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FUTURE OF TRADE FINANCE OPERATIONS - A ROAD MAP FOR TRADE FINANCING OPERATIONS POST COVID-19

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International trade remains as a cornerstone for attaining as well as sustaining international development, economic growth and poverty eradication in the world. It empowers the growth of many economies. Along with trade, trade finance also has attained global attention. During post financial crisis of 2007-2008, the market has realized that inadequate trade finance facilities are equal to trade barriers. Report published by the World Bank (2021) show a contraction of 4.3% in the global economy in 2020 as a result of Covid-19 [1].

All economic activity was devastated globally due to lockdowns to curb virus transmission. As the global economy contracted, international trade experienced a corresponding decline. The 2020 ICC Global Survey on Trade Finance published initial predictions of a 20-30% decrease in trade flows in 2020 (ICC, 2020b). However, a more optimistic report published in October 2020 by the WTO has forecast a fall of only 9.2% in the volume of world merchandise trade in 2020 (WTO, 2020).

[1] https://www.worldbank.org/en/news/pressrelease/2021/01/05/global-economy-to-expand-by-4-percent-in-2021-vaccine-deployment-and investment-key-to-sustaining-the-recovery [Accessed: 3 October 2021]

The current article seeks to explore selected characteristics of trade finance instruments in the market today, with special reference to Bahrain, and also critically analyse the risks, challenges and opportunities in the trade finance market thereby provides a Road map for Trade financing operations Post COVID 19.

Importance of Cross-Border Trade and Trade Finance

Cross-border Trade has been recognized as an important engine for economic growth as it enhances a country's access to visible and invisible trade, technical know-how and thereby promotes commercial activity and creates jobs. Access to trade finance is crucial for every country. According to the World Trade Organization (WTO), trade finance supports nearly 90% of global trade [2], making it vital to economic prosperity. The importance of trade finance was clearly demonstrated during post global economic crisis, when trade finance became scarce and expensive, the value of the world merchandise trade declined leading to a striking drop of 40% of trade flows from Asia to Europe and the Americas and 90% drop in the cost of ocean transport. Trade and trade finance are integral part of the industrial development of any country.

What is Trade Finance?

Trade finance is a specialized area of finance that enables a trading activity to take place. It may be made directly to the supplier, to facilitate procurement of items for immediate sale and/or for storage for future activities. It could be provided to the buyer also, to enable him meet contract obligations. Due to the inherent complex dynamics involved in international trade, trade finance is imperative for both importers and exporters. Trade finance fundamentally involves four aspects: facilitation of payment, provision of financing, effective risk mitigation and provision of information.

Trade finance products can be classified under 2 headings, traditional/simple products and Supply Chain Financing - structured products. Traditional products are letters of credit (L/Cs), import financing, guarantees, L/C confirmation, pre-shipment export financing, invoice financing and documentary collections. The past few years has seen a shift towards structured finance with a simultaneous fall in the traditional trade finance [3].

The Importance of Trade Finance for Bahrain Based Banks

In Bahrain both the conventional and Islamic banks play a crucial role in trade financing. The major banks who are active in trade financing (Import and Export LC - Issuing, Advising and Confirming) are Bank of Bahrain and Kuwait (BBK), National bank of Bahrain (NBB), Ahli United Bank (AUB), Arab Banking Corporation (ABC), HSBC Middle East, Standard Chartered Bank (SCB), BNP Paribus, in the conventional side and Bahrain Islamic Bank, Kuwait Finance House, Khaleeji Commercial, AlBaraka and Al Salam in the Islamic banking front. Due to the size of the market, there is tough completion among the bankers to gain the market share. As a result, many of them do not resort to price competition. This is evidenced by lack of variation in the charges and fees for issuance, advising, confirmation and negotiation by the major banks [4]. To gain the market share, most of them have resort to non-price competition like differentiated products, provisions of ancillary services, and there by achieving their targets.

[2] 2020 Global risks trade finance report by International Chamber of Commerce.
[3] ICC survey, as reported in 2020
[4] Based on the formal and informal discussion with the trade finance staffs of various banks in Bahrain

Majority of the government sector entities prefer to bank with NBB, the private and semi-governmental organizations deal with conventional/Islamic banks in the region. Many of the banks are targeting at SME trade financing and are ventured into structured and supply chain financing also which were earlier handled by the multinational banks. In the global market Bahrain has recorded an increase of 22% of the imports with a yearly volume higher than 10,000 trade messages MT 700 sent [5]. This clearly evidences the growing market for import trade financing in the Island.

