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AFRICAN DEVELOPMENT BANK GROUP

Assessment of the Trade Finance Market in Africa Post-Crisis

Timothy Turner, Leila Mokaddem and Ghazi Ben Ahmed ⁽¹⁾

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Abstract

The financial crisis, which began to hit the trade finance markets in 2008, caused a sharp slow-down in trade in 2008 and 2009. The tightening of global credit reduced capital inflows and curtailed the availability of trade finance. This sudden shortage of trade finance negatively impacted African economies. In response, the African Development Bank (AfDB) established, on March 2009, a multiphase USD 1 billion Trade Finance Initiative (TFI).

As part of the Trade Finance Initiative, AfDB commissioned a trade finance survey conducted three times between 2009 and 2010. The financial institutions contacted during these market surveys are listed at the end of this document. During this research, banks in Senegal, Burkina Faso, Ghana, Nigeria, Egypt, Morocco, Kenya, South Africa, Tanzania and Rwanda were contacted. In addition, financial institutions active in the international and regional trade finance markets based in the USA, UK, France, Germany and the Netherlands were contacted. Finally, development finance institutions active in supporting trade both within Africa and without were interviewed. Generally trade operations officers, international department management, treasury officers or senior commercial bankers were contacted. Participants were asked to:

- Describe their trade finance related activities*
- Describe the state of the market for trade finance products*
- Describe how availability of facilities has changed*
- Describe how terms and conditions of facilities have changed*
- Discuss overall economic activity in their markets*
- Discuss potential roles for AfDB to play to facilitate access to trade finance*

The overall conclusions of these surveys are:

- African trade grew rapidly during the pre-crisis period, spurred by growing south-south trade and the emergence of Asia as a major purchaser of African raw materials and primary products. Anecdotally, it appears that trade finance was increasingly available during this period.*
- The crisis has had a negative impact on African trade due to falling demand for African primary product exports. Trade finance availability was sharply constrained during the initial crisis period.*
- It is difficult to discern real trends in African trade finance as markets remain highly volatile. Liquidity and risk appetite vary widely across markets and counterparties. Across all markets, trade finance tenors have shortened.*
- There is an overall decrease in demand for trade products due to decreased economic activity but a higher proportion of the current transactions are using trade instruments.*
- International commercial banks that historically provided confirmation lines for trade instruments remain risk averse and seek to maintain/increase returns.*
- Low income countries and the smaller Regional Member Countries are hit hardest by the lack of availability of trade finance due to higher perceived risk, even for low risk transactions.*
- Basel II related capital allocation rules will have a negative impact on the cost and availability of trade finance across the continent.*
- Multilateral Development Banks in other regions play a variety of roles to support trade finance availability, from which AfDB could learn some lessons.*
- The African Development Bank can have a significant impact on trade finance availability and, consequently, RMC economic performance over the short/medium term.*

I. Introduction

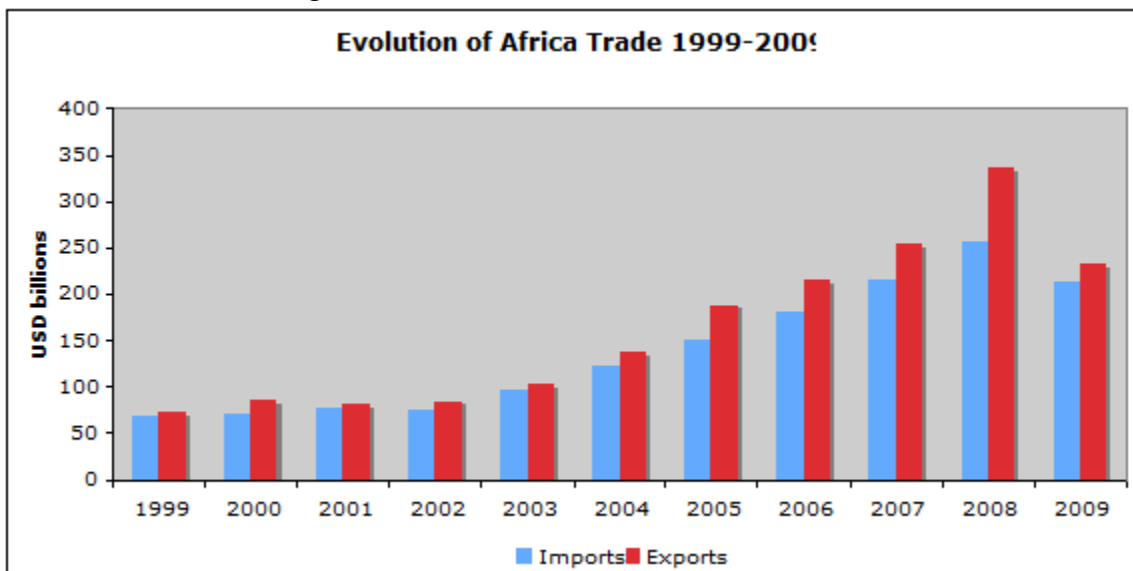
A recent survey on the availability of trade finance conducted by the International Chamber of Commerce concluded “it remains difficult to say with any precision whether a significant gap in the provision of trade credit compared with corporate demand remains and, if so, how it can be filled by multi-lateral development banks.” However, surveys conducted of financial institutions active in African trade finance in early 2009 and updated in the first quarter 2010 and again in the third quarter 2010 show that commercial banks believe that access to trade finance remains constrained, hampering economic growth and that the African Development Bank can play an important role stabilizing and catalyzing private financial markets.

The following reviews African trade, and trade finance markets, examines the programs other MDBs are implementing and recommends four strategic interventions the African Development Bank should further dimension to support trade finance availability and economic growth in Africa.

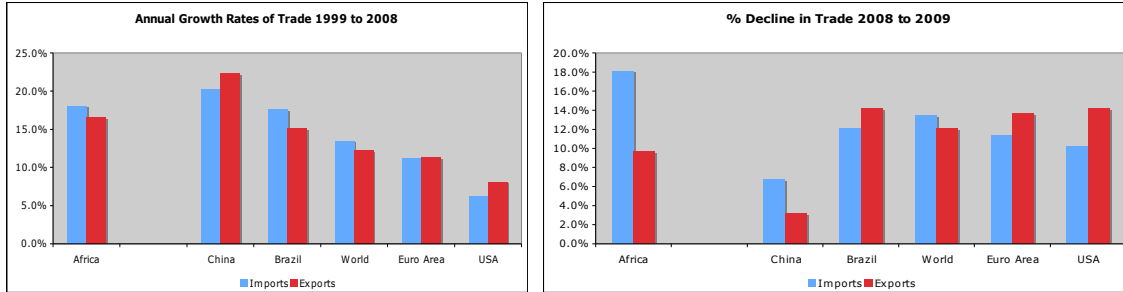
II. Trends in African Trade

Summary: African trade has grown rapidly over the past decade, driven by growth in south-south trade and the growing importance of Africa as a supplier of raw materials to emerging Asia. In 2008, 73% of Asia’s raw materials were imported from Africa. China is Africa’s second largest trading partner and is among the top ten trading partners of 26 African countries. African exports performed less poorly than global exports during the financial crisis while imports declined faster than global imports.

The period 1999 to 2008 saw rapid growth of African trade with the world. According to the WTO, African trade grew from 2.2% of the continent’s GDP in 1995 to 3.3% in 2008.

