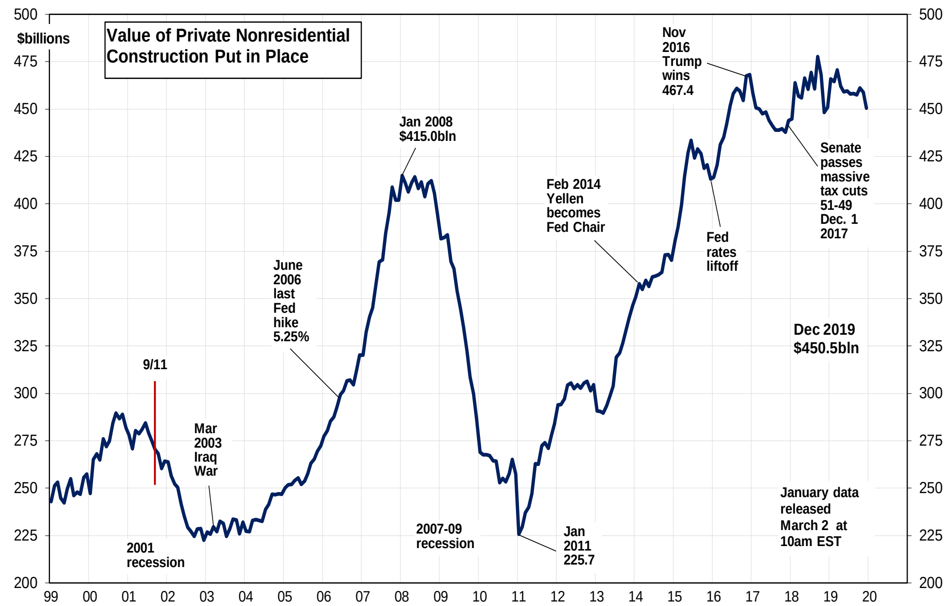
Financial Market Weekly

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

14 FEBRUARY 2020

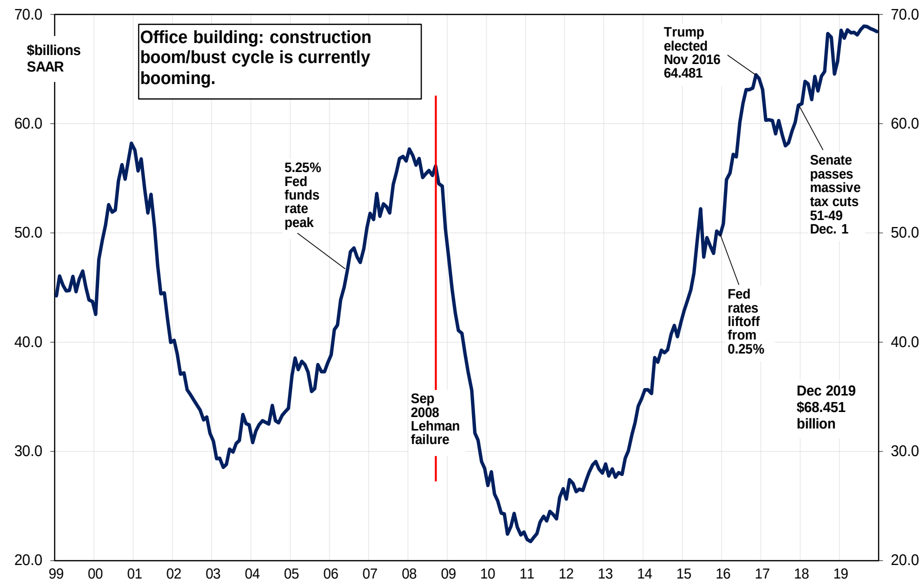
BUSINESS INVESTMENT IN FACTORIES, SHOPPING CENTERS, WAREHOUSES, OFFICES IS TIRING LATE IN THE DAY

