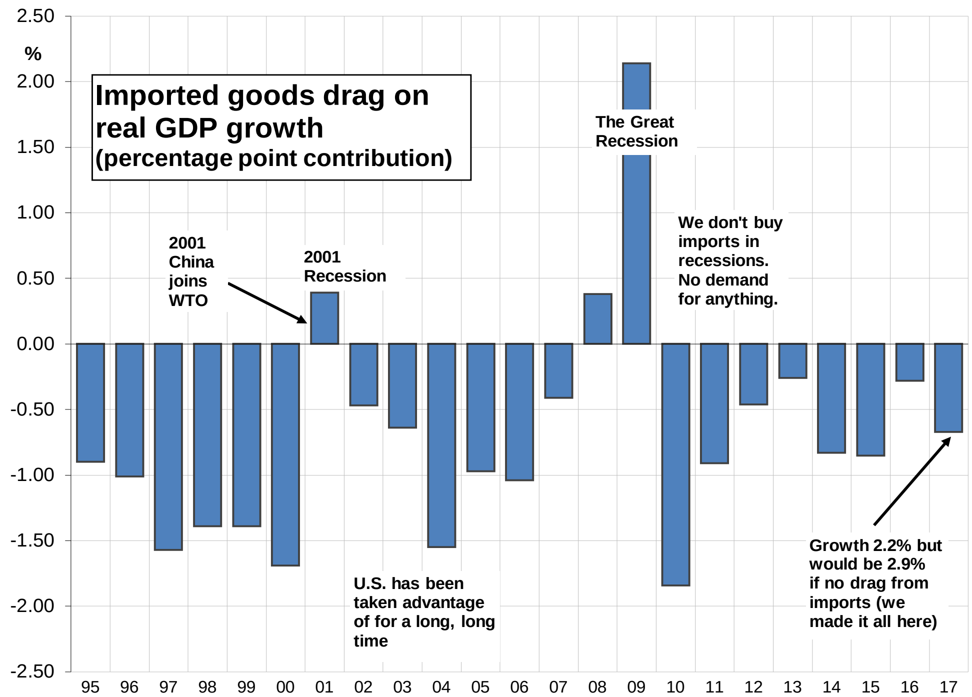
MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
(212) 782-5702
crupkey@us.mufg.jp

