Financial Market Weekly

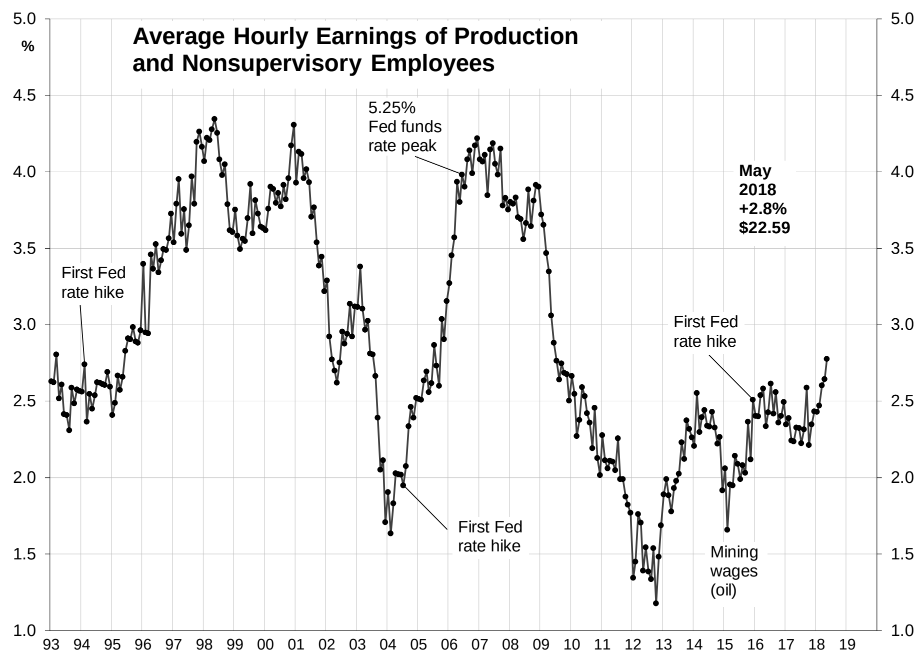
MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
(212) 782-5702
crupkey@us.mufg.jp

MUFG Bank, Ltd.
A member of MUFG, a global financial group

1 JUNE 2018

LOOKING FORWARD TO SEEING THE EMPLOYMENT NUMBERS, AND HOW! 223K BIG ONES

Breaking economy news. The monthly employment report for May. We had to raise our 200K jobs forecast (sorry if you all did not receive the update) after the unrealDonaldTrump 721am EDT tweet "Looking forward to seeing the employment numbers at 8:30 this morning." Glad we were in the office early. Looks like someone leaked the jobs numbers, and we are likely to see an investigation by the special prosecutor.



The May jobs report was good all over and definitely something for the President to crow about. Squawk! Call the Hotline. America's news network. 223K payroll jobs in May with 15K of upward revisions to March/April, unemployment falling a tenth to 3.8% (just missed 3.7% at 3.755%), wages up 0.3% to $26.92, an increase of 2.7% the last year. Wages are 2.8% for working guys and gals, the best since 2009, the series that does not include bosses. And darn it, everyone is participating, everyone a winner with... oops, our bad, the participation rate fell to 62.7% in May from

	May	Apr	Mar	Feb	Jan	Dec
Payroll jobs (000s)	223	159	155	324	176	175
Unemployment rate %	3.8	3.9	4.1	4.1	4.1	4.1
Unemployment (3 decimal)	3.755	3.929	4.071	4.142	4.149	4.095
Participation rate %	62.7	62.8	62.9	63.0	62.7	62.7
Average hourly earnings	$26.92	$26.84	$26.80	$26.74	$26.71	$26.64
MTM % Chg	0.3	0.1	0.2	0.1	0.3	0.4
YOY % Chg	2.7	2.6	2.6	2.6	2.8	2.7
Production Worker earnings	$22.59	$22.52	$22.46	$22.39	$22.34	$22.31
MTM % Chg	0.3	0.3	0.3	0.2	0.1	0.4
YOY % Chg	2.8	2.6	2.6	2.5	2.4	2.4

62.8% in April as there are more people dropping out! Those not in the labor force rose to 95.915 million in May, and increase of 170K from 95.745 million in April. The unemployment rate fell to 3.8%, the number of unemployed fell 281K, but partly because 170K dropped out and are not with a job or not looking for work.

