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Recent Export Credit Market Developments

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Abstract

Export credit agencies (ECAs) have played a critical role in financing for developing countries in recent years, and officially supported export credits have been growing in volume. The current export credit exposure to developing countries and economies in transition has reached almost half a trillion dollars. This paper reviews developments in export credit markets affecting exposure, new commitments, and cover policy for developing countries and economies in transition and discusses three key issues affecting export credit markets: a more widespread involvement of ECAs in project financing transactions, a strong presence of ECAs in the market for investment insurance, and a deepening of the forfeiting market.

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SUMMARY

This paper reviews developments in export credit markets, including exposure, new commitments, and cover policy for developing countries and economies in transition. It also discusses the more widespread involvement of export credit agencies (ECAs) in project financing transactions; a strong presence of ECAs in the market for investment insurance; and a deepening of the forfeiting market.

Total export credit exposure to developing countries and economies in transition increased to almost half a trillion dollars in 1995, while the share of exposure in the form of arrears and unrecovered claims increased to about one-third. ECAs' new commitments increased in 1995, although more slowly than in 1994; most went to relatively large middle and low-income countries and a small group of high-performing Asian economies.

The financial performance--measured by net cash flow--of most ECAs improved considerably in 1995. For the first time since 1981, premium income and recoveries have almost offset new claims payments and administrative costs.

The following three key issues have affected export credit markets in recent years:

An increased use of <u>project financing</u> has resulted from (1) stepped-up privatization and deregulation in developing countries, which has provided opportunities for agencies to finance project transactions without sovereign guarantees; and (2) an increased sharing of creditor risks by agencies and commercial banks.

Demand for <u>investment insurance</u> has strengthened in the context of growing external finance for developing countries from private sources and the privatization of a number of public enterprises. The supply of investment insurance by official bilateral and multilateral agencies has helped developing countries catalyze more private finance for projects.

A widening of the <u>forfeiting market</u> has improved the flexibility of terms and conditions for export operations although at the expense of making credit available to countries for which the ECAs themselves may originally have been reluctant to provide cover. This increase in liquidity may have been associated with increased overall riskiness in the export credit market.

This paper reviews recent developments in export credit markets including export credits exposure, new commitments and cover policy for developing countries and economies in transition and discusses three key issues affecting export credit markets: (i) the more widespread involvement of ECAs in project financing transactions; (ii) a strong presence of ECAs in the market for investment insurance; and, (iii) a deepening of the forfaiting market.

I. TOTAL EXPORT CREDITS [2]

A. Exposure

Total export credit exposure to developing countries and economies in transition increased by 12 percent to US$475 billion at the end of 1995 compared with an average growth rate of 10 percent during 1990–94 (Chart 1).[3] About two thirds of total exposure was due to outstanding export credit commitments—while unrecovered claims accounted for the other one third. Outstanding commitments—including soft loans [4]—increased by 6 percent as higher medium- and long-term commitments more than offset a decline in short-term commitments during the year. At the same time, exposure in the form of arrears and unrecovered claims increased by 28 percent reflecting in part, as far as unrecovered claims are concerned, debt restructurings in the context of the Paris Club.

During 1995, the exposure of export credit agencies remained heavily concentrated in ten middle- and low-income countries, which accounted for half total agencies' exposure at the end of 1995 (Chart 2): exposure was largest to Russia (12 percent of total exposure largely as a result of claims on the former Soviet Union); the next largest exposure was to China (9 percent) and Indonesia (about 6 percent), reflecting the strong export credit activity in these countries in recent years. Other countries with large ECA's exposure were Algeria, Brazil, and Poland where the share of total agencies' exposure remain in the range of 4–6 percent each.

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[2]This section updates the information provided in the earlier papers based on information from the International Union of Credit and Investment Insurers (the Berne Union), the OECD, and individual export credit agencies. For a description of developments in export credit markets in 1994, see "Official Financing for Developing Countries," World Economic and Financial Surveys, December 1995. For a detailed description of the role of export credit agencies in financing developing countries and economies in transition, and of the basic features of official support for export credits, see "Officially Supported Export Credits - Developments and Prospects," World Economic and Financial Surveys, March 1995; a glossary of terms used in export credits is contained in Appendix I.

[3]While the trends reported here are clear, specific figures need to be interpreted with caution. The problems that arise in discussing export credit statistics are discussed in detail in Appendix II of "Officially Supported Export Credits - Developments and Prospects," World Economic and Financial Surveys, March 1995.

[4]Concessional credits as defined by the OECD or the respective Berne Union member country. Consists of credits for which a premium has been paid and a claim could be paid.

B. New Commitments[5]

Total new export credit commitments to developing countries and economies in transition reported by agencies to the Berne Union increased by US$20 billion to about US$107 billion in 1995 reflecting mostly a broader country coverage.[6] Based on the 1994 country coverage, new commitments in 1995 showed a modest increase of about 1 percent compared with 1994.[7] This moderate growth in new commitments reflected, on the one hand, reinforced export promotion and strong demand for imports of capital goods by some developing countries. On the other hand, new export credit commitments declined to certain economies in transition in Eastern Europe and the former Soviet Union and to countries that are perceived as a relatively high risk.

New commitments in 1995 were concentrated in few countries with relatively large export activity and countries with a favorable risk assessment, despite agencies' already high exposure to these countries (Chart 4). Half of the new commitments was received by five countries in Asia: China and Indonesia received jointly almost 30 percent of all the new commitments in 1995, while the joint share of Hong Kong, Malaysia, Thailand was almost 20 percent.

