Principal Global Investors

# Economic Insights

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

## Topic summaries:

- **The coming transition:**

  The economic quagmire that began with the U.S. financial crisis in mid-2007 has likely come to an end. The ongoing global cyclical upturn may be the start of a long-term transition to an era of better growth with mild inflation, a time vaguely resembling the Old Normal.

- **Cyclical reflation in two acts:**

  The global upturn began early last year with a recovery from a near recession and collapse in commodity prices. Act II is when it becomes sustainable. For the United States, that means improved capital spending and faster wage growth. Both are likely on the way.

- **Central banks gain confidence:**

  The Federal Reseve (Fed), the European Central Bank (ECB), and the Bank of Japan (BOJ) are all feeling better about their respective economies, but the Fed is the only one to normalize policy. The ECB is likely next. Rising German yields may pave the way for higher long-term U.S. yields.

- **Asset Allocation - timing the next bear market:**

  Is it time to worry now? No, we don't think so. There's likely another leg higher in the long stock market rally from early 2009. Another 1% up on long-term U.S. Treasury yields would be a big drag on stock prices.

For the month of May 2017

## The coming transition

The free trade negotiations of the late 1980s and 90s that lowered world trade barriers plus the opening up of countries of the former Soviet Union in 1989 led to a massive, positive, global labor supply shock. It was the biggest in history because the world's labor supply more than doubled. Over two decades from those beginnings the world economy would be tasked with integrating the labor forces of China, Eastern Europe, and parts of Asia into the international workplace, a monumental undertaking. Assimilating hundreds of millions of low wage, mostly underemployed workers into the global marketplace naturally had dramatic repercussions. The world economy has been dealing with those after-effects, positive and negative, ever since.

The positive impacts were a much lower cost-of-goods production because global companies extended their supply chains around the globe to include low wage workers. The resulting investment boom that built factories, power plants, steel mills, highways, airports, and railroads to utilize those workers brought more than a decade of soaring commodity prices, surging economic growth, and roaring developing-country business profits. As the local savings implicit in sky-rocketing trade surpluses of emerging countries found their way into developed-country bond markets, interest rates were pushed much lower than could have been expected.

But, the adjustment costs inflicted on developed-country workers and economies of adapting to the influx of so many low-wage workers have been large and long-lasting. The costs included middle class wage and salary stagnation and rising income inequality, which brought slow growth of consumer spending. Because it was cheaper to hire low-wage workers than make existing ones more productive, businesses preferred outsourcing to investment, so capital spending stayed weak. Some industries were decimated; U.S. manufacturing employment fell by six million from 1990 to 2010, about one-third of the U.S. manufacturing workforce.

**In relatively free economies, no cycle lasts forever. Businesses, consumers, and governments respond to recent trends and those collective reactions set in motion the roots or causes of the next.**

Bob Baur • Chief Global Economist, Principal Global Investors

### The quagmire decade:

These costs were part of what led to a decade of economic morass that began with the U.S. financial crisis in mid-2007. That was followed by three years of sovereign debt crisis in the Eurozone. The final economic ugliness came from the collapse of oil prices and surge in the U.S. dollar from mid-2014 to early-2016. Emerging country currencies plunged and China's stock market melted. The finale in 2015 was the biggest U.S. dollar-denominated world recession since the 1930s. It was a decade of zero-interest rates, ultra-slow growth, deflation angst, hyperactive central banks, and most of all acute fears of relapse into recession, depression, another financial crisis, or worse.

### Transition:

But, that decade is surely over. For several months, we've described the cyclical economic rebound from that quagmire: a global upturn that has synchronized around the world became firmly established last summer and was finally accepted by the investment consensus after the U.S. election. That recovery is ongoing, improving, and will likely last well in 2018.

What is now happening is likely much more than just a cyclical bounce from an economically ugly time. It's probable that the adjustment costs of doubling the world's labor force are behind us, so the global economy is likely in a long transition to an Old Normal: U.S. growth that resembles the 1980s or 90s, but slower; deflation fears abating; interest rates normalizing from the nether lands of zero or below; a fading of extraordinary monetary policy; better growth; advancing real wages and mild inflation.

### Its called convergence:

Wages and salaries in those low-wage countries have risen to a level that makes developed countries competitive. That's partly why many Chinese companies are building manufacturing plants in the United States. U.S. workers should begin to have more bargaining power. In the longer term, the wage and salary stagnation of the last 25 years is likely over. And the income inequality so often in recent headlines may have already peaked.

### The point:

In relatively free economies, no cycle lasts forever. Businesses, consumers, and governments respond to recent trends and those collective reactions set in motion the roots or causes of the next. The quagmire decade had its causes and impacts; the world suffered and has moved on. It's likely that the current global upturn (updated in the next section) is the initial phase of a long-term transition to a more fruitful economic era.

