Financial Market Weekly

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8 JUNE 2018

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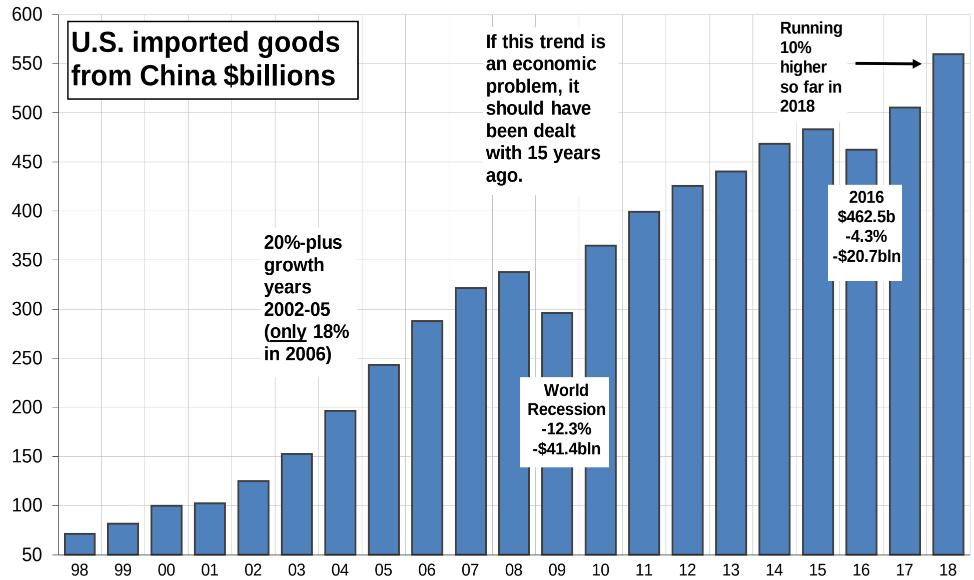
TRADE WINDS BLOWING HARDER FOR THE WORLD ECONOMY

There is certainly a risk for the world economy from protectionist trade policies. Go back and study the Great Depression. The House of Representatives first passed what became known as the Smoot-Hawley Tariff in May 1929 and the Great Depression started three months later. Companies may be already rethinking their expansion and investment plans due to the trade war. The irony is that tariffs have been raised historically in countries to save jobs, but right now the US economy is moving beyond full employment where everyone already has a job.

Total 2017 US goods imports $2.341 trillion
Goods imports from China $505.5 billion



Red sky at night, sailor's delight. Red sky at morning, sailors take warning. It's almost red sky at morning in America when it comes to these America First policies with tariffs, quotas and sanctions from the Trump administration which risk uprooting long established trade patterns that have evolved over the past two decades. The President has said there would be some short-term pain, but eventually things would be much, much better. We don't know though, and judging from the early reaction from America's trading partners, it is possible that the kick in world growth that comes from increased exports between nations, however

Latest is $70 billion in concessions. China will import more, but will the US import less from China? Americans want what is coming in. Two down years for imports—minus $41 billion in global recession 2009 and oil crash $20 billion drop in 2016. Good luck. Mission Impossible.

unbalanced they have become over the years, could be a risk for the outlook if Washington seeks change too abruptly. To conclude this part of our comment on trade, the Smoot-Hawley tariff sunk the economy's ship before the Great Depression, and it will be a miracle if the US economy can stay afloat with the protectionist stance the Trump administration has taken. Economists don't agree on much, but it is hard to find one wo thinks tariffs are pro-growth.