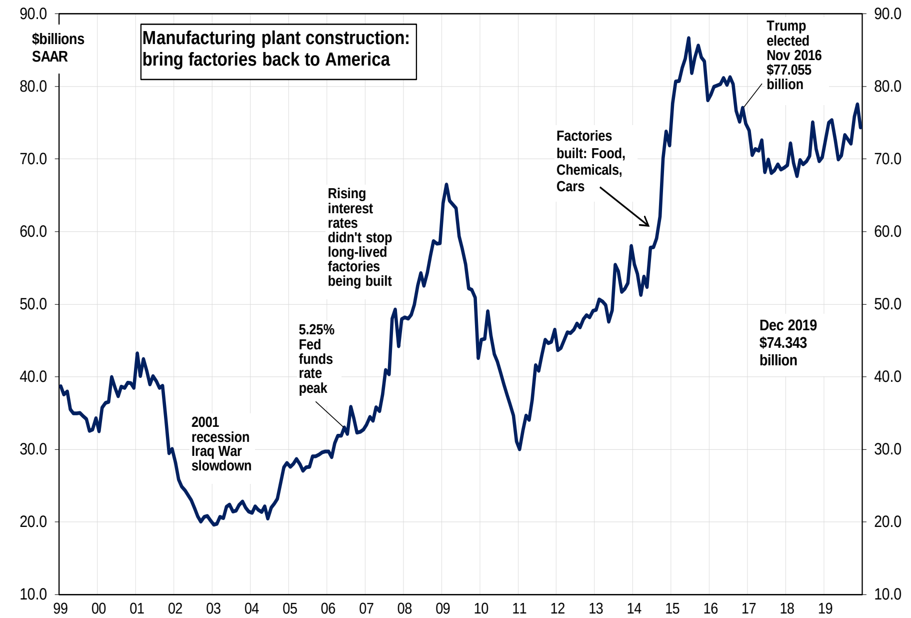


How many new offices does the country still need in a long economic upturn that will start its 12th year in July? Companies are not increasing the amount they spend each year on "structures," with the value of private nonresidential construction put in place less than it was when Trump was elected in November 2016. If the economy is the best in 50 years, then why are companies not building more for tomorrow? The China-U.S. trade/economic war was 2019 and now the coronavirus is the biggest economic risk (let's be honest, biggest recession risk) in 2020. But we still don't have an answer to whether the economy is more prone to a fall after it has built and built and built following a recession to the point where no more investment is needed… for now. Let's put it this way, the U.S. population in 2019 is 329.3 million which is 1.6 million more people than in 2018 (0.5%); in every business cycle, even one of this length, the question remains, how many more seats and desks does the country need for companies, businesses,

Nonresidential Construction $bln	Dec 19	% Chg	2019 YTD	2018 YTD	Peak Year 2008	Peak % Chg
Total private	450.484	0.0	460.386	460.547	409.440	12.4
Lodging	29.744	6.2	32.349	30.464	35.364	-8.5
Office	68.451	6.0	68.485	64.591	55.502	23.4
Commercial	78.462	-12.5	80.329	91.799	82.654	-2.8
Health Care	34.193	5.8	35.183	33.255	38.437	-8.5
Educational	17.901	-10.9	19.022	21.351	18.624	2.1
Religious	2.866	-10.6	2.915	3.262	7.197	-59.5
Amusement	13.234	-8.8	14.149	15.522	10.508	34.6
Transportation	16.265	-0.5	16.523	16.605	9.934	66.3
Communication	23.530	-4.5	23.370	24.461	26.343	-11.3
Power	90.101	6.0	92.964	87.708	69.242	34.3
Manufacturing	74.353	4.6	73.545	70.330	53.625	37.1

corporations? This is the question for offices, but it could apply equally to all business investment on structures: hotles/motels, factories, amusement parks, hospitals. The question on how many retail premises, shopping centers, are are needed is even more concerning. A worry because even though fewer are being built, investors seem to be shying away from providing financing for this sector of the economy. Some real-estate investment funds centering on retail establishments like shopping malls have seen their investors asking for their money back. Retail malls have seen reduced traffic as the rise of e-commerce, shopping on your phone, continues.





Shopping malls construction is down to $2.2 billion in 2019 or 14.6% of total retail establishment construction in the country. Shopping malls construction fell in the recession and had recovered to $3.9 billion in 2017 before falling back. There was a severe drop in shopping center construction from $14.895 billion in 2018 to $9.615 billion in 2019. Shopping centers include so-called shopping plazas and town centers.

