

ICC Banking Commission

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An ICC Banking Commission Market Intelligence Report

Rethinking Trade Finance 2009: An ICC Global Survey

31 March 2009

Highlights

- A Global Survey Based on Responses from 122 Banks in 59 countries
- The Impact of the Crisis on Trade Finance
- Trade Finance 2008, prospects for 2009

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INTERNATIONAL CHAMBER OF COMMERCE

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Rethinking Trade Finance 2009: An ICC Global Survey

Key Messages

■ **There is evidence of a major economic crisis**, spreading and deepening across the global economy. The ICC study confirms the anecdotal evidence gathered over the past few months, as the financial problems are now impacting trade as a whole. All data collected, including that of our partners, confirm this view. For instance, the World Bank predicts that the volume of world trade in goods and services will decrease by 6.1% in 2009. According to WTO, the collapse in global demand is expected to drive manufacturing exports down by roughly 9% in volume terms in 2009.

■ **Emerging markets are said to be more directly affected.** Trade finance to and from emerging markets in Asia appear to have been particularly hard hit. SWIFT data evidences that the Asia/Pacific region is severely impacted. Low-income countries are affected through lower commodity prices and lower remittances.

■ **Supply chains have produced undesirable side effects.** Exporters in international supply chains are better shielded from financial turmoil because they have access to credit from buyers. However, with their own access to finance drying up, global buyers will become more restrictive in providing finance along their supply chains.

■ **The overall decrease in volume and value** is confirmed by the ICC Survey. Some 47% of banks surveyed reported a decrease in export letter of credit (L/C) volume. Similarly, 43% of banks reported a decrease in the L/C value of aggregate transactions.

■ **Open account sales are less common in the present situation** because they substantially increase the risk for the seller. On the other hand, many banks reported an increase in demand for documentary credits—such instruments are considered to substantially reduce risks for both exporters and importers.

■ **Tight credit conditions** may further reduce access to trade finance. Some 51% of respondents indicated that their trade credit lines for financial institutions decreased between the last quarter of 2007 and the last quarter of 2008. At the same time, 48% of respondents indicated they had experienced an increase in demand for issuance of bank undertakings between the last quarter of 2007 and the last quarter of 2008, recognizing the increased security sought by exporters for their shipments. The main reasons provided by banks that indicated a decrease in credit lines were:

- More stringent credit criteria being applied
- Capital allocation restrictions

- Exiting markets
- Reduced inter-bank lending

■ **Trade finance is still open today but limited.** Shortage of liquidity and risk re-appraisal have driven up interest rates on loans and advances in many countries, especially in emerging markets. For instance, 52% of respondents indicated that they had experienced an increase in confirmation requests between the last quarter of 2007 and the last quarter of 2008. Again, this reflects the increased security sought by exporters and the perceived payment risk of the country of the issuing bank.

■ **There is a widespread increase in pricing** of banks' trade finance instruments, reflecting higher funding costs, increased capital constraints and greater counterparty risk. Over 40% of respondents indicated a significant increase in fees for Commercial Letters of Credit, Standbys and Guarantees in the past 2 years. The tight credit conditions have also allowed lenders to drive up interest rates for their loans in many countries, especially in emerging markets.

■ **There is intense scrutiny of documents by some banks**, eventually leading to higher rates of rejection on the basis of minor discrepancies. The ICC Survey notes that 48% of respondents, when acting in the capacity of a nominated bank, indicated they had experienced an increase in the number of spurious/questionable refusals. The ICC quarterly trade finance journal DCINSIGHT, in its regional study (Europe, USA, China and Israel), also confirmed a higher rate of rejection of L/Cs on first presentation and greater difficulties in obtaining payment. This trend was noted for all regions covered by the study.

■ **Many banks are facing tougher capital requirements for their trade assets.** Evidence is therefore accumulating that the implementation of the new capital adequacy regime, at a time when the world is experiencing a global recession, has contributed to the drought of available finance. However there is still a paucity of data on trade finance, in particular for historical and performance data for trade finance products. A consensus emerged to argue that key risk attributes should be determined on the basis of industry benchmarking, ICC playing a role in collecting such data.

■ **A call is made for the official sector to ease current conditions.** ICC Banking Commission members underscore the importance of targeted temporary financing, and, in some cases, agreements with international banks, to address liquidity shortages and problems of risk perception. Business has greatly appreciated the measures taken in recent months by export credit agencies, regional development banks, and international banks, in particular in the following areas: 1°) Trade facilitation programs; 2°) setting up of trade guarantees facilities; 3°) increase of financial liquidity pools; and 4°) improving export insurance processes.

■ **The outlook for 2009 is negative.** A wide consensus emerges to argue that 2009 will be negative as recession strikes. International trade is forecast to continue deteriorating in 2009. The collapse in global demand may have long term effects and economies will slowly recover after 2010. ICC Survey makes a distinction between short-term trade (six months maturity) and longer-term projects of a more capital nature. The latter is more heavily affected at the current time, with large scale-financing projects being deferred, particularly in the BRIC countries.

ICC Department of Policy and Business Practices

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List of Acronyms

ADB	Asian Development Bank
BRIC	Fast growing developing economies of Brazil, Russia, India, and China
CCF	Credit Conversion Factor
DCI	ICC's quarterly newsletter, DCInsight (ICC Publication)
EBRD	European Bank for Reconstruction and Development
GDP	Gross Domestic Product
ICC	International Chamber of Commerce
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFSA	International Financial Services Association
ILO	International Labor Organization
IMF	International Monetary Fund
L/C	Letter of Credit
LGD	Loss given default
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UCP	Uniform Customs and Practices for Documentary Credits (ICC Rules)
UK	United Kingdom
USD	United States Dollar
WTO	World Trade Organization

Foreword

Gary Collyer

Technical Adviser, ICC Banking Commission

It is extremely unfortunate that this kind of Survey should have to be conducted in the circumstances the world is facing today. The uniqueness of its information, details on trends in volume and value of transactions, coupled with insights into operational structures and issues, is something that would also have been of immense benefit to the trade finance community under normal trading and economic conditions.

This Survey, responded to by representatives of 122 banks in 59 countries, provides some graphic, and sometimes dramatic illustrations of the trends seen by banks in the last quarter of 2008 compared with the same period in 2007. Admittedly, these responses may be considered an individual's perception or recollection of the business at that time, but it is known that a large number of the banks collected data internally and provided a collective response reflecting their global or regional perspectives. In this respect, it should be noted that 53% of respondents indicated that their trade finance operations were globally situated.

The one anomaly that stands out in the findings relates to the percentage of open account transactions banks are handling. Most source documents available today indicate that the percentage of open account transactions is usually around 80% of world trade. The Survey, by contrast, shows that 13% of export transaction volume and 12% of import transaction volume handled by the banks surveyed is open account. The low figures in this Survey may reflect the trend found in banks that have become more involved in the open account sphere, e.g., via usage of the SWIFT Trade Service Utility, in processing these transactions separately from traditional trade products such as letters of credit (L/Cs), guarantees and collections. It also reflects the fact that traditionally banks only process the payment instructions of the customer that arise as a result of an open account transaction and may not track the actual volumes processed. The respondents to the Survey were predominantly those working in the departments handling traditional trade products.

Over the past few years, there has been a perceived movement to outsourcing of trade finance processing; however, the Survey shows that 83% of the banks currently process all of their transactions in-house. Having said this, over 10% of these banks appear to be actively considering outsourcing some of their trade finance processing between now and 2011. The decision to outsource some or all of this processing has often been predicated on the simple mathematics of costs versus revenue, coupled with the need for enhanced customer service and the inability of the outsourcing bank to control fluctuating volumes. With volumes of traditional trade products decreasing in most markets, as evidenced by the Survey, the figure of 10% may grow significantly during the next 12 months as banks look to reduce costs even further.

When reviewing the volume percentages of trade finance products serviced in the various regions, it is not surprising to find that letters of credit feature prominently as the most commonly used product in each of the three regions providing the main feedback (North America, Europe and

Asia). However, the fact that respondents in Europe indicate that 37% of import transactions involved letters of credit seems to go against the perceived movement of European importers from L/Cs to open account settlement and may evidence the increased demands being made by exporters to secure their shipments. For Asia, the data provided by SWIFT clearly indicate that a large percentage of the import L/C transactions issued in Asia are advised to banks in the same region.

It is also not surprising that standby letters of credit feature heavily for North America, whilst guarantees have the same impact for Europe. The most surprising statistic, from my perspective, is the high volume of documentary collections handled and the consistent percentage of their use across the three regions – around 20%. This may be the result of exporters looking for more security in the transaction, as opposed to their handling transactions under open account, as well as a desire for the banks to act as “custodians” of the documents until payment or acceptance is made.

Values of trade finance products have closely matched volumes on both the import and export side. As one would expect, over 50% of the value of import trade transactions handled in North America relates to standby letters of credit, whilst a similar figure applies to issuance of L/Cs in Asia. The North America statistics are a little surprising, as values of standby letters of credit are often significant and disproportionate to the volume of transactions issued. Historically, the average value of a letter of credit is not that significant. Whilst there are numerous transactions covering projects or commodity shipments, which are therefore of a significant value, the more traditional form of L/C covering the supply of basic goods does not amount to great sums of money.

Part of the problems being faced by banks today is the need for increased capital requirements under Basel II for their trade assets. Suffice to say that the Survey results paint a clear picture showing that the vast majority of respondents (86%) consider the risk rating of traditional trade products to be the same or lower than that of general banking facilities. This reflects the structure of the transactions and the desire of one party to buy and another to sell. The results also highlight the divergence of views that exist globally concerning the rating of risks for these products – even within the same region. This is clearly an issue that needs to be resolved in order that banks can operate with a similar consistent threshold and structure.

The views expressed on the risk rating of traditional trade products is borne out by the statistic that 66% of the respondents considered their trade finance losses to be significantly less than those experienced under general banking facilities, and the overwhelming figure of 91% that consider this level to be slightly less, moderately less or significantly less. This is a clear message to regulators highlighting the need to reform the current guidelines in order to stimulate the marketplace and encourage banks to actively participate so that the level of traditional trade product volume seen prior to the fourth quarter of 2007 can be restored.

Despite the very low level of losses for traditional trade products, when compared to general banking products, banks have continued to cut trade credit lines for corporates and financial institutions. With regard to the latter, 51% of respondents indicated that lines had been reduced or withdrawn in the last quarter of 2008 compared with the same period in 2007. This reduction has occurred in the face of increased demand for the issuance of bank undertakings such as letters of credit, guarantees and standby letters of credit. Various reasons have been cited for the decline, but for financial institutions it generally comes down to exiting a market or banking relationship due to perceived higher levels of risk. This has often happened even when financial institutions have perfectly good payment records.

We now have markets with the capability to handle more trade finance business, but limited counterparties willing to undertake confirmation or offer trade finance services to the exporter.

Potential issuing banks for letters of credit are signaling their willingness to issue, but are finding their credit line reduced or their requests for increases being held up. One banker commented that, in the past, requests for increases in a credit line (temporary or permanent) were usually handled within days; now it is a question of weeks or months. At the end of the day, there is an underlying transaction between two parties ready to buy and sell. But in the midst of all these developments, suddenly banks are seen as inhibitors of trade finance transactions.

On a more practical level, the financial constraints being experienced have other serious implications for the trade finance business. At a time when exporters, and often importers, are moving from open account to letters of credit (contrary to the trend of the last 10-15 years), the future for the L/C would not seem to be more positive. However, there is a down side. In addition to the reduction in trade credit lines, which impedes the ability of banks to confirm letters of credit, transactions that are being processed are coming under greater scrutiny than ever before. Nominated banks do not wish to give an issuing bank any reason to refuse, and issuing banks do not want their applicants to reject an honored presentation based on the fact that the product has seen its unit price fall in the commodity or local market.

The result of all this is an increase in the number of refusals of documents (the Survey indicates that 30% of respondents have seen such an increase.) This can be accepted if the discrepancies have some validity but, more disturbingly, 48% of respondents reveal that, as nominated banks, they had experienced an increase in the number of spurious or dubious discrepancies. At the other end of the transaction, 20% noted that, as issuing banks, they were coming under increased pressure from applicants to "find" discrepancies, with falling commodity prices being the main reason. In short, on the one hand there is an increased demand for letters of credit but, on the other, where the demand is met, the exporter and/or the nominated bank is subjected to practices that call into question the working processes of the issuing bank.

