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Commodity report for H1 2019 shows drastic drop in volumes

Overall volumes of global commodity trade financing fell by almost 30% according to the TXF H1 2019 Commodity Report. Jonathan Bell reviews this drastic drop and assesses whether it is simply a portrait of volatile commodities and market trends or more far-reaching influences impacting global business.

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Editor in Chief 28 August 2019 COMMODITY TRADE (/HOME/SECTOR/23/COMMODITY-TRADE)

According to the TXF H1 2019 Commodity Report which has just been released global volumes in commodity trade financing fell by almost 30% compared to the same period for 2018. This is a significant drop in volume by any measure and is something which upon initial examination can not simply be explained by a robust performance in the sector last year or by volatile commodity prices through the first part of 2019.

Sure, there is a roller-coaster ride on the commodity price front – but when isn't there through a six-month timeframe? The TXF report is based on data submitted by most of the major commercial banks and other institutions submitting data. So, could it be that banks have not submitted deals they have already done in H1? This is very possible – but this is something which takes place each year – and why should the volume fall be so big this year? Is it because many deals have been delayed, or put off until the second half of the year? If so, why would this be the case?

It is likely that there are a range of reasons – related specifically to commodities, companies etc - as to why there is such a drop in volumes, but the question that also needs to be asked could be: is this also part of a much bigger pattern or trend in the sector or global trade, and if so what has brought this about? Some would argue that this clearly points to global trade wars which have been pushed along by the current US administration - and in particular, the US's trade war with China. And there is a good case for that. Below we will assess these questions with the help of market commentators and also provide some other pointers from the TXF Commodity report.

According to the H1 2019 report, banks provided a total of $73.07 billion in commodity financing for both commodity producers and traders. This represents a significant drop in volume of $30.5 billion compared to H1 2018.

Other report highlights include the fact that around 58% of this debt comprised unsecured revolving credit facilities (RCFs) for both commodity producers and traders, an increase in volume of around $2.9 billion compared with the same period in H1 2018.

In addition, traders signed a total of 19 RCFs in H1 2019 compared to 20 RCFs in H1 2018, while producer RCF fundraising decreased by over half in terms of the number of deals, from 24 RCFs in H1 2018 to 11 in H1 2019.

And probably rather unsurprisingly, commodity traders Glencore and Trafigura were the largest single recipients of bank debt in H1 2019. On the producer front, Emirates Global Aluminium was the largest recipient of bank debt.

Those who are familiar with TXF Data (https://www.txfdata.com/) will know that it is driven by tagmydeals.com (http://www.tagmydeals.com) where deal data is submitted by banks and other institutions. Naturally, not all deals are captured as some may be considered too sensitive to be submitted – this may be some of the smaller club deals. And bilateral transactions are not counted as there is no verification process for these. Some deals – often for reasons of sensitivity – are not reported to us until calendar year end.

However, it does need to be stated that TXF Data aims to present as comprehensive and accurate a picture of the market as possible, and this can only be achieved with broad industry participation. Consequently, tagmydeals is free of charge and accessible to everyone in the industry. Importantly, it allows users to add new information and improve existing information in a simple manner. We would urge all institutions to send in their closed deal details as soon as they are able to do so.

Other general highlights which come out of the report note that the oil and gas sector dominated volumes, remaining the largest recipient group for commercial bank loans in H1 2019 and accounting for 49% of the total loans; with producers totalling $19.3 billion and traders totalling $16.5 billion. Interestingly though, metals and mining came in second position and together with oil and gas represent 87.8% of the total debt for the first half of this year, with one transaction, the $9.7 billion Glencore RCF representing nearly 13.5% of the total 64 deals in H1 2019.

Back in late March Glencore reported this $9.7 billion RCF as well as a separate $4.65 billion five-year RCF with two 12-month extension options. The trader also noted that a total of 53 banks committed to the facilities, including 31 mandated lead arrangers and bookrunners. By all accounts only one bank dropped out from last year's financing and three new banks came in. This firmly demonstrates that bank appetite for trader-related loans remains strong from the global banking community.

But this is not always the case – as it very much depends on what the funds might be used for. Although Trafigura was one of the largest trader recipients of loans in the first half of 2019 it was not entirely plain sailing. For instance the trader was singled out by Iceberg Research with a range of criticism over accounting and this may have impacted some investor appetite.

Additionally, in the financing related to the restructuring of Nyrstar and the Trafigura takeover of that entity – the funding was severely delayed due to a range of complexities. Consequently, the financing did not close till 31 July – much later than expected. And for some banks the experience it seems has left a rather sour taste. With such financings dragging through several months it is no wonder that some banks may have been consumed to the extent that other deals also got pushed back.

One banker tells TXF: "Overhanging the structured market in the first half was the Nyrstar restructuring, which touched a lot of the regular players, and I got the strong impression that a lot of credit departments were waiting to see how the relative priorities came out between bondholders, borrowing-base finance lenders and prepayment lenders. Prepayment as a proposition took a particular hammering." It is understood that this related to the commercial prepayment and the need for legal due diligence on the security held by all creditors, including bondholders.

