Financial Market Weekly

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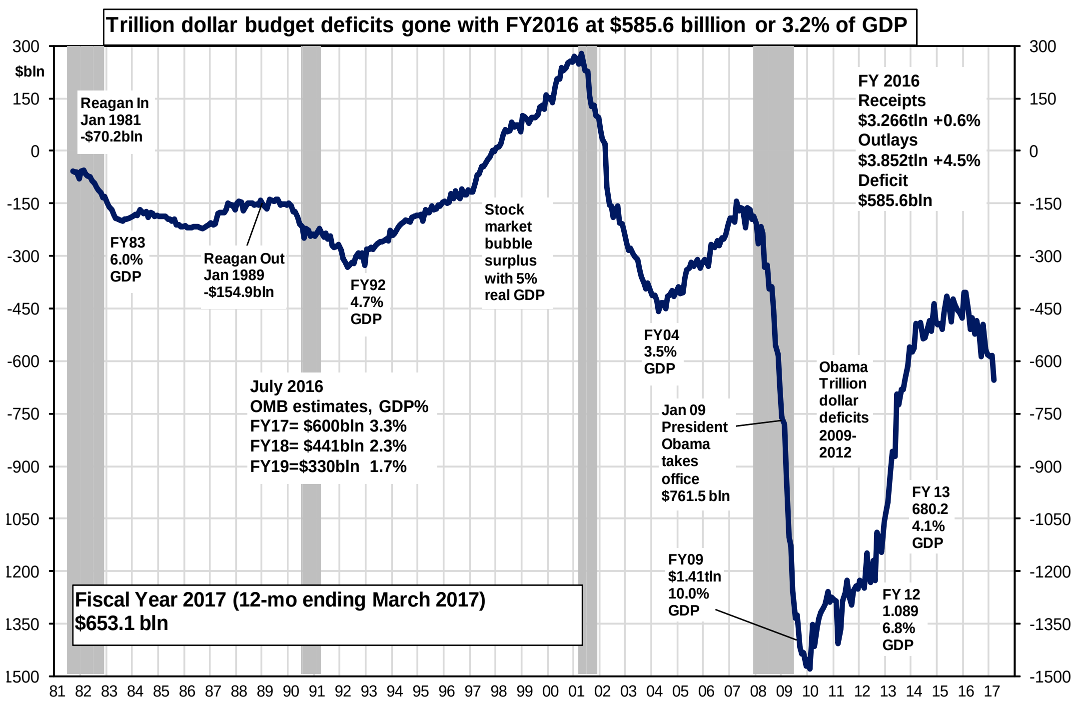
14 APRIL 2017

FISCAL STIMULUS REQUIRES FEDERAL BUDGET DEFICIT SPENDING, DOESN'T IT?



There has been a lot of change down in Washington. But we guess it can be still counted as true that fiscal stimulus to increase the economic growth that leads to more employment means there would have to be an increase in the Federal government's budget deficit. Planned deficits are normally done when the economy is in recession. The Federal government spends more than it takes in, the budget deficit increases. (It borrows from the public to fund the deficits, the public that has stopped spending during the economic downturn). President Obama was inaugurated during a recession on January 20, 2009, and signed into law The American Recovery and Reinvestment Act on February 17, 2009 less than a month after getting there. The unemployment rate was 7.6% at the time of signing on its way up to the 10% peak in October 2009. This fiscal stimulus "Recovery Act" at the time it was signed was estimated at $787 billion. And of course the Federal budget "Obama deficits" were over $1 trillion each year from 2009 through 2012.

President Trump was inaugurated this year on January 20, 2017, and as yet, 84 days later, there is no $787 billion stimulus package that he could sign in sight. Just as well. And before you point fingers on this and assign blame, from an economic research stance, we still question the need for such Federal government deficit spending at this stage of the cycle where year nine of the economic expansion from the 2007-09 recession starts in July. The unemployment rate is 4.5%, not the 7.6% unemployment rate, darkening-skies economy that President Obama inherited. Anyway as these discussions continue to go on down there in Washington, we will take our regular assessment of Federal budget matters this week as we do every three months as an update. The Federal budget deficit for March was released on Wednesday this week, March as in the end of the first quarter and also the halfway point of the Federal government's fiscal year (FY) that ends in September each year.