Banks should seize this opportunity of growth in letter of credit demand and, where it can be serviced, be true to the principles of UCP 600. This may require that the underlying L/C be better structured to protect the applicant, but this extra care and attention to detail can also serve to remove any ambiguities in the wording for a beneficiary. The concern I have is that the corporates will look at this period as one in which banks can come to the fore with their letter of credit offerings and, if they fail to deliver according to expectations, the demand will remain short-lived once the financial crisis is over.

On a positive note, the Survey indicated that 71% of respondents expected to see an increase in demand for traditional trade products. This may be optimistic, but it demonstrates the willingness of banks to listen to the needs of their customers and hopefully to satisfy those needs.

It is my hope that the results of this Survey will demonstrate the need for reform of the capital adequacy requirements under the Basel II regime and will support proper recognition of the trade finance product suite. The optimism shown by many respondents who foresee increased business in 2009 will only come to fruition through the concerted efforts of all of us and our respective governments.

A handwritten signature in black ink, appearing to be 'Rump', written in a cursive style.

Rethinking Trade Finance 2009: An ICC Global Survey

1. Introduction

ICC Banking Commission

- 1.1. The ICC Banking Commission is a leading global rule-making body for the trade finance industry, as well as a worldwide forum for trade finance experts whose common aim is to facilitate international trade finance. The ICC Banking Commission has more than 500 members in 70 countries, many of them from emerging countries.
- 1.2. The Banking Commission is known for producing universally accepted rules and guidelines for documentary credits, documentary collections, bank-to-bank reimbursements and bank guarantees. ICC's voluntary market-based approaches have often been praised for leveling the playing field in trade finance practices.

The ICC Survey: purpose and scope

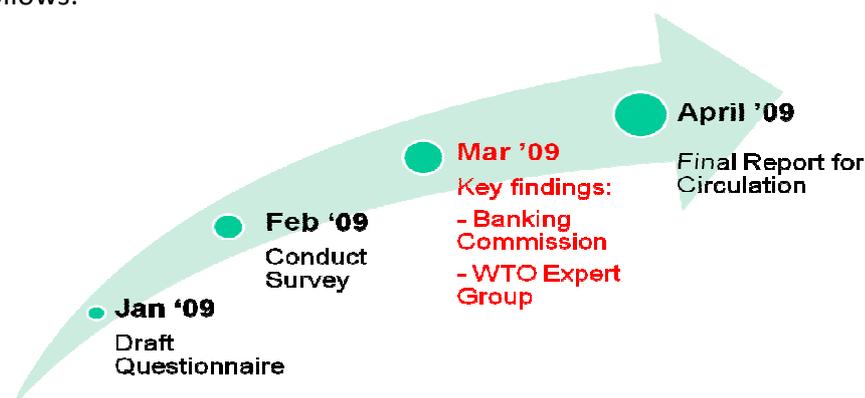
- 1.3. At the request of the WTO, and against the unfolding financial and economic crisis, the ICC Banking Commission has undertaken a survey to gather reliable quantitative and qualitative data on trade volume flows; the impact of current market conditions on the delivery of trade finance; and an outline of future expectations for the marketplace. This report was prepared by the ICC Banking Commission for the WTO Expert Group Meeting on 18 March 2009.
- 1.4. The purpose of the Survey is to obtain information from the marketplace that reflects current commercial and operational practice in the international trade finance banking community that can facilitate the formulation of a coherent response to the problems being faced in trade finance.

Methodology outline and timeline

- 1.5. The methodology for this report is primarily based on a 27-item questionnaire developed to collect information from the trade finance banking members of the participating organizations. The Survey questions targeted trends occurring in trade

finance operations of banks between the last quarter of 2007 and the last quarter of 2008 to highlight the impact of the credit crisis. Given the urgent need for information and the short time frame available to collect it (December 2008 to March 2009), the Survey was conducted online. The questionnaire was made available to participants from 4 February 2009 to 22 February 2009.

- 1.6. Specifically, the Survey questions addressed the following topics:
- Breakdown of traditional trade finance products handled within banks
 - Trends in volumes and values of traditional trade products
 - Trends in demand and pricing for bank undertakings and L/C Confirmations
 - Operational impact of the credit crisis
 - Trade credit line availability
 - Loss experience for rating traditional trade products versus general banking facilities
- 1.7. It should be noted that the final report integrates, not only the material collected from the ICC Survey, but also the analysis undertaken at the ICC Banking Commission meeting held in Dubai on 10-12 March 2009. The timetable for the ICC Survey was as follows:



Constraints

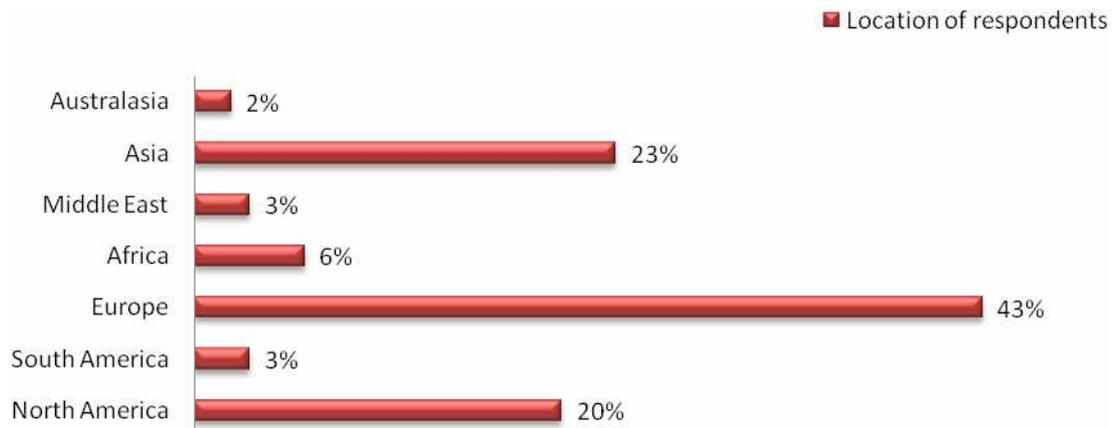
- 1.8. ICC was originally asked by the WTO at the November 2008 Group of Experts Meeting to set up a “loss database” which could track the default history for the whole trade finance industry. To this end, ICC has interacted with major trade finance banks to examine the regulatory requirements impacting upon trade finance, recent market changes and the data taken from them to provide the information for the proposed database. However, we would indicate that such a compilation of data can only be done over the long term. Thus, in the present report, we have not been able to collect sufficient meaningful information related to the three main variables for evaluating risk exposure for trade finance: loss given default (LGD), probability of default (PD) and exposure at default.
- 1.9. It is possible to quantify such variables across different financial asset classes. However, the collection of data would presuppose the development of a specific methodology and collection system to ensure that data are obtained in an efficient

and accurate manner. Furthermore, for the data to be fully representative, ICC would need to approach the banking community as a whole and ensure that the confidentiality issue is addressed upfront.

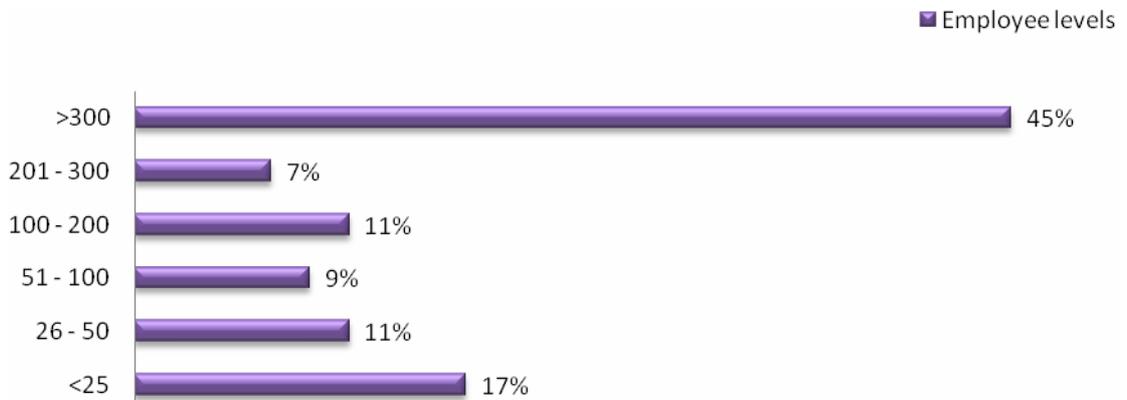
Participants in the ICC Survey

- 1.10. The present report has been prepared by the ICC Secretariat based on a Survey conducted in early 2009. Coastline Solutions, ICC's information technology partner, has been responsible for the collection of the data. The Survey received responses from 122 banks in 59 countries. Using the feedback received, we are able to provide some elements of consensus on key issues arising from the crisis. We have also referred to the material collected at the last Banking Commission meeting of 10-12 March 2009 in Dubai. This meeting was representative of the full ICC membership, with participants from over 70 countries, many of which are emerging markets, present.
- 1.11. In addition to ICC Banking Commission members, the scope of the Survey was extended to include international trade banking members and partners from:
- The International Financial Services Association (IFSA);
 - The European Bank for Reconstruction and Development (EBRD);
 - The International Finance Corporation (IFC);
 - The Asian Development Bank (ADB);
 - The Inter-American Development Bank (IDB); and
 - ICC UK¹
- 1.12. The World Bank and the Society for Worldwide Interbank Financial Telecommunications (SWIFT) have also provided recent and historical trade flow data (volume and value) for contextual and comparative purposes. A regional study was also conducted by the staff of ICC's DCINSIGHT publication. This broad participation allows specific regional analyses to be conducted and facilitates the accurate capture of trends in global operations and practice.
- 1.13. The breakdown of respondents to the ICC Survey by geographic region was as follows:

¹ ICC United Kingdom ("ICC UK") is the UK chapter of the ICC and includes among its membership 24 of the top 30 FTSE companies. ICC UK conducted a study in early 2009. Eight major trade finance banks were surveyed. Further consultations were taken forward with banks on a bilateral basis over the past two months to develop a clearer picture of the impact of Basel II on the provision of trade finance.



1.14. The profile of respondents (by size of employer) varied significantly:



1.15. The structure of respondent banks' international trade operations were as follows:

- 53% of banks' trade finance operations are distributed globally.
- 32% of banks' trade finance operations are based in one country.
- 15% of banks' trade finance operations are based within a number of countries in one geographic region.

1.16. This report is an amalgamation of the feedback and opinions of this geographically and organizationally diverse cross-section of the trade finance banking community.