The source adds: "Trafi in the end engineered an almighty fudge, allowing everyone to keep all figleafs in place, but in doing so they have also inflicted damage on their own model. That this was not yet terminal is probably demonstrated by the Nayara prepayment, but then again, that was another deal slated to close much earlier than it did." In the Nayara Energy (formerly Essar Oil) deal closed in May the company raised $750 million through a prepayment structure – but it is understood that this is half of what Nayara had originally been seeking.

Another banker tells TXF that the commodity market through some of late 2018 and the first half of this year: "has been impacted by the increasing number of US and EU reviews on of leveraged lending, where there is visually at least a certain overlap with structured commodity trade financing (SCTF) if you look just at the regulatory definitions".

He adds: "Also if you look at the way increasingly the LMA (Loan Market Association) templates for anything structured converge with their LevLending templates to produce more of a 'senior secured' rather than 'commodity-backed' structure, then everyone finds themselves bogged down in trying to establish whether their 'SCTF' deal should not be denominated for regulatory reporting purposes as 'leveraged lending'."

Some of these issues do not make it any easier for commodity finance bankers in commercial banks to pursue some of the deals they would like. Increasingly, issues such as these are impacting the sector and probably contributing to at least part of the drop in volumes over the short-term.

Bringing some of the macro elements into the equation as to why commodity trade finance might be down, speaking to TXF, Jean-Francois Lambert, founder of Lambert Commodities, comments: "Trade is in a flux. The global environment has not been as uncertain for a long time. Overall the economic performance is not that bad. Growth as forecast by the IMF for 2019 is lower than 2018, but still at 3.2% and assuming this is the new base line global GDP would double in 24 years. Yet markets are extremely nervous. Recession is the new buzz word, but the reality is that we are only witnessing a general slowdown."

He adds: "Trade is the concern, obviously. WTO forecasts are negative. Clearly trade is slowing sharply. When considering trade has been the engine of growth in the world for 30 years, this is worrisome. Commodity prices are also largely down and this reflects the general lack of confidence.

"The trade wars are obviously taking a toll: we have seen trade slowing below GDP growth level in the past, but there is the perception that this time it is different. The deconstruction of the globalised model is under way and under this backdrop, one can wonder whether trade will continue to be the locomotive of the train of world growth.

"Under this backdrop, (slow-down, commodity prices falling, uncertainty re politics, protectionism), it is not surprising that players in the commodity field are more careful in managing their debt. There is a general awareness that the right race is about profitability, not size. Piling up debt when profitability is low and outlook very uncertain, and even if interest rates are low, is not what one CFO advises his CEO to do.

"Traders needs are dictated by commodity prices. At current level, they need less liquidity to buy/sell than last year. Besides the yield curve on commodity prices are mostly backwarded or flat. No cash and carry. Producers will not embark into an investment spray in the current context. Additionally, banks are certainly not forthcoming either."

And speaking specifically on the TXF Data volume figures, he comments: "The volume drop shown through the tagmydeals figures are shocking and are probably partially due to the fact that not everything is reported. I would expect the second half to be better than the first as it is possible that a few players delayed (or that the banks got slower in arranging) their decisions. Overall though, I would not be surprised if 2019 shows a drop versus 2018 anyway."

He adds: “Structured trade finance is down, but we will need to wait for a full year to make intelligent comments. As commodity prices are down, there is less need for structures. Plus, banks which struggle to optimise capital requirements to reflect structures, might just be less interested – however, we will need a longer trend to validate this. RCFs unsurprisingly are still in fashion for borrowers, especially genuine traders like Trafi. Borrowing base deals should get renewed for sure, but I would not expect many new ones in the current context though.”

Speaking on specific sectors, Lambert says: “Overall the agri sector is a very difficult market. Bulk commodities are difficult to make money with. The big reshuffling of the Chinese supply chain is a complicated process and I believe the US traders will have a hard time in taking advantage of it. Besides, the swine fever outbreak in China is mudding the situation: less livestock less demand.”

Within metals, the EV (electric vehicles) hype is over. EV is a reality albeit a slower one to actually influence the demand. Meanwhile the supply side got excited too soon. So we have a sharp market correction for now. Concerns about China are in my view too hasty; China has a reservoir of growth through its domestic market and in any case the second economy in the world was never going to sustain 6% + growth rates forever. Iron ore has dropped to more reasonable prices after the Vale drama, but it is still quite attractive though. Watch out for gold though as a pure geopolitical play!”

And on the energy front, Lambert says: “There is enough oil despite the Iran crisis, the Venezuela meltdown and a few others. US shale remains strong and production is unabated. Russia has suffered because of the dirty pipeline problem but this should be over by now. There remain doubts about demand growth, hence the squeeze that OPEC/Russia will struggle to fight through production cuts.”

The overall commodity finance report contains numerous charts and diagrams expanding on some of the above as well as looking at a number of other aspects. We even analyse pricing and tenors – take a proper look.

The full new commodity finance report covering the latest commodity finance trends for H1 2019, with all the related charts, is available for subscribers only. If you do not subscribe to us yet and you want to find out more please contact my colleague Vanisha at TXF: vanisha.meisuria@txfmedia.com (mailto:vanisha.meisuria@txfmedia.com).