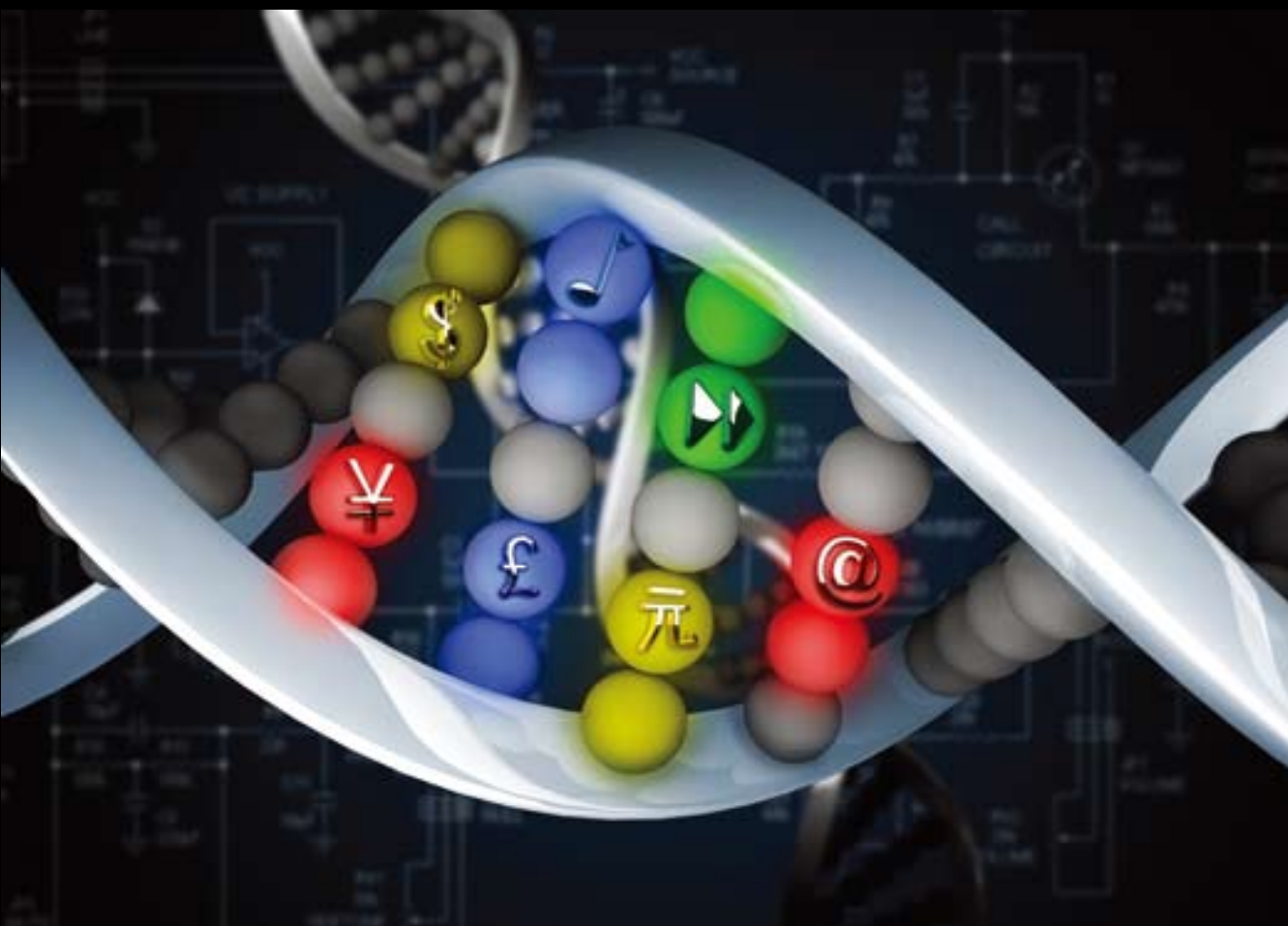


HSBC's Guide to Cash, Supply Chain and Treasury Management in Asia Pacific 2010



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African Trade with China and India: From Strength to Strength

