Economic Insights

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

Topic summaries:

- **"Play it again, Sam":**
  The world economic expansion that began in early 2016 is still going strong. It should continue through 2018 and into 2019 with robust capital spending and rising wages.
- **U.S. tax reform:**
  The first major change to tax law in three decades could add 0.25% to 0.5% to U.S. growth for several quarters. It should bring faster wage and productivity growth and more consumer spending.
- **Central banks, on a course to normal:**
  World growth is surging; stock markets are screaming higher; yet, interest rates remain at Depression-era lows. The conundrum should resolve itself in 2018 as long-term interest rates edge higher.
- **Asset allocation - "fundamental things apply":**
  Investors who paid more attention to economic fundamentals than politics in 2017 were well rewarded. Growth will stay robust in 2018, but financial markets may be much more volatile.

For the month of January 2018

"Play it again, Sam"

While a misquote from the 1942 movie Casablanca, that line aptly describes the replay of 2017 that everyone wants for the new year. Robust, accelerating world growth, a surge in world stock indices, soaring business and consumer attitudes, confidence near multi-decade highs: what's not to like? Sam was Rick's piano player in the Humphrey Bogart-Ingrid Bergman classic that celebrated its 75th anniversary last November. It was Rick's former girlfriend Ilsa who said, "Play it, Sam; play As Time Goes By." And while 2017 has gone by, next year should be a replay with some mild growth deceleration in the second half and more volatile financial markets as central banks turn less accommodative.

"It's still the same old story":

The end of 2016 was rife with fear and uncertainty. Worries about Brexit, populism in Europe, angst about the incoming U.S. administration, and a world barely recovering from collapsed oil prices and plunging profits weighed on investors. Underneath the surface though, positive forces were at work that helped make 2017 a robust year for growth. Continental Europe transitioned from struggling recovery to sustained expansion despite political anxieties. Chinese officials learned how to tighten policy effectively without jarring the economy. Japan benefitted from widespread global growth. Both U.S. consumers and businesses developed real confidence. Central banks kept policy easy and predictable for markets. The widespread strength of a synchronized economic expansion and surge in markets in 2017 was a surprise to many.

"Round up the usual suspects":

The statistics we note below show the world economy is firing on all cylinders. The usual, but missing, suspect is inflation. Don't lose faith, it's coming; prices are showing signs of life. The Federal Reserve's (Fed) favorite inflation measure gained some

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>
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ground, with the headline up to 1.8% from a recent 1.4% low, and the core (ex food and energy) up to 1.5%, near the 2% target. Closely watched inflation gauges in the Eurozone and Japan are both 0.9% and trending higher. Core producer prices, which often lead broader inflation gauges, are clearly trending higher around the world. While we don't expect inflation to get anywhere close to out-of-control, it's not dead either.

“As Time Goes By”:

World growth should remain solid as 2018 goes by, although it may decelerate a bit after mid-year while momentum peaks and central banks normalize interest rates. Commodity prices, while currently very strong, should peak in the first quarter or two along with world growth momentum. The European Central Bank (ECB) and Bank of Japan (BOJ) are still buying bonds, keeping policy easy, although ECB purchases will slow, then end by October. The global expansion has a while yet to run, so economists can sit back and enjoy the ride. The world economy, like Sam, will be playing it again in 2018. But, with inflation edging higher, financial markets will surely not be as calm nor as rewarding as in 2017.

Data roundup, United States:

After a slow first quarter, the U.S. economy began to rev with two quarters of 3% annualized growth; year-end data suggest fourth-quarter growth could match it. Capital spending has been robust: investment in equipment and software jumped at an annualized 8% in 2017's first three quarters, and total investment rose over 6%, a result of better profit growth; third-quarter corporate earnings after taxes and inventory adjustments climbed 5.7% quarterly, and 7.7% over the prior year. Consumer spending has been healthy, up by an annualized 2.5% during the first three quarters, a bit above the expansion average. Consumer purchases should pick up as wage growth rises to 3% or more in 2018.

Fourth-quarter growth should be robust too. In the three months through November, nominal consumer spending jumped 6.3% annualized, a huge gain. Wage and salary income grew 4.5% year-over-year, and the savings rate fell to 2.9%, consistent with soaring confidence in consumer's financial futures. New-home sales in November rocketed 17.5%, the strongest monthly gain since 1992 and the fastest annualized pace of sales since 2007. While consumer confidence fell a bit in December, surveys are still near 17-year highs.

Business sentiment remains robust and surveys of purchasing managers show vigorous activity. So, capital spending stayed spirited in the fourth quarter; core capital goods orders (non-defense, ex aircraft) jumped a whopping annualized 18% over three months through November. We expect investment to be solid throughout 2018. And with just a bit more consumer spending, U.S. growth could surpass 3% in 2018 by the largest margin since 2005. U.S. forecasts are at the end of the commentary and in Exhibit I, and include a 0.2% boost from tax reform.