Construction of Multi-Retail Establishments

Millions of dollars	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
General Merchandise	4,373	3,976	3,794	3,368	3,773	2,942	2,792	2,362	2,659	1,864	2,582	2,265
Shopping Center	22,780	11,447	6,725	6,748	7,934	9,806	12,946	13,752	15,713	17,558	14,895	9,615
Shopping Mall	4,045	2,171	1,332	2,356	2,288	2,938	2,868	3,035	3,292	3,921	2,980	2,200
Total	31,963	18,390	12,486	13,361	14,904	16,686	19,543	20,036	22,404	24,048	25,892	15,042

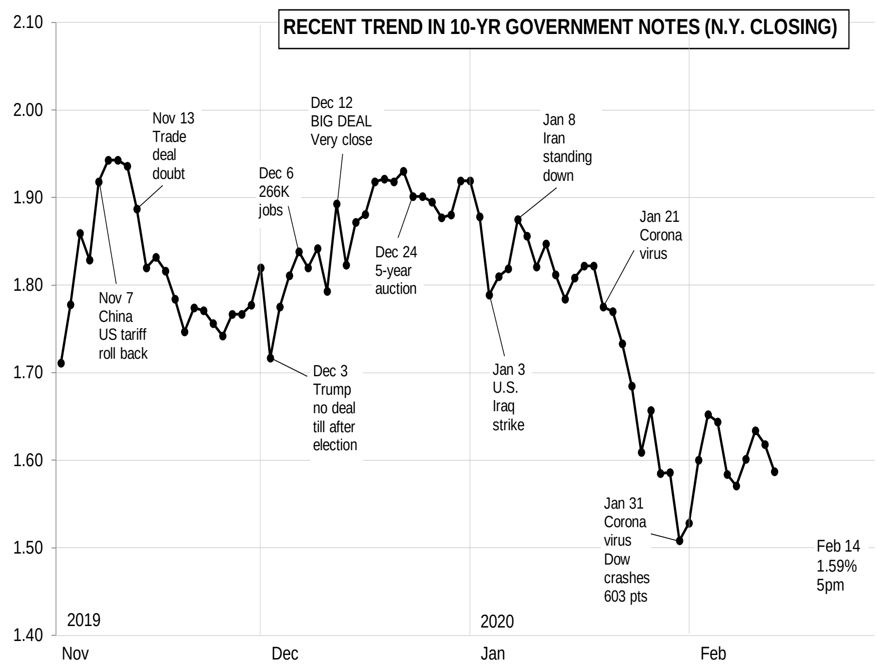
General Merchandise: department stores, variety stores
Shopping center: shopping centers, shopping plazas, town centers
Shopping mall: shopping malls

To conclude, business investment in all structures were unchanged for the full year 2019 at $460.4 billion. This is a high level of spending, fully recovered from the recession, but construction has to move higher or it does not add to real GDP growth. The Tax Cuts & Jobs Act in December 2017 may have led to some additional spending for a time, but generally, there is little that Washington can do to increases investment. Lowering interest rates from 1.75% would do little if nothing.