2. Trade Development and Prospects²

Overview

- 2.1 Over many years, governments in most countries have steadily opened their economies to international trade, whether through the multilateral trading system, increased regional cooperation or as part of outward-oriented domestic reform programs. Generally, trade and globalization have brought enormous benefits to many countries and citizens. Trade has allowed nations to benefit from specialization and economies to produce on a more efficient scale. It has raised productivity, supported the spread of technologies, knowledge and ideas, and enriched the range of choices available to consumers (WTO 2008, World Bank 2008).
- 2.2 The trend toward increased globalization suffered a major setback in 2008. The food, fuel and financial crises put great strain on the global trading system, even slowing — and at times reversing — progress in trade integration. In early 2008, sharp increases in world food and fuel prices triggered disorderly and at times harmful trade policy responses — including the imposition of export taxes, quotas or outright bans by some large food-exporting countries. In late 2008, the financial crisis compounded the food crisis and led to a trade and trade credit crunch and sharp increases in trade credit spreads.
- 2.3 In early 2009, the global economy is going through a severe recession and prospects are bleak. According to the World Bank April 2009 Global Economic Prospects, global GDP is projected to decline by 1.7 percent in 2009, which would be the first decline in world output on record. High-income countries are mostly hit, with OECD economies likely to contract by 3 percent. GDP growth in developing economies should decelerate from 5.8 percent in 2008 to 2.1 percent in 2009.
- 2.4 Also, for the first time since 1982, international trade is expected to contract in 2009. The volume of world trade in goods and services is projected to drop by 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of manufactured products. These projections corroborate the WTO forecast of a 9 percent fall of world merchandise trade in 2009, with developed economy exports falling by some 10 percent on average and developing country exports shrinking by 2–3 percent. With the global economy remaining weak in 2009 and downside risks to the outlook, a gradual pick-up in trade volumes is not expected to take place before 2010.
- 2.5 As past economic crises have shown, trade can be a powerful engine to transmit shocks (positive but also negative) from one part of the globe to another — potentially building into a downward spiral in world trade. This phenomenon is asserting itself today, as initially a sharp falloff in U.S. import demand created adverse effects on exports and commercial activity in partners such as Japan and Europe. As import

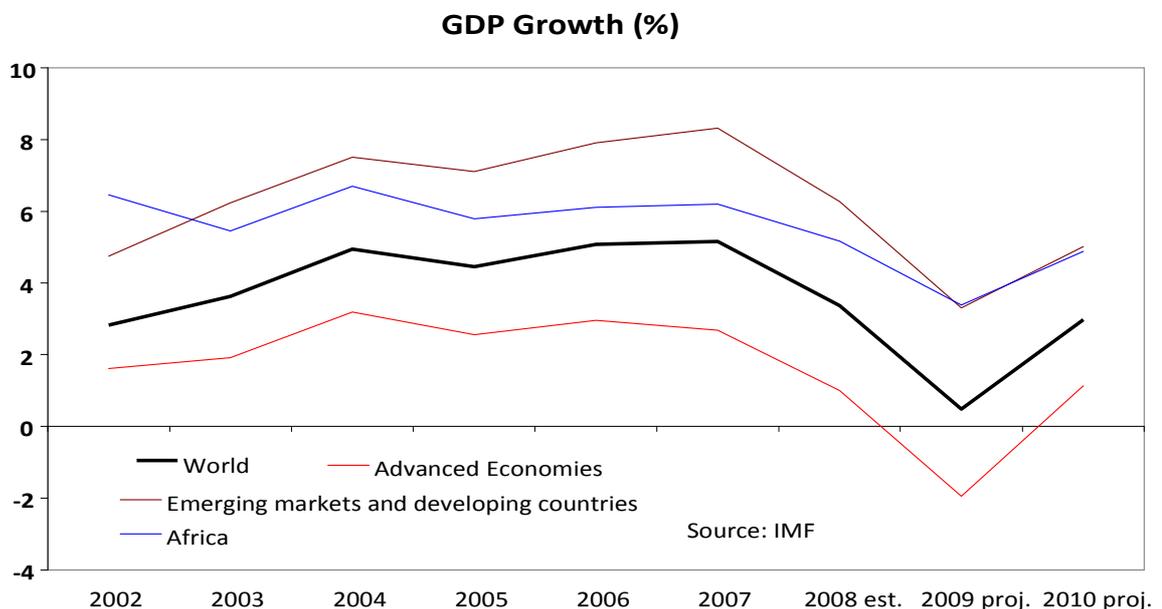
² Section prepared by Mr. Jean-Pierre Chauffour and Ms. Mariem Malouche, World Bank Group.

demand from developed countries began retrenching in a synchronized manner, developing countries started to lose export earnings and other sources of external finance, such as remittances, foreign direct investment and portfolio investment, and debt.

- 2.6 Risks of protectionism and other trade-distorting policies have heightened as economic activity collapsed and unemployment soared in many countries. Although trade actions have remained circumscribed, several countries have raised border barriers and/or subsidized export-oriented industries such as automotives and steel. A resurgence of “buy national” and other inward-looking policies risk retarding market corrections, distorting trade and triggering retaliation.
- 2.7 Maintaining and enhancing trade openness is therefore key, not only to preserve the mutual benefits of trade, but also to support the eventual economic recovery. External competitiveness and access to international markets are of paramount importance for poor countries, enabling them to realize the development promise of international trade. Pressing ahead with trade openness is a powerful means for developing countries to help mitigate the financial crisis and realize the development advantages flowing from international trade.

A world recession?

- 2.8 In the last quarter of 2008, it is estimated that global industrial production and world GDP dropped by 15% and 5% respectively. While the crisis began in the United States, it rapidly spread over to other developed countries and emerging economies.
- 2.9 In contrast with the recession of 1982, when the United States experienced a sharp decline while European countries maintained or increased growth, the current recession is characterized by its tight synchronization. Industrial output decreased by 15% in the United States, Europe and Russia; 20% in Japan, 12% in China and 9% in Brazil.



- 2.10 Since economic and financial prospects remain bleak in early 2009, an outright fall in world GDP is not excluded this year, even with a modest rebound in the second half of the year. According to the April 2009 Global Economic Prospects from the World Bank, global GDP growth is projected to slip from 2.5% in 2008 to 1.7% in 2009, its lowest rate since World War II.
- 2.11 Developing country growth is expected to decelerate to 2.1% in 2009. Growth in rich countries will be negative. All countries are moving into a danger zone and, because of the nearly universal pattern of falling growth, it will be difficult for individual countries to export their way out of the slowdown.
- 2.12 In the East Asian crisis of the late 1990s, it was possible for Thailand, Korea, Indonesia and other affected countries to recover growth through sharp export expansion and a swing from current account deficits to large current account surpluses, because the United States and other major economies were sustaining growth (Cline 2009). Such an exit strategy is not available on a global scale in the current circumstances. As noted by World Bank President Robert Zoellick, what began as a financial crisis has become an economic crisis and is now becoming an unemployment crisis; and without concrete action, it will become a human crisis on a global scale.
- 2.13 Unemployment is soaring in many countries. The International Labor Organization (ILO) suggests that up to 30 million jobs could be lost by the end of 2009.

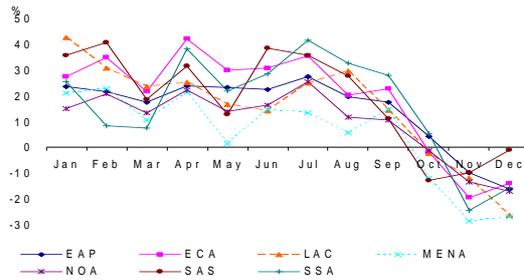
Trade already in negative territories

- 2.14 The global recession has put great pressure on trade. By late 2008, robust trade growth had turned negative in most countries. The quarter-on-quarter growth of world trade (as measured by merchandise exports) slowed to just over 1% in the last quarter of 2008, from over 5% during the same period in 2007, with trade in advanced economies and Asia particularly hard hit (IMF 2009). For the year as a whole, the volume of world trade growth moderated to 3.4% in 2008 from an average of 7.9% during 2003-07.
- 2.15 Exports and imports of forty-five countries that have reported trade data for January 2009 are uniformly weak, with an average drop of over 30 percent as compared to January 2008. Based on a handful of countries that have reported February data, including China, trade continues to be very weak. (Figures 1 and 2).
- 2.16 International trade is forecast to decline in 2009 for the first time in 27 years, the volume of world trade in goods and services is projected to drop by 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of manufactured products (The World Bank, 2009). According to the WTO, the collapse in global demand is expected to drive merchandise exports down by roughly 9% in volume terms in 2009, the biggest such contraction since the Second World War.³

³ See PRESS/554, 23 March 2009, WTO sees 9% global trade decline in 2009 as recession strikes (www.wto.org)

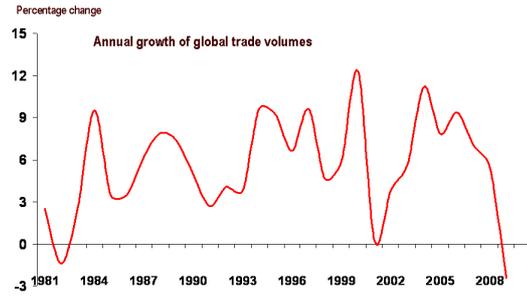
2.17 Developing country export volume growth is projected to reflect the general trend throughout 2009, with the possible exception of Sub-Saharan Africa, where overall export growth could remain relatively strong as a result of good harvests in many countries (e.g., cotton production).

Figure 1 - Export growth by region, 2008



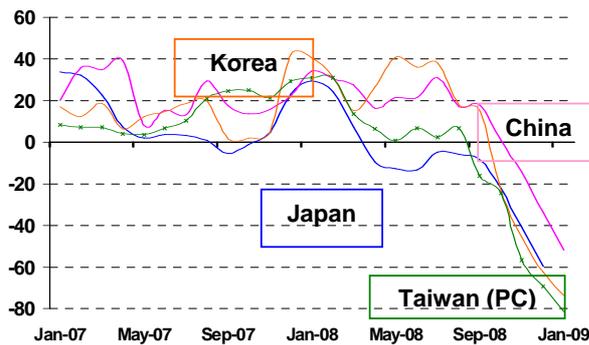
Source: Data collected from national sources. World Bank Staff calculations

Figure 2 - Robust trade growth turned negative in most countries by late 2008



Source: World Bank, Global Economic Prospects, 2009

Figure 3 - Imploding East Asia trade



Source: National Agencies through Haver Analytics

2.18 Trade figures for East Asia show an unprecedented falloff in exports during the final months of 2008. Expressed in nominal U.S. dollars, hence reflecting a downturn in commodity prices exported by several countries, the data are nonetheless alarming. Exports declines range between 52% for China to 80% in Taiwan (PC) through January 2009. Asia has been more sensitive to developments in developed countries than previously thought—especially with China at the hub for the assembly of final products for shipment to OECD partners, with a large proportion of intermediate goods supplied by Korea, ASEAN members and the newly industrialized economies. Intra-region trade appears to have imploded, and the export downturn is being echoed in slowing GDP growth.

2.19 The decline in world trade is also due to falling commodity prices. In the second half of 2008, commodity prices decreased sharply and the U.S. dollar appreciated against the currencies of major traders. The 27% decline in the IMF commodity price index between November 2007 and November 2008 is estimated to have contributed to an

11% drop in trade. The slowdown has been widespread, across regions and between developed and developing countries, as well as across exports and imports, implying that reduced demand is playing a large role.

2.20 For instance, U.S. import data by sector indicate that, although the decline in commodity prices is evident, with large drops in mineral products, U.S. imports fell across nearly all industries. Declining demand and investment was especially evident among imports of transportation and machinery, electrical equipment and stone and glass, all of which fell by double digits. Small countries in Africa, Eastern Europe and Central Asia have experienced the largest percentage declines in U.S. imports.

Pressure on trade finance

2.21 As the financial crisis unfolded, the availability of trade finance declined and its cost increased because of growing liquidity pressure in matured markets, the general scarcity of capital, unprecedented increases in the cost of funding and a perception of heightened country and counterparty risks. The contraction in trade finance was also fueled by the loss of critical market participants, such as Lehman Brothers, a drying up of the secondary market for short-term exposure (as banks and other financial institutions deleveraged)⁴ and the volatility of commodity prices. Banks in developed countries are also required to hold more capital at home and are providing less liquidity to banks in emerging economies.

2.22 In addition, the implementation of the Basel II Accord on banking laws and regulations, with its increased risk sensitivity of capital requirements in an environment of global recession, has added pressure on banks to hold back on trade finance. In particular, Basel II inflicts a harsher treatment on the less risky segments of trade finance (e.g., letters of credit and transactionally secured financing) by focusing on counterparty risk rather than on performance risk, the latter having a better track record within the trade finance segment thanks to the self-liquidating nature of the majority of its transactions. Finally, as countries and companies continue to be downgraded, higher risk premiums increase capital requirements and further reduce access to trade credit, especially for small- and medium-sized enterprises and banks in emerging markets.

2.23 While an estimated 20% of the USD14 trillion in world trade involving secured documentary transactions, such as letters of credit (L/Cs), trade finance is critical to sustaining the multilateral trading system.⁵ As the financial crisis spread, the demand for L/Cs, insurances and guarantees increased, because exporters wanted to be certain importers would pay on schedule. This led to delays in international trade, with goods

⁴ The secondary market plays a key role in helping banks undertake transactions that are larger than their current credit and cross-border limits.