The Eurozone:

To most forecasters, the strength in the Eurozone was the biggest surprise of the year. It showed up in a stronger euro rather than higher stock prices since profit growth is somewhat anemic. Earnings may come because the economy is still accelerating. Markit's initial December survey of manufacturers was fabulous, with the headline at 60.6. France's gauge hit 59.3 and Germany's a very robust 63.3. The composite survey (services and manufacturing) hit 58, the highest since the financial crisis. Germany's IFO business sentiment indicator hovers near all-time highs and French business confidence was the best since 2007. Employment is up 1.7% over the prior year in December and the jobless rate is falling rapidly, 8.8% in October, down from 12.1% in February 2013. Third-quarter growth in real gross domestic product (GDP) was 2.6% over the prior year, the second best since 2007.

While political worries have not disappeared, they've lessened substantially from early 2017. Populist fervor is nowhere near the high of last year, with the elections of Macron in France and Merkel in Germany and the fall in support of Italy's Five Star movement. Political angst will remain with new Italian elections on March 4 and the feud between Catalonia and Spain, but robust growth may keep disruptions to a minimum. An extraordinarily accommodative ECB keeps financial conditions very easy and interest rates low. Car registrations are robust, businesses investing, consumption strong, and attitudes ebullient. I look for real GDP growth in 2018 in a 2% to 2.5% range, with significant upside risk.

Japan:

The economy is likely past its peak in momentum, but growth is still well above trend. Third-quarter real GDP growth was 2.5% annualized over the prior quarter. Bloomberg notes that this is Japan's longest expansion since the mid-1990s. Japanese exports surged 16.2% year-over-year in November. Recent business surveys suggest robust growth and confidence will continue. The jobless rate is an incredibly low 2.7%. Core inflation is even trending higher, up 0.9% over the prior year, so the BOJ may be winning its long fight against deflation. Growth in 2018 should be 1% to 1.5%, with some upside risk; that sounds low, but it's great for a country with a declining population.

China:

2018 will be a year of deceleration. Reducing the fast rate of debt growth, curbing pollution, and quelling the home buying frenzy will slow economic growth from the upper 6% pace. But, each of those goals is good in the long term. I expect growth in 2018 to be in the low 6% range with some risk of falling into the upper 5% range. The synchronized world expansion is helping China's exports. For years, forecasts of a hard landing in China were rampant. Those forecasts may come true since debt growth is still faster than nominal economic growth, but, that day is likely several years in the future.

U.S. Forecast Table	2016 (A)	2017 (E)	2018 (E)
Real GDP	+1.5%	+2.3%	+3.1%
Domestic Final Sales	+2.1%	+2.4%	+3.1%
U.S. Auto Sales (units)	17.5m (0.4%)	17.2m (-1.7%)	17.4m (1.1%)
Industrial Production	-1.2%	+1.9%	+1.8%
Housing Starts (million)	1,117 (6.3%)	1,215 (4.1%)	1,300 (6.1%)
After Tax Corporate Profits (National Income and Products Accounts	+2.2%	+9.2%	+7%
Federal Budget Balance (Fiscal Years)	-$0.6t	-$0.7t	-$0.7t
Civilian Unemployment Rate	4.9%	4.4%	4.0%
CPI – Overall	+1.3%	+2.1%	+2.3%
CPI – ex Food & Energy	+2.2%	+1.8%	+2.0%
GDP Price Index	+1.3%	+1.7%	+2.0%

Sources are in the tables at the end of the commentary

A - Actual

E - Estimated

U.S. tax reform

The first major change in U.S. tax law in three decades is on the books. Tax rates for all individual tax brackets are lower and some brackets widened, so some taxpayers would have even lower taxes. Deductions for state and local taxes and mortgage interest are limited for some individuals; the standard deduction is nearly doubled, and tax credits for dependents are vastly expanded. Most of the changes for individuals are not permanent and sunset in 2025; that may set up another political squabble in eight years. Still, between now and then, most households will see lower taxes and more take-home income from these changes.

Key changes for businesses are the cut in marginal corporate tax rates from 35% to 21%, repeal of the corporate alternative minimum tax, five-year 100% expensing of investment, and a combined tax reduction for qualifying S corporations and limited-liability companies. There are also significant, but complicated, benefits for companies with international operations.

Impact on growth:

U.S. growth in 2018 would have been robust even before the tax package, but, it should boost growth in several ways. Solid incentives for capital spending could add 0.2%or more to U.S. growth in 2018 and beyond. But, indirect benefits of more capital spending to households may also provide big gains through higher wages. Already, several companies have raised wages or given sizeable bonuses, with tax reform as their explicit justification. In addition, more investment should bring higher productivity, making further wage gains probable. Faster wage growth based on greater productivity will not be a drag on profits; greater consumer spending from better wage growth will add to businesses' bottom lines, rather than detract from them. This additional consumption could add another 0.2% or so to U.S. growth for several quarters.

Those second-round effects assume companies do indeed follow the incentives and raise capital spending. Tax reform opponents say that won't happen: companies will just use tax savings for stock buybacks, acquisitions, and dividends. I disagree: since the tech bubble burst in 2001, investment outside of housing and shale energy has been extremely weak since profits collapsed in 2001 and 2002 and plunged again during the financial crisis. Facilities and equipment have aged and new investment is sorely needed. Further, weak capital spending has kept productivity growth virtually nonexistent for years; with wage growth picking up, businesses will want more productivity and thus need to increase investment. I expect the tax changes to bring greater capital spending and faster productivity growth.

