Principal Global Investors

Principal

Economic Insights

Commentary by Bob Baur, Robin Anderson, and the Economic Committee

Topic summaries:

- **Four Funerals and a Wedding**

  A broad-brush overview from the summit suggests that four long-term economic trends are over and that mild inflation and better growth are joining together in a gradual, several-year transition back to something resembling the "old normal."

- **Finding Your Spirit Animal:**

  Secular stagnation has likely met its demise. Households and businesses are getting much more confident because data continues to validate the global economic upturn. Given how long it's taken confidence to resurface, overconfidence and euphoria is surely a ways off.

- **Global Economic Warming Hits Interest Rates:**

  Global interest rates rose sharply since the U.S. election, accelerating a trend that actually began in the third quarter in response to widely improving economic data. As we expect the global upturn to strengthen, the rise in rates is surely not over. U.S. 10-year treasury yields will likely surpass 3% in 2017.

- **Asset Allocation: The Tide is Turning:**

  The economy is transitioning from a decade of slow growth, deflation fears, and low interest rates to one with better growth and mild inflation. Investors are rotating from safe, defensive assets to cyclical securities that benefit from the global upturn. Even though the U.S. rally is already extended, equities should outperform in in this environment for a while longer.

For the month of January 2017

Four Funerals and a Wedding

To get a handle on where the U.S. and global economies are headed, it's important to understand how the current environment came to be. It's asking, why are we here? How did we get here? What are the trends and forces that brought us here? The narrative that answers those questions is what connects and makes sense of disparate events. Statistics describe the setting, but the connecting storyline is what helps project the future. The following overview is how we connect the events of the last decade or two. We call it "Four Funerals and a Wedding."

The first funeral:

The investment boom in China and other emerging markets that peaked in 2011 along with the top in commodity prices. China's economic surge had its roots in the free trade negotiations of the 1990s that culminated with the creation of the World Trade Organization (WTO) in 1995. Integrating China and its large underemployed, low-wage workforce into the world economy meant a huge investment in factories, infrastructure, and facilities. This needed an enormous supply of commodities forcing oil, metal, and grain prices to hit many new record highs in the 2000s. Since emerging markets exported commodities, that huge demand and record prices brought an historic economic boom throughout the developing world: fabulous profits, super-fast growth, and soaring stock prices.

Like all such past euphoric times, it was expected to last forever; this one didn't either. Like all the others, it went too far, creating way too much productive capacity. So prices began to fall, profits plunged, deflation set in, and growth slowed dramatically as excess capacity negated the need for new capital spending. Unsustainable investment: rest in peace.

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>
> Bob Baur • Chief Global Economist, Principal Global Investors

The second funeral:

Soaring demand financed by an unsustainable buildup of debt. U.S. private debt totaled about 50% of gross domestic output (GDP) just after World War II, but soared over six decades to nearly 300% of GDP in 2005. When a car is bought today with borrowed funds, Ford has to hire people today to make the car. Consumption is pulled from the future and demand today is greater and growth today is faster than it otherwise would have been without the debt. New borrowing accelerated for six decades, which led to rapidly expanding demand and faster growth the entire time. Similar debt-fueled demand growth by Euro area governments persisted there for two decades.

Debt-powered growth works until it doesn't. Debt eventually becomes unsustainable since either banks won't lend, no one wants to borrow, or financial markets fret about bankruptcies. At that point, households and businesses deleverage and growth slows dramatically since consumption is no longer pulled from the future. In fact, demand plunges as past debt-fueled purchases have to be paid for or written off. Unsustainable debt-driven demand: rest in peace.

The third funeral:

Secular stagnation, the belief that economic fundamentals had permanently worsened. As the above two trends faded and approached their demise, they created a catch-22: at the exact time the emerging world's ability to supply goods was soaring, demand in developed countries was plummeting. Too much supply and shrinking demand brought the last 10 years of deflation, ultra-slow growth, super-low interest rates, extraordinary monetary policy, fearful households, and businesses worried about a relapse, which kept savings high. It created a never-ending series of crises: U.S. financial crisis; Euro area debt crisis; then Greek debt, Cyprus, Greece again; stock market meltdown and surprise devaluation in China; and collapsing currencies all across the developing world. Last to come was the dread that all this mess was permanent, i.e., secular stagnation, radical monetary policy, and historically-low interest rates, forever.

But, the slow-growth decade of deflation fears and crisis was not a structural shift toward stagnation or a permanent "new normal." It came from the forces of where we had been, i.e., the trends that took us there: a glut of supply amid plunging demand. The world is now working through those imbalances: reflation is replacing deflation; excess capacity is shrinking; anxious consumers are regaining confidence; debt is written off or extended; growth is improving; and interest rates and the stock market are rising. There never was a "secular stagnation" or a "new normal" as propagated by those anxious for press coverage. We're returning to the "old normal," but it may take a while to get there. Deflation, secular stagnation: rest in peace.

