Swiss Re

Fed will decrease purchase of Treasuries by early 2014, says Swiss Re Chief Economist, Kurt Karl

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New York, 19 June 2013 – After today's decision by the Federal Reserve to maintain the target fed funds rate at zero to 25 basis points, Swiss Re's Chief Economist, Kurt Karl, commented that any decline of purchases of Treasuries will be determined by economic developments in the second half of this year.

Kurt Karl commented: "The Fed has consistently been dovish on its policies as it seeks to support the economy, given the benign inflationary environment. Towards year-end, however, it will be clear that the current volume of Treasury buying is more than the issuance since the deficit is declining rapidly with the tax increases and spending cuts enacted this year. Thus, the tapering off of purchases is likely to happen early next year at the latest. Under these circumstances we expect yields on the 10-year Treasury note to rise to 2.5% by end-2013 and 3.0% by year-end 2014."

He continued that consumers are gaining confidence along with rising equity and home prices and continue to spend and purchase homes. Business investment continues to contribute to growth, but is no longer robust, and government spending remains a drag on economic activity.

He further explained that "sentiment indicators for the Euro area are finally showing some signs of improvement. PMIs for both the manufacturing and the services industries increased in May. The improvement was particularly pronounced in Spain and Greece while the Italian composite PMI remained broadly flat. For our expectations of slow growth in 2H 2013 to materialise, we need to see some further improvement in these survey-based indicators. Our growth forecast of -0.6% for 2013 is dismal, but growth next year of 1.0% is expected."

He continued that monetary tightening expectations have driven longer-term bond yields higher. Ten year government bond yields are up by 50 basis points since early May in the US and 40 basis points in Germany. We expect the uptrend to continue, albeit not at the recent pace. Our year-end forecast for the 10y yield is 1.7% in Germany.

He also said, "In Asia, Abenomics in Japan has weakened the yen, lifted the stock market and improved growth prospects modestly. Chinese growth has been disappointing, but is still expected to be over 7.5% this year and about 8% next year. The Chinese government has a delicate balancing act – restraining asset bubbles, containing inflation and supporting growth. Nevertheless, the authorities have always proved adept in such situations in the past and there is every reason to expect the new leadership to maintain growth, keep inflation low and avoid a hard-landing. "

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