Other effects:

Tax reform stimulus could help the Fed achieve its long-awaited 2% inflation target a bit sooner. It's also probable that faster wage growth will bring more workers back into the workforce and raise the labor force participation rate from current doldrums. Falling U.S. tax rates may induce other countries to lower their own business taxes to be competitive again: a race to the bottom. Japan is already considering cutting rates by a third for companies that raise wages a certain amount.

Negatives?

There has been so much enthusiasm for tax reform lately that its implementation may be anti-climactic and market negative early in 2018 if investors were "buying the tax rumor" and planning to "sell the fact." Further, home prices could soften in certain upscale neighborhoods from limits on mortgage-interest deduction. And with interest no longer fully deductible, there will likely be a negative reaction in credit markets for companies with barely enough income to service high debt levels. Last, this tax package is coming at an unusual time: late in the business cycle when growth is robust and slack is limited. The benefits could be less than if enacted more typically, shortly after a recession.

Central banks – on a course to normal

With world growth so robust, 2018 will be a year when major central banks try to normalize interest rates. By raising the fed funds rate a fifth time, the Fed is on that path; the ECB will tip-toe there when it cuts bond purchases by half in January; the BOJ is at least thinking about it. Each is worried that inflation will stay below target, but all know their economies are surging. Fed Chair Yellen said it well in her last press conference, "This change [the 0.25% rate hike] highlights that the Committee expects the labor market to remain strong, with sustained job creation, ample opportunities for workers, and rising wages." We look for the Fed to hike rates in March; further hikes will depend on inflation and the depth of any stock market correction.

If growth stays solid, the ECB will end its bond purchases next September, but wait until 2019 to raise rates. The BOJ may move its 0% rate target to the five-year bond and let the yield on 10-year government bonds rise, allowing the yield curve to steepen to help local financial institutions. We expect that change by mid-year. The Bank of England (BOE), also moving toward normal, raised its policy rate to 0.5% in November. BOE Governor Carney noted that Brexit fears and the reaction of UK businesses, households, and asset prices to Brexit outcomes would determine future tightening measures.

Yields on long-term U.S. Treasury bonds remained remarkably muted in 2017, ending the year not far from where they began, with only a 0.6% yield swing from high to low. Short rates did surge with two-year treasury yields up 0.6% since mid-September, flattening the 10-two yield curve by 1% to only 0.52% at year-end. That raises angst about an inverted yield curve that often portends a recession. Recent U.S. rate history is in Exhibit II.

Interest Rates

	12/31/2014	12/31/2015	12/31/2016	03/13/2017 (High)*	09/07/2017 (Low)*	12/29/2017 Current
2 year	0.66%	1.05%	1.19%	1.37%	1.26%	1.88%
10 year	2.17%	2.27%	2.44%	2.63%	2.04%	2.40%
10-2 spread	1.51%	1.22%	1.25%	1.26%	0.78%	0.52%
30 year	2.75%	3.02%	3.07%	3.21%	2.66%	2.74%

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

Long-term interest rates:

Expecting yields on long-term sovereign bonds to rise, as we have, has been a wildly unsuccessful trade; the consensus of "lower for longer" has been very right so far. The reasons? Ongoing Fed, ECB, and BOJ bond purchases and huge balance sheets keep tremendous down-pressure on long-term yields; inflation weakened over the spring and summer and has been slow to work higher; investors believe globalization and technology will keep inflation low far into the future, so any yield spike has been met with plenty of bond buyers.

A conundrum:

But, there's a problem. U.S. and world growth are surging; stock markets are screaming higher; developed country central banks are turning away from monetary ease; yet, interest rates are at Depression-era lows. Something seems out of kilter. Maybe it's inflation expectations.

Inflation markedly lags economic performance; so, the mid-2017 price weakness may have been a leftover effect of the near-recession in late 2015 and early 2016. Current gauges of future inflation are all pointing up: energy and metals prices are making new highs; producer price rises are accelerating; the New York Fed's gauge of underlying inflation is in the 3% range; U.S. import prices are rising faster; and wage gains are picking up. We expect the Fed's favorite indicator to reach the 2% target in the first half of 2018. If that happens, expectations of future inflation should rise from current levels and push long-term interest rates higher.

Further, the recent underperformance of dividend-paying, bond-surrogate stocks like real estate investment trusts, telecommunications, utilities, and health care sectors suggest those markets are already subtly preparing for higher long-term interest rates. With central banks moving toward normal, robust economic growth continuing through 2018, and inflation likely to reach target, the conundrum should resolve itself in 2018 in the form of mildly higher yields on the world's long-term government bonds. At year-end 2018, yields on 10-year German bunds could be 0.75% to 1%. Forecasts for U.S. Treasury bond yields are in Exhibit III.

Interest Rates	Year-end 2018
Federal Funds	1.88%-2.13%
2-Year UST Yield	2.25%-2.5%
10-Year UST Yield	3.0%
10-2 year spread	0.5%-0.75%
30-year UST yield	3.25%

Asset allocation – "fundamental things apply"

For all the fear and angst in early 2017, investors who looked past the uncertainties were amply rewarded with an extraordinary investment year. A combination of robust and accelerating world economic growth, remarkably mild inflation, low initial expectations, and central banks that remained ultra-accommodative generated excellent returns for investors, with exceptionally low volatility for virtually the entire year. It was a "perfect" year for the S&P 500 Index: every single month had a positive total return. Of the 46 world equity indices we track, 43 had returns greater than 4% for the year; the best was in Mongolia, up 66.5% in price. Positive returns for December and the fourth quarter were nearly as widespread. Bond investors were treated well too. Returns on emerging market bond indices were low double-digits; Barclay's Long-Term U.S. Treasury Index had an 8.5% return; high-yield bond indices returned in the 6% to 8% range.

