PACIFIC FUNDS insights

Informational commentary from Pacific Funds

December 2020

THREE MORE YEARS

Fed officials project interest rates will be near zero through 2023, as the distribution of the COVID vaccine appears to provide light for the economy in 2021.

Key Points

- As expected, the Federal Open Market Committee (FOMC) held the federal funds target rate range at 0.00-0.25%.
- FOMC's language changes were minimal; rising COVID cases and the start of vaccine distribution seemed to offset each other in the committee's eyes.
- Federal Reserve's revised year-end projections improved with the unemployment rate dropping from 7.6% to 6.7% and GDP increasing from -3.7% to -2.4%.

At the December meeting, Federal Reserve (Fed) officials kept interest rates near zero and said they still expect rates to remain at current levels through 2023. They also reaffirmed support for the economy and financial markets until inflation rises above 2% "for some time," which they continue to project to be in 2023.

As part of its ongoing accommodative stance and to continue supporting the economy in light of the sunsetting corporate credit facilities at year end, the Fed expects to maintain the current pace of asset purchases and will monitor whether future stimulus will still be needed to propel the U.S. economy's return to normalcy. Chair Jerome Powell stated, "No one should doubt that the Fed will act if needed to support the economy and use their full range of tools if the economy could use stronger accommodation."

December's projections showed improved optimism by the committee, as unemployment and U.S. gross domestic product (GDP) numbers were adjusted from 7.6% to 6.7% and from -3.7% to -2.4%, respectively. Since March, household spending has continued to steadily recover from earlier declines, albeit recent increases in COVID cases and new business restrictions will likely cause spending to slow until vaccines can be distributed more broadly.

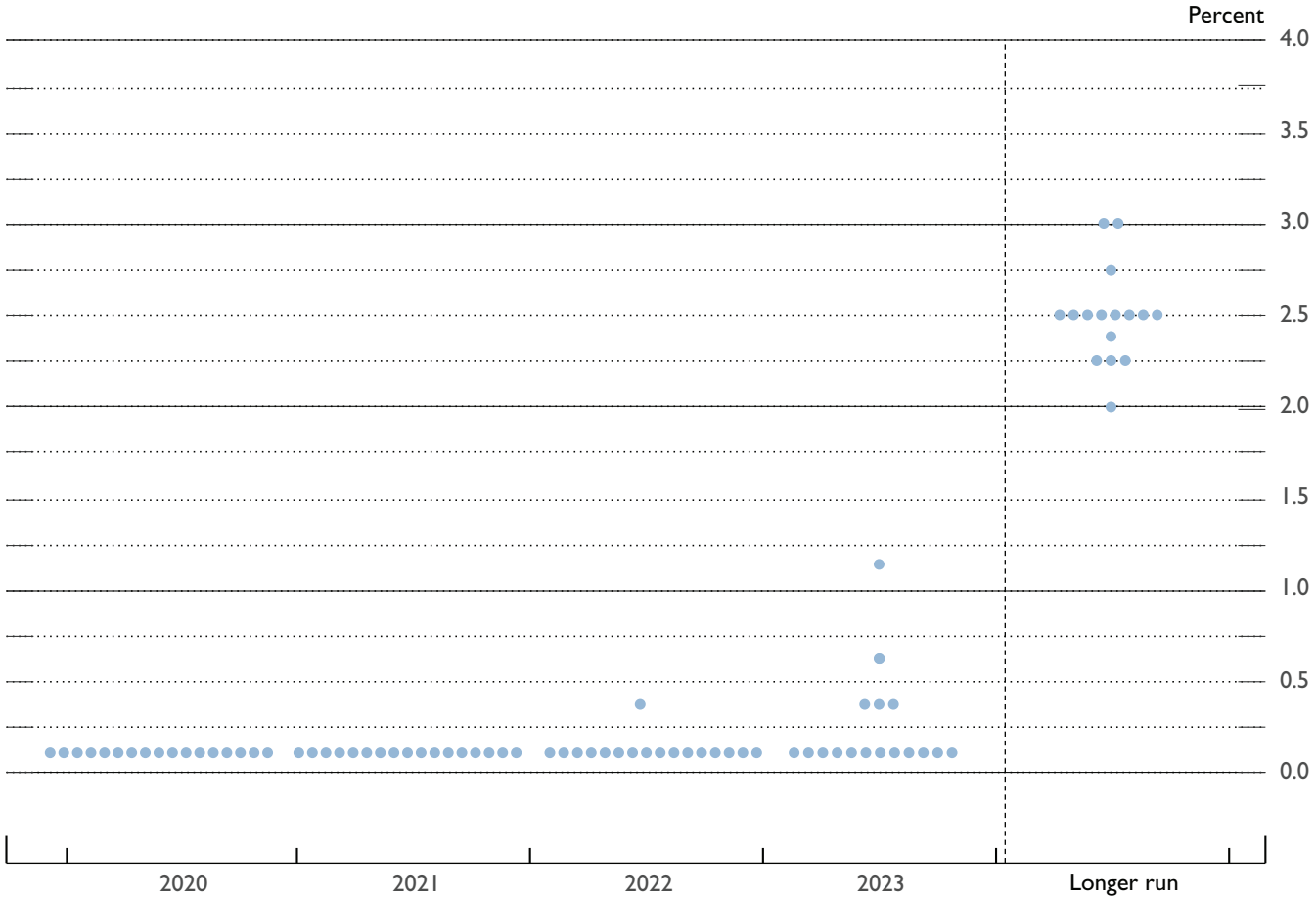
Below are the language changes made in the Fed's statement from November:

Nov. 5 Statement	Dec. 16 Statement
In addition, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses.	In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

The market did not anticipate a change in the Fed's stance of low-rates-for-longer, so investors focused on FOMC's revised economic projections and the committee's comments on the economic recovery. This was only the third glimpse in 2020 of the Fed's estimates (March projections were canceled due to the pandemic). Here are the committee's December projections for GDP, unemployment, inflation, and the federal funds rate for 2020 and next three years:

	Median				
	2020	2021	2022	2023	Longer Run
Change in real GDP	-2.4%	4.2%	3.2%	2.4%	1.8%
September 2020	-3.7%	4.0%	3.0%	2.5%	1.9%
Unemployment Rate	6.7%	5.0%	4.2%	3.7%	4.1%
September 2020	7.6%	5.5%	4.6%	4.0%	4.1%
Federal Funds Rate	0.1%	0.1%	0.1%	0.1	2.5%
September 2020	0.1%	0.1%	0.1%	0.1	2.5%
Core PCE Inflation	1.4%	1.8%	1.9%	2.0	
September 2020	1.5%	1.7%	1.8%	2.0	

The "Dot Plot" showed rates to remain at current levels for the coming years, as median projections show no rate hike until 2023. While all policymakers expect to keep the fed-funds rate near zero through the end of 2021, one official saw rates increasing in 2022, while five saw a higher fed-funds rate in 2023:



Source: U.S. Federal Reserve. The "dot plot" is a statistical chart consisting of data points plotted on a simple scale. Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual Federal Open Market Committee member's view, where each participant at that particular meeting thinks the federal funds rate should be at the end of the year for the current year, the next few years, and the longer run. Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

Following the Fed news, the 10-year Treasury rate rose by 1 basis point at 0.93%; short and long rates were both higher on the day:

10-Year Treasury

	Change in yield for the day	Yield as of 9/16/20
2-Year Treasury	+0.02%	0.14%
10-Year Treasury	+0.01%	0.93%
30-Year Treasury	+0.01%	1.67%

Source: FRED® as of 12/16/20

In Conclusion

Markets gained traction during the Fed's press conference as investors seemed buoyed by the Fed's statements. The dollar fell from the day's highs, while U.S. stocks moved higher. The Dow Jones Industrial Average and S&P 500 indexes finished the day mixed at -0.15% and 0.18%, respectively. Fed officials reaffirmed their stance that policy will remain highly accommodative until they are confident the economy is far along the road to recovery. The next meeting is scheduled for January 26-27, which is expected to be the first under a new administration and post the closing of the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility.

Definitions

One **basis point** is equal to 0.01%.

The **Dow Jones Industrial Average index (DJIA)** tracks the share price of the top 30 large, publicly-owned U.S. companies which is often used as an indicator of the overall condition of the U.S. stock market.

The **S&P 500 index** is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the U.S. stock market.

Disclosures

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Mailing address:
P.O. Box 9768, Providence, RI 02940-9768
(800) 722-2333, Option 2 • www.PacificFunds.com

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