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# Why Trade Finance Matters— Especially Now

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## **WRITTEN BY**

This note was authored by Susan K. Starnes, IFC Lead Global Trade and Commodity Finance Strategist, Sector Economics and Development Impact Department, and Ibrahim Nana, IFC Consultant, Sector Economics and Development Impact Department.

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# Why Trade Finance Matters— Especially Now

The COVID-19 pandemic has affected both international trade and trade finance. Trade finance is a critical element for cross-border trade, and in many cases the movement of goods across borders, particularly in emerging markets, cannot occur without it. The pandemic has affected most sectors of the global economy through both supply and demand shocks, and the financial sector has not been spared, whether through potential loan quality challenges or increased demand for finance. Both global and local financial systems have been impacted, putting further pressure on trade finance. In the same way that trade supply and demand has been affected, trade finance has suffered, increasing the trade finance gap in emerging market and developing economies (EMDEs) in particular. This is a significant concern, as trade finance provides essential short-term liquidity, and additional trade finance will be urgently required when demand for traded goods begins to recover.

This note is the second of IFC’s “Trade and COVID Trilogy,” and it follows the first installment, “When Trade Falls: Effects of COVID-19 and Outlook.” This note collects and analyzes trade-related findings from over 70 “Daily News Summaries” and other data sources from late March to early November, 2020. It uses these sources to examine and discuss the effects of COVID-19 on trade finance in particular, assessing the impact of COVID-19 on trade finance and highlighting the importance of trade finance to global trade, especially during crises. Finally, the note examines the extent to which the pandemic has affected the persistent trade finance gap.

## Key Takeaways

- Trade finance is essential to global trade. In many cases, goods simply cannot cross borders without it. This is particularly true in emerging market and developing economies (EMDEs), as risk perception, jurisdictional differences, unfamiliar counterparty relationships, and geographic distances, among other factors, create a need to document and share risk on shipments.
- Trade finance both leads and lags trade: multiple studies have found that between 15 and 20 percent of the precipitous drop in trade that occurred during the 2008-2009 financial crisis was attributable to shortages of trade finance. Thus, ensuring that there is an adequate supply of trade finance helps to “raise the floor” for the current crisis’s trade trends and provides an important source of working capital while businesses continue to deal with operational shutdowns. An increased supply of trade finance can also expedite recovery, as shuttered businesses will require additional cash flow to resume both operations and trade.
- EMDEs continue to face a significant trade finance gap, one that remains notoriously persistent. Even before the COVID-19 pandemic, as pent-up global demand for trade finance outpaced supply, the trade finance gap appeared to be expanding across all EMDE regions.
- The complexities of the economic impact of the pandemic on individual countries and bilateral trade pairs create differences in trade finance trends and timing. However, we see trade finance demand increasing in several EMDEs at present, as well as a need to maintain existing volumes of trade finance. Recently, indicators have suggested that trade finance has fallen globally since the beginning of this pandemic, and on-the-ground information suggests it is falling in specific countries. However, the reduction has not been as large as originally expected in some places. And there are already signs of a fragile recovery in trade finance. We recognize that there are opposing forces on demand for trade finance, and significant downward pressure on supply. The transmission of these forces to the trade finance gap is having different effects as the economic impact of COVID-19 evolves and reverberates.
- We expect the trade finance gap to expand, potentially as the pandemic continues, and certainly once COVID-19 abates and businesses need additional trade finance to emerge from lockdowns. See *When Trade Falls—Effects of COVID-19 and Outlook*<sup>1</sup> for additional analysis of the outlook for trade. Historic patterns suggest that the supply of trade finance, which was already retrenching before the pandemic, will not recover as fast as demand. This may be exacerbated if new regulatory challenges emerge as COVID-19 subsides. We expect the trade finance gap to continue to expand in the medium and long terms.
- Three dynamics will be at play upon economic emergence from the current crisis; all three will drive adaptation of innovations in trade finance as well as highlight the need for strengthening some of the traditional fundamentals of the asset class. For example, several digital innovations in the trade finance space open doors for new sources of growth, increasing efficiency and reducing cost and risk. Such measures support a fundamental increase in trade and thus growth. However, the extent to which this potential is realized relies on both clarity and efficient cohesion in related regulatory standards, and the commitment of multiple stakeholders to support related EMDE development in this area.

