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Implementing RCEP

Checking in amid trade challenges

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Economics - Asia

- Eight months on from the start of the RCEP trade deal, we find Asian markets are building deeper trade ties
- According to ADB estimates, Japan and South Korea will experience the largest percentage jump in exports in 2030…
- …while RCEP will likely deliver the biggest productivity kick to economies like Thailand, Vietnam and Malaysia

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RCEP to the rescue

From lingering supply chain bottlenecks to the slowing global economy, trade is being challenged across Asia. However, one long-term positive is that regional trade is gaining traction. Much of this in Asia is thanks to the Regional Comprehensive Economic Partnership (RCEP) that kicked off at the start of the year with 15 Asian economies as members, with more on the way. The biggest direct advantage of joining RCEP is that tariffs on over 90% of goods will eventually be eliminated, while expansive rules of origin will facilitate the sourcing of inputs from within the bloc. Also, the comprehensive agenda should boost growth in investment, intellectual property and e-commerce.

How is it going?

Eight months into the implementation of RCEP, we check in to see how it's going. We find several nations have already taken advantage of this accord to strengthen regional trade ties. For instance, Malaysia (approved the deal in mid-March) is working with China's Chongqing province to consider launching investment projects related to electronic vehicles (EV). While Japan, one of the largest car manufacturers in Asia, has entered into a trade deal with China and South Korea for the first time, thanks to RCEP. Crucially at this time of accelerating inflation, preferential tariff treatment will help producers across RCEP source inputs at lower cost, strengthening their global competitiveness. The agreement will therefore also be key to spurring FDI flows into the region, whether from member economies or from outside.

A new trade engine to revive economies

Despite the trade challenges in the short term, this piece focuses on the broader horizon. Estimates from ADB show that markets including Japan and South Korea will experience the largest jump in exports in 2030e as RCEP is the first free trade agreement that includes China, Japan and South Korea, three of the more technically advanced economies in East Asia. Trade liberalisation should also trigger a productivity kick for Asia and drive more FDI flows. Estimates from World Bank suggest that the productivity 'kicks' alone could raise real incomes by 5% by 2035e in economies like Thailand, Vietnam, and Malaysia.

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A trade deal that matters

Remind me. What's all this about?

The Regional Comprehensive Economic Partnership (RCEP) agreement came into force on 1 January 2022. It covers Australia, mainland China, Japan, New Zealand, South Korea and 10 ASEAN members, though not all economies have ratified the agreement yet (Indonesia approved the deal in August, while the agreement took effect for Malaysia in March and for South Korea in February, with these economies joining 10 others that have been trading under the new preferential terms since the start of 2022). The Philippines is still in the final stages of approval for ratification.

Tariffs on over 90% of goods will eventually be eliminated under RCEP

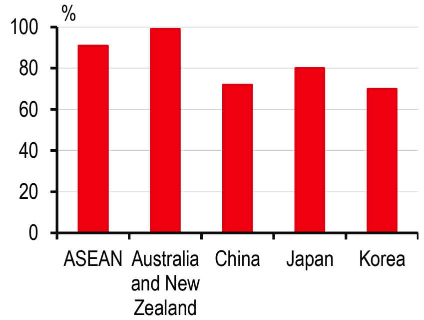
The scope of RCEP is not as wide-ranging as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the regional free trade deal that went before it, especially on topics like labour and the environment. However, RCEP provides reasonable coverage for trading rules and procedures, enabling tariffs on more than 90% of the goods to eventually be eliminated. RCEP's generous rules of origin, especially given the sheer number of nations involved, mean that local businesses can benefit from exporting tariff-free within the bloc, provided some of their inputs (typically around 40%) are sourced from other RCEP members.