Federal Government Spending ($bln)			Fiscal	Fiscal	
Where to cut?	2 Qtrs FY17	2 Qtrs FY16	Year	Year	Full Year
	Q4 16-Q1 17	Q4 15-Q1 16	Changes	% chg	FY 2016
TOTAL BUDGET OUTLAYS	1,999.991	1,935.579	64.412	3.3	3,854.100
Legislative	2.303	2.193	0.110	5.0	4.344
Judicial	3.754	3.713	0.041	1.1	7.497
Agriculture	81.028	80.703	0.325	0.4	138.162
Food Stamps	35.506	37.123	-1.617	-4.4	73.081
Child Nutrition	12.791	12.370	0.421	3.4	21.978
Commerce	5.657	4.511	1.146	25.4	9.162
Defense	285.620	284.199	1.421	0.5	565.364
Military Personnel	76.401	76.962	-0.561	-0.7	147.905
Operation Maintenance	118.906	117.672	1.234	1.0	243.200
Procurement	52.546	52.786	-0.240	-0.5	102.651
Research Development	32.161	31.956	0.205	0.6	64.873
Military Construction	3.258	3.650	-0.392	-10.7	6.677
Education	40.241	37.356	2.885	7.7	76.981
Office of Federal Student Aid	16.630	17.520	-0.890	-5.1	42.796
Energy	12.866	12.325	0.541	4.4	25.852
Health Human Services	554.307	530.202	24.105	4.5	1102.965
Medicare	346.665	330.425	16.240	4.9	698.609
Medicaid States Grants	190.840	181.398	9.442	5.2	368.280
Homeland Security	25.375	22.071	3.304	15.0	45.195
Housing Urban Development	18.739	20.238	-1.499	-7.4	26.393
Interior	5.396	5.814	-0.418	-7.2	12.584
Justice	15.304	13.825	1.479	10.7	29.523
Labor	20.773	19.653	1.120	5.7	41.371
State Unemployment Benefits	16.480	17.206	-0.726	-4.2	32.178
State	12.782	11.785	0.997	8.5	29.448
Transportation	35.628	34.605	1.023	3.0	78.419
FAA	7.779	7.626	0.153	2.0	15.560
Federal Highway Admin.	18.961	88.116	-69.155	-78.5	114.055
Treasury	310.627	286.331	24.296	8.5	526.116
TARP	1.869	2.476	-0.607	-24.5	4.961
IRS	97.886	97.914	-0.028	0.0	133.126
Earned Income Credit	50.947	52.935	-1.988	-3.8	60.580
Child Tax Credit	16.734	17.719	-0.985	-5.6	20.188
Interest on Public Debt	222.961	189.090	33.871	17.9	429.963
Veterans Affairs	85.880	83.154	2.726	3.3	174.018
Corps of Engineers	3.468	2.988	0.480	16.1	6.388
Other Defense Civil Programs	29.557	32.593	-3.036	-9.3	64.505
Environmental Protection	4.415	4.587	-0.172	-3.7	8.729
Exec. Office of President	0.197	0.196	0.001	0.5	0.395
International Assistance	11.998	11.303	0.695	6.1	16.241
NASA	9.389	9.300	0.089	1.0	18.829
National Science Foundation	3.348	3.187	0.161	5.1	6.904
Personnel Management	47.793	45.492	2.301	5.1	91.316
Small Business Admin.	0.505	-0.946	1.451	----	-0.444
Social Security Admin.	493.964	480.490	13.474	2.8	976.783
Retirement Benefits	391.760	377.787	13.973	3.7	762.126
Federal Disability Payments	71.218	71.404	-0.186	-0.3	143.130
Other Independent Agencies	6.491	8.309	-1.818	-21.9	13.162

Where's the deficit spending to double GDP and create jobs? Early yet, it is only March. The Federal budget deficit is running $653.1 billion this year at the halfway point for FY 2017 (12-month trailing sum basis). The Obama administration's final FY2017 deficit estimate from the mid-session review last July was $600 billon. Trump's "America First" budget released March 16, 2017 seeks to increase spending and the deficit by $10 billion this year ending September 2017 with an increase of $25 billion in Defense spending, and a $15 billion reduction in Non-defense spending. Actually, Non-defense spending is down $18 billion because a $3 billion increase is requested as a down payment on the Border Wall. The Border Wall is non-defense spending.