By the end of 1995, export credits were about a third of the total external debt of the 20 largest countries in terms of export credit agencies' exposure (Chart 5). For several countries (Algeria, Iran, Nigeria) export credits have been their main source of foreign finance representing as much as 70 percent of their external debt. For other countries with a more diversified base of foreign financing such as Brazil, India, and Mexico, export credits represented only about 10–15 percent of their external debts.

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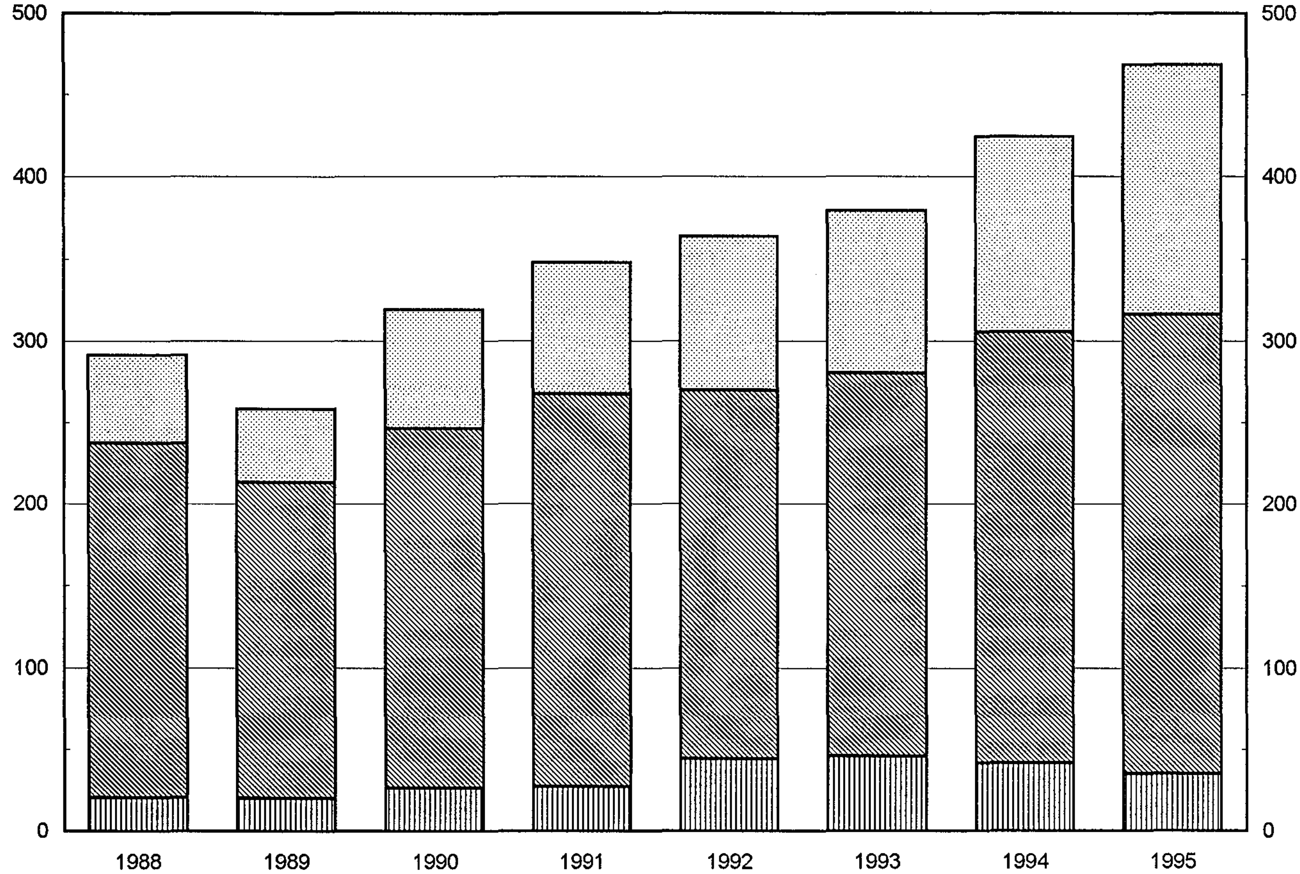
[5]In discussing export credit activity, a distinction needs to be made between **commitments** and **disbursements**. Berne Union data focuses on commitments, but the disbursements of insured credits arising from these commitments often occur months or years later. For this reason, it is not possible from the Berne Union figures to get a clear picture of net flows in any given year.

[6]The Berne Union expanded its debtor country coverage by 20 countries at the end of 1994, and this expansion of coverage was reflected in the figures for new commitments only in 1995.

[7]Berne Union members supported total exports—including intra-OECD commitments by export credit agencies—of about US$400 billion in 1995, an increase of 2.6 percent over the 1994 level. This is equivalent to about 13 percent of exports from the countries of Berne Union members.

Chart 1. Export Credit Exposure, 1988-95

(In billions of U.S. dollars)



Arrears and unrecovered claims 1/ Medium- and long-term commitments outstanding 3/

Short-term commitments outstanding 2/

Sources: Berne Union; and IMF staff estimates.