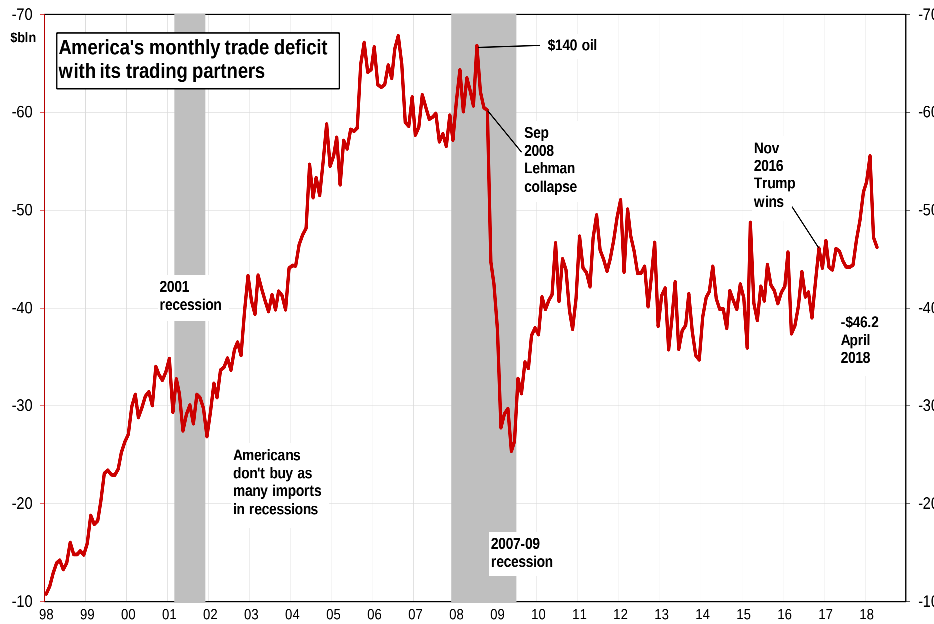
$835 billion of imported goods this year to date. There is a long list of items being imported which shows the difficulty in trying to stem the flow with selective tariffs.

U.S. Goods Imports
2018 Year-to-date Totals
(through April)

$ Millions	2018	2017	Change	% Change
Total	835,353	766,956	68,397	8.9
Foods, feeds, beverages	49,007	44,833	4,174	9.3
Fish and shellfish	7,489	7,036	453	6.4
Fruits, frozen juices	6,473	5,878	595	10.1
Other foods	5,964	4,619	1,345	29.1
Vegetables	4,355	4,012	343	8.5
Industrial supplies/materials	188,639	169,002	19,637	11.6
Crude oil	52,179	47,767	4,412	9.2
Industrial supplies, other	12,368	10,913	1,455	13.3
Petroleum products, other	11,695	10,332	1,363	13.2
Chemicals-organic	9,811	8,300	1,511	18.2
Capital goods, ex-auto	226,781	204,196	22,585	11.1
Computers	25,859	21,138	4,721	22.3
Telecommunications equip.	24,685	24,990	-305	-1.2
Computer accessories	21,674	18,892	2,782	14.7
Industrial machines, other	19,917	17,869	2,048	11.5
Automotive vehicles, parts	122,671	119,852	2,819	2.4
Passenger cars	58,905	59,311	-406	-0.7
Other parts and accessories	37,335	35,256	2,079	5.9
Trucks, buses	11,616	11,712	-96	-0.8
Engines, engine parts	10,279	9,441	838	8.9
Consumer goods	215,422	198,716	16,706	8.4
Pharmaceutical prepartions	44,932	36,935	7,997	21.7
Cell phones	37,725	34,556	3,169	9.2
Apparel, textiles, nonwool/cotton	17,097	16,856	241	1.4
Apparel, household goods-cotton	14,769	14,550	219	1.5
Other goods	32,832	30,357	2,475	8.2

