Regional solutions yield global results

Alexander R. Malaket explores some selected regional issues and themes related to the financing of international trade.

Dominic Broom at Bank of New York Mellon in London

Trade finance has been significantly impacted by the global crisis, and at the same time, has had its profile raised to the highest levels. While the economic crisis is often spoken of in the context of globalisation and inter-dependence, the reality is that regions across the globe are affected in unique ways. Trade finance, similarly, has its distinct characteristics in various markets, and the state of trade finance varies accordingly.

Global trade, global finance

Finance is international. Even finance which is meant to address the needs of domestic operations, or enhance the returns of a domestically based pension plan or mutual fund, will often include a direct or indirect international element. Capital markets are increasingly integrated and cross-border, financial mobility is enabled and more rapid despite various security, anti-money laundering and anti-terrorism measures.

In international commerce, it is increasingly the reality that imports, exports and investments (inward or outward) are part of an integrated whole. Exporters often must import inputs to production, and traders are increasingly involved in business arrangements which require investment in their target markets. Similarly, what were once very narrow definitions of national interest – straight exports of domestically produced goods – have broadened considerably, to the degree that government agencies now justify equity investments in foreign firms, as a matter of national interest. The increasingly creative, far-reaching mandates of export credit agencies are a direct result of this broader view.

At the same time, top-tier risk insurance providers, partly of fully privatised, have so extended their reach, that a Canadian company doing business in Chile might easily be supported by guarantees or risk mitigation solutions offered through a European provider.

Trade finance is global, and the economic crisis has touched the financing of cross-border business in different ways, depending on where the deal takes place on the map.

Middle East & Africa

At the start of the financial crisis, one or two markets in Africa were identified as being fully insulated from the anticipated effects of the crisis. The Middle East, in particular because of the conservative, stewardship-oriented approaches to banking required under Shari'a law, was held up in contrast to some of the reckless practices which drove the global economy to crisis

As the crisis inevitably evolved from financial to economic, and financial services companies retreated from international markets to the relative safety of domestic markets – often at the demand of governments whose bailout money was keeping those institutions on life support – the realities quickly changed across Africa and in parts of the Middle East.

While even the most promising economies of the region were impacted by aspects of the crisis – as well as a significant drop in the price of oil – the optimism of leaders and financiers in the region, and those most familiar with the area, has been strikingly resilient.

Dominic Broom, managing director, market development, treasury services EMEA at the Bank of New York Mellon, in London, notes, "We believe that leading economies in the Middle East will be a key engine of growth for the world economy, given limited exposure to toxic assets. Infrastructure spends are far outpacing what we see in Europe at the moment. Those investments, coupled with increased interregional trade, and the development of a vibrant, competitive SME segment will drive the region ahead. The business needs of the region are motivating an evolution in➤

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Jean-Paul Riolacci at BNP Paribas in Paris

➤bank-to-bank partnerships and relationships, combining local delivery capabilities with global reach."

While the implications of recent fraud and financial loss in Saudi Arabia reverberate across the region, and talk of real estate bubbles in Dubai attract attention, authorities continue planning infrastructure investments, and pursue diversification strategies to reduce dependence on oil revenues.

In Africa, the crisis has, by most accounts, adversely affected the SME segment, and poses some risk to poverty-reduction measures tied to export and trade development. While some specialists challenge anecdotal evidence about SME difficulties in accessing viably-priced financing, the reality described by others is more in line with 'the textbook': crisis sparks an exodus from developing markets, credit tightens up and becomes untenably expensive, and SMEs are the first to suffer.

Africa and the Middle East face their own set of challenges in working through the crisis and positioning for the post-crisis reality of trade and trade finance. Both regions exhibit broadly acknowledged potential, and may, from a trade finance perspective, exit the tunnel of crisis in better shape than they entered it.

AfDB provides crucial level of support

The recent initiative by the African Development Bank (AfDB), to introduce a Trade Finance Programme similar to those which exist elsewhere introduced by other DFIs, is perhaps testament to the reality on the ground. Africa was hit with a reduction in demand for exports, unfavourable volatility in foreign exchange markets and a significant reduction in the inflow of remittances.

According to those familiar with the launch of the programme, the AfDB acted quickly, devising a two-tiered programme including a $1.5 billion Emergency Liquidity Fund in support of financial institutions in Africa, and a $1 billion trade finance Initiative, half directed at supporting the use of letters of credit (LCs) facilitating trade, and half under the auspices of the IFC's new Global Trade Liquidity Programme.

Ghazi Ben Ahmed, trade finance specialist at the AfDB in Tunis, observes, "The crisis has demonstrated that the focus of development efforts must extend beyond pure infrastructure, to enable and facilitate commercial activities and trade. SMEs are a key recipient group in terms of support from the bank, and our efforts will extend to trade finance, supporting traditional markets as well as an increasingly vibrant level of intra-African trade.