Impact of COVID 19 on Trade Finance Products

COVID-19 has exposed the shortcomings of paper-based trading/banking operations. Financial institutions (FIs), including central banks, universal banks, regional banks, fintech all are at the front-line of the economic disruption brought out by the pandemic. Banks have adopted 'rapid response' and 'quasi-digital solutions' to keep the trade flowing when physical transactions become untenable. The lessons learnt during these unprecedented times will positively change how transaction banking especially trade finance is originated, transacted and settled. Trade finance operations predominantly relies on hard-copy documentation to process payments and transfer ownership rights as electronic trade documentation are either prohibited or their legal status is uncertain in many jurisdictions including Bahrain. This crisis has exposed the vulnerability of the bank-intermediated trade financing where multiple parties are involved – from shipping companies, insurance companies to government agencies – and where the paper is still legally accepted document, with submission, verification, resubmission being the norm. Unfortunately, the electronic equivalents in the place of paper processes still not accorded legal effects, hence many banks have responded with pragmatism by using electronic equivalents carrying a significant legal risk and operational disruption. The pandemic exacerbates challenges to the vital aspects of the trade financing operations like:

- Document preparation, authentication and transmission
- Legality of negotiable instruments
- Authorized signatures
- Original documents for ownership transfers

It is true that the FIs within two to three months from the onset of the COVID 19 crisis, quickly adapted to the digitization thereby enabled clients to keep operation running despite working remotely. Banks have comprehended that post-COIVD -19 the only way to ensure resilience will be through digitization. Clients are anticipating proactive actions and resiliency plans from banks and these behavioural changes of the customers will tend to stay post-COVID also.

What are the anticipated changes on the horizon?

- Enhanced use of electronic trade documents – removing the need for hardcopy documents through the adaption of the MODEL LAW OF ELECTRONIC TRANSFERABLE RECORDS (MLETR) promoted by UNCITRAL which would enable banks and governments to accept electronic signature and records as much as physical ones.

- The rollout of digital solutions. There will be rapid adoption of blockchain, the digitization of documentation and automated processing and handling of software platforms.

[5] ICC survey, as reported in 2020

- Applications of the Internet of things (IoT) to create new means of inventory-based financing, Artificial intelligence (AI) in tracing and following up the logistics and shipping and cloud-based computing to transfer cash management and payments electronically.

- Use of cognitive OCR (optical character recognition) to automate document checking.

- Deploying Distributed Ledger Technologies (DLT) in trade finance business.

- The development of "Documentary Trade Credit" a trade finance substitute for a commercial bank documentary letter of credit is another change happened in 2020. A DTC is issued and negotiated under the same UCP guidelines as a documentary letter of credit; except the funds supporting the instrument are available with a third-party international escrow company instead of a commercial bank.

- In addition to the existing rules viz., UCP 600, URDG 758, ISBP 745, Bankers will have to adhere to the newly developed rules governing digital trade documents.

- Another anticipated change in Trade finance is Banks globally are channeling capital flows to sustainable business and projects. There is growing demand both from governments and Clients towards innovative trade finance mechanisms to facilitate implementation of sustainable strategies and operations. The belief is that the focus on Sustainability in trade finance will reduce inequalities in income distribution as micro-, small, and medium-
- sized enterprises from the least developed countries will get access to international trading system.

- The ICC has developed a set of sustainable trade criteria for their members to use in Customer Due Diligence (CDD) processes. These guidelines help banks to identify "ESG risks associated with commodities or other goods and services produced by a bank customer or within its supply chain, and available mitigants".

A Cautionary Note

The rapid deployment of aforementioned digital solutions exposes banks to new risks like:

- Anti-money laundering/Know your customer (KYC) risks as data breaches may happen due to work from home and also through Business email compromise (BEC)
- Cybersecurity risks
- Sanctions issues –due to disruptions cargo being not shipped on the intended vessel or passing through alternative port which is sanctioned.

The radical change that has been brought to the behaviour of Banks and customers due to COVID has been the rush to digital. The challenge due to digitization is to use technology enhancements to create a more flexible cost base that banks can variablise and facilitate rapid development when the competition heats up. To stay in business in the competitive environment post-COVID, Banks need effective government intervention and support which will help them to fully mitigate the potential implications of COVID-19 challenges and enhance the smooth flow of global trade. It won't be an easy ride ahead, but banks may be able to wither this storm away through operational resilience and business continuity planning.

QUARTERLY NEWS UPDATE

Local News

BAHRAIN ANNOUNCED ITS INTENTION TO DRILL 900 OIL WELLS OVER THE NEXT FIVE YEARS

Bahrain announced its intention to drill 900 oil wells over the next five years, according to an official report issued by Tatweer Petroleum, the oil arm of Bahraini government investments.