The last funeral:

The decline in wages and salaries as a portion of U.S. national income. As millions of workers in developing countries began to integrate into the global labor force, their low wages became significant competition for the jobs and paychecks of some U.S. households. Freer trade, the WTO, and the investment boom in China further enabled that competition. Six million manufacturing jobs disappeared from U.S. shores between the mid-1990s and 2010, a third of the manufacturing workforce. Automation and robots added to the strain on wages. So, employee compensation as a portion of U.S. gross domestic income fell over four percentage points to about 52% in 2011 from the early 1990s. This squeeze on middle class incomes was likely behind the recent U.S. election result that few expected.

As global manufacturers relocated to China and other low-wage countries, demand for workers soared and wages did too. With wages now several times higher, an appreciated currency, and higher transport costs, China is not nearly as competitive as in the 1990s. So, the competition with U.S. workers is less intense as manufacturing and other jobs are coming back. As a result, the portion of U.S. gross domestic income that is employee compensation stabilized since 2011 and lately has edged higher. With the United States near full employment, small businesses unable to find qualified workers, U.S. growth picking up, labor force participation inert at a low level, and fiscal stimulus likely coming in 2017, wages are set to rise, perhaps significantly. Stagnant middle class incomes: may they rest in peace.

The wedding:

A marriage between better growth and mild inflation. Growth is clearly improving as the global upturn widens and becomes entrenched. The U.S. and Eurozone economies are both advancing healthily (see next section). Business and household confidence is spreading; faster nominal growth is giving profits a boost; green shoots of renewed capital spending are evident; wage growth is picking up; interest rates are catching the wave; and reflation is in the air.

Inflation should rise but stay mild. The collapse of commodity prices that helped foster worries of a deflationary relapse into crisis is all but over, but their down cycle has further to run; so severe inflation driven by another price surge is not likely. There is also plenty of spare productive capacity: U.S. capacity utilization is only 75%; China has barely begun to rein in its excess plant and equipment. Central banks, including the Federal Reserve (Fed), will surely accommodate the better demand at least initially, letting wage growth extend and help bring about that rising share of national income to households.

The marriage of mild inflation and better growth may be a return to the "old normal," reminiscent of U.S. economies in the 1950s, 60s, 80s, and 90s. This transition away from a decade of crisis fears, very slow growth, and super-low interest rates will take some time and it may not all be pretty. If households gain a larger share of national income, then the portion going to capital will shrink. The financial market implications of this transition can wait for a later conversation. For now, mild inflation and a boost to growth make for a better economy and a good stock market; the intermediate future looks pretty good. Long live the happy couple.

Finding Your Spirit Animal

In some sense, the U.S. recovery from the global financial crisis started eight years ago, but nobody really believed it was happening. Concerns about a double- or even triple-dip recession weighed on investors. Government shutdowns, debt ceilings, new regulations, higher taxes, and, most recently, collapsing energy prices kept everyone queasy, fretful. Outside the United States, there were troubles with European debt, fears about emerging markets, and deflationary problems brewing in China. Companies refused to invest and households kept savings high.

But now, the tide is turning (it's "the third funeral"). The global economy is in the midst of a mild reflation; prices are finally picking up in the United States, Europe, and China. At the same time, despite risks from rising populism, confidence is returning on both sides of the Atlantic. Good old fashioned "animal spirits" that disappeared post-financial crisis are finally finding their way back to consumers and business. The global upturn is continuing and the data are validating the transition described above in "the wedding."

United States:

December data has been fantastic, especially consumer and business surveys. The Michigan consumer confidence index hit the highest since 2004, the Conference Board's index reached 2001 levels, and Bloomberg consumer comfort had the best year since 2007. All regional manufacturing indices, except Chicago, surged over the prior month.

The robust job market is part of the reason. Jobless claims stayed below 300,000 for the 95th consecutive week! Unemployment rates are falling sharply across the country with 271 out of 387 metro areas having declining unemployment rates year-over-year in November. For example, in Iowa where Principal has its home office, the labor market is terrific despite hits from falling agricultural prices. The unemployment rate for Des Moines fell below 3.0%; Ames, home of Iowa State University, had the lowest unemployment rate in the United States, at 1.8%. Even in the rust belt, beleaguered Detroit has a solid labor market, with 5.1% unemployment.

Hard activity numbers in November were somewhat disappointing. Personal income was flat; real consumer spending was up only 0.1%, but part of the weakness came from unseasonably warm weather and low utility spending. On a three-month average, real spending rose 2.7%, off slightly from the 3% third-quarter growth. Another positive signal of animal spirits: the savings rate has declined to 5.5% in November 2016 compared to 6% the year before. Business data were a bit more positive. The key leading indicator, durable goods orders ex-aircraft, rose 0.5% in November. Capital goods orders jumped 0.9% and rose in four of the last six months.

