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.**
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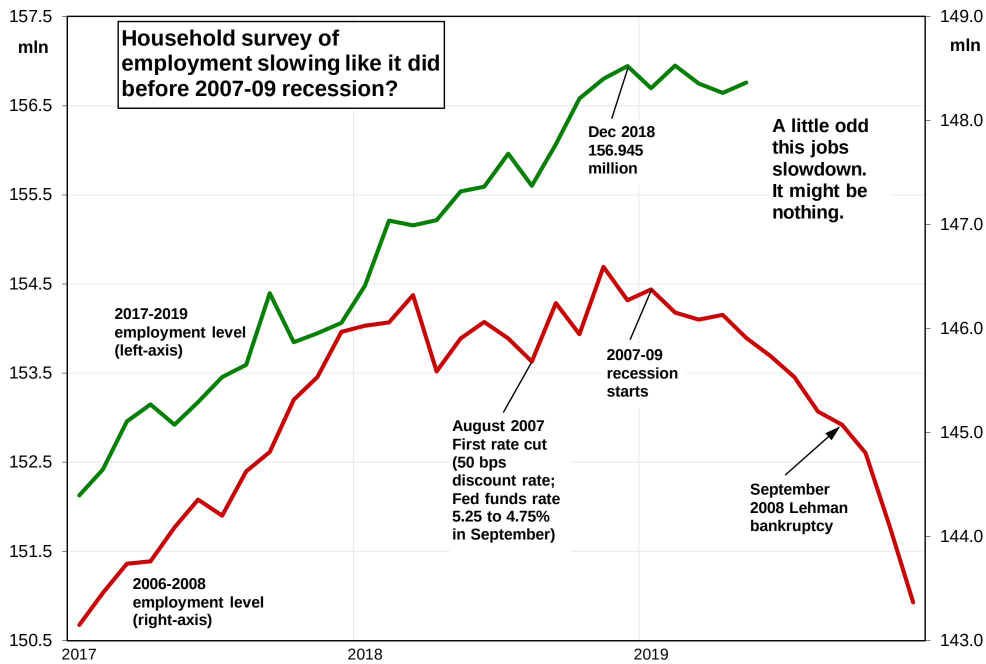
**7 JUNE 2019**

# TRADE WAR ESCALATION BRAKES THE ECONOMY TO THE STALL SPEED FOR NEW JOBS




The economy is braking hard due to the heightened uncertainty and the labor markets have stalled just one month short of the ten year anniversary of this long economic expansion from the Great Recession. Payroll jobs rose just 75 thousand in May, but new jobs created were actually a big fat zero when accounting for the 75 thousand of downward revisions to March and April. Wow. Give credit where credit is due, the ADP estimate on Wednesday was close in predicting 27K in private jobs this month and private jobs rose 90K in today's official employment report from the Bureau of Labor Statistics (BLS). Market doesn't know what to do as it has been chasing trade tariff news all week concerning Mexico. Dow stock futures were up 59 points at the jobs report's 830am release time and 10-yr Treasury yields were 2.10%. Does this report boost the odds the Fed will ease interest rates this year? Stocks think so with the Dow industrials closing up 263 points on the day and +11.4% YTD. We don't see the point of additional monetary stimulus, cutting rates

| | May | Apr | Mar | Feb | Jan | Dec |
|---|---|---|---|---|---|---|
| Payroll jobs (000s) | 75 | 224 | 153 | 56 | 312 | 227 |
| Unemployment rate % | 3.6 | 3.6 | 3.8 | 3.8 | 4.0 | 3.9 |
| Unemployment (3 decimal) | 3.620 | 3.585 | 3.811 | 3.821 | 4.004 | 3.856 |
| Participation rate % | 62.8 | 62.8 | 63.0 | 63.2 | 63.2 | 63.1 |
| Average hourly earnings | $27.83 | $27.77 | $27.71 | $27.66 | $27.56 | $27.53 |
| MTM % Chg | 0.2 | 0.2 | 0.2 | 0.4 | 0.1 | 0.4 |
| YOY % Chg | 3.1 | 3.2 | 3.2 | 3.4 | 3.2 | 3.3 |
| Production Worker earnings | $23.38 | $23.31 | $23.25 | $23.17 | $23.11 | $23.09 |
| MTM % Chg | 0.3 | 0.3 | 0.3 | 0.3 | 0.1 | 0.4 |
| YOY % Chg | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.5 |

from 2.5%, from the Federal Reserve at this point, as rate cuts are unlikely to increase inflation or economic growth. Wait for the recession. Stop the risk-management, just in case, stuff. You want stimulus? Mortgage rates are 3.82% this week down over 100 bps from last November, so the economy has gotten a "boost" from interest rates already.

