



## Financial dimensions in post-crisis trade

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## Outline

### **Financial aspects of post-crisis trade**

Section I

## Recent trends in trade finance

Section II

Regulatory risks to trade finance

Section III

South-South trade

Section IV

Summary and policy conclusions

## Section I

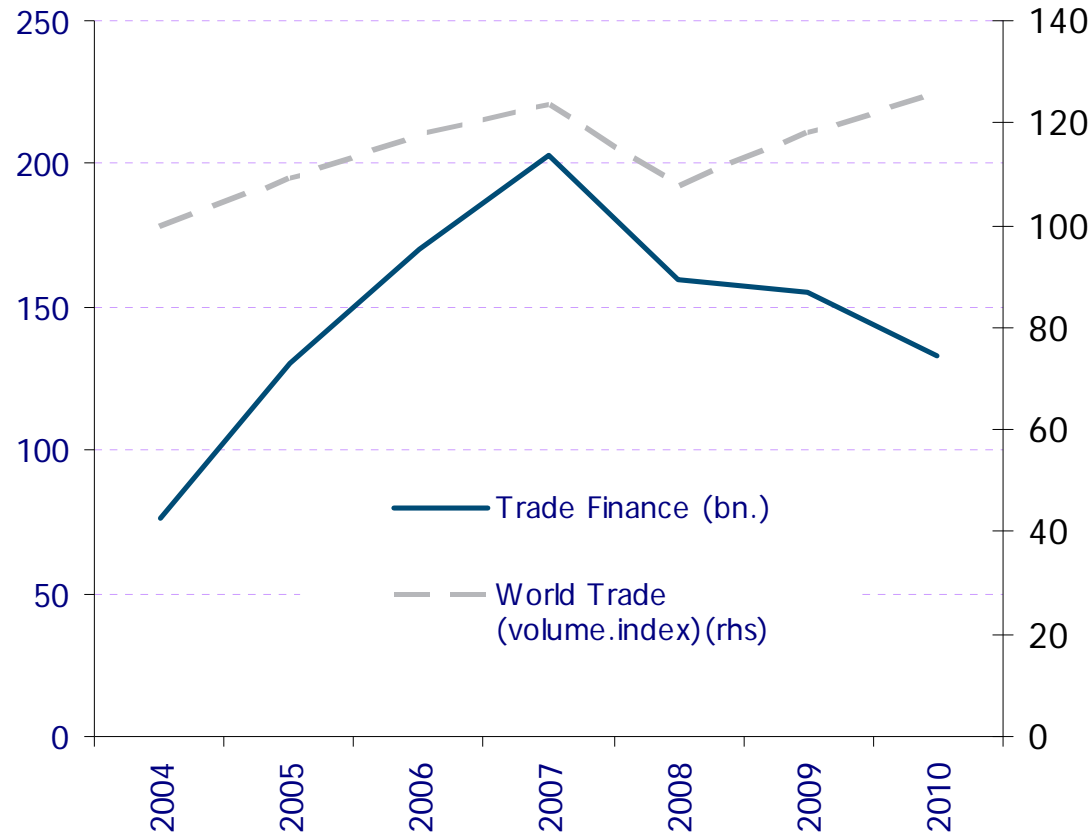
# Trade finance is still lagging in the recovery of trade

### Recent trends

- Trade finance is still below the levels seen in 2009 and clearly below previous maximums
- This contrasts with the recovery in global trade