Less trade deficit as America First starts to have an effect

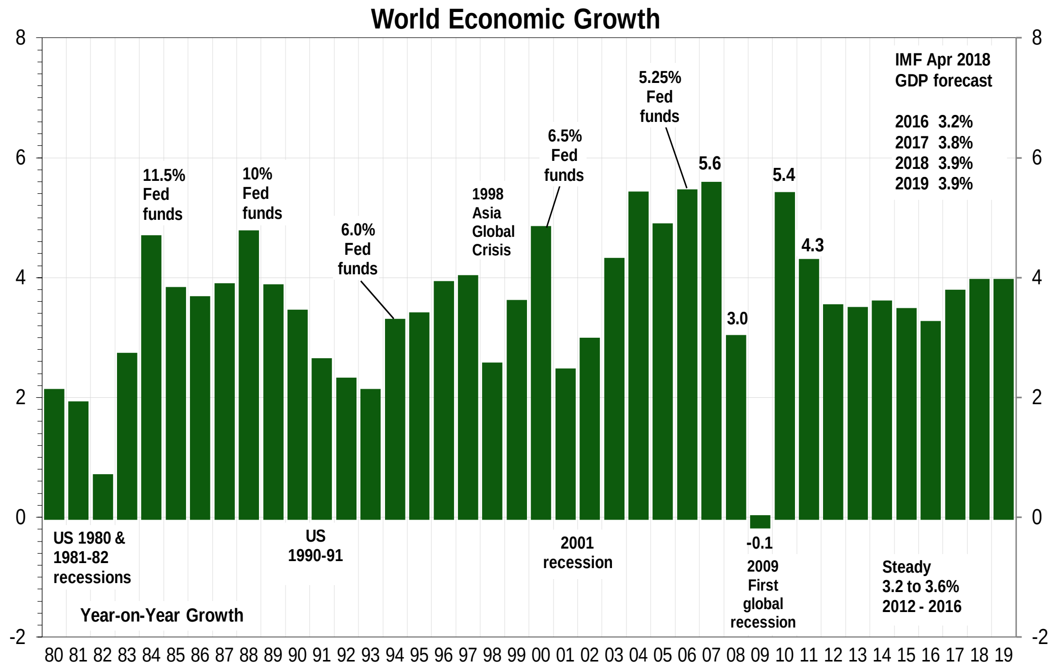
Breaking economy news. Joking really. The April trade deficit for goods and services fell to $46.2 billion. It fell mostly upon the annual revisions that come this time of year, the deficit actually falling $1.0 billion from $47.2 billion in March (March that was $49.0 billion prior to revision). Glad we got that clear.



Exports of goods to the rest of the world are strengthening with the world economy up 9.9 percent to $139.6 billion in April over last year's levels. Imports are up the same percentage roughly, 9.3% the last year to $211.1 billion. That's the way it is supposed to work, all countries winning. If you want to correct the trade imbalance you really need to talk to the American companies that rely on these goods, and shipped factories overseas years ago.

Net, net, there's plenty of trade deficit red ink still out there in April to keep Trump's economics team at the bargaining table. Today's data will only reinforce upon the Administration just how unfair the country's trade is with the rest of the world. The US trade deficit in goods with China is running $119.1

billion in the first four months this year 11.7% or $12.5 billion wider than the $106.6 billion trade deficit in the first four months of 2017. Same story for Europe. The US trade deficit in goods with the European Union is running $52.5 billion in the first four months this year 17.7% or $7.9 billion wider than the $44.6 billion trade deficit in the first four months of 2017.



American consumers' love affair with exotic foreign goods remains ongoing. Many US companies are also hooked on foreign goods to help make their own finished products as well. The US hasn't been an island relying on its own natural resources to provide goods and services to the domestic economy for many decades now. Time will tell if this Administration can change the pattern of trade that relies increasingly on foreign imports. On a more somber note. America's trade deficit with the world is widening, but for how long? With all these tariffs and quotas and sanctions being thrown around the world, trade between nations could cool down in a hurry putting the world economy at considerable risk. The world economy can't win a trade war and rising protectionism between nations will take a toll on growth. Stay tuned. Story developing.

