

News release

First Fed rate hike will be in 2015 at the earliest, says Swiss Re Chief Economist, Kurt Karl

New York, January 29, 2014 – 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, said that with economic growth this year still uncertain, the Fed will want to reassure the markets that they are not expecting to raise rates until next year.

"Until growth prospects for 2014 are clarified by incoming data, the Fed's guidance will be that there will be no rate hikes until 2015 at the earliest," says Kurt Karl

Recent worries about US growth prospects have actually lowered the yield on the 10-year Treasury note, but this seems very likely to reverse this year.

He continues: "Our latest forecast for the 10-year yield is 3.5% by end-2014 because real GDP growth is expected to be over 3.5% in the next three quarters, as housing starts to increase, business investment accelerates, consumers keep spending and the fiscal drag eases."

Karl adds: "Fed tapering will be completed this year, freeing the Fed to decide on the appropriate timing of the first Fed funds rate hike. Given our outlook for economic growth, the Fed is likely to begin raising the Fed funds rate in early 2015, lifting it to 1.75% by end-2015. Growth is expected to continue to be robust next year as well, so the yield on the 10-year Treasury note will end the year close to 4.2%."

Growth is also improving in the euro area, though France continues to lag behind. The peripheral countries are also expanding with the Manufacturing Purchasing Managers Indices (PMIs) of Italy, Spain and Ireland above the 50-threshold in December. The recovery in the euro area is expected to continue this year, albeit at a modest pace of around 1%. While fiscal policy should become less of a drag, ongoing deleveraging of the private sector and tight credit conditions are likely to prevent more robust growth.

Yields on the 10-year German bunds will only rise to 2.3% by end-2014 and to 2.8% by end-2015. The UK looks particularly strong, so we have lifted our 2014 growth forecast for the UK economy from 2.2% to 2.8%. Yields in the UK will rise along with US interest rates.

Karl adds: "The Chinese economic outlook remains positive and steady. Nevertheless, credit risk is gaining increasing market attention. Domestic bond yields and interbank rates are trending higher, reflecting tighter liquidity and the impact of interest rate liberalization. Local government debts rose to

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CNY17.9 trillion in June 2013 (up 67% from 2010) and 2014/15 will be the repayment peak. Rising bond yields would make refinancing challenging."

Swiss Re

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