RCEP overview

	Status	% of exports to member nation (2021)	% of imports from member nation (2021)	Change to exports by 2035 (%)*	Change to imports by 2035 (%)*	Change in real income by 2030 (%)*
Australia	Ratified	66%	42%	3.6	3.2	0.0
Brunei Darussalam	Ratified	97%	59%	-	-	0.5
Cambodia	Ratified	29%	89%	3.6	2.7	-
Mainland China	Ratified	26%	37%	1.7	1.8	0.3
Indonesia	Ratified	57%	67%	3.0	2.6	0.1
Japan	Ratified	46%	50%	7.6	5.2	1.0
Korea	Ratified	49%	48%	2.0	2.0	1.0
Laos	Ratified	90%	94%	3.9	3.1	-
Malaysia	Ratified	56%	62%	1.6	1.7	0.6
Myanmar	Poised to ratify**	40%	36%	-	-	-
New Zealand	Ratified	63%	60%	3.6	3.2	0.2
Philippines	Primarily ratified by PM, waiting for Senate approval	50%	69%	5.6	4.6	0.3
Singapore	Ratified	53%	49%	-	-	0.0
Thailand	Ratified	53%	61%	1.9	2.2	0.5
Vietnam	Ratified	38%	72%	6.2	4.7	0.5

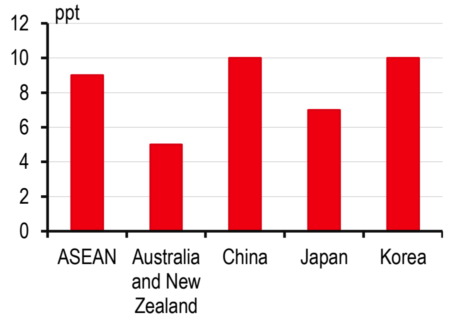
Source: HSBC, ADB, World Bank, PIIE, CEIC and local government sources; NB: *relative to baseline, **Philippines and New Zealand have noted they will reject Myanmar's ratification given the political situation there.

Chart 1: Share of products with zero tariff between RCEP members eventually



Source: UNCTAD, HSBC

Chart 2: Average tariff concession by RCEP members



Source: UNCTAD, HSBC

Eight months in and it's delivering results

Since taking effect at the beginning of the year, several businesses have rushed to take advantage of the new deal. For example, table 1 sets out a number of certificates of origin under RCEP issued by various Chinese customs authorities. Meanwhile, there are 43,600 RCEP certificates of origin issued between January and May in 2022, which are valued at USD2.08bn, according to the China Council for the Promotion of International Trade (CCPIT). Uptake of RCEP trade preferences is only likely to grow as the deal continues to be implemented and further liberalisation is phased in.

Table 1: RCEP certificates of origin issued by select Chinese cities/provinces

City/province	No. of export certificates	Value	Tariff savings	Time period
Guangdong	22,000	Not specified		As at 25 January 2022
Zhejiang	5,100	USD240m	CNY13m	January 2022 month
Shanghai	4,553	USD281m		January 2022 month
Xiamen	1,013	USD78.53m	CNY5m	January 2022 month
Wuxi	589	USD26.87m		January 2022 month
Shijiazhuang	587	USD44.21m		As at 20 February 2022

Source: HSBC based on Twitter, Equal Ocean and Global Times. Note: These are just a selection of RCEP certificates of origin issued by Chinese customs authorities.

Beyond making use of tariff concessions, there are other benefits, too. For Japan, signing up to RCEP meant it was the first time it has entered into a free trade agreement with China. On the back of RCEP, Chinese automaker Guangxi Auto quickly struck a deal with Japanese EV startup ASF Company to produce a range of small EV commercial vehicles in China for sale in Japan. The two companies intend to collaborate on developing prototypes as per an agreement signed at the RCEP Business Leaders Forum earlier this year (Just Auto, 10 January 2022).

An express sea route between Qingdao in China and Osaka in Japan also opened in June 2022 after Qingdao and Dongchen Line Co agreed a strategic cooperation deal once RCEP took effect. Under this route, vessels can be directly boarded with loading equipment (e.g. trucks) and cargo, with the sailing time cut from two to three days to just 36 hours (Global Times, 26 June 2022).

What's next? Implementation and expansion

As we highlighted earlier, RCEP was recently approved by Indonesia and is close to being ratified by the Philippines, two of the three biggest economies in ASEAN. Myanmar has approved the deal but New Zealand and the Philippines said that it won't accept its ratification given the political situation in Myanmar (ABC News, 18 February 2022). India refused to join the accord, and while the door remains open for it to join, we think it is unlikely to try as India struck a bilateral deal with Australia recently and is pursuing negotiations with the UK (The Hindu, 20 March 2022).