MARKETS OUTLOOK

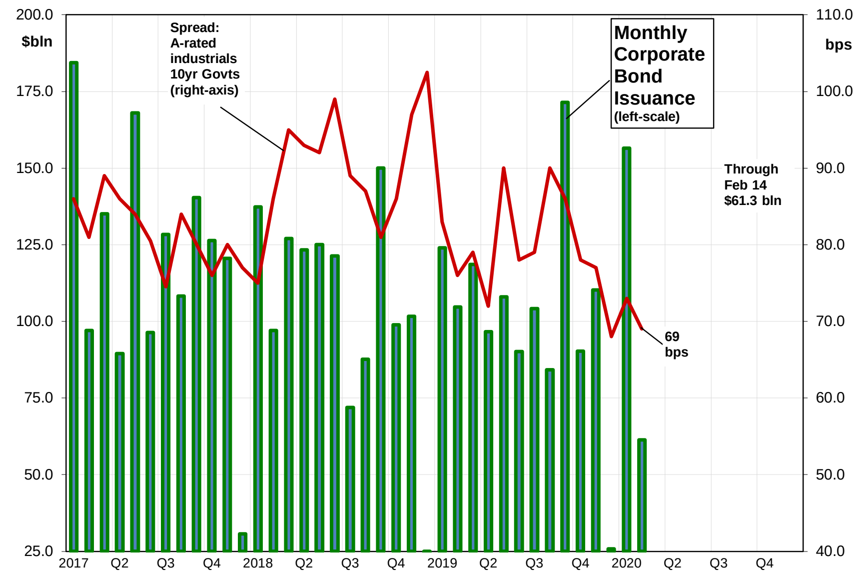
	29-Mar 2019	28-Jun 2019	30-Sep 2019	31-Dec 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021
30-Yr Treasury	2.81	2.53	2.11	2.39	2.30	2.30	2.40	2.50	2.60	2.70
10-Yr Note	2.41	2.01	1.67	1.92	1.85	1.90	2.10	2.20	2.30	2.40
5-Yr Note	2.23	1.77	1.55	1.69	1.65	1.75	1.90	2.05	2.15	2.25
2-Yr Note	2.26	1.76	1.62	1.57	1.60	1.70	1.80	2.00	2.10	2.20
3-month Libor	2.60	2.32	2.09	1.90	1.90	1.90	1.90	1.90	1.90	1.90
Fed Funds Rate	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75
2s/10s spread	15	25	5	35	25	20	30	20	20	20

A quiet week with daily closes ranging from 1.57 to 1.63 percent for 10-yr Treasuries. The Dow industrials made a record high close at 29,551.42 on Wednesday, up 3.5% YTD, and bond yields closed at the week's high of 1.63%. The S&P 500 kept going and made a second record high this week on Friday, but bond yields were too tired to climb back up and closed the week at 1.59%. The market is still glued to coronavirus headlines with the news Wednesday evening of 14,840 new cases (methodology revised) dropping yields back from the week's Wednesday 1.63% closing high. For all the talk of the $1 trillion Federal budget deficit, the Treasury sold $84 billion 3-years, 10-years, 30-years this week without much effect on yields.



CORPORATES: CARRIER GLOBAL, NOVARTIS, SYSCO, INTEL, AT&T, OSHKOSH

Corporate offerings were $34.6 billion in the February 14 week versus $26.6 billion in the February 7 week. On Tuesday, DTE Electric sold $1.1 billion 10s/30s. It priced a $600 million 2.25% 10-yr (m-w +15bp) at 68 bps (Aa3/A). The energy company (electric energy in southeastern Michigan) will use the proceeds to repay $300 million 4.89% notes, repay short term borrowings, capex, and for general corporate purposes. Corporate bond yields (10-yr Industrials rated A2) were 69 bps above 10-yr Treasuries Friday versus 71 bps last Friday.



