

## Key Takeaways

- Demand for trade finance instruments in the first half of 2020 has flattened compared to growth expectations because of furloughed projects and or investments. However, demand has not collapsed.
- Larger banks interviewed, although sufficiently liquid throughout the period, have restricted supply of finance to existing clients, away from new clients / projects.
- Overall, the finance market has contracted by at least 10% from 2019 levels in volume and even more in value. Early positive signs have been seen since June, largely concentrated in traditional sectors like commodities. Full recovery is only expected by end of 2021 at the earliest.
- The main frustrations during the crisis for interviewed banks revolve around risk / macro-prudential constraints to extending credit outside their well-known larger clients, especially as liquidity has been sufficient to take on more business.
- MDBs and governments could expand risk participation or guarantees schemes, to give greater leeway to local banks in underwriting new banking relationships, improve confirmation counterparties access and SME trade.

## Have swift reactions by MDBs avoided a “Trade Meltdown”?

In this current unprecedented environment, policy makers, & development organizations have attempted to respond to the multi-faceted pandemic crisis and help sub-Saharan African countries ride these difficult times. In particular, keeping trade in goods and services flowing presents, not only an economic, but also a social imperative to preserve the livelihoods of millions of Africans. Pre-COVID-19, the trade finance gap in Africa was already estimated to be above USD 100 billion. What has been the impact of the pandemic on trade finance in the region and what can MDBs and governments do to support the trade finance sector?

To answer this question, eight MDBs and trade development institutions engaged with selected members of the banking community across the region to gauge how the sector has fared so far during the Covid-19 pandemic and what MDBs could do to support it. This report is a qualitative summary of those conversations.

## A decline in expected growth but no catastrophic collapse

Surprisingly, most respondents report only a “loss of expected growth” on the demand side of between 5 to 10% in Q1 and Q2. Requests for trade finance in Africa do not seem to have experienced an “absolute” drop in volume from a comparable period in 2019. Further probing shows that beyond this reported “flat demand” lies a more complex reality.

## Large variations in demand over time during the first half of 2020

Activity in January and February 2020 seems to have continued apace from 2019’s momentum. This was followed by a devastating March to May 2020. After lockdown measures were gradually lifted and the health situation in much of the world brought under control, budding “green shoots” appeared in June & July that partially offset the initial shock.

## A changing nature of client requests towards working capital solutions and new sector trades

Banks have witnessed a significant fall in financing of existing trade credit lines due to a fall in trade contracts and sustained uncertainty on new projects or investments. Their traditional requests have been limited to “keeping the lights on” / maintenance requests even during the worst of times. However, a large number of existing or new clients have asked for instruments to finance short-term working capital to buy imported materials for new orders and supply-chain finance instruments (especially in local currencies). Additionally, sectors like health and medical supplies expanded dramatically to spawn additional trade finance activity.

## Mixed view on demand dynamics depending on economic sectors

Manufacturing, transport, tourism, hospitality and retail have been severely hit over the past months, whereas traditional “trade finance” sectors such as commodities, public works, technology, energy, infrastructure and telecom have been a little more cushioned from the

pandemic, at least in volume if not in value. Finally, the economic slowdown may have taken a greater bite out of the overwhelmingly dominant and riskier form of trade settlement through non-bank intermediated means (e.g., open account, cash on advance, transfer pricing, centralized purchasing); this is especially worrying for smaller exporters and the informal sector who make up 80% of upstream supply chains in African exports.

## For the moment, banks have avoided a liquidity and solvency squeeze

Although no actual financial reports were shared, banks seem to be more resilient than in previous crises and are not reporting any drastic squeeze in liquidity.

## Stronger regulatory frameworks and decisive monetary actions have boosted resilience

Strengthened balance sheets and other actions in the wake of the “2007 Global Financial Crisis” seem to have buffeted the continent from a severe liquidity crisis. Most importantly, decisive actions from central banks such as low-interest liquidity windows have in the words of bankers on the ground: “nipped in the bud” any jitters on existing lending portfolios.

## Commercial Banks have focused mainly on existing, larger customers whilst SMEs and new clients have been side-lined

There are signs that banks engaged in trade finance have “flown to safety” – focusing their activities on existing clients and rejecting almost all clients without

pre-existing relationship and MSMEs that have weak balance sheets. As a result, state-owned enterprises and large regional corporates continue to capture the “lion’s share” of the market.

## Trade finance remains centered on commodity trading through unfunded instruments

Our discussions confirmed that trade finance in Africa remains a commodity-centric activity: mostly for energy, mining, food staples and large infrastructure projects. Demand increased as expected for financing of medical supplies and healthcare imports. Unfunded instruments such as avalised bills, documentary collections or LCs remain the norm, with little reported take-up of funded instruments, supply-chain or structured financing.