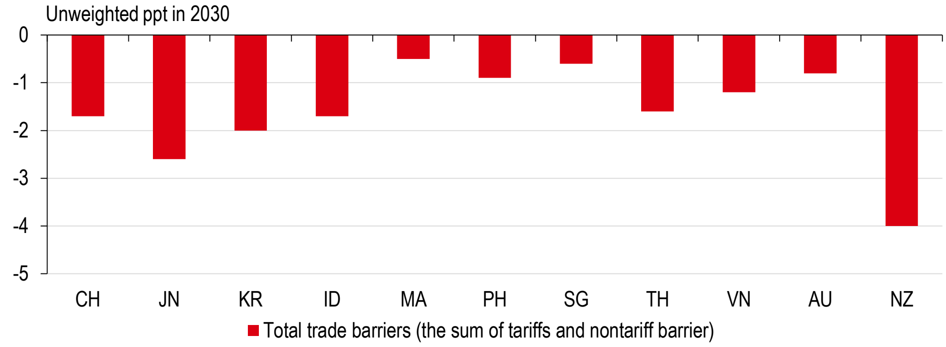
Other economies will be able to join from 1 July 2023. For instance, Hong Kong has applied to join, as around 70% of its trade already takes place with RCEP members. A successful bid would be a natural extension for the economy given its openness to international trade and given the fact that it already has trade deals in place with 13 RCEP members (the 10 ASEAN economies, mainland China, Australia and New Zealand). Joining the deal could help strengthen Hong Kong's role as a professional services hub as members will fully open at least 65% of the services sector to foreign investors, and it could provide new opportunities for Hong Kong's logistics sector (e.g. from handling more intra-regional trade flows) and for businesses located in the Greater Bay Area (GBA) that use Hong Kong as a springboard to go global and enter new markets.

Elsewhere, Bangladesh's Trade and Tariff Commission has conducted preliminary analysis on the possible benefits of joining the deal and the costs of remaining outside the agreement. Sri Lanka could be another potential member further down the line (The Economist, 16 August 2022). (Note that the UK, mainland China, and Taiwan have meanwhile all applied to join the CPTPP.)

Why is everyone so eager to come on board?

The biggest direct advantage for economies joining RCEP is the tariff concessions. Under the agreement, tariffs on more than 90% of the goods will be eliminated, although this will happen in stages, with an implementation period of 20 years (sensitive and strategic sectors are exempted). The broad scope of tariff elimination will promote investment, intellectual property provisions and electronic commerce within the bloc.

Chart 3: Percentage change in total trade barriers when trading among RCEP members by 2030 compared to baseline*

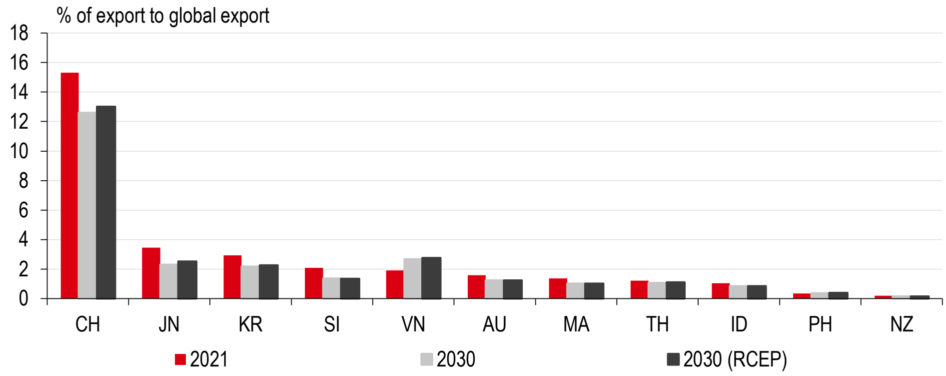


Source: ADB, HSBC
* Baseline values refer to the barriers in 2030 without any policy changes

Estimates show that some markets, such as Japan and South Korea, will experience the largest jump in exports in 2030 (ADB, 2021). This is mainly because it's the first time Japan has entered into a free trade agreement with China. The result is that 86% of Japanese exports to China and 88% of Chinese exports to Japan will eventually be eligible to enter duty-free thanks to RCEP, up from 25% and 57%, respectively, on the first day when RCEP took effect (Global Times, 24 February 2022). Moreover, RCEP is the first free trade agreement that includes China, Japan and South Korea together, three of the more technically advanced economies in East Asia. Interestingly, ADB forecasts that the share of global exports in East Asia is going to drop over the coming decade, as companies diversify their manufacturing base into other developing markets. However, this should ultimately strengthen their remaining production base by tying producers more closely with regional supply chains, enabling them to take advantage of more cost-competitive component sourcing.