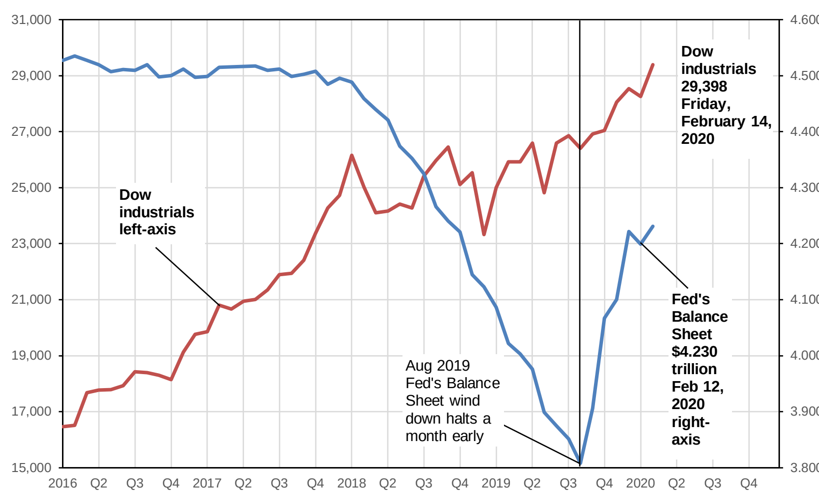
MUFG

FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	12-Feb	5-Feb	29-Jan	22-Jan	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2442.621	2427.880	2409.108	2381.020	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1391.526	1387.289	1387.288	1398.642	0.000
Repurchase agreements	164.400	170.250	175.125	186.076	126.750
Primary credit (Discount Window)	0.000	0.000	0.034	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)	0.000	0.000	0.000	0.000	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	0.055	0.048	0.051	0.054	62.000
Federal Reserve Assets	4230.9	4214.9	4199.3	4194.1	961.7
3-month Libor %	1.70	1.74	1.78	1.80	2.82
Factors draining reserves					
Currency in circulation	1796.425	1794.675	1792.779	1794.751	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	0.309	4.112	0.300	15.604	0.000
Reserve Balances (Net Liquidity)	1695.082	1652.873	1612.223	1609.594	24.964
Treasuries within 15 days	52.182	53.364	28.266	23.659	14.955
Treasuries 16 to 90 days	129.306	115.176	135.202	126.629	31.549
Treasuries 91 days to 1 year	376.189	378.638	378.533	369.212	69.272
Treasuries over 1-yr to 5 years	918.350	917.955	908.219	902.619	170.807
Treasuries over 5-yrs to 10 years	319.315	319.329	315.598	315.605	91.863
Treasuries over 10-years	647.278	643.419	643.290	643.297	101.337

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

The Fed meets March 17-18, 2020 to consider its monetary policy. Nothing for them to do. The bond market's hopes for Fed rate cuts because of the coronavirus are later this year. June Fed funds futures say the odds of a 25-bps rate cut to 1.5% at the June 2020 Fed meeting are 56%, and for the December 2020 Fed meeting, 13 bps of a second rate cut this year to 1.25% is discounted. Nothing for the Fed to do soon, but what about further off in the future? Like when there's a recession. Powell said on Wednesday the Fed will aggressively use QE and forward guidance to fight the next recession. This sounds a lot like the old Monty Python movie where the brave knight insists he can continue to fight his foe without his arms and legs. The reality is the Fed has nothing. Some rate cuts and QE could take bond yields down to 0.75% and mortgage rates maybe to 2.5%, but that's it. It's one shot. An unnecessary shot that could ruin the financial system, where if the Fed simply stood aside, the economy would most likely come back on its own. Former Fed Chairman Bernanke used to have his fans saying he stopped the Great Recession from turning into the Great Depression. We don't know. We think the economy can come back on its own. And the Federal Reserve's research saying it takes 500 bps of rate cuts to get us out of a recession is just plain wrong.



Okay. Calm down. There will still be a bond market after 10-year Treasury yields fall below 1 percent, it's just that there won't be a bond market for half of those on Wall Street employed in trading and sales. Wall Street economists should be fine as investors will still need an interest rate forecast after the Fed's QE pushes yields down along the curve all to zero.