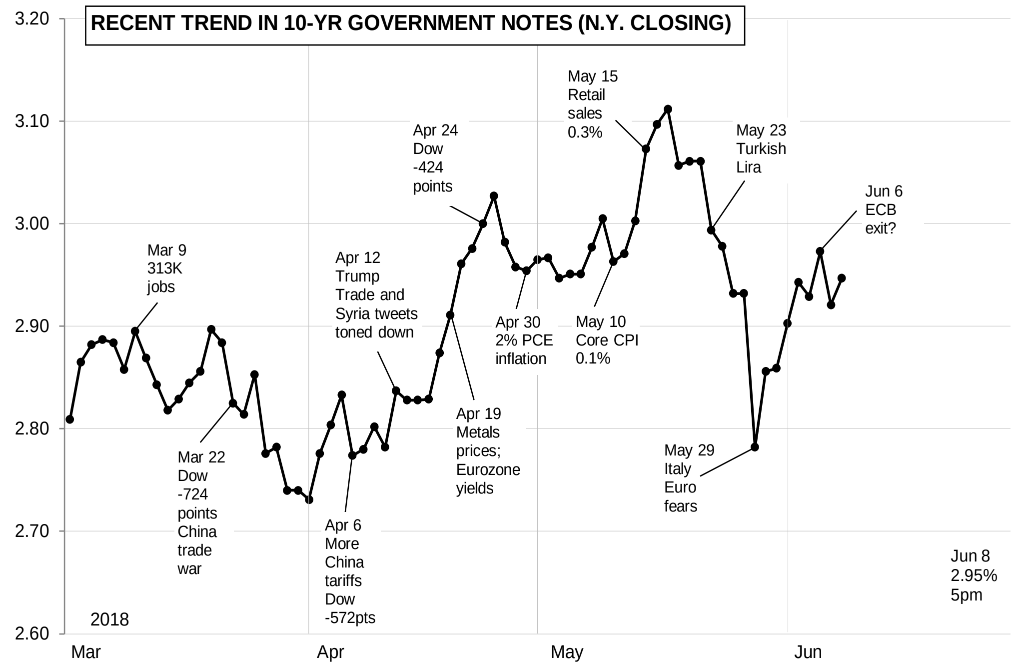
FEDERAL RESERVE POLICY

The Fed meets June 12-13 to consider its monetary policy. The market knows the Fed is going to hike rates 25 basis points to 2.0% at 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. The September 2018 meeting odds of a 25 bps rate hike to 2.25% closed the week at 56%. One further note: the balance sheet wind down that the market feared last September? Fed's Treasury holdings were $2.377 trillion this week, down $87 billion from October 2017… only two trillion more to go. Dragging their feet on rates and on draining the liquidity swamp.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	6-Jun	30-May	23-May	16-May	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2377.872	2387.103	2387.010	2386.966	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1734.593	1734.588	1744.179	1745.514	0.000
Primary credit (Discount Window)	0.016	0.038	0.028	0.009	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)	1.713	1.712	1.713	1.712	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	0.070	0.063	0.082	0.080	62.000
Federal Reserve Assets	4366.8	4374.3	4384.9	4385.2	961.7
3-month Libor %	2.32	2.30	2.33	2.33	2.82
Factors draining reserves					
Currency in circulation	1662.415	1661.292	1656.691	1653.732	834.477
Term Deposit Facility	0.000	0.000	3.686	0.000	0.000
Reverse repurchases w/others	16.772	3.920	2.966	2.545	0.000
Reserve Balances (Net Liquidity)	2031.965	2005.886	2040.545	2022.661	24.964
Treasuries within 15 days	0.000	28.479	28.479	28.479	14.955
Treasuries 16 to 90 days	105.885	84.952	84.951	61.882	31.549
Treasuries 91 days to 1 year	305.415	306.289	306.288	329.356	69.272
Treasuries over 1-yr to 5 years	1051.115	1059.169	1052.018	1052.008	170.807
Treasuries over 5-yrs to 10 years	296.172	288.986	296.104	290.054	91.863
Treasuries over 10-years	619.284	619.228	619.195	625.189	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

