Inflated Expectations: How government partisanship shapes bureaucrat's inflation expectations

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Abstract

A government's party identification can indicate the types of economic policies it is likely to pursue. Left-party governments are expected to pursue policies for lower unemployment, but which may cause inflation. Right-party governments are expected to pursue lower inflation policies. How do these expectations shape monetary policy bureaucrat's inflation forecasts? If there is a mismatch between the policies bureaucrat's *expect* governments to implement and those that they *actually* do, forecasts will be systematically biased. There is evidence that at least in the United States the differences in policies implemented by left-leaning Democratic and right-leaning Republican presidents is minimal (Bartels, 2008). Using Fed Staff's forecasts we test for presidential partisan biases. We find that irrespective of actual policy and economic conditions forecasters *do* systematically overestimate inflation during Democratic presidencies and underestimate inflation during Republican ones. Our findings suggest that Fed Staff's inflation forecasts are shaped by heuristic presidential partisan biases.[1]

Keywords: forecast bias, Federal Reserve bureaucrats, rational partisan cycle, heuristics, inflation, monetary policy

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This paper was written using `knitr` (Xie 2013). It can be entirely replicated from data, analysis source code, and markup files available on our GitHub page at: https://github.com/christophergandrud/GreenBook.