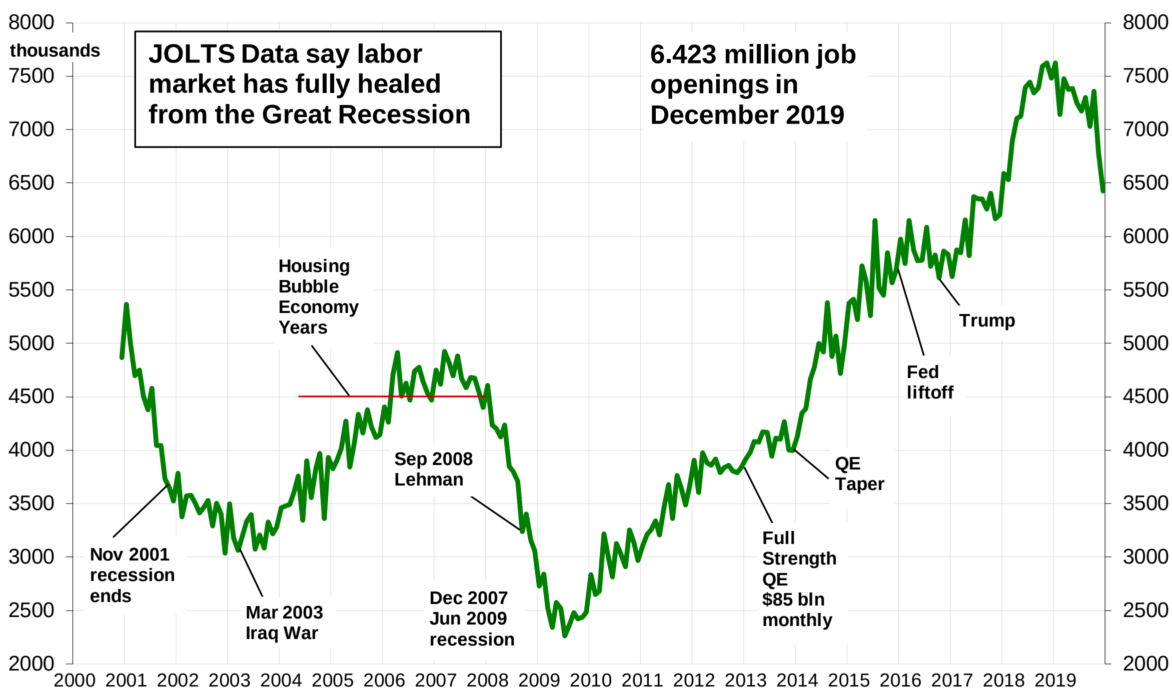
Here are the key takeaways from two days of Powell Q&A before Congress this week. Just to be clear. Here are the key takeaways from two days of Powell Q&A before Congress this week. There were some we guess besides him being willing to employ all their tools in the next recession. (1) It's too early to know if the coronavirus will cause a material change in the outlook. (2) No reason the economy can't keep on going. (3) Fed still wants banks to switch from Libor. (4) Fed will buy T-bills at least into April. (In Fed balance sheet table above, repos are $164.4 billion this week and will likely be slowly replaced with T-bills.) (5) Reduced uncertainty about trade could mean investment will pick up. Stay tuned. Story developing.

OTHER ECONOMIC NEWS THIS WEEK

Wow. Job openings are plummeting in this best economy in history (Tuesday)

Breaking economy news. The Jolts data. Job openings and labor turnover survey. Job openings around the country plummeted 364 thousand to the 6.423 million level in December. Jobs are disappearing in manufacturing, education and health services, retail trade, financial activities, and the information industry. The last time job openings fell this dramatically was in the early months of 2018 during the Great Recession.

Net, net, job openings around the country are plummeting in a way that we hate to say looks like a recession. Since November 2018, the month before the Fed's bridge-too-far final rate hike to 2.5%, 1.3 million job openings have disappeared from the nation's jobs boards which is an astounding number. The high-water mark was 7.626 million openings in November 2018 and in December 2019 there were 6.423 million openings. Something is happening out there to the economy and while we can't be quite sure what it is, this collapse in the need for labor on the part of companies is not a positive development. It's a good thing that Powell is saying the Federal Reserve is monitoring the economy closely because the labor market is saying they really need to pay attention. This is serious.



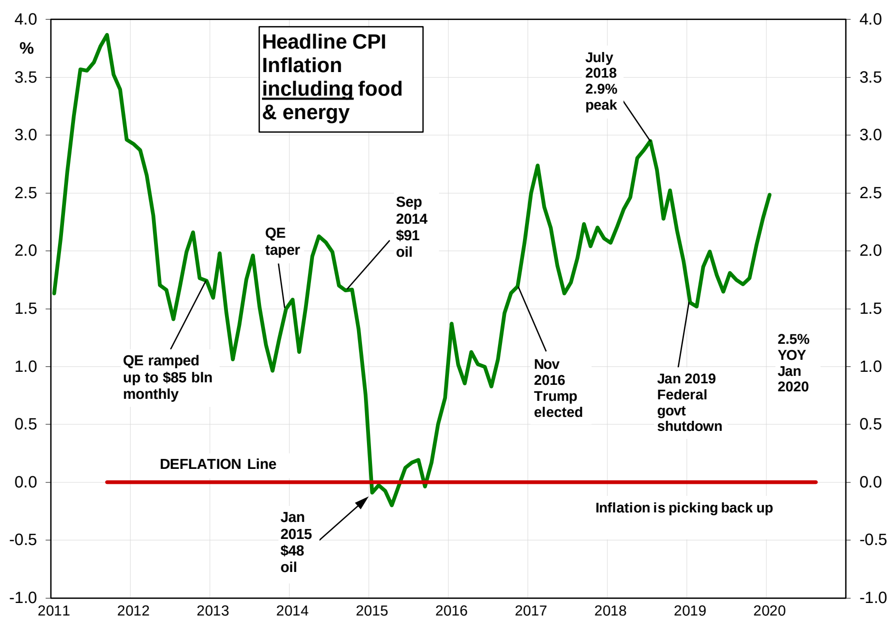
Inflation still above target (Thursday)