### Trade finance trends

Source: WTO and Dealogic



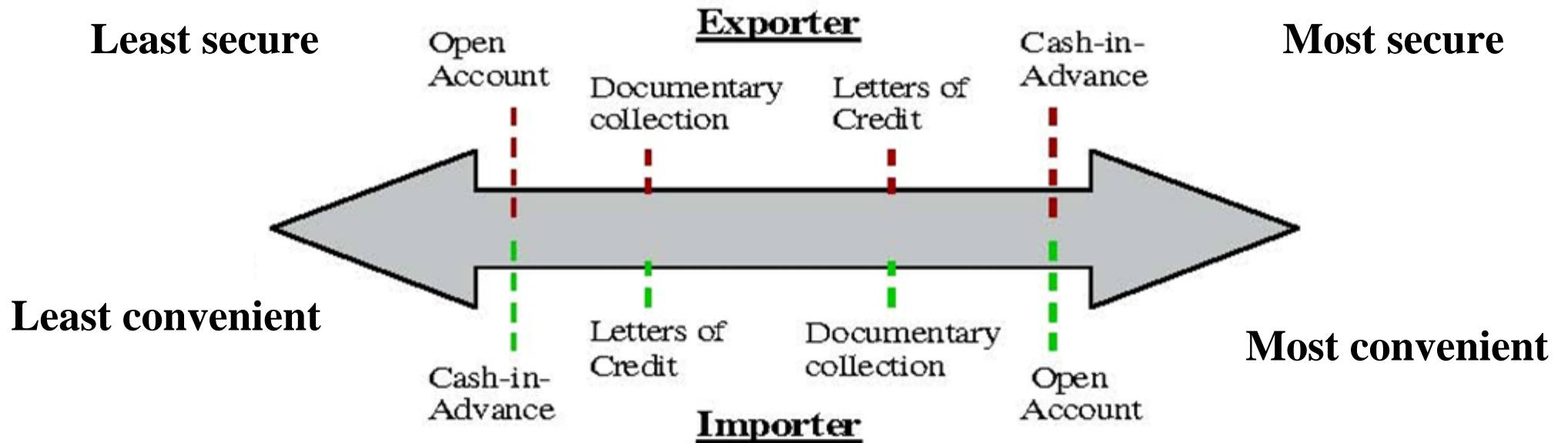
Section I

Trade finance is undergoing structural changes

Recent trends

- Under the umbrella of trade finance there are several distinct mechanisms, differing in the amount of financial intermediation they require...

**Payment Risk Diagram**



Source: US Department of Commerce, International Trade Administration

# Section I

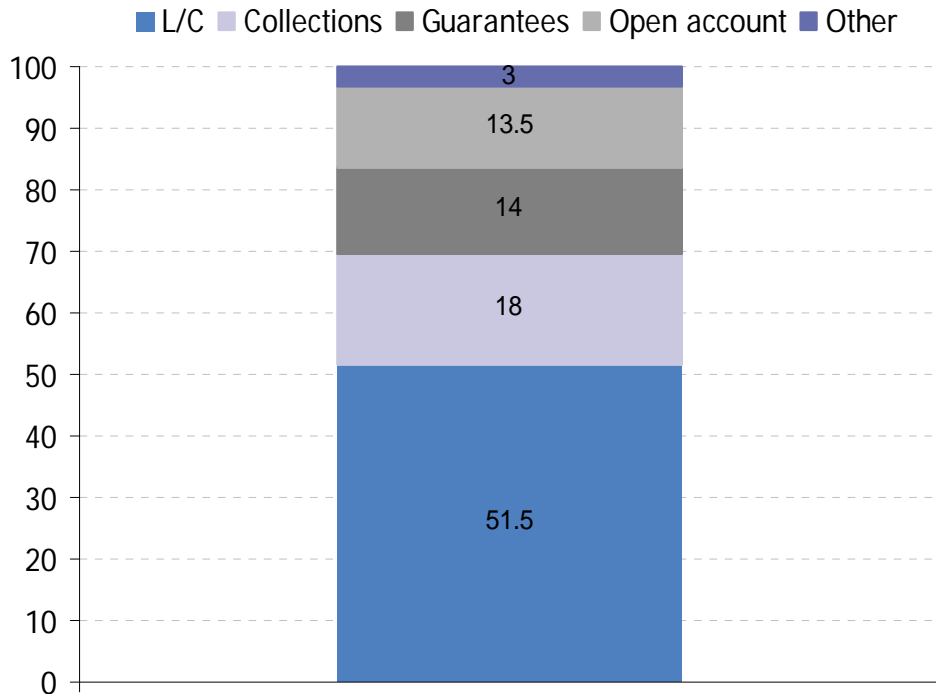
## ...going back to securitization of trade

### Recent trends

- Share of open account transactions seems to be falling: letters of credit increasing
- Two related forces in this trend:
  - 1) search for higher security in trade transactions after the crisis
  - 2) growing role of south-south trade, which relies more heavily on LC

### Breakdown of trade finance use (percent, average import-export)

Source: ICC Survey



Source: ICC Global Survey 2010.

Note: SWIFT figures are used in this graph, which underestimate share of Open Account transactions. Market participants generally estimate this figure at 80% but there is consensus it has been falling since the crisis.

