ABSTRACT

Although extensively studied in industrial regions, empirical evidence regarding the predictability of yield spread on the real economy in developing countries remains limited. This research examines the predictability of yield spread on a binary recession variable for five Asia-Pacific countries from October 2004 to May 2022, totalling 1060 observations using a panel probit fixed effects model approach. The findings reveal that yield spread is a significant negative predictor of recessions with an optimal lag of three months and a Pseudo R2 of 18.3%. The relationship between yield spread and recessions is non-linear, with recession probability reaching 50.5% when the yield spread level is at 0.5. The analysis also indicates that yield spread performs better under conditions where the relationship between interest rates and optimal output is more pronounced, or when economic shocks originate from the demand side rather than the supply side. Additionally, international linkage analysis finds that the Australian yield spread also significantly predicts recessions in the Asia-Pacific region. This phenomenon is attributed to the presence of global shocks and monetary policy homogeneity. Monetary policy plays a crucial role in explaining the relationship between yield spread and recessions, as the model's strength increases when monetary authorities implement restrictive monetary policies. However, the yield spread parameter remains robust when controlling for the policy rate, suggesting the presence of additional information beyond monetary policy contained within the yield spread. Lastly, structural break analysis through the Likelihood Ratio Test indicates a break in July 2013 for the yield spread parameter. The use of unconventional monetary policies and the presence of supply-side shocks are considered the primary factors behind the decline in the model's strength over the past decade.

Keywords: *Yield spread, real economy, recession, probit regression, Asia-Pacific*