Breaking economy news. CPI inflation slowed in January from falling energy prices, a modest uptick of one-tenth percentage point, but it is still 2.5 percent higher than last year which makes a mockery of Fed officials' claims that the sky is falling because there’s not enough inflation. 2.5 percent inflation is well above the Fed's 2 percent target.

Housing costs are a bigger part of the consumer's paycheck than the Fed's PCE inflation measure acknowledges and this is one major reason there is more inflation out there in the country than we think. Certainly more than the bond market thinks, otherwise why buy bonds at yields under 2.5 percent? Shelter costs in CPI rose 0.4 percent in January and are up 3.3 percent the last year. The only nonenergy prices running faster than home prices are medical care services up 5.1 percent the last year.

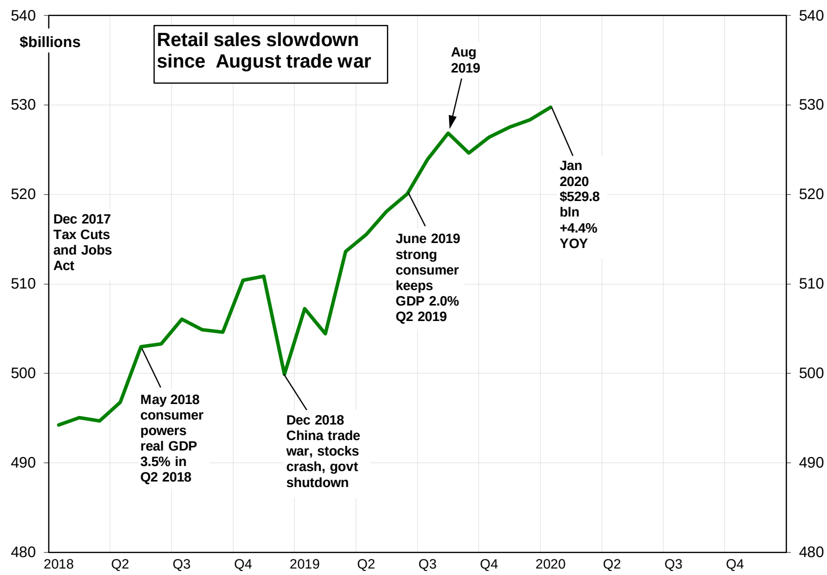
There's inflation out there which is what textbooks say should happen after over a decade of growth. Just look at dining-out costs up 3.1 percent the last year. Core consumer prices rose 0.2 percent in January to a 2.3 percent year-to-year rate, held back a little by used cars and trucks falling 1.2 percent in January. Meanwhile new car prices are up just 0.1 percent the last year which we never understood as the quality adjustment method of calculating CPI prices has plainly gone mad. Although we would not wish this on even our enemies, go to a car dealer if you think there is no car inflation. They will assure you you are getting a better deal with more cupholders and wood veneer paneling. You will still pay more. There’s car inflation.

Net, net, consumer inflation has risen steadily to a 2.5 percent year-on-year rate the last few months as the sharp fall in gasoline prices during the period of the Federal government shutdown and financial market turbulence falls out of the year-to-year data. There is not no inflation out there and with unemployment claims remaining at low full employment levels of 205 thousand in the February 8 week, inflation pressures will continue to build and consumers who can least afford it will have to pay up. Does the Fed *Listens*? Stay tuned.



Retail sales up after downward revisions (Friday)

Breaking economy news. Retail sales for January rose 0.3% to start the year off right although November and December sales were revised down one-tenth each. That is, December is now 0.2% lower than reported last month. Retail sales were a slow 1.8% in Q4 2019 and now with just January in, sales are again rising 1.8% in Q1 2020 with February and March data left to go.