Housing data were mixed: homebuilder confidence soared to an 11-year high. Housing starts dropped nearly 19% with a 45% drop in multifamily starts. Permits fell by nearly 5%, but single family permits, which lead housing starts, were up 0.5%. Mortgage rates hit a yearly high of 4.18% in December, but haven't curbed sales yet; existing home sales rose 0.7%, new home sales 5.2%. December numbers could be even stronger if home buyers buy early to beat further rate increases.

The last estimate of third-quarter GDP had modest but good revisions. Growth was revised to 3.5% from 3.2% and consumer spending growth to 3.0% from 2.8%. There were nice revisions to investment as well as state and local government spending. Net exports still supported growth, adding 0.85 percentage points, mostly driven by a one-off surge in soybean sales. Profits rose 2.1% over the prior year, up for the first time in almost two years. Some selected U.S. forecasts are in the table below; complete forecasts for U.S. economic growth are in tables at the end of the commentary.

U.S. Forecast Table	2015 (A)	2016 (E)	2017 (E)
Real GDP	+2.6%	+1.7%	+2.9%
Domestic Final Sales	+3.1%	+2.1%	+2.7%
U.S. Auto Sales (units)	17.4m (5.8%)	17.3m (-0.8%)	17.5m (1.4%)
Industrial Production	+0.3%	-0.9%	+1.0%
Housing Starts (million)	1,108 (10.7%)	1,200 (8.0%)	1,320 (10.0%)
After Tax Corporate Profits (National Income and Products Accounts	-8.5%	+1.7%	+5.1%
Federal Budget Balance (Fiscal Years)	-$0.4T	-$0.6T	-$0.6T
Civilian Unemployment Rate	5.3%	4.9%	4.5%
CPI – Overall	+0.1%	+1.3%	+2.0%
CPI – ex Food & Energy	+1.9%	+2.3%	+2.2%
GDP Price Index	+1.1%	+1.4%	+2.0%

Sources are in the tables at the end of the commentary

A - Actual

E - Estimated

Around the world:

Deflation is over in China; producer prices rose 3.3% year-over-year, the strongest in five years. Industrial profits continued their upward surge in November, up 14.5% year-over-year, remarkable compared to the 2.3% fall in 2015. Business surveys remained solid even after losing a little steam. The official manufacturing survey edged lower to 51.4 as did the services survey to 54.5. Real estate sales have slowed some but from super-high levels; that sector is still a big driver of growth. The rise in profits and producer prices, more electricity use, and higher freight traffic all suggest a solid bounce in factory activity.

New Year, new basket:

The Chinese Foreign Exchange Trading System (CFETS) revised the yuan's trading basket, increasing the number of currencies in the basket from 13 to 24. The Korean won is the biggest new edition, with about a 10% weight. The U.S. dollar remains by far the largest share at 22.4%. The basket change will impact how the yuan compares to other currencies. *J.P. Morgan* analysis shows that including the won means the fall in yuan has been less dramatic than previously estimated and may offset future dollar strength.

Eurozone business surveys keep rising despite all the political uncertainty. Look at Italy: despite the political upheavals and headwinds from the banking system, confidence is up! In the month to December, consumer confidence rose four points to 111 and manufacturing confidence hit the highest level in a year. Italy's manufacturing survey jumped a full point to 53.2. Other countries had robust surveys too. France's surged to 53.5 with new orders at the strongest level since May 2011. Germany's increased over a point to 55.6, the best reading since January 2014. Spain's survey rose from 54.5 to 55.3. German business confidence hit a multi-year high. Eurozone reflation is happening; German producer prices turned positive annually the first time in three years.

Recent Japanese data were generally decent too. Industrial output increased 1.5% month-over-month and companies expect the strength to continue with 2% plus rises in production forecast for December and January. November real exports were up 3.4%. The manufacturing survey was 51.9, up a bit in November. The Tankan index increased for the first time since 2015's second quarter. Inflation is weak; the core consumer price index softened to 0.2% versus 0.3% in October. In fact, for Tokyo, core-core price index (ex-food and energy, including alcohol) moved back to deflationary territory.

A look ahead:

Against the transition backdrop of reflation and rising confidence, U.S. economic growth should accelerate further. A strong labor market and robust wage gains will support consumer spending growth in the 2.5% to 3.0% range, with solid upside potential. Oil rig counts are up sharply from their lows, supporting new investment. Business confidence, whether of small or large companies, is sharply higher post-election, suggesting that healthy capital spending may finally reappear. The added vigor from newly rediscovered animal spirits should support GDP growth of nearly 3% in 2017.

At some point, though, rising interest rates will become a drag on the U.S. economy. There is some chance growth could slow significantly in late 2018 as our forecasts indicate. We'll be watching for that possibility as 2017 marches on.

In China, faster nominal growth, higher profits, an easy flow of credit, and further fiscal stimulus will support the economy even if growth edges below the 6.5% target. The deflationary low for nominal growth was likely hit last year at 6%. Huge piles of debt remain a big risk, but reflation is helping the problem. Solid Eurozone business surveys suggest that the mild recovery in the currency union will persist. Growth should remain in the 1.5% to 2% range as we've been forecasting. Japan's economy will grow as exporters and manufacturers benefit from yen weakness.

