Issues in Trade Finance

Purpose: Information
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Issues in Trade Finance

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Nature of international trade

- Cash-in-advance
- Cash on order
- Open account

- International transaction typically involves higher levels and numbers of risks (i.e. exchange rate risks, political and non-payment risks)
- International active firms also have larger financial needs (e.g. the time lag between production and delivery)
Roles of trade finance

Ordering ➔ Production ➔ Transportation ➔ Delivering ➔ After-sale

TRADE FINANCE

Payment Facilitation
• Secure
• Timely & prompt
• Global
• Low cost
• All leading currencies

Financing
• Providing capitals to parties in a supply chain or trade transaction

Risk Mitigation
• Risk transfer
• Mitigate political and commercial risks

Information flow facilitation
• Financial flows
• Shipment status
• Quality of shipment
Trade finance is vulnerable to financial crisis, thus impeding trade flows

Change in exports and trade finance during October 2008 – January 2009 (%)

- Trade finance – typically low risk, high collateral – was not exempted from the 2008 GFC
- The difficulty of securing and enforcing credible commitments across borders makes trade finance more vulnerable in times of turmoil

Source: Asmondson et al
The current state of trade finance

- Difficulties in raising USD funding and new capital rules caused European banks to reduce lending.
- Total global trade finance volume fell by 5% in 2012 to USD 171.0 billion from USD 180.9 billion in 2011.
- The number of deals also fell by 36% to its lowest level since before the GFC, with 718 deals completed in 2012.

After steadily recovering following the GFC, global trade finance declined in 2012

Source: Dealogic. (Data for 2012 are preliminary.)
Many APEC economies traditionally relied on Europe for trade finance.

- European banks have been playing a prominent role in providing trade credit in Asia.
- European banks specialize in complex project financing, which would not be substituted easily.
The role of European banks has been diminishing in the APEC region

For 7 reporting APEC economies, claims from developed European economies as a share of total foreign claims fell between 2008 & 2012.

Asian banks are stepping up in providing trade credit to the region: Mitsubishi UFJ Financial Group increased market share to 16.6% in Q1 2012 while that of Sumitomo Mitsui Financial increased to 9.6%

Source: Bank for International Settlements and PSU calculations.
SMEs have not been able to benefit from the abundant global liquidity and low cost of trade financing.

SMEs in developing economies – given their opacity, lack of collateral and audited financial statements, are considered as high risk by banks.

SMEs in some developing APEC economies, such as Viet Nam and Russia, are experiencing difficulties in obtaining trade finance.

Demand for the ADB’s trade finance facilitation program increased strongly in 2012.
Basel III is expected to have a negative impact on trade finance

- Standard Chartered estimates that the implementation bank capital requirements under Basel III could raise the average cost of trade finance by up to 40%, thereby reducing its lending capacity by 6%.
  - Such a reduction in trade finance could potentially shrink the volume of world trade by 2% and global GDP by 0.5%.

- In a recent survey conducted by the ADB, 79% of respondents indicated that Basel regulatory requirements were a significant obstacle limiting trade finance.

- In April 2013, Europe relaxed Basel III trade finance rules but other economies have not yet followed suit.
Empirical evidence shows that:

• Access to trade finance enhances the probability of becoming an exporter

• Economies in which trade finance is either more difficult or more expensive to obtain tend to export less
K9 Natural, a pet food company in New Zealand, won a new contract with NASDAQ-listed buyer.

- Buyer required 60 day credit term
- K9’s first major export sale
- Private insurer declined cover due to single buyer risk
- With the help of NZECO, K9 Natural obtained USD 2 million trade credit
- K9 Natural became the fastest growing manufacturers in New Zealand: from a small business with NZD 650,000 of sales to NZD 5m turnover and to 22 staff in three years through an export focus.
- It has become one of the most popular international brand in dog food with the United States, Canada, Japan and Hong Kong, China being its main overseas markets.
APEC Policy Support Unit’s issues paper on trade finance: Outline

Introduction

• provides a thorough explanation of trade finance, including its role in global trade, as well as an overview of APEC’s work in this area

Recent Trends in Trade Finance

• analyses recent trends in trade finance, drawing out the issues currently facing trade finance both globally and across the region, with a particular focus on how the current challenges impact SMEs in APEC

Trade Finance Conditions in APEC Economies

• examines the current issues impacting trade finance in the APEC economies, including measures recently undertaken by members to ensure the flow of trade finance

Conclusion and the Role for APEC

• suggests a possible way forward for APEC economies to address the issues affecting trade finance that are discussed in the paper
### Question 1: Currently, is there a trade financing problem in your economy? If so, how serious is it?