"In Africa, efforts to address the most fundamental issues, from food crisis to poverty reduction to crisis in development, are interwoven, touching every aspect of life, and the linking thread is often financing – by its availability, or by its absence. The crisis has demonstrated that the bank can take bold steps beside its normal business to be closer to its regional member countries."

Europe

In Europe, the crisis has had significant impact in both its iterations – financial and economic. While there is arguably a balanced political environment as relates to the engagement of government in areas of market activity, the receptiveness of stakeholders to public sector intervention has been cautious and often counterbalanced by concerns about runaway deficits and endless bailout.

While Europe was often discussed in terms of the high degree of open account trade flows in pre-crisis days, the severe impact of the crisis on key industries and important trading markets, as well as the significant impact to financial institutions across continental Europe and the UK, have shifted the discussion markedly toward the risk mitigation dimension of trade finance.

ECAs and various government agencies have been active and engaged in responding to the crisis, and their interventions have been, overall, well received.

Markus Wohlgeschaffen, head of global trade finance and services at HypoVereinsbank/UniCredit Group in Munich observes: "The interventions by ECAs and government agencies has been largely welcome, particularly as a partnering risk-taker in supporting critical industries and transactions. Liquidity injections and risk mitigation support in the form of guarantees have been invaluable. There remain opportunities for the public sector to further assist and enable international trade – at the level of regulation and process.

"ECA cover on the buyer side, for example, was always meant to enable banks to finance investment goods. Now, more existing ECA-insurance products such as supplier-side or buyers portfolio ECA cover, could be used to provide more and faster liquidity. For this purpose immediate and indisputable equity relief under the new Basel II regulations is mandatory. Similarly, as governments and their partners offer greater support in facilitating confirmations of letters of credit, any programme, however well-intentioned, that requires eight weeks or even more for approval will miss the mark, given the speed at which the underlying trade transaction must be concluded."

There is a suggestion from some quarters that Europe has been, in some respects, about six months behind the Americas in its response to the crisis – the example cited being a relatively recent focus on SMEs. In any event, the leading economies of Europe remain drivers of the global economy, and there is broad consensus that the actions of government have been helpful and effective, imperfections and all.

Jean-Paul Riolacci, global head of GTS at BNP Paribas in Paris, notes: "There are some realities in dealing with ECAs and government agencies, but it is important to appreciate that these agencies are often approached to finance or provide security in transactions where there is little knowledge about a counterparty, and where the transaction is inherently risky. Experienced exporters know to engage ECAs in discussions as early as possible for sizable transactions, and to provide as much detail as possible, to facilitate appropriate assessment and due diligence of recurring and important buyers.

"The involvement of ECAs is important to provide comfort under current conditions – to banks as well, given the requirements under Basel II. It should be noted also that the interventions of international institutions such as the IFC have been quick, decisive and largely effective. All things considered, we perceive that the system of trade finance has been quite resilient throughout the crisis. But it cannot replace orders."

It will be interesting to observe the post-crisis nature of trade and trade finance in Europe. Will a major centre of pre-crisis open account trade shift to more emphasis on risk mitigation, and what will be the enduring effects on the financial sector in the region?

Asia

Asia may have been geographically removed from the origins of the financial and economic crisis, but, from the perspective of globalisation and ever-increasing interdependence of economies, it was about as close to the centre of the crisis as Wall Street.

While the local and regional financial sectors escaped relatively unscathed, the evaporation of pre-shipment finance and the demand-based economic crisis which followed the financial sector debacle across the Pacific was felt acutely throughout much of Asia.

The epicentre of the race for power and prosperity between India and China, saw many of its leading economies shaken by reduced trade flows and recession. Normally bustling ports at a standstill, shorelines looking for ways to earn revenue as anchorage points for empty vessels, and the prospects of protectionism and reversals of offshoring initiatives painted a bleak picture for much of the year.

Pre-crisis discussions about the advantages of decoupling (particularly from the US economy) have been revisited even as everyone acknowledged the need for a global solution, and top advisors spoke of the necessity for increased intra-Asia trade as a key element of the region's crisis resolution strategy.

In this as in many other respects, Asia has been a region of sharp contrasts.

Observes Lok Nath Mishra, head of commercial banking at ICICI Bank in Mumbai: "India has been insulated – in relative terms – from the worst effects of the crisis, due to the existence of strong domestic consumption, and due to the makeup of India's trade, with exports to the US and Europe heavily skewed toward software products. The trade credits market is showing very clear signs of softening, with pricing reduced from rates as high as 300 basis points above Libor, to a more typical current level of 60-70 points


Simon Constantinides at HSBC in Hong Kong

above Libor. That said, there is also an increased focus on effective counterparty risk mitigation, including in areas such as working capital management. We have nor, however, seen a marked change in trading patterns, intra-Asia or otherwise, through this crisis."