## Cyclical reflation in two acts

Cyclical reflation, or a rebound of inflation and growth, has come a long way over the last year. The first act of reflation was the recovery phase. Deflation risks subsided; recession risks receded; confidence repaired. The next act: sustainable growth, is just getting started.

### Act I, recovery:

After five years of supply-driven downdrafts, consumer and producer prices stopped declining in every major country. Deflation ended: a very big deal. Central banks now have

breathing room. The Fed can move rates further from zero. The ECB and BOJ are getting a reprieve, too. The latter two banks pushed policy to the limit, nearly running out of bonds to purchase and slashing deposit rates well below zero. Last year's big question was what could the central banks do next: even more negative deposit rates? Or worse, monetary finance? Now, both can slowly consider incremental moves away from extraordinary policy, instead of pushing the frontiers of policy further. Rising prices rather than falling ones are good for debtors too, since old burdens are easier to pay off. And lastly, higher prices boost nominal growth and thus profits.

Closely linked with a recovery in inflation are upturns in industrial production and trade. Deflationary pressures emanating from the plunge in commodity prices hit goods-producing sectors hard, as well. But, once those price-pressures receded, industrial production stopped falling, and business surveys, key measures of activity, rebounded too. Global trade picked up; Chinese exports and imports surged.

The finale of Act I, or the recovery, was a return to normal confidence levels. Instead of a New Normal, it's a return to the Old Normal. Business and consumer confidence estimates reached six-year highs in Europe. U.S. business and consumer confidence indices reached the highs of prior cycles. Some of these gains may be related to the U.S. election, but much is related to a clearly improving economy. The unemployment rate is only 4.5%; consumer job expectations are the best since the 1980s; and job openings hover near cycle highs.

## Act II, sustainability:

During the recovery phase, the troubled parts of the global economy began to heal. The next act of a reflation cycle is one that can be sustained. The forces that nourish an economy and keep it moving forward after recovery are now starting to drive growth.

For the United States, that means investment and wage growth. Headline growth of gross domestic product (GDP) was nearly flat last quarter, but capital spending was strong. Business fixed- investment added the most to economic growth since 2013. Leading indicators point to more such spending in the pipeline; the portion of companies that plan to expand investment is at cycle highs. Households are increasing their home investment too; residential spending has been robust the last couple of quarters, up nearly 10% at the end of 2016 and up 13.7% in the first quarter. There is plenty of pent-up demand for housing, which suggests the trend may continue.

## Better wages:

Wage growth is accelerating. Across a broad range of measures, average wage growth has reached 3%. That's still well below prior cycles but a vast improvement from the meager 1.5% pace in 2010 and 2011. Consumer and business survey questions on income, compensation, and wage growth are reaching prior cycle levels, suggesting good wage gains will be maintained.

Better wage growth supports stronger consumer spending. A vigorous labor market plus healthy confidence levels imply consumer spending will rebound from its recent faltering pace. Further, with labor no longer cheap and plentiful, businesses may finally invest in productivity-enhancing equipment and software. Strong productivity growth is the missing ingredient for sustaining above-trend U.S. growth.

## Inflation targets:

For reflation to continue, core inflation must pick up in the Eurozone and it is happening. Higher energy prices boosted headline inflation to nearly 2% in April. Core inflation was a big surprise: still weak, but near a four-year high at 1.2% over the prior year and rising. The unemployment rate is high at 9.5%, but is declining rapidly and employment surveys are improving. While GDP growth should be a robust 2% or more last quarter, initial readings were mixed: Spain grew 3.2%, but France and the United Kingdom expanded at only 1% and 1.2%, respectively. Business surveys are very robust and suggest growth will stay above

trend. Faster growth and a healing labor market should keep core inflation moving higher.

Japan's inflation backdrop is more tenuous. The headline consumer price index rose only 0.2% in March and core inflation (excluding fresh food) actually declined for the first time since 2013. But, the labor market is incredibly tight, with the unemployment rate at a super-low 2.8% and the ratio of job openings to applicants is the highest since 1990! Waiting for Japanese inflation feels like "Waiting for Godot;" but contrary to Vladimir's and Estragon's experience in Beckett's play, inflation in Japan will likely appear eventually.

China was a big driver of the recovery phase. Surging producer prices helped rocket the industrial sector out of deflation and fiscal stimulus boosted growth even more. Despite tentative signs of tightening and expectations of slower growth, first-quarter data were robust with GDP up 6.9% year over year. A synthetic growth index from Evercore ISI research, which tracks easy-to-measure activity like railway freight, airline passengers, and electricity consumption, was up more than 9.2% over the prior year. As long as growth does not slow sharply, China should not derail the path to sustainable global growth.

