

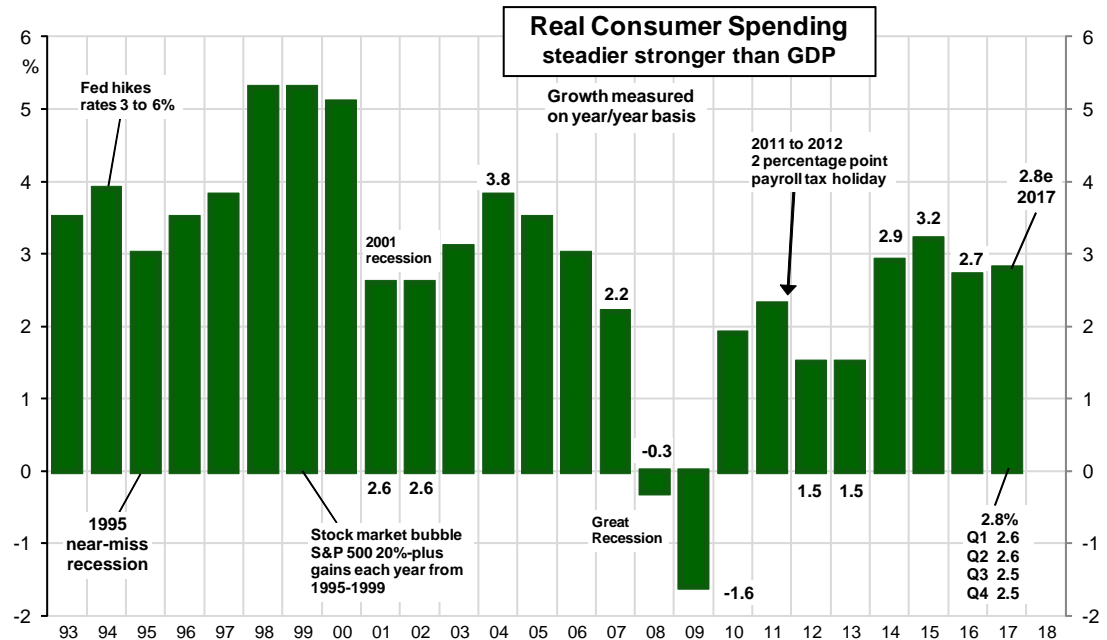
CHRISTOPHER S. RUPKEY, CFA  
 MANAGING DIRECTOR  
 CHIEF FINANCIAL ECONOMIST  
 ECONOMIC RESEARCH OFFICE (NEW YORK)  
 (212) 782-5702  
 crupkey@us.mufg.jp

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MUFG | 1251 Avenue of the Americas  
 New York, New York 10020

## GDP ECONOMY IS STILL 1.9%, BUT CONSUMER IS POWER LIFTING 3.0%

A tale of two economies in the last quarter of the Obama Era. First revision to the Q4 2016 GDP data shows growth still “stalled” at 1.9%. Too-slow 1.9% as in we should make America great again and take steps to boost economic growth. But is GDP the right measure of how the economy is doing? Because consumer expenditures continue to rise at a fast-normal pace: revised up to 3.0% now from the preliminary estimate of 2.5% last quarter. The consumer already looks pretty great again. [Pay no attention to the man behind the curtain: full disclosure, real consumer spending dropped in January (reported the day after the Q4 GDP revision), meaning real consumer spending will almost certainly slow in Q1 2017 to start Trump’s first quarter in office. January, and now February car and SUV sales are “weaker” at a 17.5 million annual rate in both months after 18.0 million in Q4 2016. If you’re trying to help with tax cuts:



	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16p	Q4 16r
REAL GDP	0.9	0.8	1.4	3.5	1.9	1.9
CONSUMPTION	1.5	1.1	2.9	2.0	1.7	2.1
Durables	0.3	-0.1	0.7	0.8	0.8	0.8
Nondurables	0.2	0.3	0.8	-0.1	0.3	0.4
Services	1.1	0.9	1.4	1.3	0.6	0.8
INVESTMENT	-0.4	-0.6	-1.3	0.5	1.7	1.5
Business Plant & Equipment and Intellectual Property	-0.5	0.0	-0.1	0.3	-0.1	-0.1
Homes	0.4	0.3	-0.3	-0.2	0.4	0.4
Inventories	-0.4	-0.4	-1.2	0.5	1.0	0.9
EXPORTS	-0.3	-0.1	0.2	1.2	-0.5	-0.5
IMPORTS	-0.1	0.1	0.0	-0.3	-1.2	-1.2
GOVERNMENT	0.2	0.3	-0.3	0.1	0.2	0.1
Federal defense	0.2	-0.1	-0.1	0.1	-0.1	-0.1
Fed nondefense	0.1	0.0	0.1	0.1	0.1	0.1
State and local	-0.1	0.4	-0.3	0.0	0.3	0.1

Percentage point contributions to Q4 16 1.9% real GDP

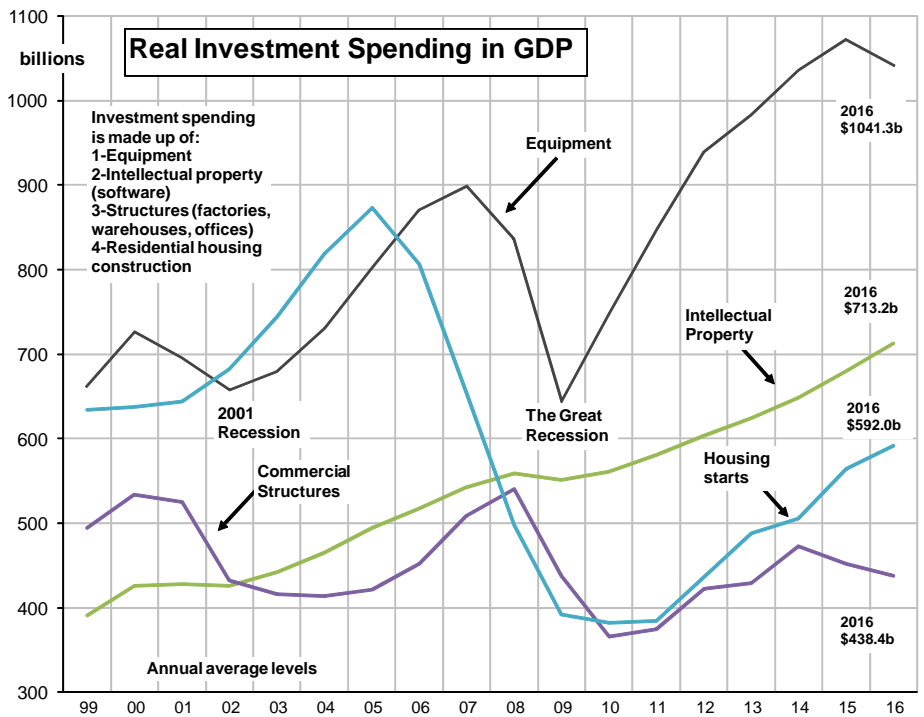
Final estimate for Q4 is Thursday, March 30



been there done that in 2011-12 with a huge tax cut to payroll taxes that did not boost consumer spending.]

The point is that the economy is okay right now, growth is, if you just look at consumer expenditures. Fed Chair Yellen has said she has had concerns about the relative weakness in investment spending, but we do not see the yellow caution light on business investment at all. Most of the “investment weakness” has been in residential housing construction. That’s right. Fed

Chair Yellen has testified to Congress that she wishes consumer spending were stronger so that companies would start increasing investment to meet that demand, but this has little to do with whether economic growth is 2% or 3%-plus that Team Trump is trying to achieve. Housing starts are not adding to the GDP economy as they did at the bubble peak in 2005 and this is why overall business investment “suffers” according to those whose views naturally think the economic outlook is uncertain. Business equipment purchases are actually much higher than they were before the recession, so let’s not look for companies to boost capex to help the economy grow. For all the complaints that business is not spending enough to make the economy go, maybe companies have already bought the equipment they need for now to meet the demand for their goods and services from consumers.