Whether it was worry about a U.S. reversal of free trade; populist parties winning in France, Germany or the Netherlands; nuclear arms in North Korea; or a hard landing in China, markets paid more heed to solid economic fundamentals. Economics dominated politics. As Sam sang for Ilsa, "The fundamental things apply…as time goes by."

A financial replay?

Of 2017? I doubt it. When things are so good they can't get any better, they usually don't. The unique combination of events that made 2017 returns so strong will surely not be repeated. In 2018, central banks will be less accommodative; inflation will work its way higher; rising long-term interest rates will bring more volatility. Expectations for returns are much higher than at the beginning of 2017; disappointment is more likely.

Low interest rates have been the driving force pushing stock prices to today's value extremes, so, I suggested a few months ago that a significant correction was likely if 10-year U.S. Treasury yields worked their way up to 2.75% or 3%. Clearly, we were early with that advice since interest rates stayed tame and stock prices surged. Inflation was too weak and the down pressure on U.S. yields from central bank intervention in Europe and Japan was too great for yields to rise. Returning monetary policy to normal will be a slow process, so, any disruption to the investment environment from higher interest rates may happen later. It will surely come, though, so, markets should be much more volatile in 2018.

More volatility:

Signs of change are already visible. The leadership of super-growth stocks was dented in December as the S&P 500 Index outperformed the tech sector. Yield spreads of high-yield bonds to U.S. treasuries blew out in November but have recovered less than half of the loss. Defensive sectors like healthcare and telecommunications have outperformed technology recently. Emerging market stocks are no longer performing better than those in developed countries. Surging enthusiasm during the runup to tax reform suggests that markets have already discounted its benefits. 10-year U.S. treasury yields bumped up against resistance near the top of their 2017 trading range. Momentum stocks are no longer besting the overall market.

I'd guess the above changes are the first steps of a gradual topping process for the stock market that may take the better part of 2018. Profit-taking and a mild setback in first quarter could be another step in the sequence. Less financial repression by central banks, rising long-term sovereign bond yields, and reaching official inflation targets are further steps along the way.

What to do?

Even if a mild correction occurs, stock prices could recover and be pushed somewhat higher by strong earnings gains, robust economic growth, and rising enthusiasm for equities. And if interest rates stay "lower for longer" as the consensus believes, stock prices could match the earnings gains for much of 2018. But, the remaining upside in overall market prices will likely be modest. The mammoth rally from March 2009 is probably winding down.

In the interim, I like stocks in the financial sector, especially banks, that benefit from higher interest rates. Consumer stocks, other than autos, should outperform as wage growth starts to pick up. Stable value, low volatility stocks would be less risky if the expected disruptive climate appears. Japanese companies have had excellent profit gains and stock indices there were star performers in the fourth quarter. I'd overweight Japanese stocks in an international portfolio and expect those good relative returns to continue. Rising interest rates, less central bank financial repression, and decelerating growth in China are negative for emerging market stocks and bonds. I'd underweight emerging market securities since 2017's outperformance will likely not persist. For fixed income investors, I'd stay with short to medium maturities of better-rated high-yield or investment grade corporate bonds.

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	1.5%	1.3%	4.9%	0.62%	2.46%
		2017 F	2.3%	2.1%	4.4%	1.38%	2.50%
		2018 F	3.1%	2.3%	4.0%	2.13%	3.00%
	**Canada:**	**2014**	2.6%	1.9%	6.9%	0.75%	1.78%
		2015	0.9%	1.1%	6.9%	0.50%	1.39%
		2016	1.5%	1.4%	7.0%	0.50%	1.72%
		2017 F	3.0%	1.6%	6.4%	1.25%	2.05%
		2018 F	2.2%	2.0%	6.0%	1.50%	2.50%
	**UK:**	**2014**	3.1%	1.5%	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	1.5%	2.7%	4.4%	0.50%	1.40%
		2018 F	1.4%	2.5%	4.5%	0.70%	1.70%
	**Eurozone:**	**2014**	1.3%	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	2.4%	1.5%	9.1%	0.00%	0.50%
		2018 F	2.3%	1.4%	8.5%	0.00%	0.70%
	**Japan:**	**2014**	0.3%	2.7%	6.3%	0.10%	0.31%
		2015	1.1%	0.8%	3.4%	0.10%	0.26%
		2016	1.0%	-0.1%	3.1%	-0.10%	0.04%
		2017 F	1.8%	0.5%	2.8%	-0.10%	0.05%
		2018 F	1.3%	0.7%	2.7%	-0.05%	0.10%
	**Australia:**	**2014**	2.8%	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	2.5%	2.0%	5.6%	1.50%	2.70%
		2018 F	2.8%	2.2%	5.4%	1.75%	3.00%
		**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%	2.2%		4.50%	

