Trade finance: between disruptions and demand

Disruptions to global trade are in the news almost every week. This begs the question: how do these disruptions impact trade finance investors and what drives deal flow activity for them?

By *Martin Opfermann* and *David Newman*

Recently there have been many headlines about how global trade gets disrupted. Attacks by Houthi rebels on merchant ships passing through the Red Sea have led to a 50% drop of ships passing through the Suez Canal, forcing ships to take the longer route around the Cape of Good Hope. Passages through the Panama Canal are also down by a third due to a severe drought. A recent shipping accident in the Baltimore port has temporarily cut off shipping routes for some EU car manufacturers to their US customers. The effects of different events on trading volume is shown in Figure 1.

The impact of these disruptions will not be the same across different market segments of trade finance. Most impact will be felt in commodity trade finance. Goods are mostly in transit and any delay will force commodity trading houses to hold working capital for longer, which means that they need more working capital to ship the same quantity. This can lead to higher defaults for investors. Small and medium-sized enterprises may also be affected by trade disruptions, but companies will have more leeway to buffer adverse working capital requirements compared with smaller trading houses. Large-cap oriented trade finance strategies should be least affected, as their companies typically have large working capital lines from banks or commercial paper programs to buffer these delays.

Geopolitics affecting global trade

While the pictures of accidents and attacks make the headlines most often, structural trends have also been negatively impacting global trade: geopolitics has reversed globalization and has led to a reshoring or friend-shoring of corporate supply chains. The number of companies mentioning the trend in their earnings calls has surged since the start of the Ukraine war.

In addition, protectionism has been on the rise for a few years now. As such, the number of policy interventions that restrict goods and services trade has been surging: 2023 saw almost 3,000 restricting government actions globally (see Figure 2).

These trends have slowed down the growth rate of global trade. As such, 2020-2024 was the half-decade with the lowest growth since the early 1990's.[1]

Growing demand for trade finance

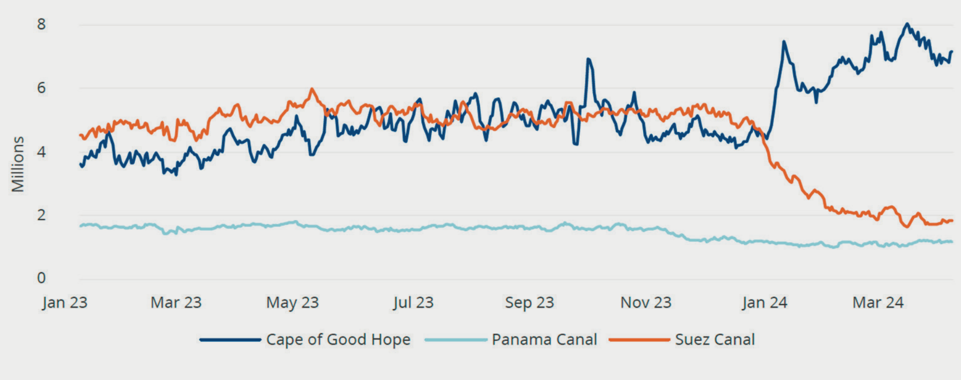
Despite a slowing growth of global trade, demand for trade finance has been on the rise. The so-called trade finance gap, which measures the difference between demand for trade financing and its supply, has been increasing in the past years. It now stands at $ 2.5 trillion, up from $ 1.5 trillion a few years ago.[2] The reasons why this demand cannot be satisfied are multifold, from limitations for emerging markets and SME risk appetite to KYC onboarding costs.

The World Trade Organization estimated that of the $ 17 trillion trade around 80-90% rely on financing.[3] Others put the size of the trade finance market at around $ 5 trillion.[4] The banking industry provides the lion share of this financing, whereas trade finance provided by asset managers is very small in relative terms.