Anyway, three out of four main statistics were good for the economy, jobs, unemployment rate, wages (especially for working men and women and not their bosses). Only the labor force dropouts went the wrong way, but frankly, people drop out continually over time as the population grows each year and is not a sign of economic distress. The unemployment rate is falling for the right reason.

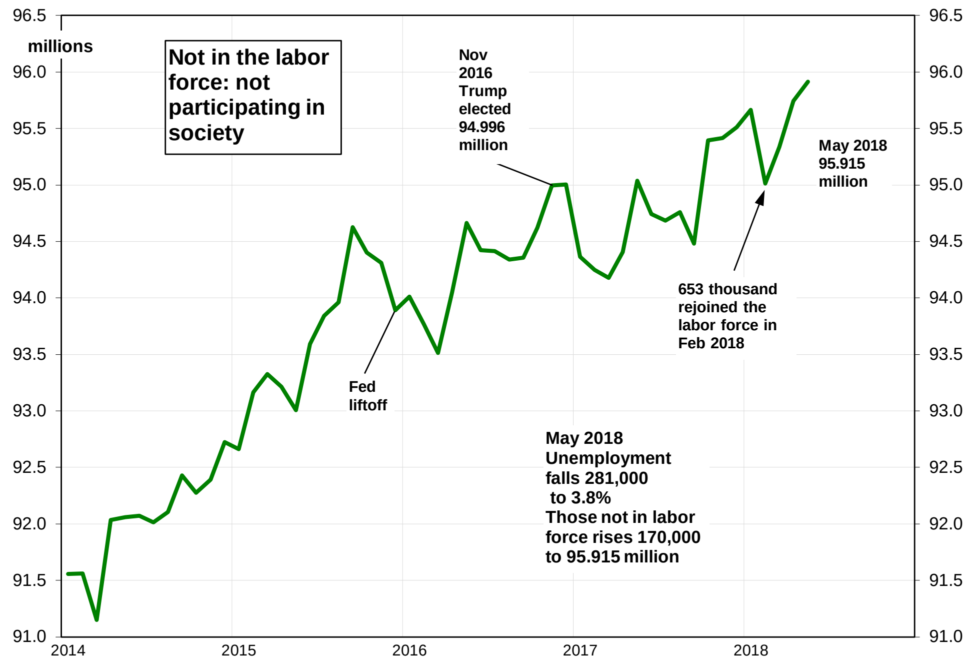
Where are the jobs? Well, retail is not dead as 31K more workers were hired in May after just 9K in April. This accounts for most forecasters misses on the jobs report today where 190K was the consensus. Other job category standouts. Health care jobs added 29K in May, and construction added 25K in May.

Payroll jobs in year nine following the recession

Dec. 2017 Totals millions		May 18	Apr 18	Mar 18	5 months Dec 17 to May 18	12 months Dec 16 to Dec 17
147.625	Nonfarm Payroll Employment	223	159	155	1037	2188
125.294	Total Private (ex-Govt)	218	162	153	1042	2163
20.328	Goods-producing	47	53	26	288	509
0.648	Mining	6	8	8	37	53
12.558	Manufacturing	18	25	21	115	207
0.956	Motor Vehicles & parts	-4	0	0	0	4
7.072	Construction	25	21	-3	138	250
104.966	Private Service-providing	171	109	127	754	1654
27.593	**Trade, transportation, utilities**	53	0	41	196	169
15.861	Retail stores	31	9	11	109	-29
3.122	General Merchandise	13	9	-7	28	-51
3.100	Food & Beverage stores	1	3	-3	-2	3
5.236	Transportation/warehousing	19	2	30	73	135
1.460	Truck transport	7	-6	8	17	9
0.708	Couriers/messengers	5	7	8	30	39
1.011	Warehousing and storage	7	5	3	20	43
0.554	Utilities	-1	1	-1	0	-3
2.776	**Information**	6	4	6	-1	-36
8.511	**Financial**	8	3	5	48	142
2.664	Insurance	3	-2	2	8	38
2.220	Real Estate	3	1	4	20	60
1.323	Commercial Banking	2	2	1	4	5
0.951	Securities/investments	0	2	1	11	20
20.677	**Professional/business**	31	43	41	214	458
2.998	Temp help services	-8	9	-3	19	96
2.308	Management of companies	8	2	5	18	38
1.456	Architectural/engineering	1	3	-4	10	45
2.065	Computer systems/services	7	6	7	34	47
1.137	Legal services	0	0	0	-2	5
0.982	Accounting/bookkeeping	7	3	13	17	-3
23.380	**Education and health**	39	33	29	183	458
5.124	Hospitals	6	9	8	43	70
3.696	Educational services	7	4	-6	13	77
16.207	**Leisure and hospitality**	21	12	2	74	354
2.014	Hotel/motels	0	2	3	8	31
11.844	Eating & drinking places	18	12	0	67	261
22.331	Government	5	-3	2	-5	25
2.182	Federal ex-Post Office	-3	-1	-1	-3	-12
5.129	State government	2	-4	2	-17	-16
2.462	State Govt Education	-1	-4	1	-18	-1
14.407	Local government	6	3	1	21	56
7.938	Local Govt Education	2	4	-1	4	28