## Typical “pain points” remain, coupled with slowed-down Government services and worsening country risk

According to interviewees, there have been no notable “spikes” in typical challenges such as securing foreign currencies (except in non-diversified export-dependent economies), correspondent banking, KYC / AML constraints, confirmation counterparties or other typical funding challenges. Most banks however noted a slow-down in responsiveness from government services and central banks during COVID-19 restrictions. This is due to poor progress with digitalization. Documentation exchanges with customs and port processing were the worst financing bottlenecks. Prices of LC confirmations may have risen due to worsening sovereign risks especially in hard-

hit commodity-dependent African countries.

## NPLs are stable. That may be due to central bank COVID-19 support

Most banks report no degradation in NPL or credit events in their trade finance portfolio. However, numbers may rise if temporary payment moratoriums or rollovers financed through dedicated liquidity facilities from Central Banks, are not extended to existing obligors.

## After a 10% drop in transactions volume, will we see recovery end 2021?

So, what of the resulting matching of supply and demand during the first half of 2020?

## A drop of at least 10% in volume

Banks interviewed have witnessed a drop in transaction volumes in the first quarters of 2020 of at least 10% compared to 2019 (with a large dispersion of responses) and may have sunk even further in value. Note that family or MSME banks (usually with total assets of not more USD 100 million) report a much worse falloff in transaction numbers. In all, all respondents assign this contraction to a sagging demand, falling commodities prices and rising costs of trade financing.

## Recovery only at the end of 2021

So, where does this leave us for the remainder of the year? The June-July rebound has inspired hope. The 2020 momentum should be maintained so long as COVID-19 does not revive in importing countries in Q4. Interviewed bankers expect a return of market activity by end of year if lockdowns are fully lifted



and economic activity slowly returns to normal. However, no one can foresee the high double-digit expansion required to catch-up on “lost growth”. Tight-lending conditions are likely to remain in place without further intervention. This is frustrating some bankers as additional lending could be possible given their institutions’ strong liquidity positions. They are constrained by underwriting and macro-prudential rules, especially for new clients and sectors. As such, an “L-shaped” recovery in trade finance seems likelier than a “U-shaped” one as policy makers may not be able to intervene further in a decisive and timely manner when current support programs expire.

## **MDBs’ crisis response from bankers’ point of view**

At the onset of the crisis, MDBs responded with a range of facilities to support the private banking industry throughout sub-Saharan Africa. The intervention of MDBs is particularly relevant as African banks increasingly depend on MDB support for trade financing.

## **Lack of awareness of MDBs’ private sector interventions**

Most respondents report little awareness of available MDB funding or risk-sharing programs. Only the larger corporate banks were abreast of available programs. None of the small to medium-sized banks interviewed were aware of these facilities. This could reflect the fact that, while MDB support to the private sector was not absent, support to governments has been more prominent. In addition, travel

restrictions could have compounded the lack of awareness problem, preventing typical face-to-face meetings to discuss financing opportunities.

## **Need for greater responsiveness and risk sharing**

According to certain interviewees, greater responsiveness from MDBs in application processing is essential in those troubled times. Some others have asked for greater risk-loading towards the MDB side. In particular, 50/50% arrangements are judged insufficient at this time to overcome macroprudential reporting limits for SME lending or for convincing confirming banks.

## **What can be done to support trade finance in the short-term?**

In the next few months, governments will likely continue to prop up household consumption, investment and companies and central banks will try to maintain sufficient liquidity. Continent-wide organizations will plough on with wide-range initiatives in hard (e.g., transport, logistics) and soft trade infrastructure (e.g., lower intra-continental tariffs, regional settlement platform, collateral registries). So, what could MDBs focus on in the very short term to facilitate trade finance, according to interviewees?

## **Continue support to the private sector**

First, interviewees’ responses underline the need to continue programs that target private sector and smaller size enterprises. Support can be expanded to include awareness

campaigns to SMEs about how to access MDB resources, accelerated due diligence and capability building including trainings for credit-risk and underwriting staff at banks.

## **Stronger risk sharing offerings**

Secondly, banks’ “flight to safety” has excluded a huge share of enterprises from access to trade financing because of COVID-19 uncertainties. Good businesses are simply unable to get affordable financing to respond to new orders. To help match financing supply with demand, MDBs could strengthen their role in lowering the cost of credit for these country bank clients and “real economy” sectors. This would complement existing initiatives such as the creation of specialized MSME agencies, establishment of collateral registries, or enablement of a regional payment settlement platform. A diligent and decisive “risk-reduction nudge” from MDBs specifically dedicated to COVID-19 recovery would be timely. Such facilities offered to banks to allow them to safely expand trade credit and ease access to confirmation counterparties whilst conforming to reporting needs. Respondents suggested MDBs’ support could take the form of guarantees or low-rate risk participation agreements (RPAs).