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-17	Level Oct-17	Level Nov-17	Y/Y Sept-17	Y/Y Oct-17	Y/Y Nov-17	Level 2016	Level 2017 F	Level 2018 F	Y/Y % 2016	Y/Y % 2017 F	Y/Y % 2018 F
1 Industrial Production Index (2007=100)	104.9	106.1	106.4	1.9%	2.9%	3.4%	103.1	105.1	107.0	-1.2%	1.9%	1.8%
2 Capacity Utilization Rate, Total Industry (1997=100)	76.2	77.0	77.1	0.8%	1.7%	2.1%	75.7	76.5	77.6	-1.4%	1.1%	1.5%
3 Total Private Housing Starts (SAAR)	1,159	1,256	1,297	9.1%	-5.4%	12.9%	1,177	1,225	1,300	6.3%	4.1%	6.1%
4 Total Light Vehicle Sales (YTD)	12,801.0	14,148.1	15,539.5	-1.9%	-1.8%	-1.5%	17,465	17,168	17,340	0.4%	-1.7%	1.0%
5 Civilian Labor Force (thousands)	161,146	160,381	160,529	0.8%	0.5%	0.7%	159,186	160,321	161,541	1.3%	0.71%	0.76%
6 Civilian Employment (thousands)	154,345	153,861	153,918	1.6%	1.3%	1.2%	151,437	153,335	155,174	1.7%	1.3%	1.2%
7 Total Unemploment (thousands)	6,801	6,520	6,610	-14.0%	-15.8%	-10.8%	7,750	6,936	6,367	-6.5%	-9.9%	-8.9%

Indicator	Level Q1-17	Level Q2-17	Level Q3-17	Y/Y % Q1-17	Y/Y % Q2-17	Y/Y % Q3-17	Level 2016	Level 2017 F	Level 2018 F	Y/Y % 2016	Y/Y % 2017 F	Y/Y % 2018 F
8 After-Tax Corporate Profits (billions $, quarterly)	1,810.5	1,774.7	1,858.4	11.8%	7.4%	9.8%	1,687.9	1,843	1,972	2.2%	9.2%	7.0%
9 Index of Hourly Compensation Non-farm Business (2009=100, quarterly)	117.1	117.2	118.0	1.9%	0.8%	0.8%	116.0	117.8	120.2	1.1%	1.6%	2.0%

Indicator	Annual 2014	Annual 2015	Annual 2016	Monthly Jun-17	Monthly Jul-17	Monthly Aug-17	Monthly Sept-17	Monthly Oct-17	Monthly Nov-17	Annual 2017 F	Annual 2018 F
10 Consumer Price Index, All Urban Consumers Y/Y%	1.6%	0.1%	1.3%	1.6%	1.7%	1.9%	2.2%	2.0%	2.2%	2.1%	2.3%
11 Consumer Price Index, Ex. Food & Energy Y/Y%	1.7%	1.8%	2.2%	1.7%	1.7%	1.7%	1.7%	1.8%	1.7%	1.8%	2.0%
12 Non-farm Payroll Growth (thousands)	2,998	2,713	2,240	210	138	208	38	244	228		
13 Unemployment Rate, All Workers	6.2	5.3	4.9	4.4	4.3	4.4	4.2	4.1	4.1	4.4	4.0
14 Unemployment Rate, All Workers, >15 Weeks	3.0	2.3	2.0	1.6	1.7	1.7	1.7	1.5	1.6	-	-
15 Unemployment Rate, Adult Men	5.7	4.9	4.5	4.0	4.0	4.1	3.9	3.8	3.7	-	-
16 Unemployment Rate, Adult Women	5.6	4.8	4.4	4.0	4.0	4.0	3.9	3.6	3.7	-	-
17 Unemployment Rate, Teenagers (16-19)	19.5	16.9	15.7	13.3	13.2	13.6	12.9	13.7	15.9	-	-