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- African trade with China and India has grown inexorably over the past five years.
- There are tentative signs that the composition of this trade is starting to change, with some Africa countries beginning to export manufactured value-added goods to China.
- However, the challenges faced by Chinese and Indian importers and exporters dealing with Africa remain significant. These include unfamiliar business practices, wide fluctuations in foreign exchange rates and uncertainties regarding the credit status of trading counterparties.
- Neither Chinese or Indian domestic banks nor African banks are well placed to assist in dealing with these challenges; a suitable banking partner for these markets requires a mix of global product and solution sophistication, and local expertise.

While China and India's trade flows are still relatively modest when compared to those of Europe, both countries have in recent years seen a very marked increase in bilateral trade with sub-Saharan Africa. Total bilateral trade between China and Africa in 2008 was slightly in excess of USD65bn, up from about USD40bn in 2007 on a trajectory of steady growth. In the case of India, the figures are even more impressive, with bilateral Africa trade in 2007–08 at about USD24.5bn, up from USD5bn in 2003–04 – again on a steady growth trajectory.

The relative importance of African countries as trading partners has also been increasing. Africa's share of India's imports stood at 3% in 2004 and after dipping slightly in 2004–05 and 2005–06 has continued to increase, hitting 6.7% in 2008–09 (April–December). The picture for Indian exports to Africa is similarly encouraging; starting at 3% in 2003–04 and reaching 6.2% in 2008–09 (April–December) on steady growth.

Future Prospects

While recent falls in commodity prices and a relative reduction in China's recent meteoric growth rate are likely to have a short-term impact on Sino–African trade, the longer-term prognosis is good. Initiatives such as the China–Africa Development Fund (CADF), which will eventually commit USD5bn over the next five years to assist Chinese firms in expanding their operations across the African continent, give a clear indication of the long-term commitment China is making to Africa.¹ Furthermore, the

establishment of initiatives such as CADF indicates the implementation of a far broader approach to trade with Africa than merely an exchange of commodities for money.

A similarly positive long-term outlook applies to India's trade relations with Africa. Despite India's recent decline in overall exports, India–African bilateral trade is projected to grow by a factor of nearly 10 to reach USD150bn by 2012, according to the Associated Chambers of Commerce and Industry of India (ASSOCHAM). In a recent report on Africa, the association projected that Africa will continue to have greater business significance for India, which will continue to drive strong two-way trade growth.²

The general economic backdrop for many African countries is also reasonable, albeit less optimistic than in recent years. The Organisation for Economic Cooperation and Development (OECD) recently published

1. For more information, see web site www.cadfund.com.

2. The ASSOCHAM Africa Manual 2008. See www.assochem.org.

its forecasts for key sub-Saharan economies.³ The OECD expects South African growth to fall to 1.1% in 2009, well below the 5% seen in the past three years, but it also expects GDP to recover to 3.5% in 2010. The prediction for Nigeria in 2009 is a more modest decline to 4% from 6.1% in 2008, while Kenya is expected to post growth of 5% and 4.3% in 2009 and 2010 respectively, bouncing back from the political violence that marred 2008. Apart from South Africa, the OECD expects Mauritius to post the largest decline in growth in 2009 to 3% in comparison with 4.8% in 2008, with the key textile and tourism sectors negatively affected by recession in the US and Europe. However, while these African states may see slower growth in 2009 than 2008, it is noteworthy that they are still showing growth at all, in contrast with the declines seen in many developed economies such as the US and the UK.

Composition

The preceding two years have seen some interesting shifts in the pattern of trade between Asia and Africa. In the case of China, South African exports are perhaps predictably topped by minerals, with a 60% share of the total in 2007, rising to 61% in 2008. Interestingly, base metal and base metal product exports declined from 27% to 21% over the same period. However, the most striking change (in percentage terms) has been in the increase in precious metals and products exports, which quintupled from 1% to 5% over the same period. Other significant exports include chemical products; textiles; plastics and rubbers; and paper and wood pulp. Significant declines were seen in various other commodities between 2007 and 2008 including foodstuffs, and machinery and electrical products, although in all cases these were from already relatively low levels.

