Swiss Re

News release

Growth in second half of this year will push up Treasury yields, says Swiss Re Chief Economist, Kurt Karl

New York, April 30, 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 believes that with tapering continuing at a consistent pace, attention will soon shift to the first rate hike, expected in early 2015.

Karl says: "The winter weather, which dampened first quarter growth, is now over. The stage is set for a strong second half of 2014 with growth averaging 3.8% and this is expected to push up yields on the 10-year Treasury note to 3.5% by year-end. Real GDP growth for next year will also be strong, 3.5%. By end-2015 yields on the 10-year Treasury are projected to be over 4%."

With this growth profile and rising wages – up 2.1% year-on-year in March compared to 1.5% for all items inflation – the Fed will need to raise interest rates earlier and more rapidly than currently expected. This is likely to occur in the first quarter of next year.

Karl adds: "Of course, if growth and wages prove more anemic than projected, the Fed could delay rate hikes well into 2015. Currently, the Fed fund rate is forecast to reach 1.75% by end-2015."

The ECB has returned quantitative easing to the table, but is also considering lowering its policy rates, possibly even into negative territory. With growth improving and unemployment falling in many Euro-area economies, none of these moves are currently expected. Inflation is projected to rise modestly, reducing pressure on the ECB to provide additional monetary easing. The April Markit Eurozone Flash Composite PMI rose to 54.0 from 53.1, implying sustainable growth this year which will firm prices, stabilizing inflation.

"The recent indicators are consistent with Euro area growth of at least 1.0% this year and 1.4% next year," says Karl. "Yields on the 10-year German bunds will rise to 2.3% by end-2014 and to 2.8% by end-2015. Economic growth in the UK is projected to be much stronger – 2.8% this year and 2.4% next year. Inflation will be near 2% and yields on UK 10-year government bonds will rise along with US interest rates to 4% by end-2015."

After a string of disappointing Chinese economic indicators, risks to growth are increasing. However, inflation is benign, providing the

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Chinese authorities with the leeway to bolster growth and Premier Li Keqiang has reiterated his willingness to do so. Real GDP growth is expected to be between 7% and 7.5% this year and next. The high level of debt to GDP, coupled with the authorities' interest in curbing credit growth and shadow banking, are key market concerns. Most likely, the policymakers will be able to slow the pace of credit expansion and engineer a soft landing of the economy.

Karl concludes: "In Japan, the current quarter of real GDP growth is very likely to be negative, but this is due to the front-loading of consumption before the April sales tax increase. Growth will resume in Q3 and average 1.5% this year and next. Inflation will be over 2% this year, but fall back to 1.5% next year."