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 Actual		3rd QUARTER 17 Actual		4th QUARTER 17 Forecast		2015 ACTUAL		2016 ACTUAL	
Real GDP	**16,903.2**	**1.2%**	**17,031.1**	**3.1%**	**17,163.9**	**3.2%**	**17,289.4**	**3.0%**	**16,471.5**	**2.9%**	**16,716.2**	**1.5%**
Personal Consumption Expenditures	**11,758.0**	**1.9%**	**11,853.0**	**3.3%**	**11,916.6**	**2.2%**	**12,002.9**	**2.9%**	**11,264.3**	**3.6%**	**11,572.1**	**2.7%**
Durable Goods	1,647.3	-0.1%	1,677.8	7.6%	1,712.9	8.6%	1,729.8	4.0%	1,511.9	7.8%	1,595.1	5.5%
Non-Durables	2,540.2	1.1%	2,566.6	4.2%	2,581.5	2.3%	2,600.6	2.5%	2,446.8	3.1%	2,514.3	2.8%
Services	7,621.0	2.5%	7,664.4	2.3%	7,685.5	1.1%	7,723.6	2.0%	7,340.2	3.2%	7,507.3	2.3%
Gross Private Domestic Invest.	**2,897.0**	**-1.2%**	**2,924.7**	**3.9%**	**2,976.5**	**7.3%**	**2,987.5**	**1.5%**	**2,905.4**	**5.2%**	**2,858.2**	**-1.6%**
Bus. Fixed Invest.	2,263.6	7.1%	2,300.6	6.7%	2,326.9	4.7%	2,356.9	5.3%	2,223.5	2.3%	2,210.4	-0.6%
Structures	468.0	14.8%	476.0	7.0%	467.4	-7.0%	472.0	4.0%	465.4	-1.8%	446.4	-4.1%
Equipment	1,059.4	4.4%	1,082.0	8.8%	1,110.1	10.8%	1,123.7	5.0%	1,084.5	3.5%	1,047.8	-3.4%
Intellectual Property Products	738.6	5.8%	745.3	3.7%	754.8	5.2%	763.2	4.5%	677.8	3.8%	720.4	6.3%
Residential Invest.	605.5	11.1%	594.1	-7.3%	587.0	-4.7%	595.6	6.0%	556.9	10.2%	587.5	5.5%
Change in Inventory	1.2	-	5.5	-	38.5	-	35.0	-	100.6	-	33.4	-
Net Exports	**-622.2**	**-**	**-613.6**	**-**	**-597.5**	**-**	**-603.1**	**-**	**-545.3**	**-**	**-586.3**	**-**
Exports	2,162.3	7.3%	2,181.1	3.5%	2,192.4	2.1%	2,207.6	2.8%	2,127.1	0.4%	2,120.1	-0.3%
Imports	2,784.5	4.3%	2,794.8	1.5%	2,790.0	-0.7%	2,810.7	3.0%	2,672.4	5.0%	2,706.3	1.3%
Gov't Purchases of Goods & Services	**2,896.6**	**-0.6%**	**2,895.2**	**-0.2%**	**2,900.0**	**0.7%**	**2,900.3**	**0.0%**	**2,878.5**	**1.4%**	**2,900.2**	**0.8%**
Federal	1,108.4	-2.4%	1,113.7	1.9%	1,117.4	1.3%	1,117.4	0.0%	1,114.1	-0.1%	1,114.6	0.0%
National Defense	658.6	-3.3%	666.2	4.7%	670.2	2.4%	670.2	0.0%	672.0	-2.2%	667.0	-0.7%
Non-Defense	449.0	-1.1%	446.9	-1.9%	446.6	-0.3%	447.2	0.5%	441.6	3.2%	447.0	1.2%
State & Local	1,786.2	0.5%	1,779.6	-1.5%	1,780.7	0.2%	1,782.9	0.5%	1,762.8	2.3%	1,783.7	1.2%
Real Final Sales	16,883.5	2.7%	17,006.6	2.9%	17,106.3	2.4%	17,254.4	3.5%	16,354.3	2.6%	16,664.1	1.9%
Real Domestic Final Sales	17,502.7	2.4%	17,618.3	2.7%	17,703.5	1.9%	17,857.5	3.5%	16,900.4	3.3%	17,250.3	2.1%
y/y	2.0%		2.2%		2.3%		2.6%					

	1st QUARTER 18 Forecast		2nd QUARTER 18 Forecast		3rd QUARTER 18 Forecast		4th QUARTER 18 Forecast		2017 FORECAST		2018 FORECAST	
Real GDP	**17,421.9**	**3.1%**	**17,558.7**	**3.2%**	**17,685.8**	**2.9%**	**17,809.0**	**2.8%**	**17,096.9**	**2.3%**	**17,618.8**	**3.1%**
Personal Consumption Expenditures	**12,089.3**	**2.9%**	**12,176.4**	**2.9%**	**12,252.9**	**2.5%**	**12,327.7**	**2.5%**	**11,882.6**	**2.7%**	**12,211.6**	**2.8%**
Durable Goods	1,751.0	5.0%	1,772.5	5.0%	1,790.0	4.0%	1,805.4	3.5%	1,691.9	6.1%	1,779.7	5.2%
Non-Durables	2,619.9	3.0%	2,639.4	3.0%	2,655.7	2.5%	2,672.2	2.5%	2,572.2	2.3%	2,646.8	2.9%
Services	7,769.6	2.4%	7,815.8	2.4%	7,858.4	2.2%	7,901.3	2.2%	7,673.6	2.2%	7,836.3	2.1%
Gross Private Domestic Invest.	**3,026.4**	**5.3%**	**3,069.2**	**5.8%**	**3,112.5**	**5.8%**	**3,153.9**	**5.4%**	**2,946.4**	**3.1%**	**3,090.5**	**4.9%**
Bus. Fixed Invest.	2,387.1	5.2%	2,423.8	6.3%	2,461.2	6.3%	2,498.1	6.1%	2,312.0	4.6%	2,442.5	5.6%
Structures	475.5	3.0%	482.5	6.0%	489.6	6.0%	495.6	5.0%	470.9	5.5%	485.8	3.2%
Equipment	1,142.9	7.0%	1,165.1	8.0%	1,187.7	8.0%	1,210.8	8.0%	1,093.8	4.4%	1,176.6	7.6%
Intellectual Property Products	770.7	4.0%	778.3	4.0%	785.9	4.0%	793.7	4.0%	750.5	4.2%	782.1	4.2%
Residential Invest.	604.4	6.0%	610.3	4.0%	616.3	4.0%	620.9	3.0%	595.6	1.4%	613.0	2.9%
Change in Inventory	35.0	-	35.0	-	35.0	-	35.0	-	20.1	-	35.0	-
Net Exports	**-607.6**	**-**	**-610.2**	**-**	**-612.4**	**-**	**-612.7**	**-**	**-609.1**	**-**	**-610.7**	**-**
Exports	2,224.0	3.0%	2,241.0	3.1%	2,257.1	2.9%	2,271.1	2.5%	2,185.8	3.1%	2,248.3	2.9%
Imports	2,831.5	3.0%	2,851.2	2.8%	2,869.5	2.6%	2,883.8	2.0%	2,795.0	3.3%	2,859.0	2.3%
Gov't Purchases of Goods & Services	**2,911.9**	**1.6%**	**2,921.4**	**1.3%**	**2,930.9**	**1.3%**	**2,938.2**	**1.0%**	**2,898.0**	**-0.1%**	**2,925.6**	**1.0%**
Federal	1,122.4	1.8%	1,125.1	1.0%	1,127.9	1.0%	1,130.8	1.0%	1,114.2	0.0%	1,126.6	1.1%
National Defense	673.5	2.0%	675.2	1.0%	676.9	1.0%	678.6	1.0%	666.3	-0.1%	676.0	1.5%
Non-Defense	448.8	1.5%	449.9	1.0%	451.1	1.0%	452.2	1.0%	447.4	0.1%	450.5	0.7%
State & Local	1,789.6	1.5%	1,796.2	1.5%	1,802.9	1.5%	1,807.4	1.0%	1,782.4	-0.1%	1,799.0	0.9%
Real Final Sales	17,386.9	3.1%	17,523.7	3.2%	17,650.8	2.9%	17,774.0	2.8%	17,062.7	2.4%	17,583.8	3.1%
Real Domestic Final Sales	17,994.5	3.1%	18,133.8	3.1%	18,263.2	2.9%	18,386.7	2.7%	17,670.5	2.4%	18,194.6	3.0%
y/y	3.1%		3.1%		3.0%		3.0%					