**Payroll jobs in year ten following the recession**

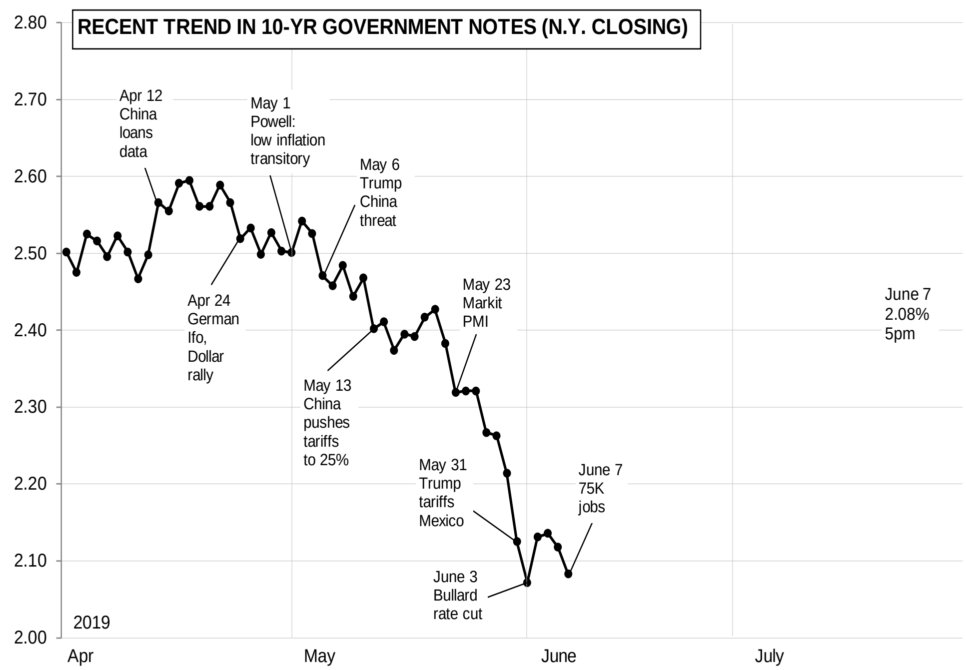
| Dec. 2018 Totals millions | | May 19 | Apr 19 | Mar 19 | 5 months Dec 18 to May 19 | 12 months Dec 17 to Dec 18 |
|---|---|---|---|---|---|---|
| 150.275 | Nonfarm Payroll Employment | 75 | 224 | 153 | 820 | 2679 |
| 127.790 | Total Private (ex-Govt) | 90 | 205 | 153 | 791 | 2583 |
| 20.961 | Goods-producing | 8 | 35 | 13 | 117 | 631 |
| 0.705 | Mining | 0 | 1 | 1 | 6 | 63 |
| 12.809 | Manufacturing | 3 | 5 | -3 | 30 | 264 |
| 1.005 | Motor Vehicles & parts | 3 | -2 | -7 | -5 | 23 |
| 7.400 | Construction | 4 | 30 | 15 | 82 | 307 |
| 106.829 | Private Service-providing | 82 | 170 | 140 | 674 | 1952 |
| 27.788 | **Trade, transportation, utilities** | 0 | 1 | -17 | 23 | 304 |
| 15.821 | Retail stores | -8 | -14 | -15 | -40 | 14 |
| 3.105 | General Merchandise | 6 | -11 | -7 | -46 | 9 |
| 3.108 | Food & Beverage stores | -1 | 1 | 1 | 8 | 20 |
| 5.511 | Transportation/warehousing | 0 | 7 | -3 | 27 | 216 |
| 1.512 | Truck transport | 0 | 0 | -1 | 5 | 44 |
| 0.750 | Couriers/messengers | 2 | 1 | -1 | 4 | 54 |
| 1.170 | Warehousing and storage | 1 | 4 | 0 | 20 | 84 |
| 0.555 | Utilities | 0 | -3 | 1 | -2 | -1 |
| 2.827 | **Information** | -5 | -10 | 4 | -30 | 6 |
| 8.615 | **Financial** | 2 | 13 | 11 | 37 | 115 |