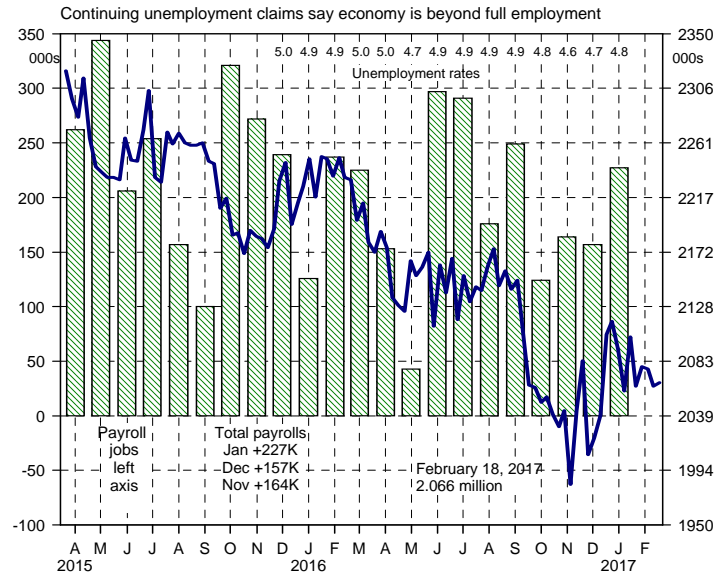
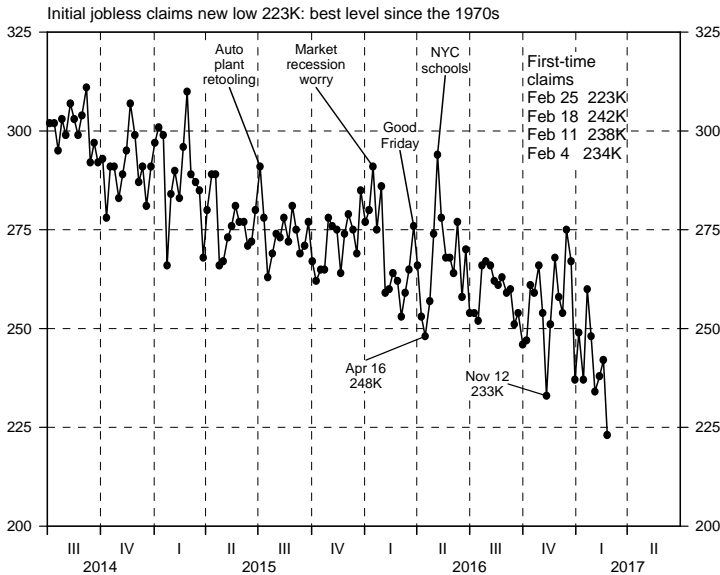
Business Investment Spending in the real GDP accounts			
Q4 2016 \$bln	Level	% YOY	YOY
Equipment	1037.0	-3.9	-41.6
Intellectual Property	725.8	5.1	35.1
Construction			
Business structures	440.3	1.2	5.2
Mining, shafts, wells	46.8	-29.5	-19.6
Other	393.5	6.7	24.8
Residential housing	596.0	1.1	6.5
Total	2801.3	0.3	8.0

\$BLN Nominal GDP expenditures	Q4 15 YOY%	Q1 16	Q2 16	Q3 16	Q4 16 YOY%
Equipment & Intellectual Property	1823.5 4.4	1806.4	1817.4	1813.2	1828.8 0.3
EQUIPMENT	1092.6 4.2	1066.3	1058.7	1049.3	1053.4 -3.6
Information processing equipment	322.1 4.6	319.9	316.8	322.8	324.4 0.7
Computers	75.4 -7.1	76.0	78.2	77.0	74.4 -1.3
Other processing equipment 1	246.6 8.7	243.9	238.6	245.8	250.0 1.4
Industrial equipment	224.7 3.8	222.2	227.3	228.2	224.7 0.0
Transportation equipment	310.7 10.3	301.3	297.6	286.7	286.6 -7.8
Other equipment 2	235.1 -3.2	222.9	217.0	213.7	213.7 -9.1
INTELLECTUAL PROPERTY	730.9 4.9	740.1	758.7	763.9	775.4 6.1
Software	330.1 3.8	336.0	339.4	342.6	345.5 4.7
Research & Development (R&D)	320.3 5.7	323.0	337.9	338.8	344.7 7.6
Entertainment, literary, artistic	80.6 6.2	81.1	81.4	82.5	85.1 5.6
1 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments					
2 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment					

# JOBLESS CLAIMS—BEST OF BEST TIMES RIGHT NOW FOR LABOR MARKET

Unemployment claims fell to a new low for this cycle: 223K for the February 25 week. The lowest level (meaning best conditions) in 44 years as the headlines said. Was it President Nixon in office back then? Jobless claims, the series that is in the index of leading economic indicators. What in the world is the Fed's policy interest rate doing at 0.75%? The economy is at full employment so there is no pressing need for fiscal stimulus to create jobs. The timing is completely off. Historically, no other administration has done fiscal stimulus with the economy where it is today.