## Trade Finance is essential for Trade

Scholars suggest that trade finance has ancient origins. The first known letter of credit dates to Ancient Egypt, where a clay note recorded a debt to be paid upon the delivery of wheat, with a right of execution to the noteholder should payment not be made.

And trade finance remains as essential today. In many cases, goods cannot cross borders without trade finance. Two counterparts engage in cross-border trade: an exporter that requires payment for goods or services and an importer that requires the correct and timely arrival of those goods or services. Given the many complexities involved with cross-border payments and receipt of goods, cross-border trade has a unique set of risks<sup>i</sup>. Trade finance instruments, intermediated by commercial banks, are designed to address the risks associated with cross-border payments and timing, which are amplified by jurisdictional and operational differences among trade counterparties. Trade finance instruments are premised on an existing credit relationship between counterparty banks. For example, a cross-border correspondent bank is often required to “confirm” the payment to the exporter, subject to performance required by a letter of credit. By doing so, the correspondent bank takes on the reimbursement risk related to the respondent bank, which in turn agrees to pay for the imported goods on behalf of its importer-customer. Thus, in order for goods to be shipped, a cross-border correspondent bank must be willing to take the payment risk of the respondent bank. In many cases, this is heavily reliant on a correspondent relationship business model<sup>2</sup>. As such, trade finance is essential to cross-border payments, and even more so during crises, when both real and perceived cross-border risk increases while, simultaneously, much-needed capital and liquidity can dry up from the financial sector on both sides of the border.

## Trade Finance has a separate and independent effect on trade, even more so during crises

Trade finance belongs to an asset class that has short tenors and a cross-border component. It is often vulnerable to the retrenchment of lenders. The global trade finance network, however, requires a long-term commitment by banks on both sides of a border. In fact, the current network embodies decades of the construction of individual banks in building familiarity and expertise in this asset class. It also embodies actual, legal, and documentary pathways of trade transactions, as well as mastery of their cross-border counterparts and geographies.

Extensive economic analysis demonstrates the importance of trade finance to trade, and econometric analysis of the 2008-09 global financial crisis highlights this. Of 16 articles reviewed regarding the “Great Trade Collapse” of 2008-2009, 12 attributed that collapse, at least in part, to financial constriction. For example, Ahn (2013) finds evidence of a substantial impact of bank liquidity shocks on the supply of letters of credit import transactions during the 2008–2009 crisis.<sup>3</sup> In fact, estimates indicated that credit shocks related both to working capital and trade finance accounted for between 15 and 20 percent of the decline in trade during the 2008–2009 crisis.<sup>4</sup> At the firm level, Behrens, Corcos, and Mion (2013), Bricongne et al. (2012), and Coulibaly, Sapriza, and Zlate (2011) all find that financial constraints explain part of the decline in exports during the 2008-2009 trade collapse.<sup>5,6,7</sup> Using sector-level data, Chor and Manova (2012) find that tight financial conditions (i.e., higher interbank interest rates) led exports to fall more during the 2008–2009 crisis in sectors with high external finance dependence or low asset tangibility.<sup>8, 9, 10, 11</sup>

<sup>i</sup> These include payment risk, country risk (exchange rate risk, political risk, sovereign risk, etc.), operational/delivery risk, and corporate risk, among others.

Thus, a high availability of trade finance can cushion the economic impact of COVID-19 by “raising the floor” for global trade, despite downward pressure. Supporting the financial sector’s capacity to extend trade finance can also protect working capital when it is most needed. It can expedite post-pandemic recovery by providing the exact financing needed to restart business activities and renew trade. Both anecdotally and econometrically, trade finance is an important component of trade and private sector working capital, especially in periods of crisis. Trade finance is, in effect, a specific form of working capital finance, which injects liquidity into operating cycles. Crises also tend to expand the difference between demand and supply of trade finance; and demand typically outpaces supply. The expansion of this gap can hinder recovery efforts and confine economic growth potential.