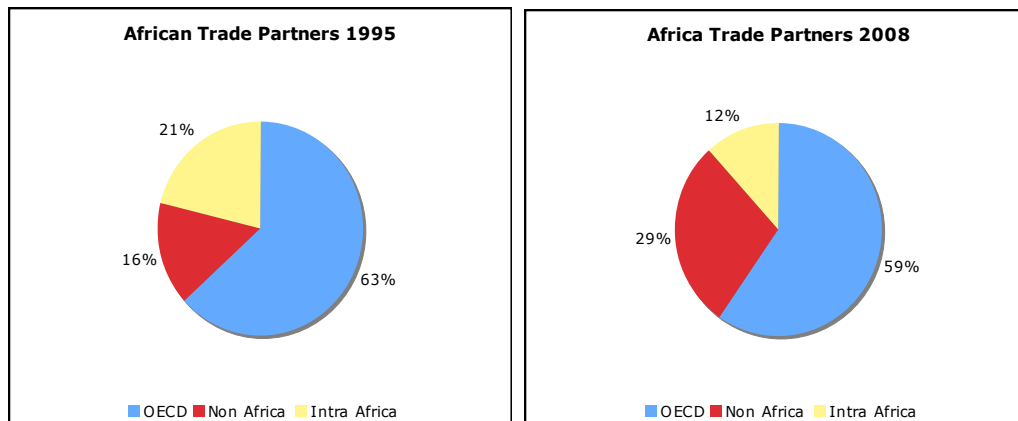


Spurred by global growth, and consequently demand for Africa’s primary products, strong regional economic growth, increasing integration into global economies as well as high commodity prices, African trade grew faster over the course of the 2000s than any other region except China.



Similarly, as world trade shrunk by 12% from 2008 to 2009, Africa’s export performance remained relatively robust, shrinking 8%. African imports performed less well, shrinking by 18% from 2008 to 2009.

Further, there has been a fundamental change in the composition of African trade flows. Africa’s total merchandise trade with non-African developing countries increased from \$34 billion in 1995 to \$283 billion in 2008 while trade with developed countries increased from \$138 billion to \$588 billion over the same period. The share of non-African developing countries in Africa’s trade increased from 16% in 1995 to almost 30% in 2008.



The growth of trade with non-African developing countries has been due mainly to expanding trade with Asia. According to UNCTAD, in the 1990s, India, the Republic of Korea and Taiwan were the main drivers of trade growth. Since 2000 however, the expansion of trade between Africa and China has increased nearly tenfold reaching \$93 billion in 2008, making China Africa’s second largest trading partner after the United States. According to UNCTAD, China represents 11% of Africa’s external trade and is among the top 10 trading partners of 26 African countries.

The rapid growth in trade with developing countries in the period preceding the financial crisis was comprised principally of growth in primary product exports from Africa and imports of machinery and consumer goods into Africa. As Asian economies experienced continued rapid growth, the share of primary products imported from Africa rose to 73% in 2008 from 55% in 1995. As would be expected, fuels have dominated this growth as a result of increasing oil production in the region and rapidly rising prices of oil over the period 2000 to 2008.

III. Financial Crisis Impact on Trade Finance in Africa

Summary: Prior to the crisis, trade finance availability was increasing in most markets. The crisis led to lower demand, increased risk perceptions and volatile markets. Tenors have shortened to less than 180 days versus maximum tenors of 270 to 360 days in 2007. Prices, which had reportedly risen 50% from late 2008 to mid 2009 have fallen to 25% above pre-crisis levels. There is an overall decrease in demand for trade products due to decreased economic activity but a higher proportion of transactions are using trade instruments. International commercial banks that historically have provided confirmation lines for those trade instruments remain risk averse.

Statistics on African trade are frequently idiosyncratic, incomplete and contradictory. They are, however, better than statistics related to African trade finance. There are no comprehensive statistics available on African trade finance growth. There are statistics available from SWIFT but they may be misleading and are very difficult to access. However, a review of international trade focused publications and the published financial statements of several African banks indicate that trade finance was increasingly available and increasingly affordable for African banks during the pre-crisis growth period of 2000 to 2008.

For example, Ecobank reported \$92 million in contingent liabilities related to clean line letters of credit at the end of 2003 and \$302 million at the end of 2007. While these numbers are not precisely comparable due to expansion of Ecobank's branch network they are consistent with figures reported by other financial institutions. Bank of Africa reports trade finance commitments of €45 million in 2002 and €128 million at the end of 2007. Standard Bank of South Africa report R25.5 billion of outstanding letters of credit and trade-related guarantees at the end of 2002 and R52 billion in 2008. On a more anecdotal note, during the course of the trade finance survey undertaken in early 2009, senior product managers at Citibank, BNP, Standard Chartered Bank and HSBC all indicated that their exposure to African trade finance had grown rapidly from 2004 to 2007.

Similarly, the trade finance specialty press frequently featured stories highlighting noteworthy transactions indicating increased risk appetite, increased transaction size, lower pricing and new borrowers coming to market. Beginning in earnest in 2005, transactions such as crude oil prepayment financing facilities raised for Angola's state-owned oil company or COCOBOD's pre-export finance facilities, transactions were being hailed as record breakers in terms of size, tenors or pricing. In addition new borrowers were entering the market as international syndicated financial transactions searched for yield. One international banker contacted indicated that "in early 2007 we could see that there was going to be turmoil in the OECD markets but prices were not adjusting. We were looking for higher returns given the risks we perceived. We liked Nigeria, Angola, energy plays that the market understands."

The global financial crisis resulted in a sharp drop in global trade. Observers indicate that total global trade fell by 12% over the course of 2008. Trade fell in both value and volume terms as lower commodity prices, due to falling demand, further impacted trade receipts.

Limited financial market integration with the advanced economies did not shield Africa from the global economic shocks, rather simply delayed their transmission. Recessions in OECD markets reduced demand for African exports and curtailed worker remittances and aid programs. According to the IMF, GDP growth in countries that were large purchasers of African exports fell from 12% per annum in 2004 to -6% in 2009; at the same time, prices for oil/gas, African metals and African agrocommodities fell 63%, 31% and 18% from their pre-crisis peaks.

Recent research conducted by the Centre for Economic Policy Research suggests that trade performance in African countries is hit harder by financial crises than other regions. Even though the direct effects of the crisis may be weaker due to the relative insulation and underdevelopment of the financial systems of most sub-Saharan African countries, the indirect effect through trade may be stronger. It was found that in past financial crises, African exports were “more negatively impacted by recessions and financial crises than the countries they export to.” This is not only due to the composition of African exports and the concentration on primary goods as both primary and manufactured exports are hit harder than in other regions. Another finding is that African exports are hit hardest when the importer country is an industrialized country.

The Centre for Economic Policy Research postulates that higher dependence of African exports on trade finance may explain this vulnerability: during financial crises, when uncertainty is high and liquidity is low, banks in importer countries first reduce exposure to particular countries that are seen as more risky. Exporters in countries with strong financial systems may be able to better resist such retrenchment, which is not feasible for African financial institutions and firms dependent on foreign finance.

Although this data is preliminary and, according to the authors, “the interpretation of results is only tentative” the disruption effect on trade finance availability and the consequent negative impact on trade and economic welfare as described above is consistent with what international commercial banks and African domestic banks report: demand has fallen, risk perceptions have increased and overall trade finance is more difficult to access.

The impact of the global financial crisis and its continuing aftermath on trade finance availability in Africa was severe. In the trade finance survey conducted of over 70 financial institutions in the first part of 2009, banks reported both sharp decreases in credit availability and increased pricing. Banks reported that trade finance was dominated by a few large international commercial banks including Citibank, Standard Chartered Bank, HSBC and Deutsche Bank and some legacy niche players that were important in specific markets or products. Smaller commercial banks in the region indicated they were increasingly using facilities from emerging regional banks like Standard Bank of South Africa and Ecobank as well as the offshore subsidiaries of African banks like Ghana International Bank, Medi Capital and FBN London, although these banks indicated that their sources of funding were being constrained by “reduced risk appetite” of their European and north American correspondent banks and “lower demand for paper in the secondary market.”