Net, net, the economy accelerated in the second quarter with businesses hiring more workers that will pump new life into the outlook and keep this expansion on track to smash the ten year record of growth during the roaring 90s. The Fed meets in less than two weeks, and another rate hike along their gradual path of firming interest rates is a slam dunk. The economy doesn't need any more monetary stimulus from the central bank that's for sure. Inflation pressures are building and wages will pick up further with the 3.8% unemployment rate matching the lowest level during the 90s stock market bubble economy years with its red hot 5% real growth. To find a lower unemployment rate you have to go back to the year 1969. Not the summer of '69, more the end of that year if you remember. Those were the best days of my life.

The economy's pace is showing surprising strength this late in the long expansion since the Great Recession and is catching the Federal Reserve sleeping and their policy is increasingly out of whack with what is happening out there in the country. They need to recalibrate and fast. Interest rates are too low and the Fed is behind the curve when it comes to normalizing its policy both for rates and its massive $4 trillion balance sheet as well. There are risks from geopolitics and the war of words over trade and protectionism is getting louder, but the US at this moment remains an island of tranquility and prosperity with economic growth getting stronger and stronger. Rate hikes are coming. Lots of them. Bet on it.



"We have 93 million people out of work. They look for jobs, they give up…" Donald Trump August 2015

And add a million more not in labor force since Trump elected.