## The Trade Finance Gap was large pre-COVID-19 and is expanding

Prior to COVID-19, the trade finance gap was already large and continuing to expand. In 2018, the global trade finance gap reached an estimated \$1.5 trillion.<sup>12</sup> And the gap has been pronounced in emerging market and developing economies. As of 2019, the trade finance gap in Africa was estimated at \$82 billion.<sup>13</sup> The Developing Asia trade finance gap is estimated at \$700 billion.<sup>14,15</sup>

### ***Demand for trade finance is following typical crisis patterns so far during the COVID-19 pandemic, including some spikes and some reductions across countries and time.***

Historically, uncertainties created by crises have resulted in increased demand for trade finance products, as the use of these products tends to increase proportionately to perceived commercial risk.<sup>16</sup> Historical data suggests that exporting firms rely on trade finance

products during uncertain times. Therefore, even as trade falls,<sup>17</sup> the demand for trade finance in proportion to trade typically rises.<sup>18</sup> Demand for trade finance in crisis faces two opposing forces: increased risk and liquidity needs push demand up while reductions in trade drive demand down. The relationship between these two forces can shift quickly as the situation evolves. We note that the dip in demand is typically lagged, as remaining trade requires proportionately more trade finance. In addition, crisis-emergent increases in trade finance demand can precede trade’s recovery due to the finance sequencing for exports.

When trade declines past the size of a geography’s trade finance gap, demand for trade finance can fall for a brief period. However, trade finance is, effectively, a unique subset of working capital. Thus, in terms of demand, it is a prioritized asset where there is a need for short-term liquidity. This is especially true for businesses facing greater risk or other short-term operational constraints. It also occurs as businesses position themselves for near-future operational growth (e.g., demand for trade finance accelerated out of the 2008-2009 crisis). Demand for trade finance also increases when there is a combination of real-sector pressure for additional trade and a significant increase in the existing counterparty “country risk” (real or perceived). Thus, as most countries emerge from potential or real crises over time, trade finance becomes a greater necessity than “steady state.” Therefore, the absence of sufficient trade finance hinders actual trade and threatens recovery, even if demand for trade finance initially falls when trade dips.

While the dollar volume data for global trade finance is not consistently available, during this crisis we see the two opposing forces at play in EMDEs through publications, news reports, real time surveys, and multilateral trade finance transactional activity:

- **Publications from institutions such as the Bank for International Settlements (BIS) and the Financial Stability Board (FSB) highlighted global crisis dynamics:** In the early stages of the COVID-19 crisis, demand for trade finance appeared to rise for structural reasons. The pandemic shocked global supply chains, halting operating cash flow generation and straining working capital. In addition, the COVID-19 shock is synchronized across sectors and countries. Buyers and suppliers remain simultaneously unable to sell or buy products, thus operating cash flow has frozen and firms are no longer able to rely on inter-firm credit to mitigate the financial effects.<sup>19</sup> Simultaneously, demands on financial systems' capital and liquidity rose and remain high, particularly in the short term.<sup>20</sup> The World Trade Organization (WTO) noted that several banks indicated that demand for trade finance was increasing so rapidly that additional guarantees and other forms of capital relief are needed.<sup>21</sup>
- **Recent emerging market bank surveys record the two forces:** IFC's 2020 *Annual Emerging Market Issuing Bank Survey* finds a significant portion of banks reporting increased demand across the globe. Thirty-six percent of respondents reported that demand for funded trade finance increased, while 32 percent reported decreases (the remaining respondents reported flat activity). Unfunded trade finance followed fairly similar patterns (25 percent, 37 percent, and 38 percent, respectively). A publication detailing the entire set of survey results is forthcoming. A very recent multi-development finance institution survey, *Pulse Check - Trade Finance in Sub-Saharan Africa during Covid-19* ("Pulse Check"), finds that, in a select group of Sub-Saharan African countries, while transaction volume has fallen by only 10 percent over the first half of 2020, banks indicated that demand pressure was only a "loss of expected growth" versus year-on-year reductions. This reduction was

driven by, among other things, a reduction in trade, falling commodity prices, price spikes for the trade finance asset class, and supply choices driven by potential credit challenges. The reduction was offset by temporal spikes in demand in early 2020 and the fragile recovery more recently. In addition, banks reported a surge of new customer demand for trade finance for new import orders, much of which was rejected due to market financial conditions.<sup>22</sup>

- **On-the-ground experience from DFI trade finance units aligns expectations:** In May, the European Bank for Reconstruction and Development (EBRD) reported record demand for trade finance, leading to a reported \$1 billion increase in its trade finance program limit in July.<sup>23,24</sup> In July, the Inter-American Development Bank recorded a demand increase of 245 percent year-over-year.<sup>25</sup> IFC's Global Trade Finance Program Indicates demand spikes across several countries, even as global trade has fallen, as recently as November.