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

BASELINE ECONOMIC FORECASTS FOR 2017-2018, BY QUARTER

Baseline Forecasts

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

	1st QUARTER 17		2nd QUARTER 17		3rd QUARTER 17		4th QUARTER 17		2015 ACTUAL		2016 ACTUAL	
	Actual		Actual		Actual		Forecast					
Real GDP	**16903.2**	**1.2%**	**17031.1**	**3.1%**	**17163.9**	**3.2%**	**17289.4**	**3.0%**	**16471.5**	**2.9%**	**16716.2**	**1.5%**
Personal Consumption Expenditures	**11758.0**	**1.9%**	**11853.0**	**3.3%**	**11916.6**	**2.2%**	**12002.9**	**2.9%**	**11264.3**	**3.6%**	**11572.1**	**2.7%**
Durable Goods	1647.3	-0.1%	1677.8	7.6%	1712.9	8.6%	1729.8	4.0%	1511.9	7.8%	1595.1	5.5%
Non-Durables	2540.2	1.1%	2566.6	4.2%	2581.5	2.3%	2600.6	2.5%	2446.8	3.1%	2514.3	2.8%
Services	7621.0	2.5%	7664.4	2.3%	7685.5	1.1%	7723.6	2.0%	7340.2	3.2%	7507.3	2.3%
Gross Private Domestic Invest.	**2897.0**	**-1.2%**	**2924.7**	**3.9%**	**2976.5**	**7.3%**	**2987.5**	**1.5%**	**2905.4**	**5.2%**	**2858.2**	**-1.6%**
Bus. Fixed Invest.	2263.6	7.1%	2300.6	6.7%	2326.9	4.7%	2356.9	5.3%	2223.5	2.3%	2210.4	-0.6%
Structures	468.0	14.8%	476.0	7.0%	467.4	-7.0%	472.0	4.0%	465.4	-1.8%	446.4	-4.1%
Equipment	1059.4	4.4%	1082.0	8.8%	1110.1	10.8%	1123.7	5.0%	1084.5	3.5%	1047.8	-3.4%
Intellectual Property Products	738.6	5.8%	745.3	3.7%	754.8	5.2%	763.2	4.5%	677.8	3.8%	720.4	6.3%
Residential Invest.	605.5	11.1%	594.1	-7.3%	587.0	-4.7%	595.6	6.0%	556.9	10.2%	587.5	5.5%
Change in Inventory	1.2	-	5.5	-	38.5	-	35.0	-	100.6	-	33.4	-
Net Exports	**-622.2**	**-**	**-613.6**	**-**	**-597.5**	**-**	**-603.1**	**-**	**-545.3**	**-**	**-586.3**	**-**
Exports	2162.3	7.3%	2181.1	3.5%	2192.4	2.1%	2207.6	2.8%	2127.1	0.4%	2120.1	-0.3%
Imports	2784.5	4.3%	2794.8	1.5%	2790.0	-0.7%	2810.7	3.0%	2672.4	5.0%	2706.3	1.3%
Gov't Purchases of Goods & Services	**2896.6**	**-0.6%**	**2895.2**	**-0.2%**	**2900.0**	**0.7%**	**2900.3**	**0.0%**	**2878.5**	**1.4%**	**2900.2**	**0.8%**
Federal	1108.4	-2.4%	1113.7	1.9%	1117.4	1.3%	1117.4	0.0%	1114.1	-0.1%	1114.6	0.0%
National Defense	658.6	-3.3%	666.2	4.7%	670.2	2.4%	670.2	0.0%	672.0	-2.2%	667.0	-0.7%
Non-Defense	449.0	-1.1%	446.9	-1.9%	446.6	-0.3%	447.2	0.5%	441.6	3.2%	447.0	1.2%
State & Local	1786.2	0.5%	1779.6	-1.5%	1780.7	0.2%	1782.9	0.5%	1762.8	2.3%	1783.7	1.2%
Real Final Sales	16883.5	2.7%	17006.6	2.9%	17106.3	2.4%	17254.4	3.5%	16354.3	2.6%	16664.1	1.9%
Real Domestic Final Sales	17502.7	2.4%	17618.3	2.7%	17703.5	1.9%	17857.5	3.5%	16900.4	3.3%	17250.3	2.1%
y/y	2.0%		2.2%		2.3%		2.6%					