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

21 SEPTEMBER 2018

IF IMPORTS SHOW THE WORLD IS RIPPING US OFF, ITS BEEN HAPPENING A LONG, LONG TIME

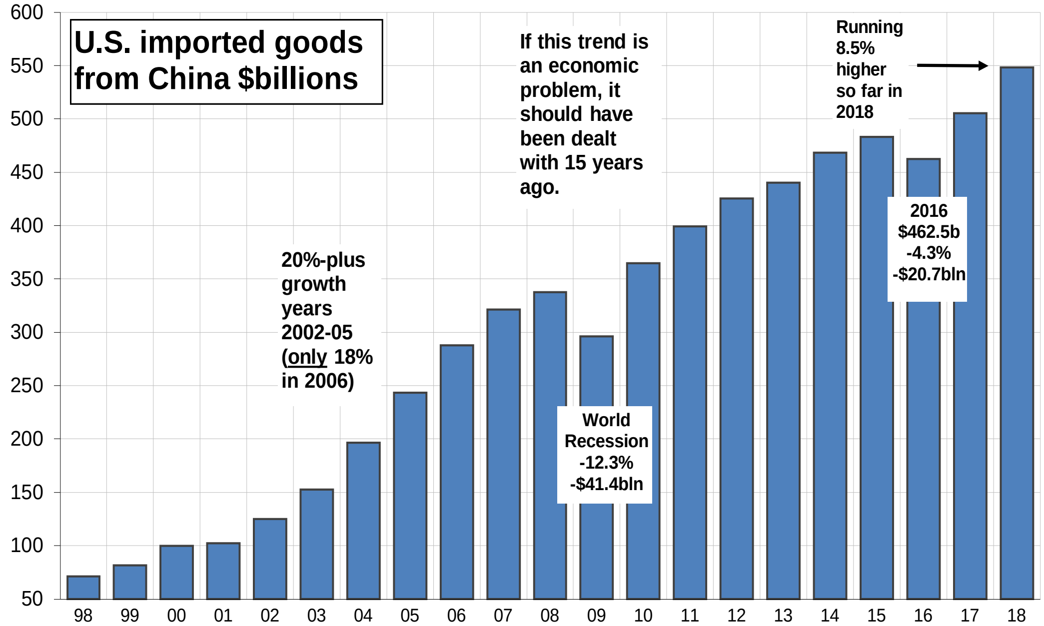


Americans don't seem to mind being ripped off: they like imported goods. BMWs, iPhones. And the stock market doesn't think there is much risk from a trade war. Not for the economy. Maybe the Smoot-Hawley trade tariffs were one of the causes of the Great Depression in the 1920s. But economic growth doesn't seem to be slowing down yet. Real economic growth was 4.2% in the second quarter. Estimates of third quarter GDP from the Atlanta Fed "GDPNow" forecast that Trump seems to look at is currently 4.4%. We get our first look at the Q3 GDP number on Friday October 26, a week and a half ahead of the Tuesday, November 6 midterm elections.

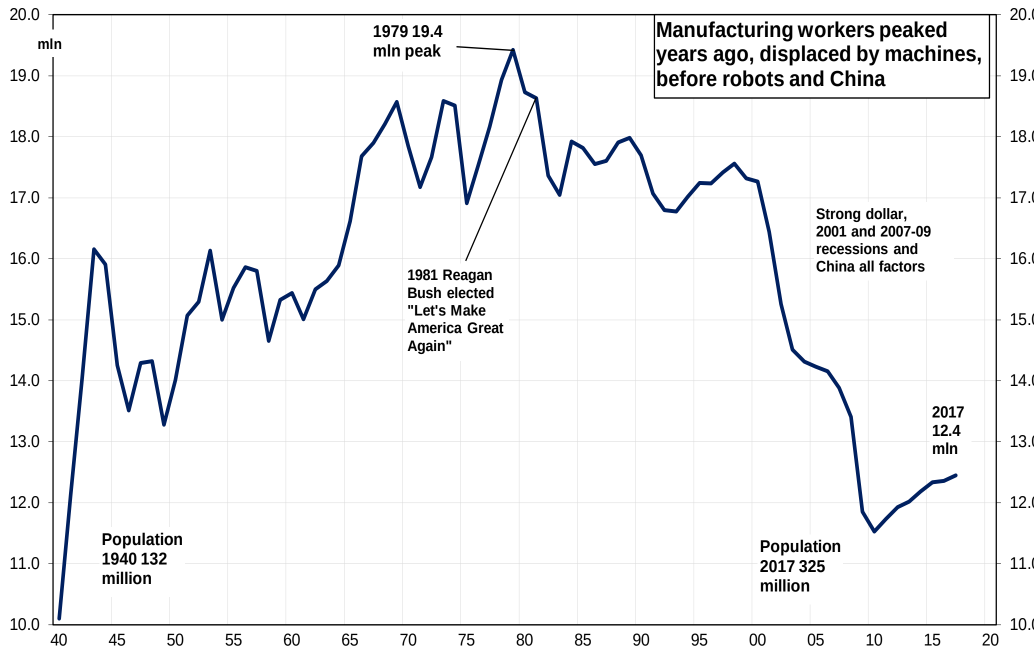
Trade War 2017

Trade deficit in goods $ billions		Exports	Imports
China	375.5	129.8	505.4
EU	151.3	283.2	434.6
Germany	63.6	53.8	117.5
Mexico	70.9	243.3	314.2
Japan	68.8	67.6	136.4
Vietnam	38.3	8.1	46.4
South Korea	23.1	48.3	71.4
Canada	17.0	282.2	299.3
World	795.6	1,546.2	2,341.9

Timeline. It is early yet to see the tariffs effect on imports from China. The latest trade data is for July. July 6 is when the first 25% tariffs on $34 billion of China imported goods went into effect. August 23 is when the 25% tariffs on another $16 billion of China imports went into effect. On Tuesday this week the US trade rep said the tariffs on another $200 billion of China imports would go into effect on September 24: tariffs start at 10% and go to 25% at the start of the year. (Don’t worry some initial products, like smart watches, bicycle helmets, child car seats and playpens, were dropped from the final list.) The total will soon be $250 billion of imported Chinese goods out of $505 billion imported for all of 2017. There is no slowdown in imports from China yet, as obviously companies are bringing in even more goods in advance of the tariffs. In the first 7 months of 2018, US imports from China are running 8.5% higher than prior year levels, which if continued would bring the full year 2018 imports to just shy of $550 billion.