## Section I

## Can trade finance become a hurdle to trade growth, then?

## Implications

- Estimates suggest the effect of trade finance is important, but not enough to explain crisis downfall
- BBVA Research empirical model:

- 1) Gravity model for bilateral trade flows
- 2) 61 countries (developed and developing)
- 3) Three and a half years of data
- 4) Variable selection
  - Each country-pair GDP (to capture demand effects)
  - Each country-pair credit (to capture financial crisis effect)
- 5) Panel data estimation

Section I

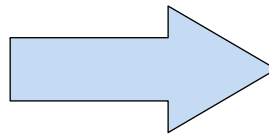
Can trade finance become a hurdle to trade growth, then?

Implications

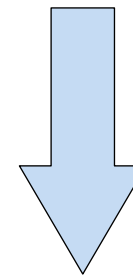
- Models usually indicate that demand factors are more important than credit... but credit has a role even in these “reduced form” equations
- Identification issue is important: simultaneous shock to demand and credit

Dependent Variable: Bilateral Quaterly Exports

Exporter GDP	0.269 ***
Importer GDP	0.335 ***
Exporter credit	0.093 ***
Importer credit	0.141 ***
Country pairs fixed effects	yes
Quarters fixed effects	yes
R <sup>2</sup>	0.962
NUMBER OF OBSERVATIONS	12524



Credit availability has impact beyond demand effect



Restrictions on trade finance can be particularly damaging

Note: \*\*\* means significant at the 1% level. Sample: 61 exporters and importers in the last 21 available quarters. All variable are in logs. Source: United Nations for trade and IFS for GDPs and credit to the private sector.

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# Trade finance is penalized in current proposals

## Regulatory risk

- Basel II was already bad for trade finance...

### Basel I

- Under the standard approach, short-term self-liquidating trade-related contingencies subject to credit conversion factor equal or superior to 20%.
- **Trade finance received favourable regulatory treatment** (one of the safest, most collateralised and self-liquidating forms of finance).

### Basel II

#### Trade-related lending is disadvantaged:

- Focus on counterparty risk rather than product of performance risk
- Rigidities in the maturity cycle applied to short-term trade financing.
- High concentration of lending in small and medium sized enterprises

#### Capital Reserves under Basel I

Obligor Type	Amount
Corporate AA+/Aa1	\$0.24
Corporate BB-/Ba3	\$0.80
OECD Bank AA+/Aa1	\$0.24
EM Bank BB-/Ba3	\$0.72
Sovereign BBB+/Baa1	\$0.00
<b>Total Risk Capital</b>	<b>\$2.16</b>

\*All Amounts in USD Millions

#### Capital Reserves under Basel II

Obligor Type	Amount
Corporate AA+/Aa1	\$0.07
Corporate BB-/Ba3	\$1.02
OECD Bank AA+/Aa1	\$0.07
EM Bank BB-/Ba3	\$4.58
Sovereign BBB+/Baa1	\$0.44
<b>Total Risk Capital</b>	<b>\$6.21</b>

## Trade finance is penalized in current proposals

### Regulatory risk

- But Basel III could be even worse, and particularly for south-south trade.
- On the basis of current proposals...

### New Instrument: Credit conversion factor for the leverage ratio

- Basel III proposes 100% for all off-balance sheet, which would include letters of credit

Same treatment as derivatives, etc.

LCs make the bulk of trade finance now

On balance-sheet solution could be more costly

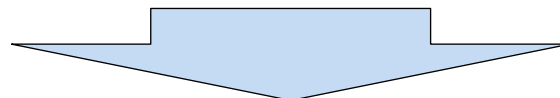
Particularly relevant for South clients, more use of LC

### Maturity floor

- LCs are usually very short-term (up to 180 days) but treated as 1 year instrument, increasing risk requirement

Treated as other products with no clear connection to real activity

Particularly damaging for South smaller clients, where shorter maturity than before was recognized as mitigant



Some estimates suggests the capital requirements could increase very substantially, particularly for lenders from emerging countries

