Standard Life

Trade pacts, rate rises and the global economy

October market review 2018

For financial advisers only

This month, Andrew Milligan, Head of Global Strategy at Aberdeen Standard Investments, considers the continuing headlines surrounding the US and trade. He also takes a closer look at US rate rises, volatility in markets around the world, whether a recession is on the horizon, and the outlook for the UK market in the face of Brexit negotiations.

Trade remains in the headlines

After all the bluster this year, the US has now reached trade agreements with South Korea, Canada and Mexico, while discussions are also under way with Japan. At first sight this is good news, but the sting in the tail is that the US looks to be putting a trade war with China even more firmly in its sights.

There are also early signs that the focus of the US political establishment is moving away from trade towards intellectual property and technology. This will be the battle for the next generation of industrial supremacy, and even military and political control of the Pacific region.

How far these trends go is very uncertain. The US mid-term elections in November might well be important, confirming how much room for manoeuvre the White House has in terms of foreign policy.

Fed raises rates for third time this year

The US Federal Reserve has raised interest rates for the third time this year, begging the question – where next?

Inflation is beginning to rise in the major global economies, leading central banks either to raise interest rates, as in the US, or to warn of the approaching need to do so, as in Europe.

One piece of good news is that financial markets are forward looking and have already priced in the majority of rate increases expected in the US in 2018-19. So there would need to be a major surprise in wages and inflation to shock the markets.

Another piece of good news is that technology, such as price comparison websites and new ways of delivering goods and services via the internet, is restraining inflation in developed and emerging economies. The result is a slow upward trend in wages and therefore inflation, rather than any sharp rises.

Volatility affecting US and other markets

Markets in emerging countries have been under pressure in recent months because of the growing concerns about the US and its major trading partners. The good news about the trade agreements reached between the US, Mexico and Canada had reassured investors. But concern has reappeared about the US's trade conflict with China.

This, combined with likely further interest rate rises in the US, has led to a sharp sell-off by investors in equity markets – indeed the sharpest slide in stock prices since February.

We never thought that 2018 would be a straightforward year. However, it looks like the forthcoming earnings season will bring positive news to reassure investors, with many companies reporting solid profits growth. That's unless politicians and policymakers make the wrong decisions on interest rates and trade policies.

Recession remains unlikely

With the US economic expansion now the second longest on record, I'm often asked if a recession is on the horizon.

The US economic cycle is indeed long-lived, but that doesn't mean it will necessarily end quickly. The usual causes of a downturn or recession are a mixture of imbalances. This could include too much debt or a large trade deficit, which are then triggered by some shock such as much higher interest rates, or an oil price or trade shock.

The momentum of the global economy may be slowing, but from a high level the pace of growth looks to be solid in 2018 and 2019. 2020 is more uncertain – but traditionally the US economy performs well in the year before a US presidential election, so perhaps 2021 is a greater risk.

We'll continue to monitor the situation carefully. So far, leading indicators suggest slower growth into 2019, but the likelihood of a recession is on the low side.

Brexit completion could signal market volatility

The range of possible Brexit outcomes remains very wide indeed. The general view is that the pound is fairly valued against the dollar at about $1.30. But it could rise or fall to say $1.50 or $1.10 depending on whether the final outcome is seen as particularly bad or good for the UK economy. Then the stock market would react accordingly, to the Brexit news and the currency shock. Neither a very positive or negative outcome is yet priced into markets.

Politicians on both sides of the Channel will have a lot to answer for if they go to the wire in their negotiations.

For an in-depth look at what's happening in global markets, read the **Aberdeen Standard Investments Global Outlook October 2018**

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Information is based on our understanding in October 2018.

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