Supporting trade in a disruptive environment

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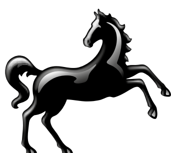

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The global economic landscape is perhaps more unpredictable and uncertain than it has been in many years. Lloyds Bank has gathered the views of three experts to reflect on some of the key drivers behind this uncertainty.

What is happening to global trade, what is the outlook and what implications do you foresee?

Jeavon: Well, it's hard not to get a little downbeat about the near-term prospects for international trade. Continuing US-China trade tensions, uncertainty over the UK's future trading relationship with the EU and the greater use of economic sanctions elsewhere, has led to increased anxiety about the future of international trade. The new trade barriers and elevated uncertainty in particular have already had a marked impact on investment and the purchases of durable goods, leading to a sharp slowdown in global trade growth.

Looking ahead, the major risk is that protectionism becomes the norm and broadens out, which would potentially be very damaging for the world economy. Conventional economic wisdom which says barriers, tariff and non-tariff, are bad for trade, is currently being proven true. However, globalisation also clearly brings domestic challenges alongside the opportunities and potential benefits.

That said, the current headwinds facing the global economy could also fade quite quickly, helping to bolster broader optimism. Several major central banks like the US Federal Reserve have already eased monetary policy to offset downward pressures on the global economy and there is growing talk of potentially supportive fiscal policy measures. In the meantime, some of the current trade tensions could ease significantly if political cooperation improves.

The uncertainty around all of this and the actions of central banks have, however, moved foreign exchange markets significantly and made the management of foreign exchange risk far more of a challenge.

What impact has the fall in the sterling exchange rate had and what's next for the currency?

Jeavon: The currency's sharp decline immediately after the result of the EU Referendum in 2016 was an advantage for UK exporters by improving relative demand and boosting profitability, but the depreciation has also been a major challenge for importers and households.

Looking at the wider economy, the potential benefits of the sharp depreciation for exporters and overall UK trade have been constrained by the enduring uncertainty around the UK's future trading relationship with the EU. The weaker global growth outlook has also not helped. UK business investment has struggled, including expenditure by exporters to boost capacity and take advantage of any relative price benefits. Whilst there was a sharp pick up in the final quarter of 2016, and some noticeable strength in 2017, the impact of weaker sterling has not delivered a sustained benefit for export volumes. Instead, it appears that exporters have

taken advantage of a weaker exchange rate by keeping foreign currency prices unchanged, therefore boosting their profit margins.

The sterling broad trade weighted index is close to record lows, as foreign exchange market participants increasingly envisage a 'no deal, no transition' scenario on October 31st. Trying to predict what sterling will do next is difficult given that politics, rather than fundamentals, seem to be driving valuations. Nevertheless, when the dust around Brexit does settle, there are reasons to argue that sterling should rise from current levels.

For one, even in the event of 'no deal', which is still not the UK government's preferred position, the 16.4% depreciation in sterling versus the euro since the referendum, seems to more than compensate for the direct tariff effects of the UK falling back on WTO schedules. Current estimates show that the weighted average tariff impact of WTO schedules on UK exports to the EU would be 5.7% and 4.1% for EU exports to the UK. In other words, the foreign exchange market may be pricing a far too pessimistic view on the UK. However, it is worth noting than non-tariff barriers might add to future trade costs, or even stop some trade altogether.

Furthermore, the relative strength of the UK's balance sheet in terms of net foreign assets and largely sterling denominated claims, means that the longer-term exchange rate should be insulated from any balance of payments issues should serious external stresses arise. As such, exchange rate risks could easily become opportunities for UK businesses, but require some deeper thought in terms of strategy.

What impact is increasing geopolitical and economic risk having on UK trade?

Llewellyn: Jeavon mentioned that foreign exchange is one area where we are seeing a lot of movement and the fall in sterling at the end of 2016 increased competitiveness for UK exports. We've definitely seen an uplift in exports over the last three years.

In the latest Lloyds Bank UK International Trade Index, we analysed HRMC's regional trade data which showed a 25% growth in annualised quarterly exports since the beginning of 2016, worth just over £68 billion.

Oil and petroleum are responsible for some of the big flows through the UK over this period but a number of other sectors like clothing, food & drink and general manufacturing have also experienced a boom in exports.

More recently our Trade Index report shows that this growth in exports has slowed, with the first quarterly drop in manufacturing export orders in three years recorded in the second quarter of 2019. This was partly due to the slowing of stockpiling in Europe, which we had seen at the beginning of 2019 but also reflects the general international trade climate.

In Q2 2019 global international trade volumes, measured by IHS Markit, have fallen at the fastest pace since the end of 2012, with two thirds of the countries surveyed by IHS Markit reporting a fall in exports.

In spite of this climate however UK companies are very aware of the need for growth from exports with larger companies particularly focused on new markets. Nearly 85% of those surveyed reported they were exporting, the highest proportion in nearly four years.

Our own Business in Britain Manufacturing report from Q2 2019 showed the optimism of UK firms with nearly 80% expecting revenue to grow over the next five years and nearly one in five focused on expanding into new markets.

That's a theme we are seeing in all of our trade data and conversations with clients – the fact that trade flows are changing, companies are seeing the need to diversify markets and supply chains. Interestingly 8 out of 10 key UK trading partners posted economic growth in the second quarter of this year showing the opportunity for the year ahead.

An important part of our focus is therefore to anticipate the shifting trends across the main UK trade corridors globally and to make sure we are able to offer trade finance solutions to our clients into the key markets for them.

Chris Spedding,
Managing Director,
Head of FI Trade,
Global Transaction Banking,
Lloyds Bank

Is this increasing risk affecting UK firms ability to trade and how are they managing it?