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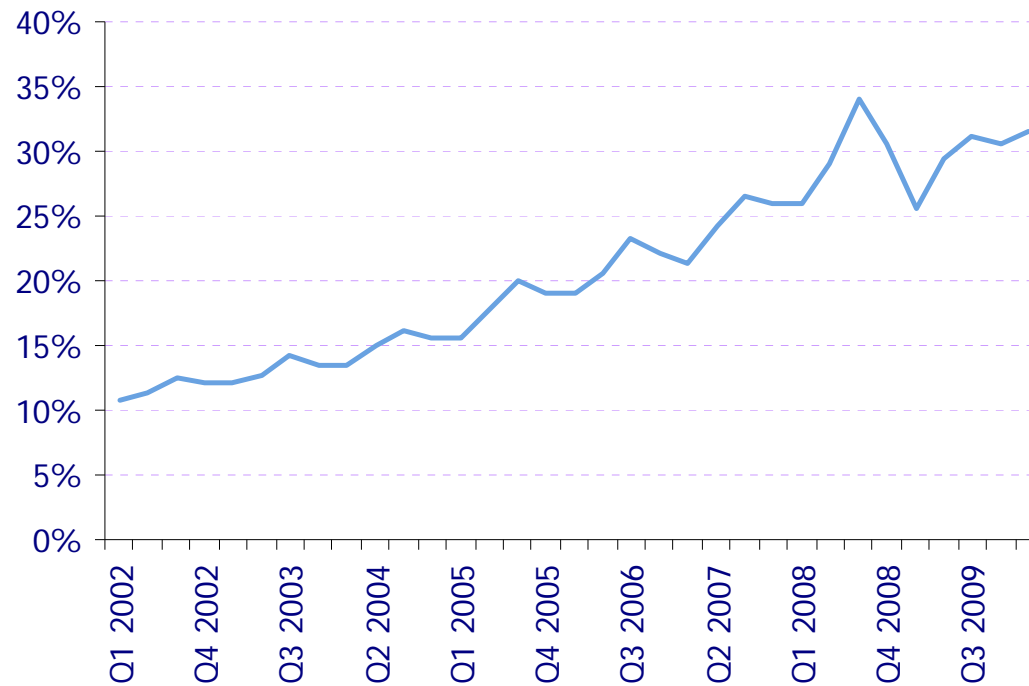
# South-South is increasingly important

## South-South trade

- The South-South trade route is strengthening...how prepared is it for incoming regulatory challenges?