| 2.703 | Insurance | 1 | 2 | 7 | 9 | 31 |
| 2.287 | Real Estate | 5 | 9 | 7 | 37 | 67 |
| 1.316 | Commercial Banking | -1 | -3 | -3 | -9 | -7 |
| 0.967 | Securities/investments | -4 | 2 | 1 | 0 | 23 |
| 21.254 | **Professional/business** | 33 | 62 | 19 | 173 | 561 |
| 3.060 | Temp help services | 5 | 10 | -11 | -15 | 83 |
| 2.395 | Management of companies | -3 | 3 | 0 | 10 | 62 |
| 1.495 | Architectural/engineering | 4 | 3 | 6 | 21 | 42 |
| 2.162 | Computer systems/services | 8 | 16 | 13 | 44 | 86 |
| 1.140 | Legal services | 2 | -2 | 1 | 3 | 1 |
| 1.034 | Accounting/bookkeeping | 2 | 2 | 4 | 11 | 39 |
| 23.912 | **Education and health** | 27 | 73 | 72 | 259 | 532 |
| 5.195 | Hospitals | 3 | 9 | 8 | 37 | 100 |
| 3.746 | Educational services | 4 | 17 | 5 | 35 | 50 |
| 16.554 | **Leisure and hospitality** | 26 | 17 | 32 | 167 | 359 |
| 2.036 | Hotel/motels | 5 | -1 | 1 | 15 | 23 |
| 12.074 | Eating & drinking places | 17 | 21 | 31 | 123 | 258 |
| 22.485 | Government | -15 | 19 | 0 | 29 | 96 |
| 2.192 | Federal ex-Post Office | 1 | 8 | -2 | 14 | 9 |
| 5.183 | State government | -10 | -6 | -2 | -15 | 19 |
| 2.487 | State Govt Education | -8 | -1 | 1 | -10 | 10 |
| 14.504 | Local government | -9 | 17 | 3 | 27 | 74 |
| 7.974 | Local Govt Education | -6 | 9 | 0 | 13 | 31 |

