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Trump's trade wars, Brexit, and geopolitical strife is boosting Citigroup's trade finance business. But it might not last.

Alex Morrell Jul. 29, 2019, 9:33 AM

Combine harvesters crop soybeans during a demonstration for the press, in Campo Novo do Parecis, about 400km northwest from the capital city of Cuiaba, in Mato Grosso, Brazil, on March 27, 2012. YASUYOSHI CHIBA/AFP/Getty Images YASUYOSHI CHIBA/AFP/Getty Images

- While many Wall Street businesses are suffering amid market turmoil, Citi's treasury and trade-services business is surging, the bank reported in its second-quarter earnings results.
- Amid Brexit, President Trump's trade wars, and other geopolitical flare ups, long-standing trade flows are shifting. China, once the largest importer of US soybeans, is buying from South America instead, for instance.
- Citi's trade-financing business, thanks to the bank's presence in nearly 100 countries, has benefited from the disrupted trade routes, in some cases financing the same trade flows twice as countries adapt.
- The dynamic showcases the value of the bank's global network, but Citi global trade head John Ahearn cautioned there are early signs the volatility is slowing the global economy.

When Citigroup announced its second-quarter earnings results last week, a familiar division popped up to steal the thunder in its institutional division: Treasury and Trade Solutions.

The group got a shout out during executives' call with Wall Street analysts thanks to revenue growth of 4% to $2.4 billion in the quarter, with "growth in deposits, transaction volumes, and trade spreads" and "strong client engagement," according to CFO Mark Mason.

The treasury and trade business, which handles cash management and trade financing needs for multinational corporations and governments, often flies under the radar compared to more glamorous investment banking endeavors. But it is nonetheless considered the bank's crown jewel given its consistent growth, robust returns, and centrality to Citi's global network.

Taking aside a one-off $355 million gain from the firm's investment in bond-trading platform Tradeweb, most businesses in the Citi's Institutional Clients Group, which includes its investment banking and sales and trading units, suffered year-over-year declines amid tough market conditions.

The uncertainty that roiled the markets thanks to tariff wars, Brexit, and other geopolitical discord would appear the perfect maelstrom to upend trade financing operations.

But at Citi — the No. 1 transaction banking franchise, according to industry data and consulting firm Coalition — business has seemed to only grow stronger in 2019, Jim Mitchell, an analyst with Buckingham Research, pointed out.

It begged the question: Is "the trade war helping you a little bit?" Mitchell asked.

It turns out, it is.

Citi's trade-finance business is uniquely positioned to benefit from President Donald Trump's confrontational trade tactics with China, Mexico, and Europe, showcasing the value of the bank's entrenched presence in nearly 100 markets.

To explain why Citi's trade-services unit is thriving, take one high-profile example: soybeans.

China is the world's top soybean consumer and for many years has relied on US farmers to meet its voracious demand, eclipsing $14 billion worth of US soybean imports as recently as 2016, according to US Census estimates.

Amid the trade dispute with the US — Trump has imposed tariffs on $250 billion of Chinese imports — China has drastically cut back its US soybean consumption and is instead buying from South American countries like Argentina and Brazil, according to John Ahearn, global head of trade at Citi. Argentina and Brazil are in turn buying soybeans from the US to fill their own domestic supply, much of which has been diverted to China.

The overall demand and soybean capacity hasn't changed much, but now there are new trade routes that require financing services, and Citi's presence in each of these countries means it's poised capitalize — in some cases essentially financing the same trade flows twice.

"Because of Citi's global footprint, we are financing both the export of soybeans from Brazil and Argentina to the Chinese, and also financing the exports of soybeans from the US to Argentina and Brazil," Ahearn told Business Insider in an interview. "As our clients adapt and need financing through these new routes, we get to finance the same transaction throughout the entire lifecycle, which has helped our profitability."

Other banks with less global operations won't necessarily experience the same dynamic.

Disrupted trade flows only help a bank's trade-finance business if they have an established presence wherever the flows are shifting, according to Eric Li, a research director and trade-finance expert at Coalition.

"When trade corridors shift, not every bank benefits," Li said, adding that "it can take years to develop a footprint in a given country or region."

Citi's trade unit also drums up more business in the short term when individual companies on its long global roster move their operations because of the trade volatility.

More than 50 multinational firms, including the likes of Amazon, Apple, Dell, and HP, have uprooted or are planning to shift operations out of China amid the tariff war, according to research from Nikkei Asian Review.

The disruption may be helping Citi's trade business for the time being, but uncertainty has the potential sap confidence and dry up global demand, taking a toll on the whole industry — Citigroup included.

Ahearn, who has a front-row seat in observing shifts in trade flows and financing demand, says every region in the world is dealing with some form of economic upheaval right now, and that there are early signs that the global economy may be losing steam as a result.

"You're seeing all these trade quarters shifting," Ahearn said. "Will it lead to a global economic slowdown? We're seeing some early signs, but the next few quarters will be key."