### Act II nearly underway:

Starting early last year, the global economy began to rebound from several years of deflation and a near-recession in 2015. As investment and wages pick up in the United States, core inflation improves in Europe and Japan, and growth in China stays the course, this recovery should move to Act II: sustainable, above-trend growth.

## Central banks gradually gain confidence

The ECB concluded the April meeting of its Governing Council on a positive note. At his press conference, President Draghi announced no policy changes, but the risk assessment edged closer to "balanced." Draghi described Eurozone growth as "increasingly solid" and downside risks as "increasingly diminished." This makes a balanced risk assessment at the June meeting more possible. There is also growing speculation that the ECB will announce plans to reduce the €60 billion of bond purchases per month when it expires in December since Eurozone inflation hit 1.9% in April and has averaged near the ECB's target this year.

The BOJ also met and had an identical outcome, i.e., no policy change, but with different implications. Unlike the ECB, there was little reason to expect any change because the BOJ has been unable to foster anything close to its 2% target, despite four years of stimulus. Consumer prices for April were barely up over the prior year. Industrial production has been growing nicely and corporate profits are strong, but wage gains are subdued and consumer spending hasn't shown much strength even with the unemployment rate the lowest since 1990. The BOJ will stick with its expansionary policy for some time.

The Bank of England (BOE) is also standing pat as its policy is tied to exit negotiations from the European Union. The BOE will likely leave current policy in place, even though there were murmurs at the last Monetary Policy Committee meeting that a rate boost was justified; one member voted to raise rates by 0.25%. This sentiment will dissipate by the May meeting, given that Prime Minister May called for a June election. There are also signs that UK consumer spending is softening, which would lead to slower GDP growth. The exit negotiations may shape the BOE's policy direction in the near term.

The U.S. Federal Reserve is the only developed-country central bank that is trying to normalize monetary policy. Market odds of a rate hike in June rose to 72% from 23% a month ago. Investors expect one more rate hike after that in September or December and, by yearend, a signal that initiates shrinking its bond portfolio. The minutes from the March meeting noted that "most" members agreed that it makes sense to start letting the Fed's holdings mature "later this year." The Fed would let both Treasurys and mortgage-backed securities run off together. The coming rate hikes and bond portfolio reduction is testament to the Fed's confidence in the U.S. economy and inflation trends, along with rising inflation expectations in the Eurozone.

## Rate trends:

Growing confidence in U.S. and Eurozone monetary policy trends did not push interest rates higher over the past month because investor worries about political risk led to safe haven bond purchases. Ten-year U.S. Treasury yields edged lower during April from 2.39% to a month-end level of 2.28%. Yields on 10-year German bonds were flat for the month at 0.32%. Yields on 10-year Japanese government bonds remain pegged at 0.0% by the BOJ and presently hover close to that. Recent U.S. rate history is shown in Exhibit I.

## Exhibit I

### Interest rates

| | 12/31/2013 | 12/31/2014 | 12/31/2015 | 3/13/2017 (High)* | 7/08/2016 (Low)* | 4/28/2017 Current |
|---|---|---|---|---|---|---|
| 2 year | 0.38% | 0.66% | 1.05% | 1.37% | 0.61% | 1.26% |
| 10 year | 3.03% | 2.17% | 2.27% | 2.63% | 1.36% | 2.28% |
| 10-2 spread | 2.65% | 1.51% | 1.22% | 1.26% | 0.75% | 1.02% |
| 30 year | 3.97% | 2.75% | 3.02% | 3.21% | 2.10% | 2.95% |

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

## Interest rate outlook:

Despite the meager first-quarter GDP report of just 0.7%, investors anticipate a sharp pickup in activity this quarter and the rest of the year. The GDP price deflator of 2.3% over the year surprised to the upside and is consistent with our expectation of nominal growth above 4% later this year. If that's the case, current yields on 10-year U.S. Treasury bonds seem way too low.

Investors see several areas of political risk pressuring U.S. yields lower. In the United States, hopes for significant tax reform are dimming as the Trump administration may be unable to push a bill through Congress. Negotiations between the United Kingdom and Brussels are heating up with both sides digging in. North Korea's attempts to perfect a nuclear capability sends shivers around the world. Still, with the French election result, there has been enough improvement in the political climate to allow some recovery in U.S. Treasury yields from their 2.17% low in mid-April.

The key factor keeping U.S. rates from pushing higher are super-low yields in Europe and Japan. We do expect German rates to work their way higher later this year as better growth and inflation near target improve the prospects for the ECB to begin its exit from extraordinary monetary policy.