The $375 billion trade deficit in goods with China was going to get Washington’s attention at some point, even if the latest $200 billion of tariffs are America’s response to China’s theft of intellectual property and forced transfer of technology secrets. The original trade deficit issue during the presidential campaign was to halt the movement of factories overseas that eliminated manufacturing jobs. Manufacturing jobs have stopped declining and were 12.4 million in 2017 as shown in the graph below. About 5 million manufacturing jobs were lost since 2000 which is an important number for politicians counting votes even if the votes for Hillary (65.8 million) and Trump (63.0 million) were much larger. Most of the factory jobs were lost during the two recessions of the 2000s.

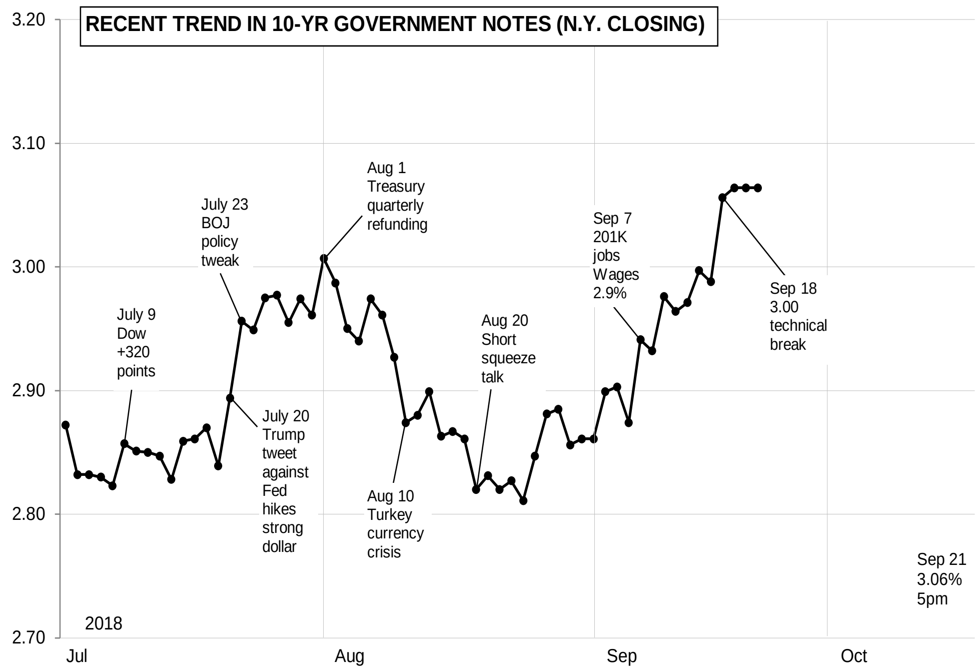


Sometimes we wonder if the tariffs will halt trade, hurt the economy, and slow growth. Americans want what has been coming in. Maybe they will pay more for it. The stock market at record highs might think so. Though a 25% tariff tax on $200 billion more goods coming in from China will be pretty tough to swallow when it fully phases in at the start of 2019. Stay tuned. Story developing. There probably won’t be much more movement on this trade story before the midterm election results.