1/ **Arrears and Unrecovered Claims** - overdue payments by borrowers, classified as arrears if overdue payments have not yet resulted in claims on export credit agencies.
2/ **Commitments** - total amount of loans by, or guaranteed or insured by, an export credit agency, either globally or to entities in a specific country, excluding amounts that are in arrears or on which claims have been paid. Usually includes principal and contractual interest payable by the importing country on disbursed and undisbursed credits, and sometimes includes not only liabilities of the agency but also uninsured parts of the loan.
3/ **Short-term commitments** - commitments which provide repayment within a short period, usually six months. Some agencies define short-term credits as those with repayment terms of up to one or two years.

Note: The 1994 and 1995 figures reflect an enhanced debtor country coverage by the Berne Union of 19 countries with total exposure that amounted to \$9.2 billion in 1994 and \$35.4 billion in 1995. See Chart 5.

II. Financial Performance of Export Credit Agencies

The financial performance of most export credit agencies, as measured by net cash flow, improved during 1995 (Chart 6).[8] For the first time since 1981, premium income and recoveries have almost offset new claims payments and administrative costs so that the combined cash-flow deficit of export credit agencies in 1995 was US$0.5 billion, down from US$6.4 billion in 1994. Except one large agency and two smaller ones, all 39 agencies surveyed recorded improvements in their cash flow balances. New claims payments declined to about US$12 billion in 1995 after peaking at US$16 billion in 1994.[9] At the same time, recoveries increased by about 30 percent across agencies to US$8.4 billion while premium income rose 13 percent to US$3.7 billion.[10]

The improvement in agencies' financial position reflected three developments in export credit markets in recent years. First, a number of major debtor countries have experienced an improvement in their payments' position and several countries have exited from the Paris Club rescheduling process. Second, recoveries on rescheduled debts have become a significant source of income, particularly for large agencies. Third, many agencies have adjusted their premium schedules to reflect better the risk of transactions covered in recent years.

III. New Commitments and Cover Policy for Selected Countries

Export credit agencies reinforced their exposure to certain large middle- and low-income countries with a relatively large export activity and to countries where their risk assessment remained favorable (Charts 2 and 4). All agencies remained open for business, generally without restrictions, in **China and Indonesia**, the two largest low-income recipients

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[8]Accounting practices of agencies differ and only data on a net cash flow basis—not on an accrual basis—are available on a consistent basis from all export credit agencies (ECAs). Assessing the financial position of ECAs on an accrual basis requires, inter alia, estimating the expected recovery of claims and provisioning for possible eventual losses. An increasing number of agencies have been moving towards more sophisticated accounting systems but inter-agency comparisons remain extremely difficult given differences in accounting treatment between agencies.

[9]As discussed above, the accounting treatment of arrears and restructured debts differ among agencies. In particular, an insured claim restructured by refinancing will generally not be reflected in the cash flow of an agency whereas one rescheduled with a cash payment by the agency to the claimant, would be. For this reason, inter alia, the Berne Union data and cash-flow balances reported by the agencies should be interpreted with caution.

[10]In real terms the increase in premium income was 8.2 percent.

of new commitments—including tied-aid credits. New commitments to China increased by 5 percent to US$18 billion in 1995, and to Indonesia by almost 60 percent to about US$12 billion in 1995 reflecting strong import demand and these countries' strong external positions.

All agencies were open for cover without restrictions in **Hong Kong** and new commitments increased slightly to US$8 billion in 1995, mostly for medium- and long-term transactions. New commitments to **Malaysia** and **Thailand** were also quite large at US$9 billion and US$5 billion, respectively, reflecting their high growth rates and good payments record, notwithstanding recent market concerns about overheating and widening current account deficits in these countries.

In the **Philippines**, new commitments more than doubled to US$4.5 billion in 1995 reflecting strong activity and large capital inflows; most agencies were open for cover but some only with sovereign guarantees. Regarding **India**, agencies generally remained open for cover without restriction for short-term transactions and with limited restrictions on medium- and long-term transactions; new commitments declined slightly to US$3.6 billion.

