Matthews Asia

Matthews Asia Perspective

Global Markets Fret Over What the Fed Will Do Next

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Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.

It's the Fed again!

With all the great things happening in Asia—One Belt, One Road infrastructure spending, innovative monetary policy in Japan, rising profit growth in China, the consistent raising of living standards across the region and the exciting growth in some of Asia's poorest countries—it is rather depressing that the markets are almost single-mindedly focused on what the U.S. monetary authorities are doing.

How can I make this claim? Quite simple. Take the stock markets of Asia. Look at those in countries with low inflation and high current account surpluses; I believe they will almost exclusively have positive returns for the year. Look at those countries with current account deficits and high structural inflation; I believe they will almost exclusively have negative returns for the year.

There can be only one reason for this division: worries about U.S. monetary policy. And these worries are not without cause. For the new Federal Reserve Chair, Jerome Powell, seems intent on establishing his credentials as someone who believes in "sound money," a euphemism for tight policy. This is at a time when inflation in the U.S. remains quite low. There is easily a risk that the Fed tightens too quickly. This has only been exacerbated by the fact that questions are arising again over the stability of the European Union, with Italy's financial worries hitting the headlines and the price of the shares of some important global banks.

I have been frustrated that many of the Southeast Asia nations did not take the chance to reflate at the same time as China did. They may have missed their chance. It seemed strange that one of the few countries to loosen was Indonesia, which seemed the least well-placed to do so. It is now tightening policy. So we are left with economies and profits that are underperforming where they could have been. That is so frustrating!

But the judgment of the markets has already been very severe—Indonesia is down double digits for the year, even as the currency has remained quite stable. India, too, has been weak. Concerns over Turkey and Argentina have again caused Asia to be lumped in with "emerging markets" rather than being considered as the most vibrant part of global growth. It is not that the recent weakness in these Asian markets is unfounded, nor that it is unreasonable, but it does seem rather short-sighted.

Ultimately, a lot of good things are going on in Asia—infrastructure spending, productivity growth and sound economic management—that are setting a platform for the future. While the world fears a U.S. tightening and the European Union is mired in Italy's problems, however, caution is the watchword.