G20 Trade Finance Experts Group - April Report
Canada-Korea Chair's Recommendations for Finance Ministers[1]

Introduction

The day-to-day international trade in goods and services is a vital part of a well functioning global economy. Given the large share of trade transactions involving some sort of credit, either insurance or guarantee, it is clear that trade finance provides the necessary liquidity and security to complete transactions between buyers and sellers around the globe. The financial crisis of 2008-2009 brought a worldwide shrinkage of available financing and a somewhat smaller decline in trade finance. Beyond the cyclical downturn, there were credible concerns that the effects on trade finance would yield supply-side driven shortages, due to a private sector 'pull-back', which would inflict further damages to already falling trade volumes.

In response to these concerns, the G20 agreed in London to ensure the availability of support for $250 billion of trade finance for 2 years starting in April 2009. The commitment to support the provision of short-term trade finance was one element in a wider set of fiscal, monetary, and financial actions undertaken by the international community to support the continued functioning of international trade and financial markets during a period of acute stress. The G20 agreed to provide temporary and extraordinary crisis-related trade finance support that would be delivered on a basis that respected the need to avoid protectionism and would not result in the long run displacement of private market activity.

Moreover, the G20 trade finance initiative was intentionally designed to be a broad and flexible framework capable of responding effectively to market gaps affecting global and regional trade flows. Learning from past experiences with financial crises, the coordinated approach agreed to in London included an understanding that a menu of instruments should be made available so financing could be delivered to wherever in the trade finance chain it was most needed.

With the G20 initiative having been in place for its first full year now, the purpose of this report is to monitor recent developments in trade finance, account for the progress in delivering the G20 commitment and make recommendations on next steps.

Recent Developments in Trade Finance

Although world trade volumes are estimated to have fallen roughly 12% in 2009, recent evidence is showing a resumption of growth in world trade and output for late 2009 and early 2010. This growth is being led by a strong recovery in the Asia-Pacific region and strong export performances by advanced economies, particularly Japan and the United

[1] The co-Chairs would like to thank the members having provided their data submissions, as well the multilateral organisations having provided qualitative assessments of the trade finance market.

States. More generally, it is a positive sign that, overall, G20 exports and imports have both been on an upward trend in recent months.

Notwithstanding the efforts of G20 members and multilateral agencies to collect and share trade finance information, a complete picture of the trade finance market is still lacking and work remains to be done on improving data collection for trade finance and cross border banking statistics. Nevertheless, available evidence indicates that, overall, trade finance markets are improving but that the recovery is uneven across regions and market size.

Through the second half of 2009 and the first quarter of 2010, there is evidence that short-term trade finance markets have generally improved. Average prices for letters of credit in large emerging economies have fallen from 150-250 basis points a year ago to 70-150 basis points today, and the markets in many advanced economies are quickly returning to normalcy. Unfortunately, this recovery has not been universal and several regions have markets that remain stressed, especially in Africa. In these regions, trade finance for smaller traders remains considerably more expensive, or is simply non-existent, as markets have disappeared and not returned. As an example, market sources cite international or large pan-African banks that continue to charge 200 to 320 basis points to endorse a letter of credit in countries regarded as having a lower risk in Africa. Moreover, in these lower risk economies, it would cost an additional 200 to 300 basis points to insure the transaction, if insurance is available. For countries considered higher risk, private sector trade finance is extremely limited and when available often prohibitively expensive.

Low income countries in Asia and Central America seem to be experiencing a comparable situation. In these areas, liquidity has returned but there is still a market gap resulting from the general deterioration in the credit-worthiness of traders coupled with greater risk aversion by commercial banks. The result is that the cost of trade finance remains particularly high and gaps continue to exist in these regions even though other markets are well on the way to recovery.

An interesting development is a potentially long lasting shift towards structured trade finance. The financial crisis brought a heightened sensitivity to risk, weaker balance sheets and constrained liquidity positions for many international traders, which has led to an increase in the relative demand for intermediated trade finance over traditional open account financing. In fact, recent estimates indicate that the level of intermediated (bank-supported) trade finance in the second quarter of 2009 surpassed the level of open account transactions, reversing a long-term trend towards open account financing.