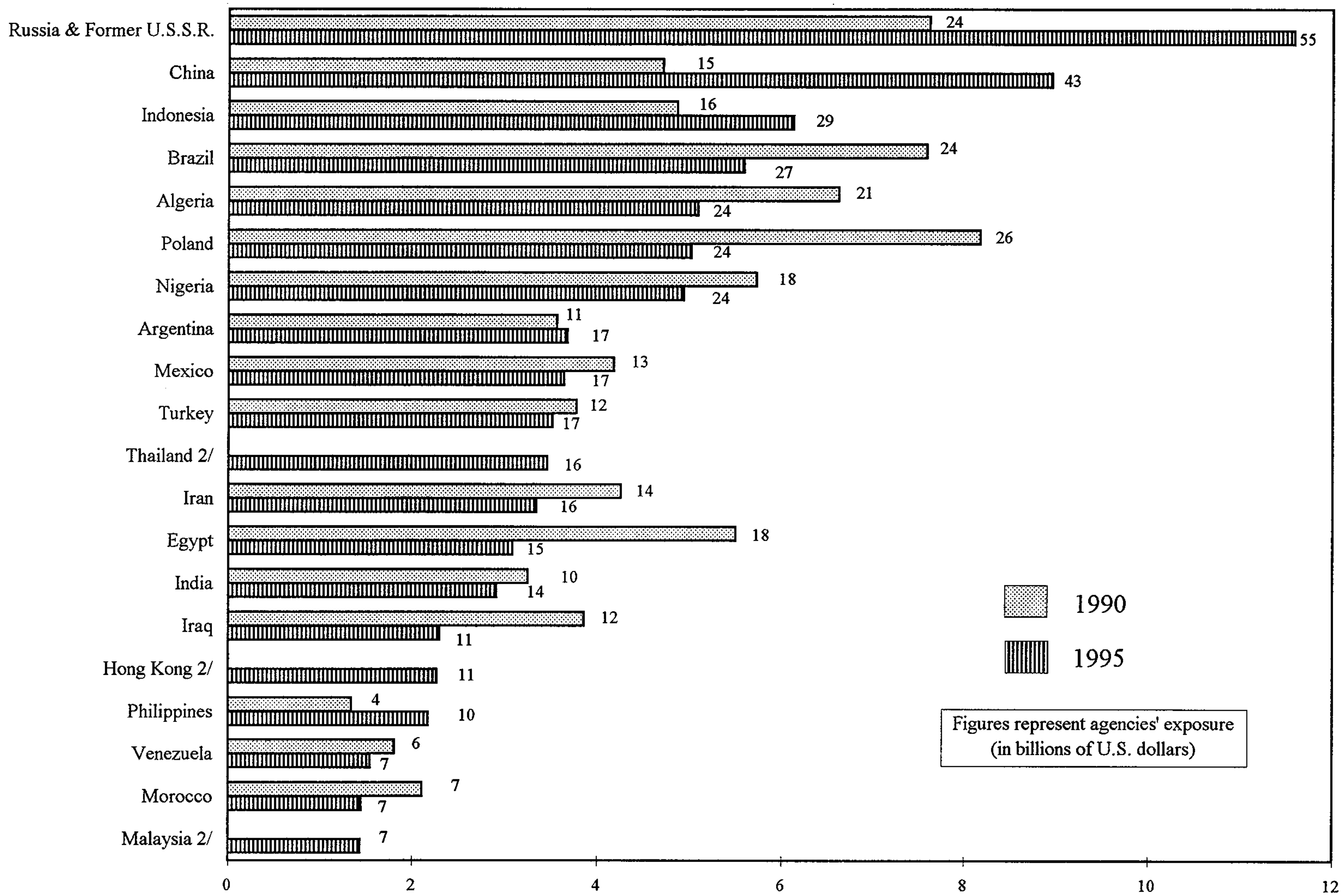
New commitments to **Mexico** increased by almost 40 percent to about US$5 billion in 1995, with most agencies open for cover without restrictions. Most agencies have reported a good record of payments. Concerns about Mexico's economic situation have been reduced by its strong adjustment program since early 1995. In **Brazil**, most agencies remained open for cover only subject to commercial bank guarantees and some agencies provided cover only for the private sector. New commitments increased by 30 percent to US$3.5 billion in 1995 due to strong demand, despite a mixed record of payments.

New commitments to **Turkey** rose by 9 percent in 1995 to almost US$4 billion and agencies generally remained open for cover with limited restrictions. Some agencies remain cautious about Turkey's economic prospects.

Most agencies were generally open for business in **Russia** with restrictions for short-term transactions. Some agencies remain off cover for medium- and long-term transactions and others open only with a sovereign guarantee and with limits on new business. Cover policy for the Baltics and the other countries of the **former Soviet Union** remained restrictive. Most agencies were on cover for the Baltic countries but subject to a sovereign guarantee; the volume of new commitments to these countries has been low. For the resource-rich Asian states of Kazakstan, Turkmenistan, and Uzbekistan, most agencies were open for business only with a sovereign guarantee. Only in Turkmenistan and Uzbekistan were new commitments relatively large—about US$500 million—while in Khazakstan agencies remained cautious. Most agencies were off cover for Ukraine and Belarus as the perceived risk of these countries remained high.

Chart 2. Twenty Main Recipients of Export Credits Among Developing Countries and Countries in Transition, 1990 and 1995

