Trans-Pacific Partnership clears first hurdle: What's the outlook for Asia?

On 5 October 2015, trade representatives of 12 Pacific Rim countries reached an agreement on a free trade deal known as the Trans-Pacific Partnership (TPP). The TPP is the biggest trade deal agreed to date in the world, encompassing about 40% of global GDP with annual economic output of almost US$30 trillion[1]. In this note, Manulife Asset Management's Global Economist Team and Asia and Japan equity specialists share their views on how the still-to-be-defined details of the pact could impact industries and companies in their regions.

The TPP agreement comes after more than five years of negotiations between member nations – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam – and is expected to reduce or eliminate tariffs on 18,000 categories of goods, establish a common framework for intellectual property protection, hold member countries to enforceable standards for labour and environmental law and establish an investor-state dispute settlement mechanism[2], among other things. The deal marks a potentially significant win for the Obama administration and its stated goal of pursuing a geopolitical pivot to Asia, highlighting the US's continued commitment to the region.

However despite reaching an agreement, the deal must still be passed into law by governments in each of the 12 nations before it can take effect. This process has the potential to be challenging and lengthy, with elections scheduled in Canada later this month and in the US next year. It is also likely to face opposition from local interest groups in each of the signatory countries.

In addition to the TPP, the US is negotiating with EU member states to cut tariffs and barriers to trade between the US and the EU under the Transatlantic Trade and Investment Partnership (TTIP) agreement. The TPIP aims to make it easier for companies on both sides of the Atlantic to access each other's markets.

China flirts with TPP while pursuing independent accords

The TPP has significant implications as it marks the first free trade agreement (FTA) between the largest and third largest economies in the world: the US and Japan, respectively. Perhaps equally important is the exclusion of China, which has been one of the key drivers of global economic growth over the past decade. China's absence could limit the economic benefits of the agreement. That being said, Chinese officials have indicated some interest in possibly signing up in the future[1].

Since joining the World Trade Organization in 2001, China has eliminated a range of barriers to trade, but is moving forward with trade liberalisation at its own pace. Chinese authorities have opted to negotiate bilateral FTAs with other economies in the region, including Australia and South Korea.

News of the TPP agreement could accelerate these efforts, which include the Regional Comprehensive Economic Partnership (RCEP) – an FTA between ASEAN nations and Australia, China, India, Japan, South Korea and New Zealand – and the concurrent roll out of projects related to the new China-led Asian Infrastructure Investment Bank (AIIB) and the "One Belt, One Road" initiative. Collectively, this means that China is likely to continue to have a significant influence on the Asian and global economies whether or not it is included in the TPP.

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[1] Bloomberg: TPP Trade Deal: Who Stands to Gain, Suffer in Asia-Pacific http://www.bloomberg.com/news/articles/2015-10-06/tpp-trade-deal-who-stands-to-benefit-suffer-in-asia-pacific

[2] The Economist: Twelve countries reach an agreement on trans-Pacific trade http://www.economist.com/news/finance-economics/21671151-tpp-now-faces-hard-road-passage-national-legislatures-twelve-countries-strike-ambitious

TPP could drive economic growth, but likely to be winners and losers

From a theoretical viewpoint, more trade should be a net gain for the global economy. From a macro perspective, less regulation and protection for tradable goods and services – as the barriers to trade are lowered – should allocate capital more efficiently and could improve general consumer welfare via lower prices and better-quality products.

However, that is in theory only explains Oscar Gonzalez, Economist with Manulife Asset Management's Global Economist Group, "We argue it is much more complicated in practice, particularly given the inclusion of patents, labour policies and environmental regulations in the TPP framework. We think the agreement can be construed as being a positive overall, but there are sure to be winners and losers based on how well various industry lobbying groups can work with policy makers to have their concerns reflected in related legislation."

According to Gonzales, "That said, we await details before we can offer a developed view on some of the more difficult issues which arise from TPP. In this regard, we will be looking to see how the US labour force might be impacted by increased competition from other rival workforces. We think this is especially true for highly labour-intensive industries and believe the likes of the automobile component suppliers are vulnerable."

Asia (ex-Japan) outlook: TPP unlikely to be a game changer in the short term

Within Asia, the overall impact of the TPP is unlikely to be known until full details of the agreement are released. Early indicators are that car and auto-parts manufacturers, large food exporting countries such as Australia and New Zealand[3] and Vietnamese manufacturers are among the winners while generic drug and biosimilar companies could be affected due to extended protection for on-patent biotech drugs.

Kenglin Tan, Senior Portfolio Manager, Asian Equities with Manulife Asset Management believes that while the TPP should contribute to regional economic integration over the longer term, it is unlikely to be a game changer for the economic prospects of region in the shorter term. "At this stage, it appears that the US is likely to be the main beneficiary from this agreement as it remains unclear how much Asian economies will benefit," explained Tan. "However, it could take as long as two years for all of the signatory countries to approve the agreement and a lot could change in that time."

As things stand at the moment, she believes Vietnam could emerge as a winner in the mid- to long term based on accelerated foreign direct investment (FDI) and the establishment of manufacturing facilities to take advantage of the nation's preferential tax treatment under TPP. Other beneficiaries are likely to be countries that are included in both the TPP and the RCEP, as they stand to gain trade relationships with China, Japan and the US. This includes Australia, Japan, Malaysia and New Zealand.

Meanwhile, non-member countries such as South Korea and Taiwan have expressed interest in joining in the near future. In South Korea's case, the country already has FTAs with several major countries in the TPP group, including the US, so the impact of not being part of the agreement at this stage should be relatively limited.

According to Tan, "In the near term, the China-led AIIB and the 'One Belt, One Road' initiative are likely to have a more immediate impact on economic growth in the region via increased infrastructure investment. We have already seen the commencement of a medium-speed railway in Indonesia that is ultimately expected to be extended into Thailand. Similarly, projects related to the One Belt, One Road initiative are underway in non-member countries such as Pakistan and India and more are likely to be announced going forward."

Japan outlook: Agriculture sector set for change?

From a Japan perspective, the key area where TPP could have a significant impact is in agriculture, according to Ed Ritchie, Senior Investment Analyst, European & EAFE Equities.

"The Japanese government could potentially save up to 1% of GDP by bringing subsidies to Japanese farmers down to the levels of Australia and New Zealand, which we believe could help reduce the government deficit. Historically, Japan's farmers have been a very strong lobby group in Japanese politics, with agriculture

[3] BBC: TPP trade deal: Who are the winners and losers? http://www.bbc.com/news/business-34451423

subsidies exceeding 1% of GDP during 2012-2014 compared to 0.5% for the US and 0.8% for the European Union[4]," explained Ritchie.

"While we are still waiting for key details of the TPP agreement, we believe the most significant potential impact is the opportunity for government deficit reduction through lower farm subsidies. This would also benefit households in Japan, which have typically spent more of their discretionary income on food than other major economies, partly because of high tariffs on foodstuffs like imported rice." TPP is expected to mean a cut in tariffs on beef and pork, among other imports.

[4] http://www.oecd.org/tad/agricultural-policies/monitoring-evaluation-2015-highlights-july-2015.pdf (see p14 - Figure 1.4. Total Support Estimate by country, 1995-97 and 2012-14