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Asian Trade Finance Navigates Choppy Waters

While the Asian trade finance market has not been as badly impacted by the current economic climate as other regions, various Asian governments have taken steps to shore it up through stimulus packages. For instance, both Korea and China made large-scale investments in infrastructure projects to stimulate their domestic economies, which reportedly yielded positive effects on their export figures.

Against this backdrop there have also been changes in the types of products and services demanded by corporates. Due to a combination of factors — most importantly the challenging credit environment and a decline in alternative liquidity sources — the demand for risk mitigation and financing products such as documentary letters of credits (LCs) and other traditional forms of trade finance has recently increased. Given that total trade in Asia declined in the last quarter of 2008 and the early part of 2009, the increase in documentary-supported trade likely occurred at the expense of trading on open account.

Another trend impacting trade finance in Asia — and across other regions — is the flight to quality in transaction banking. Counterparty risk has become an industry-wide issue, with clients no longer just looking at product pricing and service levels, but also at the financial health of their banking service providers.

Corporate Liquidity Challenges
While some traditional sources of liquidity have dried up, large corporates with sound and sustainable business models will continue to access adequate trade finance facilities. However, pricing in the area has certainly increased as some banks, especially those servicing small- and medium-sized enterprises (SMEs), are acting with extra caution given the potential impact on this sector if the recession persists into 2010. Some institutions have even moved to reduce their exposure to the SME sector.

Given the challenges faced by smaller Asian exporters, the Asian Development Bank recently announced a significant expansion of its trade finance programme, boosting its annual facility from USD 150m to USD 1bn. For private trade finance suppliers in the region, this should translate into additional support of up to USD 12bn through 2013.

Financial Supply Chain Management
Many larger corporates are becoming increasingly wary of the threat posed by key suppliers experiencing financial difficulty. This is one of several trends that have led to increased adoption of financial supply chain management solutions, especially those that allow large, well-rated buying corporates to take an active interest in the funding needs and financial health of their key suppliers.

One example of this approach is a product known as supplier finance, which allows large corporates to offer financing, through their bank, to their suppliers at a rate lower than the supplier could secure through its own banking arrangements. By leveraging this competitive advantage, the buying corporate is often able to secure extended payment terms, leading to a win-win situation for both buyer and supplier.

Interest in solutions of this nature has grown as alternative sources of funding have become difficult to secure. As a result, corporates and banks have sought new techniques to manage trade risks and working capital needs, leading to a growth of interest in financial supply chain management.

Credit Insurers

Another factor that has affected trade finance in Asia has been the lack of available credit insurance. This is a result of a diminishing appetite for risk among many credit insurers and internal exposure caps, leading banks to become more selective about the credit insurers with which they do business. The ensuing increases in pricing have negatively impacted some trade finance products that are driven by credit insurance structures, such as the purchase of accounts receivable.

These issues — particularly the diminishing risk appetite of many insurers — are being exacerbated by increased demand for credit insurance in the region. While demand for credit insurance in Asia was not pronounced before the current crisis — as corporates were content to self-insure then — it is now rising due to an increased sensitivity to risk among exporters. This incongruence between demand and supply is also the cause for an increase in the cost of credit insurance.

Changing Patterns

One long-term consequence that the market should expect from the current economic downturn is the likelihood of increased intra-Asian trade.

Recent events have highlighted the potential threats to an economic model that is over reliant on exports to the United States and the European Union. The decline in consumer demand in the West has led many economies in Asia — notably China, Korea and Japan — to adopt fiscal policies and introduce stimulus packages aimed at increasing domestic and regional demand.

Nevertheless, many of these economies remain focused on outward exports. For example, in April 2009, China and the United States signed a trade cooperation agreement that involved deals inked between top-tier corporates from both countries totaling over USD 10bn. However, despite these short-term developments, intra-Asian trade is likely to continue increasing in the long term, while dependence on exports to the West wanes.

These developments, coupled with the effects of the financial crisis, have corporates looking for security and banking partners with a strong capital position, good liquidity, an established global presence and a sound reputation in trade finance.