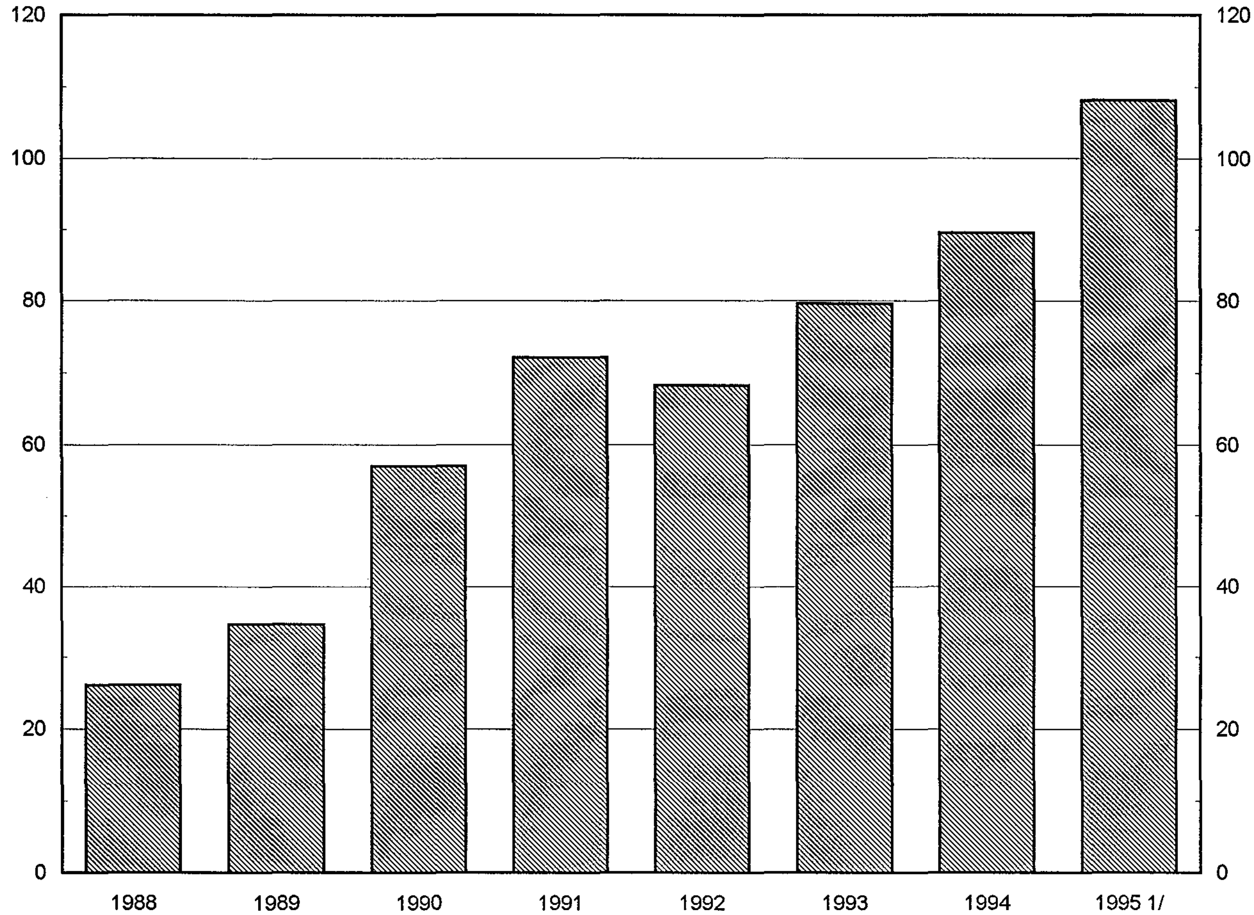
(Percent share in agencies' portfolio) 1/



Sources: Berne Union; and IMF staff estimates.

1/ Berne Union reporting agencies.
2/ 1990 data not available.

Chart 3. Officially Supported Export Credits: New Commitments, 1988-95
(In billions of U.S. dollars)



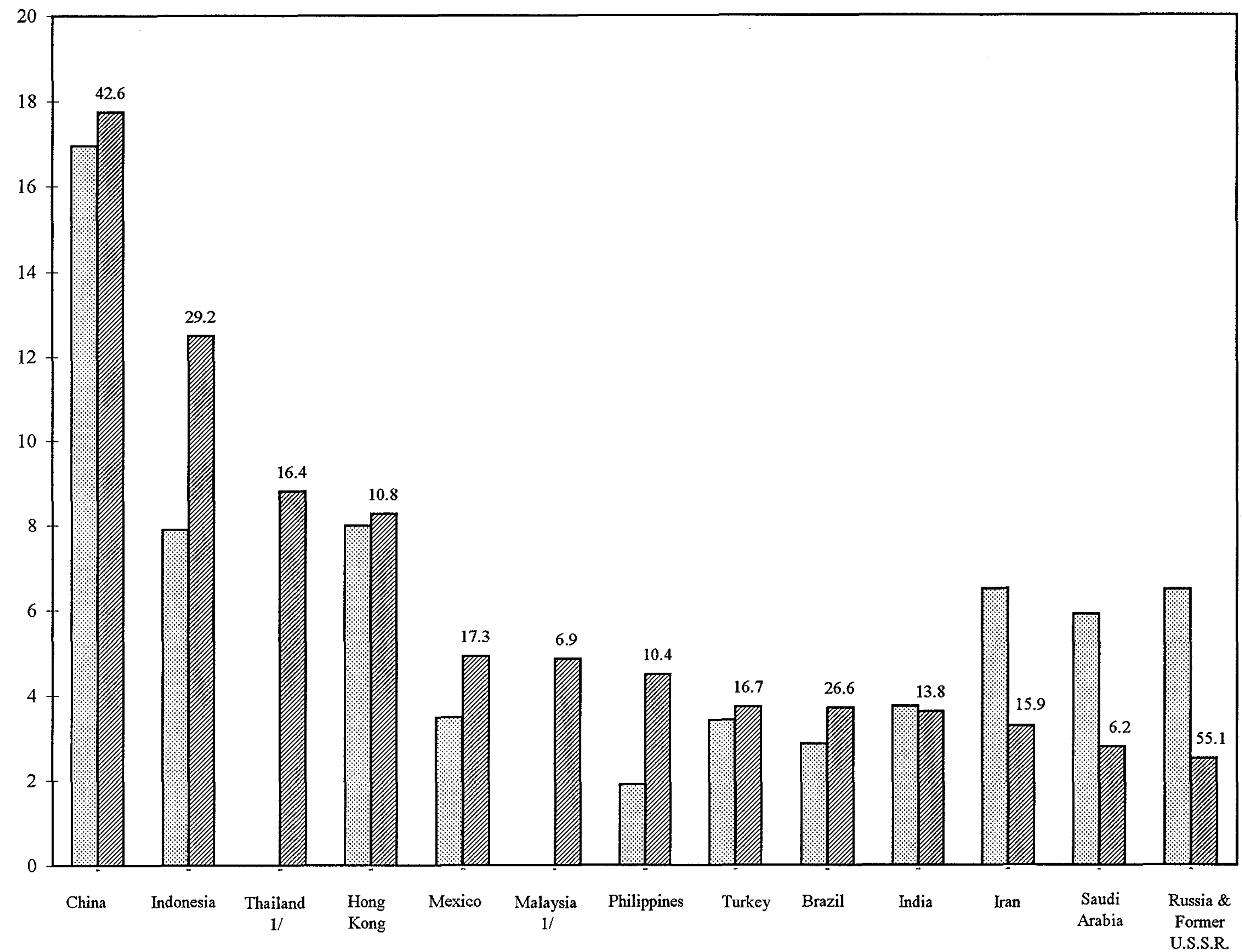
Sources: Berne Union; and IMF staff estimates.