	1st QUARTER 18		2nd QUARTER 18		3rd QUARTER 18		4th QUARTER 18		2017 FORECAST		2018 FORECAST	
	Forecast		Forecast		Forecast		Forecast					
Real GDP	**17,421.9**	**3.1%**	**17,558.7**	**3.2%**	**17,685.8**	**2.9%**	**17,809.0**	**2.8%**	**17,096.9**	**2.3%**	**17,618.8**	**3.1%**
Personal Consumption Expenditures	**12,089.3**	**2.9%**	**12,176.4**	**2.9%**	**12,252.9**	**2.5%**	**12,327.7**	**2.5%**	**11,882.6**	**2.7%**	**12,211.6**	**2.8%**
Durable Goods	1,751.0	5.0%	1,772.5	5.0%	1,790.0	4.0%	1,805.4	3.5%	1,691.9	6.1%	1,779.7	5.2%
Non-Durables	2,619.9	3.0%	2,639.4	3.0%	2,655.7	2.5%	2,672.2	2.5%	2,572.2	2.3%	2,646.8	2.9%
Services	7,769.6	2.4%	7,815.8	2.4%	7,858.4	2.2%	7,901.3	2.2%	7,673.6	2.2%	7,836.3	2.1%
Gross Private Domestic Invest.	**3,026.4**	**5.3%**	**3,069.2**	**5.8%**	**3,112.5**	**5.8%**	**3,153.9**	**5.4%**	**2,946.4**	**3.1%**	**3,090.5**	**4.9%**
Bus. Fixed Invest.	2,387.1	5.2%	2,423.8	6.3%	2,461.2	6.3%	2,498.1	6.1%	2,312.0	4.6%	2,442.5	5.6%
Structures	475.5	3.0%	482.5	6.0%	489.6	6.0%	495.6	5.0%	470.9	5.5%	485.8	3.2%
Equipment	1,142.9	7.0%	1,165.1	8.0%	1,187.7	8.0%	1,210.8	8.0%	1,093.8	4.4%	1,176.6	7.6%
Intellectual Property Products	770.7	4.0%	778.3	4.0%	785.9	4.0%	793.7	4.0%	750.5	4.2%	782.1	4.2%
Residential Invest.	604.4	6.0%	610.3	4.0%	616.3	4.0%	620.9	3.0%	595.6	1.4%	613.0	2.9%
Change in Inventory	35.0	-	35.0	-	35.0	-	35.0	-	20.1	-	35.0	-
Net Exports	**-607.6**	**-**	**-610.2**	**-**	**-612.4**	**-**	**-612.7**	**-**	**(609.1)**	**-**	(610.7)	-
Exports	2,224.0	3.0%	2,241.0	3.1%	2,257.1	2.9%	2,271.1	2.5%	2,185.8	3.1%	2,248.3	2.9%
Imports	2,831.5	3.0%	2,851.2	2.8%	2,869.5	2.6%	2,883.8	2.0%	2,795.0	3.3%	2,859.0	2.3%
Gov't Purchases of Goods & Services	**2,911.9**	**1.6%**	**2,921.4**	**1.3%**	**2,930.9**	**1.3%**	**2,938.2**	**1.0%**	**2,898.0**	**-0.1%**	**2,925.6**	**1.0%**
Federal	1,122.4	1.8%	1,125.1	1.0%	1,127.9	1.0%	1,130.8	1.0%	1,114.2	0.0%	1,126.6	1.1%
National Defense	673.5	2.0%	675.2	1.0%	676.9	1.0%	678.6	1.0%	666.3	-0.1%	676.0	1.5%
Non-Defense	448.8	1.5%	449.9	1.0%	451.1	1.0%	452.2	1.0%	447.4	0.1%	450.5	0.7%
State & Local	1,789.6	1.5%	1,796.2	1.5%	1,802.9	1.5%	1,807.4	1.0%	1,782.4	-0.1%	1,799.0	0.9%
Real Final Sales	17,386.9	3.1%	17,523.7	3.2%	17,650.8	2.9%	17,774.0	2.8%	17,062.7	2.4%	17,583.8	3.1%
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y/y	3.1%		3.1%		3.0%		3.0%					

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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