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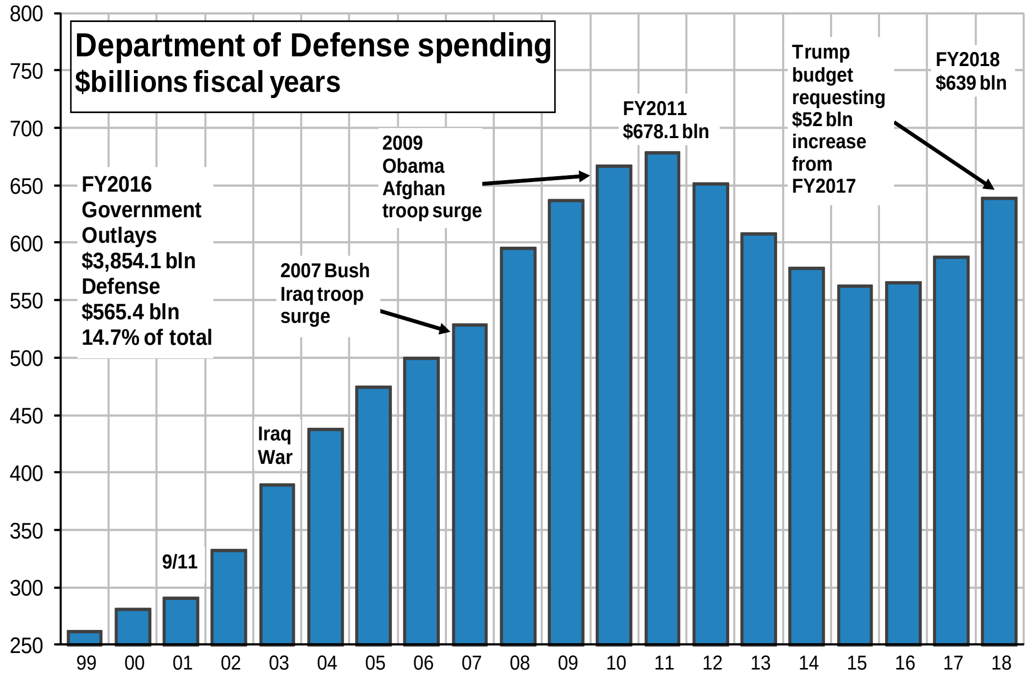
It doesn't sound like the Trump administration's proposed FY2017 changes will be voted on and passed by Congress. Defense spending in nominal terms has been enormous following 9/11, the 2003 Iraq War, the Bush Iraq troop surge and the Obama Afghanistan troop surge. Defense spending had been in decline from the FY2011 peak, but now the President has proposed increasing defense spending back closer to the peak despite any current military engagements. We will see where this goes, but the current deficit estimate of $600 billion in the year ending September 2017 (Obama's not Trump's) does not count as enough fiscal stimulus to boost economic growth appreciably, let alone double GDP.



Trump's proposals for the next couple of years, the rough sketch to date, also do not look like fiscal stimulus. What did Yellen say about the Trump yield rally in Treasury bonds in testimony late last year? "Markets are anticipating that [Congress] will ultimately choose a fiscal package that involves a net expansionary stance of policy, and that in a context of an economy that's operating reasonably close to maximum employment, with inflation heading back toward two percent, that such a package could have inflationary consequences…" she reasoned. Stay tuned. Story developing.

FEDERAL RESERVE POLICY

The Fed meets May 2-3 to consider its monetary policy. This is a non-regularly scheduled press conference meeting so no action is expected. The median Fed forecast made at the March meeting looks for three rate hikes this year. They've done one 25 bps rate hike to 1.0%, and now have two more left to go, presumably at one of the three remaining meetings with press conferences in June, September, and December.

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Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	12-Apr	5-Apr	29-Mar	22-Mar	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2464.546	2464.454	2464.335	2463.974	479.782
Federal agency debt securities	13.329	13.329	13.329	13.329	0.000
Mortgage-backed securities	1781.091	1769.122	1769.118	1777.645	0.000
Primary credit (Discount Window)	0.001	0.000	0.000	0.001	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.708	1.718	1.707	1.707	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	0.045	5.075	1.007	1.019	62.000
Federal Reserve Assets	4530.7	4520.8	4515.7	4524.5	961.7
3-month Libor %	1.16	1.15	1.15	1.16	2.82
Factors draining reserves					
Currency in circulation	1540.933	1540.054	1536.334	1533.834	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	105.528	174.644	260.357	251.013	0.000
Reserve Balances (Net Liquidity)	2367.767	2337.776	2269.984	2313.962	24.964
Treasuries within 15 days	0.460	0.460	13.559	13.559	14.955
Treasuries 16 to 90 days	59.336	59.336	46.911	46.910	31.549
Treasuries 91 days to 1 year	201.692	201.689	183.368	183.363	69.272
Treasuries over 1-yr to 5 years	1194.562	1194.547	1216.893	1216.867	170.807
Treasuries over 5-yrs to 10 years	381.007	380.988	376.236	376.203	91.863
Treasuries over 10-years	627.489	627.435	627.368	627.071	101.337

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

The Committee under first Bernanke and then under Yellen has shown a lot of caution, "what's the hurry," when it comes to normalizing its easy money policies. The June 13-14 meeting does not seem very likely at the moment with real consumer expenditures barely positive in the first quarter (Q1 real GDP due Friday, April 28), and this week's CPI inflation report fell back a little. July Fed funds futures at the week's early close on Thursday at 1pm before the Good Friday holiday said the odds of a rate hike at the next Live decision date on June 14 were 50%. Not high.