MARKETS OUTLOOK

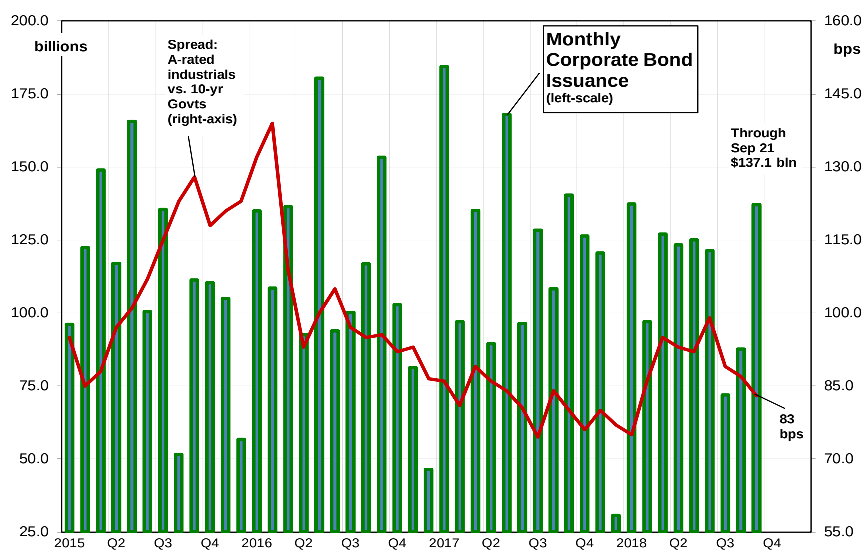
	29-Jun 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.99	3.10	3.20	3.35	3.45	3.60	3.60	3.75	3.85	3.80	3.95
10-Yr Note	2.86	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.80	3.80	3.95
5-Yr Note	2.74	2.70	2.90	3.10	3.20	3.45	3.45	3.65	3.75	3.80	3.95
2-Yr Note	2.53	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.75	3.80	4.00
3-month Libor	2.34	2.55	2.80	2.95	3.20	3.45	3.45	3.70	3.95	3.95	4.20
Fed Funds Rate	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	33	35	20	20	15	10	10	10	5	0	(5)

Ten-year Treasury yields hurdled the 3% barrier this week, a technical break out at the close on Tuesday that led to some follow-through selling. Yields peaked at 3.09% on Thursday. The yield high for 2018 still stands at 3.13% on May 18. There aren't a lot of downside economic risks, the Fed won't put its rate hikes on hold any time soon, with the stock market closing at record highs this week. We are waiting to see what Fed officials do with their new forecast for the year 2021. The last dot forecast currently is 3.4% (3.5%) in 2020, and it is important to know for the bond yield forecast how high they think they need to push interest rates. We will update the interest rate forecast next Friday; it is likely to stay the same—10-yr yields 3.5% at end of 2019.



CORPORATES: NESTLE, SASOL, BP, FORTUNE BRANDS, SEMPRA ENERGY

Corporate offerings were $40.5 billion in the September 21 week versus $33.7 billion in the September 14 week. On Thursday, Fiserv, Inc. sold $2.0 billion 5s/10s. It priced a $1.0 billion 4.2% 10-yr (m-w +20bp) at 115 bps (Baa2/BBB). The financial services technology company will use the proceeds to repay debt under its revolving credit facility and term loan, and 4.625% notes due 2020. Corporate bond yields (10-yr Industrials rated A2) were 83 bps above 10-yr Treasuries this week versus 85 bps last Friday.



MUFG

FEDERAL RESERVE POLICY

The Fed meets September 25-26 to consider its monetary policy. (Finally, next week. So happy!) Fed funds futures say the odds are ~~still~~ sky high for a rate hike to 2.25% on Wednesday, September 26 -- 100% at Friday's close. Odds for a fourth hike this year to 2.5% at the December 18-19 meeting are 80%. Eight of fifteen Fed officials (53%) saw four rate hikes this year at the June meeting.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	19-Sep	12-Sep	5-Sep	29-Aug	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2313.206	2313.204	2313.202	2324.589	479.782
Federal agency debt securities	2.409	2.409	2.409	2.409	0.000
Mortgage-backed securities	1695.223	1697.016	1697.006	1679.006	0.000
Primary credit (Discount Window)	0.152	0.065	0.001	0.039	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)	0.007	1.720	1.719	1.718	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	
Central bank liquidity swaps	0.100	0.091	0.090	0.092	62.000
Federal Reserve Assets	4255.8	4258.5	4255.8	4266.3	961.7
3-month Libor %	2.35	2.33	2.32	2.31	2.82
Factors draining reserves					
Currency in circulation	1685.759	1686.970	1688.628	1681.023	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	8.915	1.315	0.010	0.840	0.000
Reserve Balances (Net Liquidity)	1822.718	1924.008	1897.901	1880.507	24.964
Treasuries within 15 days	19.007	0.000	0.000	20.932	14.955
Treasuries 16 to 90 days	83.154	102.160	102.160	77.244	31.549
Treasuries 91 days to 1 year	315.819	315.819	315.819	326.061	69.272
Treasuries over 1-yr to 5 years	1010.629	1010.629	1010.628	1016.040	170.807
Treasuries over 5-yrs to 10 years	267.466	267.465	267.464	267.189	91.863
Treasuries over 10-years	617.132	617.131	617.130	617.123	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Yellen spoke at Brookings last week. What tools the Fed has to fight the next recession? Not much, so commit to holding rates lower for longer. Forever and ever. Zero rates for ten years. Great. There goes the concept of an interest rate in the US. Japan here we come. Won't need a fixed income economist.

