

IS REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP (RCEP) THE BEGINNING OF THE DECOUPLING?



On November 15th, 2020, 10 members of the Association of Southeast Asian Nations plus China, Australia, New Zealand, South Korea, and Japan, signed the Regional Comprehensive Economic Partnership (RCEP). This is the world's largest trade agreement covering 1/3 of the world's GDP, 40% of global trade and 45% of the world's population. The economic effects of this agreement will not be felt immediately but coming within the context of increasing talk of US-China decoupling, its long-term consequences cannot be underestimated and can also morph into an epochal change in the world balance of power.

RCEP is merely replacing already existing bilateral free trade agreements between the signatories and establishes a unified and comprehensive set of rules whose objective is to make it easier for goods and services to be traded. This also involves a gradual reduction of tariffs, a dispute resolution mechanism, e-commerce rules and intellectual property protection.

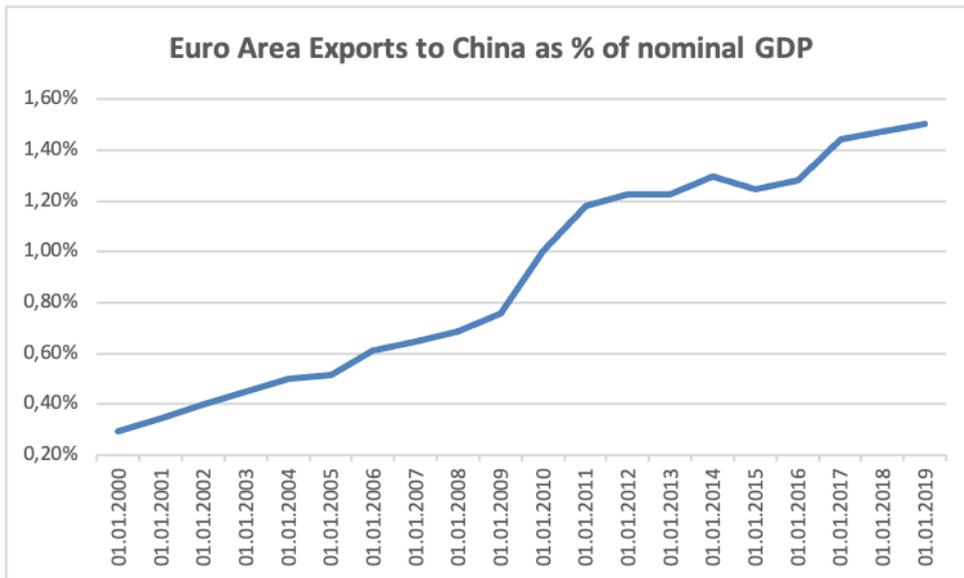
What makes RCEP particularly important from an economic point of view is that it involves some of the fastest growing countries in the world and its growth will be backed by a massive infrastructural project called the Belt and Road Initiative, illustrated below, which will link Asia with Europe.



Source: Belt and Road Initiative (beltroad-initiative.com)

The combination of the Belt and Road and RCEP will cause a reorganisation of the global value chain and accelerate the development of its signatories while China moves up the value chain. In a real sense RCEP can be China's answer to the economic pressures it is being subjected to by the US. Europe has shown considerable interest in the Belt and Road Initiative and Italy has already signed a memorandum of understanding with China. The reason is obvious: Europe is an export juggernaut and cannot afford to ignore fast growing markets which will become increasingly hungry for the things that Europe makes, from luxury consumer goods to machinery from wine to high end foods and so on.

Europe has already experimented export growth with China. In fact, while since the year 2000 Euro Area (EA) nominal GDP has doubled, exports to China have risen almost eleven-fold. As the chart below illustrates, EA exports to China accounted for 0.29% of EA nominal GDP while as at the end of 2019 they accounted for 1.5%.



Source: World Bank, IMF.

Now Imagine a similar progression of exports to an area (ASEAN) that has a population, ex-Japan, China, South Korea and Australia, of 655 million (and growing) and is still in the early stages of development.

Unfortunately for Europe, everything these days is geopolitical and, as we have seen over the past four years, the US has targeted China as an adversary whose development must be stunted. Therefore, it is to be expected that significant pressure will be put on Europe not to cooperate with anything Chinese. This is where RCEP combined with the Belt and Road Initiative can cause a tectonic shift in the world balance of power.

Relations between Europe and the US have suffered because of the tariffs and US demands to sanction various countries that are not in Europe's interest to sanction. As of this writing the US is preparing sanctions on European companies that worked on the almost complete Nordstream 2 pipeline.

Since it is highly unlikely that the incoming administration will change policy with regard to Nordstream 2 and China, the Europeans will have to make the difficult choice of either choosing to bend to the US demands, since the US is still Europe's largest export market, and consequently renounce to the incremental growth of exports that would be generated by Asia, or simply start a slow decoupling from the US.

The new decade will be interesting indeed!

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