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Are we close to the next 'tipping point'?

September marked the 10-year anniversary of what most consider to be the beginning of the financial crisis, when images flashed across the world of Lehman Brothers employees with packed boxes outside their offices following their employer filing for bankruptcy.

As it is widely accepted that we are probably closer to the next downturn than we are from the last, scrutinising indicators for signs of a potential 'tipping point' is becoming a greater fascination for many market analysts. The last quarter has thrown many obstacles in the path of economic momentum, such as the deterioration in trade talks between the US and China, fears of contagion from uncertainties in Turkey and Argentina, the reintroduction of US sanctions against Iran, a gradual shift towards quantitative tightening and stalling Brexit negotiations.

Brexit uncertainty continues

Brexit continues to dominate the headlines in the UK as the 29th March 2019 deadline fast approaches and the two sides seek to agree on terms of the exit and outline the agreement on future co-operation. Theresa May's Chequers plan has been publicly criticised by chief-Brexiteers, who labelled her policy as a 'soft Brexit' in disguise, and EU leaders, who described her proposals of a free trade zone and common rule book for goods with greater divergence as 'unworkable'. Should the PM be forced to ditch her Chequers strategy, a Canada style trade accord may be offered as an alternative and should have the support of Messrs Johnson and Rees-Mogg, as well as the EU. Signed in 2016, Canada's deal with the EU removes the majority of customs duties on EU exports to Canada and Canadian exports to the EU.

BoE and ECB follow different paths

The Bank of England's 25bps interest rate rise in August was well flagged, however the next move is less clear and likely to be dependent on the Brexit outcome. GDP growth in the second quarter was in line with expectations, coming in at 1.5% on an annualised basis, and CPI unexpectedly jumped from 2.5% to 2.7% in July.

Second-quarter GDP growth in Europe was revised up to 2.2% annualised and core inflation remained low at 1% year-on-year. Consequently, the European Central Bank is expected to keep interest rates on hold for the next year. Firm fundamentals were, however, once again overshadowed by politics in the region. Markets are nervous about the new Italian government's budget plans, which are due to be submitted to the EU in October. Should the plans deviate from the objectives of the stability and growth pact, the European Commission could be forced to reboot the excessive deficit procedure against Italy, in turn, putting the country's credit rating at risk. The 10-year Italian government bond yield hit 3.2% in August, as the spread between Italian BTPs and comparable German bunds widened to 290bps.

Turkish Lira down 46%

Turkey has been in the headlines for all the wrong reasons of late. The Turkish central bank did not act with adequate strength to support the currency, which is now down over 40% against the dollar since the start of the year. Policymakers did eventually raise rates by a hefty 6.25% to 24% in September in an attempt to stem the currency's collapse. Fears over the current account deficit, which has widened to 6% of GDP, were compounded at the start of August as the US increased tariffs on Turkish steel and aluminium as a consequence of the imprisonment of a US citizen in Turkey. The iShares MSCI Turkey Index is down 46% over the last twelve months, however Turkey only accounts for 0.6% of the MSCI Emerging Market Index, which is down just 2.5% on the year.

US economy marches on

Behind the circus that is the Trump administration, US economic growth has been stellar, both in magnitude and quality as net trade and consumption grew strongly.

Trade tensions have, thus far, had little impact on business sentiment within the US as investment spending remained robust, according to the July durable goods report. Consumers also continued to spend as they benefitted from the tailwinds of fiscal reform and a labour market going from strength to strength. Should the economy continue to tick along in such impressive fashion, we expect the Federal Reserve to continue raising rates at a pace of 25bps per quarter.

Almost two years since his shock election victory, the November mid-term elections will be the first test of how Trump's Republican party is managing in the eyes of the American public. Despite controlling both the House of Representatives and the Senate, political pundits suggest a liberal base hoping to derail Trump's agenda could see a 'blue wave' of Democrats sweeping into power. Should this happen, Trump's final two years could prove far more difficult, as efforts to fund the border wall with Mexico, pass further tax cuts, and make another attempt to repeal Obamacare will meet fierce opposition.