Strong confidence and rising animal spirits are very good things so long as they don't go too far and turn into irrational exuberance and euphoria. Given how long businesses and households have kept savings lofty and spending contained, the point where the global economy moves from good old-fashioned animal spirits to a good old-fashioned bubble may take a long time.

Global Economic Warming Boosts Interest Rates

The spreading world economic upturn that began the spring of 2016 is testing the resolve of the "lower rates for longer" camp. Few saw it coming early in the fourth quarter because interest rate signals seemed mostly noise. The September Fed meeting gave no hint of what was coming, even if three hawks wanted to start normalizing rates. The minutes of that meeting favorably described the U.S. economy and even though financial markets felt a December rate hike was assured, it wasn't a done deal, still dependent on better data. By the end of October, the smell of reflation was wafting as data improved and commodity prices gained momentum. U.S. inflation had been near the Fed's target for months and bond markets began to sense global warming.

Recent data validated those perceptions. U.S. third-quarter GDP growth hit 3.5% with fourth-quarter progress likely not far behind. Job growth was steady at good levels and confidence soared. So, the Fed moved the federal funds rate range up another 0.25% in December. This contrasts with the ease at the European Central Bank (ECB), the Bank of Japan (BOJ), and the Bank of England (BOE). Neither the BOJ nor the BOE made any recent policy changes. The ECB extended its purchase program to yearend 2017 and cut back its monthly purchase rate a bit. The ECB likely felt compelled to maintain a very easy policy because of the uncertain political setting in Europe. ECB President Draghi delivered a message of extended accommodation, despite the dip in the pace of purchases.

U.S. election focuses attention:

There's nothing like a big surprise to concentrate the mind. All the pre-election talk was that markets would tank on a Trump victory. What his unexpected win did was cluster attention on the many signs of strong economic progress; the nascent upward move in rates was fast tracked. 10-year U.S. treasury yields quickly reached the year's high of 2.6% before fading to 2.44% at yearend. Yields on 10-year German bunds followed suit, surging from negative yields as low as 0.19% to a positive yield near 0.4%, before ending the year at 0.2%. 10-year Japanese government bonds (JGB) also turned positive after having been negative much of the year. Recent rate history is shown in the table below.

Interest Rates

	12/31/2013	12/31/2014	12/31/15	12/15/2016 (High)*	07/08/2016 (Low)*	12/30/2016 Current
2 year	0.38%	0.66%	1.05%	1.27%	0.61%	1.19%
10 year	3.03%	2.17%	2.27%	2.60%	1.36%	2.44%
10-2 spread	2.65%	1.51%	1.22%	1.33%	0.75%	1.25%
30 year	3.97%	2.75%	3.02%	3.16%	2.10%	3.06%

*Twelve month high and low, based on the 10-year Treasury bond over the prior 12 months
Source: Bloomberg

Rates to move higher in 2017:

With the December rate hike out of the way, what's in store for 2017? The surprise at that Fed meeting was the hawkish change in Federal Open Market Committee (FOMC) expectations. The median forecast rose to three rate hikes in 2017 even though the underlying growth outlook was unchanged at 2.1%. Financial markets expect a much better outcome and our own projection is for GDP to advance 2.9%. The rise in rates in the fourth quarter was for the right reasons: improved growth prospects, less recession risk, and fewer deflation worries. In fact, inflation expectations have risen along with prospects and oil prices. The price of Brent crude oil ended the year above $56 per barrel and could be higher by May. So headline inflation should reach at least 2.0% in 2017.

We suggest 10-year U.S. treasury yields will rise to have a "3-handle" during 2017. The move to that level, though, will likely wait until the ECB and BOJ reduce their monetary accommodation and German bund and JGB yields rise above their current low levels. The current better economic environment of faster growth, rising confidence, and expanding profits can surely support higher yields. Higher rates mean a steeper yield curve and rising profits to banks, which encourages new lending and makes credit available.

The political backdrop has shifted to one of fiscal stimulus, tax and regulatory reform, plus more defense and infrastructure spending. While the U.S. economy is indeed strengthening, there has yet been no actual stimulus. Interest rates may plateau until there is more clarity about the nature of the fiscal packages that might be proposed and passed. Our thoughts about yields for yearend 2017 are in the table below.

Interest Rates	Yearend 2017
Federal Funds	1.38%
2-Year UST Yield	1.75%
10-Year UST Yield	2.75%-3.25%
2-10 Year Spread	1.0-1.5%

Looking preliminarily into 2018, yields could be expected to move even higher, at least during the first half of the year when rates might possibly be at or above 3.50%. At some point, though, higher rates will become a drag on the U.S. economy, prompting worry about a slowdown, stock market correction, or mild recession as rate normalization works its way through the economy.

