WORLD MERCHANDISE TRADE

6.50 The economic slowdown in U.S. in 2007 following the subprime crisis in August 2007 which resulted in a fall in GDP growth from 2.8 per cent in 2006 to 2.0 per cent in 2007 and consequent fall in U.S. import growth had started affecting India's exports to the U.S. in 2007. However, this simmering crisis accelerated and turned into a full blown global recession with the dramatic escalation of the global financial crisis in September 2008 which resulted in an unprecedented contraction of world growth to 3.2 per cent and trade to 3.3 per cent with the growth and imports of advanced economies at 0.9 per cent and 0.4 per cent respectively. This situation worsened in 2009 with world output projected at -1.3 per cent and world trade volume at -11.0 per cent. The fall in growth and imports of advanced economies was worse with projections at -3.8 per cent and -12.1 per cent respectively. This has severely affected the growth and trade of all the countries. India was no exception though it has weathered the crisis more confidently than many other countries including the developed countries (Box 6.5).

6.51 While the IMF in April 2009 has projected a 11 per cent fall in world trade volume of goods and services, WTO has forecast in March 2009 a 9 per cent decline in global trade for 2009, the largest such decline in over 60 years. The World Bank has also projected in March 2009 a fall in both global GDP by 1.7 per cent and world trade in goods and services by 6.1 per cent in 2009. The collapse in world trade has been attributed to the unprecedented fall in global demand and shortages of trade finance causing supply side constraints to export growth (Box 6.6).

Box 6.5 : G-20

The leaders of G-20 met in London on April 2, 2009 at the backdrop of the worst economic and financial crisis, a crisis which has deepened further since the Washington Summit held on November 15, 2008.

To ensure early, amongst other things, India has strongly emphasized the need to continue with coordinated contra-cyclical policies within an overall framework of fiscal sustainability and restoration of the banking system in the industrialized countries to full functionality; to avoid protectionist sentiments in the trade of both goods and services emerging in the industrialized economies in the backdrop of global financial crisis; and to take concrete steps to ensure adequate credit flows, including trade finance, to developing countries for which it is imperative to raise resources of the international financial institutions (IMF, World Bank, ADB), and to bring forward the quota review in the IMF.

Further, India has stressed upon the need for longer term reform of the global financial architecture including increasing the representation of developing and emerging market economies; reform of the global financial system through stronger regulation and improved supervision, especially of systemically important financial institutions, through, among other things, developing an effective early warning system which can spot a build up of risks threatening global financial stability. India has also endorsed sharing information and bringing tax havens and non-cooperating jurisdictions under closer scrutiny.

The leaders of G-20 on April 2, 2009 resolved to restore confidence, growth and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform the international financial institutions; promote global trade and investment and reject protectionism; and build an inclusive and sustainable recovery.

As per the London communiqué the leaders have agreed to treble resources available to the IMF to US$ 750 billion, to support a new SDR allocation of US$ 250 billion, to support at least US$ 100 billion of additional lending by the multilateral development banks (MDBs), to ensure US$ 250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional US$ 1.1 trillion programme of support to restore credit, growth and jobs in the world economy.

The other major initiatives agreed upon are:

- For *Strengthening the Financial System* a new Financial Stability Board (FSB) with a strengthened mandate, as successor to the Financial Stability Forum (FSF), including all G-20 countries, FSF members, Spain, and the European Commission, which should collaborate with the IMF to provide early warning of macroeconomic and financial risks and actions needed to address them. Extend regulation and oversight to all systemically important financial institutions, instruments and markets, including systemically important hedge funds, for the first time.
- For *strengthening global financial institutions,* leaders committed to implement the package of IMF quota and voice reforms agreed in April 2008 and to complete the next review of quotas by January 2011. For World Bank also, similar reform should be completed on an accelerated time scale, to be agreed by the 2010 Spring Meetings.
- For *resisting protectionism and promoting global trade and investment,* members have committed to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports and will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries.
- For *ensuring a fair and sustainable recovery* all leaders reaffirm their commitment to meet the Millennium Development Goals and achieving respective ODA pledges, including commitments on Aid for Trade, debt relief and the Gleneagles commitments, especially to sub-Saharan Africa.

