Fed rate action commentary from Swiss Re chief US economist

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After today's 25 basis point (bp) Federal Reserve increase in the target fed funds rate to 2.5 percent, Swiss Re chief economist Kurt Karl commented, "Slow and steady wins the race. We still believe that the Fed's most likely course of action is consecutive 25 bp increases at the next six FOMC meetings. This will boost the funds rate to 4 percent, or 2 percent above core inflation.

"Solid, if not spectacular, growth will allow the Fed to continue raising rates," Karl noted. "Core inflation remains under control at about 2 percent. Rate increases at coming meetings will keep inflation in check. The Fed will tighten more gradually if growth slows and in larger increments if growth picks up. The chief threats to inflation remain high energy prices, large budget deficits and a weakening dollar. Ongoing fed funds increases, continued growth and inflation near 2 percent suggest that the yield on 10-year Treasuries will rise to 4.9-5.4 percent by year-end 2005. "Outside the US, a strong euro and weaker export demand slowed Euroland growth in the second half of 2004, making it likely that the European Central Bank will not raise rates for a few quarters," added Karl. "In Japan, growth has moderated and inflation remains near zero, so the Bank of Japan will remain accommodative for most of the year. In the United Kingdom, inflation remains low and last year's rate hikes have had the intended effect of slowing growth in consumer spending and borrowing. The Bank of England can therefore leave rates unchanged. Slowing growth in Canada will prompt the Bank of Canada to be on hold for a few months before raising rates later this year."

Notes to editors

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