1/ The 1995 figures reflect an increased number of countries (20) reporting to the Berne Union. New commitments to these countries in 1995 were as follows:

Countries:	(U.S. dollar millions)
Azerbaijan	8
Belarus	60
Costa Rica	74
Croatia	161
Estonia	18
Georgia	127
Greece	1,060
Jamaica	124
Kazakhstan	93
Kyrghyzstan	56
Latvia	12
Lebanon	808
Lithuania	111
Malaysia	4,860
Slovenia	106
Tajikistan	3
Thailand	8,801
Turkmenistan	537
Uzbekistan	461
Vietnam	869
Total:	18,350

Chart 4: New Export Credit Commitments in Selected Major Markets, 1994-1995

(In billions of U.S. dollars)



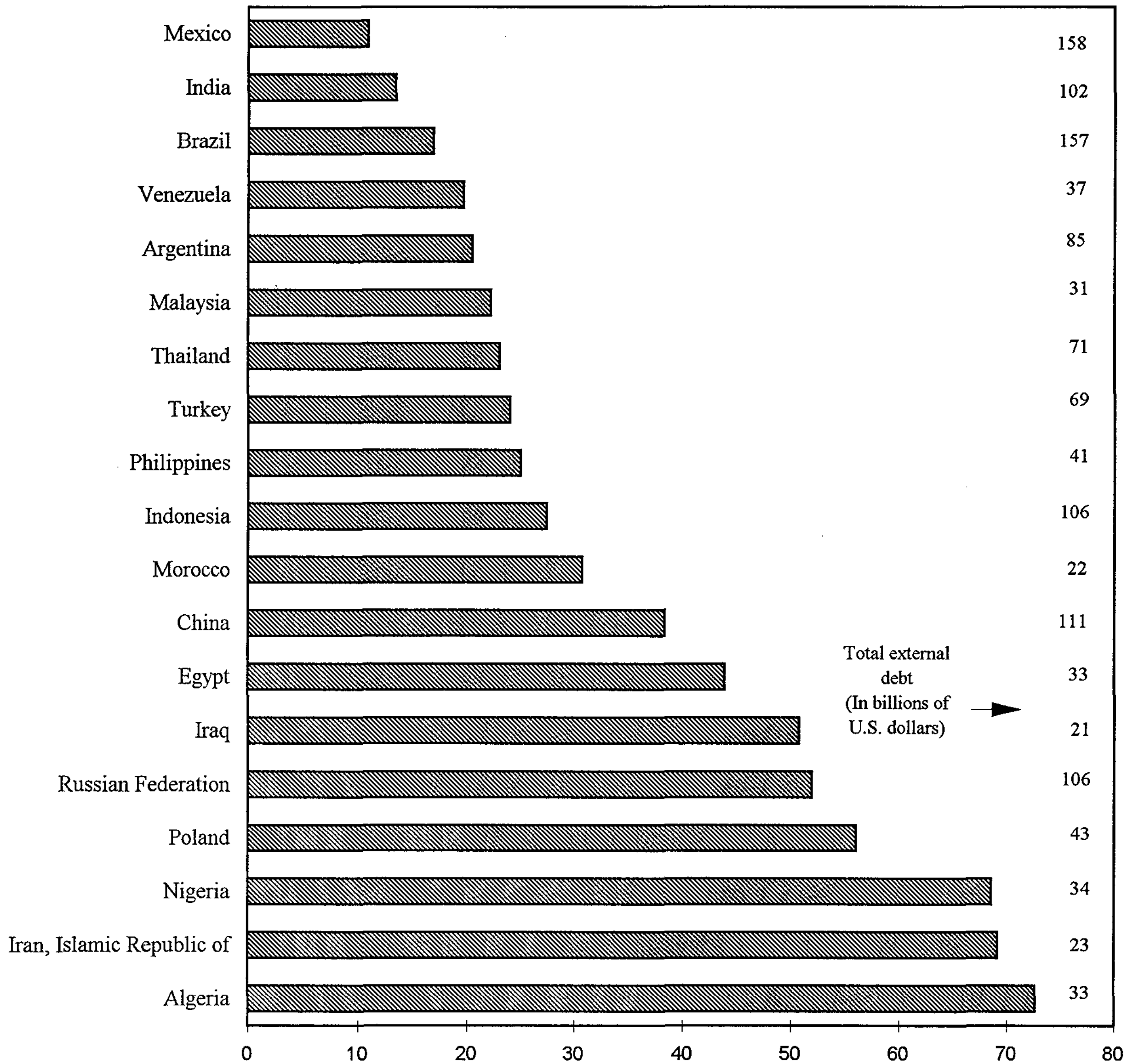
1994   1995   Figures reflect total export credit exposure (commitments, arrears and unrecovered claims) in 1995 (in U.S. dollar billions).