Bank syndication as driver

Irrespective of the direct impact of any trade disruptions, it is the risk appetite of banks that is the major driver for the trade finance asset management industry. Banks syndicate assets to non-bank investors, which typically consist of insurance companies, pension funds, family offices, corporates, local govern-

FIGURE 1: DAILY TRANSIT TRADE VOLUME



Note: million metric tons, 7-day moving average. Source: UN Global Platform, IMF PortWatch

'Despite a slowing growth of global trade, demand for trade finance has been on the rise.'

ments and other institutional investors. Their syndication determines asset supply. Banks also compete against non-banks for financing facilities. If banks want to grow their trade books, competition can be fierce, irrespective of whether non-bank investors source directly from corporates or buy syndicated transactions from banks or fintechs. The factors driving banks' actions are multifold: one is the availability of credit insurance which determines whether banks are able to hold exposure at optimal risk capital charges. Moreover, bank regulation, the general corporate default cycle, and the seasonality of many sectors also have an impact. Besides, many banks have several trade finance business lines/departments/books as well as several syndication desks. Asset managers need to have good relationships to be able to manage through changes of responsibilities or employee departures and ensure uninterrupted deal flow.

Lastly, bank syndication is also driven by operations and systems. As most banks have been active in trade finance for many decades, they typically operate many legacy systems which are dependent on the line of business and the country. The ability to connect to every part of a bank is key for asset managers.

Fintechs on the rise

The world has seen a huge wave of fintech start-ups over the past decade. The trend was fueled by ultra-low interest rates and large flows into venture capital. While those trends have reversed over the past two years, there are many fintechs that have already reached self-sustain-ability. Their business models center around sourcing, underwriting, and operations, but most often require funding from third parties. Asset managers are the natural partner for those businesses, as they are usually not perceived as direct competition. It is therefore no surprise to see many asset managers partnering with fintech companies.

Contradicting trends, how do investors navigate them?

Slowing macro trends, changing bank syndication, growing fintech market share: where does this leave institutional investors in the field? It is important to focus on what can be influenced, and to be prepared for what can't be. It is not about attempting to forecast global macro trends or the supply and demand dynamics of global trade. Instead, it is key to be prepared for every outcome and establish a robust and resilient sourcing framework that does not depend on a single sector, geography, or isolated segment of the market. This is also an important aspect in particular for institutional investors with an insurance background. In addition, it is necessary to maintain a very open dialogue with sourcing partners. And it might sound basic, but not to overpromise and to underdeliver is a must: reliability is key in every syndication relationship. ■

1 World Bank, Global trade has nearly flatlined. Populism is taking a toll on growth (2024).
2 Asian Development Bank (2022).
3 World Trade Organization (2024).
4 McKinsey & Company, Reconceiving the global trade finance ecosystem (November 2021)

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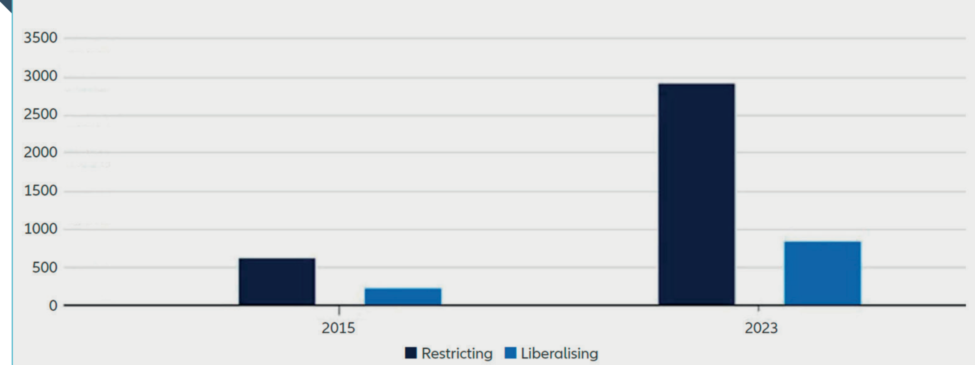
FIGURE 2: NUMBER OF TRADE POLICY INTERVENTIONS AFFECTING GOODS AND SERVICES TRADE



Note: restricting/liberalizing measures are interventions that discriminate against/benefit foreign commercial interests. Adjusted data for reporting lags as of 31 December 2023. Source: Global Trade Alert, World Bank

SUMMARY

Recently, many disruptions affected global trade.

Structural trends have been impacting global trade negatively: geopolitics has reversed globalization, leading to a reshoring or friend-shoring of corporate supply chains.

Protectionism is on the rise, with a number of policy interventions that restrict goods and services trade.

Despite that, demand for trade finance has been on the rise.

Risk appetite of banks, slowing macro trends, changing bank syndication, and growing fintech market share drive deal flow. Non-bank investors require a platform that is able to connect with many partners and quickly adapt to changing deal flow.

PHOTOS: ARCHIVE ALLIANZ GLOBAL INVESTORS