

Executive Summary

International trade has played a central role in Latin America's economic development and poverty reduction. For businesses, access to trade finance is essential to capitalize on trade opportunities by managing risks and securing working capital. This report focuses on three upper-middle income economies in Latin America: Guatemala, Honduras, and Mexico. These three countries have diverse economic profiles and have experienced robust trade growth over the past decade. Drawing on each country's long-term trends and trade profiles, the report examines the state of bank-intermediated trade finance and quantifies the potential benefits to be reaped from improving access to affordable trade finance.

The evolving trade patterns point to rising demand for trade finance. Guatemala, Honduras, and Mexico have each posted average annual trade growth of 4–5 percent in the past decade. Mexico has moved up the value chain, including as a major supplier to the United States (US) market, especially in motor vehicles and parts, electronics, machinery, and precision instruments. Guatemala and Honduras have expanded their volume of trade and diversified their import and export baskets, especially within Latin America, in light manufacturing and agriculture. Mexico's strong export links to the US, and a high share of capital and intermediate goods in total trade, point to significant potential demand for trade finance, particularly supply chain finance (SCF) to fill working capital needs. Rising economic and policy uncertainty may add to demand for bank-intermediation to mitigate risks. Although Guatemala and Honduras start from a lower base, with macroeconomic and financial sector

weaknesses, their expanded export footprint in light manufacturing and food products and growing diversification into new markets are also expected to increase demand for trade finance.

However, an IFC survey of banks across the three countries reveals that bank-intermediated trade and supply chain finance (TSCF) remains underused. The share of merchandise trade covered by TSCF is relatively low: 8 percent in Mexico, 10 percent in Honduras, and 12 percent in Guatemala (based on a more limited sample). This compares to 21 percent for Viet Nam and 25 percent West Africa, the subjects of previous IFC-WTO trade finance studies. Open-account financing arrangements prevail for trade transactions, and bank intermediation consists mainly of trade loans. Their use of traditional trade finance instruments, such as letters of credit (LCs), is notably lower than in West Africa or in Southeast Asia's Mekong region.

These patterns align with the generally limited use of bank intermediation in the region. In Mexico, most trading firms do not rely on bank financing, with only a quarter receiving any type of loan, either short- or long-term, from Mexican banks. New trading firms are underrepresented in bank loan portfolios, and those that secure financing typically have had relationships with banks before engaging in international trade. The trade finance market in particular is concentrated both on the demand and the supply side: few banks serve a small number of large firms. Three-quarters of TSCF recorded in each country is supplied by the respective country's top three banks, and foreign bank subsidiaries tend to dominate the market.

In Mexico, the high share of related-party trade with the US helps explain the limited use of bank-intermediated TSCF. In 2023, around 56 percent of total trade and 65 percent of Mexico's exports to the US was between related parties, which frequently use open account arrangements. Foreign or domestically owned multinationals accounted for two-thirds of Mexico's trade in 2020, a share that has consistently exceeded all comparator countries over the last decade. Moreover, as import flows from China and exports to the US have expanded faster than bank lending for traders, many Mexican firms appear less reliant on local banks for finance.

Even within related-party trade, payment lags and mismatches can create working capital shortfalls, indicating potential for SCF solutions. Additional payment and transaction risks apply to trade between unrelated parties. Nevertheless, SCF accounts for just 17 percent of banks' total

TSCF assets in Mexico, and even lower shares in Guatemala (4 percent) and Honduras (1 percent). Although Mexico's SCF market has benefited from regulatory, market, and digital innovations, it only supports about 1 percent of Mexico's international trade, pointing to significant potential for growth, notably for Mexican-owned firms operating in global value chains. Guatemala and Honduras, with a relatively lower share of US related-party trade and growth in textile and other light manufacturing exports, are also expected to see growing demand for SCF.