The effect on exports for ASEAN members before and after signing the agreement might not be as prominent as advanced markets. Pre-existing ASEAN free trade agreements with RCEP members have already eliminated tariffs on 86% to 90% of goods. Regardless, as a whole, RCEP nations will contribute to 30% of global exports by 2030, according to ADB.

Chart 4: Share of export of RCEP members to global exports in 2030

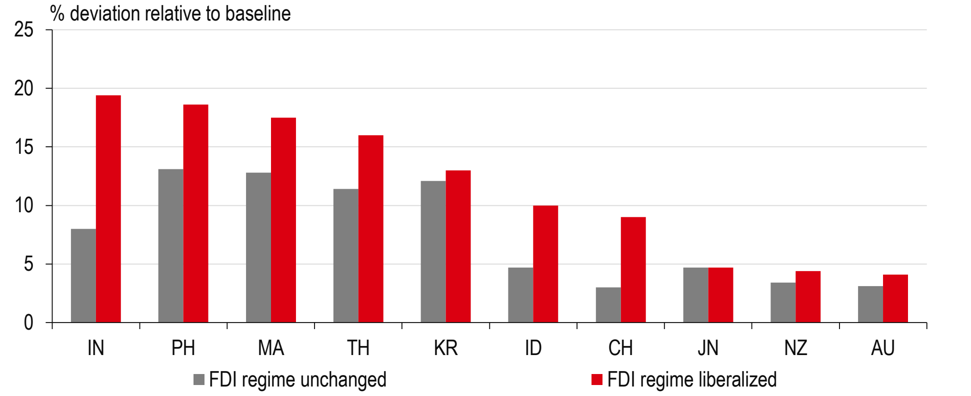


Source: ADB, ITC Trade Map, HSBC
Note: *CH = mainland China

Longer term: How will real incomes be affected by the RCEP agreement?

It is important to note that RCEP is not only likely to boost exports, but that there are other indirect, positive impacts to a nation's income given the depth of the accord. Many members have strict restrictions on foreign direct investment. According to the OECD Foreign Direct Investment Regulatory Restrictiveness Index 2020, Indonesia tops the list while China and New Zealand are in third and fourth place, respectively. The free trade agreement opens up investment opportunities intra-RCEP, and may also spur direct investment from firms based outside the region that will want to take advantage of the agreement. In principle, FDI liberalisation, whether spurred by RCEP or unilaterally, could lead to more than 15% incremental real income gains from trade in the Philippines, Malaysia and Thailand, according to IMF.

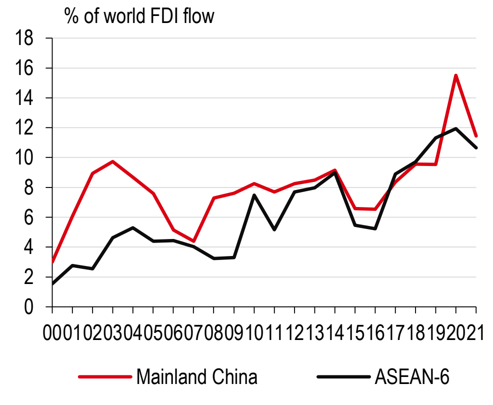
Chart 5: Potential real income gains from trade under different FDI regimes over 10 years



Source: IMF, Regional Economic Outlook: Asia at the forefront - growth challenges for the next decade and beyond, October 2018, HSBC; NB: CH refers to mainland China