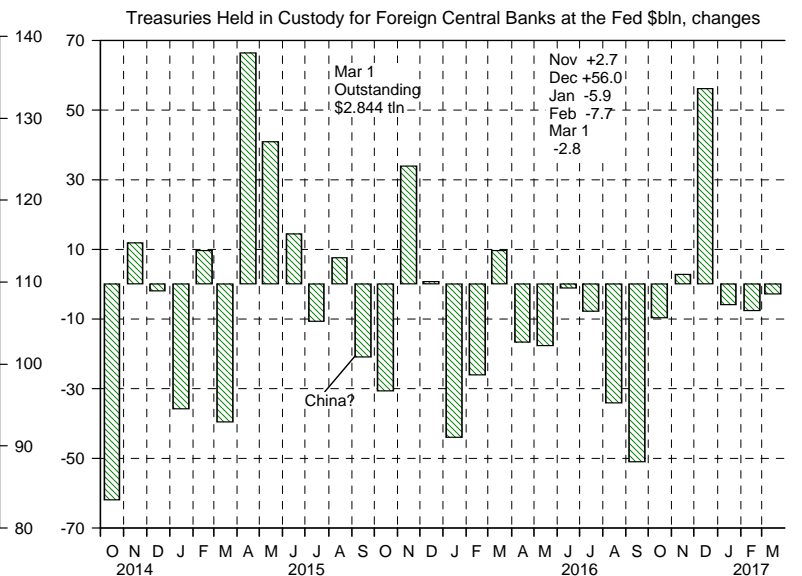
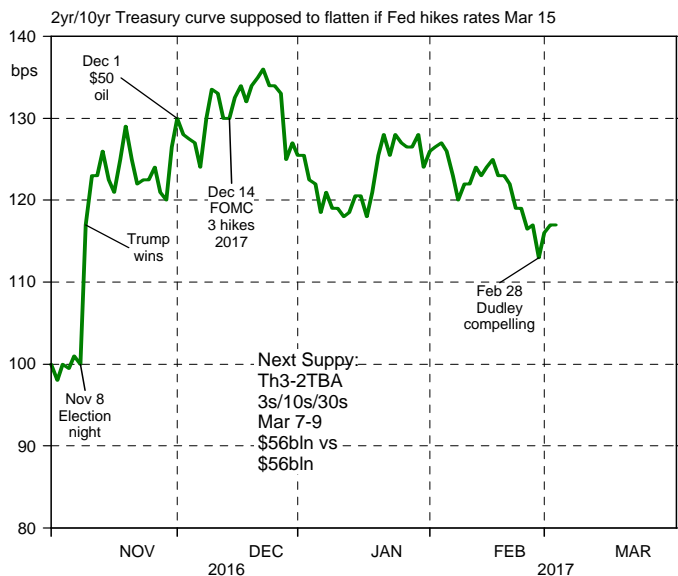
President takes Office	Unemployment
Clinton	Jan 1993 7.3%
Bush	Jan 2001 4.2%
Obama	Jan 2009 7.8%



# TREASURY CURVE WAS STEEPER: TRUMP FISCAL STIMULUS MUMBO JUMBO

The yield curve between 2-yrs and 10-yrs was 117 bps on Friday versus 117 bps last week. The biggest upward move in yields came Tuesday afternoon on the New York Fed President Dudley comment about how "fairly soon" could mean March 15. Yields also went up the morning after Trump's State of the Union speech following stocks: Dow industrials rose 303 points Wednesday. The curve flattened to 113 bps on Dudley's compelling rate hike comment Tuesday, the low for the week.

