in light of market conditions and opportunities. We refine our approach incrementally where appropriate, and are not taking an opportunistic view on the challenges faced by financial institutions and businesses in Europe or elsewhere."

He adds: "We are not running up our book of business indiscriminately, rather, asking first if particular opportunities fit our strategic focus. We have remained in our core markets, including those in Europe, through the worse of the crisis, and continue to be there today."

The Canadian experience is similar for certain institutions. It has been widely recognised and reported that the Canadian economy and the financial institutions, including those engaged in trade finance, have fared well through the crisis, and continue to do better than most. Trade with Europe is also relatively limited, and bankers report limited direct impact from the eurozone crisis.

Some Canadian banks have a more international outlook however. Scotiabank executives refer to the bank as Canada's "most international bank", given its significant international activity and physical presence in over 50 countries.

Dyanne Carenza, vice-president, product development and business planning, global transaction banking, at Scotiabank in Toronto, notes: "Canadian banks are prudently managed and work in a strong regulatory environment. At Scotiabank, our balance sheet is solid and we have sufficient liquidity to fund the business we choose to support, including bringing dollar liquidity to the table."

She adds: "We have observed that many financial institutions have had to pull back, but we have been strategically active and on a growth trajectory in Europe, including in markets like Turkey that is in a 'sweet spot' between Europe and Asia. Overall, we are fully engaged in trade finance due to our solid experience and strong on-the-ground presence in the markets we serve, including those in the eurozone."

Several commentators have observed that financial institutions are working to create strategic partnerships and alliances, with a view to addressing market demand and complementing capabilities and capacity through well-selected FI relationships. The flight-to-quality in selecting commercial and corporate client relationships continues, and most observers concur that developments in the supply chain finance space will continue to move forward.

LatAm normalisation

Latin America has shown signs, likewise, of normalisation, even growth in the leading economies, like Brazil, where infrastructure investments have created value and opportunity.

The eurozone crisis has had, it appears, limited direct impact on the leading economies in Latin America. It has been noted that trade finance sourced from Europe accounted for just less than 40% of the total, pre-crisis. With certain European institutions still active in the region, liquidity and availability of trade finance in Brazil, Colombia, Peru and Chile has been impacted on pricing, but not materially as far as volumes or liquidity are concerned. While Portuguese, Italian and some Spanish banks have restricted their activities in Latin America, leading German banks remain active.

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Brazil is uniquely positioned as one of the emerging BRIC powers, with direct experience managing financial crises, and past experiences from political and regulatory authorities, and bankers, have enabled the country to draw valuable lessons. While recent announcements from Brazil related to the imposition of a tax on foreign-originated trade finance were less than enthusiastically welcomed by the industry, there is a domestically-based rationale for such action. Suggestions are however, that these measures will have to be tempered in order to avoid eventual adverse impact on funding costs and on the commercial activities of Brazilian businesses.

Brazil's growth, is fuelled in part by trade and by commodity exports, however, domestic demand is the major driver, and the Brazilian authorities are more concerned with the adverse impact of excessive capital inflows on the Brazilian real and on domestic inflation. At the moment, funding in foreign currency offers no advantage to funding in Brazilian real. As such, the Brazilian banks do not appear to be overly concerned about this aspect of trade finance.

Regulatory authorities are proactively and visibly engaged in financial sector oversight, from verifying the consistency of corporate risk rating between banks, to offering financial institutions the option of depositing funds with the central bank at zero returns, or, using such funds to provide liquidity to mid-tier➤

Mike McDonough at BNY Mellon in New York

➤banks in exchange for positive returns. This approach motivates larger institutions to provide liquidity to benefit the domestic economy, and to benefit mid-corps and smaller enterprises.

Angela Martins, executive director at Banco Pine in Sao Paulo, observes: "The financial sector in Brazil is very solid, and the business of trade finance for Banco Pine has been robust and growing. Our experience with the financial crisis, and the effective measures of the government and the central bank, have established a strong foundation, and we are particularly well positioned to respond to the needs of the low corporates segment, with revenues in the 500 million to two billion reals – a segment that is emerging, and in need of liquidity and increasingly sophisticated solutions. We have been able to take advantage of the exit of certain financial institutions, and have enjoyed a two-level upgrade to our S&P global rating."

Local businesses in Brazil are concerned about concentration in banking relationships, and will actively seek to develop multiple financial sector relationships, often maintaining three or four banking relationships to meet their requirements.

Overall however, the business of trade finance is robust and dynamic. Some of the larger financial institutions are reporting ongoing investment and project planning among both their corporate clients and their financial institution clients. In the US, record-low borrowing rates are positively impacting planning activities targeted at the medium to long term, particularly aimed at building production capacity. ECA-backed trade finance business is robust and evidences a solid pipeline of business in Europe and in Asia, among other markets.

Bruce Proctor head of global trade and supply chain finance at Bank of America Merrill Lynch in New York, observes: "We are seeing a lot of opportunity for trade finance in a variety of areas, including the extractive industries, airlines and other sectors with long-term horizons. We are well-positioned, with balance sheet strength and ample liquidity to support our clients. We are looking at a lot of new deals and facilities, though we are selectively pursuing opportunities and remain focused on high credit standards.

"We continue to be fully engaged with our clients, doing the right deals under appropriate structures, as we take the long view on transactions and on the business objectives of our clients. There is clearly some degree of pent-up demand in the market and, in conjunction with very low borrowing costs, we believe we'll be seeing increased volumes of cross-border trade activity. Quality delivery, differentiation and the ability to integrate into client plans will make the difference."

While there is, rightly, a great deal of attention on the eurozone crisis on several levels, including as relates to certain trade flows, it is observed that about 60% of global trade flows today are intra-Asia. Trade finance specialists must take a balanced global view of market conditions and evolving trade flows.

Steady as she goes

In sum, the view from the Americas appears to be that the Eurozone crisis has had, so far, only limited impact on trade and trade finance, whether in terms of funding or in terms of the demand for dollar liquidity.

Mike McDonough, managing director, BNY Mellon global trade and supply chain product management, based in New York, states: "The measures taken by the EU and the European Central Bank have thus far succeeded in tempering the impact of the eurozone crisis. That said, we continue to see financial institutions taking a more cautious approach, both those in the region and in other parts of the world. Notwithstanding the persistent risk of further complication and crisis in Europe, we sense a level of 'normalisation' in the trade finance space, and a reduction in tensions.

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"There is significant demand for dollar liquidity," adds McDonough, "attributable in part to the US dollar's continuing role as the leading currency of commerce for the medium-term. The euro has made some inroads as a currency of trade, and the RMB is the focus of much attention, but given the US dollar's importance to trade finance for the foreseeable future, institutions well positioned to provide dollar liquidity will enjoy a measure of competitive advantage. For BNY Mellon, the strength of our balance sheet and our capabilities around liquidity and funding allow us to remain strong partners to our financial institution clients in Europe and in the other global markets we serve."

The eurozone crisis is unquestionably of critical importance on numerous levels. As far as trade and supply chain finance in the Americas, however, it seems the ripple from across the Atlantic has had limited direct impact, representing more of an opportunity than a case of 'crisis contagion'. ■