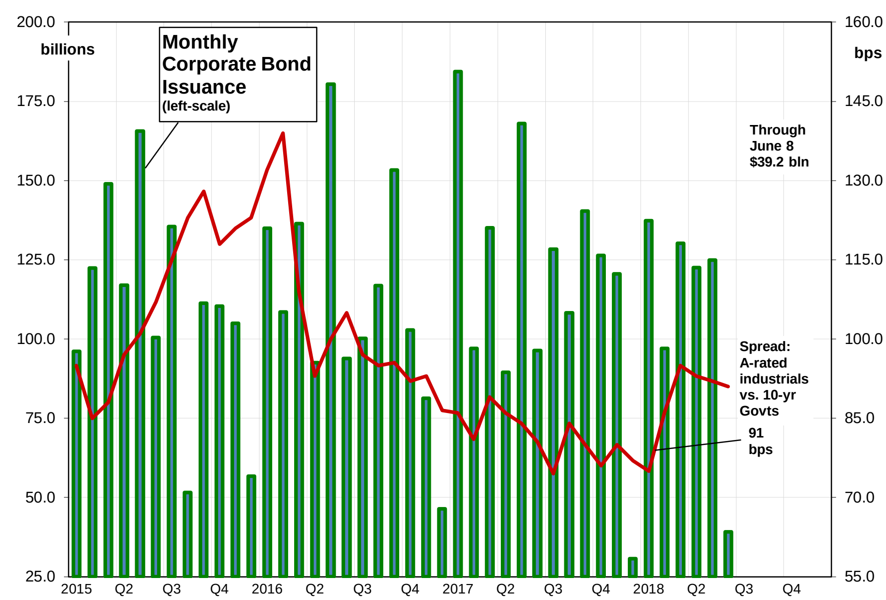
MARKETS OUTLOOK

	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)



Bonds recovered further from the Italy crisis lows, but stalled at the 3.00% level. On Wednesday, yields moved higher with Euro debt on the hawkish change in market tone where the ECB is now likely announce the end of QE at Thursday, June 14's meeting. Emerging Market risks centering on Brazil and higher yields in Italy helped bring yields back down to earth on Thursday. To work around the Fed's meeting next Wednesday, Treasury will sell 3-yr and 10-yr notes on Monday, and then a 30-yr bond on Tuesday. The 10-yr yield closed the week at 2.95% versus 2.90% the prior week.