Banks in the three countries face varying constraints in meeting trade finance needs. In IFC's survey, Honduran banks report the most severe constraints, citing macroeconomic volatility, regulatory barriers, and limited liquidity. Uncertainty and liquidity shortages are particularly binding for smaller banks in the country. Guatemalan banks of all sizes similarly identify a shortage of low-cost funding, high internal risk ratings, and strict collateral requirements as constraints. For Mexican banks, limited institutional readiness hindering their ability to offer new trade finance products is the top concern, followed by correspondent bank processing delays. Correspondent banking relationships remain a bottleneck for smaller banks in all three countries, where high financing costs, tenor restrictions, and compliance requirements limit banks' ability to provide trade finance.

On the demand side, TSCF is often seen as prohibitively expensive even considering variation in pricing terms offered to traders. In Mexico, LC fees vary considerably, a reflection of the range of risks associated with diverse trade transactions

and clients in a large economy. Small trading firms in Mexico incur, unsurprisingly, higher and more variable interest rates on loans than other firms, while new traders exhibit considerably higher dispersion in rates, even compared to firms that do not participate in international trade. Interest rate spreads on trade loans over the policy rate are higher in Honduras and Guatemala than in Mexico—likely a reflection of supply-side constraints, such as banks' ability to assess risks and cost of funds.

Improving access to affordable TSCF stands to significantly boost trade flows, including by unserved traders. An analysis of survey data collected from banks and traders in the three countries, using the WTO Global Trade Model, suggests that doubling TSCF coverage and reducing financing costs (for loans, SCF, and LCs) to more advanced economies' benchmarks could raise imports by 5.7 percent in Guatemala, 7.4 percent in Honduras, and 6.7 percent in Mexico, and raise exports by 7.8 percent, 8.9 percent, and 7.4 percent, respectively. This corresponds to an increase in the annual volume of merchandise trade of \$2.8 billion¹ in Guatemala, \$2.3 billion in Honduras, and \$85.1 billion in Mexico. Expanding bank-intermediated TSCF holds the greatest potential to enhance trade, followed by lowering financing costs of export and import loans and SCF, whereas reducing LC fees would play a more marginal role.

Projected increases in trade flows vary across sectors and trading partners. In Guatemala and Honduras, the largest export gains would come from textiles and leather to North America (Canada and the US). In Mexico, transport

(including automotive) and electronic equipment and machinery, already Mexico's largest exports, would see the biggest increase. On the import side, Guatemala is projected to expand trade in chemicals and other goods from a variety of trading partners (Central America, East Asia, Europe, and North America). For Honduras, trade is projected to increase in textiles, apparel and leather, and other goods imported from Central and North America. In Mexico, imports of transport and other equipment and chemicals from North America, and to a lesser extent from East Asia and Europe, would lead the way.

Coordinated action by companies, financial institutions, national policymakers, and international organizations could help increase the uptake of trade and supply chain finance in the three countries. Measures with the highest potential include supporting the expansion of SCF markets in the region through harmonized regulations, reducing trade finance costs by better assessing risks, increasing access to financial products, and offering targeted capacity building.

Mexico's SCF market has already benefited from regulatory and digital innovations, as well as the presence of large foreign bank subsidiaries active in SCF. Further regulatory harmonization, combined with greater use of digital invoicing and warehouse receipts, would help grow the market. Starting from a lower base, SCF markets in Guatemala and Honduras would benefit from raising market awareness, strengthening the capacity of key stakeholders (banks, large buyers, investors), and promoting the development of common sector-level operating infrastructure.

¹ All dollar amounts are US dollars unless otherwise indicated.

Revisiting pricing methodologies for trade finance products by incorporating instrument-specific risk assessments can help make trade finance more affordable across the three countries. This may require enhancing banks' capacity to competitively price TSCF, potentially including liquidity support, advisory support on regulatory compliance, setting up collective market intelligence and risk assessment mechanisms, and expanding correspondent banking relationships for second-tier banks. International organizations, including regional and multilateral development banks, could help in this respect.

Access to financial services for smaller and women-owned firms is crucial to expand coverage of trade by bank-intermediated TSCF. All stakeholders can help broaden the range of TSCF beneficiaries: banks may benefit from tailored training; governments can facilitate risk-sharing facilities among traders and financial institutions—for example, by proposing first-loss guarantees; and smaller traders can benefit from greater participation in industry associations that offer technical assistance and knowledge sharing.