On the import side, machinery and electrical products represent comfortably the largest purchases by southern African countries from China, rising from 43% of total imports in 2007 to 46% in 2008. Base metals and base metal product imports from China also rose from 8% to 9% over the same period. Other significant imports include textiles, chemical products, furniture and transportation.

India's five largest trade partners in Africa are (in order of importance) Nigeria, South Africa, Angola, Kenya and Mauritius. In the case of Nigeria, primary imports from India are engineering products such as machinery, moulds and engines, while major exports to India include mineral fuels, aluminium, lead, and fruits and nuts. In the case of South Africa, major imports from India are vehicles, pharmaceutical products, machinery, and precious and semi-precious stones, while major exports to India include precious stones, mineral fuels and ores.

Patterns and Trends

To date, Africa's exports to China and India have been largely driven by increasing demand in those countries for primary commodities to supply their burgeoning industrial sectors. These primary commodities currently represent well over 80% of Africa's exports to Asian countries, while a similar percentage of its imports are of manufactured goods.

While this breakdown has proven relatively stable, there has been some movement. For example, China recently started importing certain African manufactured value-added goods, including household consumer goods and processed food. A more pronounced shift has been in the balance of trade flows since the early 1990s. While Africa's imports from China and India have grown over this period, its exports have grown considerably faster, thus substantially reducing the overall trade deficit and freeing up further import capacity.

Another emergent trend is China's interest in growing its level of oil imports from Africa. While Africa significantly lags the Middle East as a holder of proven oil reserves, analysts believe that it could harbour appreciable undiscovered reserves – a view that China evidently shares.

India may not have so prominent a presence in Africa as China, but has made clear its commitment as it has to compete with China and other developed countries to secure oil and other commodities to support its growing economy. This desire to build closer relations with African countries is apparent from various

3. *African Economic Outlook 2009, published by the OECD in May 2009. See www.oecd.org.*

Indian government announcements. For example, at the 2008 India–Africa Forum the Indian prime minister declared that India would increase its trade credits to Africa to USD5.4bn in 2008–09, as well as doubling the number of scholarships it offers African students.⁴

Traditionally, Indian companies have focused on selling into higher-margin western markets. However, with those markets in the doldrums, a growing number of Indian exporters are realising that Africa is a natural market for their expertise in producing non-luxury but highly price-competitive products in areas such as automotive manufacturing.

Corporate Challenges

Impressive as the growth of African trade with India and China is, the vastly different cultures and degrees of economic maturity involved pose many broadly similar challenges for Indian and Chinese exporters and importers. A common factor for both buyers and sellers is that for many of them Africa is unfamiliar territory. Local business practices and regulation differ appreciably from country to country as of course do language and taxation, etc.

In addition, there are country and financial institution risks to consider, plus occasionally wide fluctuations in foreign exchange (FX) rates – often in currencies that are not readily tradable and for which hedging instruments are unavailable. In the case of Chinese and Indian exporters, the short track record and lack of credible financial information for many African companies raise concerns about customer defaults – especially when the goods have to be supplied over a long tenor, which is commonly the case with vehicle supply. By contrast, Chinese and Indian importers have concerns about commodity price fluctuation and also the inability of many African suppliers to offer extended payment terms or supplier finance.

The Right Choice

When looking for the right partner bank for their African trade many Chinese and Indian importers and exporters will understandably look first to their domestic banks for support. In practice, few (if any) domestic banks will be in a position to provide this. In the first instance, they are very unlikely to have a large-scale network that includes African branches, which will impact transaction turnaround times and reduce their ability to service trade flows or provide risk mitigation solutions. It will also obviously limit their ability to provide relevant advice on local conditions and business practices.

