What the Covid-19 means for trade banks and open account

04 May, 2020 Ouida Taaffe

In the second of a series of articles, Ouida Taaffe – editor of *Financial World* – looks at some of the critical challenges for trade finance around the world.

Central banks responded quickly to the pandemic to turn on the liquidity taps with:

- ultra-low interest rates
- a relaxation of capital rules and
- in some cases, monetary financing.

Specifically for trade, EU, US and UK regulators have amended the rules to allow multilateral institutions and credit insurers to provide credit for short-term trade finance.

The regulations on when a default – and so a capital provision – comes into effect have also been eased for the time being.

But what are banks facing? And could this mean a move away from open account trading?

Covid-19 and open account trading

"The coronavirus has triggered a very peculiar situation: a shock to both supply and demand," says industry consultant, Jean-François Lambert.

"The whole supply chain, upstream and downstream, is under considerable stress. You cannot predict where the chain is going to break – that is the biggest problem. And those logistics problems create counter-party risks at all levels, for all the participants and therefore for banks."

Bank losses have already materialised.

For example, Hin Leong Trading – an oil trading company based in Singapore – filed for protection from its creditors at the end of April. It is said to owe nearly US$4bn to banks, among them HSBC, DBS Group and Standard Chartered.

Bloomberg News reports that HSBC is owed the most – US$600m. It also reports that the company had sold oil inventories that it was using as collateral.

Pressure on commodities

There are also reports of a wider credit squeeze for commodities traders.

On 20 April, a benchmark oil price – West Texas Intermediate Futures – hit negative territory for the first time ever. The price went from US$17.85 a barrel, already an eye-catching low, to minus US$37.63 as traders scrambled to avoid taking physical delivery of oil that they have nowhere to store.

That roiling of commodities markets has led to a credit crunch in some segments of trade finance. Many banks were already refusing to issue letters of credit to smaller commodities traders, particularly in Asia, reports say.

"There has been a huge demand shock and the risk profile of many sectors has worsened," says Michael Vrontamitis, Head of Trade, Europe and Americas at Standard Chartered Bank.

"The challenge for policy makers is that lending is risk-based, which means that facilities will cost more and be less available. So government guarantee schemes targeting trade and SMEs will be more effective in increasing lending than low interest rates."

The complexity of government schemes

Many governments have increased the export credit guarantees they supply through export credit agencies. But as Lambert points out, their main focus is on keeping domestic corporates alive and able to maintain employment levels. That means that it's not really clear how export credit guarantees will play out in practice.

The interplay of support schemes is also not easy to navigate, as Mark Ling Head of Trade & Working Capital at Santander UK Corporate & Commercial, points out.

"Banks advising clients need to think carefully about how all of the government support schemes for businesses hang together," says Ling.

"There is a lot of complexity and it is very much a movable feast. UK Export Finance, for instance, is looking at a significant development – which will be announced in a month or two – which could really help exporters as they move out of full lock down."

Demand for trade finance

Despite the difficulties for both banks and businesses, however, Ling is seeing "no fall in demand for

Despite the difficulties for both banks and businesses, however, Ling is seeing "no fall in demand for trade finance at present". UK banks are also still lending.

"Banks are well very well capitalised now, post 2008, and able to withstand shocks," says Ling. "There will likely be bigger loan losses, because of what Covid-19 uncovers, but banks are still lending."

UK bank liquidity

"We haven't seen any liquidity pressures, unlike 2008 when it was all about liquidity," says Ling.

"UK trade finance is provided in a number of currencies and we have not seen any dislocation yet. The one exception to that is potentially in long-term ECA transactions. There it may be hard to get deals off the ground because long-term wholesale dollar funding is tight."

Part of the challenge for banks, of course, is that it is likely to take time for them to assess the real effects of the crisis and how they should respond.

"As the crisis ebbs, banks will start redefining their strategies as they take a hard look to their books and exposure and this will also be the case in trade finance," says Lambert.

The importance of supply chain finance

"We think supply chain finance is going be really important as we move forward," says Ling at Santander.

"There is likely to be a reduction in trust across markets. A lot of businesses are going to say, 'we really want some sort of comfort that we will get paid'. That means maybe going back to traditional trade finance instruments."

He points out that, people expected the same thing after the great financial crisis of 2008, although it didn't happen. "But this time," he says, "It really could".

The caveat is that, in the UK not many people still understand these techniques, unlike in the Far East where a lot of companies use them.

"Government schemes will be critical to getting back to some sort of normality over the next few years," says Ling.

Related content

- Trade finance in a pandemic: the shortcomings of a paper-based trade system (https://www.libf.ac.uk/news-and-insights/insights/detail/2020/05/01/trade-finance-in-a-pandemic-the-shortcomings-of-a-paper-based-trade-system)
- How trade finance is adapting to crisis (https://www.libf.ac.uk/news-and-insights/insights/detail/2020/04/27/how-trade-finance-is-adapting-to-crisis)
- Banking, finance and alternative data (https://www.libf.ac.uk/news-and-insights/insights/detail/2020/04/22/banking-finance-and-alternative-data)

More about our trade finance qualifications (https://www.libf.ac.uk/study/professional-qualifications/trade-finance)

Go Back (https://www.libf.ac.uk/news-and-insights/insights)

Financial skills for life

Look to the next level

Keep ahead of the curve

Be part of our community

Financial Capability Qualifications (/study/financial-capability/qualifications)

My Financial Career (/study/financial-capability/my-financial-career)

Teacher Development (/study/financial-capability/teacher-development)

Undergraduate (/study/undergraduate)

Postgraduate (/study/postgraduate)

Apprenticeships (/about-us/partnership/apprenticeships)

Professional Qualifications (/study/professional-qualifications)

Business Services (/business-services)

Global Learning (/study/global-learning)

Members (/members-and-alumni/members)

Alumni (/members-and-alumni/alumni)

Continuing Professional Development (CPD) (/members-and-alumni/cpd)

Jobs board (https://www.careerwebsite.com/home/index.cfm?site_id=21898)

We use cookies on all our websites to gather anonymous data to improve your experience of our websites and serve relevant ads that may be of interest to you. Please refer to the cookies policy (http://www.libf.ac.uk/about-us/data-protection-privacy-cookie-policy) to find out more.

By continuing, scrolling the page or clicking a link, you agree to the use of cookies.

Continue

Accessibility (/accessibility)

Data protection (/about-us/data-protection-privacy-cookie-policy)

© The London Institute of Banking & Finance 2019 - All rights reserved