Payroll jobs were 75K in May down from 224K in April. Construction jobs were 30K in April and now just 4K in May. It was cold in May. Manufacturing has stopped hiring since February this year as the trade war is hitting exports and manufacturing output hard. Manufacturing new jobs were just 3K in May where the average for all of 2018 was 22K each month, so no factories are coming back to America yet. Realistically, companies who do say they are trying to move some production out of China are going to Vietnam or Malaysia or the Philippines or Mexico... Well, maybe scratch Mexico. Other job categories have been weak this year as well like retail jobs down 8K in May after a 14K drop in April. Tech jobs have fallen the last two months and are down 5K in May.

Net, net, there is an air of caution in the wind as the latest escalation in America's trade war with China led businesses to throw a switch and stop all new hires until they see where the trade talks will lead. The potential economic hit to growth is too big not to take account of for companies who are always looking to the future to judge the demand for their goods and services and adjusting their headcounts accordingly. This may be one way the president gets the Fed to spring into action and pay for his trade war. Push the economy to the brink in this trade war and cushion the blow to growth by having the Federal Reserve cut interest rates. The world economy is slowing, inflation is below target, and now the slowing US economy with today's no-jobs report may be the final straw to break the camel's back for the Federal Reserve sitting on the sidelines.

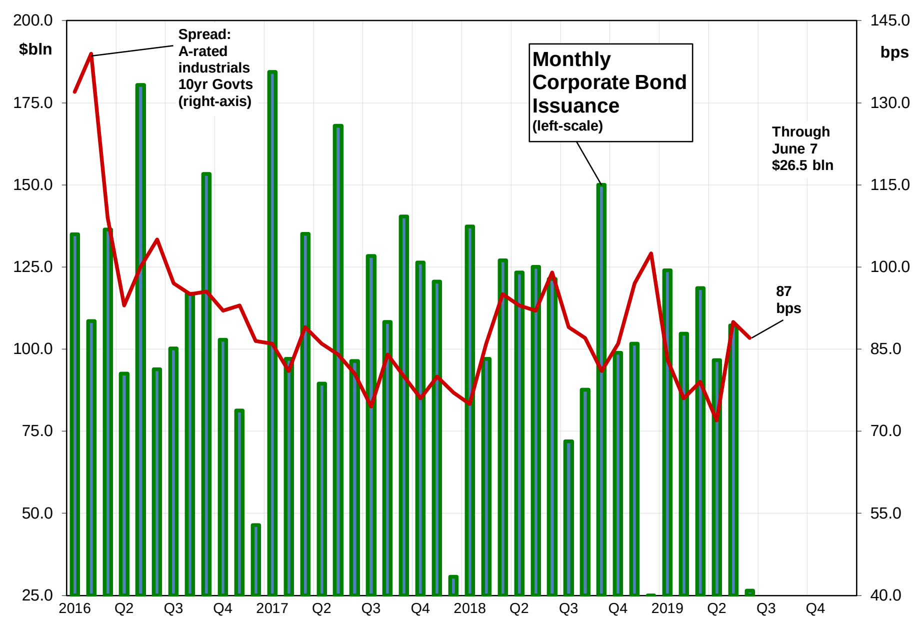
## MARKETS OUTLOOK

| | 29-Mar 2018 | Q2 2019 | Q3 2019 | Q4 2019 | Q1 2020 | Q2 2020 | Q3 2020 | Q4 2020 |
|---|---|---|---|---|---|---|---|---|
| 30-Yr Treasury | 2.81 | 3.00 | 3.00 | 3.10 | 3.10 | 3.25 | 3.20 | 3.20 |
| 10-Yr Note | 2.41 | 2.60 | 2.70 | 2.90 | 2.90 | 3.10 | 3.10 | 3.10 |
| 5-Yr Note | 2.23 | 2.45 | 2.60 | 2.80 | 2.80 | 3.05 | 3.05 | 3.05 |
| 2-Yr Note | 2.26 | 2.45 | 2.50 | 2.70 | 2.70 | 2.90 | 2.95 | 3.00 |
| 3-month Libor | 2.60 | 2.60 | 2.60 | 2.90 | 2.90 | 3.10 | 3.10 | 3.10 |
| Fed Funds Rate | 2.50 | 2.50 | 2.50 | 2.75 | 2.75 | 3.00 | 3.00 | 3.00 |
| 2s/10s spread | 15 | 15 | 20 | 20 | 20 | 20 | 15 | 10 |




Monday was the low close for the week. Selling at 3am for an unknown reason, recovery, then afternoon comment from St. Louis Fed's Bullard that a rate cut may be warranted helped the rally along closing at 2.07%. 10-year yields were 2.10% before the no-jobs report, fell to a new 2.05% low for 2018, but closed at 2.08%. Bond valuations look okay at this level, 50 bps below the 2.5% Fed target, and can stay here for a while even if the Fed does not cut interest rates. Two rate cuts to 2.0% are discounted by the market by the September 17-18 meeting. The Fed cut rates early before the last two recessions and with bigger 50 bps moves because rates were higher, 6.5 and 5.25 percent.

## CORPORATES: HOME DEPOT, APACHE, DEERE, ALLSTATE, HCA HEALTHCARE




Corporate offerings were $26.5 billion in the June 7 week versus $6.1 billion in the May 31 week. On Wednesday, Parker-Hannifin sold $2.375 billion 5s/10s/30s. It priced a $1.0 billion 3.25% 10-yr (m-w +20bp) at 117 bps (Baa1/A). The manufacturer of motion and control technologies and systems will use the proceeds help finance its acquisition of Lord Corp. (adhesives and coatings). Corporate bond yields (10-yr Industrials rated A2) were 87 bps above 10-yr Treasuries this week versus 90 bps last Friday.

