PACIFIC FUNDS insights

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WITH INFLATION SLOWING, THE FED SHOWS MORE OPTIMISM

The central bank lifts rates 0.25%, while signaling a softer-than-expected economic landing may be possible.

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Key Takeaways

- As expected, the Federal Open Market Committee (FOMC) increased the federal funds target rate range to 4.50% to 4.75%, a 0.25% increase.
- The Federal Reserve (Fed) vowed to continue rate hikes until inflation is within reasonable range of the central bank's 2% objective.
- The FOMC also stated that it might be able to achieve its inflation target without major economic hardships or a spike in unemployment.
- The committee softened its statement language as inflation has likely peaked but cautioned there was still work to be done before pausing what has been the most aggressive rate-hiking cycle in history.

At their January meeting, Federal Open Market Committee (FOMC) members agreed to hike the fed funds rate by 0.25%, raising it to the 4.50% to 4.75% range. It was the first 25-basis-point hike since March (and smaller than its previous six raises). The smaller increase was helped by the January CPI print, which saw a continued move down in inflation and didn't force the FOMC's hand to enact a larger hike than the market had priced in.

The Fed softened its latest statement regarding inflation, noting, "Inflation has eased somewhat but remains elevated," signaling to investors that the light at the end of the rate-hike tunnel was closer than a month ago, when rates were raised by 50 basis points. The Fed also dropped listing the pandemic and supply-chain troubles as reasons for the elevated inflation. However, the FOMC appeared reluctant to unconditionally signal that its aggressive campaign to combat price increases was nearing an end. Chair Jerome Powell said at his news conference that inflation "has moderated but remains too high." He added, "We still think there's work to be done there. We haven't made a decision on exactly where" rates will peak.

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

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Dec. 14, 2022 Statement	Feb. 1, 2023 Statement
Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures.	Inflation has eased somewhat but remains elevated.
Russia's war against Ukraine is causing tremendous human and economic hardship. The war and related events are contributing to upward pressure on inflation and are weighing on global economic activity.	Russia's war against Ukraine is causing tremendous human and economic hardship and is contributing to elevated global uncertainty.
The Committee's assessment will take into account a wide range of information, including reading on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.	The Committee's assessment will take into account a wide range of information, including reading on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Source: FOMC as of 2/1/23.

After the Fed announcement, the 10-year Treasury ended the day lower and finished at 3.39%; short and long rates were also lower for the day.

	2-Year Treasury	10-Year and 2-Year Treasury Spread	10-Year Treasury	30-Year Treasury
End of Last FOMC Meeting (12/15/22)	**4.23%**	**-0.79%**	**3.44%**	**3.48%**
Start of FOMC Meeting Week	**4.19%**	**-0.67%**	**3.52%**	**3.64%**
End of FOMC Meeting (2/1/23)	**4.09%**	**-0.70%**	**3.39%**	**3.55%**

Source: FOMC as of 2/1/23.

In Conclusion

Markets closed in positive territory on the final day of the FOMC meeting, as both the Dow Jones Industrial Average and S&P 500 Index moved higher (0.02% and 1.05%, respectively) during Chair Powell's press conference. As the committee reiterated its stance on reining in inflation, albeit at a less aggressive pace than in past meetings, Treasury yields across the curve finished the day mostly lower.

The committee delivered on investor expectations with its 25-basis-point hike. Chair Powell also left open the possibility of a similar rate hike in March, which matched market expectations. The Fed continued to reiterate a data-dependent approach to determine if a pause was warranted. Still, Chair Powell struck a less hawkish tone by saying, "Inflation data received over the past three months show a welcome reduction in the monthly pace of increase" and "labor market conditions have continued to improve, even in light of the current

rate environment." But even after the eighth rate hike since March 2022, prices in some areas of the market remain elevated and have yet to fully absorb the past rate hikes. Overall, this meeting was a welcome sign that we are closer to an end of this rate-hiking cycle, and the potential for a softer landing for the economy gave investors a more optimistic outlook.

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.

Gross Domestic Product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

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.

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