The synchronized global upturn is alive and well and will likely be able to presently begin Act II (see above). A sustainable expansion, favorable election results in Europe, and a partial fading of political risk should overcome investors' tendency to rush to quality at the first whiff of adverse news. Further, if these forces combine with better hard data in the United States and ongoing strong job growth, U.S. yields will move higher. We think that will be the case and look for higher U.S. yields by yearend as shown in Exhibit II.

## Exhibit II:

| Interest Rates | Yearend 2017 | Yearend 2018 |
|---|---|---|
| Federal Funds | 1.38% | 1.88% |
| 2-Year UST Yield | 1.75% | 2.0%-2.5% |
| 10-Year UST Yield | 2.75%-3.25% | 3.0%-3.5% |
| 2-10 Year Spread | 1.0%-1.5% | 1.0% |

# Asset allocation: timing the next bear market

While it may be time to at least start thinking about it, April certainly wasn't the beginning of one. Stock markets generally trended higher in April and year-to-date. The pace was led by the Euro area with the MSCI Europe Index up 3.2% in price. The S&P 500 Index returned 1.0% with dividends. The MSCI All Country World Index made another new all-time record high the day after the first round of the French election, up 1.4% in price during April and 7.9% for the year. And the technology-heavy NASDAQ Composite crossed above 6,000 for the first time in April, after eclipsing its year 2000 record high of 5132 in July of last year. No bear market anywhere here.

For the most part, the only major stock indices in the red for April were in China since the Shanghai and Shenzhen Composite Indices lost 2.1% and 4.0%, respectively. Many commodities suffered April price setbacks, from oil and copper, to corn and wheat, to silver and sugar.

Global bond indices had a mostly positive month because interest rates edged lower. The Barclays U.S. and Global Aggregate Indices gained 0.8% and 1.1%, respectively.

## What, Me, worry?

The beginning of the current U.S. bull market rally was on March 6, 2009 because that day's low on the S&P 500 Index was 666.79. At the end of April, that index closed at 2384.2, up 3.57 times, for an annualized return, including dividends of 19.2%. After such a spectacular gain, is it time to worry?

Well, investors have actually been worried for years. Even though the return has been just fantabulous, this has been the most disbelieved, distrusted rallies ever. It was spawned in the midst of the most severe financial crisis since the Depression. And the crises just kept coming: in Europe, then in China, emerging markets, and the oil patch. The losses in 2008 were severe, down an appalling 57.4% on the S&P 500 Index, and so soon after the tech collapse in 2001 and 2002, also down a horrifying 49.1%. After two huge drawdowns in nine years, a decade of crises, deflation fears, ultra-slow growth, and a dread of eternal secular stagnation, it's no wonder investors lost faith in stocks. Money flowed out of equity mutual funds and into bond funds for years.

## Bear market causes:

For those who kept the faith with us in the U.S. stock market since this column began in 2011, it's time to think about what might bring the rally to a conclusion. Clearly, bear markets are associated with economic recessions and have preceded or coincided with one for decades. Our models and intuition suggest low odds of a U.S. recession this year or even in 2018. Profits are picking up; job growth is excellent; capital spending is increasing; confidence has surged; inventories are lean; the global upturn continues. What's not to like?

Tight monetary conditions often presage economic drags and a bear market. But, with an ultra-cautious Fed, super-accommodative central banks in Europe and Japan, and still very low interest rates, monetary problems seem like a non-starter.

Yes, U.S. stock valuations are quite high. The ratio of price to trailing 12-month reported earnings is around 23, well above its long-term average of 17. Using operating earnings, the P/E is about 20, not far from its long-term average of 19. While valuations are excellent at showing prospects for very long-term returns, like 10 years; they are very poor predictors of short-term returns, like six to 12 months.

Further, market internals don't suggest immediate problems, either. Market breath (advancing issues versus declining ones) slid in March but has surged back near all-time highs. Stocks sputtered in March and early April but not to a correction, even with all the uncertainty. Markets that don't go down on bad news are usually good markets.

## Interest rates:

That leaves interest rates as a potential bearer of bad news for equities. That makes sense. A defining characteristic of the entire stock market rally of the last eight years has been the decline of interest rates to historic lows, a yield of 1.36% on 10-year U.S. Treasury bonds in July 2016. Falling interest rates, fear of relapse, a search for yield, and the distrust of equities led investors to defensive, safe securities: sovereign bonds, dividend paying stocks, real-estate investment trusts, growth stocks thought to be able to increase earnings even during uncertain times. Those defensive securities were pushed to high valuations, which they still command.

So a rise in yields on 10-year U.S. Treasury bonds to the 3% to 3.5% range might be enough to make investors question those high valuations and precipitate a significant correction in the stock market. A further rise in yields toward that range might be a signal to at least rethink equity ownership for a time. For the near term, though, with profits rebounding and the economy improving, we still believe there is another leg higher in U.S. and global stocks.

