E|V|M Eaton Vance Management

Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

FEBRUARY 18, 2021

Markets and Economy

New FOMC minutes renew Fed's commitment to dovish policy

Eric Stein, CFA
Chief Investment Officer
Fixed Income
Eaton Vance
Management

Boston - The newly released minutes for the Federal Open Market Committee's meeting on January 26 provided interesting reinforcement of the Fed's dovish stance.

The Fed is signaling to the markets that they are very focused on keeping real rates low, even with the pickup in growth prospects and asset prices. This leads me to believe that they will continue with that message even if or when inflation accelerates and further fiscal easing occurs.

"The Fed is signaling to the markets that they are very focused on keeping real rates low, even with the pickup in growth prospects and asset prices. This leads me to believe that they will continue with that message even if or when inflation accelerates and further fiscal easing occurs."

I believe that at some point, there are limits to how much inflation could pick up — and an upper bound on the amount of fiscal stimulus —with no corresponding monetary offset. However, I think both of those limits are a pretty long way off. That's something the Fed is trying to signal to the market, particularly given the current debates over the inflationary impact of monetary and fiscal stimulus.

I also think it is notable that most of the rise in U.S. Treasury rates we have seen over the past few months has been due to rising inflation expectations, not to a rise in real rates — although those rates did back up modestly on February 16, along with the related risk-off price action in certain markets. It will be interesting to keep watching this dynamic.

Bottom line: Given that future economic prospects do seem to be getting better, and that's being priced into markets, it is surprising on the surface that real rates have largely stayed unchanged at quite low (negative) levels. However, keeping a lid on real rates appears to be an explicit goal of Fed policy, which shows that its communication strategy has generally been working.