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Economic Cooperation**

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## **Issues in Trade Finance**

Purpose: Information

Submitted by: PSU, APEC Secretariat



**11<sup>th</sup> Senior Finance Officials' Meeting  
Manado, Indonesia  
22-23 May 2013**

# Issues in Trade Finance

22-23 May 2013  
APEC SFOM, Manado

*Presented by*  
Quynh Le  
APEC Policy Support Unit

Advancing Free Trade for Asia-Pacific Prosperity



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# Nature of international trade



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*Increase in payment risk for exporter*

Cash-in-advance

Cash on order

Open account

*Increase in payment risk for importer*

Ordering

Production

Transportation

Delivering

After-sale

- 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



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## 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

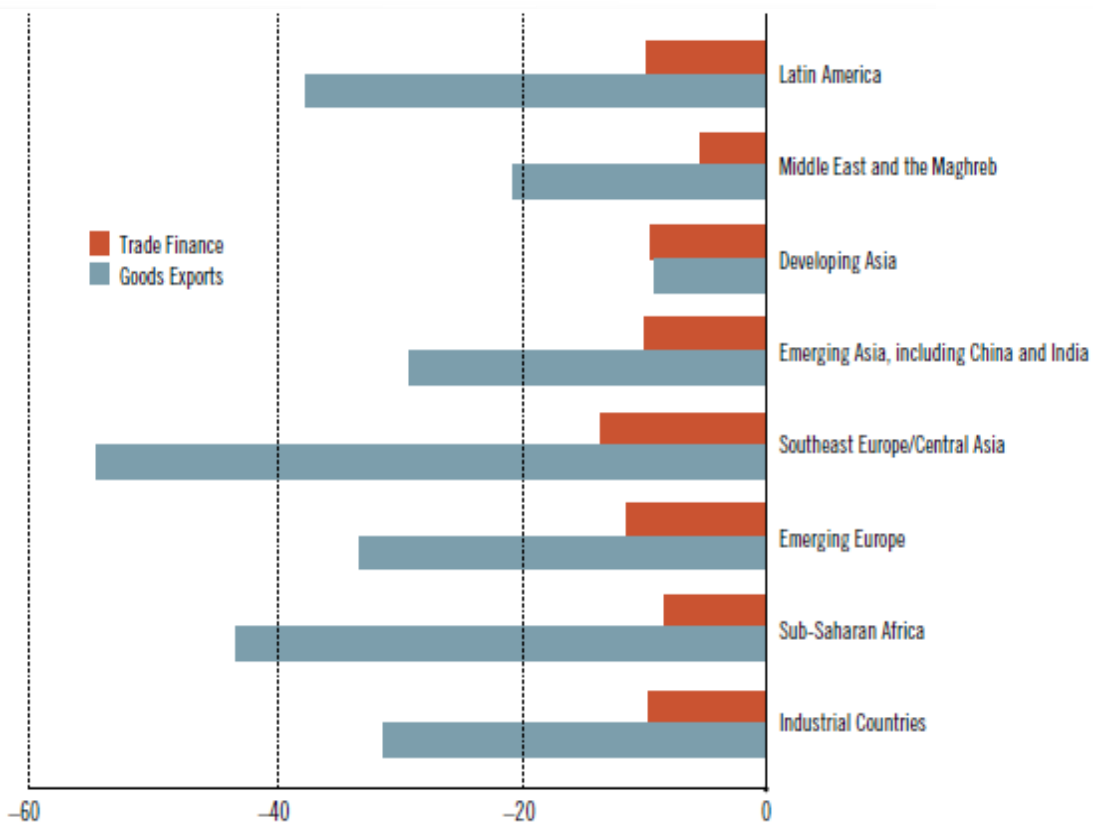
- Financial flows
- Shipment status
- Quality of shipment