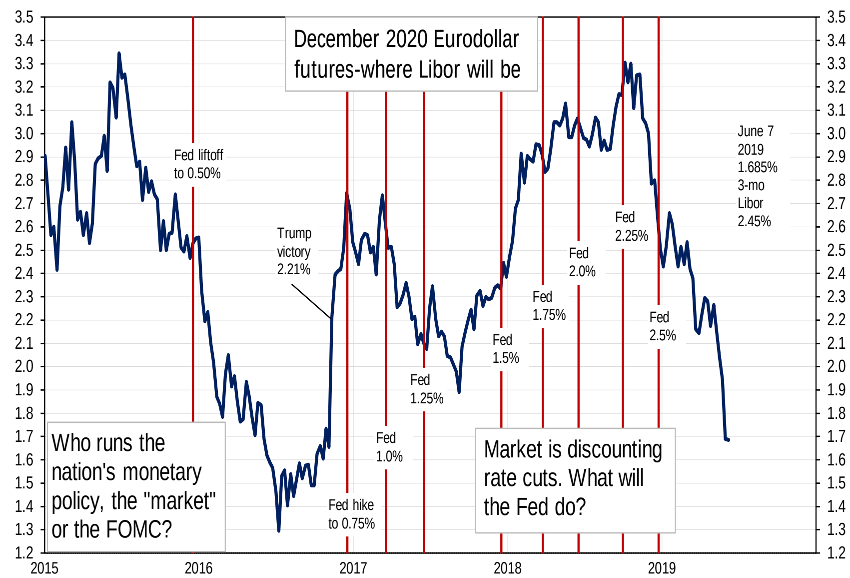
# FEDERAL RESERVE POLICY

The Fed meets June 18-19 to consider its monetary policy. The drumbeat for rate cuts from the market grew louder after the 75K soft-spot payroll jobs number reported Friday for May. A positive 75K jobs number isn't a recession, so we wouldn't advise chasing the economic cycle with a rate cut at this early stage. Not without serious economic weakness. A rate cut or two from 2.5% will not increase business borrowing for investment that stokes the fires of economic growth and pushes inflation back higher to their 2.0% target. A rate cut could improve "financial conditions" and make the stock market move up; not sure the Fed should want to have the stock market give them their annual performance review. Rate cuts could bring down mortgage rates that helps residential housing construction and increases mortgage refinancing that saves consumers money. But mortgage rates have already come down over 100 bps from the peak last November to 3.82% this week.

The Fed held another "We Listen, We Care" event, this week held at the Chicago Fed: probably the main event for its ongoing tour of the country as it seeks public input in its "Review of Its Monetary Policy Strategy, Tools, and Communication Practices." The market doesn't care about the discussion of its monetary policy framework, it just wants three rate cuts by the end of this year. Powell gave the opening remarks. We doubt much change will come from this examination of their policy. The only thing we found scary is that they might seek to flatten yields across the curve to zero in the next recession. This policy didn't work for Japan or Europe, so let's try it here. All it would do is permanently alter the way we save, borrow and invest. Negatively.

<u>Stocks liked Powell's Tuesday comment</u>
I'd like first to say a word about recent developments involving trade negotiations and other matters. We do not know how or when these issues will be resolved. We are closely monitoring the implications of these developments for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion, with a strong labor market and inflation near our symmetric 2 percent objective. My comments today, like this conference, will focus on longer-run issues that will remain even as the issues of the moment evolve.

| **Odds of Rate Cuts Fed funds futures** | |
|---|---|
| F6-7-2019 | |
| 20% | 2.25% June |
| 178% | 2.25% September |
| 270% | 2.25% December |
| Odds at June, September, December Fed meetings | |