Bahrain produced, according to official statistics from the National Oil and Gas Authority, 71.1 million barrels in 2020, and it exported 84 million barrels of oil derivatives from which Saudi Aramco produced more than 350,000 barrels for Bahrain.

BAHRAIN HAS TOPPED THE GCC RANKINGS IN THE LATEST ANNUAL ECONOMIC FREEDOM OF THE WORLD INDEX

Bahrain has topped the GCC rankings in the latest annual Economic Freedom of the World index compiled by the Fraser Institute.

As per the list prepared on the basis of 2019 data, the kingdom ranks higher taking the 65th place ahead of the UAE (67th), Qatar (80th), Saudi Arabia (91st), Kuwait (98) and Oman (102nd).

Globally, Hong Kong and Singapore, as usual, occupy the top two positions in the Economic Freedom of the World: 2021 index.

Regional News

ECONOMIES OF THE GCC COUNTRIES ARE EXPECTED TO RETURN TO AN AGGREGATE GROWTH OF 2.2%

Economies of the Gulf Cooperation Council (GCC) will likely grow at an aggregate 2.2% this year after a 4.8% contraction last year caused by the pandemic and lower oil prices, the World Bank said.

It remains vital for GCC countries - which include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates - to diversify their economies, the World Bank said, as oil revenues account for over 70% of total government revenues in most GCC countries.

THE NEW DEVELOPMENT BANK (NDB) HAS ADMITTED THE UNITED ARAB EMIRATES (UAE) AS ITS NEW MEMBER

The New Development Bank (NDB) set up by the BRICS group of nations said on Thursday it had admitted the United Arab Emirates, Uruguay and Bangladesh as members in its first expansion push.

Brazil, Russia, India, China and South Africa - a group of major emerging economies known as BRICS - launched the bank in 2015 and started formal talks with potential new members last year.

BAHRAIN ECONOMISTS SOCIETY

QUARTERLY NEWS UPDATE

International News

GLOBAL ISSUANCE OF GREEN, SOCIAL AND SUSTAINABILITY BONDS IS EXPECTED TO HIT $850 BILLION IN 2021

Global issuance of green, social and sustainability bonds – or sustainable bonds, collectively – is expected to hit $850 billion in 2021, a new annual record and a 59% jump from 2020, Moody's Investors Service said.

Global issuance of sustainable bonds in the second quarter jumped 66% from a year earlier to $189 billion. This consisted of $94 billion of green bonds, $46 billion of social bonds and a quarterly record $49 billion of sustainability bonds. The quarterly issuance total was the third-highest on record, indicating that market momentum is still exceptionally strong.

THE CHINESE YUAN IS ON COURSE TO BECOME A MUCH MORE INFLUENTIAL PART OF THE GLOBAL FINANCIAL SYSTEM

The Chinese yuan is on course to become a much more influential part of the global financial system with almost a third of central banks planning to add the currency to their reserve assets.

The Global Public Investor survey, published annually by the London-based OMFIF think tank, showed 30% of central banks plan to increase yuan holdings over the next 12-24 months, compared with just 10% last year.

BES RESEARCH SUMMARY: A BEHAVIORAL ECONOMICS APPROACH TO IMPROVING HEALTHY FOOD SELECTION AMONG FOOD PANTRY CLIENTS.

There are two main challenges that the hunger relief network faces, one is in supplying healthy food to clients and in making those foods appealing to clients. Donations, foods purchased at a discounted price, and items rescued from the food waste stream are all sources of food for the pantry, but without active efforts on the part of pantry personnel, a continuous supply of healthful foods may be difficult to come by. The nutritional quality of meals available in food pantries is not regularly checked, and there are no criteria for what is offered, although research has shown that there is significant opportunity for improvement. For example, an analysis of the Minnesota pantries that implemented the US Department of Agriculture's Healthy Eating Index-2010, which also aligns with the dietary standards of Americans, has discovered that the dietary component score for total dairy and whole grains of food pantry inventories, even the total fruits, were lower than half of the target scores. While on the demand side, clients have expressed a need for more healthful foods at the food pantry, such as dairy, fruits, meats, and vegetables; yet, they may reject what is supplied if it is unappealing. Clients have expressed concerns about food safety, a lack of product variety, and the short shelf-life of healthy perishables, which could be misinterpreted by food pantry personnel, who have problems moving perishable foods through the system in a timely manner.

These challenges are exogenous; clients cannot pick healthy meals without an appropriate and consistent supply, and pantries may not be encouraged to collect healthier donations or invest in infrastructure to support healthy food suppliers without evidence of client demand. The methods that were used to break down those challenges were as some behavioral economics tactics that encourage healthy foods while minimizing nutritious meals are ideally suited for application in pantry transformations. In the current short pilot study, properly following these measures resulted in significant improvements in the nutritional quality of items that clients took home.