	30-Dec 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
30-Yr Bond	3.07	3.10	3.10	3.20	3.40	3.60	3.70
10-Yr Note	2.45	2.40	2.50	2.70	3.00	3.20	3.40
5-Yr Note	1.93	2.00	2.10	2.40	2.70	3.00	3.20
2-Yr Note	1.19	1.60	1.80	2.00	2.20	2.50	2.75
3-month Libor	1.00	1.25	1.50	1.70	1.95	2.20	2.45
Federal Fund Rate	0.75	1.00	1.25	1.50	1.75	2.00	2.25
2s/10s spread	126	80	70	70	80	70	65



## FEDERAL RESERVE POLICY

The Fed meets March 14-15 to consider its monetary policy. If [Yellen gave the green light on Friday for a rate hike](#), no one cared. The process of rates normalization has been too drawn out, a new Fed Chair is coming shortly, and too much discounting of a March 15 rate hike already took place earlier in the week. The odds of a rate hike were 90% on Thursday and rose to 94% on Friday “after Yellen spoke.” It’s not going over 100%, the only direction left is down, perhaps on a disappointing Friday, March 10 employment report, although jobless claims are the lowest in 44 years so how bad can the labor markets be?

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data					pre-LEH
	1-Mar	22-Feb	15-Feb	8-Feb	
<b>Factors adding reserves</b>					
U.S. Treasury securities	2463.488	2463.456	2463.446	2463.436	479.782
Federal agency debt securities	13.329	13.329	14.829	16.180	0.000
Mortgage-backed securities	1763.186	1773.621	1759.700	1744.642	0.000
Primary credit (Discount Window)	0.001	0.000	0.011	0.007	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TAF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.705	1.705	1.705	1.705	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	1.132	0.143	0.236	0.265	62.000
Federal Reserve Assets	4504.3	4514.6	4500.9	4502.5	961.7
3-month Libor %	1.09	1.05	1.04	1.03	2.82
<b>Factors draining reserves</b>					
Currency in circulation	1521.561	1512.508	1508.844	1505.331	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	156.010	177.833	105.123	122.934	0.000
<b>Reserve Balances (Net Liquidity)</b>	<b>2307.954</b>	<b>2243.156</b>	<b>2254.271</b>	<b>2237.460</b>	<b>24.964</b>
Treasuries within 15 days	0.000	13.175	13.175	7.159	14.955
Treasuries 16 to 90 days	48.558	48.558	48.558	41.249	31.549
Treasuries 91 days to 1 year	195.256	163.208	163.208	167.127	69.272
Treasuries over 1-yr to 5 years	1216.789	1240.509	1240.508	1210.167	170.807
Treasuries over 5-yrs to 10 years	376.104	372.215	363.532	407.661	91.863
Treasuries over 10-years	626.781	625.791	634.466	630.073	101.337

\*\*September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

Okay so, it was just a couple weeks ago with the release of the January Fed meeting minutes on February 22 that the odds of a Fed rate in March were low at 34%, using the Fed funds futures odds on the Bloomberg “WIRP” page: World Interest Rate Probability. Will the world ever be the same again. The WIRP page is used more and more as fixed income traders and their robots have forgotten how to calculate the market-based odds of a Fed rate hike for themselves. The January Fed meeting minutes said “many” thought a rate hike “fairly soon.” The “many” have now swelled in number into just about every Fed speaker this week. That is until Friday when perma Doves Chicago Fed President Evans and St. Louis Fed President Bullard fought back. The biggest move discounting a March meeting rate hike came on Tuesday at 4pm, after the Fed funds futures settlement, on New York Fed President Dudley news headlines; so it was this news late Tuesday that boosted the WIRP March Fed hike odds on Wednesday to 80%... long before Yellen chimed in on Friday if that is what she did. New York Fed President Dudley gave extended remarks but all the market heard at 4:07pm Tuesday, February 28 was that he thought that the case for tightening has become a lot more compelling.