⁵ According to Global Business Intelligence (GBI), a consulting firm specialized in international supply chain matters, accounts receivable and payable (aka open accounts) represent 78% of international trade; L/Cs represent 15% of international trade and finance for export collection, another paper-based transaction similar to L/Cs but without credit, another 7 percent. The use of traditional trade finance instruments such as L/Cs remains widespread in developing countries.

reportedly being docked for weeks before shipment, as terms of financing were finalized. Although this trade finance is clearly collateralized and tied directly to cross-border trade transactions, and is usually straightforward to organize, it is nevertheless highly vulnerable in times of crisis. For instance, trade finance to developing countries collapsed during the 1997-98 East Asian financial crisis.

- 2.24 According to the IMF, bank-financed trade credits declined by about 50% and 80% in Korea and Indonesia, respectively, in 1997-98. During the 2001-02 crisis episodes in Argentina and Brazil, trade credits also declined by as much as 30-50%.⁶

Trade protectionism: Incipient and worrisome

- 2.25 With the global economy in recession, political pressures demanding protection from import competition to protect employment are surfacing with increasing intensity around the world. Raising barriers at the frontier, starting with barriers to trade in goods or services, is often a tempting political option under these circumstances. Restricting capital movements, including for the most secured operations to finance imports and exports, is another inward-looking temptation. However, if there is one lesson from the experience of the 1930s, it is that raising trade barriers merely compounds recessionary forces — and risks pushing economies into prolonged contraction.
- 2.26 At the Washington Summit in November 2008, the leaders of the Group of Twenty (G-20) underscored the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty.⁷ They committed to refrain, during the following 12 months, from raising new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing WTO-inconsistent measures to stimulate exports. Many countries could increase their applied levels of tariffs and trade-distorting subsidies without breaching their bound rates or other relevant WTO disciplines. For a number of emerging economies, the temptation to impose protection could be especially seductive, because the levels of bound tariffs are much higher than those of tariffs actually applied.
- 2.27 According to the WTO monitoring of trade developments, there has been a marked increase in protectionist pressures globally since September 2008 including by a large number of G-20 countries. While there is not a general trend, a pattern is beginning to emerge of increases in import licensing, import tariffs and surcharges and trade remedies to support industries that have faced difficulties early on in this crisis. However, given the higher potential for increases in import tariff and subsidies, the World Bank estimate that only a limited number of trade protectionist measures took place so far.⁸

⁶ IMF, 2003, Trade Finance in Financial Crisis: Assessment of Key Issues, Washington DC.

⁷ Statement from the G-20 Summit on Financial Markets and the World Economy, Washington D.C., Nov. 15, 2008.

⁸ Newfarmer, Richard and Elisa Gamberoni, 2009, Trade Protection: Incipient but Worrisome Trends, Trade Note 37, Washington D.C.

- 2.28 In general, more countries implemented non-tariff measures. For example, although Russia raised tariffs on a number of products such as cars, and Ecuador raised tariffs on more than 630 items, Argentina also introduced non-automatic licensing requirements on auto parts, textiles, TVs, toys, shoes and leather goods; and Indonesia requires that five categories of goods (including garments, footwear, toys, electronics, food and beverages) would be permitted in only five ports and airports. In some countries, tightening standards have slowed import entry, including, for example, China's import ban on Irish pork, as well as rejection of some Belgian chocolate, Italian brandy, British sauce, Dutch eggs and Spanish dairy products; and India's ban on Chinese toys.
- 2.29 While resisting outright protectionism, governments, mainly in developed countries, have launched extensive domestic stimulus packages targeted at troubled export industries or competing import industries (e.g., airline, construction, steel, semi-conductors, and automobiles). Subsidies proposed for the auto industry have proliferated and total some USD48 billion worldwide, mostly (USD42.7 billion) in high-income countries. In addition to the U.S.' direct subsidy of USD17.4 billion to its three national companies, Canada, France, Germany, United Kingdom, China, Argentina, Brazil, Sweden, Spain and Italy have also provided direct or indirect subsidies — not including Australia's support for its car dealers and South Korea's and Portugal's support for their component suppliers.
- 2.30 While not barriers to trade in the traditional sense, these programs aimed at protecting businesses, jobs or farm incomes from the effects of the global slowdown could nevertheless restrict or distort trade, especially when they include "buy domestic" provisions.⁹ In particular, industrial subsidies in one country (e.g., for the automobile industry) provide an incentive for other countries to respond with their own subsidies or protection against imports from subsidized producers.¹⁰ These actions are contagious and could result in a subsidy war that compounds the damage caused and leaves everyone in worse shape.
- 2.31 In addition, they pull resources away from more productive uses. To the extent that the industry is laden with excess capacity, these subsidies impede exits and delay adjustments. Even worse, subsidies may be linked to requirements that companies preserve domestic employment, even at the cost of shutting more efficient plants abroad in developing countries.

Moving ahead

- 2.32 The global economy is currently in the midst of the most severe and most globally synchronized recession since the Great Depression. Downside risks continue to

⁹ For instance, a "Buy American" provision made it into the final US\$787-billion fiscal stimulus bill passed by the United States in February 2009. It requires the purchase of US-made iron, steel, and manufactured goods for projects of construction, alteration, maintenance, or repair of a public building or public work financed by the bill. However, it also requires that the measure be applied in a manner consistent with U.S. obligations under international trade agreements.

¹⁰ Major U.S. and European car makers received various form of financial support in late 2008/early 2009.

dominate, as the scale and scope of the current financial crisis have taken the global economy into uncharted waters.

- 2.33 The main risk is that unless the current financial strains and uncertainties are forcefully addressed, the pernicious feedback loop between real activity and financial markets will intensify, leading to even more toxic effects on global growth. Restoring growth in a context of financial deleveraging and risks re-appraisal is therefore a serious challenge. In this context, it is crucial that all major countries refrain from imposing new trade protection measures to help ensure that this cycle does not turn into a global depression.
- 2.34 As governments consider their policy options, they should remain mindful of the international consequences of their actions. While trade and industrial policies may boost domestic consumption and production in the short term, they tend to have adverse domestic consequences on resource allocation and economic efficiency and to discriminate against foreign producers, leaving other nations worse off. In addition, they are likely to be met with retaliation from other countries, limiting their effectiveness and undermining the international trading system. "Best practice" trade policy in current circumstances, to accompany financial and fiscal stimulus, is to reduce trade restrictions so as to cut costs and prices worldwide.
- 2.35 Finally, once in place temporarily measures might become difficult to remove and create a legacy of uncompetitive industries and sectoral over-capacity that will continue to generate protectionist pressures even after economic activity picks up again. Less distorting policies would favor tax cuts and fiscal policy to stimulate domestic demand across the board (e.g., public investment programs).
- 2.36 Unlike in 1929, international trade is now governed by rules and disciplines aimed at preventing the world economy from falling into another trade-induced depression.¹¹ As noted by WTO's Director-General Pascal Lamy, the WTO "provides the real economy, the everyday economy, with a collective insurance policy against the disorder caused by unilateral actions, whether open or disguised; a guarantee of security for transactions in times of crisis, henceforth an element of resilience that is vital to the running of a globalized world". Yet for the system to hold up in time of crisis, all countries need to obey these multilateral rules and disciplines.
- 2.37 The lack of access to affordable trade finance has emerged as an important concern, especially in emerging economies. Just as multilateral cooperation leads to a superior global trade outcome than beggar-thy-neighbor policies, multilateral cooperation can also help make trade finance more affordable and resilient in times of crisis.

¹¹ U.S. Senator Reed Smoot and Congressman Willis Hawley, whose 1930 act raising tariffs is widely blamed for intensifying the Great Depression

3. Trade finance trends and statistics

Evidence of trade contraction

- 3.1. As noted in Section 2 of this report, today there is evidence of a major economic crisis, spreading and deepening across the global economy when some 90% of the USD14 trillion of world merchandise trade is supported by trade finance. The ICC study confirms the anecdotal evidence gathered over the past few months that the financial problems are now impacting trade as a whole.
- 3.2. According to participants at the ICC Banking Commission in Dubai on 10-12 March 2009, which gathered about 400 bankers from all over the world, demand and supply chains have been affected in an unexpected order of magnitude. This is the most severe recession since the Great Depression, which originated in developed countries but is spreading to developing countries at an ever-increasing speed. Emerging markets are more directly affected because they are more financially integrated. Low-income countries are harmed because of lower commodity prices and less remittances. GDP growth for developing countries is likely to be severely impacted, with negative growth in the 3-6% range for some regions.
- 3.3. According to statistics quoted at the Banking Commission meeting, net private capital flows to developing countries dropped from USD650 billion in 2007 to USD120 billion in 2008. Remittances may decline by 6% in 2009. As a result, vulnerabilities of sovereign borrowers and the corporate sector are increasing. There are also major concerns about the risk of “financial mercantilism” through, for example, pressures on banks to further curtail cross-border lending.
- 3.4. The deterioration of trade is being felt worldwide. According to the regional study conducted by ICC’s quarterly trade finance journal DCINSIGHT (in Europe, USA, China, and Israel), markets are being constrained by credit availability, a decrease in import and export volumes and lower confidence among financial institutions (See case studies in the following table).

Voices from the trenches

ICC Banking Commission experts speaking on the current situation

(Extracts from ICC's quarterly trade finance journal DCINSIGHT, April-June 2009)

- USA -

“The volumes being traded ... are down 50-75 per cent from their peak”, says Michael Quinn, J.P. Morgan Global Trade Services

From a North American perspective, trade finance encompasses letter of credit issuance for importers who are customers of the bank; advising and confirmation of L/Cs on behalf of the bank's overseas correspondents; provision of both pre- and post-shipment financing to exporters; and providing overseas correspondents with financing to support their customers' dollar-denominated trade finance requirements.

Trade finance in the US context – making dollar-based loans to overseas financial institutions – and export letter of credit activity in the US market have now reached a point of confluence. Foreign financial institutions, constrained by the limited credit available from their US correspondent banks, have much less ability to provide their customers with import finance. In some cases, the toxic mortgage-related assets on their books preclude US banks from using their capital on international transactions. Other banks, although willing to continue lending to their correspondents, lack the capacity to meet demand because they can no longer rely upon the secondary market to distribute risk. Since the fourth quarter of 2008, when the secondary market became moribund, there have not been enough risk takers in the market to maintain strong flows of liquidity.

Though now improving by the day, the volumes being traded in these markets are down 50-75 per cent from their peak. A small number of banks have “disappeared” – either through bankruptcy or becoming “wards of the state” – further diminishing capacity in the market. Without the ability to finance their purchases at cost-effective rates, buyers in emerging markets either seek alternative local suppliers, stagnate because they cannot grow their business or go out of business completely. This perpetuates the decline in developed world exports and contributes to forecast reductions in merchandise trade.

Though market pricing has increased significantly compared with last year at this time, we do see cross-border risk costs down from their peak in November-December 2008, and are they beginning to stabilize. We realize there will be continued scarcity of capacity and price volatility through at least year-end 2009 and perhaps into early 2010. However, since global trade continues and is key to a global economic recovery, we believe that providers and customers must continue to work together to keep supply chains healthy through funding, liquidity and risk mitigation -- both in the face of current challenges and in readiness for more positive direction in the markets. The historical record shows that in the world of trade, good news always arrives eventually.

- Europe -

“The crisis could well enhance the position of the L/C”, says Kim Christensen, Vice President and Head of Trade Products and Business Relations at Nordea in Denmark

In many ways, the financial crisis came as a shock to trade finance departments in Europe, causing fear and leading to extreme care in examining documents. Though predictions on how the crisis will evolve would only be guesswork, I will hazard a few comments. One is that a balance may well be established, wherein trade finance banks will act – not based on feelings and fear – but on the basis of information and knowledge. If that is the case, the crisis will have had a positive side. It may also reinforce banker’s claims that the benefits of L/Cs, which banks have been telling their customers about for years, are, in fact, relevant and real. In the past, corporate customers have argued that they see no reason for L/Cs to be confirmed, since banks rarely go bankrupt. No doubt this perception has changed.

The crisis may impel corporate customers to establish a solid risk strategy, to decide how they will choose between the various payment instruments available, tailored to their individual trading and risk profiles.

In the end, then, the crisis could well enhance the position of the L/C. If the crisis has proven one thing, it is that strong and reliable payment instruments are still needed. Banks should realize that corporate customers do not necessarily use the L/C because they like it, but because they see the benefits in doing so. This is the time to remind customers of those benefits.