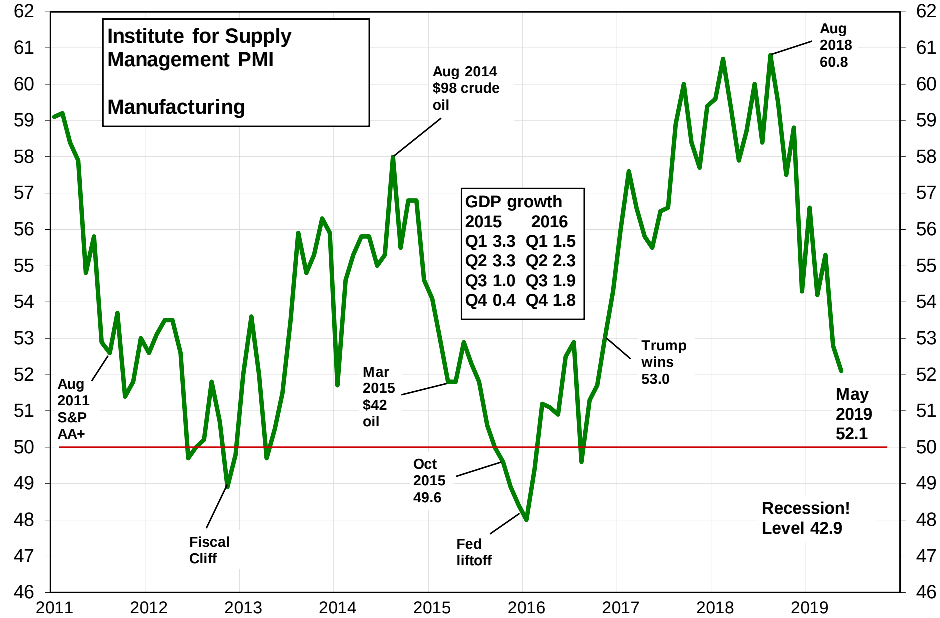



NY Fed President Williams 6-6-19
I do follow market views; we have our own views
Doesn't bother me if market, Fed views differ

## OTHER ECONOMIC NEWS THIS WEEK

### Manufacturing survey slides, but company orders and hiring are up (Monday)

Breaking economy news. Manufacturing took another step downward according the ISM survey of purchasing managers with the index falling to 52.1 in May from 52.8 in April. The bond market rally is screaming recession and massive Fed rate cuts are on the way although the index level that forecasts recession for the broader economy beyond manufacturing is miles away at the 42.9 level which is almost ten points lower. Get a grip is what we are telling bond traders and their robots on the desk executing "customer" orders. (There is no prop trading: wild speculative bets on the future.) Maybe the Fed needs to talk some sense into the robots on the desk buying bonds with mindless abandon, talk them down off the wall. There is no recession.




The overall ISM index was down in May, but new orders, hiring or employment, and new export orders rebounded from some steep losses in April. There is even a little more inflation that is likely to calm the hearts of worried Fed officials that want more inflation so they can raise interest rates higher so they can cut interest rates further if the economy goes into recession. We guess that makes sense. Actually, they have left rates so low for so long, they are struggling to know what they should do next.

Net, net, manufacturing orders and hiring rebounded somewhat, but the economy is not out of the woods with higher tariffs to come on $300 billion of China imports and now the imports from Mexico. The global supply chains are tightly woven the last two decades with just-in-time parts crossing international borders many times before the final product comes off the factory finish line. The risks are rising that the Trump administration's America First policy is going to throw a monkey wrench into manufacturers plans and time will tell if trade tariffs are the death blow for this long economic expansion. In conclusion, purchasing managers say the economy slowed dramatically in the second quarter and their view is consistent with most economists who look for real GDP to slow dramatically from 3.1% in the first quarter to only 1 to 1.5 percent in the second quarter. Manufacturing is bearing the brunt of this escalation in the trade war.