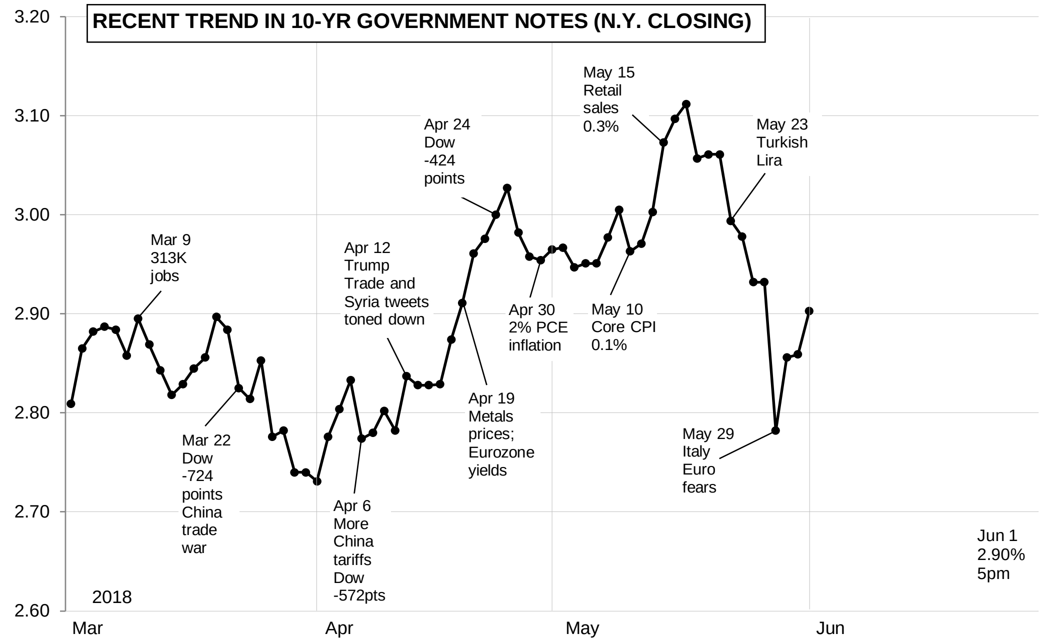
FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	30-May	23-May	16-May	9-May	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2387.103	2387.010	2386.966	2395.528	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1734.588	1744.179	1745.514	1744.972	0.000
Primary credit (Discount Window)	0.038	0.028	0.009	0.000	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)	1.712	1.713	1.712	1.715	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	0.063	0.082	0.080	0.080	62.000
Federal Reserve Assets	4374.3	4384.9	4385.2	4405.8	961.7
3-month Libor %	2.30	2.33	2.33	2.36	2.82
Factors draining reserves					
Currency in circulation	1661.292	1656.691	1653.732	1649.163	834.477
Term Deposit Facility	0.000	3.686	0.000	0.000	0.000
Reverse repurchases w/others	3.920	2.966	2.545	2.720	0.000
Reserve Balances (Net Liquidity)	2005.886	2040.545	2022.661	2046.775	24.964
Treasuries within 15 days	28.479	28.479	28.479	26.228	14.955
Treasuries 16 to 90 days	84.952	84.951	61.882	90.360	31.549
Treasuries 91 days to 1 year	306.289	306.288	329.356	290.879	69.272
Treasuries over 1-yr to 5 years	1059.169	1052.018	1052.008	1068.428	170.807
Treasuries over 5-yrs to 10 years	288.986	296.104	290.054	304.602	91.863
Treasuries over 10-years	619.228	619.195	625.189	615.031	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

The Fed meets June 12-13 to consider its monetary policy. The market knows the Fed is going to hike rates 25 basis points this meeting, but it doesn't know if the gradual pace of rate hikes means three or four rate hikes in 2018. The Fed raised rates three times in 2017, skipping the September meeting. There's been a lot of market turbulence from trade wars talk (some action), and political uncertainty from Europe in Italy and Spain, could the Fed skip a September 2018 rate hike and just go three times this year? The September meeting rate hike odds were as low as 16% on Tuesday, the worst point from the Italian political crisis effect in world markets judging by the closing 3.15% high for the week in 10-year Italian government bonds. The September Fed meeting rate hike odds of a 25 bps move to 2.25% closed on Friday at 58%. Employment day lifted the odds from 42%. NY Fed President Williams told Reuters Friday he still thinks neutral is 2.5% and that the Fed statement language needs to be changed.