- China -

“It’s not as easy ... to obtain a Chinese bank’s approval”, says Wang Shanlun, Jiangxi University of Finance and Economics

The outlook for international trade in China is not positive. The latest statistics from China’s General Administration of Customs revealed that Chinese exports recorded their biggest decline in last ten years in January, falling 17.5 per cent from the same month in 2008 as the impact of the global financial crisis hit home. Over the last few months, imports to China plummeted a dramatic 43.1 per cent, a further indication of sharply lower demand in the Chinese economy. And during the last three months, both exports and imports experienced a continuous and accelerating decline. This also has happened for the first time in the last ten years.

China is the world’s manufacturing centre, and most Chinese coastal small- and medium-sized enterprises (SMEs) are exclusively export-oriented, relying on foreign demand, especially from the US and Europe. Once there is shortage of foreign orders, these companies are threatened with closure. And when SMEs close down, this creates operational difficulties for their related (upstream and downstream) enterprises. Although the Chinese central government launched a RMB4 trillion rescue package to stimulate the economy, it is still difficult for most export-oriented enterprises to share in a piece of the cake, because they are not able to transform themselves overnight.

What's worse, some foreign investors have had to withdraw capital from their investment projects in China, either because they have problems of their own, or because their investments in China are in difficulty. In November 2008, in a rare move, four Chinese governmental authorities (Ministry of Commerce, Ministry of Foreign Affairs, Ministry of Justice, and Ministry of Public Security) published a joint circular entitled "Guidelines for the stakeholder's cross-border litigation against abnormal divestment from China", which demonstrates the seriousness of the divestment issue.

In short, the Chinese economy seems trapped in a vicious circle, and the L/C market is no exception. Some 50-60 per cent of China's foreign trade is transacted by using L/Cs. Consequently, the country's total L/C figures (whether in terms of value or quantity) shrink sharply when China's trade volume declines. The figures from Chinese banks reveal the seriousness of the situation: the amount of incoming L/Cs declined 30-40 per cent, and the amount of newly issued L/Cs declined 40-60 per cent compared with the same period in 2008.

Under the impact of worldwide financial tsunami, many commercial banks have gone bankrupt; more and more banks are on the problem list; and many banks' and firms' credit ratings are on a downward trend. When banks are busily looking for self-protection, one consequence is that, at times, the UCP rules may be overlooked. There are more and more cases involving bad banking practice, such as wrongful dishonor, delayed payments, and so forth. An expert from Sinasure (China Export & Credit Insurance Corp.) stated that more than 50 per cent of China's export trade is settled by L/Cs, and found that the average rate of bad debts is as high as 5-10 per cent. The average time accounts are in arrears is now around 60 days.

When there are financial or credit problems, in principle there should be more demand for L/Cs to serve as a lubricant for international commerce. That is why optimists believe the worldwide financial turmoil will lead to a renaissance of L/Cs. Part of our current problems is the result of a psychological panic rather than real threats (though some of the threats are real enough). Emotional reactions lead to a lack of confidence in the future of the world economy. Because the L/C is one instrument providing a certain level of security, my own belief is that it will play an important role in restoring the confidence we need.

- Israel -

" ... a marked decrease in L/Cs issued by Israeli banks", says Sarah Younger, Head of International Trade and Payments at Bank Leumi le-Israel

The global financial crisis, which has led us into an economic crisis, caught Israel during one of its longest periods of economic growth (2003-2008). Since 2004, the Israeli economy has grown at a rate exceeding 5 per cent per year, and this upward trend continued during 2008, albeit at the more moderate pace of 4.1 per cent. This impressive growth over the last few years is a result of an increase in both exports and domestic demand. Moreover, Israel's positive macroeconomic condition has contributed to the stability and resilience of the Israeli banking system.

International trade is one of the fundamentals of the Israeli economy. No less than 50 per cent of the GDP is derived from exports. Moreover, exports have been Israel's growth engine, helping the Israeli economy out of the recession that started in late 2000 and came to an end in mid 2003. In 2008, the value of goods exported from Israel was USD 51 billion, and the value of the

goods imported to Israel was USD 64 billion. Israel exports mainly high-end goods, such as high-tech, electronic, and pharmaceutical products (48 per cent), chemicals, petrochemicals and machinery (23.5 per cent), base metals, plastics and rubber goods (9 per cent), and others (9 per cent). The geographical composition of Israeli exports in 2008 was to the USA (32.8 per cent), Europe (29.2 per cent), Asia (20 per cent), the Middle East (Turkey, Cyprus, Greece, Egypt and Jordan) (5 per cent), and others (13 per cent). Israel's largest regional trade partner is still Turkey.

In recent years, international trade has been constantly evolving as a result of globalization on the one hand, and the development of the Internet, on the other. These historic revolutions caused a dramatic shift from L/C-based trade to more open account buyer and supplier relationships. During the last ten years, the ratio of L/Cs to overall trade-related transactions in Israel (in terms of the number of transactions) has decreased from 12 per cent to about 4 per cent. The majority of import L/Cs issued are for Asian countries, primarily China, Taiwan, South Korea and India. Only a minority are issued to European exporters, although the size of imports to Israel from Europe is higher than those coming from Asia. On the export side, most Israeli export transactions are open account-based, backed by either the Israeli ECA, or by private insurance companies. Israeli exports to less-developed countries are usually backed by L/Cs or full advance payments.

We have noticed a marked decrease in L/Cs issued by Israeli banks over the last few months, even in comparison to documentary collections and open accounts. The main reason for this during the last quarter of 2008 emanates from the economic slowdown, and this decrease is forecast to continue through 2009. When L/Cs are received by an Israeli exporter from banks in LDC countries or from banks/countries that have been downgraded, confirmations are requested. Due to the crisis, the price of mitigating these risks has increased, as have the CDS rates of banks and countries.

During times when prices are steep, the exporter must make the difficult choice of whether to pay the growing cost, which eats away at his profitability, in exchange for mitigating credit risk and keeping his business flowing. Regarding the risk appetite of the banks, we see a growth in the usage of insurance, country risk, and credit when they add confirmations or discount L/Cs issued by smaller banks based in less developed countries.

The 2009 projection for the reduction in Israeli GDP (-0.2 per cent) and foreign trade (-3.0 per cent) will certainly bring a lower number of L/Cs. However, the ratio of L/Cs to open accounts may increase if the economic crisis deepens.

SWIFT trade traffic statistics and commentary

3.5. Before considering the SWIFT¹² trade volume statistics and the related commentary, it is necessary to mention the context in which these figures should be viewed. It is generally accepted that 80%-85% of trade transactions are settled on an open account basis, the rest using "traditional" trade products such as documentary and standby letters of credit, documentary collections and guarantees.

- Open account settlement is achieved by making a payment, which may or may not be sent over the SWIFT network. "Payment messages" on SWIFT are

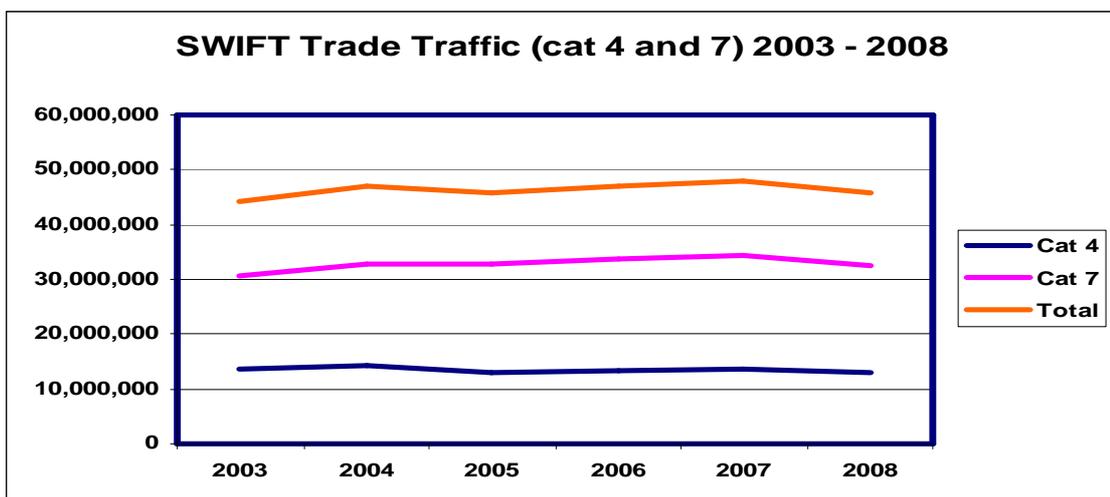
¹² We would like to thank SWIFT for having provided access to their data and statistics (Ms Nicola Boothby).

not useful as a source of statistical data for open account trading, since a payment message may not only be for a trade-related transaction, but could also be for an FX deal, a trade in securities, etc.

- SWIFT “trade” statistics, therefore, deal with the remaining percentage, the 15-20% portion of trade not settled on an open account basis. At the end of 2007, in a SWIFT trade survey, 20 of the top trade banks worldwide reported on their usage of SWIFT for trade. Around 80% of the banks surveyed indicated that 90% of their letter of credit transactions went via SWIFT; the remaining 20% of the banks said that 50% of their L/C transactions used SWIFT. SWIFT statistics can be considered a good indication of the overall usage trends for the letter of credit product.
- SWIFT statistics concern trade volumes; SWIFT cannot look at the content of the messages, and therefore cannot comment on the value of the trade.
- “Traffic” refers to messages sent over the SWIFT network.
- The charts/graphs refer to “Category 4” and “Category 7”. SWIFT Category 4 messages are flows for documentary collections (with the exception of three little-used “cash letter” messages). SWIFT Category 7 messages are flows for documentary and standby letters of credit and guarantees. In Category 4, the most commonly used messages are the MT 400s (Advice of Payment) messages and the MT 410s (Acknowledgement) messages, which, between them, represent 50% of the total. In Category 7, the most commonly used messages are the MT 799s (Free Format) and the MT 700s (Issue of a Documentary Credit), which, between them, represent just over 50% of the messages sent.

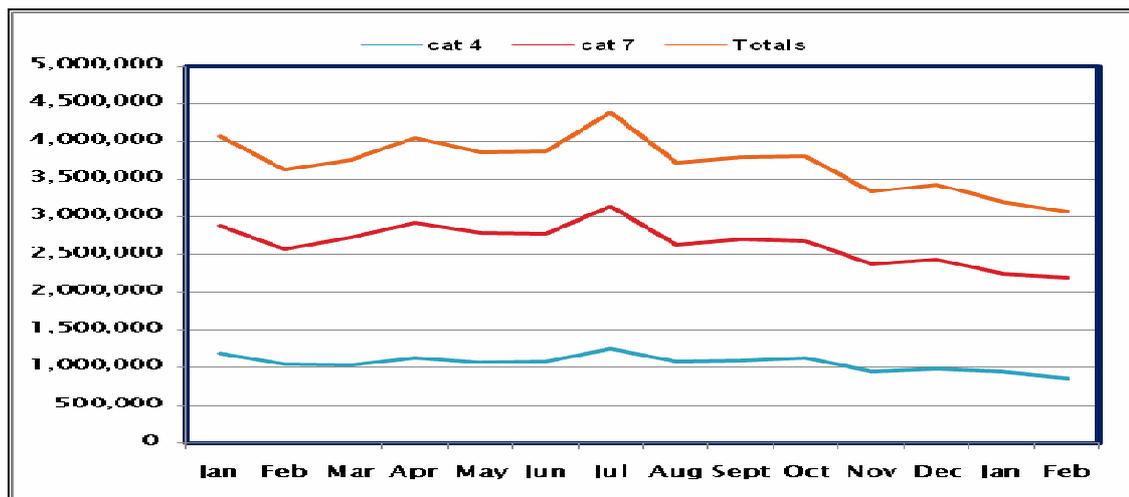
3.6. The 2003-2008 figures (Figure 4) for trade show a gradual rise in SWIFT trade messaging, reaching a peak in 2007 of 48 million (rounded) messages, falling in 2008 to 46 million. Documentary collections accounted for 30% of trade transactions in 2003 and dropped slightly to 29% in 2008.