Asset Allocation: The Tide is Turning

The major economic transition described at the end of the first section is surely underway, a shift of regimes that may be long-term. Financial trends are already changing with it. The secular investment themes of the last decade were propelled by the anxieties listed above in "the third funeral." Portfolios became positioned for safety, income, and defense rather than appreciation; billions flew out of equity mutual funds into bond funds. Thus, came the long outperformance of safe, secure assets from 2011 or so through 2015.

That began to change once the U.S. dollar peaked and oil bottomed in the first quarter of 2016. Energy and materials companies were the first to charge ahead followed by the financial and industrial sectors. From the market trough on February 11th, 2016, those sectors have soared 36.5%, 27.8%, 45.9% and 27.0% respectively, while the S&P 500 Index was up a lower, but still terrific 26.9%. The sector with safe, defensive growth companies had the least return: consumer staples, up only 5.1%. U.S. treasury bonds were hit hard as Barclay's index of long Treasurys plunged 7.9%. That rotation from defensive to cyclical assets persisted throughout the fourth quarter. There was likely some profit-taking or window-dressing during December as the prior underperformers racked up gains.

The rally in cyclical stocks and U.S. equity markets in general this year has likely been from perceptions of significantly reduced risks of recession, faster growth, stronger profits, as well as expectations for a better business environment. Interest rates are rising too, but for all those right, i.e., similar reasons.

What's ahead?

The question is how will this transition to better growth with mild inflation treat the stock market? We think just fine at least through mid-2017 and perhaps even well beyond. The key drivers of stock markets are perceptions of future economic growth, profits, and risk. We've described in this and prior commentaries the reasons behind our positive view of growth prospects. So far, the data have validated those expectations.

Profits:

Evidence of profit growth is coming in. Economy-wide U.S. profits rose 2.1%; 12-month trailing reported S&P 500 Index earnings jumped 14.9% with operating earnings up 8.4% all over the prior year. Moreover, faster nominal growth leads to better profits and that is improving quickly. Nominal growth in China may approach 9% in 2017, the highest in a long time. Third-quarter U.S. nominal growth at 5% is the highest in two years; it will likely accelerate throughout 2017.

Risks:

If growth and profit prospects suggest higher stock prices, what about risks? At this point, one key risk is that interest rates go high enough to be a drag on growth. What level of interest rates that is cannot be known; but it's likely somewhere above or maybe not even much above 3% on 10-year U.S. treasury bonds. The yield may not reach that level until the second half of 2017. High debt in China and other emerging countries is another big risk, but faster nominal and real growth in the developed world will postpone those troubles until a later time.

There are plenty of political risks, especially in Europe where several elections will be held in 2017 and populist movements are gaining. Radical change is not a high probability, but it still seems appropriate to underweight Eurozone equities. The biggest U.S. political risks are in the new administration's attitude toward trade. President-elect Trump's potential trade advisors seem less free-trade oriented than those in past years. The President-elect backed off some of his extreme trade positions; trade issues need to be closely watched.

Conclude:

We think the stock market rally will continue, although there may be some consolidation after the inauguration. We suggest overweighting equities at least until later in the second quarter. We'd prefer U.S. stocks, especially financials, industrials, and technology stocks (ex social media). Japanese stocks could also outperform the global average, but any investment there should be hedged back to U.S. dollars. For fixed income investors, U.S. high yield and investment grade bonds could perform acceptably if interest rate rises stay mild.

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Table I: Global Economic Trends

		Real GDP	CPI	Unemployment Rate	Benchmark Rate EOP	10 yr. Treasury Rate EOP
US:	**2013**	1.9%	1.5%	7.4%	0.25%	3.03%
	2014	2.4%	1.6%	6.2%	0.25%	2.18%
	2015	2.4%	0.1%	5.3%	0.38%	2.27%
	2016 F	1.7%	1.3%	4.9%	0.62%	2.46%
	2017 F	2.9%	2.0%	4.5%	1.13%	3.00%
Canada:	**2013**	2.0%	0.9%	7.1%	1.00%	2.75%
	2014	2.4%	1.9%	6.9%	0.75%	1.78%
	2015	1.1%	1.1%	6.9%	0.50%	1.39%
	2016 F	1.3%	1.5%	7.0%	0.50%	1.71%
	2017 F	2.1%	2.0%	6.9%	0.50%	2.00%
UK:	**2013**	1.7%	2.6%	7.6%	0.50%	3.02%
	2014	3.0%	1.4%	6.3%	0.50%	1.75%
	2015	2.2%	0.0%	5.4%	0.50%	1.96%
	2016 F	2.0%	0.7%	5.0%	0.25%	1.23%
	2017 F	1.3%	2.0%	5.3%	0.25%	1.60%
Eurozone:	**2013**	-0.3%	1.3%	12.0%	0.25%	1.95%
	2014	1.1%	0.4%	11.6%	0.05%	0.54%
	2015	2.0%	0.0%	10.9%	0.05%	0.63%
	2016 F	1.6%	0.3%	10.2%	0.00%	0.25%
	2017 F	1.4%	1.2%	9.8%	0.00%	0.50%
Japan:	**2013**	1.5%	0.4%	4.0%	0.10%	0.73%
	2014	-1.0%	2.7%	6.3%	0.10%	0.31%
	2015	0.6%	0.8%	3.4%	0.10%	0.26%
	2016 F	1.0%	-0.2%	3.3%	-0.10%	0.04%
	2017 F	1.3%	1.0%	3.2%	-0.10%	0.10%
Australia:	**2013**	2.0%	2.5%	5.7%	2.50%	4.27%
	2014	2.7%	2.5%	6.1%	2.50%	2.75%
	2015	2.4%	1.5%	6.1%	2.00%	2.88%
	2016 F	2.8%	1.3%	5.8%	1.50%	2.76%
	2017 F	3.0%	2.1%	5.7%	1.50%	3.00%
	2014	7.3%	2.0%		5.60%	
China:	**2015**	6.9%	1.4%		4.35%	
Official	**2016 F**	6.0%	2.0%		4.25%	
Statistics	**2017 F**	5.7%	2.0%		4.00%	