Fed Meeting	2017	2018	2019	2020	Longer run
Jun 18		2.4	3.1	3.4	2.9
Mar 18		2.1	2.9	3.4	2.9
Dec 17	1.4	2.1	2.7	3.1	2.8
Sep 17	1.4	2.1	2.7	2.9	2.8
Jun 17	1.4	2.1	2.9		3.0
Mar 17	1.4	2.1	3.0		3.0
Dec 16	1.4	2.1	2.9		3.0
Sep 16	1.1	1.9	2.6		2.9
Jun 16	1.6	2.4			3.0
Mar 16	1.9	3.0			3.3
Tax cuts and fiscal spending stimulus moved 2020 forecast to 3.4% in March. Now what for 2021?					

The Fed funds rate is 2%. There isn't that much room to cut interest rates to stimulate the economy seems to be the problem that Fed officials have been concerned about. Been worrying about this in academic papers over at least the last two decades. It has never been clear to us on the ground watching the economy and markets real-time for decades that there is a magic number of interest rate cuts that will bring the economy "back to life from recession." The studies of the monetary policies in years past seem to miss the point. Half-baked, or overdone with too much math. If you look back uncritically, it seems as if rate cuts from 6.5% to 1%, 550 basis points, lifted the economy out of the shallow GDP 2001 recession. In the not-so-great 2007-09 recession, it seems as if it took 500 bps of rate cuts (5.25-0.25) to keep the deep recession from going Great Depression on us. Not that many 100 bps rate cuts from a 2% Fed funds rate right now. I don't know. First off, Greenspan and Bernanke cut rates hard and fast, and it was music that fell on deaf ears as consumers and businesses were running for the hills in a panic and didn't want to borrow to spend money at the shopping malls or to build a new factory or buy some equipment. The big fat (sp) rate cuts were a waste. We really just need a confidence booster from Washington, the economy does. Yellen also has said QE could help in the future by pushing down long-term interest rates and thus help spur investment. Some people out there would sure like to refinance their mortgages, thank you very much, so maybe this would help. The problem is the Fed balance sheet is $4.255 trillion this week, and the Fed doing two or three trillion more QE might not look so good: money printing, etc. Anyway, all of this idle speculation is about something that's way down the road, fighting the next recession, let's see how many rate hikes the Fed thinks they have to do by the end of 2021 at next week's meeting. Don't do too many rate hikes and no recession. That simple.