Figure 4 - SWIFT trade traffic worldwide in number of transactions, 2003-2008



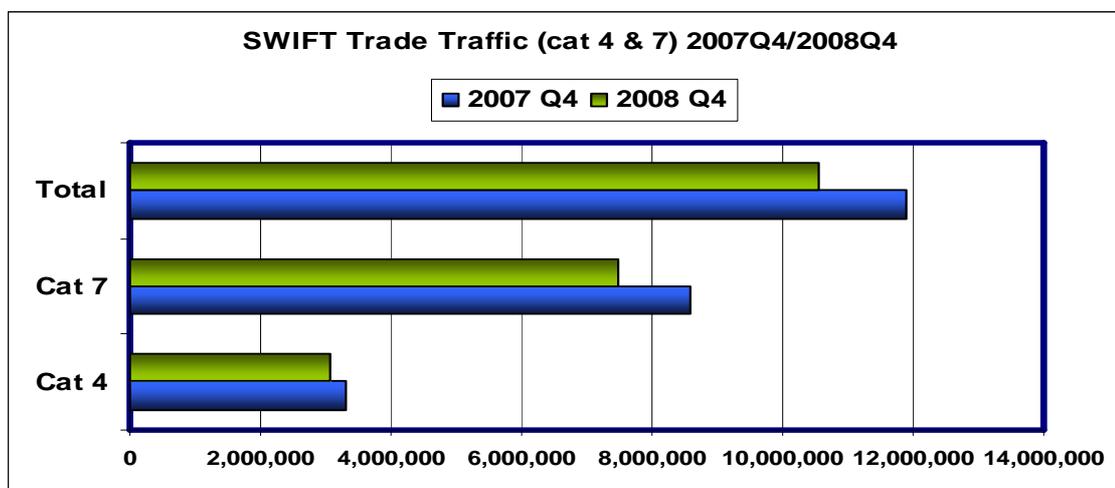
- 3.7. The more granular figures by month—January 2008 to February 2009 (Figure 5)—show a steady fall post-July 2008. The peak in July 2008 of 4.4 million dropped to just over 3 million by end February 2009. (SWIFT messages sent equal SWIFT messages received.)

Figure 5 - SWIFT trade traffic worldwide January 2008-February 2009



- 3.8. Various questions in the ICC Survey asked for comments on the respondents’ change in business from the fourth quarter of 2007 to the corresponding quarter in 2008. Figure 6 shows SWIFT statistics for these quarters, with more shrinkage evident in Category 7 than in Category 4 messages. Category 7 messages fell by 13% from the fourth quarter of 2007 to the corresponding quarter in 2008, while Category 4 messages fell by 8%.

Figure 6 - SWIFT trade traffic worldwide, Last Quarter '07 - Last Quarter'08



- 3.9. The graphs in Figure 7 show SWIFT trade traffic by region and by month from January 2008 to February 2009 inclusive, for messages sent and received. (Note that these

regions are those decided by SWIFT, and may not necessarily be aligned with regions shown in data coming from other organizations.)

- 3.10. As expected, the Asia Pacific region registers far greater volumes for both sent and received messages. As the major exporting region, the Asia Pacific region shows a wider gap between it and the other regions in terms of messages received. On the sent side, in February 2009 all regions continue to show a fall, apart from Asia Pacific, which was up by 2.5% in February 2009 as compared to January 2009. All regions show a continuing fall on the receiving side (See Figure 8 below).

Figure 7 - SWIFT Trade Traffic: By Region, January 2008 - February 2009 (Sent)

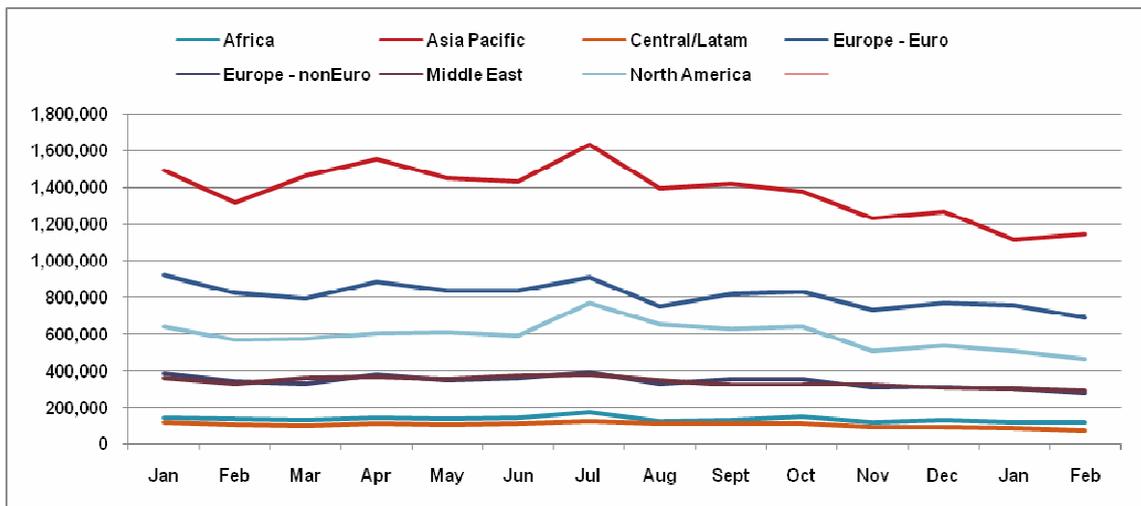
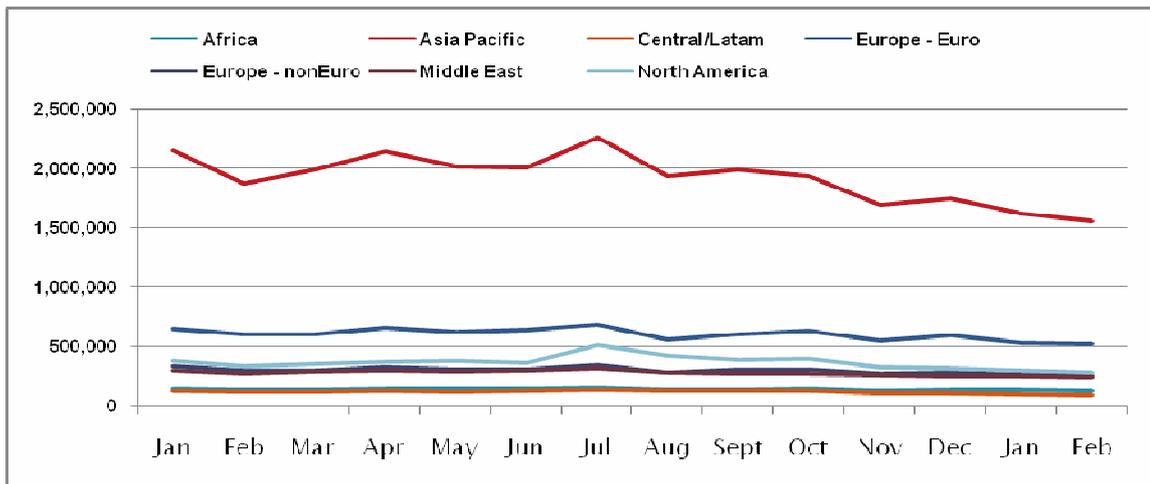


Figure 8 - SWIFT Trade Traffic: By Region, January 2008 - February 2009 (Received)



- 3.11. Looking at major recipient regions (Figure 9), there are few changes from 2007 to 2008. Central and Latin America's largest recipient region was the region itself in 2007, but the major recipient region changed to Asia-Pacific in 2008. The Middle East moved in the opposite direction, from having Asia-Pacific as its main recipient region in 2007 to going intra-regional, with the Middle East as the main recipient region. Note that that while volumes have fallen, the percentages of messages sent to these

recipient regions have remained essentially stable.

Figure 9 - Trade Traffic: Major Recipient Regions 2007 & 2008

SWIFT messages sent from	Largest recipient region 2007	Volume	% of total sent here	Largest recipient region 2008	Volume	% of total sent here
Africa	Europe - Euro zone	552,274	33	Europe - Euro zone	572,059	34
Asia-Pacific	Asia-Pacific	12,274,953	70	Asia-Pacific	11,897,623	70
Central & Latin America	Central & Latin America	449,696	30	Asia-Pacific	413,103	31
Europe - Euro Zone	Asia-Pacific	4,227,323	40	Asia-Pacific	3,910,429	40
Europe - Non Euro Zone	Asia-Pacific	1,817,559	40	Asia-Pacific	1,705,574	40
Middle East	Asia-Pacific	1,322,130	31	Middle East	1,301,894	31
North America	Asia-Pacific	4,386,660	57	Asia-Pacific	4,188,669	57

3.12. SWIFT data also show that for documentary credits and guarantees, by region, the main business was both out of and into Asia Pacific for sent traffic (i.e., on the issuing side) down by 15% from the fourth quarter of 2007 from the corresponding quarter in 2008 (Figures 10 and 11).

3.13. The received traffic (i.e., on the advising side) was down by 14%. For documentary collections, by region, the main business was out of Asia (the received messages on the bottom chart), with North America and the Euro zone being on the receiving end of the collections.

Figure 10 - Trade Traffic: Category 7 by Region, Last Quarter 2007 & Last Quarter 2008 (Sent)

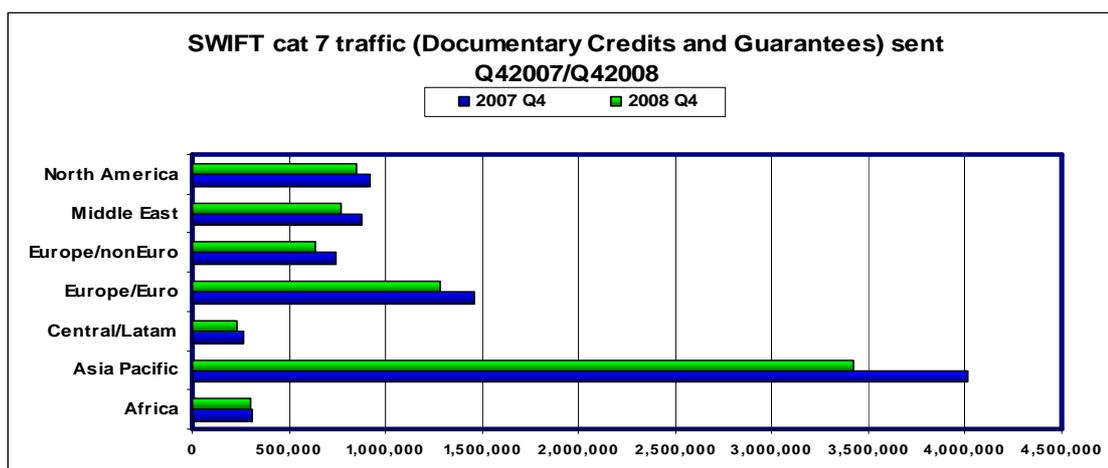
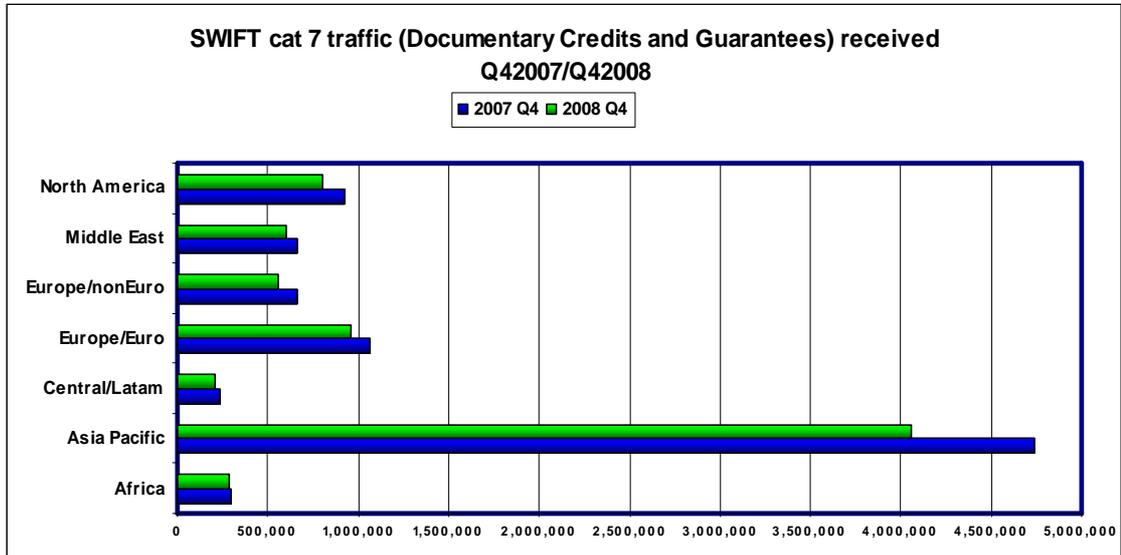


