# The implications of the Fed’s March minutes and an inverted yield curve on Asian markets

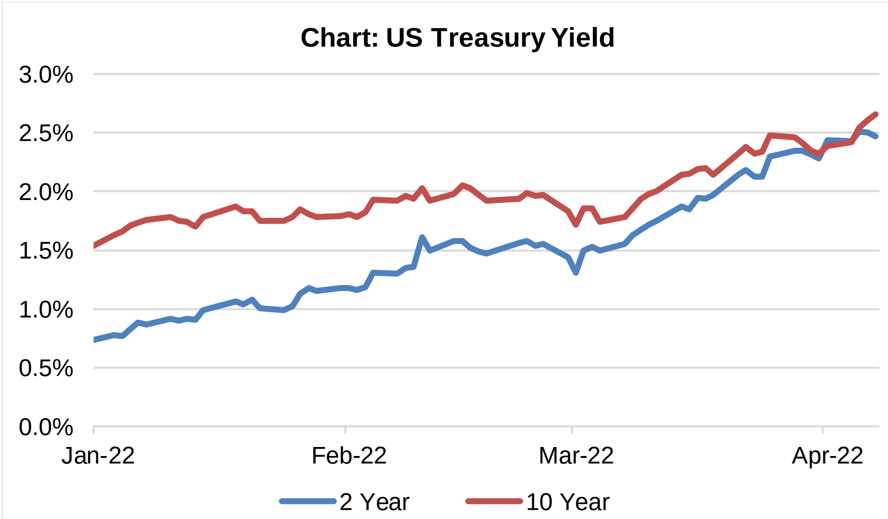
**April 8, 2022**

**David Chao**
Global Market Strategist,
Asia Pacific (ex-Japan)

**Thomas Wu**
Analyst, Global Thought Leadership, Asia Pacific (ex-Japan)

As we start off into the second quarter of the year, investors are now faced with rising global macro challenges that have caused significant stock and bond market volatility.

The gap between the US 2yr and 10yr recently inverted during the past few trading days as investors price a more aggressive pace of interest rate hikes from the Fed.




Source: U.S. Department of Treasury and Macrobond. Data as of 7 Apr 2022.

While a good indicator of future economic woes, a yield curve inversion typically signals a recession distantly out in the future.

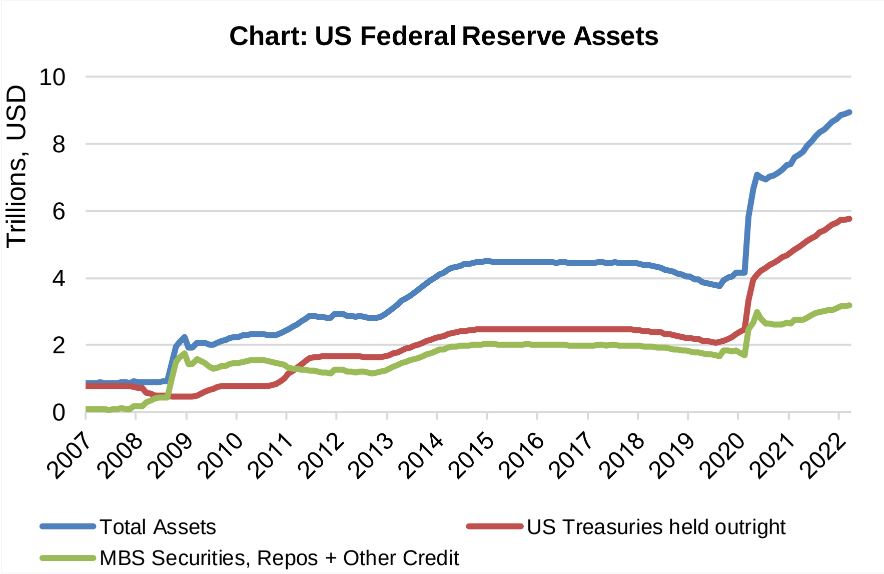
Make no mistake, the risks to the current business cycle are elevated though my interpretation is that the current inversion is only a warning signal of possible future economic woes.

Over the past six decades, the median amount of time between the initial inversion of the yield curve and the onset of a recession is 18 months.

That said, a subsequent recession is not inevitable. Developed central banks, especially the US Federal Reserve, may still be able to engineer a soft landing.

### A deep dive into the Fed’s policies

In its recently released March FOMC meeting minutes, the Fed revealed plans to taper its asset purchases by USD 100bn/mo possibly starting in May, which is double to pace of the tapering between 2017-2019.




Source: Federal Reserve. Data as of Mar 2022.

It's possible that the May meeting will also be the first time that we see a 50bps rate hike. Remember, the Fed only instituted a 25bps instead of a 50bps hike in March due to geopolitical uncertainties.

Since then, it's clear that the Fed's priorities have shifted back towards tackling inflation and appears laser-focused on ensuring that longer term inflation expectations are well-anchored.

Also, there are many different US treasury maturities that haven't inverted, meaning a holistic analysis is required.

I believe the Treasury yield curve is pricing in two things: first, a relatively buoyant economy driven by robust consumption demand and supply side shortages, and second, a period of high inflation that could peak some-time in the 2H of this year.

Still, there's a chance that the Fed won't have to be that aggressive. A principal reason is that core inflation in the US could peak soon due to a significant reduction in federal spending this year as well as the reduction in M2 money supply.

Inflation can also be self-curing — high prices could reduce demand which helps ease the pressure on prices. That doesn't mean inflation will get down to 2% any time soon, but it could soon be moving in the right direction.

### Implications for APAC investors

More notably, an inverted yield curve has not been a very good timing tool for equity investors. In fact, the median return of the S&P 500 Index from the date in each cycle that the yield curve inverts to the market peak is 19%.

# The implications of the Fed's March minutes and an inverted yield curve on Asian markets

April 8, 2022

Even though the MSCI Asia Pacific Index has often underperformed the MSCI World Index during periods of inversion since 1990, I believe conditions are vastly different this time around.

APAC investors may care less about the inversion and more about an increasingly hawkish Fed.

Historically, tightening US monetary policy would appear to spell trouble for EM assets including in Asia – though this time around, the Fed has already well-communicated its policy normalization trajectory and the region's economies are in a better position to withstand external pressures.

Asia is also relatively insulated from geopolitical risks and enjoys low consumer price inflation. This allows most Asian central banks to deploy relatively more easy monetary policy that should support growth and corporate earnings.

As the US battles high inflation and tightening monetary policy and the EU is faced with stark geopolitical risks and a possible energy crisis, I believe Asian equities appear quite attractive from a valuation and macro perspective and have a decent chance to outperform for the remainder of the year.

# The implications of the Fed's March minutes and an inverted yield curve on Asian markets

April 8, 2022