F - Forecast, EOP - End of Period

Source: International Monetary Fund, OECD & Sovereign Group, China NBS, Principal Global Investors

Table II: U.S. Economic Indicators

	Indicator	Level Sept-16	Level Oct-16	Level Nov-16	Y/Y Sept-16	Y/Y Oct-16	Y/Y Nov-16	Level 2015	Level 2016 F	Level 2017 F	Y/Y % 2015	Y/Y % 2016 F	Y/Y % 2017 F
1	**Industrial Production Index (2007=100)**	104.2	104.3	103.9	-1.0%	-0.8%	-0.6%	105.2	104.1	105.1	0.3%	-0.9%	1.0%
2	**Capacity Utilization Rate, Total Industry (1997=100)**	75.4	75.4	75.0	-1.0	-0.9	-0.7	76.7	75.4	76.2	-2.0	-1.7%	-1.1%
3	**Total Private Housing Starts (SAAR)**	1,052	1,340	1,090	-11.5%	24.9%	6.9%	1,112	1,200	1,320	10.7%	8.0%	10.0%
4	**Total Light Vehicle Sales (YTD)**	13,044.1	14,409.3	15,783.7	0.4%	0.2%	0.1%	17,387.2	17,300	17,500	5.8%	-0.8%	1.4%
5	**Civilian Labor Force (thousands)**	159,907	159,712	159,486	1.9%	1.7%	1.3%	157,166	159,189	160,691	0.8%	1.3%	0.94%
6	**Civilian Employment (thousands)**	151,968	151,925	152,085	2.0%	1.8%	1.8%	148,857	151,455	153,498	1.7%	1.7%	1.3%
7	**Total Unemploment (thousands)**	7,939	7,787	7,400	-0.2%	-1.4%	-6.6%	8,309	7,734	7,193	-13.7%	-6.9%	-7.0%

	Indicator	Level Q1-16	Level Q2-16	Level Q3-16	Y/Y % Q1-16	Y/Y % Q2-16	Y/Y % Q3-16	Level 2015	Level 2016 F	Level 2017 F	Y/Y % 2015	Y/Y % 2016 F	Y/Y % 2017 F
8	**After-Tax Corporate Profits (billions $, quarterly)**	1,550.5	1,636.7	1,679.4	-5.3%	-1.7%	4.3%	1,583.8	1,610	1,692	-8.5%	1.7%	5.1%
9	**Index of Hourly Compensation Non-farm Business (2009=100, quarterly)**	155.6	117.3	118.4	2.4%	2.7%	3.0%	114.5	117.7	121.1	2.9%	2.8%	2.8%

	Indicator	Annual 2013	Annual 2014	Annual 2015	Monthly Jun-16	Monthly Jul-16	Monthly Aug-16	Monthly Sept-16	Monthly Oct-16	Monthly Nov-16	Annual 2016 F	Annual 2017 F
10	**Consumer Price Index, All Urban Consumers Y/Y%**	1.5%	1.6%	0.1%	1.0%	0.9%	1.1%	1.5%	1.6%	1.7%	1.3%	2.0%
11	**Consumer Price Index, Ex. Food & Energy Y/Y%**	1.8%	1.7%	1.8%	2.2%	2.2%	2.3%	2.2%	2.2%	2.1%	2.3%	2.2%
12	**Non-farm Payroll Growth (thousands)**	2,311	3,015	2,744	271	252	176	208	142	178		
13	**Unemployment Rate, All Workers**	7.4	6.2	5.3	4.9	4.9	4.9	5.0	4.9	4.6	4.9	4.5
14	**Unemployment Rate, All Workers, >15 Weeks**	3.9	3.0	2.3	2.0	2.0	1.9	2.0	2.0	1.8	-	-
15	**Unemployment Rate, Adult Men**	7.0	5.7	4.9	4.5	4.6	4.5	4.7	4.6	4.3	-	-
16	**Unemployment Rate, Adult Women**	6.5	5.6	4.8	4.5	4.3	4.5	4.4	4.3	4.2	-	-
17	**Unemployment Rate, Teenagers (16-19)**	22.9	19.5	16.9	16.0	15.6	15.7	15.8	15.6	15.2	-	-