Box 6.6 : Trade Finance : International developments and impact on India

Trade financing has been used in more than 90 per cent of trade transactions (mostly short-term credit) in the world. The global financial crisis, which has resulted in slowdown in economic growth, has also impaired the access to trade finance. Developing and emerging economies are most vulnerable to the shortages in trade finance.

During the period of economic boom, trade (particularly when it takes place between associated companies in developed countries) was not financed by banks through letters of credit, but by general credit extended by the companies, usually secured on other types of collateral. This type of credit has been badly affected by the financial crisis, due to the general pessimism about the prospects of the companies, and the prices of their assets. International banks, which used to extend credit to local banks (by way of letters of credit confirmations, bill of exchange endorsements or interbank loans, swaps, hedges and other treasury activities, which enable the local banks to offer trade finance denominated in foreign currencies), started adopting a cautious approach, in the wake of financial market turmoil, and reduced the "bank limits" or "country limits." As a result, the cost of trade finance in developing countries went up by 3 to 4 per cent.

Exporters in general started seeking confirmed letters of credit, where they had exported on the basis of open account or cash against delivery (CAD). The banks' perception of risk was leading to tightening of liquidity, and therefore greater difficulty in getting confirmed letters of credit. According to Bankers' Association for Finance and Trade (BAFT), USA, in addition to cost escalation due to financial turmoil and low level of risk appetite, increased capital costs under Basel-II, is also expected to increase the cost of trade finance for developing country exporters. There are also reports that even developed country buyers/banks, in the guise of intense scrutiny, were rejecting/delaying the processing of trade documents on the basis of minor discrepancies. In such a situation, the acceptability of letters of credit from least developed markets, as also from some of the developing markets, was scrutinized by the banks critically, restricting the wheels of trade finance.

Scarcity in trade finance was a result of pressures from both demand-side and supply-side. In the initial months of crisis, Indian credit market faced credit squeeze, which was led by net capital outflows, as international investors withdrew capital from India to compensate their losses incurred in exotic derivatives trading. This eventually affected the Indian firms as there was lending restraint shown by the banks. Further, there was contraction in trade credit extended by supplier firms, as also increase in demand for trade credit by the end-user firms, affecting the working capital liquidity of exporters. To combat the working capital liquidity, Indian companies turned to trade financing.

The shortage of availability of trade credit, following the financial crisis, could be viewed from the decline in short-term trade credit inflows into India, as reflected in India's overall balance of payment statistics. During the period April-December 2008, net capital inflows under the head "short-term trade credit" have shrunk to US$ 0.5 billion, as compared to US$ 10.7 billion received during the corresponding period of the previous year. Short-term trade credit to India witnessed a net outflow of US$ 3.1 billion in the third quarter of 2008-09 (as against inflows of US$ 4.1 billion during the same period of 2007-08), mainly due to lower disbursements reflecting tightness in the overseas market and increased repayments as roll over was difficult. Exporters were also reporting challenges of liquidity in foreign currency, and high cost of foreign currency, especially for pre-shipment credit, where they need to source raw materials to service an export order.

6.52 Fall in global output and demand led to fall in commodity prices and this along with the appreciation of the US dollar against a number of currencies accelerated the fall in world trade as the financial crisis intensified. As pointed out by the WTO, the drying up of global liquidity combined with a general reassessment of risks by commercial banks led in the second half of 2008 to a rise in the cost of trade finance instruments such as letters of credit, and in some cases, to serious gaps between demand and supply with spreads above LIBOR increasing by some 25 to 300 basis points per annum and in some cases as much as 600 basis points. Trade finance experts who met in WTO in March 2009 have pointed out to a market gap in developing countries that is imminent demand for trade financing of between US$ 100 billion and US$ 300 billion on an annual and roll-over basis (Box 6.7). All the above causes reinforced on each other in this highly globalized world which had seen a rising presence of global supply chains in total trade in recent years leading to a sharp decline in world trade towards the end of 2008 and into 2009.

6.53 According to the World Trade Organisation (WTO) statistics, world merchandise trade growth at 2.0 per cent in real (i.e. constant price) terms in 2008 was lower than the 6.0 per cent growth in 2007. The growth of merchandise trade in 2006 was the second highest since 2000 and well above the average annual growth of the last decade (1996-2006). Growth of world demand for exports decelerated from 8.5 per cent in 2006 to 6.0 per cent in 2007, and further to 2.0 per cent in 2008.