China's experience evolved as far more threatening to the sustained prosperity and growth of the nation, perhaps until recently, when the crisis was characterised as being no more than a 'speedbump' on China's path to prosperity.

Anecdotally, one can hear reports of small businesses with healthy orders and solid prospects, driven to bankruptcy due to an inability to finance production, or in the export sector, a lack of pre-shipment finance and an inability to transact on open account terms.

At the same time however, increasing domestic demand fueled in part by a change in saving and borrowing habits (read increased spending), coupled with the evolution of the yuan as a regional currency, lend credence to those who posit imminent recovery in the region.

Wang Guosheng, general manager, global trade services at Bank of China notes, "Against the backdrop of worldwide financial turmoil, major international currencies like the US dollar and euro have experienced large fluctuations and the international monetary system has shown an increasingly obvious trend of diversified development. The market has an increasing expectation and demand in taking RMB as the instrument of payment; what's more, the market-oriented development of the RMB exchange rate fix mechanism creates favourable condition for enterprises to choose RMB as the payment and settlement currency.

"On July 6, RMB settlement pilot work for China's cross-border trade started formally, marking the enhanced position of RMB from pricing currency to settlement currency in international trade settlement. The promotion of RMB settlement business suits the needs of markets and enterprises at home and abroad for taking RMB as the instrument of international payment, [and] is good for trade growth between China and its neighbours.

"[It also allows] for enterprises to choose proper settlement method, avoid exchange rate risk, go through simpler cross-border trade procedures and have lower trading cost, and for banks to expand business scope, enhance service quality and consolidate business cooperation with enterprises. These distinctive advantages from RMB as the very currency for settlement enable RMB to be more influential and acceptable by more and more countries and regions in world trade.

The earliest launching of RMB settlement business for cross-border trade will help the RMB to grow into a regional currency. With its more frequent and wider use in international trade settlement, RMB will have better settlement functions and more common regional mobility. This will also create a good external environment for further promoting the opening RMB exchange rate and capital account. "

It makes intuitive sense to expect that prospects for intra-Asian trade will be positive in the post-crisis commercial realities, given the sheer size of the combined economies and the high rates of growth which continue to be forecast relative to other regions. Perhaps equally importantly, the ongoing development and formalisation of regional trade agreements has created markets which present tremendous long-term opportunity.

Simon Constantinides, head of trade and supply chain, Asia-Pacific at HSBC in Hong Kong observes: "Due to our historic ties in Asia, it is natural that HSBC closely follow the intra-Asian trade patterns. With the recognition that no market is immune from the effects of globalisation we are very focused on understanding and leveraging our wide franchise to service the needs of our clients as they operate not only inter-regionally but also intra-regionally.

"Identification and understanding of intra regional trade flows has received increased attention now because the effects have been magnified as a result of current market conditions. The strength of our network in Asia naturally positions us to be on both ends of many trade transactions and this has enabled us to get a better view than most of how intra-Asian trade is developing and evolving.

"We continue to focus heavily on these emerging trade corridors and are looking to continue to support our clients and develop their businesses in this region. In terms of trade growth, 49% of businesses surveyed in HSBC's Trade Confidence Index indicated they are looking at China, with growth prospects for Western Europe and the US/Canada significantly behind at 13% and 8% respectively. It is increasingly clear that once global trade growth picks up, it will be driven by Asia and the Middle East."

Americas

The Americas provide several interesting perspectives on the global crisis – devastation from Wall Street to Main Street in the United States, contrasted by the impressive, and now highly-regarded stability of the Canadian financial sector, as well as the decisive, economic battle-hardened reactions of Brazil and other jurisdictions in Latin America.

Much has been written and said about the stunning financial and economic debacle in the US; at this stage, as positive economic reports begin to trickle in from various parts of the world, the interesting issue may be around the long-term implications of the crisis in the US and beyond.

A core question related to the US revolves around the post-crisis dynamics between financial institutions and public sector entities. Has the crisis been severe enough to irrevocably alter the landscape, in a country profoundly shaped by free-market tenets?

Sanjiv Sanghvi, CEO of the Trade Bank and EVP at Wells Fargo in San Francisco notes: "The clients we serve in the mid-market are challenged by reductions in demand, as opposed to any trade-related 'financing gap' which has been the subject of much attention elsewhere. Pre-crisis questions about the need for ECAs have faded to some degree, and the market appreciates the option to access ECA support, although in the US the Small Business Administration has been a key player in the provision of liquidity to the SME and mid-market segments.