In early 2009, banks in all markets in Africa reported decreased availability of trade finance, shortening tenors and higher prices. Banks contacted in Senegal and Ghana

reported prices for letter of credit confirmation had increased by 50% from pre-crisis levels while banks in Kenya consistently reported prices doubling. Nigerian banks indicated that price increases had been “significant” while financial institutions in Egypt and South Africa reported that prices for confirmation lines had increased by over 25% and that liquidity was becoming difficult to access. Similarly, banks in all markets reported that available tenors were shortening with most indicating that lines were no longer available for more than 180 days versus maximum tenors of 270 to 360 days in 2007.

The impact of these shocks was moderated by falling demand for trade instruments. In early 2010, banks reported that their customers were using less trade finance instruments. In a survey conducted by the Bankers Association for Financing Trade, 41% of African financial institutions surveyed indicated a decline in trade finance activities, compared to the previous year. In addition, all financial institutions surveyed reported a drop in trade volumes during the first quarter of 2010 attributable to a drop in demand from corporate customers. Similarly, one regional financial institution reported that exports had dropped by 40% over 2009 due to depressed demand in developed countries. Commercial banks did report, however, that in late 2010 exports have rebounded due to increasing demand from emerging Asia.

In the first quarter of 2010, commercial banks reported increased liquidity, falling prices and depressed demand for trade finance. “Supply is not the problem” reported one large domestic commercial bank. “Financial Institution capacity [to supply credit] is not the issue” reported a regional commercial bank who reported also that demand for trade transactions remained constrained by low growth in the real economy. “Imports are way down” indicated a medium sized west African financial institution: “compared to 24 months ago, demand is not at the same level.”

According to international commercial banks active in Africa, this situation prevails today. In the third quarter of 2010, international commercial banks report that demand for confirmation lines are “40% of pre-crisis levels.”

Increased supply and depressed demand created “a buyer’s market for trade risk” according to an international commercial bank active across the continent. “Prices are falling” was a common refrain from international commercial banks contacted in the spring of 2010. Most reported that prices, which had reportedly risen 50% from September 2008 to June 2009 had fallen to levels 25% above pre crisis levels with spreads in some markets “down to levels seen in late 2007.”

The impact of falling prices and increased liquidity did not, however, result in increased access to trade instruments, especially for smaller economic operators. Commercial banks reported that their customers’ business partners were requiring use of letters of credit more frequently than in the immediate pre-crisis period: “the demand for import LCs is up. Before, we did one LC a week, maybe two. Now, everyone wants LCs to cover the importer risk” commented one large west African financial institution that has a significant SME portfolio. “We have started seeing a lot of small ticket trade items for all Africa” reported another international commercial bank.

The availability of supply has also not impacted tenor availability. In Nigeria, bankers indicate that in the third quarter 2010 short tenors are available and fairly priced but that

“tenors over 90 days are problematic.” Similarly, bankers in Kenya indicated that “short term” transactions are “largely available” but anything longer is difficult to access. One international bank reported that they “continue to manage down the term of our exposure” in order to “optimize our returns to a point where we can understand the future” indicating that they would like to have “an average tenor 10-20% shorter at the end of 2010 than we had at the beginning.”

Accordingly, there is an overall decrease in demand for trade products due to decreased economic activity but a higher proportion of transactions are using trade instruments. However, international commercial banks that historically have provided confirmation lines for those trade instruments remain risk averse and seek to maintain, or increase, return levels.

Liquidity Remains Volatile

In the first quarter of 2009, all financial institutions reported a sharp decline in liquidity. International commercial banks reported that home market management and regulators required that they reduce exposure to “high risk” assets. In addition, as self liquidating trade transactions ran off, international commercial banks were not systematically renewing lines. The impact of liquidity concerns in OECD markets cascaded through the trade financial system in Africa with regional commercial banks and domestic commercial banks all reporting severe liquidity constraints. Specifically, funded import transactions were constrained by a contraction of the secondary market for trade instruments.

However, programs like the GTLP and other emergency liquidity facilities have reversed this trend to some extent. In early 2010, one international commercial bank reported that “US and European commercial banks have not fully restored their lines” but that “liquidity constraints have alleviated.” Although no statistics were available, regional commercial banks and international financial institutions reported that the “secondary market is strong” in early 2010. In particular, bankers report that larger markets are performing well. One off-shore subsidiary of an African bank indicated that in “Nigeria and Angola are really picking up. Demand is high and pricing is getting thin again and even the secondary market for this paper is picking up.” International commercial bankers indicated that for larger markets, liquidity and risk appetite were “showing signs of life.” One international bank active as a secondary market purchaser of African trade assets said “the market is normal now.”

Available liquidity may appear to be overstated however as “there is no demand by economic actors” for trade instruments as final demand remains constrained in both local and export markets. Banks reported that demand from Asia was rebounding but there was little demand from traditional trading partners. In addition, in the third quarter of 2010, commercial bankers are expressing concerns about the availability of US dollar liquidity, particularly in Europe. Although concerns seems to have abated somewhat since the spring of 2010, according to commercial bankers demand for US dollars as a refuge currency in Europe is increasing, resulting in less US dollars available for trade finance. In addition, according to commercial banks contacted in September 2010, there are several “historical pockets of trade finance” in Europe that are withdrawing from the market. As one bank in the UK expressed “European banks are not well positioned to

generate dollars from African trade flows” and “they are all looking to generate dollars today.”

According to trade finance bankers, the situation with European banks is clouded by questions surrounding the adequacy of their capital positions. According to press analyses in the third quarter of 2010, the financial markets believe that European bank stress tests that were completed in June 2010 did not provide as comprehensive a picture of their government-debt holdings as regulators claimed and that “concerns about the health of European banks is likely to become an ongoing market factor.”

Two international banks cited West LB, in particular, as a “huge trade finance provider”-- via secondary market purchases of trade instruments--whose impending exit will disrupt the market further. West LB is seeking to strengthen its capital position by merging with another German landesbank and is exiting the African trade finance business as it seeks to limit “the number of complex factors that may make this merger unsuccessful.” When contacted, West LB trade finance team maintained that they are “solving each opportunity as they arise.”

Basel II will negatively impact trade finance availability

Although the impact may be more pronounced in Africa, the factors that have constrained availability to trade finance are not unique to the continent. In the 2009 survey on trade finance completed by the International Chamber of Commerce, financial institutions across the globe reported trade finance availability was being constrained by more stringent credit criteria, strategic refocus on key markets/sectors/clients and increased capital allocation requirements.

All banks involved in international trade have commented on the potentially negative consequences from the proposed application of the Basel II standards. In particular, international commercial banks and large regional banks that are more integrated into international financial markets are concerned that increased capital allocation requirements will result in sharply higher cost of trade finance and may also negatively impact supply.

The term Basel II is usually used for the framework of rules and standards for assessing the capital adequacy of banks and their exposures to risks through lending and other operations. The rules and standards have been formulated by the Basel Committee on Banking Supervision (BCBS). Based at the Bank for International Settlements, the BCBS initially set out these standards for the banks of the G-10 countries. The initial standards set in 1988 is known as Basel I, but its inadequacies became clear quickly and the revision, involving very wide global consultations, resulted in Basel II. Of 111 countries surveyed by BIS in 2006, 95 indicated that they planned to introduce Basel II. In the wake of the global financial crisis, Basel III has emerged. One banker at a global commercial bank reported that they are “just understanding Basel II and we are not even sure what Basel III will do.”

Among the specific factors cited as contributing to the tightening of the availability and terms of trade finance, in addition to the contraction of international trade, are the increases in the capital adequacy requirements due to the introduction of Basel II. In

addition to the commercial bankers contacted as part of the series of TF surveys, Basel II-related capital adequacy requirements were cited in two 2009 global surveys of trade finance, one by the International Chamber of Commerce (ICC) Banking Commission and another by the Bankers' Association for Finance and Trade (BAFT). These indicate the scale and geographical distribution of the contractions for major categories of trade finance and point to a widespread increase in its price.