6.54 Country/region-wise in 2008, while export growth in real terms decelerated in the United States in European Union (27) it became zero. The fall in imports in major markets of India was more marked than in exports with the United States, European Union and Japan registering negative import growth in 2008. Import growth continued to be high in natural resource rich countries like CIS, Africa, Middle East,

Box 6.7 : Measures initiated to enhance trade finance

Various measures have been taken by the multilateral institutions to enhance trade financing. World Bank/International Finance Corporation (IFC) has announced tripling of the ceiling of the trade finance guarantees available under the IFC's Global Trade Finance Programme (GTFP), a trade facilitation measure introduced to support trade from developing countries, from US$ 1 billion to US$ 3 billion.

IFC is also developing a programme to provide funded support to major financial institutions with wide trade finance networks in emerging markets, and to increase engagement with export credit agencies. IFC has also proposed to create a Global Trade Liquidity Pool (GTLP), in association with multilateral/regional institutions that are active in trade finance, to fund trade transactions for up to 270 days, which is expected to be self-liquidating once the conditions of trade finance improve. The Asian Development Bank (ADB) has announced expansion of its Trade Finance Facilitation Programme (TFFP) from the existing US$ 150 million to US$ 1 billion. The African Development Bank (AfDB) intends to support trade finance through a US$ 1 billion trade finance initiative (TFI). The European Bank for Reconstruction and Development, which expects the demand for trade finance from the member countries, proposes to hike the budget for its trade facilitation programme, from the present • 800 million to • 1.5 billion for the year 2009, to boost trade with and within eastern Europe, Central Asia, Russia and Ukraine. The Inter-American Bank for Development (IADB) has also announced increased limit for its Trade Finance Facilitation Programme (TFFP) from US$ 400 million to US$ 1 billion. G-20 has announced a US$ 250 billion trade finance package to be available over a period of two years.

The core of this package is a pool of money in which international institutions and national governments contribute 40 per cent, and commercial banks, the remaining 60 per cent. Berne Union proposes to strengthen its network and various means of coordination among members, to share the experiences in tackling the previous financial crisis in Asia and Russia, and real-time knowledge exchange, to enhance export credit, credit insurance and reinsurance.

The national governments have been supporting trade finance activities, some of them through the respective export credit agencies or developmental institutions. For example, the United States through U.S.-Exim Bank is making additional resources available to increase access to affordable trade finance. U.S.-Exim Bank, has already announced a programme to provide US$ 4 billion in new short-term trade finance facilities and US$ 8 billion in medium- and long-term trade finance facilities to support export of U.S. goods to emerging markets. Other countries like China, Japan, South Korea have also been providing similar facilities

The national governments have also been extending guarantees stimulating the financing system in a crisis period. For example, U.S.-Exim Bank has announced US$ 2.9 billion insurance cover to help meet the growing demand to insure U.S. lenders' confirmation of letters of credit issued by 11 Korean financial institutions. The U.K. Government has announced plans to guarantee as much as £ 20 billion of bank loans to small and medium companies ensuring flow of credit. Other countries like Germany, France, Hong Kong, Japan have been providing similar guarantees.

Various measures have been taken by the RBI/Government of India to address the liquidity challenges faced by the exporters, as also to enhance the availability of trade finance which include interest subvention of 2 per cent as a temporary measure for the period December 1, 2008 to September 30, 2009 to many labour-oriented sectors, increase in the period of pre-shipment and post-shipment credit, extension of period of realization of export proceeds from six months to 12 months, raising the ceiling on export credit in foreign currency, enhancing the eligible limit of export credit refinance (ECR) facility, expanding the lendable resources available to EXIM Bank of India and extension of back-up guarantee to Export Credit Guarantee Corporation (ECGC).