MARKETS OUTLOOK

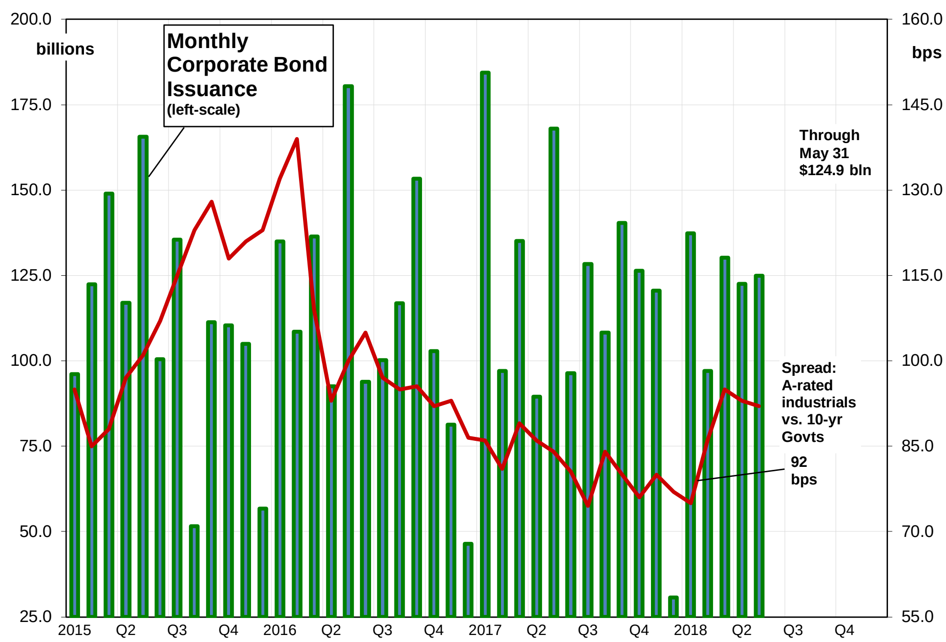
	29-Mar 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.97	3.10	3.10	3.20	3.35	3.45	3.60	3.55	3.75	3.75	3.90	4.00
10-Yr Note	2.74	2.80	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.70	3.90	4.00
5-Yr Note	2.56	2.60	2.70	2.80	3.05	3.15	3.40	3.45	3.65	3.65	3.90	4.00
2-Yr Note	2.27	2.40	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.80	4.00	4.20
3-month Libor	2.31	2.30	2.55	2.80	3.05	3.30	3.55	3.55	3.70	3.95	3.95	4.20
Fed Funds Rate	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	47	40	35	20	20	15	10	10	10	(10)	(10)	(20)



The news over the weekend that Italy was unable to form a government led to market fears the Euro area would break apart again. Another European sovereign debt crisis with 10-yr Italian yields moving up from 2.45% last Friday to close 70 bps higher at 3.15% on Tuesday. 10-yr Treasury yields fell as low as 2.76% on Tuesday with Dow industrials falling 391 points. That fear subsided, but on Thursday markets were rattled again by the Trump administration announcing indeed they would go forward with the steel and aluminum tariffs. Then the Friday jobs report was stronger than expected. Too much news this week. Most are glad it's over.

CORPORATES: TEXAS INSTRUMENTS, METLIFE, DOMINION ENERGY, SOCAL ED

Corporate offerings were $6.0 billion in the June 1 week versus $21.5 billion in the May 25 week. On Wednesday, L3 Technologies sold $1.8 billion 5s/10s. It priced a $1.0 billion 4.4% 10-yr (m-w +25bp) at 157 bps (Baa3/BBB-). The aerospace defense company will use the proceeds to redeem 5.2% notes due in 2019, and 4.75% notes due in 2020. Corporate bonds (10-yr Industrials rated A2) were 93 bps above 10-yr Treasuries this week versus 91 bps last Friday.



MUFG

OTHER ECONOMIC NEWS THIS WEEK

GDP 2.2% upon revision, still reaching for the stars (Wednesday)

Breaking economy news. Real GDP now 2.2% in the first quarter upon revision versus last month's 2.3% estimate. Going the wrong way for the Trump economics team that won't settle for less than the 3% sustainable growth rate they know is within reach after the biggest tax cuts ever in the history of civilization.

	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18p	Q1 18r
REAL GDP	1.2	3.1	3.2	2.9	2.3	2.2
REAL CONSUMPTION	1.9	3.3	2.2	4.0	1.1	1.0
CONSUMPTION	1.3	2.2	1.5	2.8	0.7	0.7
Durables	0.0	0.6	0.6	1.0	-0.3	-0.2
Nondurables	0.2	0.6	0.3	0.7	0.0	0.1
Services	1.2	1.1	0.5	1.1	1.0	0.8
INVESTMENT	-0.2	0.6	1.2	0.8	1.2	1.2
Business Plant	0.4	0.2	-0.2	0.2	0.3	0.4
& Equipment and	0.2	0.5	0.6	0.6	0.3	0.3
Intellectual Property	0.2	0.2	0.2	0.0	0.1	0.4
Homes	0.4	-0.3	-0.2	0.5	0.0	-0.1
Inventories	-1.5	0.1	0.8	-0.5	0.4	0.1
EXPORTS	0.9	0.4	0.3	0.8	0.6	0.5
IMPORTS	-0.6	-0.2	0.1	-2.0	-0.4	-0.4
GOVERNMENT	-0.1	0.0	0.1	0.5	0.2	0.2
Federal defense	-0.1	0.2	0.1	0.2	0.1	0.1
Fed nondefense	0.0	-0.1	0.0	0.0	0.0	0.0
State and local	0.1	-0.2	0.0	0.3	0.1	0.1
Below line: Percentage point contributions to Q1 18 2.2% real GDP						
Third estimate for Q1 is Thursday, June 28						