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**Table I: Global Economic Trends**

| | | Real GDP | CPI | Unemployment Rate | Benchmark Rate EOP | 10 yr. Treasury Rate EOP |
|---|---|---|---|---|---|---|
| US: | 2014 | 2.4% | 1.6% | 6.2% | 0.25% | 2.18% |
| | 2015 | 2.4% | 0.1% | 5.3% | 0.38% | 2.27% |
| | 2016 | 1.6% | 1.3% | 4.9% | 0.62% | 2.46% |
| | 2017 F | 2.4% | 2.4% | 4.5% | 1.38% | 3.00% |
| | 2018 F | 2.7% | 2.2% | 4.5% | 1.88% | 3.00% |
| Canada: | 2014 | 2.4% | 1.9% | 6.9% | 0.75% | 1.78% |
| | 2015 | 1.1% | 1.1% | 6.9% | 0.50% | 1.39% |
| | 2016 | 1.4% | 1.4% | 7.0% | 0.50% | 1.72% |
| | 2017 F | 2.3% | 2.1% | 6.8% | 0.50% | 1.75% |
| | 2018 F | 2.0% | 2.0% | 6.6% | 0.75% | 2.00% |
| UK: | 2014 | 3.0% | 1.4% | 6.3% | 0.50% | 1.75% |
| | 2015 | 2.2% | 0.0% | 5.4% | 0.50% | 1.96% |
| | 2016 | 1.8% | 0.7% | 4.9% | 0.25% | 1.24% |
| | 2017 F | 2.0% | 2.6% | 4.9% | 0.25% | 1.40% |
| | 2018 F | 1.5% | 2.5% | 5.2% | 0.25% | 1.60% |
| Eurozone: | 2014 | 1.1% | 0.4% | 11.6% | 0.05% | 0.54% |
| | 2015 | 2.0% | 0.0% | 10.9% | 0.05% | 0.63% |
| | 2016 | 1.8% | 0.2% | 10.0% | 0.00% | 0.21% |
| | 2017 F | 1.9% | 1.7% | 9.4% | 0.00% | 0.60% |
| | 2018 F | 1.7% | 1.6% | 9.1% | 0.00% | 0.80% |
| Japan: | 2014 | -1.0% | 2.7% | 6.3% | 0.10% | 0.31% |
| | 2015 | 0.6% | 0.8% | 3.4% | 0.10% | 0.26% |
| | 2016 | 1.0% | -0.1% | 3.1% | -0.10% | 0.04% |
| | 2017 F | 1.3% | 0.7% | 3.0% | -0.10% | 0.07% |
| | 2018 F | 1.0% | 1.0% | 2.9% | -0.10% | 0.10% |
| Australia: | 2014 | 2.7% | 2.5% | 6.1% | 2.50% | 2.75% |
| | 2015 | 2.4% | 1.5% | 6.1% | 2.00% | 2.88% |
| | 2016 | 2.5% | 1.3% | 5.7% | 1.50% | 2.77% |
| | 2017 F | 2.6% | 2.1% | 5.7% | 1.50% | 3.00% |
| | 2018 F | 2.9% | 2.2% | 5.6% | 1.70% | 3.25% |
| | 2014 | 7.3% | 2.0% | | 5.60% | |
| China: | 2015 | 6.9% | 1.4% | | 4.35% | |
| Official | 2016 | 6.7% | 2.0% | | 4.25% | |
| Statistics | 2017 F | 6.6% | 2.0% | | 4.35% | |
| | 2018 F | 6.2% | 2.4% | | 4.35% | |

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 | | | Y/Y | | | Level | | | Y/Y % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Jan-17 | Feb-17 | Mar-17 | Jan-17 | Feb-17 | Mar-17 | 2016 | 2017 F | 2018 F | 2016 | 2017 F | 2018 F |
| 1 | **Industrial Production Index (2007=100)** | 103.5 | 103.5 | 104.1 | 0.0% | 0.3% | 1.5% | 103.1 | 104.1 | 105.4 | -1.2% | 1.0% | 1.2% |
| 2 | **Capacity Utilization Rate, Total Industry (1997=100)** | 75.7 | 75.7 | 76.1 | -0.5% | -0.3% | 0.9% | 75.7 | 76.3 | 76.9 | -1.4% | 0.8% | 0.8% |
| 3 | **Total Private Housing Starts (SAAR)** | 1,241 | 1,303 | 1,215 | 10.0% | 7.4% | 9.2% | 1,176 | 1,300 | 1,400 | 6.1% | 10.7% | 7.7% |
| 4 | **Total Light Vehicle Sales (YTD)** | 1,138.0 | 2,463.5 | 4,013.9 | -1.7% | -1.4% | -1.4% | 17,465 | 17,400 | 17,700 | 0.4% | -0.4% | 1.7% |
| 5 | **Civilian Labor Force (thousands)** | 159,716 | 160,056 | 160,201 | 0.9% | 0.7% | 0.6% | 159,186 | 160,930 | 162,805 | 1.3% | 0.94% | 1.30% |
| 6 | **Civilian Employment (thousands)** | 152,081 | 152,528 | 153,000 | 1.0% | 1.0% | 1.1% | 151,437 | 153,732 | 156,031 | 1.7% | 1.3% | 1.4% |
| 7 | **Total Unemploment (thousands)** | 7,635 | 7,528 | 7,202 | -2.5% | -4.0% | -9.7% | 7,750 | 7,198 | 6,774 | -6.5% | -7.1% | -5.9% |