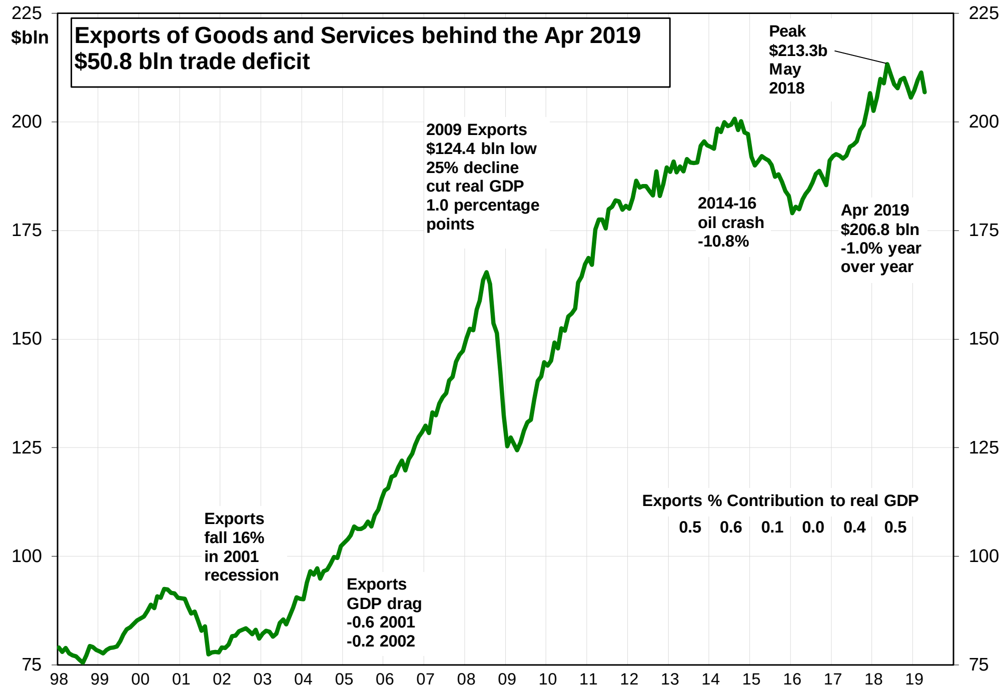
**ISM manufacturing index**

| | May 19 | Apr 19 | Mar 19 | Feb 19 | Jan 19 | Dec 18 | Nov 18 |
|---|---|---|---|---|---|---|---|
| PMI index | 52.1 | 52.8 | 55.3 | 54.2 | 56.6 | 54.3 | 58.8 |
| Prices | 53.2 | 50.0 | 54.3 | 49.4 | 49.6 | 54.9 | 60.7 |
| Production | 51.3 | 52.3 | 55.8 | 54.8 | 60.5 | 54.1 | 59.9 |
| New orders | 52.7 | 51.7 | 57.4 | 55.5 | 58.2 | 51.3 | 61.8 |
| Employment | 53.7 | 52.4 | 57.5 | 52.3 | 55.5 | 56.0 | 57.7 |
| Export orders | 51.0 | 49.5 | 51.7 | 52.8 | 51.8 | 52.8 | 52.2 |

## Trade war chickens coming home to roost. Squawk! (Thursday)

Breaking economy news. Unemployment claims were unchanged at 218K in the June 1 week but for how long with the trade war leading to a sharp reduction in both imports and exports in April. No wonder purchasing managers at manufacturing companies that export their products to the world are so pessimistic. This is April trade data which took place before Trump's May 5 tweets threatening 25% tariffs on $200 billion of China imports (up from 10%) and the 25% tariffs on the rest of the $300 billion of China imports that will be discussed in hearings down in Washington starting on June 17.

And all this before the tweet last Thursday night on Mexico tariffs. Tariffs are already having a deleterious effect on trade flows even before they grow to much higher levels that could virtually destroy world trade between nations. Trade in and out of the US is slowly grinding to a halt with goods exports tumbling $4.4 billion to $136.9 billion in April, and goods imports down a sharp $5.4 billion to $208.7 billion in April.




Trade wars are easy to win? Not with China. In the first four months of 2019 US exports to China are down 20.8% to $33.9 billion. US imports from China are down 12.8% to $161.4 billion. America is not winning in percentage terms. With tariffs at 25%, taking in $125 billion in customs duties on $500 billion of China imports is not going to cushion the blow to US manufacturers who have seen an $8.9 billion drop in what they sell to China so far this year. No exports, no jobs, jobs, jobs.

Net, net, US trade with the world is slowing dramatically and the odds are rising that the economy is going to take a big hit. The Great Depression was caused by trade sanctions and protectionist measures some economists think, and it could happen again. Globalization and expanded trade between nations benefited everyone and now the reductions in trade volumes between nations are going to subtract those benefits worldwide from everyone. Stay tuned. Story developing. The worst is still to come. You haven't seen nothing yet.

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