Growth isn't where the Trump administration wants it, but the Fed thinks growth made the grade long ago as it is still strong enough to put all those laid off in the recession back to work. Economic growth has pushed the economy beyond full employment. So the focus now for Fed officials is on inflation, and in today's report, core PCE inflation in the first quarter got revised down slightly to 1.6% from 1.7% in last month's report. This means tomorrow's core PCE inflation report for April may indeed come down to 1.8% from 1.9% in April. <u>Many Fed officials do not want to raise rates to normal any quicker without seeing inflation move closer to or even slightly above target,</u> so core PCE inflation looks more favorable for three rate hikes this year not four rate hikes. Fed funds futures are saying the Fed will skip a September 2018 rate hike, they skipped September last year as well. Odds of a September hike fell with the market turbulence yesterday after Italy failed to form a government over the weekend. Fed funds futures say the odds of a September Fed hike are 28% versus 48% before the Memorial Day weekend. Put that on your BBQ grill and smoke it.

Net, net, the economy continues spinning its wheels trying to gain traction after a lousy start to the year which was partly due to unseasonably cold weather. Time will tell if Fed officials maintain confidence in the economic outlook and keep with the plan to raise rates at a gradual pace. The Trump administration is likely to be disappointed with today's 2.2% figure. Real GDP was 2.6% in 2017, and even if it grows 3.0% for the rest of the year, economic growth will still come up short in 2018 at just 2.8%.

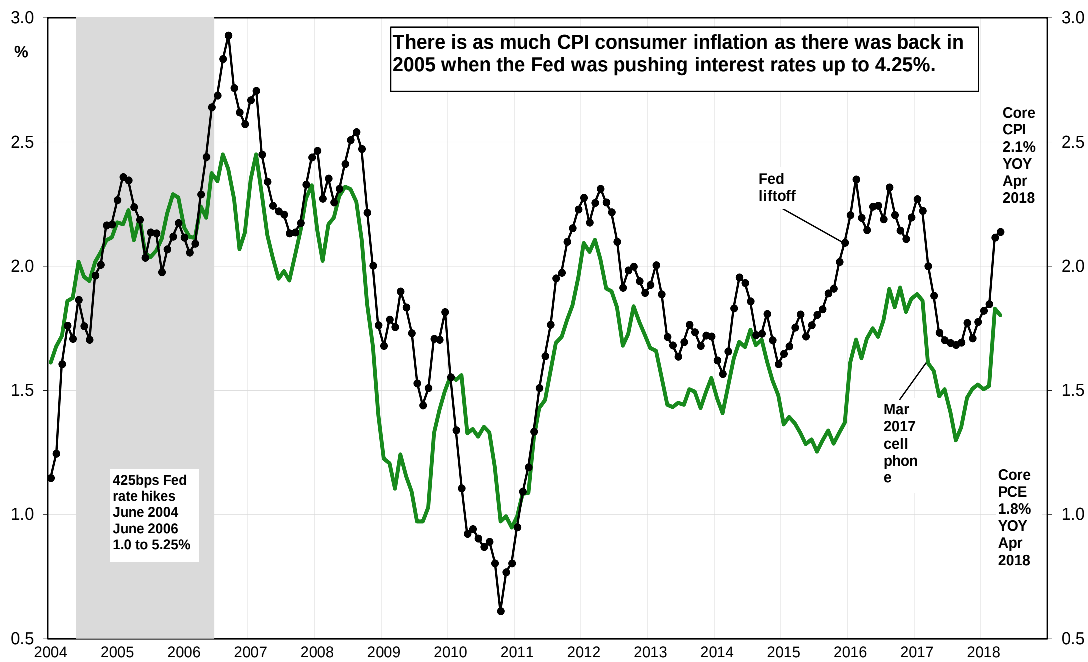
The trade war is back on this week, and has not been put on hold like the Treasury secretary told markets last week. Maybe the tough Administration’s tough talk is getting some results in today's advance look at the international trade balance in goods. Imports of goods in April are $207.8 billion down $1.1 billion from March... hey, it's a start.