Figure 11 - Trade Traffic: Category 7 by Region, Last Quarter 2007 & Last Quarter 2008 (Received)



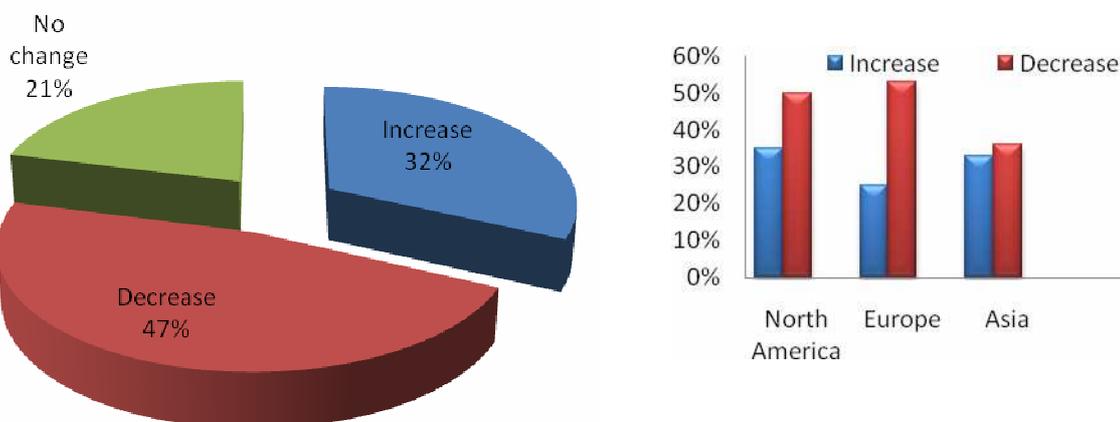
Global supply chain effects

- 3.14. According to information collected at the recent Banking Commission meeting, supply chains are having undesirable side effects. More and more goods are produced through supply chains, involving sequential stages of production across countries.
- 3.15. Exporters in international supply chains are better shielded from financial turmoil because they have access to credit from buyers. However, with their own access to finance drying up, global buyers will become more restrictive in providing finance along their supply chain. Bankruptcy of large global buyers leaves suppliers of specialized products in a difficult situation.

Overall decrease in volume and value

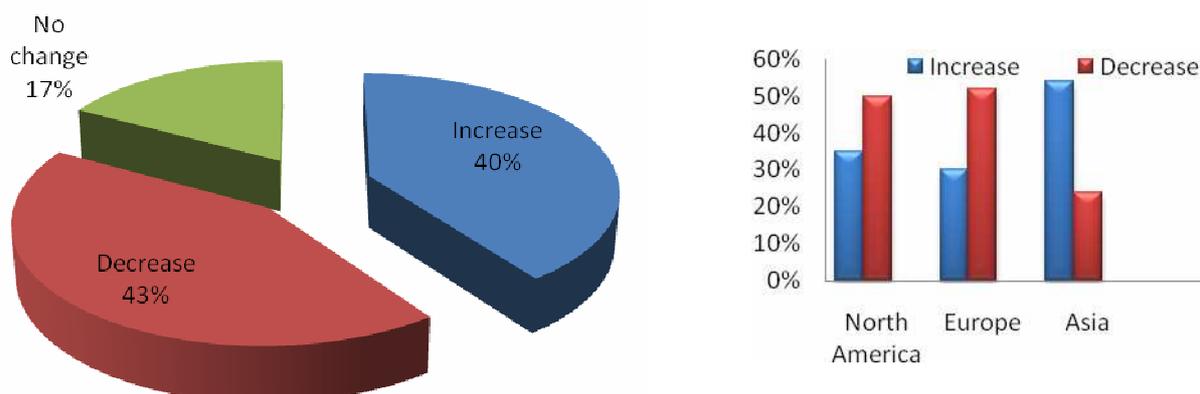
- 3.16. The overall decrease in volume and value is confirmed by the ICC Survey. Statistics have been drawn from North American, European and Asian banks, as these represented 86% of respondents. There is a clear imbalance between banks that are seeing an increase in the volume/value of export letter of credit transactions and those seeing a decrease, within the same geographical region.
- 3.17. Figure 12 shows that 47% of banks surveyed reported a decrease in export L/C volume.

Figure 12 - Export L/Cs volume trends – 4th Quarter 2007 to 4th Quarter 2008



3.18. Similarly, 43% of banks reported a decrease in the L/C value of aggregate transactions (See Figure 13 below).

Figure 13 - Export L/Cs value trends – 4th Quarter 2007 to 4th Quarter 2008

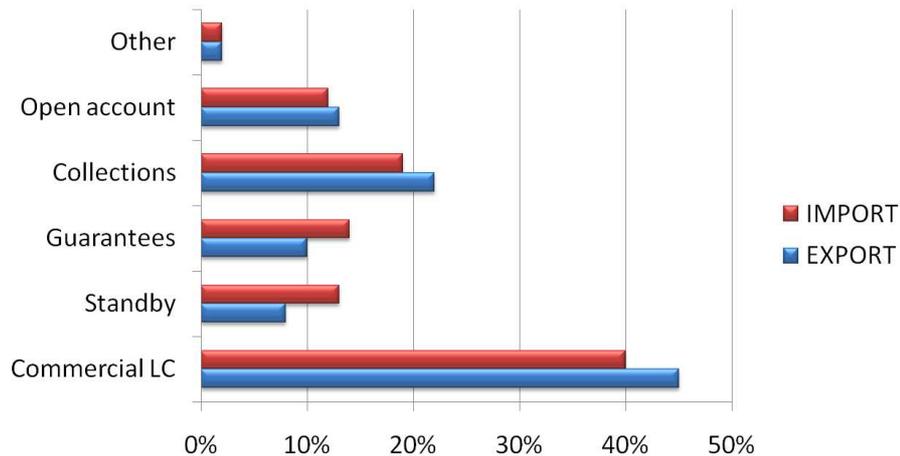


Resurgence of traditional trade finance instruments

- 3.19. In recent months, open account trading at the international level likely experienced a decrease. According to the comments received, export sellers only agree to open account terms if they have absolute confidence in the import buyers as well as in the stability of the buyer's country and its import regulations. Unstable markets are perceived as a threat, because they may motivate importers to try to escape their contracts.
- 3.20. Many banks report an increase in demand for documentary credits, also called letters of credit or "L/Cs"). These instruments are considered to substantially reduce risks for both the exporter and the importer. Not surprisingly, therefore, the documentary credit is today seen as the classic form of international export payment, especially in trade between distant partners.

3.21. This trend is confirmed from data collected in the ICC Survey. Figure 14 shows that L/Cs are still widely used. Please note that the data for open account trade reflects the respondents to the ICC Survey exposure to this trading method within the international trade operations of their banks which typically deal with traditional trade finance instruments.

Figure 14 - Breakdown, by percentage, of international trade products



Availability of trade finance is shrinking

3.22. Major problems still persist, as tight credit conditions have considerably reduced access to trade finance. Thus, the subject of trade credit line availability remains critically important at the present time. It should be noted that 40% of respondents indicated that their trade credit lines for corporates decreased between the last quarter of 2007 and the last quarter of 2008. At the same time, 51% of respondents indicated that the trade credit lines for financial institutions decreased between the last quarter of 2007 and the last quarter of 2008.

3.23. The main reasons given by banks indicating for the decrease in credit lines were the following:

- More stringent credit criteria being applied
- Capital allocation restrictions
- Exiting markets
- Reduced inter-bank lending

Demand and affordability of trade finance

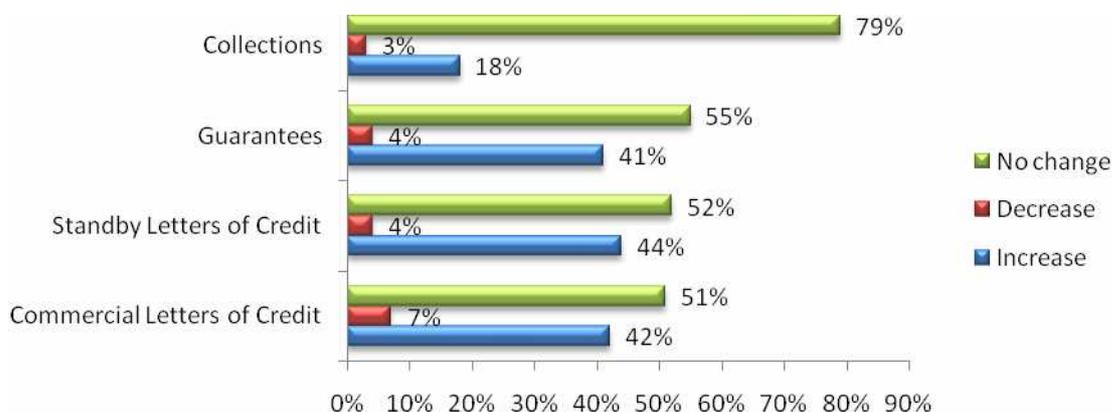
3.24. The ICC Survey addressed issues related to demand and prices. According to the Survey, trade finance is still in demand for trade products. However, shortage of liquidity and disproportionate aversion to risk have driven up interest rates on loans and advances in many countries, especially in emerging markets.

3.25. The following is noted in the ICC Survey:

- 48% of respondents indicated they had experienced an increase in demand for the issuance of bank undertakings between the last quarter of 2007 and the last quarter of 2008, a sign of the increased security sought by exporters for their shipments.
- 33% of respondents who had experienced an increase in demand indicated they had been unable to satisfy all of their customers' needs.
- 52% of respondents indicated they had experienced an increase in confirmation requests between the last quarter of 2007 and the last quarter of 2008. Again, this is an indication of the increased security sought by exporters and the perceived payment risk of the country of the issuing bank.
- Over 40% of respondents indicated that their fees for issuance of bank undertakings had significantly increased between the last quarter of 2007 and the last quarter of 2008.
- 58% of respondents anticipate that their fees for the issuance of bank undertakings will continue to rise in 2009.

3.26. It is important to note that over 40% of respondents indicated a significant increase in fees for Commercial Letters of Credit, Standbys and Guarantees in the past 2 years (See Figure 15 below).

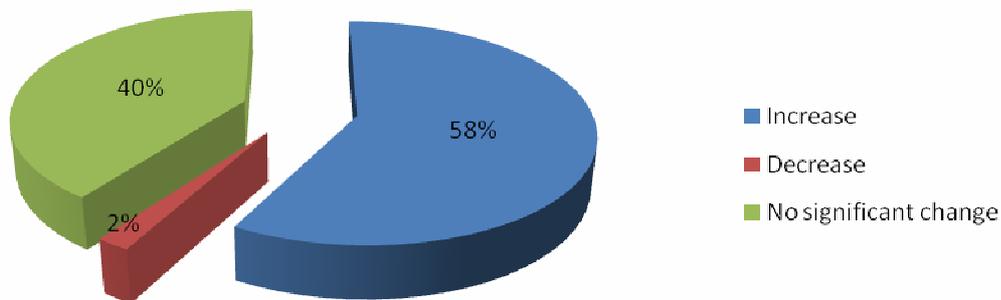
Figure 15 - Change in fees for issuance of bank undertakings



3.27. At the same time, the majority of respondents indicate a significant increase in fees for confirming Commercial Letters of Credit in the past 2 years (See Figure 16 below).

- 58% indicate an increase in fees for confirming Commercial Letters of Credit in the past 2 years.
- 2% indicate a decrease in fees for confirming Commercial Letters of Credit in the past 2 years.
- 40% indicate no significant change in fees for confirming Commercial Letters of Credit.

Figure 16 - Change in confirmation fees



Operational impacts

3.28. The last ICC Trade Finance Report (11 November 2008) noted an increase in the number of court injunctions barring payment under letters of credit on grounds other than fraud. Some of our members also reported intense scrutiny of documents by some banks, eventually leading to higher rates of rejection of trade documents under L/Cs for minor discrepancies.