While demand has followed crisis patterns across different timelines, we note that it continues, as this specific crisis creates new and unique sources of demand. As economic effects of the crisis continue to ricochet across countries, the timing of acute liquidity needs and related trade finance demand spikes vary from country to country, in some cases amplified by second- and third-level knock-on effects resulting from successive waves of COVID-19 cases. While demand holds or increases in many markets, the supply of trade finance is under severe pressure.

**The supply of trade finance is under pressure:**

When actual, potential, or perceived financial risk increases sharply in countries on either side of a trade border, trade finance is particularly vulnerable, given its short-tenor, lower-yield, cross-border nature, its dependence on a vibrant correspondent banking network, and its denomination in U.S. dollars.<sup>26,27</sup> (U.S. dollar debt coming due across

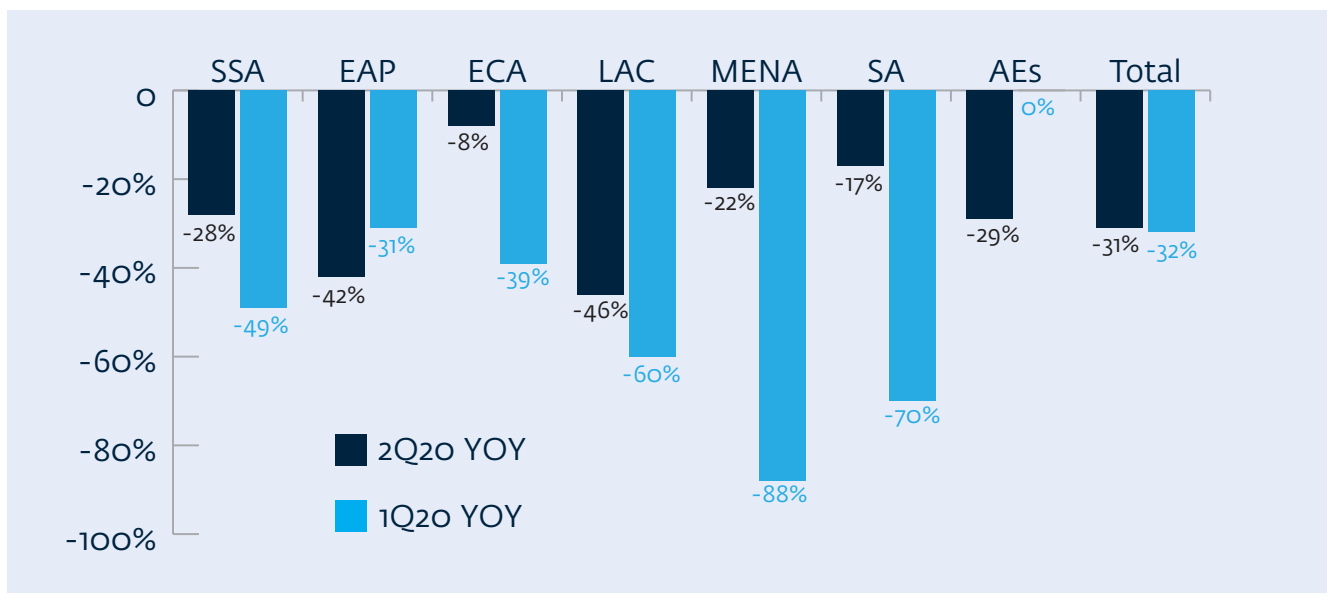
all asset classes faces increased risk when the dollar appreciates relative to the local currency and the supply of available dollars is compressed.<sup>28,29</sup> ) In response to exogenous or endogenous shocks, cross-border banks tend to look for quick ways to shore up capital while protecting returns. Trade finance portfolios, with short tenors, provide opportunities to rapidly increase capital simply by not taking on new financing obligations as existing ones expire. And because trade finance's yield is relatively low (due to its low risk profile and short tenors), trade finance returns are only significant when the business remains at scale. As a result, crises put downward pressure on trade finance, despite its favorable credit risk profile.

