

Subject: Policy Expectations
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It has been long known that people's behavioral responses to economic policies begin with the anticipation of the change, and their response is amplified or reduced when the policy actually becomes effective. Anticipatory changes have been known to energize or sink policy initiatives. Typically, there are extensive public discussions of potential policy shifts, with the recent presidential election a prime example. Nonetheless, Trump's victory in the recent election was a surprise so people did not adjust their expectations in anticipation of his election, and the election was unique in that each side strongly held quite unfavorable views of the opposition. Once the election was decided, each side immediately revised their economic expectations, and revised them to align with their strongly held partisan views on prospects for the economy. The table below replicates the analysis reported two weeks ago with updated January data. All respondents were first interviewed in June or July 2016 and then re-interviewed in December 2016 or January 2017. The table highlights how consumers have changed their expectations over the past six months by whether they self-identified as Democrats, Republicans or Independents. The additional data did not change the basic finding that consumer expectations changed dramatically following Trump's election. Democrats become more pessimistic and Republicans held more optimistic expectations across a range of economic factors.

The large changes partly reflect an exaggerated enthusiasm or despair over the surprise election results, but that should not obscure the more important message that consumers expect fundamental shifts in economic policies. While Republicans' optimism rose more substantially than it fell among Democrats, both held levels on the Consumer Expectations Index that alternatively indicated either a looming recession or an imminent surge in economic growth. Neither is likely, although the average level across all consumers was 88.9 in early January, just below its 2015 cyclical peak of 91.0. The easiest prediction is that the levels will recede among Republicans and rise among Democrats, lessening their exaggerated enthusiasm and despair; moreover, these shifts could well leave the overall Expectations Index unchanged at positive levels. Of the two, the Republicans' rise appears more exaggerated in that their views of Current Conditions posted an unusually large jump.

Ultimately, consumers' expectations will be determined by ongoing changes in economic conditions. If economic conditions improve (as most observers now expect), the relative gains among Democrats will be larger than the declines among Republicans, although the total across all consumers may be left virtually unchanged. The largest risk to the Trump administration is economic expectations that are too aggressive and result in "failed expectations," which are more damaging than if consumers originally held more modest expectations that were met with success. For all new administrations, managing economic expectations represents a shift from campaigning to governing that is often mishandled. Similarly, if the opposition continues to emphasize dismal economic prospects, that approach could benefit Trump by allowing even small gains to be judged more favorably. The likelihood of a renewed recession during Trump's term in office is quite high; its avoidance would require the current expansion to be longer than any other in the past 150 years and by a substantial margin. While old age will not end the expansion, the current state of partisanship may contribute to its early termination. The timing of a recession early in his term and subsequent recovery may give Trump an advantage in a potential re-election campaign.

Change in Economic Assessments Among Identical Consumers in June/July 2016 and in December 2016/January 2017 by Political Party

	Political Party in June/July 2016								
	Democrats			Independent			Republican		
	Jun/Jul	Dec/Jan	Diff	Jun/Jul	Dec/Jan	Diff	Jun/Jul	Dec/Jan	Diff
Index of Consumer Sentiment	101.3	84.8	-16.5	84.8	97.3	+12.5	81.0	122.5	+41.5
Index of Current Economic Conditions	115.0	116.5	+1.5	108.4	107.8	-0.6	100.4	122.3	+21.9
Index of Consumer Expectations	92.6	64.5	-28.1	69.6	90.6	+21.0	68.4	122.6	+54.2
Year-ahead Income Expectations (median %)	2.0%	0.5%	-1.5	0.5%	1.7%	+1.2	0.5%	2.3%	+1.8
Year-ahead Inflation Expectations (median %)	2.3%	2.7%	+0.4	2.9%	2.2%	-0.7	2.6%	2.0%	-0.6
Year-ahead unemployment									
More Unemployment (percentage)	22	45	+23	39	18	-21	36	4	-32
Less Unemployment (percentage)	24	12	-12	12	33	+21	8	57	+49

Note: Data differs from the official published data since these data were based on only the 358 cases that were interviewed in June/July and re-interviewed in December/January 2017.