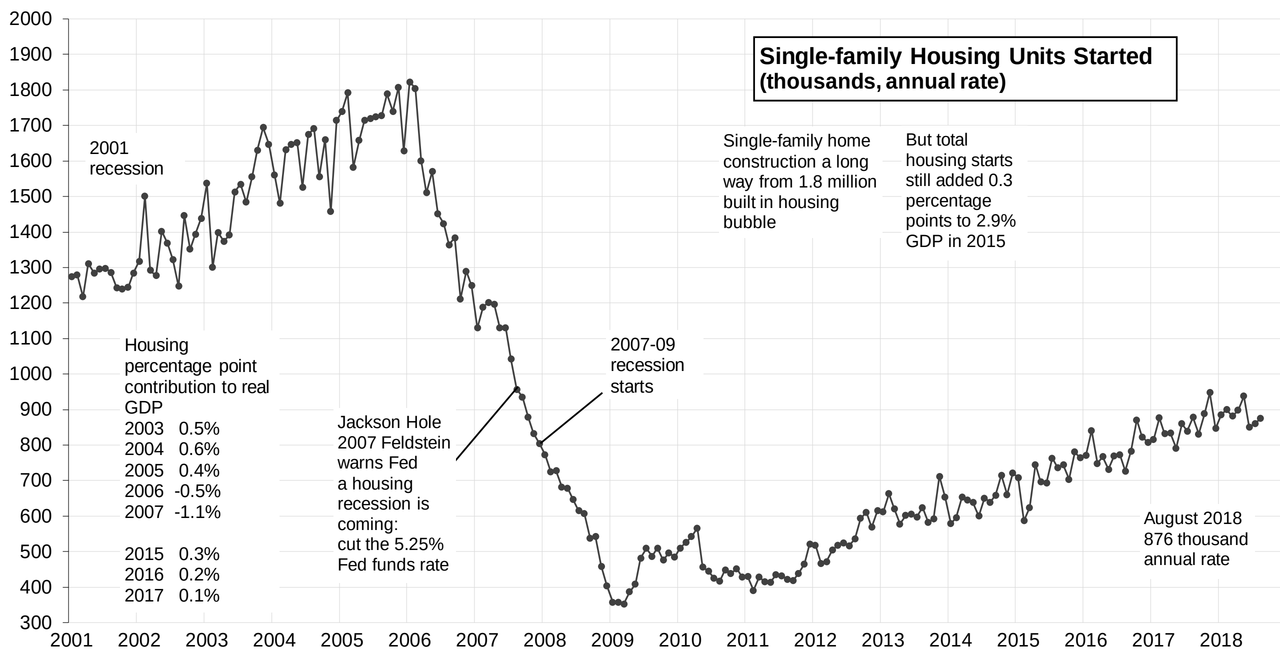
OTHER ECONOMIC NEWS THIS WEEK

Housing still sputters short of the goal line (Wednesday)

Breaking economy news. The seesaw between new permits and housing continues with starts up 9.2 percent to 1.282 million and permits down 5.7 percent to 1.229 million in August where this important leading indicator of future economic conditions is not gaining altitude. There's nothing great again about housing conditions in America. The missing piece of the puzzle of sustainable 3 percent economic growth remains investment in single family homes. No one's building them, not in sufficient numbers to slow down what looks like a new housing bubble in prices.

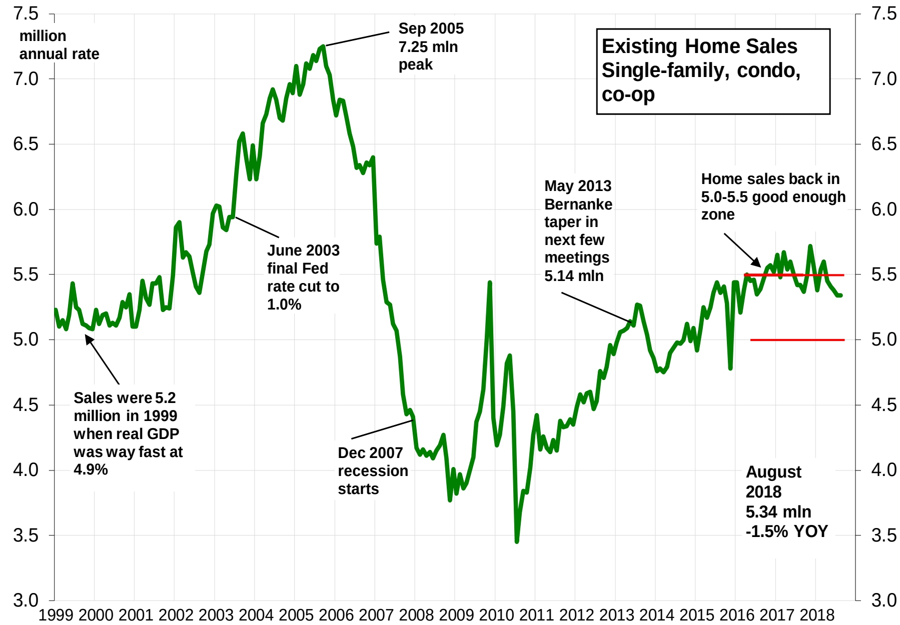
One thing that's not coming back in America is the home building of single family residential homes. Housing is still sputtering short of the goal line and it won't be great again for Americans if they don't have a place to live.