Follow-Up from August Report and G20 Utilisation Rates

The London G20 Summit committed members to "*ensure availability of at least $250 billion over the next two years to support trade finance through our export credit and investment agencies and through multilateral development banks.*" This promise has been fulfilled with national export credit agencies (ECAs) providing the bulk of measures and helped bridge some of the gap in working capital and insurance that was left by the withdrawal of private commercial banks and insurance companies. Multilateral development banks (MDBs) also provided substantial support through trade finance facilitation programs and the International Finance Corporation's (IFC) Global Trade Liquidity Programme (GTLP).

While individual figures vary (see Annex A), the average utilization rate for the trade finance made available through this G20 initiative declined to about 40% in the second half of 2009, down from 68% in the first half. This suggests that the supply of trade finance from commercial sources has improved in many markets – in fact, in some cases the total capacity has even been revised downwards.[2] Despite this small drop-off, however, the G-20 still appears on track to make available the committed $250 billion.

While global trade and trade finance markets continue to improve, several factors that led to the development of the G20 trade finance initiative continue to negatively affect certain regions and submarkets. Although the instruments to support trade finance vary by member and institution, the variance in support and utilisation levels through 2009, as shown in Annex A, is indicative of the different degree of need across the globe and the asymmetry of recovery post-crisis.

With respect to medium and long-term trade finance markets, preliminary OECD data indicates that in spite of the dramatic dip in world trade, the volume of medium- and long-term trade finance provided by its members grew strongly in 2008 and remained high in 2009, with the second semester of 2009 reaching new levels (more than $80 billion). Interestingly, trends in long-term credits have not been driven by exports related to traditional ECA-financed big ticket items such as large aircraft and ships, but rather by increased support for a wider range of exports, including large infrastructure projects. This suggests that ECAs have stepped in and filled a void by providing support to projects that would normally have been financed by the private sector in the years preceding the crisis. Thus, the demand for ECA medium and long-term financing clearly remains at extraordinarily high levels and it can be reasonably expected that the recovery will be slower for these longer tenors of trade finance.

Conclusions and Recommendations

Taken as a whole, the trade finance market has followed trade and other financial markets onto the path of recovery and growth. Given current conditions, ***it is recommended that members begin to evaluate the extraordinary and temporary measures taken to support trade finance and begin to develop plans for their scaling back, as part of their broader strategies to exit fiscal, monetary and financial actions undertaken in the context of the 2008-2009 financial crisis.***

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[2] Not all the same working group participants submitted new figures for this report. While the revised figures for capacity and average utilization rates are not perfectly comparable to the previous report, it is still possible to draw inferences on key trends.

Although the general situation is showing strong signs of improvement, some markets remain fragile. Considering the different speed of recovery in trade finance markets globally, plans to scale back measures should be sufficiently flexible to enable members to continue providing support in weaker areas while moving out of strong markets so as not to displace private commercial activity. The asymmetry in market recovery across the globe will need to be taken into account when G20 members are determining the appropriate sequencing of withdrawal from various trade finance markets. In this context, ***it is recommended that G20 members and multilateral institutions continue to focus their efforts, as much as is practicable, in markets where recovery is lagging and the private sector is slow to return***.

Moreover, additional monitoring of these markets to determine whether the reduction in capacity for financing trade is temporary or permanent will be important since a lack of trade financing and guarantees has been indentified as one of the barriers to integration of low income countries in world trade.

The August G20 trade finance report recommended keeping available an additional contingency of $150 billion in trade finance support and using it only if market developments required further assistance over and above the original $250 billion commitment. With the global recovery now on firmer footing, ***it is recommended that the additional $150 billion identified last August as a possible contingent reserve still not be deployed, and that the focus of the G20 remain on effectively providing the original $250 billion support package from London***.

Finally, the lack of a comprehensive international dataset for trade finance during the crisis has been a significant and avoidable hurdle for policy-makers to make informed, timely decisions. In particular, the inability to accurately estimate the size of the market gap and where these gaps existed is an issue that needs to be avoided in the future. Moreover, as policy makers begin to consider and administer a phasing out of these extraordinary measures, it will be important for experts to be able to indicate which markets have recovered and are safe to begin exiting from and which are still in need of current (and potentially additional) assistance. ***Given the expected utility of a comprehensive trade finance dataset, it is recommended that multilateral agencies (including private sector associations) coordinate and establish a comprehensive and regular collection of trade credit in a systematic fashion***.