Trade Finance in Africa: Trends Over the Past Decade and Opportunities Ahead

24 September 2020

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Slides and a recording of this presentation will be circulated after we conclude. They will also be available on www.mfw4a.org.

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TRADE FINANCE IN AFRICA:
TRENDS OVER THE PAST DECADE AND OPPORTUNITIES AHEAD

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About the report

• This study is the third in the series of “trade finance in Africa” reports.

• It is based on a survey of commercial banks in Africa conducted in 3 waves from 2011 to 2019.

• Questionnaires were distributed to more than a 1000 individual banks across the continent.

• An average of 259 banks responded to each wave of the survey (response rate of about 26%).

• Together, the survey provides an unbalanced panel data of 2333 observations from 49 different countries and 670 individual banks for the nine-year period.
• Historically, we have had a high response rate from private banks.

• Majority private foreign-owned banks account for half of all respondents.

• While about a quarter of respondents are locally-owned private banks.
Bank participation in trade finance

Trade finance remains a popular activity among banks in Africa, but participation rates continue to decrease – falling by 21 percentage points between 2011 and 2019.

Reasons why participation in trade finance is decreasing?

- **New regulations** have increased compliance costs and capital requirements, forcing some banks to exit the industry.
- **Correspondent banks** are cutting ties with African issuing banks as they go through a process of de-risking.
- **Increasing competition** is decreasing margins and forcing small banks with higher average costs to exit the industry.
The study shows the importance of risk mitigating trade finance instruments for African trade.

About 60% of trade finance assets are unfunded (risk-mitigating) assets such as letters of credits and risk participation agreements.

While the remaining 40% are funded assets that provide liquidity to counterparties such as pre-export finance and factoring.

Taken together, trade finance assets show significant variability over the study period. But the trend is one of decline – falling by almost 30% between 2011 and 2019.
Trade finance assets cont.

• Together, unfunded and funded assets were valued at an average of \textbf{USD364 million} for 2011-19

• While average bank assets were estimated at \textbf{USD2.7 billion} for the same period

• We find that trade finance assets therefore accounted for about \textbf{14\% of total bank assets} for the period 2011-19.
We provide an estimate of the size of bank intermediated trade finance in Africa. The average value of bank intermediated trade finance for the study period was USD417 billion while total African trade was estimated USD1077 billion for the same period.

Banks intermediated an average of 40% of total African trade. But the trend is rising – from 31% in 2011 to 53% in 2019.

However, about 80% of world trade is bank intermediated. This shows that African trade is significantly underserved by banks.
Trade finance for intra-African Trade

- Contrary to what anecdotal evidence shows, we found consistent evidence that intra-African trade receives its fair share of bank intermediated trade finance.

- While 17% of total African trade is intra-African, 18% of bank intermediated trade finance is dedicated to intra-African trade.

- It should however be noted that intra-African trade remains far too low relative to regional trade for other major regions of the world.
Performance of trade finance assets

- Trade finance remains a lucrative endeavor for commercial banks but its contribution to bank earnings continues to decrease - from 17% in 2011-12 to about 10% in 2018-19

- Reasons are increased competition and falling trade value due to commodity price falls)

- Surprisingly, earnings have been higher for state-owned banks relative to other banks since 2015.
Performance of trade finance assets cont.

- Indeed, average letter of credit fees have been consistently higher for state-owned banks relative to other banks.

- They have increased by more than 3 times from 2013 to 2019.

- We speculate that this could be the result of higher fees charged by public banks to captive clients on public-related trade transactions.
Default on trade finance transactions

- Trade finance default rates have been lower than that on gross NPLs for banks in Africa – it averaged 6% relative to 11% for NPLs.

- However, compared to default on global trade finance assets as reported by ICC (< 0.3%), default rates on trade finance activities in Africa are far higher.

- Default on trade finance transactions continues to show an upward trend – doubling from 4% to 8% between 2011 to 2019.
Default on SME trade finance transactions

- Banks report that default on SME trade finance activities is falling – from 14% in 2013 to 10% in 2018-19

- Default on assets dedicated to new clients continue to be low, at around 2.2% of total assets dedicated to such clients.
Trade finance approval (rejection) rates

- Trade finance approval rate has gone up from 75% to 88% between 2011 and 2019.

Unfortunately, SMEs have not shared in this increase. Indeed, rejection for SME trade finance has doubled over the same period.

There is more to rejection for SME trade finance applications than poor credit worthiness.
Unmet demand for trade finance

• We provide a conservative estimate of the size of the trade finance gap – the gap averaged **USD91 billion** for the period 2011-19.

• Unmet demand decreased at a rate of **10%** from 2011-16 - falling from **USD120 billion** to **USD70 billion** in 2016.

• In 2019, estimated trade finance gap was **USD82 billion**.

• Notice that the global trade finance gap is estimated at **USD1.5 trillion**. Hence the gap in Africa represents 5.5% of the global total unmet demand. Total African trade is only 3% of world trade.
Reasons for the decrease in trade finance gap

• Awareness created about the gap (e.g. AfDB, ICC and ADB)
• Support by DFIs (60% of banks that responded to the survey)
• Falling trade value since 2013

Reasons why the gap has started to rise since 2016

• AML/KYC regulations have created two effects on the market
  ➢ More expensive to process small transactions for SMEs
  ➢ Number of banks participating in the trade finance has fallen as seen before
Reasons for rejecting trade finance applications

• Client credit worthiness and insufficient collateral have become structural issues.

• AML/KYC requirements have now emerged as a serious challenge. In 2013-14 less than 0.1% indicated that as a problem. In 2015-19, 16% of banks cited that as a reason for rejection.
Ranking of constraints to trade finance supply

- Competition, correspondent banking, foreign exchange liquidity, and regulatory restrictions are the key constraints to trade finance supply in Africa.
- They have not changed significantly from what was observed in 2013-14.
- Constraints to intra-African trade follow a similar pattern.
Correspondent banking relationships

- Citibank, Commerzbank, Deutsche Bank, Standard Chartered Bank, and UBAF continue to top the list of correspondent banks servicing issuing banks in Africa.
- All but Citibank have lower shares of bank correspondent relationship in 2015-19 compared to previous waves.
- However some new banks are joining the ranks of the top performers, including Natixis and FIMBank.
Not only is the share of correspondent relationship falling but the share of total confirmation activities by the top 5 confirming banks is also decreasing across time.

This confirms the general retreat of correspondent banking relationships in Africa.
Role of DFIs in Trade Finance in Africa

- DFIs are playing a more active role in the trade finance landscape in Africa
- About 60% of banks that responded to the survey obtained some form of support from DFIs.
- Support is geared more towards banks in West and Southern Africa as well as Foreign-owned banks.
Policy recommendations

• Raise awareness about the unintended impact of KYC/AML on trade finance. This has contributed to low participation, and retreat of corresponding banking relationships.

• Persistently high rejection rate for SMEs should also be addressed.

• DFI support should be more balanced geographically and across bank ownership types. Local banks need support on how to engage in trade finance activities.

• Address the issue of weak credit systems across the region.
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**PANEL DISCUSSION**

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CLOSING REMARKS

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