Markets

Fearful Bankers Spurn Asia Commodity Traders in Credit Squeeze

By Alfred Cang, Serene Cheong, and Andy Hoffman
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- Lenders shun high-capital, low-margin businesses in the sector
- Hin Leong's financial difficulties raise fears among lenders

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CL1
WTI Crude
18.27 USD/bbl.
▼ -1.60 -8.05%

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NOBLE GROUP LTD
SGD ▼ +null +null%

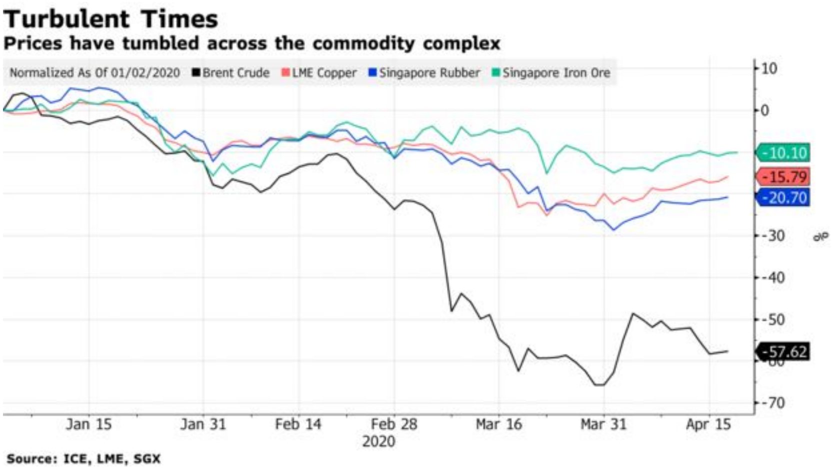
3460878Z
AGRITRADE INTERNATIONAL PTE
Private Company

HSBA
HSBC HOLDINGS PL
414.35 GBp
▲ +8.75 +2.16%

HG1
Generic 1st 'HG' Future
235.70 USd/lb.
▲ +5.15 +2.23%

Bankers are increasingly reluctant to give commodity traders in Asia the credit they need to survive as the lenders grow ever more fearful about the risk of a catastrophic default.

Their anxiety has reached new heights in recent days as fabled Singapore oil trader Hin Leong Trading (Pte.) Ltd. struggles to repay debts said to amount to almost $4 billion. And that's just weeks after another commodities firm in the city-state, Agritrade International Pte, collapsed after a unit defaulted on its loans.



It could be a bumper time for commodity traders as the huge swings in prices prompted by the coronavirus crisis create the sort of volatility on which they thrive.

But unless they've got the deep pockets and credit history of a trading powerhouse like Trafigura Group or Vitol Group, they face being frozen out of the market by risk-averse bankers demanding crippling terms or refusing to lend to them altogether.

"Only large trading houses are able to play with such a market and cope with the underlying risks," said Jean-Francois Lambert, an industry consultant and former trade finance banker at HSBC Holdings Plc. "Banks are tightening their exposures on every front. With regard to commodity trading, their reaction is to fly for quality and be quite restrictive on everything else."

Trading Lifeblood

Trade financing and access to capital are the lifeblood of the traditionally high-volume, low-margin business of trading commodities. Letters of credit are a critical part of that infrastructure.

A bank issues the so-called L/C on behalf of the buyer as a guarantee of payment to the seller. Once the goods have exchanged hands, the buyer repays the lender.

But traders of everything from zinc to oil interviewed by Bloomberg said their bankers were pulling back from short-term financing. Lenders are asking for more collateral, financing costs have jumped and in some cases the banks are simply refusing to issue letters of credit altogether to some smaller companies, according to the traders, who asked not to be identified because they're not authorized to speak publicly.

That's echoed by lenders themselves, with at least four telling Bloomberg that they were reducing their exposure to commodities by cutting short-term loans to some clients and only lending to the biggest traders.

And while this remains an Asian problem for now, there's growing consternation that it could spread to the U.S. or Europe. Saad Rahim, the chief economist of trading giant Trafigura, says a global tightening of credit across all sectors is a looming threat.

"We have been talking about this as a series of cascading waves. First the virus, then the economic and then potentially the credit side of it," Rahim said in an interview from Geneva.

Virus Fallout

The tightening of credit is another example of the extraordinary impact that the coronavirus is having on global commodity markets, from crude oil to copper. Measures to contain the pandemic are hammering demand for raw materials, throwing supply chains into chaos and forcing producers to shut down mines, refineries and processing plants.

The disruptions are putting unprecedented strain on the companies that extract, produce and process commodities, triggering defaults and even bankruptcies as prices plunge. And traders may find themselves with products they can't sell or stockpiled material that's plunged in value.

The risks in such circumstances are manifold. Tighter liquidity can constrain traders' ability to meet margin calls and pay their loans while they also face the prospect of a counterparty failing, according to Lambert.

For many banks, the danger that clients may be caught out is proving too great. Some have more than doubled the rate at which they'll lend, according to the traders and lenders interviewed by Bloomberg.

Banks were already pulling back from commodities in Asia before the chaos triggered by coronavirus. Over the past few years the industry has been rocked by a number of high-profile collapses and scandals, including multi-million dollar losses by some major Chinese and Japanese traders, and the spectacular downfall of Noble Group, one of the biggest names in the industry.

Doubling Up

"Lenders are bound to be cautious as commodity traders face a triple whammy of increased price volatility, supply chain disruptions and counterparty risks," said Soo Cheon Lee, chief investment officer at SC Lowy, a global banking and asset management group in Hong Kong. "We're expecting the near-term disruption on their earnings as a result."

Some traders are resorting to borrowing from two or more banks to finance a single deal, but ultimately the credit crunch could squeeze some of them out of the market.

Cheap funding is critical for commodity traders as they typically focus on high volumes instead of big margins, according to SC Lowy's Lee. Higher funding costs will undermine their ability to be competitive in this environment, he said.

"Smaller players, unlike larger traders, are exposed in such market conditions with often slim liquidity and are often much less equipped to monitor their books and communicate effectively with their lenders," said Lambert. "In the case of doubts or difficulty to assess the market position of their smaller customers, banks will not hesitate to reduce their lines."

– With assistance by Annie Lee

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