- No problem
- Not serious
- Moderately serious
- Very serious

### Question 2: What are the main reasons leading to the trade financing problem in your economy? (Respondents can tick more than one box.)

- General liquidity shortage in the economy
- Increased risk aversion of financial institutions towards companies
- Higher perceived counterparty risks of banks
- Higher cost of capital of banks
- Increased capital requirement of banks
- Others; please explain: __________

### Question 3(a): What are the existing measures that your economy has implemented to ease the trade financing problem? (Respondents can tick more than one box.)

- Export credit insurance
- Working capital guarantee
- Export credit
- Import loans
- Buyer’s credit
- Forfaiting
- Others; please explain: __________

### Question 3(b): What are the new/enhanced measures that your economy has implemented to ease the trade financing problem? (Respondents can tick more than one box.)

- Export credit insurance
- Working capital guarantee
- Export credit
- Import loans
- Buyer’s credit
- Forfaiting
- Others; please explain: __________

### Question 4: How does your economy foresee the trade financing situation developing in the next 6 months?

- Improve
- Deteriorate
- Same
These questions have been revised for the 2013 Trade Finance Survey

**Question 1(a):** Currently, is the demand for trade finance in your economy consistent with the level prior to the 2008 Global Financial Crisis (GFC)?

- Below pre-crisis level
- Around pre-crisis level
- Above pre-crisis level

**Question 1(b):** Currently, is the supply of trade finance in your economy consistent with the level prior to the 2008 Global Financial Crisis (GFC)?

- Below pre-crisis level
- Around pre-crisis level
- Above pre-crisis level

**Question 2(a):** Historically, what has been the role of European banks in providing trade finance in your economy (as a share of the total supply of trade finance)?

- Less than 10%
- Between 10%-30%
- Between 30%-50%
- Between 50%-70%
- Over 70%

**Question 2(b):** Has the retrenchment in European banks reduced their share of total supply of trade finance in your economy? If so, to what extent?

- Not affected
- Moderately reduced
- Substantially reduced
These questions have been revised for the 2013 Trade Finance Survey (continued)

**Question 3(a):** Has your economy implemented any new/enhanced measures to facilitate trade finance since 2009? (Respondents can tick more than one box.)

- None at all
- Export credit insurance
- Working capital guarantee
- Export credit
- Import loans
- Buyer’s credit
- Forfaiting
- Others; please explain: ________________

**Question 3(b):** What are the existing measures that your economy has in place to facilitate trade finance to SMEs? (Respondents can tick more than one box.)

- None at all
- Export credit insurance
- Working capital guarantee
- Export credit
- Import loans
- Buyer’s credit
- Forfaiting
- Others; please explain: ________________

**Question 4:** What are the main impediments for SMEs to access trade finance in your economy? (Respondents can tick more than one box.)

- General liquidity shortage in the economy
- Increased risk aversion of financial institutions towards smaller companies
- Higher perceived counterparty risks of banks
- Higher cost of capital of banks
- Increased capital requirement of banks
- Others; please explain: ________________

**Question 5:** Regarding the publicly-provided trade finance facility in your economy, please provide annual data from 2000 to 2012 for the following:

- Number of requests
- Number of approved projects
- Amount funded (in nominal local currency or in USD)
- Rate of default
PSU’s trade finance issues paper and the 2013 APEC Trade Finance Survey:

- Survey will run from **3 June 2013 to 15 July 2013** (6 weeks).
  - Economies are also encouraged to submit additional information on specific trade finance issues in their economies.

- Preliminary findings from the study will be presented at the Workshop on Trade Finance in Lombok, Indonesia on 1 July 2013.

- Draft Final Report will be circulated around mid-August 2013; members will have approximately 2 weeks to review and provide comments.

- Final Report will be presented at SFOM in Bali, Indonesia on 17-19 September 2013.
Website:
http://www.apec.org/apec/about_apec/psu.html

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