CORPORATES: DEERE, KENNAMETAL, NISOURCE, KRAFT HEINZ FOODS

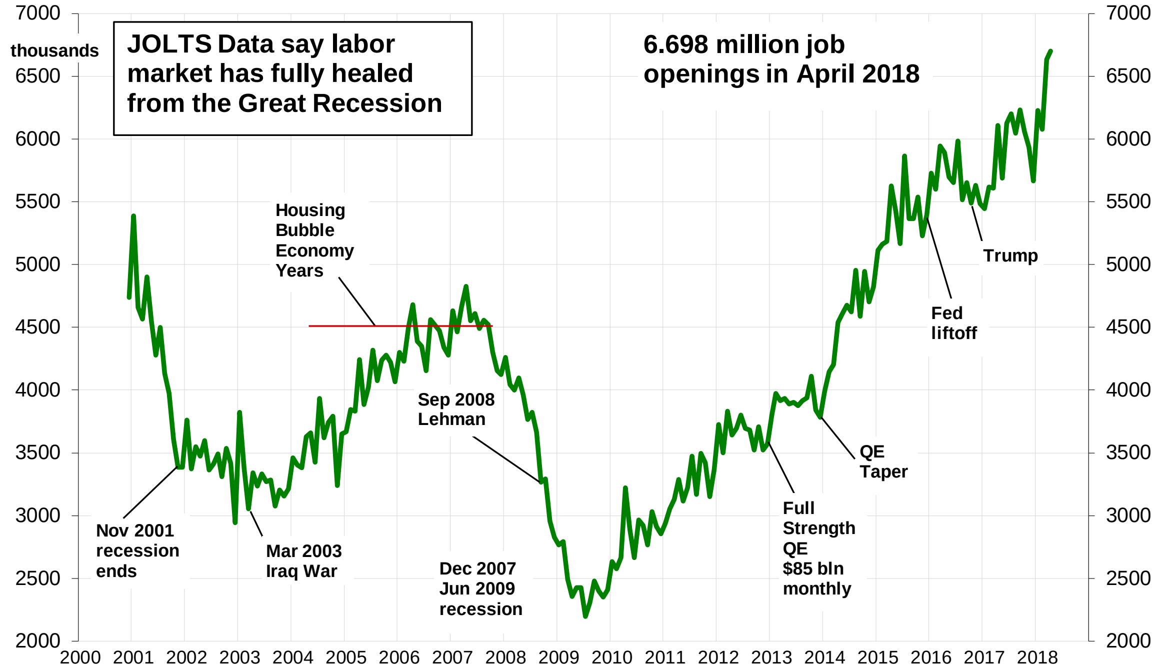


Corporate offerings were $38.4 billion in the June 8 week versus $6.0 billion in the June 1 week. On Tuesday, Union Pacific Corp. sold $6.0 billion 3s/5s/7s/10s/20s/30s/40s. It priced a $1.5 billion 3.95% 10-yr (m-w +20bp) at 105 bps (Baa1/A-). The rail transportation company will use the proceeds for share buybacks and general corporate purposes. Corporate bonds (10-yr Industrials rated A2) were 91 bps above 10-yr Treasuries this week versus 93 bps last Friday.

OTHER ECONOMIC NEWS THIS WEEK

No slack left with 6.698 million jobs for hire; ISM nonmfg rebounds too (Tuesday)

Breaking economy news. Jolts data, job openings data with more for-hire signs out there in the country than ever before in history. 6.698 million job openings in April which is 600 thousand more than the 6.065 million unemployed people out there in the country at last count. This labor market is a headhunter's dream as no company can hire the skilled or unskilled workers they need without an employment agency working for them 24/7 scouring the country for anyone they can find. And they aren't finding much. Looking under every rock. Leaving no stone unturned.



Maybe we need some more quitters out there. Let's start a bidding war. Any quitters out there in the audience? Just too tired to make it and saying, "I quit?" The so-called quits data that Yellen took as a leading indicator of economic good times was 3.351 million in April just off of March's record number of quitters in this current economic recovery that was 3.387 million. More workers are quitting their jobs right now than they did during the housing bubble economy years a decade ago, when the Fed's policy rate was 5.25%, we hasten to add, that's how confident they are, that's how easy it is to get another job. And research shows that new jobs will pay you more than your current job, so let's all quit today!

Net, net, the labor market is on fire and any thoughts that the economy is not at full employment can be thrown in the dust bin of foolish economic thoughts and stale nonsensical ideas. We are speaking here to some of those newbie Fed officials who claim some labor market slack remains. 6.698 million job openings is an unemployed worker's dream as the economy's engines rev it up a notch or two or three. Vroom! You don't need sustainable 3% economic growth when you have strong labor markets like these. You don't have to deliver on every single campaign promise. "Doubling GDP growth." This economy can't be better than it is right now today.

The only caveat being there is a massive labor shortage out there. Whatever speed the economy is growing at, it isn't going to keep moving down the road much longer if there is no one to work the economy's factories and stores and warehouse floors. Mark my words, this will be the first time in modern economic history that the economic expansion dies for lack of fuel meaning lack of workers.