According to the BAFT survey, there was a 4% increase in the global value of trade finance between the fourth quarters of 2007 and 2008 followed by a sharp fall of 11% between the fourth quarter of 2008 and the second quarter of 2009. In emerging markets as well as OECD markets there were contractions in the value of trade finance with BAFT reporting a fall in both LC and other trade instrument use across all markets surveyed.

The ICC Banking Commission survey, conducted in the winter of 2009 when the pressures on financial markets during the aftermath of the demise of Lehman Brothers were particularly acute, found that substantial proportions of responding institutions had recently decreased credit related to trade finance but also that there had been increases in the proportion of trade-finance transactions involving lower risk such as those supported by letters of credit and insurance or guarantees and a reduction in the proportion involving the simpler, cheaper but also potentially riskier open-account transactions. Accordingly, the supply of capital available for risk mitigation was decreasing while the demand for risk mitigation products was rising.

Among banks covered by the BAFT survey, 43% reported that Basel II had a negative impact on their capacity to provide trade finance.

Commercial bankers surveyed by BAFT, the ICC and over the past 18 months all point to two major structural problems associated with the Basel II guidelines. First, and most importantly, bankers note Basel II's focus on counterparty risk rather than product or performance risk. This leads to the estimation of capital requirements as an increasing function of the probability of default and, loss given default (both of which increase during downturns like the current one) and to the attribution of insufficient importance to the mitigating factors of the low risk, self-liquidating character of trade-finance instruments.

Consistently, commercial bankers contacted across market segments and bank types all report that trade finance in Africa is a low risk proposition. Importing basic consumer goods, housing materials and food via short tenor transactions with well known counterparties are risks the banks feel they understand and can manage. As one African banker put it "when you have local knowledge, you know how safe these transactions really are." Similarly, exporting raw materials, minerals, fuels and other primary products typically between long associated counterparties over short tenors is "as vanilla as vanilla gets" according to one international commercial bank. However, the Basel II counterparty approach to risk rating requires that, in the absence of data sufficient to model expected performance, trade assets, as cross border assets, require capital allocated at the level of the sovereign ceiling of the host country. Commercial bankers contacted feel that this "grossly overstates" transaction risks and "encourages our head office to seek increased prices or decreased lines."

In late 2010, commercial banks active in the European market for African trade assets expect this situation to worsen given the market expectation that European banks are not sufficiently capitalized against their own sovereign risks. One European commercial bank trade financier indicated that his team “is already under pressure to increase collateral or returns” from that bank’s internal risk management team. The same banker also indicated that this pressure is not Africa-specific but that “in all non-investment grade markets, the pressure is to use our capital better.”

In addition, Basel II sets a one year floor on the effective maturity of exposure when it estimates capital requirements for transactions. Although most trade finance institutions report their average tenor as less than 180 days, the 12 month floor established under Basel II requires capital set asides as if all transactions were a minimum of 12 months, effectively doubling the capital required for a typical 180 day letter of credit.

“We get hit twice” reported one international commercial banker contacted in the spring of 2010 “the first time is with the counterparty approach and the second is with the 12 month floor.” Bankers contacted report that these two elements will have a significant impact on their costs of funds and this “will certainly be passed on” to their customers.

IV. Multilateral Development Bank Support to Trade Finance

Summary: *There are different approaches employed to support trade finance. The Inter-American Development Bank has been successful by marketing trade products as one of a portfolio of financial institution targeted products. The Inter-American Development Bank has focused on developing links between Asia and Latin America/Caribbean. The Asian Development Bank has leveraged its Risk Participation Agreement product to allow rapid growth. The Asian Development Bank is highly responsive and customer focused. IFC has a wide range of products to support trade and large processing capacity. IFC is seen as strong partner. IFC’s cannot finance public sector transactions which limits its impact in Africa.*

As part of the global public-/private-sector partnership effort to address the crisis, the Multilateral Development Banks (MDB) launched new programs or enhanced current programs to provide credit and liquidity for the import/export marketplace. In April 2009, the G-20 pledged to ensure the availability of at least \$250 billion over the next two years to support trade finance through export credit and investment agencies and through the MDBs.

According to industry observers, each of the MDB programs provide valuable support to the international trade community and the MDBs play an important, but limited, role in providing support to the trade finance markets. Bankers felt that “private sector funding for trade always lags” and was described by one banker as “pro-cyclical...when it is needed, it is not there and when there is no need, there is too much.”

There are different models employed by the MDB programs to extend the availability of trade finance. Each of these programs describe themselves as “market based” and report that they “do not compete with the market on price.” Users of these programs that were contacted describe them all as “expensive.”

Several of these programs will be examined below:

European Bank for Reconstruction and Development

The EBRD Trade Facilitation Program (TFP) aims to promote foreign trade to, from and within central and eastern Europe and the Commonwealth of Independent States. Through the program, the EBRD provides guarantees to confirming banks in order to “take the political and commercial payment risk of transactions undertaken by participating issuing banks in the countries where the EBRD operates.” Since its inception in 1999, the TFP has closed almost 9000 trade transactions for a total value of almost €5 billion.

The TFP is open to issuing banks registered in all the EBRD’s countries of operations including banks with majority foreign ownership and subsidiaries of foreign banks. The EBRD bases its acceptance of bank risk on the financial standing of the issuing bank, the quality of its governance structures and their level of activity in trade financing. All international banks are eligible to join the TFP as confirming banks and selected banks from the region that have significant experience in trade finance instruments may also act as confirming banks.

As of September 2010, the EBRD works with 116 issuing banks in 20 member countries. EBRD has relationships with at least 500 confirming banks. Several international commercial banks contacted indicate that TFP is easy to work with and has well developed policies and procedures but that “these could be streamlined”. No TFP issuing banks were contacted.

According to the ICC, over the course of 2009 and early 2010 foreign exporters and foreign commercial banks were declining new business, even with 100% EBRD risk cover under TFP guarantee facilities because they did not have sufficient liquidity to finance these transactions particularly in cases of larger amounts and longer tenors.

As a result, the EBRD offers, not only up to 100% risk cover for letters of credit issued by TFP client banks in Eastern Europe and the CIS, but also provides issuing banks with the necessary liquidity for pre-export finance, post-import finance and financing for the local distribution of imported goods.

In 2009, in order to compensate for the lack of available trade limits from the commercial market, more than 850 foreign trade transactions for the total amount of €550 million were supported by the EBRD’s TFP program. To accommodate growing demand, EBRD increased the ceiling on the TFP from €800 million to €1.5 billion in January 2009.

Asian Development Bank Trade Finance Program

The Asian Development Bank Trade Finance Program provides guarantees and loans to 180 partner banks in order to increase financial support to companies engaged in import and export activities in Asia’s most challenging markets.

The ABD TFP is available for public sector transactions.

The ADB TFP supported \$2 billion in transactions in 2009. According to the ABD the average tenor of their guarantees is less than 180 days. ADB’s program comprises three products:

Credit Guarantee: ADB provides guarantees of up to 100% risk protection against nonpayment by approved participating banks, in support of trade transactions.

Risk Participation Agreement: For banks with large and consistent trade finance volumes, ADB provides a maximum 50% risk protection against nonpayment of a financial obligation issued by a bank in support of a trade transaction. Unlike the CG product, the Risk Participation Agreement (RPA) provides risk protection on a portfolio basis, rather than on a transaction-by-transaction basis.

Revolving Credit Facility: ADB provides revolving loans to eligible banks for on-lending to importers and exporters to finance trade-related transactions. This product is most frequently used for pre-export financing.