The COVID-19 pandemic has worsened existing financial vulnerabilities and has generated increased volatility across many markets. Limited availability of liquidity and operating cash flows, deceleration of debt service capacity, and multiple asset class portfolio outflows have been reported across many EMDEs. These financial challenges have further limited the supply of short-term liquidity and

trade finance in many countries. In the same way that COVID-19 has a more dramatic effect on individuals with preexisting health conditions, the COVID-19 economic crisis exposes and worsens existing financial vulnerabilities (e.g., increased levels of foreign currency debt coming due, reliance on single commodity exports or industries, and limited fiscal space for crisis cushion). Collectively, these factors limit the degrees of freedom that governments have for crisis response.<sup>30</sup> In addition, their own domicile-country challenges affect both EMDE domestic and cross-border correspondent banks' risk appetite.

And COVID-19 has delivered severe volatility to EMDE cross-border capital. Global cross-border investment (CBI) has decreased by 31 percent YOY in 1Q20 and 32 percent in 2Q20, driven by a significant decrease in emerging market CBI (**Figure 1**), including record-breaking portfolio outflows in March of some \$90 billion. While recent data from the Institute of International Finance (IIF) indicates a third-quarter recovery, primarily in developing Asia, the authors note a high

**Figure 1:** Total Cross-Border Investment Flows (US\$ Volume, YOY change, %)



Source: IFC Global Macro & Market Research. Note: SSA represents Sub-Saharan Africa; EAP represents East Asia and the Pacific; ECA represents Europe and Central Asia; LAC represents Latin America and the Caribbean; MENA represents Middle East and North Africa; SA represents South Asia and AEs represents Advanced Economies.



variance among EMDEs and warn of potential shifts as COVID-19 effects reverberate and potentially increase during the second wave of the virus.<sup>31,32,33,34,35</sup>

As many EMDE countries experience real currency devaluations in line with those experienced in nine of the most significant crises since the 1990s,<sup>36</sup> additional volatility is expected as hundreds of millions of dollars in foreign currency debt comes due. On the global foreign direct investment (FDI) front, forecasts predict a net drop of as much as 40 percent in 2020.<sup>37</sup> Global FDI flows fell by 50 percent in the first half of 2020 compared to the second half of 2019,<sup>38</sup> with record breaking outflows from EMDEs in early months of the COVID-19 crisis; and EMDEs are expected to experience record-breaking FDI decline.<sup>39</sup>

