FINANCIAL MARKETS

THREE ISSUES THAT WILL DOMINATE 2019

BLACKWELL GLOBAL

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THE BLACKWELL ADVANTAGE

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WHAT CAN WE EXPECT IN 2019?

FOREWORD

We're now into 2019, which is an opportune moment to take a look at the big issues that are likely to affect the financial markets over the next 12 months.

Fresh in both traders' and investors' minds is the market volatility we experienced during Q4 of 2018.

The truth is that the issues that caused some of this volatility will continue to play out in 2019. This eBook analyses each of these issues in further detail.

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THREE BIG ISSUES

THE FED'S MONETARY POLICY

The monetary policy outlook for the Federal Reserve has changed for 2019.

Despite the Federal Open Market Committee (FOMC) hiking its benchmark interest rate in December to 2.25 - 2.5% - as the markets expected - policymakers reduced the number of rate hikes forecast for 2019 from three to two.

However, the markets appear to think differently. The Fed Funds Futures market - which is viewed as a barometer of how the markets view the central bank's next monetary policy moves - shows that 'the crowd' believes that rates will remain unchanged in 2019.

One thing is clear - the Federal Reserve gave itself more room for manoeuvre at its December meeting, fuelling the feeling that future rate hikes will be largely data dependent.

So what's caused this shift in monetary policy? Well, there are a few different factors.

Firstly, there are broad concerns about global economic growth and the ongoing trade tensions between the US and China. There's no question that trade tensions have made investors nervous about protectionists trade policies and tariffs. These concerns have been amplified in recent weeks by the stock market selloff that saw the Dow Jones and S&P 500 lose their 2018 gains.

Deflationary pressures from falling commodity prices may also be a reason why the FOMC is looking to slow the pace of rate hikes. The price of oil fell to multi-year lows in the latter end of 2018, with WTO oil falling below $50 per barrel.

Traders and investors should closely watch the rhetoric from FOMC board members in the coming months while monitoring key US economic data for clues about if and when the next rate hike will take place.

US & CHINA TRADE TENSIONS

Trade tensions between the US and China - an issue which dominated 2018 - is likely to do so again in 2019.

Last year, the US applied three separate rounds of tariffs on $250 billion worth of Chinese products. China applied tariffs on $110 billion worth of US goods.

In December 2018, the US and China agreed to postpone the introduction of further tariffs until March 2019 (the US had threatened to introduce tariffs on a further $267 billion worth of Chinese products) and commence trade talks.

At the time of writing, the first round of those talks has concluded, with both the US and Chinese governments reporting positive developments. This has fuelled hoped that a trade deal can be agreed.

Traders and investors should closely monitor trade talks as they develop ahead of the March 2019 deadline. Any hint of a deal will see the global markets breathe a collective sigh of relief.

BREXIT

Brexit isn't going anywhere anytime soon. In fact, the markets are now counting down to when the UK officially leaves the European Union: Friday 29th March.

Despite this looming date, a Withdrawal Agreement has yet to be ratified by all parties concerned.

In late 2018, Prime Minister Theresa May did secure the terms of a Withdrawal Agreement with the EU. However, the proposed terms have faced stern opposition at home, including within her own party (the Conservatives).

The sticking point for many British MPs is the Irish backstop. This is essentially a safety net which ensures an open border on the island of Ireland post-Brexit (in the event that no new trade deal is agreed).

Should the backstop come into force, the whole of the UK would enter a 'single customs territory' with the EU. Northern Ireland would also have to adhere to some additional EU single market rules.

Under the proposed terms of the Withdrawal Agreement, the backstop can only be abandoned if there is an agreement between the UK and EU. Many British MPs believe this gives the EU too much power.

The opposition to the proposed Withdrawal Agreement is so strong that Prime Minister May actually faced - and survived - a Conservative leadership challenge in December 2018.

Despite this, Prime Minister May is still facing the prospect of her negotiated deal being voted down in the House of Commons. The original vote was due to take place on Tuesday 11th December, but the vote was pulled because the British government knew it wouldn't be backed by a majority of MPs.

The vote is now due to take place on Tuesday 15th January - and the parliamentary arithmetic still looks difficult for the Prime Minister. Should her deal be voted down in the House of Commons, the government will only have three days to come back to parliament with alternatives.

What those alternatives would be isn't clear. But one thing we do know is that the majority of MPs do not want to see a 'No Deal' Brexit - fearing the economic turbulence such a scenario would likely bring.

That's why many MPs want a referendum on the Withdrawal Agreement itself, while the leadership of the Labour party are starting to push for a general election.

Whether any of these scenarios unfold is unclear - but in the face of political deadlock, something unconventional may need to take place to break it. Another option could be to extend Article 50 beyond March 2019. This would give the UK and EU additional time to renegotiate a different Withdrawal Agreement.

Traders should pay close attention to the parliamentary vote on Tuesday 15th January. It's highly likely that the pound will face further downward pressure if Prime Minister May's proposed deal gets rejected by parliament.


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