This is one thing that is sorely missing in this long economic recovery and Washington doesn't have a single program or thought on how to restart home building in America. Housing is unaffordable and growing more unaffordable by the day. If home builders don't build lower cost single-family homes then cash strapped millennials will have nowhere to go but home… with their parents. Bet the ranch on it.



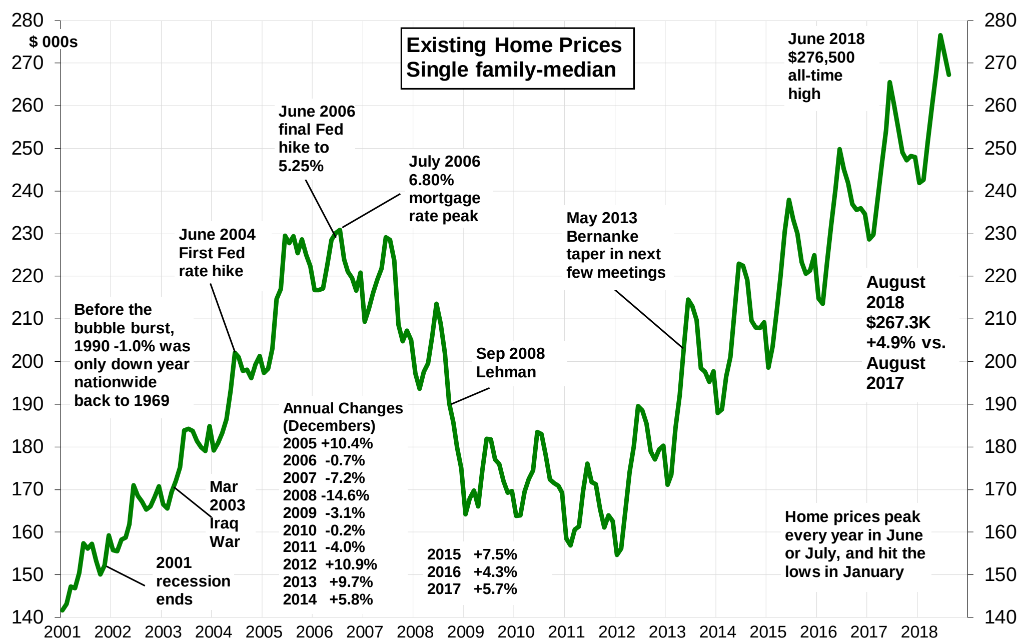
Stock market climbing to new highs, while home sales stall (Thursday)

Breaking economy news. Existing home sales were unchanged in August at a 5.34 million annual rate. Consumer confidence may be near record levels but no one appears confident enough to sell their home either to trade up to something bigger for a growing family or to downsize as the baby boom generation hits retirement age. Home sales by region showed small gains in the Midwest and Northeast offsetting a small decline in the South and larger decline (5.9%) in the West, The South remains the biggest market regionally with sales of 2.23 million in August or 41.8 percent of the total.



Net, net, existing home sales have cooled to the lowest rate in two and a half years. The law of supply and demand has not been repealed where the value of any good is dependent on cost and right now the cost of buying a new home is starting to look expensive on both the price and the financing cost.

Existing home prices plummeted in the recession but are no longer a bargain with prices of single-family homes rising for six consecutive years to the end of 2017 at an average annual rate of 7.3 percent which exceeds workers wage increases over that time. Home prices at current levels are increasingly out of reach for most Americans and affordable housing is difficult to be found as builders are not producing any. Financing costs meanwhile are also moving up with 30-yr mortgage rates of 4.65% which is nearly 125 basis points more than it was when the President was elected in November 2016. Simply put, the home sales market is facing headwinds late in the cycle, and with housing more expensive everywhere you look, many homeowners are making the decision to stay put for now. Our prediction is that existing home sales have peaked for this cycle and will never reach the 7 million annual rate seen before the housing bubble collapse over a decade ago. 5.34 million annual rate. 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.