The intervention's main goals are to
(i) provide consistent access to healthy foods and satisfy particular stocking criteria; and

(ii) use behavioral economics tactics to boost the attraction of healthy foods.

Success in each of these areas is projected to generate a feedback loop between healthy food availability and food selection by allowing healthy perishables and other goods to move swiftly through the pantry, encouraging pantries to keep up their new healthy procurement efforts. The SuperShelf pilot evaluation study took place in four food pantries, as assessments were conducted before and after the intervention. At baseline (January–February 2017), seventy-one clients were enrolled at the two intervention pantries during their visit to the pantry, those assessments comprised a complete 'snapshot' inventory of all commodities on the shelf available to clients, a walkthrough assessment, and extensive photo documentation of the food shelf space to

The methods that were used to break down those challenges were as some behavioral economics tactics that encourage healthy foods while minimizing nutritious meals are ideally suited for application in pantry transformations.

measure fidelity (i.e., how well the intervention was implemented). HEI-2010 scores of pantry inventories (things on the shelf available to clients) were derived from inventories completed at a single time point before and after the intervention in both of them as well as both of the control pantries.

Researchers instructed pantries to pack the shelf the same way they would at the start of a regular day when the pantry was open before each inventory. Before and after the intervention, each pantry's HEI-

2010 score was calculated. This intervention has the potential to result in measurable improvements in diet among a group that bears a disproportionate burden of diet-related chronic disease due to the fact that pantry clients receive a considerable amount of their total food from the pantry. The demographics and features of the survey are predominantly female (66.7%) and racially/ethnically varied (42.7%) (non-Hispanic Black, 338 percent non-Hispanic White, 74% Asian, 103% Hispanic, and 59% Other).

The average household had 37 individuals in it. The majority (77.9%) went to the food pantry once a month. More than half of the participants (55.4%) said the food pantry had provided half or more of their total food in the previous six months. More than a third (36.9%) of respondents said the food pantry provided half or more of their total produce in the previous six months.

The findings indicate that, if properly implemented, the SuperShelf intervention has the potential to increase the nutritional quality of items available to and chosen by clients at high risk of food insecurity. Both pantries increased the nutritional quality of the meals offered to

Seasonal influences are thus unlikely to account for the improvement in the intervention participants' score.

consumers following the intervention, improving their total HEI-2010 score by 8 points and 19 points. The total HEI-2010 score and the seasonal HEI-2010 sub-component scores both decreased slightly in the two control locations.

Seasonal influences are thus unlikely to account for the improvement in the intervention participants' score. Site A had a better level of implementation integrity than Site B. Client behavior changed differently depending on the location. Client HEI-2010 scores climbed by roughly 12 points on average at Site A, where faithfulness ratings were higher, whereas there was no change at Site B. At Site A, there was a significant change in client nutrition-related outcomes.

Even with a small sample size, a roughly 12-point improvement in the nutritional quality of items chosen by clients was highly statistically significant. Another intervention study among food pantry consumers in the same metropolitan area(23) found that after a 6-week cooking and nutrition education class, the total HEI-2010 score for overall diet increased by 76 points.

While the current study did not assess overall client diet in the same way as the cooking class study did, another noteworthy result was that the majority of clients received 50% or more of their total food from the food bank. Given that the intervention had a considerable influence on food selection and the items chosen at pantries made up a large amount of clients' total meals, the SuperShelf intervention is likely to increase the overall nutritional quality of food pantry clients' diets. This hypothesis has yet to be formalized.

Read more

RECAP ON KEY ECONOMIC INDICATORS

Local Indicators

Nominal GDP - Q2 2021
QoQ **6.4%**
YoY **20.7%**

Oil Sector - Q1 2021
QoQ **18.9%**
YoY **98.3%**

Non-Oil Sector - Q1 2021
QoQ **4.4%**
YoY **12.8%**

Inflation - May 2021
QoQ **+0.1%**
YoY **-2.6%**

Regional Indicators

Arab Economies Growth

2021 **2.8%**
2022 **3.6%**

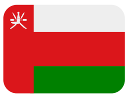
GCC Stock Market Performance - October 2021

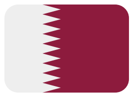
 -0.77%

 +0.12%

 -0.68%

 +0.51%

 +0.36%

 +0.39%

International Indicators

World Economic Growth

2021 **6.0%**
2022 **4.9%**

Advanced Economies' Growth **5.6%**

Emerging Economies' Growth **6.3%**

SOURCES

Bahrain Economic Quarterly Q2 2021, Ministry of Finance and National Economy

Consumer Price Index, Information and eGovernment Authority

World Economic Outlook, International Monetary Fund

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