



Fed in holding pattern until economic outlook becomes clearer says Swiss Re Chief Economist, Kurt Karl

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New York, 1 May 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: "For now, the Fed is in a holding pattern awaiting further information on the impact of sequestration on economic activity."

Karl added: "Though the Fed continues to discuss changes in policy with respect to quantitative easing, no policy change can be expected until there is greater clarity on the economic outlook. At this time, there are no signs of any inflation concerns so the focus is all on growth. Last month's employment report was disappointing, so the Fed is unlikely to change its QE program any time soon – most likely it will continue through to the end of the year. Economic activity is expected to improve, pushing yields on the 10-year Treasury note to about 3.0% by the end of 2015."

Karl continued, "The US economy remains resilient despite the drag on growth from the negative impact of tax increases and the sequester that went into effect on March 1st. The rebound in housing activity continues at a strong pace and will drive growth of residential construction. Consumer spending is also on an upward track, supported by sustained employment growth, gains in disposable income, and recovering home values."

He further added, "The growth forecast for Europe remains unchanged. However, Cyprus is a reminder that the euro crisis is not over. While the island is a special case in many respects, an exit of a smaller European peripheral remains a tangible risk."

"Economic indicators in Europe remain weak. Unemployment is still increasing in southern Europe and France, while stagnating in Germany. Though PMIs have stabilized somewhat, they remain below 50, implying the economy is shrinking. Our growth forecast of -0.3% for 2013 remains unchanged, but risks are skewed to the downside."

He continued, "The impact of the Cypriot turmoil on the rest of the Eurozone has been muted, for a variety of reasons. Cyprus is very small and widely seen as a unique and exceptional case. The European banking system is better funded and capitalized today than one year ago. Also, the promise of the ECB to do whatever it takes to preserve the monetary union has made market participants more confident. However, Cyprus came close to a disorderly exit from the Eurozone. Also, the bailing in of depositors and bondholders could change expectations of how bank creditors will be treated in future bank



resolutions. As a result, weaker banks, particularly in the periphery, could see their funding costs increase, restricting the supply of credit and thus prolonging the recession there."

He also said, "The first quarter growth in China was a bit disappointing, China's real GDP is still expected to grow by around 8% this year. Inflation appears to be contained for now. Under its new governor Haruhiko Kuroda, the BoJ seems determined to reach its 2% inflation goal over the next two years. The new inflation target is credible and striving to achieve it has already weakened the yen and modestly improved Japan's growth prospects. Nevertheless, the impact on growth of the new policies will be very short-lived without structural reforms."

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