Speaking of Yellen, President Trump surprisingly did not rule her out of the running to be the next Fed Chair in a Wall Street Journal interview on Wednesday after futures trading closed at 3pm. Her current term expires on February 3, 2018. During the campaign he criticized her low rates policies for setting off a stock market bubble. She was to be replaced because she was not a Republican. While Trump said it is early in the process, he likes her and respects her. He added, "I do like a low-interest rate policy, I must be honest with you." 10-yr yields were 2.29% at the time of these Trump-Yellen news headlines and closed the day Wednesday at 2.24%.

We would like to see change down there in Washington in how the Fed is being run; we must be honest with you. They have been too slow in raising rates back to "3%" normal, acting as if one false step could send the economy back into a recession. On the other hand, at least Yellen seems comfortable with the Committee's current forecast of a Fed funds rate of 1.5% later on this year, 2.25% at the end of 2018, and 3.0% at the end of 2019. Taking over two and a half years to push rates to a low 3% rate (money is free until it is higher than 2.4% CPI inflation) looks too slow to us, but New York Fed President Dudley suggested recently that the Fed funds rate might only need to go as high as 2.0 to 2.5 percent, and added the word "perhaps" like even that might not happen if the economy doesn't meet the Fed's objectives. At least Yellen is saying 3% someday.

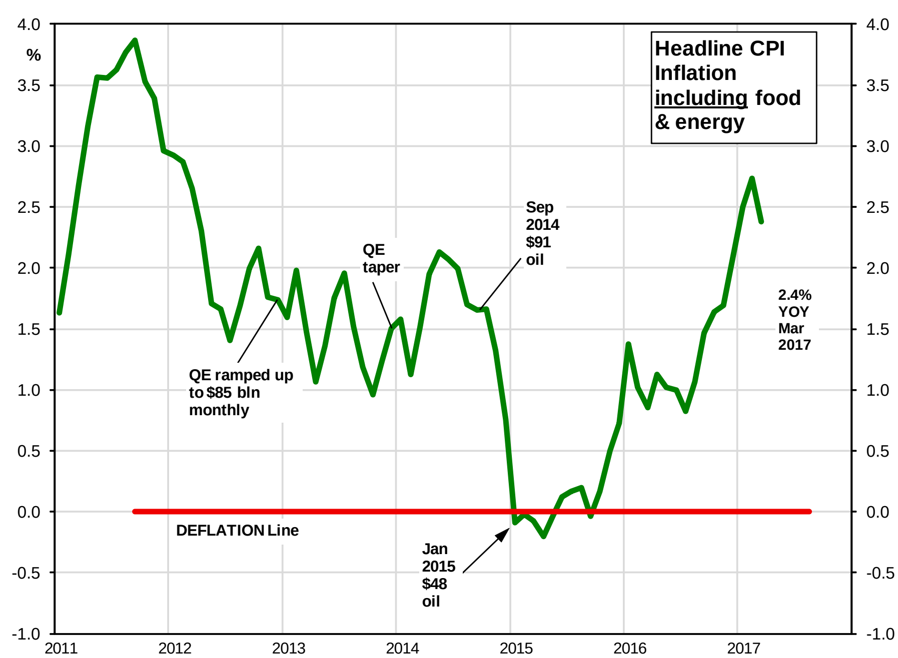
Other News This Week

Consumer doesn't see Spring yet even with cheaper prices as inflation drops

Breaking economy news. Retail sales and CPI inflation. The dollar is "trading" on this Good Friday holiday for much of the world, but the stock and bond markets are closed. If a tree falls in the forest and no one is there to see or hear it, did it really happen? That's our thought on judging the economic outlook when faced with retail sales down 0.2% in March and the CPI index in retreat, falling 0.3%, falling prices always called deflation.