Y/Y% - Year Over Year Percent, F - Forecast, SAAR - Seasonally Adjusted Annual Rate, YTD - Year to Date

Source: Federal Reserve Board, U.S. Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis, U.S. Dept. of Commerce, Principal Global Investors

Baseline Economic Forecasts for 2017-2018, by Quarter

Baseline Forecasts

A. **Growth in Real GDP - Qtr-Qtr (% Change, Annualized):**

	1st QUARTER 17 Forecast		2nd QUARTER 17 Forecast		3rd QUARTER 17 Forecast		4th QUARTER 17 Forecast		2015 ACTUAL		2016 FORECAST	
Real GDP	**16,973.3**	**3.0%**	**17,093.7**	**2.9%**	**17,209.0**	**2.7%**	**17,322.9**	**2.7%**	**16,397.2**	**2.6%**	**16,670.9**	**1.7%**
Personal Consumption Expenditures	**11,735.3**	**2.7%**	**11,811.5**	**2.6%**	**11,888.3**	**2.6%**	**11,965.6**	**2.6%**	**11,214.7**	**3.2%**	**11,519.2**	**2.7%**
Durable Goods	1,628.2	4.0%	1,644.3	4.0%	1,660.5	4.0%	1,676.9	4.0%	1,498.1	6.9%	1,575.6	5.2%
Non-Durables	2,533.6	3.0%	2,552.4	3.0%	2,571.3	3.0%	2,590.4	3.0%	2,439.3	2.6%	2,498.5	2.4%
Services	7,588.5	2.3%	7,629.9	2.2%	7,671.5	2.2%	7,713.3	2.2%	7,310.3	2.8%	7,479.0	2.3%
Gross Private Domestic Invest.	**2,882.0**	**5.8%**	**2,921.2**	**5.6%**	**2,952.9**	**4.4%**	**2,982.8**	**4.1%**	**2,869.0**	**5.0%**	**2,817.9**	**-1.8%**
Bus. Fixed Invest.	2,241.6	4.4%	2,264.1	4.1%	2,286.8	4.1%	2,307.4	3.7%	2,200.2	2.1%	2,193.7	-0.3%
Structures	451.9	2.0%	454.2	2.0%	456.4	2.0%	456.4	0.0%	452.1	-4.4%	440.8	-2.5%
Equipment	1,052.6	5.0%	1,065.5	5.0%	1,078.6	5.0%	1,091.8	5.0%	1,072.5	3.5%	1,042.0	-2.8%
Intellectual Property Products	739.1	5.0%	746.4	4.0%	753.7	4.0%	761.2	4.0%	680.0	4.8%	714.3	5.1%
Residential Invest.	605.4	8.0%	617.1	8.0%	626.2	6.0%	635.4	6.0%	564.5	11.7%	591.4	4.8%
Change in Inventory	35.0	-	40.0	-	40.0	-	40.0	-	84.0	-	17.1	-
Net Exports	**-527.2**	**-**	**-531.1**	**-**	**-533.3**	**-**	**-535.5**	**-**	**-540.0**	**-**	**-543.0**	**-**
Exports	2,190.4	3.3%	2,206.7	3.0%	2,221.4	2.7%	2,236.3	2.7%	2,120.6	0.1%	2,137.0	0.8%
Imports	2,717.6	3.0%	2,737.8	3.0%	2,754.7	2.5%	2,771.8	2.5%	2,660.6	4.6%	2,680.0	0.7%
Gov't Purchases of Goods & Services	**2,923.5**	**1.2%**	**2,932.4**	**1.2%**	**2,941.4**	**1.2%**	**2,950.4**	**1.2%**	**2,883.7**	**1.8%**	**2,908.8**	**0.9%**
Federal	1,129.8	0.8%	1,132.0	0.8%	1,134.3	0.8%	1,136.5	0.8%	1,113.9	0.0%	1,122.1	0.7%
National Defense	672.2	1.0%	673.9	1.0%	675.6	1.0%	677.3	1.0%	672.0	-2.1%	669.0	-0.5%
Non-Defense	457.5	0.5%	458.1	0.5%	458.7	0.5%	459.2	0.5%	441.3	3.3%	452.6	2.6%
State & Local	1,793.7	1.5%	1,800.4	1.5%	1,807.1	1.5%	1,813.8	1.5%	1,768.2	2.9%	1,785.4	1.0%
Real Final Sales	16,938.3	2.9%	17,053.7	2.8%	17,169.0	2.7%	17,282.9	2.7%	16,300.6	2.4%	16,643.8	2.1%
Real Domestic Final Sales	17,465.5	2.8%	17,584.8	2.8%	17,702.3	2.7%	17,818.4	2.6%	16,841.7	3.1%	17,188.5	2.1%
y/y	2.7%		3.1%		2.9%		2.8%					