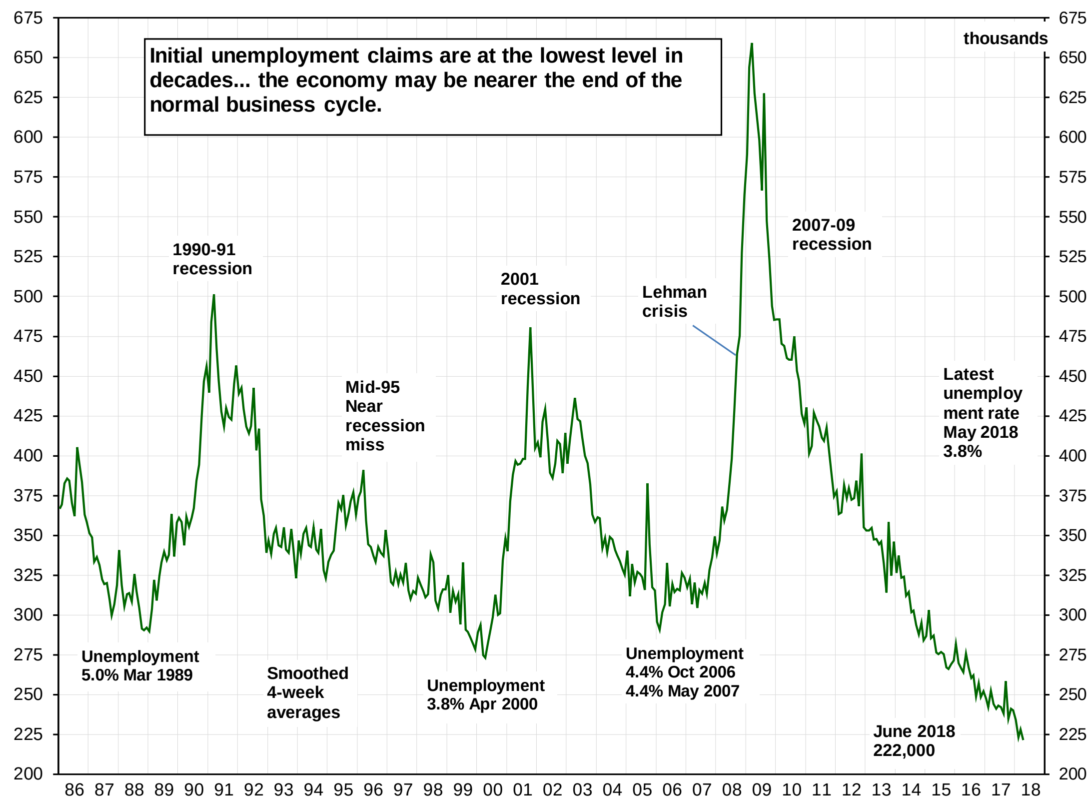
You can throw all the capital you want at US corporations and cut their taxes owed to bare bones levels, but this economy has no way to keep growing if there is no one left to hire. Wages may be just months away from heading into the stratosphere where they start producing wage-push inflation the country hasn't seen since the 60s and 70s. Stay tuned. Story developing.

The labor markets just keep getting tighter, and tighter, and tighter. We are starting to think with red hot economic data like these, a few more Fed officials might start thinking they are a little further behind the curve and vote for four rate hikes this year at next week's meeting. The economy is stronger than they think Bet on it.

222K JOBLESS CLAIMS IS TOO, TOO, TOO TIGHT A LABOR MARKET (Thursday)

The labor market has shifted into a higher gear where the focus of companies has shifted from hiring new help to retaining current workers. You want to take the day off to attend a family wedding no problem just please come back to work on Monday. You want us to up the match on your 401K plan, no problem. Jobless claims are so low precisely because no one is getting laid off. For the first time in decades it is true that you are irreplaceable. Bet on it.

The strongest labor market for new jobs and hiring in a generation keeps the Federal Reserve on the gradual path for interest rate hikes this year and they may even step it up a notch when they meet next week. This is not an economy that requires the support of the central bank. Those who say there is still some slack remaining are like the little boy crying wolf. There are more job openings than there are unemployed to fill them. The labor market is heating up and that means inflation pressures are building so the Federal Reserve better get ready for it. Rates are going up at next week's meeting and more are on the way. It's legal now. Bet on it.



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