Subject: Real Income Dominates Evaluations — December 16, 2016

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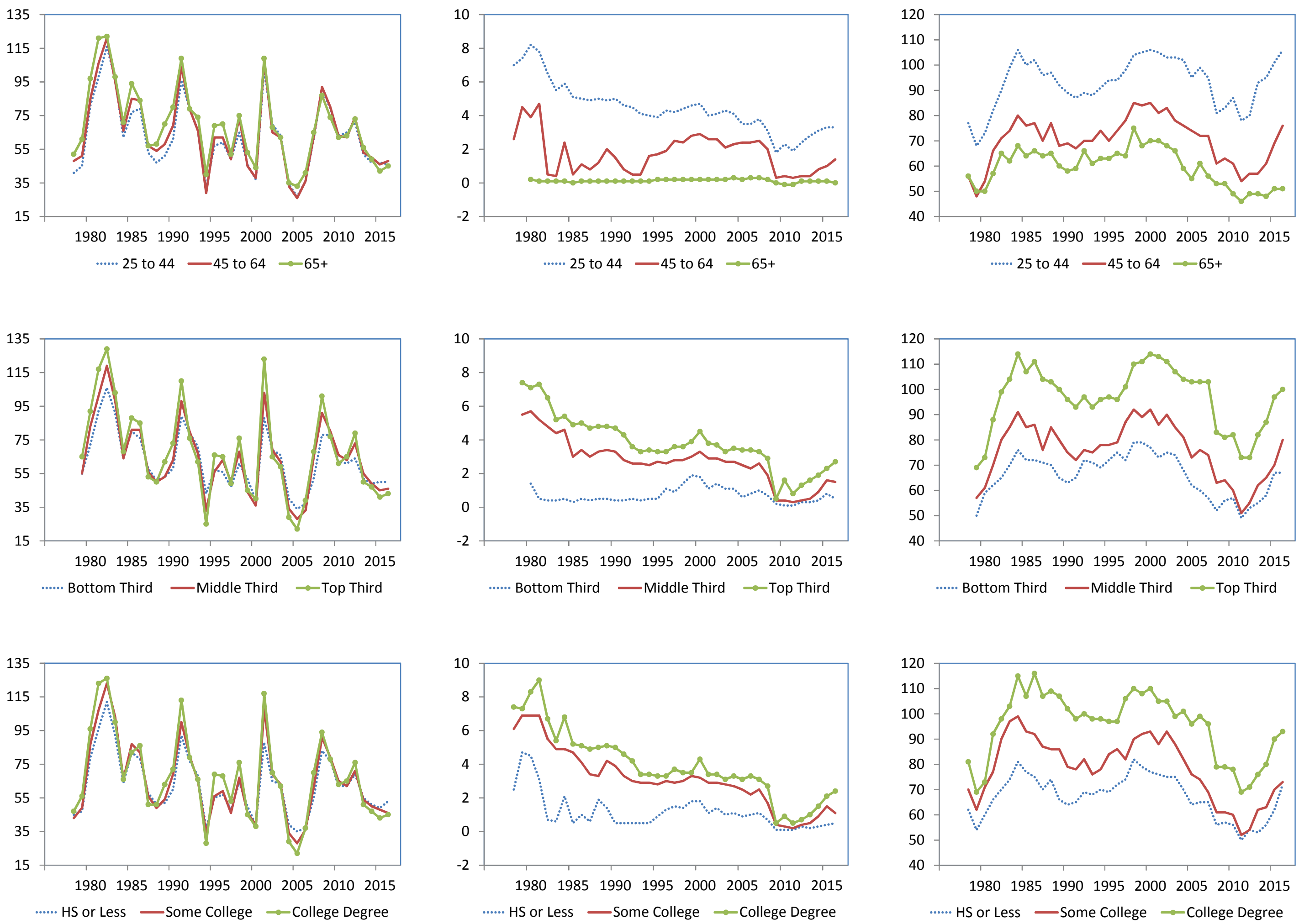
Trends in interest rates have been uniformly anticipated for decades by consumers of all ages, incomes, and levels of education. Two-thirds of all consumers expected higher interest rates in early December, and those rate increases were reflected in how consumers viewed buying conditions, especially for homes. Interest rates increase in every economic cycle, and despite those increases, consumer spending continued to expand due to improved real income expectations. Expected gains in nominal incomes have remained at low levels, however, with consumers expecting income gains of just 1.7% during 2017. Given that consumers also anticipated very low inflation rates, real income expectations have improved in 2016. Income expectations, unlike interest rate expectations, have displayed significant differences across demographic subgroups.

Interest Rate Expectations. The uniformity of trends in interest rate expectations is longstanding and reflects the dominant role of monetary policy starting in the late 1970's. Nearly identical trends in interest rate expectations were exhibited by consumers despite differences in income, age, and education. Even if Trump increases the emphasis on fiscal policies, it is still likely that monetary policy initiatives will dominate fiscal policies when consumers assess the health of the economy.

Expected Income Change. While the downward sloping trends in nominal income expectations reflect lower inflation rates, the differences between demographic groups have grown significantly smaller over time. Once consumers are asked about their inflation-adjusted income expectations, more pronounced cyclical trends become observable over the past decades.

Real Income Expectations. Consumers' evaluations of their financial situation have become increasingly dependent on the maintenance of low rates of inflation. Note that the time-series correlations are quite high among income (0.92), education (0.90), and age subgroups (0.79), even though the average levels across the past several decades are significantly different.

Interest Rate Expectations | **Expected Income Change** | **Real Income Expectations**



Note: Data are annual averages from 1978 to 2016. Chart entries represent net percentages (favorable minus unfavorable responses + 100) for interest rate expectations and real income expectations; the charts display income expectations as annual percentage changes in nominal dollars.