## **Adapt funding to reach out to MSMEs**

Thirdly, MSMEs have traditionally been locked-out of trade credit markets by the weakness of their collateral, bankability or poorly designed applications. Several enabling projects initiated by



international agencies in Africa, such as women empowerment and investment funds, microfinancing schemes and capacity-building programs were gaining momentum until COVID-19 rendered long-term risk premiums too high or difficult to calculate. Still, our discussions evidenced that good small businesses feel a disproportionate share of the pain. Those that do not possess an existing banking or trading relationship are even worse off. In addition to existing efforts, MDBs could scale down their offering towards smaller financial institutions that deal with exporting and importing MSMEs. Short-term actions could include providing smaller size funding packages as well as cooperating with partner banks further down the chain to underwrite actual transactions.

## Explore innovative solutions

Other innovative short-term solution could involve training local banks to aggregate / securitize MSME trade credit into “risk tranches” to achieve critical mass and allow easier assessment and performance management. Some MDBs, with remarkable success, have partnered with local banks to review rejected eligible applications and work to improve their bankability, this could be expanded as the crisis continues.

## Looking ahead...

If the market has not collapsed according to interviewed banks, a “second-wave insolvency” cloud could be gathering on African businesses’ horizon. Central Banks could be limited in extending current liquidity backstops as Governments in the sub-region

alleviate their international debt burden, and foreign investors continue to scale down direct foreign inflows. Stakeholders interviewed look to MDBs to intervene decisively in maintaining a proper trade finance environment, especially through credit enhancement for the private sector. Otherwise, current trends could easily lead to a derailment of hard-won efforts over the past months to help Africans return to a seemingly normal life.

8<sup>th</sup> October 2020





## About AfDB

The African Development Bank Group is a multilateral development finance institution. The AfDB was founded in 1964 and comprises three entities: The African Development Bank, the African Development Fund and the Nigeria Trust Fund. The AfDB's mission is to fight poverty and improve living conditions on the African continent through the promotion of investment of public and private capital in projects and programs that are likely to contribute to the economic and social development.

## About BADEA

Established in 1974, BADEA aims at strengthening economic (financial and technical) cooperation between Arab and African countries and the embodiment of Arab-African solidarity based on equality and friendship. To achieve these objectives, BADEA was mandated to execute the following functions: Contribute to financing the economic development of African countries, encourage the participation of Arab capital in African development and contribute to the provision of the necessary technical assistance for development in Africa.

## About BOAD

The West African Development Bank (BOAD) is the common development finance institution of the member countries of the West African Monetary Union (WAMU). It was established by an Agreement signed on 14 November 1973 and became operational in 1976.

## About EADB

East African Development Bank (EADB) is a development finance institution with the objective of promoting development in East Africa. EADB was established in 1967

under the treaty of the then East African Cooperation. The Bank offers a broad range of financial services in the Member States of Kenya, Uganda, Tanzania and Rwanda with an overriding objective of strengthening socio-economic development and regional integration.

## About ICC

The International Chamber of Commerce is the largest, most representative business organization in the world. Its over 45 million members in over 100 countries have interests spanning every sector of private enterprise.

## About ITC

The International Trade Centre is the joint agency of the World Trade Organisation and the United Nations. ITC assists micro, small and medium-sized enterprises in developing & transition economies to become competitive in global markets and contribute to sustainable economic development within the frameworks of the Aid-for-Trade agenda and the United Nations' Sustainable Development Goals.

## About ITFC

The International Islamic Trade Finance Corporation (ITFC) is a member of the Islamic Development Bank (IsDB) Group. It was established with the primary objective of advancing trade among OIC member countries, which would ultimately contribute to the overarching goal of improving socioeconomic conditions of the people across the world. Commencing operations in January 2008, ITFC has provided more than US\$51 billion of financing to OIC member countries, making it the leading provider of trade solutions for these member countries' needs. With a mission to become a catalyst

for trade development for OIC member countries and beyond, the Corporation helps entities in member countries gain better access to trade finance and provides them with the necessary trade-related capacity building tools, which would enable them to successfully compete in the global market.

## About TDB

Established in 1985, the Eastern and Southern African Trade and Development Bank (TDB) is a multilateral, treaty-based, investment-grade development finance institution, with 40 sovereign and institutional shareholders and assets of USD 6.7 bn. TDB serves 22 economies in its region, with the mandate to finance and foster trade, regional economic integration and sustainable development, through trade finance, project & infrastructure finance and asset management. The consistent delivery of high levels of development impact alongside attractive financial returns have enabled TDB to position itself as a trusted partner to intermediate global and regional capital into the region it serves. Today, more than half of the Bank's portfolio directly and indirectly contributes to SDGs. TDB has principal offices in Mauritius and Burundi, regional offices in Kenya, Zimbabwe and Ethiopia, and a country office in DR Congo.

*Disclaimer: This exercise was commissioned by a group of MDBs and trade development institutions to obtain the views and opinions of more than 70 selected experienced bankers across sub-Saharan Africa during the first half of 2020. The report reflects only the perspective of the interviewees. It does not claim to present a comprehensive and statistically significant analysis of the situation nor the official views of the organizations involved.*

