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An Asian trade agreement set to bear fruit in years to come

The Regional Comprehensive Economic Partnership should support economic growth over the long term

Recent years have been characterised by nationalism, geopolitical brinksmanship and borders locked shut by a global pandemic. So there is something encouraging about the fact that in November 2020, amid a host of divisive forces, a landmark trade agreement was signed.

This is the Regional Comprehensive Economic Partnership (RCEP), a gathering of 15 Asian nations which between them cover 30% of the world's GDP and 27% of global trade.[1] It marks the first time China, Japan and South Korea have ever participated in the same trade deal.

The symbolism of RCEP is important, standing as a counterpoint to former President Trump's decision to pull the US out of the Trans-Pacific Partnership in 2016, in almost his first act in power. It shows that the Asia-Pacific region can still see the importance in regional blocs even if the US is standing aside.

But how about the practical side? The big-picture numbers are alluring: as much as US$209 billion added to world incomes and US$500 billion to world trade by 2030, according to simulations conducted by Brookings Institute.[2] About 90% of goods traded in the region will eventually reach zero tariffs, according to a DBS report on 16 November 2020.[3]

Towards growth in regional trade

The hope is that ease of cross-border trade aids productivity and stimulates growth, which in turn ought to create a positive medium-term outlook for equity markets. There should also be a greater capacity for Asia-Pacific borrowers to raise debt, deepening regional bond markets.

Getting into the minutiae, the picture is mixed. In terms of intellectual property protection, for example, not much changes, and in many cases the avenues for tariff reduction are in places where there weren't many tariffs anyway, particularly among the Association of Southeast Asian Nations (ASEAN) which were already bound by free trade agreements (FTAs).

But the partnership does create incentives to develop supply chains across the region, and gives a considerable boost to intra-regional trade. Also, it's a starting point: RCEP creates a foundation for deeper agreements, such as those relating to labour and the environment, to be built. Financial market integration, already underway in ASEAN, should be spurred more widely across the region by RCEP.

A typical analyst response is that the signing of RCEP does not radically change short-term growth forecasts, but will pay off over the longer term as economic and political integration in Asia lead to greater trade flows and harmonization.[4] HSBC says that intra-regional trade already accounts for 60% of Asia's overall trade, and expects the figure to grow under RCEP, not only strengthening Asia's role in the global trading system but enabling the next round of economic growth.[5] That, in turn, should eventually be reflected in the outlook for investable assets, particularly equities.

Who benefits most?

Market participants are trying to work out who benefits most from RCEP, and position themselves accordingly. In terms of tariff savings, South Korea will be the most positively impacted, since it has no bilateral FTA with Japan, its third largest trade partner. There has been no China-South Korea FTA previously either, so that again creates an obvious benefit.

In terms of supply chains, Vietnam is the most frequently mentioned nation to benefit from regional trade, and in particular China-Vietnam or South Korea-Vietnam trade corridors. With this in mind, Singapore's UOB Bank announced a memorandum of understanding with Vietnam's Foreign Investment Agency in November in order to facilitate foreign direct investment (FDI) into Vietnam. UOB says that 40% of ASEAN FDI comes from fellow RCEP members and expects there to be a sharp increase in intra-regional capital flows.[6]

Beyond that, there is the potential of the demonstration effect. India, initially part of the discussions for RCEP, eventually opted not to be involved, fearing the impact of cheap Chinese imports on its manufacturing sector. But if the trade deal appears to be delivering benefits elsewhere, the door is open to it.

And a Biden presidency is likely to be less volatile and confrontational than a Trump one: even if there seems little political support for the US joining trade networks today, there is the potential for closer engagement, if only because of suspicion of China leading the bloc.

It will take time for RCEP to bear fruit. But in years ahead it should move beyond symbolism into practical support for economic growth in Asia.

Sources:

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4 Goldman Sachs, 2020.
5 HSBC, Stuart Tate, Navigator Survey, 2020.
6 UOB, November 2020.

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