# Trade finance is vulnerable to financial crisis, thus impeding trade flows



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



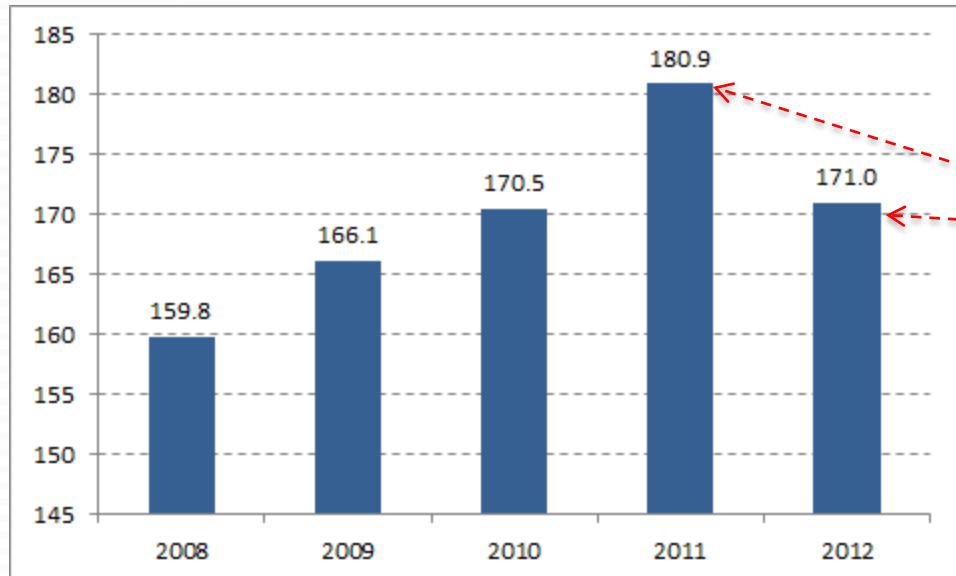
- Trade finance – typically low risk, high collateral – was not exempted from the 2008 GFC
- The difficulty of securing and enforcing credible commitments across borders makes trade finance more vulnerable in times of turmoil

# The current state of trade finance



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Total Global Trade Finance Volume (in USD billion)



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

Source: Dealogic. (Data for 2012 are preliminary.)

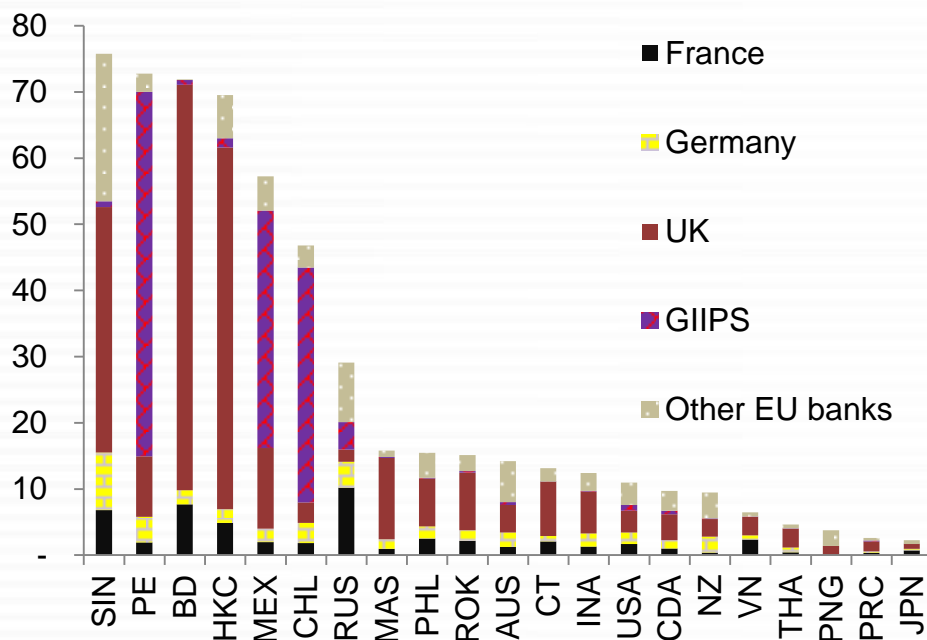
- Difficulties in raising USD funding and new capital rules caused European banks to reduce lending
- Total global trade finance volume fell by 5% in 2012 to USD 171.0 billion from USD 180.9 billion in 2011.
- The number of deals also fell by 36% to its lowest level since before the GFC, with 718 deals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

