

Executive Summary: *What Determines Household Expectations?*

Authors: Anushka Mitra (Federal Reserve Board of Governors) and Aditi Singh (CAFRAL)

Objective

This paper investigates which macroeconomic signals shape household expectations about the economy. It finds that labor-market news—particularly unemployment shocks—play a far more dominant role than inflation shocks, even when inflation is rising. The study explores how households update their beliefs after major U.S. macroeconomic announcements and whether they behave like sophisticated or naive agents.

Conceptual Framework

Households receive periodic macro announcements (unemployment, CPI, GDP, housing starts) and may adjust expectations based on the “new information” or shock in these releases.

- **Sophisticated model:** Households form expectations like professional forecasters; the surprise component (actual – forecast) measures new information.
- **Naive model:** Households rely only on past values of the variable (today’s – last period’s value).

These two cases bound the true process of belief updating.

Data and Empirical Design

The authors combine three datasets to identify high-frequency responses:

1. **Gallup Daily Tracking Poll (2008–2017):** Daily household optimism about economic conditions.
2. **Michigan Survey of Consumers (1980–2019):** Monthly qualitative and quantitative expectations (including 12-month-ahead inflation).
3. **Bloomberg Economic Calendar:** Timing and professional forecasts of major macro announcements.

They estimate local projections of changes in expectations around announcement dates, allowing causal interpretation within narrow event windows.

Key Findings

- **Unemployment dominates:** Across both Gallup and Michigan data, households' expectations about the economy respond strongly to unemployment shocks but weakly or not at all to CPI, GDP, or housing shocks.
- **Inflation expectations also move with unemployment:** Even expected inflation reacts more to labor-market shocks than to inflation releases, suggesting households infer inflationary pressure through labor-market conditions.
- **Asymmetry:** Negative news (higher-than-expected unemployment) causes sharp declines in optimism; good news has weaker effects.
- **Robustness:** The dominance of unemployment holds across decades (1980–2019), different inflation regimes, and both supply- and demand-shock episodes. Only during *positive supply or demand shocks* do CPI announcements briefly matter more.
- **Interpretation:** Labor-market information is more *salient and personally relevant*—job losses and income risk are easier for households to perceive than aggregate price changes.

Implications

- **Macroeconomic modeling:** Standard models that treat inflation news as the primary anchor for expectations may misrepresent household behavior.
- **Monetary policy communication:** Central banks should recognize that public expectations are shaped more by employment conditions than inflation data; framing policy communication around labor-market outcomes could enhance credibility and effectiveness.
- **Behavioral insight:** The results are consistent with theories of rational inattention and salience, where households overweight vivid, personally relevant information (unemployment) relative to abstract data (CPI).

Conclusion

The paper provides compelling evidence that unemployment is the dominant macro signal through which households interpret the state of the economy. This asymmetry challenges conventional models of expectation formation and suggests that understanding household sentiment—and hence the transmission of policy—requires focusing on labor-market perceptions as much as on inflation dynamics.

Figure: Response of Household Expectations to Unemployment Announcement

