



Tapering is expected to be completed by end-2014, says Swiss Re Chief Economist, Kurt Karl

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New York, 18 December 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, said that with the unemployment rate declining so rapidly, the Fed will want tapering to be completed by the end of 2014.

Karl said: "Yields on the 10-year Treasury note have already priced in the tapering, so economic activity and anticipation of fed funds policy rate increases will be the main drivers for pushing yields to 3.2% by end-2014."

Real Gross Domestic Product (GDP) growth is expected to be weak in the current quarter, due to the government shutdown and an inventory drawdown. However, Karl believes growth will re-accelerate early next year because there will be less fiscal drag and housing construction should pick-up.

He added: "The unemployment rate is already at 7%, so a strengthening economy could push it below 6.5% before the end of 2014. Thus, the Fed will want to complete its tapering program before the end of next year in preparation for a potential hike in the fed funds policy rate, which is expected in early 2015. The recent budget deal reinforces this projection since, if enacted, it will remove some of the fiscal drag and most of the fiscal uncertainty that has been hanging over the economy for the past year. As the Fed begins tightening, the yield on the 10-year T-note will climb to over 4% by end-2015."

Growth is improving in the Euro area including in the periphery, but if disinflation turns to deflation, the periphery could be challenged. While deflation improves the periphery's competitiveness, it worsens both the private and public debt situation by lowering asset values and the earning power to pay back the debt, which is fixed in nominal terms.

Karl continued: "With this economic environment of modest growth and very low inflation, yields on the 10-year German bunds will only rise to 2.3% by end-2014 and to 2.8% by end-2015. China's growth is expected to remain near 7.5% for the next few years, while Japan is forecast to sustain growth of 1.5%. The UK economy continues to strengthen, so yields on gilts will reach 3.8% by the end of 2015. Inflation is subdued in the major economies for now and no rapid increase is expected, though it is a risk worth monitoring."



The recently published economic blueprint for China is very comprehensive, and sends a strong signal of Chinese leaders' reform stance, even though many items are a continuation of existing policies. The blueprint has a strong emphasis on the role of the market in resource allocation as well as in breaking up the dominance of SOEs. This is a long-term blueprint, so its impact will likely occur gradually."

He concluded: "Japan's reforms have yet to be implemented, but some liberalisation is expected, which will modestly help to sustain growth. Inflation in Japan is projected to remain positive for the foreseeable future, but it will be difficult to keep it as high as 2%."

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