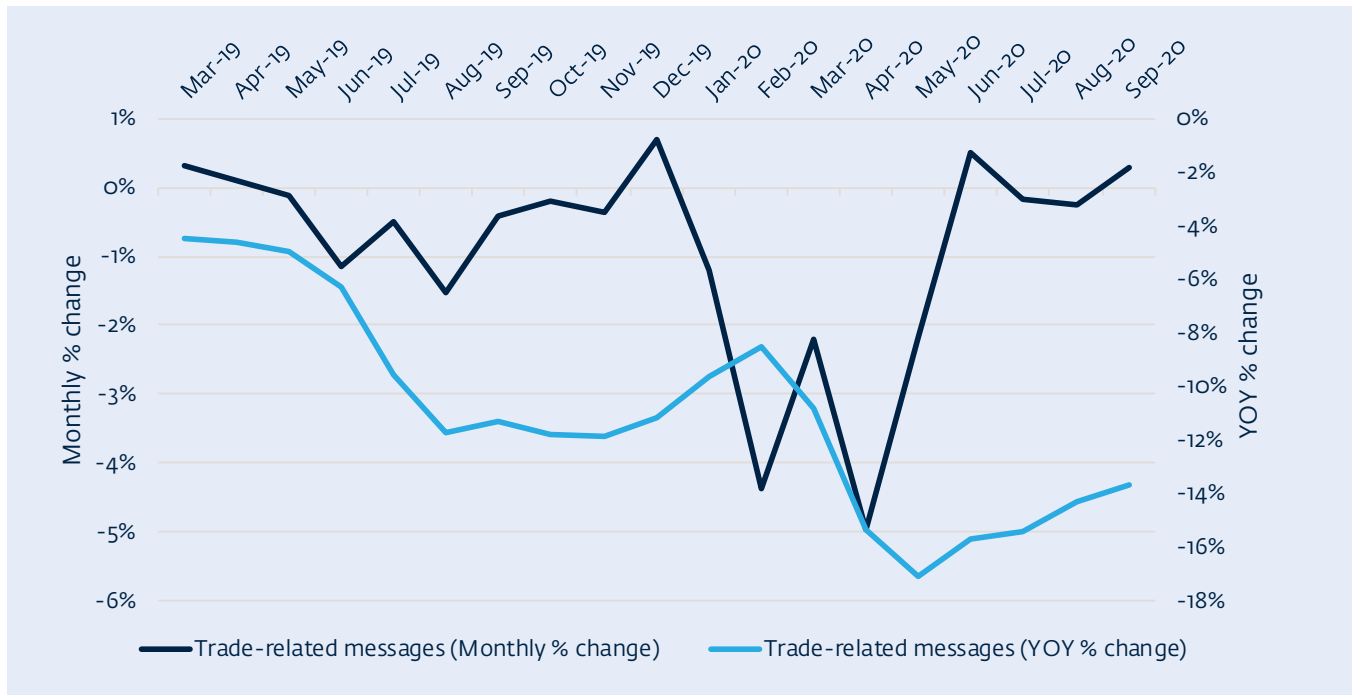
**For trade finance/correspondent banking, both anecdotal input and survey results indicate that cross-border banks are retrenching from emerging markets.** Even before the COVID-19 crisis, many international banks with trade finance expertise were already facing increased capital constraints and other regulatory pressures that impacted their emerging market operations. As banks spend more on regulatory compliance, the typically lower-margin correspondent banking business line is more vulnerable to supply pressure.<sup>40</sup> The combination of all of these factors can reduce the availability of trade finance. Examples reported during the early stages of the pandemic show that this phenomenon is playing out as expected. For example, in a joint statement, several multilateral development banks and the WTO have recognized that the COVID-19 pandemic has provoked a reduction in the supply of trade finance in their partner banks (though heads of these multilaterals committed to work to reduce trade finance gaps that emerge during this crisis<sup>41</sup>). In addition, the EBRD reported that due to the lockdowns, most of its EMDE partner banks have had to close offices and minimize physical

contact with customers. Staff at many of these banks are not connected to bank IT systems and thus cannot work remotely, and this creates a severe operational supply limit for trade finance.<sup>42</sup> As early as June, the International Islamic Trade Finance Corporation (ITFC) released funds to avoid trade finance shortages in Senegal.<sup>43</sup> Private sector firm EY<sup>ii</sup> also stressed that COVID-19 has affected the trade finance sector, with banks contending with significant operational continuity challenges and completing fewer letters of credit and invoice discounting transactions than usual.<sup>44</sup> More broadly, evidence of reduced supply of trade finance is already visible in the results from IFC's 2020 *Annual Issuing Bank Survey* where, to date, 99 percent of respondents indicated COVID-19-related pressure on themselves and their clients and/or a recent history of correspondent bank relationship stress<sup>iii</sup>.

**Trillions of dollars are needed to support the return of trade.** Based on an initial 13 to 32 percent decrease in trade forecasted by the WTO, the International Chamber of Commerce (ICC) has warned that two to five trillion dollars of trade credit market capacity will be needed to create the potential for a V-shaped recovery and restore trade volumes to 2019 levels. This calculation includes an estimated one to two trillion dollars of required capacity in the bank-intermediated trade finance market alone if merchandise trade volumes are to approach 2019 levels by 2021.<sup>45,46</sup> This is highlighted by financial transactions message volume, which fell precipitously during the first quarter of 2020. **Figure 2** shows data from compiled 24 SWIFT monthly reports and the collapse in trade-related message volume, which was already relatively low in 2019. Trade-related message volume fell by 9 percent YOY in March, followed by a significant drop of 17 percent YOY in May. Even as month-to-month message volume experienced positive change in June for the first time since late 2019, the shift remains barely positive and fragile.

ii Formerly Ernst & Young, a global public accounting and consulting firm.

iii The final report of the 2020 Annual Issuing Bank Survey is forthcoming.