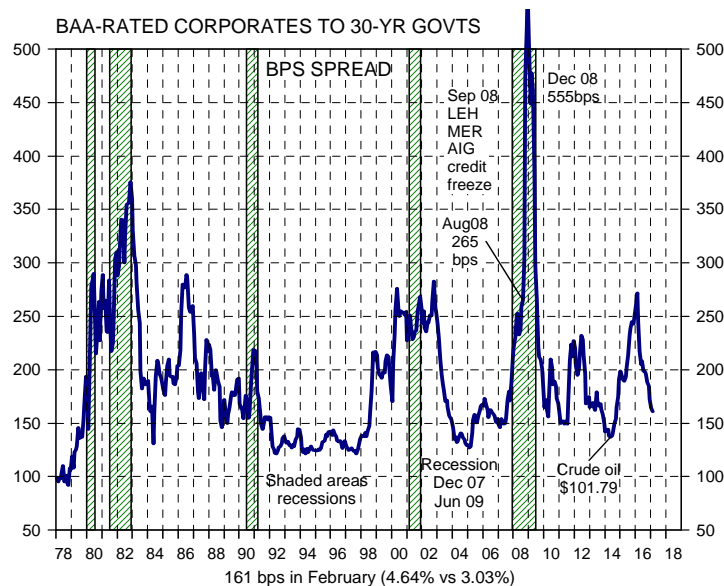
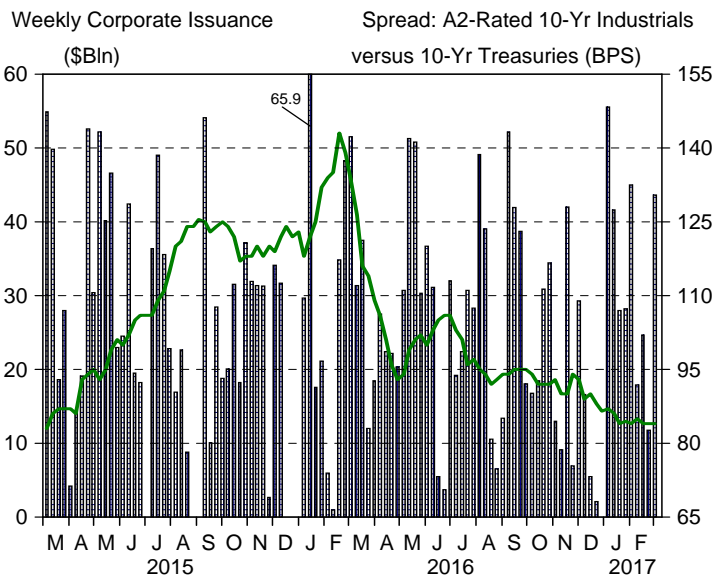
Pricing in the odds of a rate hike using Fed funds futures isn’t as simple as it sounds. There’s money involved after all. The April Fed funds futures contract says where the daily effective Fed funds rate that banks trade will average over the month of April (after a March 15 rate hike). The upper bound of the Fed funds rate target is 0.75% and the lower bound is

Fed funds futures rate hike odds					
WIRP		FFJ7	FF		
40%	Friday, Feb 24	0.725	0.66	6.5/25	26%
50%	Monday, Feb 27	0.75	0.66	9/25	36%
52%	Tuesday, Feb 28	0.755	0.66	9.5/25	38%
80%	Wednesday, Mar 1	0.825	0.66	16.5/25	66%
90%	Thursday, Mar 2	0.85	0.66	19/25	76%
94%	Friday, Mar 3	0.86	0.66	20/25	80%
	FFJ7 -- April Fed funds futures				
	FF -- Daily effective Fed funds rate				

0.50%, and although the halfway point is 0.625, the daily effective Fed funds rate has been a little higher at 0.66% since the Fed rate hike in December 2016. If the Fed raises rates 25 bps to 1.0% on March 15, then the daily effective Fed funds rate should move up 25 bps to average 0.91% for the month of April, 0.91%, and this is where April Fed funds futures will/should settle. On Friday, April Fed funds futures settled at 0.86% which is 5 bps away from fully discounting a March Fed hike to 0.91% or odds of 80%. The Bloomberg WIRP odds of a Fed hike are higher at 94%, but this is because WIRP “falsely” assumes the next level will be 0.875% for the midpoint of the Fed funds rate not the 0.91% or 25 bps higher rate that we are expecting for the daily effective Fed funds rate that is 0.66% now. 80 percent odds. If Yellen raises rates, you will make 5 bps on the April Fed funds futures contract, about \$100 after putting up margin of \$302 to play. Do you feel lucky? Do you?

