SECTOR OVERVIEW

A. Background

1. Trade is an important vehicle to promote the economic growth and job creation that reduces poverty and improves living standards. However, without sufficient trade finance, the full potential for trade to deliver such development outcomes will not be realized. Trade finance plays a central role in the economy, underpinning an estimated 80%–90% of global trade.[1] An Asian Development Bank (ADB) survey published in September 2019 estimated a global trade finance gap of $1.5 trillion, with small and medium-sized enterprises (SMEs) and businesses led by women being the most underserved.[2] The economic shock brought about by the coronavirus disease (COVID-19) pandemic has led banks to decrease support for trade, including in developing member countries (DMCs) (footnote 1). The International Chamber of Commerce anticipates that restoring trade to pre-pandemic levels in 2021 will require an additional $0.8 trillion–$1.9 trillion of trade finance, with an additional $1.9 trillion–$5 trillion required to support a rapid global recovery.[3]

B. Impediments to Closing the Trade Finance Gap

2. **Insufficient country and counterparty limits**. Trade finance gaps are typically caused by insufficient country and counterparty limits from private financial institutions, due to perceptions of risk. Many banks in the world lack country and counterparty limits for most DMCs.

3. **Availability of trade finance to small and medium-sized enterprises.** According to the World Bank, development of SMEs is critical for achieving Sustainable Development Goal 4 (improving skills of youth and women for obtaining decent jobs); about 600 million jobs will be needed by 2030 to absorb the growing global workforce, mainly in Asia.[4] However, SMEs continue to experience a shortage of trade finance and high borrowing costs, in part because of the lack of reliable financial data. Additional barriers to access include difficulty in meeting compliance and due diligence processes required by the financial sector.

4. **De-risking by global financial institutions.** Bank-to-bank (correspondent) relationships are important conduits for trade, especially in developing countries. Banks have been "de-risking" —severing correspondent relationships—particularly in DMCs, which threatens to increase the market gap for trade finance, and in some cases possibly cut some DMCs from the global financial system.[5] A combination of factors is responsible for this de-risking, including a tougher regulatory environment and concerns regarding financial crime in countries with weaker financial supervision, and these have led global banks to exit smaller markets in Asia and the Pacific. The most acute example of this withdrawal has been experienced in the Pacific, where ADB's Trade Finance Program (TFP) has expanded and is working with numerous partners to address the problem.

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1 International Chamber of Commerce (ICC). 2020. *Priming Trade Finance to Safeguard SMEs and Power A Resilient Recovery from COVID-19.* Memorandum to G20 Governments, Central Banks and International Financial Institutions (6 November).
2 ADB. 2019. *Trade Finance Gaps, Growth, and Jobs Survey.* ADB Briefs No. 113 (September). Manila.
3 ICC. May 2020. *Trade Financing and COVID-19*. Paris.
4 World Bank. Small and Medium Enterprises (SME) Finance.
5 World Bank. 2016. *Brief: De-Risking in the Financial Sector.* Global financial institutions are increasingly undertaking "de-risking": terminating or restricting business relationships with remittance companies and smaller local banks in some regions.

C. Overview of Trade Finance in Selected Markets

5. The TFP operates in 22 countries, however Bangladesh, Pakistan, Sri Lanka, and Viet Nam are the program's most active countries, representing more than 90% of its portfolio. Brief overviews of the trade finance markets in these countries are provided below.

6. **Bangladesh.** Bangladesh issues more letters of credit—a common instrument in trade finance—than any other country in the world and is one of the program's most active markets. Bangladesh's economy has expanded significantly since 2007.[6] SMEs contribute 23% of gross domestic product (GDP), 80% of jobs in industry and 25% of the total labor force. A financing gap of $2.8 billion prevails in micro, small and medium enterprises, where 60% of women owned SME's financing needs are unmet mainly due to lack of access to collateral (footnote 4). Rising exports and strong remittance inflows have been major contributors to economic growth. Bangladesh aims to become an upper middle-income country, and to do so needs to diversify its export base and focus on infrastructure development for broad-based growth.[7] Bangladesh is the world's second biggest exporter of ready-made clothes and shipped about $34 billion worth of clothes in 2019. The garment sector employs about four million people, most of them women. The banking sector in Bangladesh is developing, with improving performance on the part of some banks and increasing governance standards such as full implementation of Basel 3 standards achieved during 2020, but issues with weak capitalization and high nonperforming loan (NPL) rates remain. There continues to be strong demand for ADB's credit guarantee product and revolving credit facility in Bangladesh. Along with the International Finance Corporation, ADB is the major partner providing trade finance support to local banks.

7. The program has been operating in Bangladesh since 2004 and currently works with 12 local partner banks. As of December 2020, the program had supported 7,535 transactions in Bangladesh, valued at almost $6 billion, of which 3,388 transactions supported SMEs. This support spans a range of goods and commodities, including textiles, agricultural, commodities, and capital goods..