The ADB TFP has existed since 2004. According to product managers at ADB the program was resource constrained for the first three years. ADB reports that the creation of the RPA which allowed them to “ramp up the program with no need for huge resources” is key to their recent rapid growth.

The RPA program guarantees up to 50% of partner banks’ confirmation exposure to issuing banks on a portfolio basis.

The ADB TFP team works with 6 “very carefully chosen” international commercial banks to determine portfolio asset acceptance criteria, individual issuing bank limits and eligible transactions and then delegates management responsibility to those banks. The RPA partner banks report monthly on their exposure and ADB TFP management reviews portfolio performance and perspectives with RPA partner banks on a monthly basis.

According to ADB TFP management, the experience with the RPA program has allowed them “to learn about the potential issuing banks in a cost effective way.” Since the roll-out of the RPA program, the ADB TFP CG program “has accelerated rapidly.”

The ADB TFP team is comprised of 10 FTEs although team management thinks “this could be reduced” since they “greatly expanded as the business grew.” The team comprises three relationship managers each with one middle office support and a total of 2 operations FTEs. Industry observers and partner banks describe ADB TFP as “very efficient” with response times within 48 hours. An RPA partner bank described ADB TFP as “very flexible” and continued that “it took a large upfront investment in time” but that once they began working together “they are very easy to work with and very quick to respond.”

The ADB TFP team does not specifically target small and medium enterprise borrowers but report, “about 50% of our transactions are with SMEs.” ADB TFP believes that “this business captures the SME flows naturally” as SME-related transactions are typically “those that need our support.”

The ADB TFP is currently working with the International Chamber of Commerce to develop a pilot trade credit default register to analyze trade finance performance data in order “to demonstrate empirically that trade finance carries low risk compared with other forms of finance.”

The ADB TFP is currently working with the Inter-American Development Bank’s Trade Finance Facilitation Program to explore opportunities to share access to their trade finance programs, linking more than 100 financial institutions to support trade between companies in Asia and Latin America.

Inter-American Development Bank Trade Finance Facilitation Program

The Inter-American Development Bank (IDB) considers trade activities to be crucial to the growth of Latin American economies. IDB considers that the regional Trade Finance Facilitation Program (TFFP) complements their broader strategy to support financial sector growth.

Operating since 2005, the TFFP extends Credit Guarantees in the form of Standby Letters of Credit in favor of confirming banks to cover the risk they take on eligible trade finance instruments issued by Latin American issuing banks. Covering up 100% on a transaction-by-transaction basis, TFFP management describes their program as “the most successful of [the IDB’s] financial institution” programs.

The TFFP works with 66 issuing banks but expects this to increase to 100 issuing banks by 2012. TFFP provides both guarantees and direct loans to issuing banks. TFFP management believes that “guarantees alone do not work” as “liquidity is always a problem” whenever there is any kind of crisis. TFFP management reports that the average transaction tenor is 200 days but they will extend facilities up to 3 years. TFFP management reports that they have a global exposure limit of \$1 billion with outstanding facilities averaging \$200 million.

The TFFP is positioned as one of a basket of products that IDB FI relationship managers market to commercial banks in the region. Exposure limits are determined by the FI team, who also monitor line usage and performance. The TFFP team is comprised of two product managers and one operations FTE. TFFP management feels that IDB’s multi-product FI strategy is the key element in their successful and sustainable growth.

TFFP also conducts trade capacity building programs for issuing banks and their SME customers. TFFP management does not see a link between product use and training. They report “there is no real impact. Everyone knows it is important and it makes IDB management more comfortable” but it does not result in increased facilities.

TFFP believes trade between Latin America and China presents an important growth opportunity. The IDB has sponsored a series of Latin American forums in Beijing in order to build awareness of trade financing in the region. Issuing banks in Latin America do not have lines with Chinese banks and have difficulty getting confirmations. TFFP has recently begun working with the Asian Development Bank’s Trade Finance Program to increase information exchange between Asian and Latin American banks.

International Finance Corporation Global Trade Finance Program

In November 2008, the IFC doubled its Global Trade Finance Program (GTFP) ceiling to \$3 billion. The GTFP offers confirming banks partial or full guarantees covering payment risk on banks in the emerging markets for trade-related transactions. The program comprises 148 issuing banks in 74 countries and operates in emerging markets throughout the world.

The GTFP is generally considered extremely effective by participating banks and has grown rapidly. In 2010, IFC reported that they had worked with 183 issuing banks and 198 confirming banks since the program’s inception in XXX. In the first nine months of 2010, IFC issued 2081 guarantees for \$2.4 billion, increases of 270% and 210% respectively from 2007. IFC reports that 84% of their transactions are for less than \$1

million with a median value of \$158,000. GTFP reports that average tenor is 160 days.

GTFP management reports that program growth is constrained by the inadequate capital position of the smaller banks that need their support. In addition, GTFP management indicates that issuing bank AML/KYC policies are frequently insufficient to meet IFC requirements and “significant capacity building is required.”

GTFP can only work with private sector FIs and only on private sector trade transactions.

International Finance Corporation Global Trade Liquidity Program

The IFC Global Trade Liquidity Program (GTLP) is the newest program to be instituted in response to the global trade finance crisis. In May 2009, the GTLP was launched by the IFC to address liquidity issues in trade finance. The program is designed to support up to \$50 billion in international trade in the next three years. In July 2009, the program began dispersing GTLP funds through the first four participating banks (Standard Chartered Bank, Citigroup, Rabobank Nederland, and Standard Bank of South Africa) to provide trade finance through a network of more than 500 banks in over 70 developing countries across all regions. Funds for the program will be mobilized through the participating banks and the program partners, including the AfDB, the UK, Canadian and Dutch governments, the Japan Bank for International Cooperation, the OPEC Fund for International Development, and the Saudi Fund for Development.

IFC believes that the market for trade finance is moving beyond requiring liquidity and is requiring more guarantees. Accordingly, they have launched GTFP Phase 2, or GTLP-G, a portfolio-based, risk-sharing, unfunded program created in response to increasing demand for unfunded regional solutions by governments and banks.

GTLP-G, Central and Eastern Europe: The Guarantee part of Phase 2 was launched in January with SIDA – the Swedish International Development Corporation Agency - which provided up to \$125 million for unfunded guarantees to support trade in Central and Eastern Europe.

GTLP-G, Africa; GTLP-G, Latin America: IFC indicates they have received increased interest from partners in guarantee programs that would target trade in Africa and Latin America and “are working on developing additional targeted regional solutions.”

In addition, IFC is launching a food and agriculture specific trade liquidity program called GTLP Agri. According to IFC, GTLP Agri complements the G-8 pledge to invest \$18 billion in agriculture investments and food security over the next three years, and trade was specifically noted to be central to their Food Security Initiative. It is a short-term debt structure aimed at facilitating global trade of food and agribusiness commodities to support agricultural trade by leveraging the GTLP platform. The goal is to raise \$700 million from DFIs/governments over the next 12 months to develop a \$1 billion GTLP Agri program. IFC reports it is seeing increasing demand for such sector specific solutions from banks.

In the 2009 trade market report, the ICC reported that “the majority indicated that their institution has been utilizing trade facilitation programmes implemented by MDBs.”

In the ICC survey, banks felt that “in the months to come, financial markets should continue to improve if sustained efforts by governments and international organizations

are maintained.”

V. Potential role of AfDB

The African Development Bank can play an important role in minimizing the negative impact of crises in Africa by supporting the availability of trade finance. There are four strategic investments that AfDB could make to complement and crowd-in the private sector. Each is modular, i.e., can be initiated with a low initial investment and expanded/modified as market demand is better understood. Further, each addresses public market failures so is appropriate for quasi-public sector investment. Finally, each will have the potential to visibly strengthen AfDB’s partnership with international commercial banks as well as financial institutions in regional member countries.

