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Fed rate action commentary from Swiss Re US chief economist

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After today's 25 basis point Federal Reserve increase in the target fed funds rate to 3.75 percent, Swiss Re's US chief economist Kurt Karl commented, "though Katrina has increased uncertainty about economic growth, it is highly likely to increase inflationary pressures in the short run. Hence, this rate hike comes as no surprise. Another increase in interest rates is very likely in November also. By the middle of next year — if not sooner — the fed funds rate should reach 4.5 percent.

"Unemployment is falling, capacity utilization is rising and Katrina has increased the pressure on energy and construction materials markets. With these inflationary pressures in the pipeline, the Fed can be expected to continue raising rates. Growth prospects are uncertain. Whereas Katrina has increased energy prices, the rebuilding and stimulus implied by the government's relief package are substantial and could lead to stronger-than-expected growth, Karl said. "The Fed needs to raise rates to dampen demand, preventing an acceleration in inflation. So far, rising oil prices have done little to dampen consumers enthusiasm for spending — the savings rate fell below zero in July. Nevertheless, oil prices remain the largest risk for derailing growth and potentially changing the Fed's course.
"Though the Bank of England cut rates recently, further rate cuts are unlikely due to increased inflationary pressures from global markets. In Euroland, the European Central Bank (ECB) is still expected to raise rates next year, as the economy gains strength. In Japan, growth appears to be sustainable this year and next at something close to 2%, but no rate increases are expected until inflation picks up substantially — perhaps in 2007. Canada is expected to continue raising rates, but at a slower pace than in the US. Its economy is healthy and rates are still very low," added Karl.

Notes to editors

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