Sources: Berne Union; and IMF staff estimates.

1/ Data for 1994 are not available.

Chart 5. Main Recipients of Export Credits in 1995 Among Developing Countries and Countries in Transition;

(Percent Share of Export Credits in Total External Debt, 1995)



Sources: Berne Union; and IMF staff estimates.

Several countries experienced a substantial decline in new commitments as their external position, policy stance, and payments record deteriorated. New commitments to **Venezuela** declined by 50 percent in 1995 to US$670 million as a result of the deteriorating policy environment and the accumulation of payments arrears; most agencies were off cover during 1995 and agencies are expected to remain cautious on their cover policies, awaiting the authorities envisaged adjustment efforts. New commitments to **Algeria** declined by 40 percent to US$2 billion in 1995 due to concerns about political developments; agencies were generally off-cover for medium- and long-term transactions and open for cover only on a restrictive basis for short-term transactions. New commitments to **Iran** declined by about 50 percent in 1995 to US$3.2 billion after a spike in 1994; most agencies remained off cover. In **Saudi Arabia**, agencies were generally open for business for medium- and long-term transactions with the public sector; most agencies, however, required—and could not obtain—sovereign guarantees. New commitments declined by almost 50 percent to US$2.8 billion.

IV. MARKET DEVELOPMENTS AND INSTITUTIONAL CHANGES

The market for export credits has developed in recent years within the framework provided by the Arrangement on Guidelines for Officially Supported Export Credits (the OECD "Consensus").[11] Three developments in particular have affected this market and the market for investment insurance [12] for developing countries and economies in transition: the more widespread involvement of ECAs in project-financing transactions, a strong presence of ECAs in the market of investment insurance, and the deepening of the forfaiting market.

Project financing refers to any financing by export credit agencies or banks that relies primarily on the project's cash flow to repay external loan obligations rather than on the general creditworthiness of the borrower. Project financing transactions do not involve the

[11]The last comprehensive change to the Consensus took place in August 1994, when participants agreed to a package of measures—the "**Schaerer Package**"—designed to tighten and simplify the implementation of the earlier agreement. A detailed description of the operation of the OECD Consensus is contained in "Officially Supported Export Credits - Recent Developments and Prospects", World Economic and Financial Surveys, March 1995, Annex III. The package agreed in 1994 contained a number of measures, including restrictions on "grandfathering" of credits already in the pipeline when changes are made, the abolition of the subsidized SDR interest rate on export credits, and a tightening of the definition of concessionality in the calculation of tied-aid credits. The agreement also set in motion new work on areas not so far covered by the Consensus, including export credits for agricultural products and the setting of premia and related conditions.

[12]This market is not covered by the Consensus.

provision of sovereign guarantees, but may require additional security such as project completion guarantees, charges on the project's assets or the use of offshore escrow accounts.

The increased use of project financing has resulted, on the one hand, from stepped up privatization and deregulation in developing countries, which has provided opportunities for agencies to finance project transactions without sovereign guarantees; and, on the other hand, from an increased sharing of creditor risks by agencies and commercial banks. However, some agencies have experienced that the current guidelines under the OECD Consensus may constrain the provision of financing for viable projects to the extent that the underwriting of a project requires financing terms to be adjusted to the particular cash flow of the project.[13] This is a particularly sensitive issue for ECAs since private sector banks enjoy greater flexibility in their project financing operations as they are not subject to any Consensus rules, and is under discussion in the OECD's Export Credit Group.

Agencies have reported that the demand for **investment insurance** in recent years remained strong in the range of US$8–9 billion in the context of growing external finance for developing countries from private sources and the transfer of a number of public enterprises to the private sector through privatization programs in these countries.[14] Export credit agencies have traditionally supplied insurance against political risks other than traditional transfer risks, including host government actions that might interfere with the performance of private sector