As discussed above, trade finance markets in Africa continue to experience significant volatility. During the height of the financial crisis in 2009, banks reported limited risk appetite and lack of liquidity, particularly in the secondary markets, as major constraints to their ability to finance trade. Over the course of the past 18 months, markets have evolved and, to some degree, stabilized but liquidity and risk appetite remain problematic and volatile.

Commercial banks, industry observers, development finance institutions and specialized trade finance institutions all agree there is a role for the AfDB to play supporting trade finance availability in Africa. It is not surprising that commercial banks indicated they would like to see AfDB more active in risk mitigation and providing liquidity. The African Development Bank can play an important role in addressing these constraints in a modular and low resource manner, both by supporting industry infrastructure to address information gaps that constrain trade lending as well as by providing direct credit and liquidity support to financial institutions financing trade in Africa.

By creating a small, dedicated trade finance team, that incorporates the best elements of the other MDB trade finance initiatives, the AfDB can scale its trade finance support initiatives as the market develops and the AfDB further dimensions resource requirements. Focusing, initially, on working through commercial financial institutions the AfDB can develop the institutional competences necessary to deploy a full-fledged trade finance program, if desired. In addition supporting industry infrastructure and promoting Asian-African trade will indirectly stimulate trade finance availability. Finally, trade finance availability will extend the impact of AfDB’s regional integration investments.

Support Industry-wide Infrastructure to Address Information Gaps

Summary: *Basel II will increase cost of trade finance in Africa due to lack of consistent, portable and validatable data on trade asset performance over time. Asian Development Bank and International Chamber of Commerce are establishing a Trade Finance Default Register. The African Development Bank should collaborate with AsDB and ICC and develop an African Trade Finance Default Register.*

Commercial bankers contacted indicated that Basel II's capital allocation requirements related to non-rated transactions significantly increase the cost of trade financing trade with small and medium sized enterprises or in non-investment grade countries. Since the large majority of the AfDB's Regional Member Countries are non-investment grade and many African traders are SMEs, the increased costs associated with access to trade finance result in significantly higher costs for trade finance. Similarly, the recent ICC survey found that "there remain strong constraints to trade finance" in sub-Saharan Africa due to "the high cost of obtaining information on counterparty risk and resulting low profitability." Bankers report that these costs are likely to increase given the application of Basel II rules.

Although it has long been suggested that trade finance is a low risk asset class, there has been little empirical information to support this argument. In response to this, the Asian Development Bank and the International Chamber of Commerce have established a joint ICC/Asian Development Bank Trade Finance Default Register. The creation of the trade register recognizes that Basel II rules place an unnecessary strain on banks in capital utilization to support issuance of trade finance instruments and fails to recognize the lower risk profile that trade instruments have compared to an unsecured credit. ICC/ABD have sent out questionnaires to participating banks collecting information on letter of credit transactions, LC volumes and asset performance with the intention of providing the Basel committee with empirical evidence to support a request for relaxation of rules.

The initial report from the ICC/ADB trade register examines portfolio level data comprising over 5 million transactions, provided by nine international banks with operations in both developed and developing countries. Data was provided on import LCs, export LCs, guarantees/standby LCs, import loans and export loans covering the period 2005-2009, The average tenor of trade finance transactions in the registry was 115 days.

The registry data reports only 1,140 defaults with import loans (refinancing of import LCs) showing the highest default rate of 0.29% and guarantees/SBLCs, the lowest at 0.01% defaulting. More interestingly, the data show only 445 defaults in 2008-2009 out of 2.8 million transactions. Indeed, the rates of default declined during the crisis, although not significantly so.

The African Development Bank should collaborate closely with the ICC/Asian initiative in order to dimension and document trade product performance in Africa over time. This will provide the BCBS with the data necessary for them to provide a short term exception to the rules associated with capital allocation and trade assets. The trade register can be useful only if it becomes a comprehensive and long term tool that is updated on a regular basis and is used by both regulators and banks to assess the riskiness of the trade finance market.

Commercial bankers in all markets report that their SME sectors are increasingly focusing on modernization and consequently require capital investment. Commercial banks indicated that clients were seeking term trade credit enhancement in order to access financing from Export Credit Agencies. Across markets, domestically focused commercial banks of all sizes indicate that only highly limited term facilities are

available for SMEs. Domestic commercial banks felt that they are “gaining experience”, although they are mixed, with SMEs but “cannot lend large amounts for long periods of time” constraining modernization possibilities.

SME access to finance is indirectly affected by Basel II as most international credit flows are to large established firms. The SME sector is considered higher risk because of a generalized lack of credit history, performance track record and lack of adequate collateral. The lack of credit history constrains financial institutions from developing ratings systems to differentiate risks across firms. In the absence of a validatable system for risk rating, all non-rated transactions require the highest capital allocation, rendering SME finance more expensive relative to other sectors of the economy. The AfDB should also seek to develop an SME finance performance registry, which, while not directly trade-related will stimulate small exporter access to financing and small importer access to capital equipment.

Commercial banks contacted all indicated they would be interested in providing data to the financial performance registries if they could access the overall data and the data was used to advocate for more rational capital allocation regulations.

Support to developing and disseminating trade finance data harnesses AfDB’s unique assets: collaborative relationships with commercial finance institutions across the continent and meets the criteria established for AfDB investments:

Effective: The absence of portable, validatable and consistent data on trade finance transactions constrains the ability of a range of actors from participating in the growth of the trade finance market. It is expected that data collected in a trade finance performance registry will be useful not only to the BCBS regulators but could also contribute to the growth of the factoring industry, incite specialized trade finance funds to invest in African trade assets and contribute to a better understanding of the overall trade finance market in Africa.

Efficient: The investment in data collection from financial institutions with whom the AfDB has existing relationships and feeding that data into a model already developed by AsDB and ICC are both low resource investments and are unlikely to require additional human resources but should have a large impact on trade finance provision.

Prudent: AfDB’s support to a trade finance performance registry is a low risk investment and should contribute to a more accurate pricing of risk in the African trade finance markets.

Recognizable: The creation of the African trade finance performance register can be branded as an AfDB initiative and will be recognized among participants as an AfDB contribution to shared market infrastructure.

Direct Support to Trade Financiers through Portfolio Guarantees

Summary: *LIC-based commercial banks cannot access adequate financing due to high perceived risks. Individual guarantees to confirming banks will require a large team to analyze credits and monitor usage/performance. Partial portfolio-based guarantees issued to well-managed commercial banks will stimulate private sector finance to LICs. A partial portfolio guarantee program will allow the AfDB to dimension resource requirements and develop the institutional competences necessary to deploy a multi-product trade finance offering.*

It is not sufficient to provide indirect support to trade finance through regulatory changes. The WTO expert group on May 18, 2010, indicated that African banks are still not getting adequate financing, particularly those in LICs, where access to liquidity is still costly or even prohibitive. This is consistent with reports from banks contacted during the surveys conducted in 2009 and 2010. Throughout, commercial banks indicated that smaller markets were unable to access sufficient financing as they were perceived as too risky.

There are many options available to AfDB to support trade finance, as has been demonstrated by other MDB support to trade finance. Over time, AfDB should consider opportunities for direct support to issuing banks and confirming banks through guarantee issuance programs similar to GTFP or the IDB TFFP. However, as both those institutions have indicated, this is resource intensive in its conception and operation as AfDB would need teams to analyze the credit-worthiness of issuing banks, monitor performance and line usage and process a large number of transactions. Rather, AfDB should apply the lessons of the Asian Development Bank and develop and apply a portfolio-based risk participation product.

The Asian Development Bank RPA product is designed to share risk with international commercial banks and relies on those banks to perform credit/risk analysis on those financial institutions as well as originate, process and monitor those transactions. AsDB's role is to issue guarantees in favour of six carefully selected commercial banks, whose credit origination and administration processes are robust enough for AsDB.