Table 6.7 : Growth rate of major trading partners of India, 2008-09 (US$ terms)

	Exports			Imports		
	Apr-Aug 08	Sept-Dec 08	Jan-March 09	Apr-Aug 08	Sept-Dec 08	Jan-March 09
World	16.5	-3.7	..	18.1	-2.2	..
USA	19.8	-0.9	-22.3	14.9	-4.4	-29.9
Hong Kong	7.9	-0.1	-18.3	9.5	-1.5	-21.2
Singapore	16.9	-6.2	-40.2	23.5	0.5	-35.8
Japan	16.4	-5.1	-40.6	28.7	13.5	-29.0
China	23.0	8.6	-19.7	30.6	-1.6	-30.8
India	29.5	-3.6	-24.1	40.9	16.2	-25.3

Source : For U.S., China HK and Japan from World Trade Atlas, for India from DGCI&S and for world and Singapore from IFS, IMF.

besides India though it decelerated slightly.

6.55 Examination of the performance of exports and imports for world and some major trading partners of India in the three time periods of 2008-09, namely April-August 2008, September-December 2008 and January-March 2009 shows that the good growth in the first period started becoming negative in the second period and worsened to be highly negative for the third period (Table 6.7). Growth of world exports and imports in September-December 2008 was negative. In most of the important trading partners of India, export growth was negative in the fourth quarter of 2008. In China it turned negative only in the first quarter of 2009. Import growth also shows a lag effect with high negative growth in the first quarter of 2009 for the major trading partners of India. Month-wise export growth figures (Figure 6.2) show that negative growth set in for the world and some countries in October 2008 and in almost all cases was negative from November 2008 to March 2009. Imports growth in most cases started becoming negative in November 2008 and continued till March 2009.

6.56 The impact of global recession on India's trade sector in 2008-09 can be seen clearly by comparing the performance in April-August 2008-09 (pre-recession) and September-March 2008-09 (post-recession). Both exports and imports growth were very robust in the pre-recession period, but turned negative in the post-recession period (Table 6.8). In the post-recession period import growth of POL was negative and non-POL and non-POL + non-bullion import growths were very low. Growth of trade deficit also fell drastically.

Figure 6.2 : Month-wise growth of exports of India and some major trading partners of India

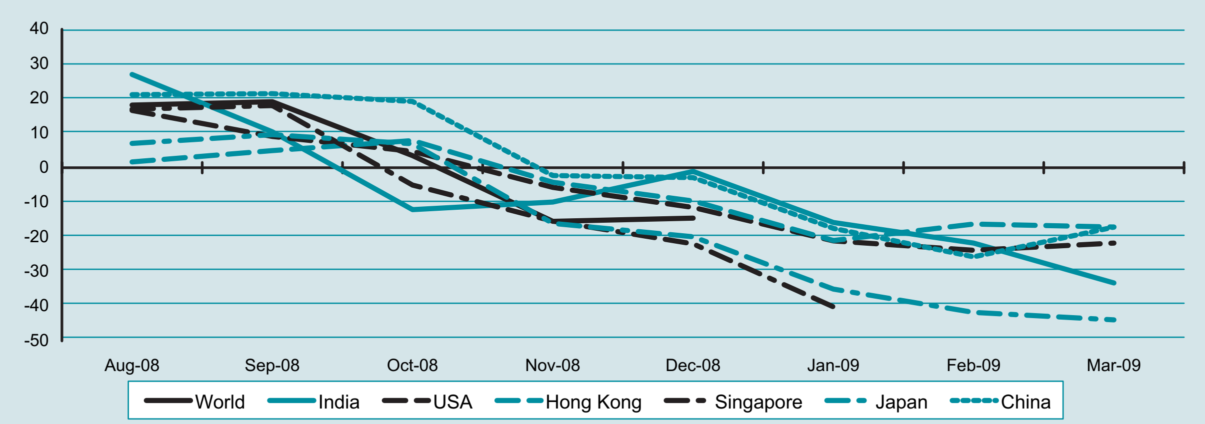

Table 6.8 : Growth rate of exports and imports (US$ terms)

	Exports	Imports POL	Imports Non-POL	Imports Gold & Silver	Non-POL + Gold & Silver	Imports Total	Trade Balance
2007-08							
April-Aug	20.8	18.4	43.6	131.7	33.0	34.4	68.4
Sept-Mar	35.3	56.1	38.5	-30.3	49.2	44.0	63.7
2008-09							
April-Aug	29.5	69.2	27.9	-13.7	36.7	40.9	61.2
Sept-Mar	-12.1	-12.8	4.0	3.2	2.9	-1.7	17.8

Source : Calculated on the basis of data from DGCI&S.