**Figure 2:** Volume in trade-related messages, already negative, contracted significantly from March 2020

Source: SWIFT FIN Traffic Document Centre.

## Outlook: The Future of Trade Finance

Trade Finance is essential to trade in emerging market and developing economies. It has been fundamental to trade, and thus to growth, for EMDEs for some time. Even as trade finance evolves, it remains dependent on a global network of banks, all willing to work with each other. Just as trade is a critical component of economic recovery, trade finance is a critical component of trade, perhaps even more so going forward, as future risk perceptions are expected to incorporate COVID-19's effects on economies and financial stability. While the fundamentals of trade finance may evolve over time and new players may enter the space, trade fundamentally relies on a deep and complex network of cross-border finance, unique to this asset class and economic activity. Building on both historic experience and emerging trends, we expect that trade finance could change in several significant ways going forward:

- The demand for trade finance may fall temporarily, with a follow-on increase.** Trade finance both leads and lags trade. Each country faces different timing as waves of COVID-19 cases have different economic effects both domestically and to major trading partners. Those effects will be either amplified or mitigated by the relative strengths and weaknesses of each bilateral trading partner pair; this, in turn affects both trade and access to trade finance. To date, the current crisis has caused a decrease in trade, which has resulted in a drop in demand for trade finance in some countries. This is expected to continue, and more countries may experience a similar reduction in demand in the short term. We expect that trade finance demand will remain flat or increase in many EMDEs going forward, even as some factors continue to apply downward pressure. We expect some countries (especially those connected to the major trading hubs still facing COVID-19 lockdowns) to experience further trade

finance pressure. In the short term, we expect trade to begin to recover, albeit slowly, especially among bilateral trading partners that are either less effected by COVID-19 or are already recovering. We also expect that countries facing increased stress will continue to need additional working capital and trade finance infusions to weather the crisis and help businesses survive. When remaining shuttered businesses begin to restart and relaunch trade, the immediate demand for trade finance will spike. The 2020 ICC Global Survey on Trade Finance highlights the potential for increased demand for trade finance over the coming two years; 86 percent and 75 percent of respondents in Asia Pacific and Africa, respectively, expect increased demand for trade finance.<sup>47</sup>

- **The EMDE trade finance gap could persist and is likely to expand over time.** While trade finance is short-term, the infrastructure required to facilitate it is decidedly long-term. This infrastructure needs to continue to deepen and grow in order to reduce the trade finance gap, yet there is significant pressure to retrench at present. Thus, without perfect markets—especially in EMDEs—trade finance has displayed a persistent and significant gap for a long time. This gap existed prior to the 2008-2009 crisis and has continued to face sustained periods of expansion, punctuated by brief periods of contraction. As of early November 2020, demand for trade finance appears to be increasing in some countries, and we expect this demand to spike globally across EMDEs sooner than supply does. The pandemic has further reduced the capacity of institutions to provide trade finance services, putting both the supply of such services and the enabling global network of cross-border banking relationships under even greater stress than before the pandemic. Thus we expect the trade finance gap to continue to expand, and particularly when the pandemic comes under control and a

widespread macroeconomic recovery is underway. Specifically in Africa, we agree with the Pulse Check view: While a return of market activity may be possible in a few months, subject to several COVID-19-related factors, 2020's "lost growth" is not expected to be recovered. According to the study, while some bankers have strong liquidity positions, they are "constrained by underwriting and macroprudential rules, especially for new clients and sectors. As such, an L-shaped recovery in trade finance [supply] seems likelier than a U shaped one."<sup>48</sup> This further expands the trade finance gap, which in turn prevents countries from reaching their true growth potential.