| | Indicator | Level | | | Y/Y % | | | Level | | | Y/Y % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Q2-16 | Q3-16 | Q4-16 | Q2-16 | Q3-16 | Q4-16 | 2016 | 2017 F | 2018 F | 2016 | 2017 F | 2018 F |
| 8 | **After-Tax Corporate Profits (billions $, quarterly)** | 1,636.7 | 1,679.4 | 1,741.2 | -1.7% | 4.3% | 22.3% | 1,652.0 | 1,770 | 1,867 | 4.3% | 7.1% | 5.5% |
| 9 | **Index of Hourly Compensation Non-farm Business (2009=100, quarterly)** | 117.3 | 118.5 | 119.4 | 2.8% | 3.2% | 3.0% | 117.7 | 121.1 | 124.5 | 2.9% | 2.8% | 2.8% |

| | Indicator | Annual | | | Monthly | | | Monthly | | | Annual | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2014 | 2015 | 2016 | Oct-16 | Nov-16 | Dec-16 | Jan-17 | Feb-17 | Mar-17 | | 2017 F | 2018 F |
| 10 | **Consumer Price Index, All Urban Consumers Y/Y%** | 1.6% | 0.1% | 1.3% | 1.6% | 1.7% | 2.1% | 2.5% | 2.8% | 2.4% | | 2.4% | 2.2% |
| 11 | **Consumer Price Index, Ex. Food & Energy Y/Y%** | 1.7% | 1.8% | 2.2% | 2.2% | 2.1% | 2.2% | 2.3% | 2.2% | 2.0% | | 2.2% | 2.3% |
| 12 | **Non-farm Payroll Growth (thousands)** | 2,998 | 2,713 | 2,240 | 124 | 164 | 155 | 216 | 219 | 98 | | | |
| 13 | **Unemployment Rate, All Workers** | 6.2 | 5.3 | 4.9 | 4.8 | 4.6 | 4.7 | 4.8 | 4.7 | 4.5 | | 4.5 | 4.2 |
| 14 | **Unemployment Rate, All Workers, >15 Weeks** | 3.0 | 2.3 | 2.0 | 2.0 | 1.8 | 1.9 | 1.9 | 1.8 | 1.7 | | - | - |
| 15 | **Unemployment Rate, Adult Men** | 5.7 | 4.9 | 4.5 | 4.6 | 4.3 | 4.4 | 4.4 | 4.3 | 4.3 | | - | - |
| 16 | **Unemployment Rate, Adult Women** | 5.6 | 4.8 | 4.4 | 4.3 | 4.2 | 4.3 | 4.4 | 4.3 | 4.0 | | - | - |
| 17 | **Unemployment Rate, Teenagers (16-19)** | 19.5 | 16.9 | 15.7 | 15.6 | 15.2 | 14.7 | 15.0 | 15.0 | 13.7 | | - | - |

