



US economy will grow despite spending cuts predicts Swiss Re Chief Economist, Kurt Karl

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New York, 20 March 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: "Triggering the sequestration will slow growth and delay the first rate hike by the Fed into early 2015."

Karl added: "If present trends continue, the unemployment rate will fall below 6.5% in the first quarter of 2015, so the Fed's first rate hike is unlikely to come any time sooner. Nevertheless, yields on the 10-year Treasury notes are expected to rise modestly this year and next, reaching about 2.6% by end-2015 as economic activity picks up.

"Though allowing sequestration to be implemented is not sound fiscal policy, it will reduce the deficit. Additionally, it will weaken economic growth this year by about 0.5%, deferring monetary tightening. Our baseline scenario assumes that more finely-tuned policies will be put in place over the next few months to reduce the dampening impact from the sequestration, so growth will be about 2.0% in 2013."

He further added: "Economic developments remain uneven in the Euro area. Economic indicators have rebounded in Germany, but have remained weak in many other European countries, particularly Italy and France. We currently expect the mild recession to continue in the Euro area, with real GDP growth of -0.3% in 2013.

"The lack of growth is one important factor that makes the resolution of the Euro area debt crisis so difficult. An excessive focus on fiscal austerity last year has probably contributed to the deepening recessions in the periphery. The focus now appears to be shifting gradually towards tolerating deficit overshoots caused by worse-than-expected economic performance. The key to longer-term sustainable growth, however, lies in further structural reforms that are conducive to growth and these, if implemented, will only have an impact over the next five years."

He continued: "The indecisive election outcome in Italy is a reminder that the reform path in Europe will not be a smooth process. In addition, reducing the private and public debt overhang involves distributional choices that can lead to a public outcry as we are currently witnessing in Cyprus."

He also said: "Recent data confirm a modest recovery in China, with real GDP growth of 8.2% expected. Inflation is picking up slowly which could point to monetary policy gradually returning to a neutral position,



unless growth falters. In Japan, the recent appointment of new senior leadership to the Bank of Japan (BoJ) promises a more aggressive monetary policy, and is a bold statement to raise the public's inflation expectations. However, the success of 'Abenomics', a combination of expansive monetary and fiscal policies, will require further policy actions including large amounts of asset purchases by the BoJ. Moreover, structural reforms will also be key to raising Japan's growth potential. Real GDP growth will be about 1.0% and inflation about 0.4% this year."

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