- **Financial institutions will need to adapt as market dynamics shift post-crisis and will be pulled forward to address shifts in funding and risk sharing for trade.** Over the past decade, as many EMDE countries became increasingly linked to the global economy via trade, new forms of cross-border trade finance have evolved or expanded (for example, open account trade finance, when goods are shipped and delivered before payment is due). As the world emerges from the current crisis, three dynamics are potentially at play: (1) the advent of digitalized trade and digital trade finance, which has been accelerated by social distancing; (2) a move toward increased trading with deeply trusted counterparties; and (3) a "risk hangover" that follows most crises. These three dynamics increase the potential for specifically different types of trade finance, ranging from traditional mechanisms (e.g., letters of credit) to more recent innovations (e.g., digitalized open accounts). While several scenarios are possible, we expect, at least in the mid-term, that the most likely scenario will be a hybrid of the three dynamics. Trade finance will evolve to follow the existing standard structures and processes of documentary trade finance, digitalizing these processes where possible and feasible. It will also

innovate incrementally with upgraded risk management and more flexible instrument offerings and process efficiencies. While traditional forms of trade finance will be increasingly demanded in the short-to-medium term, open account trade finance may resume its growth path over the long term. Financial institutions on either side of the border that are slow to distinguish market movements and adapt to them will be at risk of losing business.

- **Expedited digital innovations will benefit trade finance and trade, making future growth easier in the longer term.** COVID-19 has expedited digital innovations across multiple industries. Banks have transitioned to remote sales and service teams and have adapted their services to digital transactions and mobile money for developing countries; grocery stores have shifted to online ordering and delivery; schools have adopted e-learning; and doctors have begun delivering telemedicine.<sup>49</sup> Recent technological innovation holds both potential and risk for the future of trade as well. Several trade-related innovations (e.g., supply chain mapping<sup>iv</sup> and blockchain-like transaction tracking) are promising. If implemented properly, optimizing the digitalization of trade could reduce both costs and risk and support increased trade growth.<sup>50</sup> In addition, technological solutions offer high-value mechanisms to address regulatory compliance challenges that currently constrain correspondent banking, a critical component of trade (for example, there is a plethora of new “regtech” offerings that allow for transactional and counterparty data pooling and analysis to automatically flag potentially problematic transactions across a deeper set of data).<sup>51</sup> As trade and related activities become more efficient, less risky, and less expensive, the marginal cost of each transaction will fall, facilitating further growth.

- **Regulatory challenges may emerge following the COVID-19 crisis.**

Regulatory efforts since 2008–2009 have undoubtedly strengthened financial sector resiliency in many countries. Prior to COVID-19, regulators and banks were working to upgrade their anti-money laundering/combating the financing of terrorism (AML/CFT) program management, and potential challenges with fintech had been raised. The financial sector, along with other affected stakeholders, was already working to overcome significant challenges associated with having to address a great deal of regulatory activity in a compressed time period. Deeper collaboration across private sector financial institutions, regulators, and multilateral bodies—across and within multiple countries—was in early stages. Financial sectors across the world are currently focused on liquidity, solvency, and continuing to support the well-being of their customers and countries. As the pandemic subsides, new risks may become evident in its aftermath, with respect to regulatory capital, new products, and nonfinancial risk categories (e.g., cybersecurity, data privacy, and AML/CFT compliance). The most successful outcome will occur if the cross-stakeholder ecosystem of regulatory activity, which was in nascent stages before COVID-19, can continue to improve transparency, clarity, and frequency of communication.

iv Implemented by the Asian Development Bank and the WTO.

## Conclusion

The COVID-19 pandemic has affected all facets of international trade. This is also true of trade finance, an asset class that is critical to trade, yet also particularly vulnerable during crises, despite its low-risk nature. While 80 percent of world trade relies on trade finance,<sup>52</sup> its supply is under severe pressure. For EMDE's, trade finance demand has weakened temporarily, despite continued increases in some countries (as operating cash flow will most likely remain relatively scarce in the short term). Looking forward, trade finance will be critical to help restart production and trade when the globe emerges from this pandemic. Constraints with trade finance, which are evidenced via an expanding trade finance gap, create direct constraints to trade itself, and so also to the speed and magnitude of the global EMDE economic recovery from COVID-19.

*For questions or comments, please contact authors Susan K. Starnes, Lead Global Trade and Commodity Finance Strategist ([SStarnes@ifc.org](mailto:SStarnes@ifc.org)) or Ibrahim Nana, IFC Consultant and African Research Fellow ([inana@ifc.org](mailto:inana@ifc.org))*



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