	1st QUARTER 18 Forecast		2nd QUARTER 18 Forecast		3rd QUARTER 18 Forecast		4th QUARTER 18 Forecast		2017 FORECAST		2018 FORECAST	
Real GDP	**17,440.5**	**2.7%**	**17,557.3**	**2.7%**	**17,633.5**	**1.7%**	**17,649.0**	**0.4%**	**17,149.7**	**2.9%**	**17,570.1**	**2.5%**
Personal Consumption Expenditures	**12,043.4**	**2.6%**	**12,121.7**	**2.6%**	**12,182.0**	**2.0%**	**12,212.3**	**1.0%**	**11,850.2**	**2.9%**	**12,139.9**	**2.4%**
Durable Goods	1,693.4	4.0%	1,710.1	4.0%	1,718.6	2.0%	1,722.8	1.0%	1,652.5	4.9%	1,711.2	3.6%
Non-Durables	2,609.6	3.0%	2,628.9	3.0%	2,642.0	2.0%	2,648.6	1.0%	2,561.9	2.5%	2,632.3	2.7%
Services	7,755.4	2.2%	7,797.7	2.2%	7,836.4	2.0%	7,856.0	1.0%	7,650.8	2.3%	7,811.4	2.1%
Gross Private Domestic Invest.	**3,015.3**	**4.4%**	**3,048.2**	**4.4%**	**3,061.8**	**1.8%**	**3,047.4**	**-1.9%**	**2,934.7**	**4.1%**	**3,043.2**	**3.7%**
Bus. Fixed Invest.	2,330.6	4.1%	2,354.0	4.1%	2,377.7	4.1%	2,388.2	1.8%	2,275.0	3.7%	2,362.6	3.9%
Structures	458.7	2.0%	461.0	2.0%	463.2	2.0%	463.2	0.0%	454.7	3.2%	461.5	1.5%
Equipment	1,105.2	5.0%	1,118.8	5.0%	1,132.5	5.0%	1,135.4	1.0%	1,072.2	2.9%	1,123.0	4.7%
Intellectual Property Products	768.7	4.0%	776.2	4.0%	783.9	4.0%	791.6	4.0%	750.1	5.0%	780.1	4.0%
Residential Invest.	644.7	6.0%	654.1	6.0%	654.1	0.0%	654.1	0.0%	621.0	5.0%	651.8	5.0%
Change in Inventory	40.0	-	40.0	-	30.0	-	5.0	-	38.8	-	28.8	-
Net Exports	**-537.9**	**-**	**-541.8**	**-**	**-542.4**	**-**	**-545.1**	**-**	**-531.8**	**-**	**-541.8**	**-**
Exports	2,254.5	3.3%	2,271.2	3.0%	2,288.1	3.0%	2,299.4	2.0%	2,213.7	3.6%	2,278.3	2.9%
Imports	2,792.4	3.0%	2,813.1	3.0%	2,830.5	2.5%	2,844.5	2.0%	2,745.5	2.4%	2,820.1	2.7%
Gov't Purchases of Goods & Services	**2,960.0**	**1.3%**	**2,969.6**	**1.3%**	**2,972.4**	**0.4%**	**2,974.7**	**0.3%**	**2,936.9**	**1.0%**	**2,969.2**	**1.1%**
Federal	1,139.3	1.0%	1,142.2	1.0%	1,145.0	1.0%	1,147.3	0.8%	1,133.1	1.0%	1,143.5	0.9%
National Defense	679.0	1.0%	680.6	1.0%	682.3	1.0%	684.0	1.0%	674.8	0.9%	681.5	1.0%
Non-Defense	460.4	1.0%	461.5	1.0%	462.7	1.0%	463.3	0.5%	458.4	1.3%	462.0	0.8%
State & Local	1,820.6	1.5%	1,827.4	1.5%	1,827.4	0.0%	1,827.4	0.0%	1,803.8	1.0%	1,825.7	1.2%
Real Final Sales	17,400.5	2.7%	17,517.3	2.7%	17,603.5	2.0%	17,644.0	0.9%	17,111.0	2.8%	17,541.3	2.5%
Real Domestic Final Sales	17,938.3	2.7%	18,059.2	2.7%	18,145.9	1.9%	18,189.1	1.0%	17,642.8	2.6%	18,083.1	2.5%
y/y	2.8%		2.7%		2.5%		1.9%					

Source: Historical Statistics - U.S. Dept. of Commerce, Bureau of Economic Analysis (http://www.bea.gov/bea/dn1.htm), Projections - Internal Estimates.

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