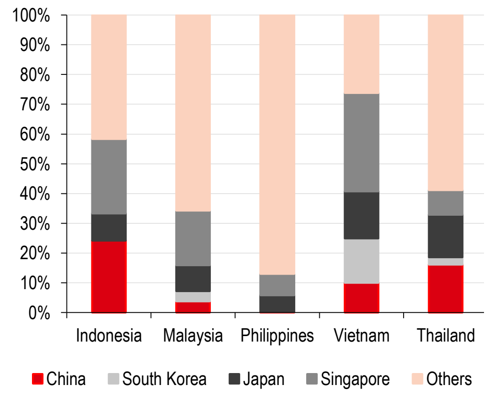
RCEP goes beyond some existing ASEAN free trade agreements in terms of investment opportunities. Prior to the agreement, China, South Korea and Japan were already top investors in some ASEAN economies. However, further opening up of ASEAN markets will attract more investment into new manufacturing technology, which could further boost labour productivity. In addition, the members have committed to review the inclusion of investor-state dispute settlements in five years' time. All in all, FDI liberalisation could boost real incomes for all RCEP members by up to 0.53% according to Petri and Plummer (2018).

Chart 6: ASEAN and mainland China's share of global FDI



Source: UNCTAD, HSBC

Chart 7: FDI inward flow in ASEAN by source market in 2021



Source: CEIC, HSBC

Increased trade and FDI flows are thus bound to lift productivity further. The cost of importing input materials will be lower and, thus, can promote local production. As a result, we expect to see a shift in the competitiveness of different sectors. Naturally, resources and capital will be used in the most competitive sector. In addition, the elimination of barriers to foreign investment can promote better resource allocation and technology. As a result, this will cause a productivity 'kick' in various sectors while promoting a shift of resources away from industries that are no longer competitive. For example, Indonesia and the Philippines' electrical equipment and machinery sectors are expected to expand by 4.1% and 6.3%, respectively by 2035, according to the World Bank. A 10% fall in tariffs could lead to a 4.8% increase in labour productivity on average[1].

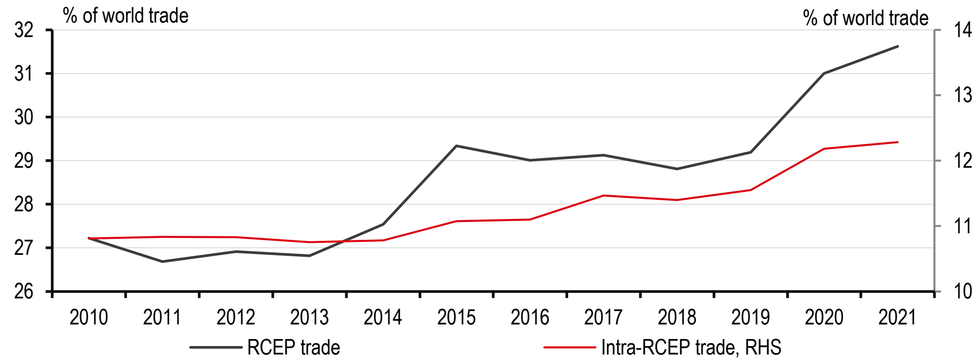
Of course, the gains are not distributed equally amongst members and across sectors. Some markets, like Vietnam and Malaysia, will likely experience magnified gains of almost 5% in real income under such a productivity kick in 2035 (World Bank, 2022). More developed members like Japan should see less of a productivity boost, but still benefit from enhanced supply chain integration and support the competitiveness of local companies.

Chart 8: Productivity kick impact on trade by economy, % change relative to business-as-usual scenario, 2035

Source: World Bank, HSBC

RCEP will, nevertheless, propel growth in trade within the area. RCEP members' share of trade has increased over the years. We expect the potential inclusion of Hong Kong to further boost real income in Asian economies. Summing up the real GDP of economies that are already on board, in 2030e, we expect the global share of GDP for RCEP markets to reach 32.9%, up from 31.7% in 2021, without taking into account the potential productivity kick induced by RCEP.

Chart 9: RCEP and intra-RCEP trade to world trade (%)



Source: ITC Trade Map, HSBC

[1] Petia Topalova and Amit Khandelwal, "Trade Liberalisation and Firm Productivity: The Case of India", January 2010

Disclosure appendix

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