Similarly, AfDB can develop and implement an RPA program to support increased trade credit in Africa. Commercial banks in small markets have indicated that international and pan-regional commercial banks' limited risk appetite for their opened LCs constrains their ability to provide trade finance. An RPA program, guaranteeing up to 50% of portfolio exposure will increase trade financing available. As one international commercial banker described, "this will bring in the private sector, help us understand the risk environment better and, hopefully, expand our footprint."

AfDB should consider working with regional financial institutions as well as international commercial banks in an RPA program. AfDB should consider the efficacy of the credit initiation and administration capacities of pan-African banks like Standard Bank of South Africa, Ecobank and Bank of Africa. Over time, AfDB should also consider working with the offshore subsidiaries of African banks like FBN London and Ghana International Bank. This support, which can be structured as the AfDB gains experience in this product should support the continued growth of African-focused service providers and insulate Africa's trade finance markets, to some degree, from

external shocks.

AfDB direct support to trade financiers will attract additional risk appetite into the market, especially for low-income country or small market financial institutions, according to commercial bankers contacted and is a good starting point for a trade facilitation program. As product managers at the AsDB indicated, their RPA program allowed the bank to “learn about the issuing banks in a cost effective way.” Further, this support will not displace commercial bank lines. An international commercial bank indicated they only use the AsDB facilities when they “are fully booked elsewhere”. Similarly, commercial banks contacted report that they only use IFC facilities when they have no other available credit lines. The BAFT survey on commercial banks indicated that they “prefer to keep commissions” and will only seek recourse to MDB programs when they need additional credit facilities.

Effective: As noted above, commercial banks believe that portfolio support for trade finance assets, particularly for low income countries, will result in expanded access to trade finance for African importers and exporters. The Asian Development Bank was reluctant to share statistics, but they believe that their RPA program has resulted in “greatly expanded trade finance availability.”

Efficient: IFC reported in 2009 that “a DFI needs to have several billion dollars in the trade finance market before you can begin to have positive returns.” This is true if the DFI is seeking to create a whole trade facilitation program like the GTFP. AML/KYC, credit origination and administration policies and marketing the program are resource intensive. However, emulating the AsDB portfolio approach would leverage the capacities of commercial banks with whom the AfDB would be sharing credit risk. This program could be established with one FTE to market to, and assess the procedures of the selected partner banks. In addition, monthly or quarterly guarantee issuance and monitoring will require only limited processing support. Over time, AfDB can increase its exposure to issuing banks, and consequently, resources devoted to trade finance, as it learns the dynamics of this market.

Prudent: According to the Asian Development Bank, portfolio-based risk participation agreements leverage the credit processes of the commercial banking partners. As interests are aligned due to risk sharing, AfDB can complement market supply in a low risk manner and scale up the Bank’s risk acceptance profile over time.

Recognizable: International, regional and domestic commercial banks surveyed all identify the AfDB as a preferred partner for financial market development across the continent. By working with larger financial institutions, AfDB will leverage their marketing networks and increase the Bank’s visibility in local financial markets.

Trade Finance to Support Regional Integration

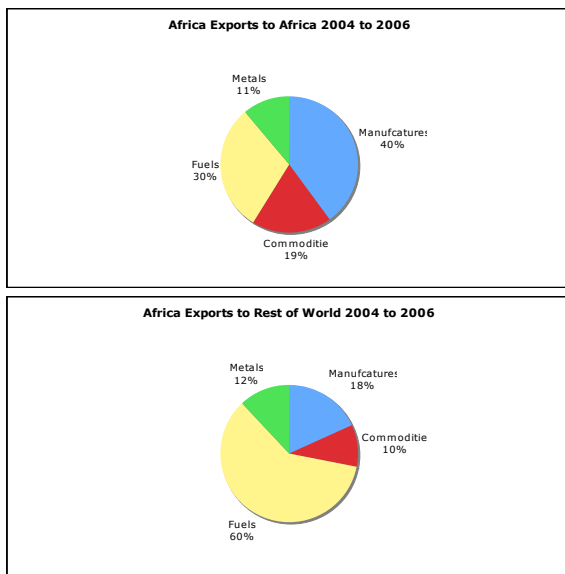
Summary: *Intra-African trade is inhibited by weak infrastructural linkages. Intra-African trade has more short-term development impact than extra-African trade. AfDB is committed to supporting regional market integration. Trade finance products, particularly a small and focused guarantee product or targeted trade loans should be included in all regional integration investments.*

The success of Africa’s regional integration efforts has been limited. There are many

factors that could explain this, including lack of cross-border infrastructure, beggar-thy-neighbor economic policies and conflicting trade policies and procedures. However, research has also shown that regional integration efforts are most successful when intra-regional trade represents a large share of total trade prior to the regional integration initiative. According to research undertaken in the 1990s, those regional integration initiatives in which trade has grown rapidly (i.e. APEC, NAFTA), trade expansion preceded the regional integration and not vice versa. Accordingly, it can be demonstrated that increased intra-regional trade supports regional integration efforts.

In Africa intra-regional trade is inhibited by weak infrastructural linkages. Poor port facilities, weak communication links and underdeveloped road networks all limit the potential for expanding regional trade. Earlier this year, the AfDB President said the “the solution to unlocking the internal market potentials and developing [Africa’s] vast resources lies on regional integration, which will have a major impact on the cost of doing business in the region and cost of access to the world.” Regional integration is necessary in Africa since a large number of the continent’s economies are small, landlocked and fragmented which hamper market expansion, thus limiting the potential for economies of scale. In the absence of regional integration, African firms will remain home-market based, will not gain efficiency through larger markets and will not be able to compete in the global marketplace for anything but raw materials.

African trade with Africa has significantly more development impact than trade with the rest of the world. Intra-African trade remains relatively modest, reaching only \$30 billion in intra-African exports, or 14% of African total exports in 2009, or roughly 10% more than African exports to China. However, if the composition of exports is examined, as in the figure below, it is apparent that exports within the continent create more jobs and have a higher poverty reduction impact than export of primary fuels and metals to Asia, Europe and North America.



Accordingly, expansion of intra-African trade should yield significant benefits to African countries. According to UNCTAD, 80% of African countries export more manufactured products to other African countries than they do elsewhere in the world.

There are number of large scale investments undertaken by the AfDB to support regional integration and intra-African trade. Each of these projects presupposes the availability of trade finance. For example, the UC 37 million financing for the Ndali-Nikki-Chicandou-Nigeria road project is intended to augment regional trade and stimulate agro-exports from Benin to regional markets, particularly by micro and small enterprises. Similarly, the Burundi infrastructure action plan--estimated to cost a total of \$5.8 billion--should "improve trade through air and rail links." In addition, the AfDB has financed over \$190 million to link Congo and Cameroon to address the large "untapped agricultural potential for trade" between the two nations.

Projects like these are consistent with the recommendations of the UN Economic Commission for Africa's ARIA IV which analyzes the status of intra-African trade, its progress and the challenges that must be addressed in legal, policy, institutional and infrastructural capacities at the national, regional and continental levels. ARIA IV concludes that regional integration projects, "particularly in the development of infrastructure are necessary" to address the challenges of economic growth and poverty reduction in Africa. According to ARIA IV, dilapidated and inadequate infrastructure and services affect the cost of production and transactions as do antiquated trade policy regimes and inconsistent administrative and registration procedures.

The AfDB should place a specific focus on trade finance as it relates to regional infrastructure investments. As the market has indicated through the numerous surveys, low-income countries will not simply attract financing when all the other necessary conditions are met. Roads can be built, policy regimes modernized and agro-productivity enhanced. However, without finance the full impact of these investments will not be realized. Support for trade finance is necessary, particularly in the small, landlocked, low income countries that do not generate sufficient transaction volume to attract international financial institutions.