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 Actual | | 2nd QUARTER 17 Forecast | | 3rd QUARTER 17 Forecast | | 4th QUARTER 17 Forecast | | 2015 ACTUAL | | 2016 ACTUAL | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real GDP** | **16,842.4** | **0.7%** | **17,001.0** | **3.8%** | **17,123.5** | **2.9%** | **17,247.8** | **2.9%** | **16,397.2** | **2.6%** | **16,662.1** | **1.6%** |
| **Personal Consumption Expenditures** | **11,679.5** | **0.3%** | **11,771.9** | **3.2%** | **11,858.3** | **3.0%** | **11,945.4** | **3.0%** | **11,214.7** | **3.2%** | **11,522.2** | **2.7%** |
| Durable Goods | 1,637.7 | -2.5% | 1,657.8 | 5.0% | 1,678.1 | 5.0% | 1,698.7 | 5.0% | 1,498.1 | 6.9% | 1,584.6 | 5.8% |
| Non-Durables | 2,532.2 | 1.5% | 2,554.1 | 3.5% | 2,573.0 | 3.0% | 2,592.1 | 3.0% | 2,439.3 | 2.6% | 2,500.5 | 2.5% |
| Services | 7,561.2 | 0.4% | 7,606.2 | 2.4% | 7,653.3 | 2.5% | 7,700.7 | 2.5% | 7,310.3 | 2.8% | 7,480.9 | 2.3% |
| **Gross Private Domestic Invest.** | **2,898.4** | **4.3%** | **2,945.4** | **6.6%** | **2,980.3** | **4.8%** | **3,015.7** | **4.8%** | **2,869.0** | **5.0%** | **2,824.6** | **-1.6%** |
| Bus. Fixed Invest. | 2,247.1 | 9.4% | 2,270.2 | 4.2% | 2,292.8 | 4.1% | 2,315.8 | 4.1% | 2,200.2 | 2.1% | 2,188.6 | -0.5% |
| Structures | 465.9 | 22.1% | 468.2 | 2.0% | 470.5 | 2.0% | 472.9 | 2.0% | 452.1 | -4.4% | 439.2 | -2.9% |
| Equipment | 1,060.0 | 9.1% | 1,073.0 | 5.0% | 1,086.2 | 5.0% | 1,099.5 | 5.0% | 1,072.5 | 3.5% | 1,041.4 | -2.9% |
| Intellectual Property Products | 723.8 | 2.0% | 730.9 | 4.0% | 738.1 | 4.0% | 745.4 | 4.0% | 680.0 | 4.8% | 711.9 | 4.7% |
| Residential Invest. | 615.4 | 13.7% | 630.2 | 10.0% | 642.5 | 8.0% | 655.0 | 8.0% | 564.5 | 11.7% | 592.0 | 4.9% |
| Change in Inventory | 10.3 | - | 45.0 | - | 45.0 | - | 45.0 | - | 84.0 | - | 22.0 | - |
| **Net Exports** | **-602.7** | **-** | **-610.7** | **-** | **-616.1** | **-** | **-620.9** | **-** | **-540.0** | **-** | **-563.0** | **-** |
| Exports | 2,167.5 | 5.8% | 2,183.6 | 3.0% | 2,198.2 | 2.7% | 2,212.9 | 2.7% | 2,120.6 | 0.1% | 2,128.2 | 0.4% |
| Imports | 2,770.3 | 4.1% | 2,794.2 | 3.5% | 2,814.3 | 2.9% | 2,833.8 | 2.8% | 2,660.6 | 4.6% | 2,691.2 | 1.1% |
| **Gov't Purchases of Goods & Services** | **2,895.2** | **-1.7%** | **2,894.6** | **-0.1%** | **2,901.2** | **0.9%** | **2,907.9** | **0.9%** | **2,883.7** | **1.8%** | **2,907.0** | **0.8%** |
| Federal | 1,115.5 | -1.9% | 1,116.6 | 0.4% | 1,118.8 | 0.8% | 1,121.0 | 0.8% | 1,113.9 | 0.0% | 1,120.5 | 0.6% |
| National Defense | 656.1 | -4.0% | 657.7 | 1.0% | 659.4 | 1.0% | 661.0 | 1.0% | 672.0 | -2.1% | 667.0 | -0.7% |
| Non-Defense | 458.3 | 0.9% | 458.9 | 0.5% | 459.4 | 0.5% | 460.0 | 0.5% | 441.3 | 3.3% | 452.7 | 2.6% |
| State & Local | 1,778.0 | -1.5% | 1,778.0 | 0.0% | 1,782.4 | 1.0% | 1,786.9 | 1.0% | 1,768.2 | 2.9% | 1,784.8 | 0.9% |
| Real Final Sales | 16,815.7 | 1.6% | 16,956.0 | 3.4% | 17,078.5 | 2.9% | 17,202.8 | 2.9% | 16,300.6 | 2.4% | 16,626.1 | 2.0% |
| Real Domestic Final Sales | 17,416.6 | 1.5% | 17,566.6 | 3.5% | 17,694.6 | 2.9% | 17,823.7 | 3.0% | 16,841.7 | 3.1% | 17,190.4 | 2.1% |
| y/y | 1.9% | | 2.5% | | 2.4% | | 2.6% | | | | | |