# CORPORATE BONDS: WALT DISNEY CO., AMERICAN EXPRESS, CHEVRON

Corporate bond offerings were \$43.6 billion in the March 3 week versus \$11.8 billion in the February 24 week. On Tuesday, Johnson & Johnson sold \$4.5 billion 5s/10s/20s/30s. It priced \$1.0 billion 2.95% 10-yrs (m-w +10bp) at 57 bps (Aaa/AAA). The pharmaceutical company will use the proceeds for general corporate purposes including share repurchases and payment of outstanding commercial paper. Corporate bonds (10-yr Industrials rated A2) were 84 bps above 10-yr Treasuries on Friday versus 84 bps last Friday.



## TREASURY MARKET OUTLOOK

EXPECTED 10-YR 2-3 WEEK TRADING RANGE 2.00% to 2.75%

Week's 10-YR Range

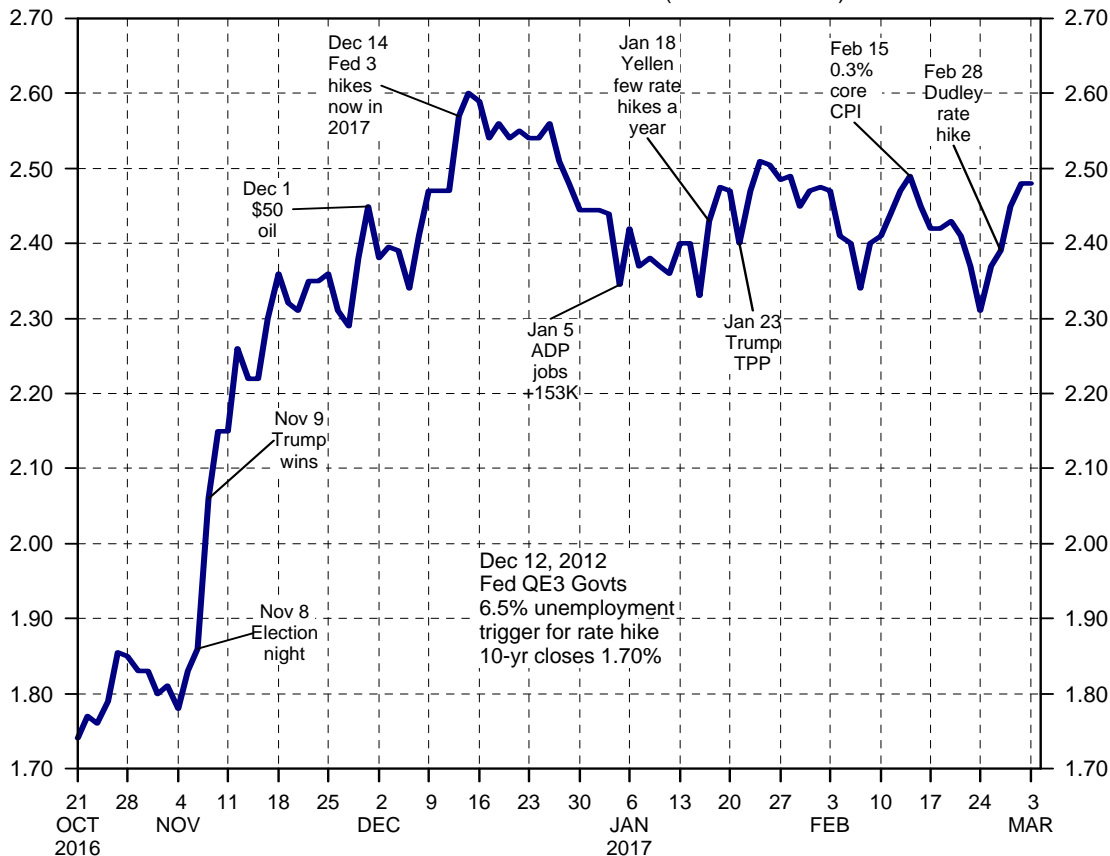
HIGH 99-13+ 2.32%

Monday, February 27, start of the week highs

LOW 97-20+ 2.52%

Friday, March 3, Yellen news headlines brief reaction: March hike appropriate if...

## RECENT TREND IN 10-YR GOVERNMENT NOTES (N.Y. CLOSING)



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