3.29. From the ICC Survey, we conclude that these problems still persist. The following should be noted:

- 30% of respondents have experienced an increase in the number of refusals by issuing banks between the last quarter of 2007 and the last quarter of 2008.
- 20% of respondents, when acting in the capacity of an issuing bank, indicated that there has been increased pressure from applicants to refuse documents. The main reason cited was “falling commodity prices”.
- 40% of respondents, when acting in the capacity of a nominated bank, indicated they had experienced an increase in the number of spurious/questionable refusals.

- 30% of respondents indicated an increase in the number of claims received under standby letters of credit and guarantees.
- 18% of respondents indicated an increase in the number of instances of non-payment/acceptance under documentary collections.
- 12% of respondents had experienced an increase in the number of court injunctions stopping payment under bank undertakings.

3.30. The ICC DCINSIGHT regional study (Europe, USA, China and Israel) also confirmed a higher rate of rejection of L/Cs on first presentation and greater difficulties to obtain payment. This trend is found in all regions covered by the study.

Loss experience of traditional trade products versus general banking facilities

3.31. The last ICC Trade Finance Report dated 11 November 2008 noted that the current environment is creating a risk-averse culture, both amongst banks and traders. From the ICC Survey, it is evident that banks continue to report that customers are asking for confirmed letters of credit where they previously dealt with unconfirmed L/Cs, CAD (cash against documents) or open account.

3.32. However, bank perception of risk is leading to a tightening of liquidity in some instances and therefore greater difficulty in obtaining bank confirmations. In March 2009, we conclude that this situation still prevails.

3.33. Other key points noted in the ICC Survey are as follows:

- 86% of respondents would rate the risk associated with traditional trade products as the same or lower than those for general banking facilities with 42% indicating a significantly lower risk rating for traditional trade products.
- 66% of respondents indicated that the level of their actual losses when using traditional trade products were significantly lower (i.e. > 50% less) than losses incurred under general banking facilities.
- Only 5% of respondents indicated that their losses under general banking facilities were less than when using traditional trade products.

Focus from the development banks perspective

Development Banks and the Financial Crisis

Trade facilitation is crucial at present time

Trade facilitation programs play an increasing role to facilitate trade, provide guarantees and improve the liquidity problem. The recent Banking Commission meeting in Dubai on 12 March 2009 included a focused panel discussion moderated by the WTO and including the leading development banks in trade finance, the EBRD, the IFC, the ADB and the IDB.

Evidence has now been collected that various strategies to support trade finance are presently being undertaken by the private sector, governments, multilateral financial institutions, and official bilateral credit agencies. Respondents to the Survey say the current crisis has greatly increased demand for risk cover under such programs.

Historically, the EBRD was the first trade facilitation program to commence activity in what could be considered high-risk emerging markets. The EBRD program commenced operations in 1999. This program achieved such clearly demonstrated success in stimulating trade finance that the methodology has been substantially replicated by the IFC, the ADB and the IDB. The preferred creditor status of the development banks has also been seen as a key factor in developing risk sharing agreements with commercial banks around the world.

However, notwithstanding this fact the significant levels of trade underwritten by traditional trade finance instruments under these trade facilitation programs are clear testimony to the lower risk nature of trade finance transactions supported by ICC rules and practices.

Loss or default experience and reaction to crisis

Since inception of the programs the four development banks referenced in this report have collectively supported approximately EUR10 billion in trade finance and to date no trade finance related claims, losses or defaults have been recorded by any of these trade finance facilitation programs.

EBRD: Since the start of the EBRD program in 1999 the EBRD has facilitated trade transactions for an amount in excess of EUR 5 billion without any claims, losses or defaults. In response to the current lack of risk coverage and liquidity in the EBRD countries of operation the bank has increased the program limit to EUR 1.5 billion. The bank has also expanded its cash based lending facility in response to the liquidity gap where risk coverage is adequate.

IFC: Since the inception of the IFC program in October 2005 the IFC has issued guarantees for an amount in excess of USD 3.4 billion to support approximately 3,000 transactions. The IFC has not experienced any claims, losses or defaults since inception of the program. In response to the crisis the IFC increased the Global Trade Finance Program by USD 500 m to USD 1.5 billion in October 2008 and then from USD 1.5 billion to USD 3 billion in December 2008.

The expansion of this program enhances IFC's counter-cyclical role and its ability to respond to the global credit crisis, by supporting trade with emerging markets. Through the Global Trade Finance Program, IFC can guarantee the payment risk of issuing banks up to the full value of a transaction. This enables the continued flow of trade credit into the market, at a time when imports may be critical and the country's exports can generate much-needed foreign exchange.

ADB: Since commencement, the ADB Trade Finance Facilitation Program (TFFP) has not experienced any losses or defaults under their trade program. The overall limit for the ADB's TFFP has been increased to USD 1 billion as a response to an increase in demand for risk coverage and liquidity in the ADB countries of operation. The bank has also extended the maximum tenor of transactions in response to market demand.

IDB: The Inter-American Development Bank commenced its trade facilitation program in 2005 with a focus on supporting trade finance operations to, from and within the Latin American and Caribbean countries. Consistent with the other participating development banks in this survey the IDB has not experienced any trade finance related claims, losses or defaults to date. The IDB has enhanced its program and approved increased trade lines to almost USD 900 million. The Bank has also developed a funding product based on portfolio based short-term trade related cash loans.

Conclusion

From the ICC Survey, it appears clear that multilateral institutions and specialized agencies are expected to continue to play a key role in trade facilitation. The trade facilitation programs described above focus predominantly on the support of short-term trade finance transactions through the issuance of Standby letters of credit subject to ICC UCP rules.

It must be acknowledged that the high level of due diligence, and institutional relationships inherent in the development banks trade facilitation programs together with quality technical assistance and training in trade finance operations provided to their issuing banks greatly reduces the operational risks involved in the delivery of trade finance. Indeed, the proven model or template used by the development banks for trade facilitation shows that available risk coverage and liquidity can be focused directly to underpin international trade finance transactions supporting the purchase, sale and movement of goods between countries.

Basel II

3.34. The feedback we have received on Basel II shows a remarkable consistency; it appears that most banks are facing tougher capital requirements for their trade assets. In this connection, we believe the financial crisis has brought into sharp relief an ongoing trend whereby the implementation of the Basel II framework has eroded the incentive of banks to lend trade finance, because of capital weightings which are not fully reflective of the low risk level of the activity. Results from a survey conducted by the ICC United Kingdom in parallel with the ICC Global Survey indicated that these increases in capital requirements had particularly adverse consequences on trade lending to SMEs and counterparties in developing economies.

- 3.35. Capital requirements under Basel II will, of course, vary according to the nature and structure of the transaction, counterparty risk and country risk. However, we understand that the capital intensity of lending to mid-market corporates under Basel II can be around four to five times higher than for equivalent transactions under Basel I. This can be ascribed to three primary factors:
- **The focus of Basel II on counterparty risk rather than product or performance risk:** Basel II makes capital requirements an increasing function of banks' estimates of their loans' "probability of default" and "loss given default"—both of which are likely to increase significantly during downturns. However, insufficient mitigating consideration is given to the inherent strengths of trade finance products. As a result, trade is anomalously treated as almost the same kind of risk as that for other unsecured lending, such as overdrafts.
 - **Rigidities in the maturity cycle applied to short-term trade lending:** Whilst trade finance lending is usually short-term in nature, consisting of between 0 to 180 days maturity, the Basel II framework applies a one-year maturity floor for all lending facilities. Since capital requirements (naturally) increase with maturity length, the capital costs of trade finance are thus artificially inflated as a result. All regulators have the (national) discretion to waive this floor, although many have chosen not to do so.
 - **A lack of historical and performance data to assist in validating risk attributes:** Many banks face difficulties identifying and isolating sufficient data to produce verifiable estimates of risk attributes that can be validated for trade lending. This is notably the case for LGD calculation. This tends to translate into overly conservative risk weightings for trade finance products—in particular, when banks are required to rely on "standardized" parameters provided by national regulators.
- 3.36. By increasing the amount of capital that banks are required to hold against trade finance lending, each of the above factors significantly restricts the ability of banks to lend essential short-term credit to businesses in the current, capital-constrained environment. As such, many respondents to the ICC UK survey believed that changes in the treatment of trade finance under Basel II are required to ensure sufficient flows of trade finance during the current economic downturn.
- 3.37. The case for revised treatment of trade finance in the allocation of banks' capital rests on the historically low-risk profile of the activity. Many banks will attest that they have experienced relatively few losses on trade lending over the past few decades. This primarily reflects the fixed, short-term maturity of trade finance products and the fact that exposures are liquidated by cash upon maturity. Moreover, even in times of severe difficulty, companies will generally try to avoid defaulting on trade obligations, because continuing access to trade finance is a lifeline for most firms. In a similar vein, it should also be noted that trade-related instruments are generally the last forms of credit to be cut, and the first to be re-

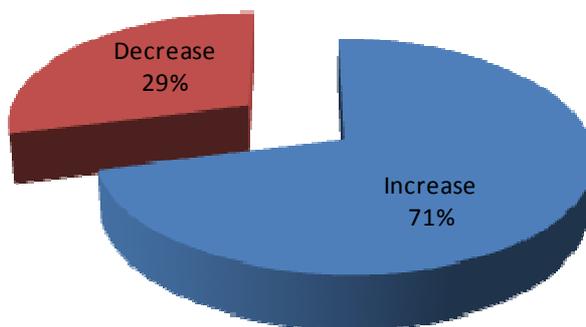
established, in debt-distressed economies.

- 3.38. In the context of the above—taking into consideration the key role that trade-related finance will play in stimulating a sustained economic recovery—we would urge policymakers to give consideration as to how changes to international capital adequacy requirements might complement other public interventions to boost trade finance flows.

Outlook for 2009

- 3.39. We believe that a general distinction can be drawn between short-term trade, say up to six months maturity, and longer-term projects of a more capital nature. The latter is more heavily impacted at the current time, with large-scale financing projects being deferred, particularly in the BRIC countries.
- 3.40. This trend tends to impact most heavily on multinational enterprises. As a result, 71% of respondents to the ICC Survey expressed the view that they anticipated an increase in demand for traditional trade products in 2009 (See Figure 17 below).

Figure 17 - Outlook 2009



4. Conclusion

- 4.1. The ICC Survey has confirmed that the current global financial crisis has severely affected financial institutions and markets worldwide. This is a challenging economic environment, and trade volumes may be further impacted in the coming months. On a global basis, the respondents foresee that different regions will experience major economic slowdowns in 2009, in particular the Asia/Pacific region. The predictions for 2010 remain cautious; many predict that the economic turmoil will continue to predominate.
- 4.2. The majority of financial institutions have restricted and limited their lending policies and activities, which has overall negative implications for liquidity in the financial markets. There is a global concern that if the recession deepens, capital costs will increase further, thus exacerbating current trends. Banks remain focused on how to best structure and manage their working capital needs in this environment. This encompasses providing guidance concerning decisions on new ventures, knowledge of counterparties, better structure of deals and assessing cross-border liquidity to obtain the best leverage possible.
- 4.3. It remains important to improve the resilience of emerging market economies. Our members indicated that it was crucial to build trust in times of extreme uncertainty. Structural measures could include an expanded use of asset-backed securitization funding structures, risk-sharing and greater risk differentiation by banks and public authorities.
- 4.4. It will remain important to maintain financing for SMEs. Despite the serious impact of the financial crisis, countries must continue to trade. The availability of trade finance is critical to the sustenance of emerging markets, but especially for small- to medium-sized enterprises relying on short-term trade finance. It has been unfortunate that many banks in the last decade have moved away from trade finance services, which are labor and skill intensive, to focus on investment banking, where greater rewards were available.



International Chamber of Commerce

The world business organization



INTERNATIONAL CHAMBER OF COMMERCE

The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rules-setting, dispute resolution and policy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

ICC enjoys a close working relationship with the United Nations and other intergovernmental organizations, including the World Trade Organization and the G8.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 130 countries. National committees work with their members to address the concerns of business in their countries and convey to their governments the business views formulated by ICC.