| | 1st QUARTER 18 Forecast | | 2nd QUARTER 18 Forecast | | 3rd QUARTER 18 Forecast | | 4th QUARTER 18 Forecast | | 2017 FORECAST | | 2018 FORECAST | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real GDP** | **17,364.4** | **2.7%** | **17,484.0** | **2.8%** | **17,576.7** | **2.1%** | **17,631.7** | **1.3%** | **17,053.7** | **2.4%** | **17,514.2** | **2.7%** |
| **Personal Consumption Expenditures** | **12,023.1** | **2.6%** | **12,107.5** | **2.8%** | **12,175.4** | **2.3%** | **12,226.4** | **1.7%** | **11,813.8** | **2.5%** | **12,133.1** | **2.7%** |
| Durable Goods | 1,717.5 | 4.5% | 1,736.5 | 4.5% | 1,749.4 | 3.0% | 1,758.1 | 2.0% | 1,668.1 | 5.3% | 1,740.4 | 4.3% |
| Non-Durables | 2,611.3 | 3.0% | 2,630.7 | 3.0% | 2,647.0 | 2.5% | 2,660.1 | 2.0% | 2,562.8 | 2.5% | 2,637.3 | 2.9% |
| Services | 7,748.3 | 2.5% | 7,794.4 | 2.4% | 7,833.1 | 2.0% | 7,862.3 | 1.5% | 7,630.3 | 2.0% | 7,809.5 | 2.3% |
| **Gross Private Domestic Invest.** | **3,043.5** | **3.7%** | **3,076.7** | **4.4%** | **3,095.4** | **2.5%** | **3,097.5** | **0.3%** | **2,960.0** | **4.8%** | **3,078.3** | **4.0%** |
| Bus. Fixed Invest. | 2,339.0 | 4.1% | 2,362.4 | 4.1% | 2,386.1 | 4.1% | 2,396.5 | 1.8% | 2,281.5 | 4.2% | 2,371.0 | 3.9% |
| Structures | 475.2 | 2.0% | 477.6 | 2.0% | 479.9 | 2.0% | 479.9 | 0.0% | 469.4 | 6.9% | 478.2 | 1.9% |
| Equipment | 1,113.0 | 5.0% | 1,126.7 | 5.0% | 1,140.5 | 5.0% | 1,143.3 | 1.0% | 1,079.7 | 3.7% | 1,130.9 | 4.7% |
| Intellectual Property Products | 752.8 | 4.0% | 760.2 | 4.0% | 767.7 | 4.0% | 775.2 | 4.0% | 734.6 | 3.2% | 764.0 | 4.0% |
| Residential Invest. | 664.6 | 6.0% | 674.3 | 6.0% | 679.3 | 3.0% | 681.0 | 1.0% | 635.8 | 7.4% | 674.8 | 6.1% |
| Change in Inventory | 40.0 | - | 40.0 | - | 30.0 | - | 20.0 | - | 36.3 | - | 32.5 | - |
| **Net Exports** | **-627.3** | **-** | **-634.8** | **-** | **-636.0** | **-** | **-639.1** | **-** | **-612.6** | **-** | **-634.3** | **-** |
| Exports | 2,230.9 | 3.3% | 2,247.4 | 3.0% | 2,264.1 | 3.0% | 2,275.3 | 2.0% | 2,190.5 | 2.9% | 2,254.4 | 2.9% |
| Imports | 2,858.2 | 3.5% | 2,882.2 | 3.4% | 2,900.1 | 2.5% | 2,914.5 | 2.0% | 2,803.1 | 4.2% | 2,888.8 | 3.1% |
| **Gov't Purchases of Goods & Services** | **2,917.4** | **1.3%** | **2,926.8** | **1.3%** | **2,934.1** | **1.0%** | **2,939.2** | **0.7%** | **2,899.7** | **-0.3%** | **2,929.4** | **1.0%** |
| Federal | 1,123.8 | 1.0% | 1,126.6 | 1.0% | 1,129.4 | 1.0% | 1,132.2 | 1.0% | 1,118.0 | -0.2% | 1,128.0 | 0.9% |
| National Defense | 662.7 | 1.0% | 664.3 | 1.0% | 666.0 | 1.0% | 667.6 | 1.0% | 658.6 | -1.3% | 665.1 | 1.0% |
| Non-Defense | 461.2 | 1.0% | 462.3 | 1.0% | 463.5 | 1.0% | 464.6 | 1.0% | 459.2 | 1.4% | 462.9 | 0.8% |
| State & Local | 1,793.5 | 1.5% | 1,800.2 | 1.5% | 1,804.7 | 1.0% | 1,807.0 | 0.5% | 1,781.3 | -0.2% | 1,801.4 | 1.1% |
| Real Final Sales | 17,324.4 | 2.9% | 17,444.0 | 2.8% | 17,546.7 | 2.4% | 17,611.7 | 1.5% | 17,013.3 | 2.3% | 17,481.7 | 2.8% |
| Real Domestic Final Sales | 17,951.7 | 2.9% | 18,078.8 | 2.9% | 18,182.7 | 2.3% | 18,250.9 | 1.5% | 17,625.4 | 2.5% | 18,116.0 | 2.8% |
| y/y | 3.1% | | 2.8% | | 2.6% | | 2.2% | | | | | |

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