# Many APEC economies traditionally relied on Europe for trade finance

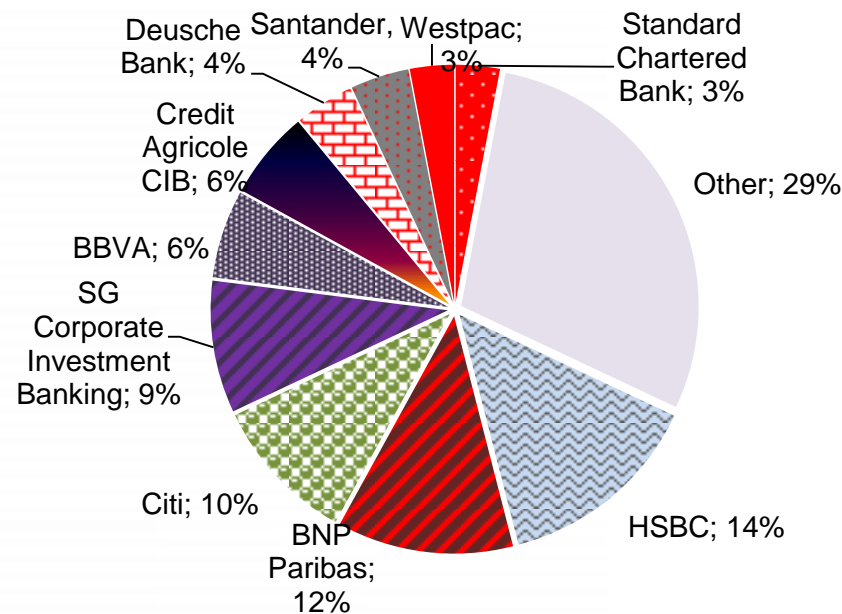


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**APEC's exposure to EU banks**  
(foreign claims as % of GDP)



**Asia: Export credit agency backed trade finance**  
(Q3 2011)

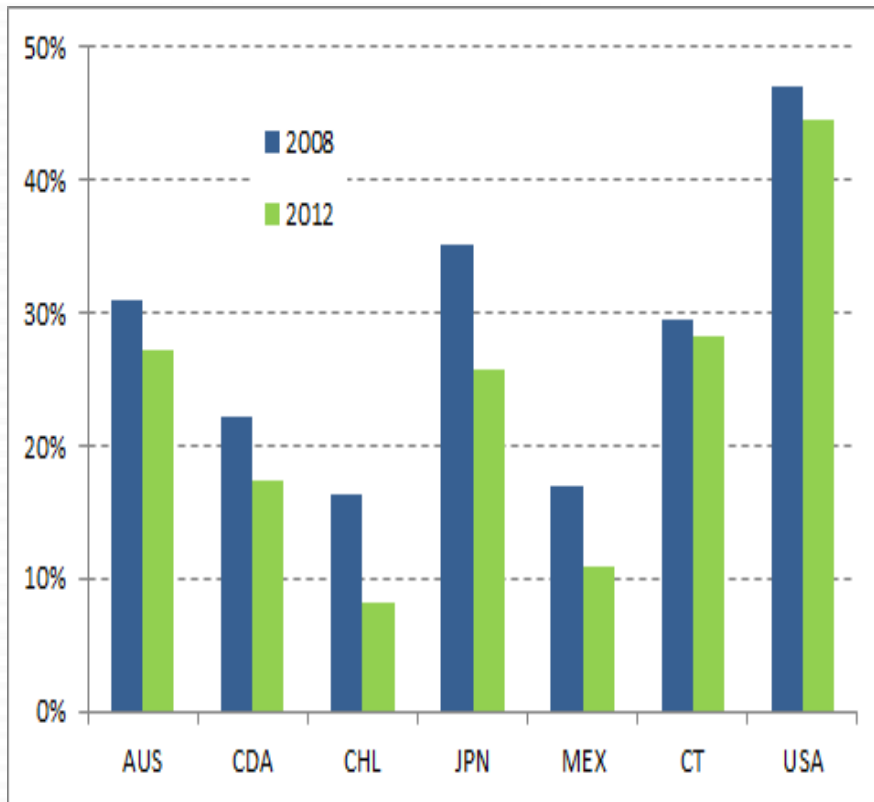


Source: BIS, IMF, PSU calculations

- 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

Foreign claims from developed European economies as a share of total on domestically owned banks in reporting economy



Source: Bank for International Settlements and PSU calculations.

- 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%



# SMEs are disproportionately affected



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- 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



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- 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

# Enhancing trade finance: a channel to sustain trade growth



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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

# Concluding observation: a case study about K9 Natural



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- 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 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



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## 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

# Following the GFC, SFOM's 2009 Trade Finance Survey asked several questions



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**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



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**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)



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**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: Timeline



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.

# APEC Policy Support Unit



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[http://www.apec.org/apec/about\\_apec/psu.html](http://www.apec.org/apec/about_apec/psu.html)

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