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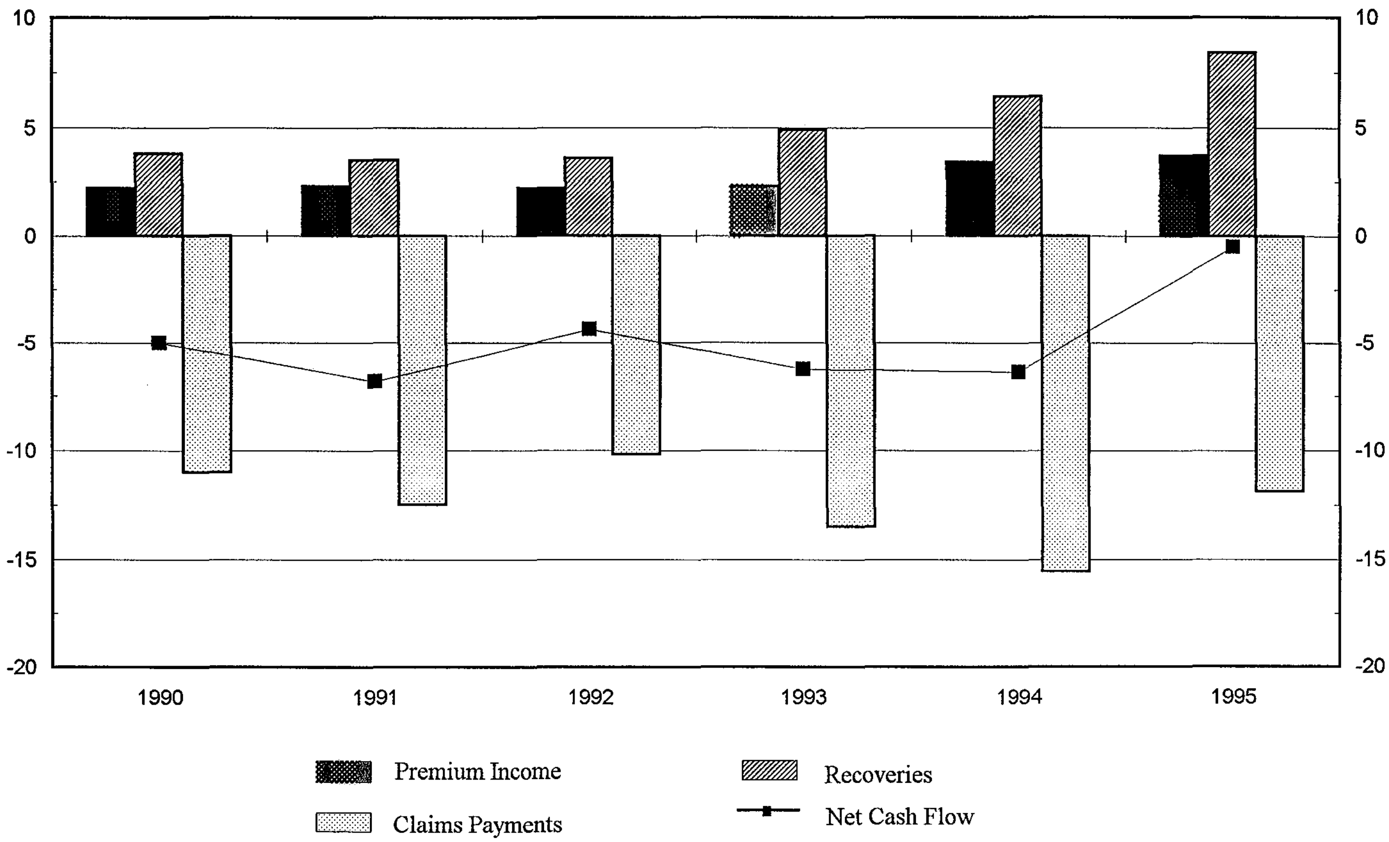
[13] The main requirements under the current OECD Consensus are:

- **maximum repayment period** of 5 years for Category I Countries and 10 years for Category II Countries;
- **repayment pattern**: principal of an export credit shall normally be repaid in equal and regular installments not less frequently than every six months commencing not later than six months after the starting point of credit; and interest, (not to be capitalized during the repayment period) shall be payable not less frequently than every six months commencing not later than six months after the starting point of credit;
- **Minimum cash payment** equal to 15 percent of the export contract value; and **maximum local cost support** equal to the value of the cash payment;
- **Minimum interest rates** equal to the currency specific commercial interest reference rates (CIRRs).

[14] Berne Union members reported a demand for investment insurance cover of US$9 billion in 1994 and US$8.3 billion in 1995.

Chart 6. Export Credit Agencies: Premium Income, Recoveries, Claims and Net Cash Flow, 1990-95 1/

(In billions of U.S. dollars)



Sources: Berne Union; and IMF staff estimates.

1/ The figures for 1993 through 1995 are for all Berne Union members. The figures for earlier years cover most, but not all, Berne Union members.

projects.[15] The uncertainties in developing countries about the future of the political, legal, and regulatory regimes governing foreign direct investment more generally, and project finance in particular, are often intractable from the point of view of prospective foreign investors. The supply of investment insurance by official bilateral and multilateral agencies has helped developing countries catalyze more private finance for projects in recent years.

As a complement to the more traditional role of export credit agencies, the **forfaiting market** has become an additional source of export finance for some developing countries. Forfaiting generally involves the purchase with a discount of trade finance paper (bills of exchange, promissory notes, or other freely negotiable instruments) where the forfaiteur assumes all risk from the exporter on the buyer, the buyer's bank and the buyer's country.[16]

The forfaiting market has helped improve the flexibility of terms and conditions for export operations although at the expense of making credit available to countries for which the ECAs themselves may have been originally reluctant to provide cover. The forfaiting market has increased the availability of credit when export credit agencies reach their credit limit for a particular market, thus providing additional liquidity. It has also provided market participants, including ECAs, a market-based risk assessment of individual countries as reflected in the discount rates implicit in forfaiting transactions. However, the forfaiting market provides a broader and less strict cover encompassing a broad range of countries, including those for which ECAs do not offer coverage or where insurance is too expensive. The increase in liquidity the forfaiting provides is therefore associated with increased overall riskiness in the export credits market.

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[15]There are broadly four categories of investment insurance risk which have been traditionally covered by bilateral and multilateral agencies: currency transfer, expropriation, war and civil disturbance, and breach of contract. Less traditional coverage for investment insurance risk provided by agencies include cover for cancellation of export or import licenses, nonpayment by a public buyer, or changes in regulations that may undermine a project. Cover is also provided by a few agencies for unexpected exchange rate losses.

[16]Forfaiting eliminates the risk of non-payment to an exporter in much the same way as traditional insurance through official export credit agencies or private insurance companies do. By providing cash flow, forfaiting suits the exporters that wish to reduce risks of export operations and do not want to carry the funding for their operations or do not want to maintain export receivables on their books.