The most recent round of US tariffs on $200bn worth of Chinese imports led Chinese officials to criticise the US as putting "a knife to China's neck", with the resumption of trade talks also dependent on the "will" of the US. Analysts at Mizuho Bank in Tokyo have even suggested that China might wait until Trump is no longer in office rather than embark on further negotiations with his administration. In addition, the President also signed the National Defense Authorization Act in August to more firmly regulate inbound foreign investment; although not a move directly targeting China, it does still restrict Beijing's ability to invest in the US. The retaliatory taxes by Beijing on $60bn worth of US products initially unnerved global financial markets, though most have since recovered.

It is, however, apparent that Chinese trade and output have been affected by the developing trade tensions. From June to July, exports to the US fell by 2.5% and fixed asset investments came in much weaker than expected. To counter this, Chinese authorities are implementing measures to stimulate domestic demand, as the banks' reserve ratio was cut by 50bps and capital outflows have been limited as FX reserves actually increased modestly in July. Even though the trade tariff news flow has generally been negative for China, Chinese investors have been unperturbed as the removal of some uncertainty has actually steadied domestic markets, though the CSI 300 trades 25% lower than its high for the year (reached in late January).

Nikkei 225 up 20%

Japanese prime minister Shinzo Abe secured another three years in office as he won a third term as leader of the Liberal Democratic Party which, given the fractious state of politics in Japan's recent history (15 prime ministers in 22 years), is some achievement and comfort to investors in the region; the Nikkei 225 has added more than 20% over the last twelve months. The economy in Japan has stabilised at a cruising speed of GDP adding roughly 1% per annum, primarily driven by private consumption which has been supported by annual wage growth of 3.6%, the highest level in over 20 years. However, underlying inflation remains anaemic at 0.3% year on year, well below the Bank of Japan's target. In an attempt to support the region's banking system, the BoJ increased the flexibility of its yield curve by doubling the range of fluctuation around the targeted 0% from 10bps to 20bps, as the flat yield curve has negatively impacted margins in the sector.

Oil price rallies

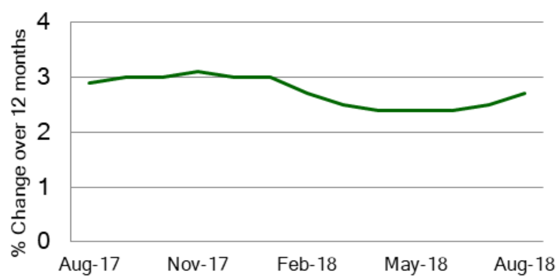
Brent crude oil prices have risen back above $80 per barrel and could move higher according to UBS, as US inventories remain low, US sanctions on Iran take effect in November and production of the Gulf Cooperation Council countries is close to capacity. The Swiss bank suggests these preconditions could be the building blocks for a supply side shock and cautions that oil prices north of $120 per barrel could contribute to a sharp slowdown in global growth.

Market decoupling

Whereas 2017 was characterised by synchronised global growth, this year has seen a developed/emerging market decoupling, as most mature economies and markets have continued to push ahead on encouraging fundamentals, whilst lesser economically developed regions have proven vulnerable to the escalating trade war rhetoric, as well as a stronger dollar. Consequently, we continue to endorse a well-diversified approach to investment and believe the current environment of robust global growth, low inflation and low (or negative) 'real' interest rates is a positive one for investors with portfolios allocated across a blend of different asset classes and geographies.

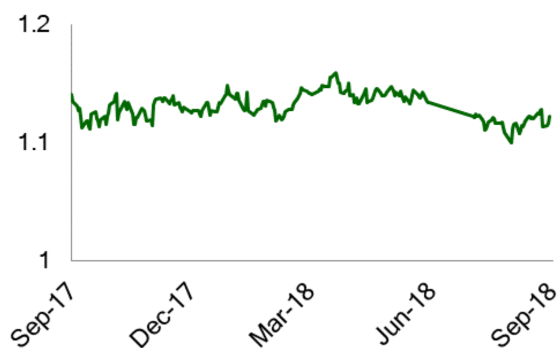
A year in numbers

UK Consumer Prices Index (CPI)



FTSE 100 Index

GBP/EUR Exchange Rate



GBP/USD Exchange Rate

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