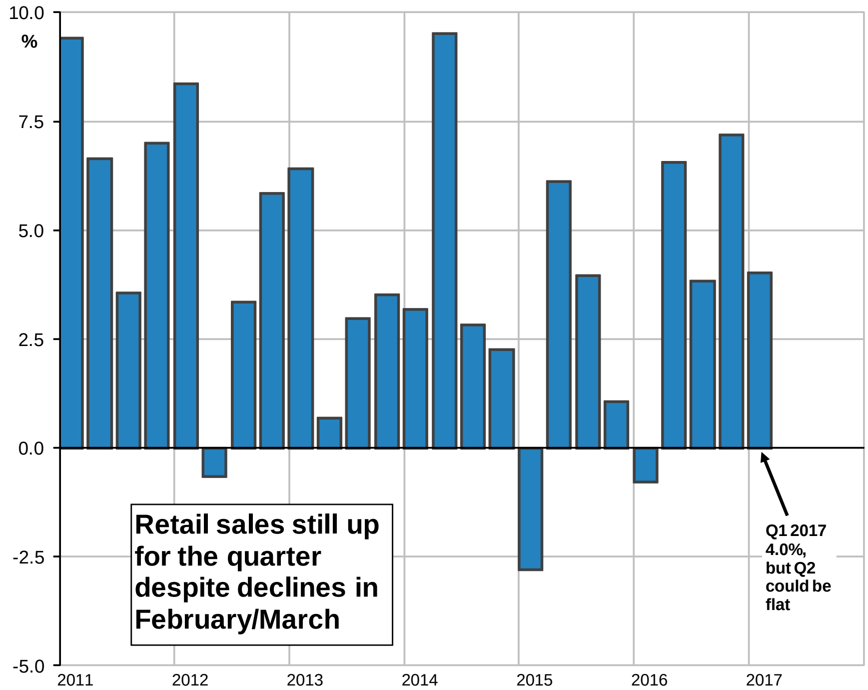
First to inflation. The Fed is waiting for the PCE inflation index not this one today, the CPI index, to move to 2%. Fed Chair Yellen wants to see more inflation (what would Volcker say?) before pronouncing the economy fully healed, or at least meeting one of the Fed's two important objectives. Core PCE inflation in particular is 1.8% year-on-year, not at the 2.0% target yet.

Well, the two inflation indexes tend to move together even if CPI always finds more inflation out there than PCE inflation does. Core CPI fell 0.1% today, and you have to go back to January 2010 to find a similar one-month decline. As a result, core CPI inflation year-on-year is back down to 2.0% in March versus 2.2% last month. With one more PCE inflation report to go before the upcoming May 3 Fed meeting decision date on rates, it does not look like 1.8% core PCE is going to move up further and seal the deal for an "off-cycle" meeting rate hike.



Why was it down 0.1% core CPI inflation? The auto industry keeps talking about the glut of cars coming off lease and indeed this is pressuring used car prices down 0.9% in March and 4.7% the last year. Shelter or housing costs uncharacteristically slowed in March rising just 0.1% where 0.3s are the norm with housing costs still up 3.5% over the last year. Apparel prices fell 0.7% this month, but this is a one-off as it had risen a cumulative 2.0% over the prior two months. Net, net, for CPI inflation today falling 0.3% to a 2.4% rate the last year, most of that was in gasoline prices which were lower based on "faulty" seasonals, with gas prices not rising as much as they normally do this spring. No worries about core inflation slowing further from a 2.0% annual rate certainly, this is not a stagnant economy with deficient demand.

Not a stagnant economy, hope we are not whistling in the dark, even with retail sales down a second month in a row today. March retail sales fell 0.2% and February sales down 0.3%. Car & light truck sales are about a fifth of retail sales and we already know these sales fell 5.7% in March from 17.5 to 16.5 million at an annual rate. Other than cars, declines were registered in furniture, building materials, sporting goods, bars and restaurants, gasoline stations. Sales are lackluster at the start of the year, just like they were early in 2015 and in 2016. Let's hope consumers return to the shops and malls later on this year to make the economy great again. Otherwise, Trump's economics team in Washington will really have their work cut out for them.



Net, net, the economy's engines were not firing on all cylinders in March with consumers' trips to the malls and prices of store bought goods falling. Time will tell if this is the pause that refreshes and growth picks back up in the second quarter. Easter falls later this year and income tax refunds have been lagging perhaps, giving consumers pause, but whatever happened to consumer spending, it certainly does not reflect consumer confidence which seemingly knows no bounds. On the other hand, the current economic picture which is cloudy and gray is not likely to be a compelling one for Fed officials when they meet in May or even in June to consider a rate hike. They only see two more rate hikes this year anyway and could easily take the summer off and take a fresh look at the economy in September. GDP growth will be hard put to reach 1.0% in the first quarter and this will not make the case for a rate hike compelling for Fed officials. Bet on it.

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