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Susan Baker Shipley at RBS in Pittsburgh

Eduardo Klurfan at Scotiabank in Toronto

➤"For our clients, the degree of engagement with ECAs is largely driven by the availability of alternatives. We see ECAs and government agencies yielding to private sector providers once the situation normalizes, even though there has been some energetic debate related to 'free market orthodoxy' over the past months. Fundamentally, we continue to be optimistic about prospects for US exporters, and are very excited about the combined value proposition in Wells' strong commercial franchise, coupled with Wachovia's solid FI-based capabilities."

There is no doubt that the public-private dynamic in the context of trade and trade finance, has been changed significantly – perhaps irreversibly – by the financial and economic crisis. While the voices of free-market economics remain strong in the US, there has been much consideration of public sector enabled measures and solutions to mitigate the effects of the crisis.

In a market where the benefits of ECA support need to be articulated to exporters, to counterbalance unfavourable opinions about government bureaucracy and intervention, the actions of US Ex-Im Bank and others have been gratefully welcomed by most.

While some jurisdictions such as Canada exhibit bank/ECA relationships characterised by both competition and collaboration, the US clearly requires its ECA to avoid competing with the private sector.

Valentino Gallo, Americas head, export and agency finance at Citi in New York notes: "The role of ECAs is, to an extent, anti-cyclical in nature, and there is a long-standing tradition of cooperation and complementarity in the roles of banks and ECAs. The increased engagement and activity of ECAs is very well viewed in the market, and welcomed by banks and traders alike, particularly as it relates to the support of emerging market business.

"The extent of support is well illustrated by the US Ex-Im`s creation of what amounts to a 'put option' on Ex-Im-backed loans: in the event of a return of liquidity issues (as defined by specific metrics and thresholds), banks can effectively transfer 100% of the loan to US Ex-Im; the support is practical and creative. So far, we are not seeing private sector providers of trade finance being 'crowded out' by the ECAs."

In some respects, financial institutions that might have had a less favourable view of the bank/ECA relationship, have had little choice but to warm up to the role and value of these public sector institutions and their privatised or semi-privatised counterparts from other regions of the globe.

Just as banks had in place significant measures related to lending and customer due diligence, corporate and commercial customers are now looking much more carefully at the health and viability of their financial institutions.

The seriousness of the situation was illustrated in the earlier stages of the crisis, when top-name US banks were forced to seek letter of credit confirmations from Canadian financial institutions.

Susan Baker Shipley, North America head of global trade finance at RBS in Pittsburgh, observes: "There is a significant focus among corporates on counterparty risk. Companies are rationalising the number of banks with which they do business, and are making sure that their banks are high-quality and will survive. In the US, we are seeing the concept of 'defaulting lender' language in revolvers of all types, which was not the case a year ago. Companies have become concerned that their liquidity might disappear, and this concern has extended to banks that provide cash management and trade finance services. Some companies that had formerly consolidated their transaction banking relationships have decided to diversify."

Under such pressures and in the context of such perceptions, it is no surprise to see that ECA and government interventions have been met with a variety of reactions, from the grudging acceptance typical in pre-crisis times, to a level of appreciation rarely directed at public sector institutions meddling in the mechanics of the free market.

In contrast to the US, and perhaps similarly to Canada, Latin America is a victim of the hemispheric and global crisis, rather than internal challenges. A key reality is that many economies in the region have significant experience with economic crises, and have been able to respond quickly and decisively in the current situation.

Eduardo Klurfan, vice president, trade finance and financial institutions at Scotiabank in Toronto states: "Economies in Latin America in particular, are accustomed to responding quickly to situations of crisis. The Central Bank of Brazil injected \$15 billion in trade-related liquidity into the market very soon after the crisis erupted, organized and executed an auction almost overnight, and made this funding available at below-market rates, reducing spreads. Colombia and Chile reacted in similarly decisive fashion. Together with effective action born of experience, the region benefits from financial institutions like Scotiabank, that stay the course and demonstrate a similar resilience and commitment in the face of crisis."

While the financial and economic crisis has touched virtually every region on the globe, either directly, or through the contraction in demand which drove economies from crisis to recession, it is equally true that many markets – and the political and business leadership of the day, untested in such circumstances, have responded with some success. Coordinated efforts across geographic, economic and political boundaries have assisted in mitigating the duration and severity of the crisis, and in all areas, there are finally some initial signs of recovery.

Trade remains an important driver of economic stability and growth, and has again been looked to, despite strong protectionist sentiment in some quarters, as an indispensable force in driving global recovery.

Trade finance, normally a quiet enabler in the background of global commerce, has seen an unprecedented level of profile and attention, and has, in many respects, proven itself in the heat of global crisis. The value of trade finance has been acknowledged at the highest levels, and perhaps now, this line of business can enjoy some measure of stature in financial institutions which have, historically, underestimated its importance and worth. ■