In addition, AfDB should work with regional member countries to improve the harmonization of trade facilitation and trade administration procedures through aid for trade programs. Gains from physical infrastructure investments will be limited by poorly developed and inconsistent institutional arrangements.

The AfDB support for trade finance provision via regional integration initiatives could be in the form of targeted lines or risk participation through financiers of infrastructure projects. Marginal AfDB support to trade finance alongside infrastructure investments will encourage the private financial markets to participate in financing trade. It is catalytic and supports regional economic growth. AfDB should sign risk participation agreements with ECAs that support regional integration investments in order to optimize the allocation of trade finance resources to extend impact.

Effective: Supporting the private sector provision of trade finance in areas where AfDB is providing support to regional integration initiatives will not require significant additional resources. Analogous to working capital financing for firms making large capital investments, AfDB's support will encourage private sector financiers.

Efficient: By supporting trade finance facilitation and trade administration reforms, AfDB will leverage the large investments made in physical infrastructure in order to maximize the impact on broad-based economic growth. As has been noted above, intra-African trade has higher returns to job creation and economic growth than primary product exports to developed countries and emerging Asia. Accordingly, these small marginal investments to ensure that intra-African trade accelerates will have a large impact.

Prudent: As has been noted above, African trade is highly dependent on trade finance. The risks associated with AfDB's large infrastructural investments will decline as trade finance is available to support economic activity.

Recognizable: AfDB is recognized as the leading infrastructure bank in Africa. Support to increase the impact of these investments in physical infrastructure will further increase AfDB's visibility as a partner to regional member countries.

Support for Trade with Asia

Summary: *Asia-Africa trade is growing rapidly and China is becoming an important trading partner across the continent, even for resource constrained countries. Chinese trade with Africa remains limited by financing as Chinese banks are unfamiliar with African risks. AfDB should work with Chinese and African financial institutions to promote risk-sharing and better information exchange.*

As noted above, African trade with Asia, particularly China, is growing rapidly. Sub-Saharan exports to China have grown 14% per annum since 1999 while sub-Sahara Africa's imports from China have grown by over 25% per year during the same period. China represents a significant market for many African exporters. Zambia, for example, realized 49% per year growth in exports to China from 2004 to 2009 and China represents almost 30% of all Zambian exports. Similarly, Ethiopian exports to China have grown by 70% per year over the same period and the Chinese market comprises 15% of all Ethiopian exports. Even in markets that are raw material scarce, China is fast becoming an important partner. Senegalese exports to China have grown 60% per year over the past 5 years but only represent 2% of Senegalese exports. Senegalese bankers expect China to become a more important partner for Senegalese exporters.

Similarly, China's importance as an exporter to Africa is growing. Chad, for example, has seen its imports from China grow 90% per year since 2004 and Chinese imports now comprise over 10% of all Chadian imports. Similarly, Niger and Rwanda have realized annual Chinese import growth of over 60% per year.

Exports from China are growing all over Africa but 7 countries comprise over 70% of Chinese exports to Africa. Surprisingly, four of the seven are resource-constrained low income countries: Benin, Liberia, Kenya and Ghana all import more than \$1.2 billion in Chinese exports.

Bankers contacted throughout this survey have indicated that trade with China is constrained by Asian banks' unfamiliarity with the continent and its financial institutions. "They know Citibank and Commerzbank" is how one Rwandan financial institution described Chinese banks. Even in the larger markets where China has more experience,

the lack of local knowledge constrains trade finance availability. A Nigerian bank described their experience commenting that “Chinese ECAs provide weak support because they do not know enough about local banks.” One international bank with subsidiaries in Africa reported that “trade with China represents 40% of our business in Ghana” and is growing rapidly but remains constrained by “lack of information about opportunities.”

In addition the African Development Bank should explore opportunities to sign a Master Risk Participation Agreement with the Asian Development Bank as it develops its trade finance activities. A Master Risk Participation Agreement would allow each institution to provide risk cover for trade transactions undertaken by the other. This would allow more efficient allocation of available trade finance risk appetite across Africa-Asia trade transactions.

VI. Conclusion and Recommendations

Trade Finance in Africa is characterized by continuing volatility, which is driven by regulatory change, an unstable competitive landscape, new trade patterns and a weak demand. All these elements exaggerate the perceived riskiness of African trade finance markets, and subsequently growth of trade is constrained by lack of financing due to higher risk perceptions.

The following recommendations are therefore presented for discussion during the round table. They assume the establishment of a trade finance team along with a dedicated interface within the trade finance ecosystem of the Bank.

- *Supporting trade financiers through guarantee facilities:* LIC-based commercial banks cannot access adequate financing due to high perceived risks. Individual guarantees to confirming banks will require a large team to analyze credits and monitor usage/performance. Partial portfolio-based guarantees issued to well-managed commercial banks will stimulate private sector finance to LICs.
- *Support regional integration by providing finance for intra-regional trade:* AfDB support for trade finance provision via regional integration initiatives could be in the form of targeted lines or risk participation through financiers of infrastructure projects. AfDB support to trade finance alongside infrastructure investments will act as a catalyzer for other private sector agents.
- *Support trade diversification, especially with Asia via greater cooperation and information sharing with the Asian Development Bank and other trade financiers in the region:* Asia-Africa trade is growing rapidly and China is becoming an important trading partner across the continent, even for resource constrained countries. Chinese trade with Africa remains below potential as Chinese banks are unfamiliar with African risks. AfDB should work with Chinese and African financial institutions to promote risk-sharing and better information exchange.
- *Improving the information gap regarding trading firms in Africa:* Basel II will increase cost of trade finance in Africa due to lack of consistent, portable and

validatable data on trade asset performance over time. The African Development Bank should collaborate with AsDB and ICC and develop an African Trade Finance Default Register.

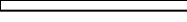
Financial Institutions Contacted

- Access Bank
- Afrexim Bank
- Africa Trade Insurance Agency
- Amal Bank
- Arab African International Bank
- Asian Development Bank
- Bank of Africa (Kenya, Senegal, Burkina Faso)
- Banque Atlantique (Senegal, Burkina Faso)
- Banque Commerciale de Burkina
- Banque du Caire
- Banque Internationale du Burkina
- Banque Misr
- Banque Regionale des Marches
- Banque Rwandaise de Developpement
- Barclays Bank (Dubai, Kenya, Ghana)
- BICIS
- Blom Bank
- BMCE Bank
- BSIC
- CAL Bank
- CBAO
- CGIC
- Citibank (Egypt, Kenya, Senegal, Nigeria, South Africa, UK)
- Commercial Bank of Africa
- Commercial International Bank
- Coris Bank
- Diamond Trust Bank
- Ecobank (Kenya, Senegal, Burkina, Nigeria, Ghana)
- Egyptian Gulf Bank
- FCMB Bank
- Fina Bank
- First Bank London
- First National Bank
- First Rand Bank
- FMO
- GT Bank (Nigeria, Ghana)
- HSBC Bank
- I&M Bank
- IFC
- Inter-American Development Bank
- Investec
- JP Morgan (UK)
- Kenya Commercial Bank
- National Bank of Egypt
- Natixis
- Nedbank
- NIC Bank
- Oceanic Bank
- OFID
- PHB Bank

- Prudential Bank
- PTA Bank
- Rand Merchant Bank
- Reichmans
- SACE
- Sasfin
- Scipion Capital
- SGBS
- SMBC (UK)
- Spring Bank
- Standard Bank (Kenya, South Africa, Ghana)
- Standard Chartered Bank (Ghana, Kenya, South Africa, UK)
- Suez Canal Bank
- Trust Bank
- UBA (Nigeria, Ghana, Burkina Faso)
- West LB

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