

## Fed rate action commentary from Swiss Re chief US economist

30 JUNE 2004, NEW YORK

Following today's announcement that the Federal Reserve Board would raise the target federal funds rate 25 basis points to 1.25 percent, Swiss Re chief economist Kurt Karl said, "Strong growth in the US economy coupled with a rise in inflation has induced the Fed into tightening monetary policy. This is the first in many rate hikes, which will likely take the federal funds rate to 2.25 percent at the end of this year and 4.0 percent by the end of 2005.

'The Fed will proceed to raise rates at a 'measured' pace unless growth or inflation accelerates sharply,' said Karl. 'Next year, if growth shows few signs of a slowdown, the Fed could get more aggressive. With this backdrop, the yield on the 10-year Treasury note will rise less sharply than the federal funds rate, reaching 5.0 percent to 5.5 percent by year-end. With robust consumer spending and healthy business investment, growth is highly likely to remain strong over the next twelve months. Hence, increasing attention will be devoted to inflation indicators and their implication for Fed policy. The key questions will be, 'will the Fed raise rates by 50 basis points next time, will it move between meetings, or will it adhere to its proposed 'measured' pace.' Currently, it is our view that productivity gains will contain inflation and the Fed's implied strategy, which we translate as 25 basis point hikes at each of the next 11 FOMC meetings, will prevail. 'Europe continues to gain strength, but the European Central Bank is unlikely to raise rates until next year,' added Karl. 'Japan's economy is growing rapidly, but the Bank of Japan needs to hold off any monetary tightening until inflation becomes firmly re-established - next year at the earliest. In the United Kingdom, the ongoing tightening of policy will continue until housing inflation pressures ease and growth slows to a more moderate pace. Their policy rate is expected to be 4.75 percent by year-end. The Canadian economy has mostly recovered from its numerous problems of last year, and will follow the Fed's lead, but at a much slower pace. The Bank of Canada will raise rates by only 50 basis points by year-end.'

### Notes for editors

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