We are really more concerned with an important driver of growth that are exports as manufacturing's prosperity is closely tied to whether American companies can sell what they make in overseas markets. Exports settled back declining 0.5% in April to $139.6 billion after jumping 3.2% in March. Auto exports fell 3.3% and hopefully, our trading partners are not limiting our exports already on the talk that import tariffs might be applied to what foreign auto makers send our way. Stay tuned. Story developing.

Business investment spending is leading the way for now when it comes to economic growth, and hopefully, consumers will pick up the pace in the second quarter and put those massive tax cuts to work instead of saving the money for a rainy day. 2.2% economic growth will never reach those starry-eyed Administration forecasts of 3 percent unless consumers reengage.

Real spending surges as consumers break out the tax cuts and put 'em to work (Thursday)

Breaking economy news. The monthly personal income report for April with inflation and consumer spending. Personal income rose 0.3% in April and personal spending rose 0.6% so the saving rate dipped a little to 2.8% in April from 3.0% in March. Most of the consumer spending was on services as car & light truck sales eased back to 17.1 million at an annual rate in April from 17.4 million in March.



Inflation is dead on the Fed's 2.0% target in April when you take energy prices into account which is surely going to move the needle on interest rates later this month. Core inflation pressures are building as well with March's inflation revised down a tenth to 1.8%, but April inflation rose faster than expected with a 0.2% gain which beat the 0.1% increase in core CPI inflation. Core PCE inflation is 1.8% in April which banishes the fears of low inflation from the summer of 2017 when core PCE inflation fell as low as 1.3%.

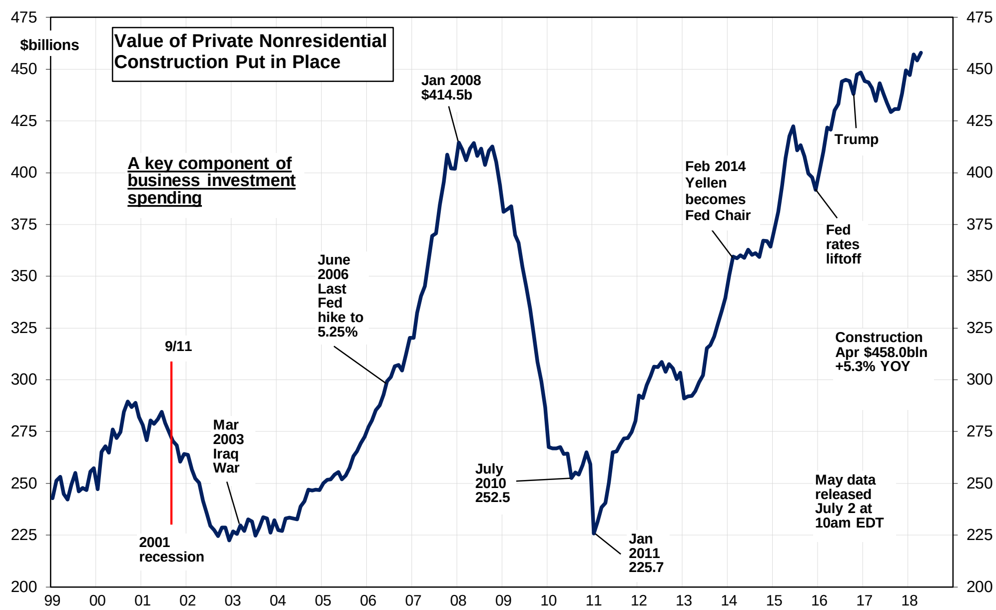
Meanwhile companies might not be paying their workers all that much, but they sure aren't letting any go either. Job layoffs were just 221K in the May 26 week near the lowest level since the 1970s. Economic growth isn't great again yet, but the labor market sure is, so the Trump economics team can stop trying to jack up the economy to create more jobs with protectionist trade policies that are roiling the world.