8. **Pakistan.** Pakistan has a population close to 216.6 million and is one of the top three markets for the program. Pakistan has bilateral and multilateral trade agreements with many nations and has been a member of the World Trade Organization since 1995. The People's Republic of China (PRC) is becoming an increasingly significant economic partner for Pakistan, and this will increase with completion of China–Pakistan Economic Corridor projects, which are part of a $45 billion program. However, in 2018 Pakistan experienced an economic crisis as a result of global monetary tightening, increased oil prices, and reduced investor confidence, which negatively impacted the country's economic situation. Real GDP growth was just 1.9% in fiscal year (FY) 2019 and ADB expects FY2020 growth to be –0.4%. In FY2021, the growth is expected to rebound and stand at 2%. [8] In response to the economic slowdown and COVID-19 pandemic, the government launched a fiscal stimulus package equal to 3.2% of FY2019 GDP. An additional measure has been taken by the State Bank of Pakistan equal to 2.6% of FY2019 GDP, which includes provision of subsidized credits and a loan guarantee.[9] The International Monetary Fund (IMF) expects the FY2020 fiscal deficit to widen to 9.3% of GDP as compared to its pre-COVID-19 pandemic projection of 7.3% and FY2019 level of 8.9%. On 24 March 2021, the IMF Executive Board completed the second through fifth reviews of the Extended Arrangement under the

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6 Gross domestic product has expanded at over 6% per year since 2007.
7 Garments make up over 80% of total exports in Bangladesh.
8 ADB. 2021. Economic Indicators for Pakistan
9 Government of Pakistan. 2020. Finance Division. *Pakistan Economic Survey 2019-20.* Islamabad.

Extended Fund Facility (EFF) for Pakistan, allowing for an immediate budget support of about $500 million. Originally, Pakistan's 39-month EFF arrangement was approved by the IMF on 3 July 2019 for SDR4.268 billion (about $6 billion at the time of approval of the arrangement).[10] The IMF program aims to support Pakistan's policies to help the economy and save lives and livelihoods amid the still-unfolding COVID-19 pandemic, ensure macroeconomic and debt sustainability, and advance structural reforms to lay the foundations for strong, job-rich, and long-lasting growth that benefits Pakistan.[11]

9. Although domestic banks are relatively well capitalized, major international banks do not have adequate country limits for Pakistan and/or bank limits for Pakistani banks, especially in light of uncertainties caused by the COVID-19 pandemic. This raises the need for support by multilateral development banks such as ADB for trade finance transactions.[12] A recurring challenge for Pakistan is strengthening its anti-money laundering and counter terrorism financing regime and addressing its strategic counter-terrorist financing-related deficiencies. Pakistan has been on the Financial Action Task Force (FATF) "grey list" since June 2018, and while it has demonstrated significant progress in a number of areas (e.g., risk-based supervision, pursuing domestic and international cooperation to identify cash couriers), the FATF is urging Pakistan to complete its full action plan by June 2021.[13] The program has delivered extensive technical assistance to Pakistan to help implement the FATF action plan. However, if Pakistan is unable to complete the full action plan by June 2021, FATF could call on its members and urge all jurisdictions to advise their financial institutions to give special attention to business relations and transactions with Pakistan.

10. The program has been operating in Pakistan since 2008 and currently works with 13 local partner banks. To date, the program has supported more than $17.3 billion in trade in the country through 5,891 transactions. This support is provided in a number of areas, predominantly oil and gas, solar panels, steel, polypropylene, fertilizers, and machinery for garments and weaving.

11. **Sri Lanka.** The country has experienced recent challenges, such as the terror attack in April 2019, a slowdown in the tourist sector, delayed repayments for government contracts, and challenges in construction. Presidential elections were held in November 2020, which also caused temporary political uncertainty. As investors become more confident of political stability under the current government with a working parliamentary majority, investment activity may increase from 2021, although the current amount of foreign currency debt remains very high and requires close monitoring. Sri Lanka left the FATF grey list in October 2019, which may help increase international activity. Local Sri Lanka banks, although mostly adequately capitalized, show higher NPLs as compared to banks in other DMCs.

12. The program has supported 1,605 transactions in Sri Lanka valued at nearly $5.6 billion since 2009. Over half of the program's support was cofinanced and most of the transactions support SMEs.

13. **Viet Nam.** Viet Nam's economy has experienced significant growth, averaging around 6.3% during 2002–2020 and, notwithstanding the impact of the COVID-19 pandemic, appears to have

[10] SDR = special drawing rights.

[11] IMF. *IMF Executive Board Completes the Combined Second, Third, Fourth, and Fifth Reviews of the Extended Fund Facility for Pakistan*. 24 March 2021.

[12] Some international banks lack a country limit for Pakistan, precluding them from doing any business in the country without external support. ADB therefore plays a catalytic role for such banks in Pakistan.

[13] FATF. *Jurisdictions under Increased Monitoring-21 February 2020*; and FATF Press Briefing. 25 February 2021.

remained on a growth track. One of the main drivers of this growth has been international trade. The country's trade-to-GDP ratio, an indicator of the relative importance of trade in an economy, is around 200%, substantially higher than the global average of 59%.[14] Major foreign companies have established factories in Viet Nam to take advantage of government's foreign direct investment-friendly policies and relatively low labor costs. The Viet Nam–European trade agreement, which entered into force in August 2020, is expected to further increase trade flows involving Viet Nam.[15] The banking sector in Viet Nam is developing, with improving governance standards such as implementation of Basel 2 standards, but issues with weak capitalization and high NPL rates remain.

14. The program currently works with 14 local partner banks in Viet Nam. During 2009–2020, it supported $14.7 billion in trade through 15,280 transactions in Viet Nam. Of these transactions, 10,987 supported SMEs, 4,809 involved DMC-to-DMC transactions, and 12,841 were intraregional transactions**.** This support spans a number of areas, including steel, agricultural commodities such as sugar and milk, and cotton and garment machines for the textile industry.

[14] World Bank. World Bank Database: Trade (% of GDP). (accessed 23 April 2021).
[15] European Commission. Trade Policy: Vietnam.