Llewellyn: One area we are focused on as a bank is working capital. Working capital is the lifeblood of any business and the cash flow impacts of working capital changes can affect a company's ability to grow and take advantage of new trading opportunities.

Over the last few years we have seen an historic build-up of working capital for UK companies with our latest UK Working Capital Index showing an average increase in cash conversion cycle for larger firms of six days.

Nearly a third of all UK manufacturers said their biggest challenge in managing working capital in the coming year was inventory. This is a direct result of increasing risk. The clear driver of the increase in working capital for UK firms is the historic build-up of inventory. Our Working Capital Index for purchases and finished goods hit an historic high of 131.3 in March 2019 (any reading above 100 indicates increasing growth).

As part of our Working Capital Index we analyse the balance sheets of over 9000 UK firms and total inventory for these firms jumped nearly £35bn (£34.9bn) or 29.2% in the last 3 years. In 2016 the rate of growth was 12.6% but this has successively slowed to 5.6% in 2018.

This shows a real challenge for UK firms in managing inventory efficiently. As uncertainty grows companies hold more buffer stock and that has a financial consequence. Over the last 3 years 62.1% of all UK firms analysed have worsened their Days Inventory Outstanding (a measure of how quickly inventory is sold).

This pressure on inventory means many UK firms are focused on improving working capital, particularly payments and collections. Our Business Barometer survey from August 2019 showed that 65% of the companies surveyed were taking proactive steps to collect overdue invoices primarily by contact through email or telephone. We are seeing this focus in conversations on working capital financing too, and is the reason we are investing in digital tools to help our clients understand and manage their working capital.

Given that uncertain backdrop, what is Lloyds Bank doing to adjust its support for companies looking to trade?

Chris: The more uncertain and volatile the economic backdrop, the more important it is that banks are able to meet their obligations to their clients well beyond the provision of cost efficient capital and a safe haven for their liquidity; our job must be to help companies who are trading internationally to manage risks as effectively as possible.

At Lloyds Bank, we are continuing to deepen and broaden our relationships with our chosen financial institution trade network partners across the globe. As Llewelyn mentions, our latest research shows UK companies reaching into new markets, particularly beyond Europe and into faster growth geographies such as Vietnam, Thailand and India. An important part of our focus is therefore to anticipate the shifting trends across the main UK trade corridors globally and to make sure we are able to offer trade finance solutions to our clients into the key markets for them. We are actively working with our bank partners to make sure we can support our clients trading across the world.

Beyond this, last year we completed the implementation of our state of the art trade platform which gives us the ability to continue to develop and deploy innovative client solutions, supported by our UK based Trade Services centre of excellence. A great example of this focus on service excellence is our Beneficiary Care programme that is embedded as part of the Trade Service operations team, which proactively contacts Letter of Credit beneficiaries exporting from the UK to support and guide them through the documentary trade process. This is all part of our aim to be considered as the go-to UK bank for trade.

And this is just the start – we continue to work with consortia and FinTech's to explore the best ways to harness emerging technology such as blockchain, as we move closer to the world of a digitised supply chain.

We've benefited from a lot of investment in our people, platforms and processes in trade over the last few years and as a result we are better placed than ever to ensure consistency of service excellence alongside the ability to adapt quickly to shifting requirements from our corporate and FI clients. With the swirling uncertainties that Jeavon mentions around global trade tariffs and the UK's trading relationship with the EU, our ability to adapt to our clients' requirements will be a key differentiator.

It's all part of a holistic approach that is centred on the customer and recognises that, for the time being at least, we all need to navigate through a highly uncertain global trade environment.

Our Lloyds Bank Business Barometer survey, every month canvasses the views of 1200 UK firms on the economy and their business environment. In August, we included some pertinent questions on international trade. A snapshot of the results is provided to the right.

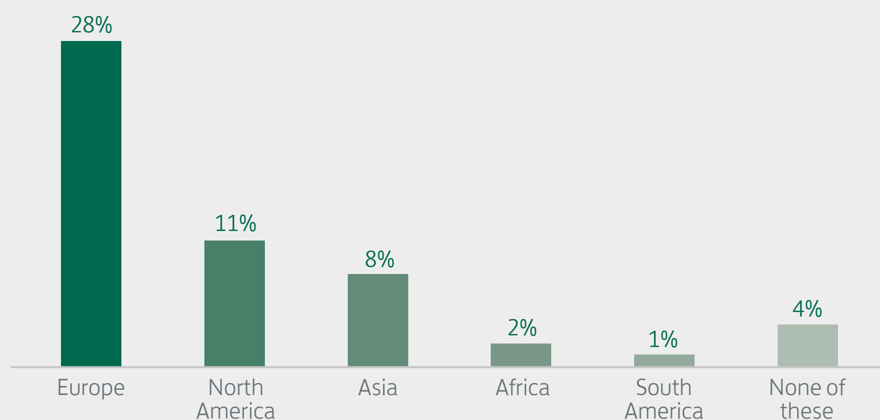
38% of respondents confirmed that they are actively involved in either importing or exporting, with a further 16% stating plans to begin trading internationally in the future.

Applying a sector lens, 68% of manufacturers, 58% of wholesalers and 53% of retailers reported being active in international trade with a further 8%, 26% and 16% respectively reporting they had plans to become active.

When thinking about the future for 28% of those already active, or considering involvement, Europe was called out as representing the greatest opportunity for growth with North America identified by 11% of respondents. Jurisdictions further afield such as Asia, Africa and South America were seen as less favourable future growth opportunities. This clearly reinforces the ongoing importance of Europe as the key trading block for the UK.

Businesses currently trading internationally[1]

Overseas region with greatest opportunity for growth[1]



1 BVA BDRC Business Barometer August 2019

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