Net, net, the economy is finally strengthening on the backs of the consumer after a cold winter start to the year. Store bought goods are literally flying off the shelves with real consumer spending jumping 2.7% early in the second quarter after a modest 1.0% gain in the first quarter. Spending is the strongest since the 4.0% increase in the fourth quarter last year when consumers bought ahead of the tax cuts monies that hit their paychecks starting in late January.

Consumer spending is accelerating and inflation is holding firm in a tightening labor market, so the Fed is likely to stay on course with those gradual rate hikes this year despite the signs of uncertainty elsewhere in the world from populism and trade protectionism. The Federal Reserve's policy is still stimulative with interest rates below normal levels, so a strengthening economy argues for more rate hikes this year.

ISM scary signs of overheating; construction spending is sharply higher (Friday)

Breaking economy news. ISM manufacturing for May, and construction spending for April. Upon revision and April is strong too, nonresidential spending on structures is getting a boost from one of the biggest corporate tax cuts in history. Business investment is a big swing factor for economic growth, and one thing is for certain, companies are loosening their purse strings and starting to build more structures such as offices, shopping malls, commercial space, warehouses, even factories is included in the data. When companies are building structures that are permanent, adding to their productive capacity, it means the economy is likely to see an extra inning or two for economic growth and makes us feel more confident in the future outlook.



Meanwhile, the ISM manufacturing index rebounded from the April decline, rising 1.4 points to 58.7 which shows factories are operating at a very high rate. Maybe too high of a rate, too much activity, making us think that things are getting hotter and the economy's wheels are spinning fast enough to set us up for some unwanted, too-high inflation. The anecdotal comments were troubling. Very difficult to hire skilled and unskilled labor. Sales are strong and lead times and material costs are now soaring. Suppliers are trying to pass on the price increases they are seeing. Sounds like the economy is hot and getting hotter, making us think more inflation is in store for us. Bet on it.

Analyst Certification

The views expressed in this report accurately reflect the personal views of **Christopher S. Rupkey**, the primary analyst responsible for this report, about the subject securities or issuers referred to herein, and no part of such analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.

About MUFG Americas Holdings Corporation

Headquartered in New York, MUFG Americas Holdings Corporation is a financial holding company and bank holding company with total assets of $148.1 billion at December 31, 2016. Its main subsidiaries are MUFG Union Bank, N.A. and MUFG Securities Americas Inc. MUFG Union Bank, N.A. provides an array of financial services to individuals, small businesses, middle-market companies, and major corporations. As of December 31, 2016, MUFG Union Bank, N.A. operated 365 branches, comprised primarily of retail banking branches in the West Coast states, along with commercial branches in Texas, Illinois, New York and Georgia, as well as two international offices. MUFG Securities Americas Inc. is a registered securities broker-dealer which engages in capital markets origination transactions, private placements, collateralized financings, securities borrowing and lending transactions, and domestic and foreign debt and equities securities transactions. MUFG Americas Holdings Corporation is owned by MUFG Bank, Ltd. and Mitsubishi UFJ Financial Group, Inc., one of the world's leading financial groups. MUFG Bank, Ltd. is a wholly owned subsidiary of Mitsubishi UFJ Financial Group, Inc. Visit http://www.unionbank.com/ or http://www.mufgamericas.com/ for more information.

About MUFG (Mitsubishi UFJ Financial Group, Inc.)

MUFG (Mitsubishi UFJ Financial Group, Inc.) is one of the world's leading financial groups, with total assets of approximately $2.6 trillion (USD) as of December 31, 2016. Headquartered in Tokyo and with approximately 350 years of history, MUFG is a global network with more than 2,200 offices in nearly 50 countries. The Group has more than 140,000 employees and about 300 entities, offering services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group's operating companies include MUFG Bank, Mitsubishi UFJ Trust and Banking Corporation (Japan's leading trust bank), and Mitsubishi UFJ Securities Holdings Co., Ltd., one of Japan's largest securities firms.

Through close partnerships among our operating companies, the Group aims to "be the world's most trusted financial group," flexibly responding to all of the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York (MUFG) stock exchanges. Visit www.mufg.jp/english/index.html.