### South-South trade as a % of North-North trade

In US Billion. Index base 1999 = 100. Source: IMF - COMTRADE



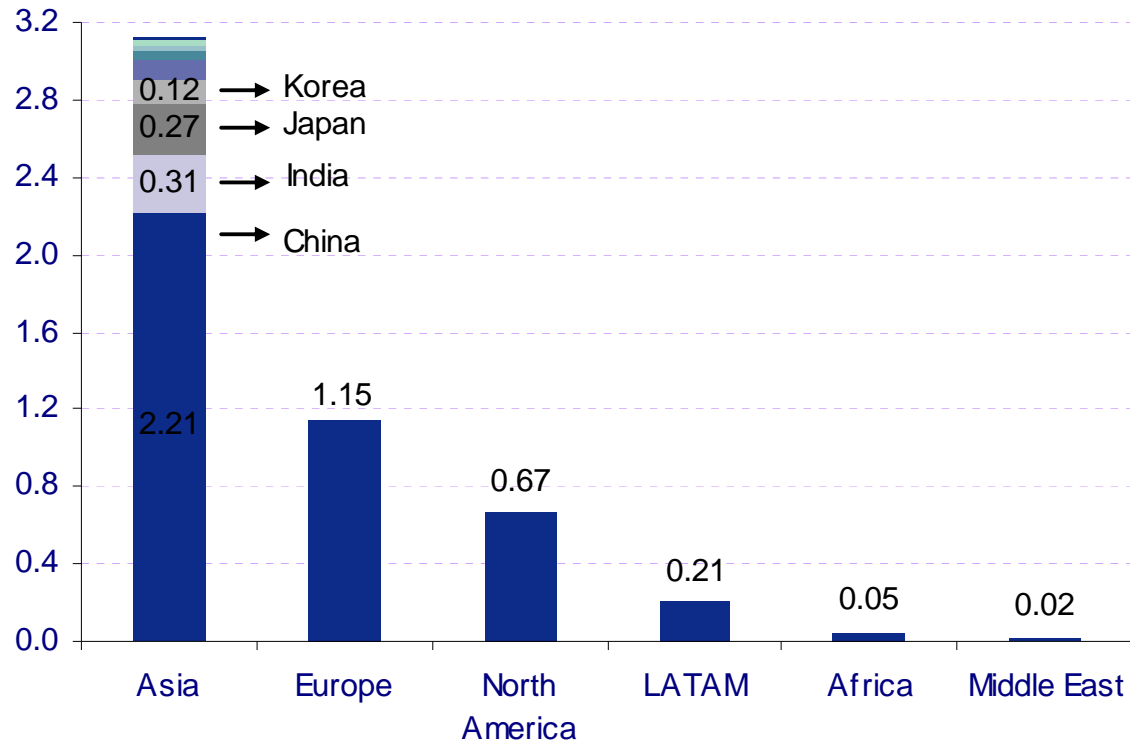
# ...and hopefully resilient

## South-South trade

- Risks to South-South trade finance could be mitigated by their deep pockets, particularly Asia
- However: most emerging banks lack at this stage the international reach to engage in trade finance in the best terms

**Internal savings. Change between 2010-2015. USD trillions**

Source: BBVA Research, IMF and World Bank



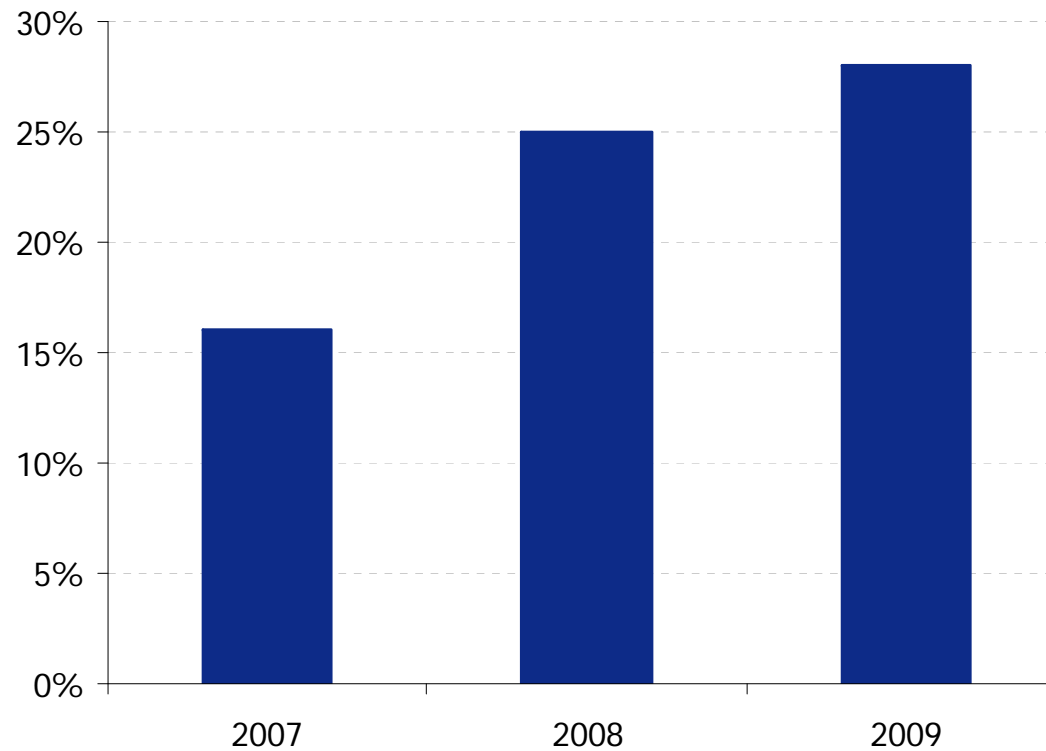
## ECAs substitute private sector in South-South trade

### South-South trade

- Increasing use of ECAs shows how difficult it is for private banks to keep up with the recovery of trade, particularly South-South

#### Share of total trade finance operations with ECA backing

Source: Dealogic



Source: Dealogic.

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## Section IV

# Conclusions

- Trade finance is still lagging behind the recovery in global trade
  - Role of trade finance should not be underestimated: identification issues likely to plague our best estimates
  - Insufficient availability of funding relative to trade growth could become a relevant hurdle to trade growth going forward
- Current regulatory proposals do not reflect the underlying nature of trade finance activities nor its positive externalities



## Conclusions II

- The increasing role of ECAs reflects the difficulties found by the private sector to cope with the recovery in post-crisis South-South trade
- Regulatory proposals so be carefully considered by emerging countries in order to:
  - Limit a potential negative impact on South-South trade
  - Avoid competitive distortions
  - Avoid unnecessary risks to the trade finance industry as a whole



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