Given these limitations, the natural alternative would appear to be an African bank. Unfortunately, while such banks may have a local presence they may also be credit-constrained and therefore unable to provide adequate credit and financing capacity, nor sufficiently competitive pricing. They may also lack awareness of the latest financing products available on international markets.

Some Indian, Chinese and African banks may be able to offer advice on local business practice in a few countries, but it is also vital for both exporters and importers to be able to gain an informed view at a higher level on both country and regional risk and also on the strength of local financial institutions in each country.

The logical conclusion might therefore appear to be a global bank, but even here there are caveats. Some global banks will lack sufficient network depth across Africa to deliver the support and service required, so it is important for importers and exporters to gain a clear picture of the exact footprint and capabilities of potential providers.

There is the crucial matter of long-term commitment. Some global banks that might meet the necessary network and product criteria have suffered significant balance sheet damage during the credit crisis and have required government bail outs. While this may have stabilised these banks in terms of solvency, it raises concerns regarding their ability to sustain a substantial and ongoing commitment to Africa. (Any government supporting a bank balance sheet will be keen to ensure that this resource is primarily dedicated to the bank's home market to support domestic business.)

4. See the Prime Minister of India's web site, www.pmindia.nic.in, for his opening statement at the India–Africa Forum summit and his opening remarks at the joint press interaction on 8 and 9 April 2008 respectively.

The Right Solutions

For Chinese and Indian importers and exporters one of the cardinal requirements for success in African trade is the selection of a bank capable of delivering an expert and consultative relationship, backed by a comprehensive network and realistic country limits. Apart from high-quality market intelligence, a comprehensive network also presents the opportunity of faster settlement times, as the bank will be capable of acting on both ends of the transaction and thereby expediting payments. Where large projects such as infrastructure are involved, a strong network also delivers the necessary close contact, interaction and monitoring.

Bank product capabilities need to match the day-to-day business realities faced by exporters and importers, such as the ability to provide foreign currency financing or to forfeit African trade transactions, which is particularly relevant for larger, longer-term business such as vehicle fleet supply.

In a continent as varied (and in many cases unknown) as Africa, there is also a need for a comprehensive set of risk-mitigation products, including documentary credit (DC) confirmation, FX products, and recourse and non-recourse financing tools. However, there is considerable variation in the competitiveness of these products from bank to bank. For example, Indian and Chinese exporters have found that banks with an on-the-ground presence in Africa are able to provide better terms for confirming African bank DCs, as these banks have put in place special lines of credit for key African banks. As regards FX, many African currencies are very thinly traded and so only a select few banks are capable of quoting firm spot rates. In addition, Africa's diversity means that a generic product approach is insufficient; the bank must also be capable of flexible product customisation and innovation to meet individual situations.

In some cases, such expertise can be most valuable when available outside the actual African country where trade is flowing. A classic example of this is Mauritius; because some sellers may not have in-country marketing infrastructure (sales offices, warehousing, etc.) they use Mauritius as a hub for their African regional sales and warehousing for large shipments and send smaller individual shipments into African countries. Therefore any bank with African regional expertise, plus a substantial presence in Mauritius, is well placed to deliver this. A similar situation applies to Johannesburg, which plays an important role in the African market as a gateway in facilitating trade flows between Africa and other continents. Again, a potential partner bank should have a strong presence in Johannesburg through which it is able to leverage its pan-African expertise.

Conclusion

The current economic uncertainty notwithstanding, it is apparent that the prospects for African trade with China and India remain strong. However, in a market as diverse and demanding as Africa, converting that opportunity to profitability is extremely challenging.

One of the most vital steps in ensuring success in African trade is the judicious choice of banking partner. Expert advice from an organisation well-networked and well-versed in the intricacies of doing business in Africa combined with strong yet flexible product capability and robust balance sheet capacity are the primary qualities required. The number of banks capable of ticking all these boxes is a number tending towards one.

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