Real consumer expenditures rose just 1.8% last quarter adding 1.2 percentage points to that modest 2.1% real GDP growth. Whatever the consumer is doing in the first quarter to start 2020, it doesn't look like it is shaping up to be a strong quarter for growth if they don't take more shopping trips to the malls of America. It looks like consumers don't know if they are going backwards or forwards after the downward revisions to last year and modest spend in January. Consumers wake up! The economy is counting on you. Every day a Fed official is out speaking around the country talking about how solid the consumer is, but that's starting to look less true.

In January, sales of most categories were up slightly, but sales were down 0.5% at electronics and appliance stores, and down 0.4% at health and personal care stores. Gasoline prices were down in January so sales at gasoline stations fell 0.5%. Clothing and clothing accessories stores saw their sales collapse 3.1% after a 2.7% sales increase in December.

Net, net, the consumer seems to be on the back foot for a second quarter in a row, and this has to be disappointing news for the Trump administration that is counting on consumers to carry the load as business investment remains cool due to the constant barrage of negative news which creates uncertainty for companies and businesses. This isn't the greatest economy ever if consumers don't decide to spend their paychecks. Stay tuned. Story developing.

Retail spending, actual dollars, each month

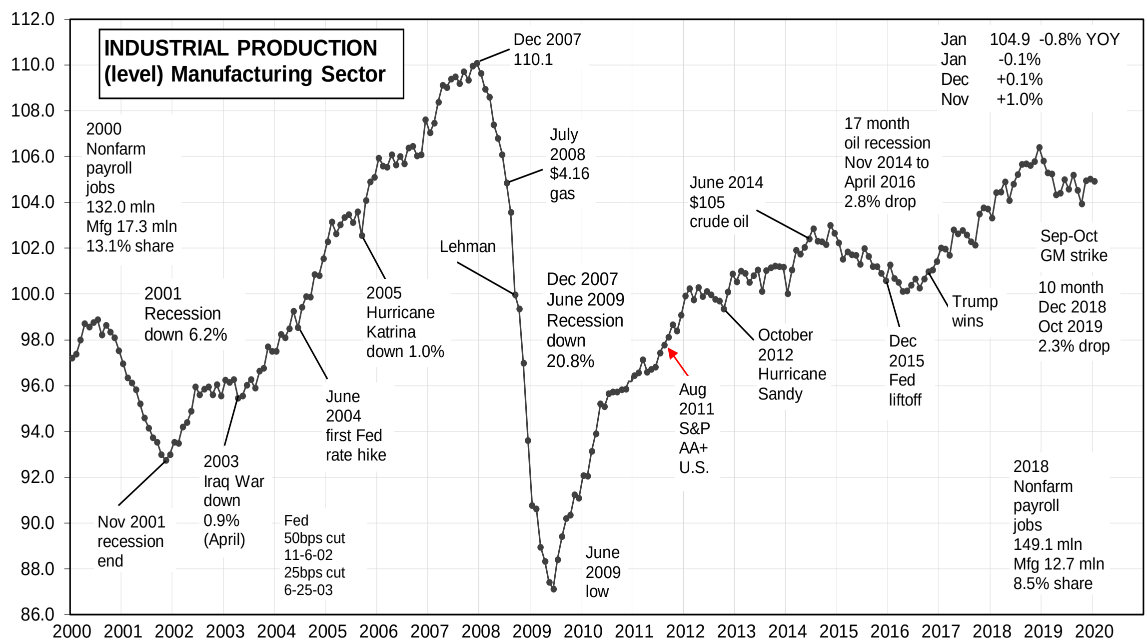
	$million	% to	Percent Changes %		
	Jan 2020	Total	Jan	Dec	Year/year
Total Retail Sales	529,766	100.0	0.3	0.2	4.4
Motor vehicles/parts	106,484	20.1	0.2	-1.7	5.7
Furniture/furnishings	9,746	1.8	0.6	-1.6	1.8
Electronics/appliances	8,054	1.5	-0.5	0.4	-3.2
Building materials/garden	32,806	6.2	2.1	1.3	-1.3
Food & beverage	65,908	12.4	0.2	0.5	2.3
Health/personal care	28,956	5.5	-0.4	-0.4	-1.9
Gasoline stations	44,159	8.3	-0.5	1.7	10.4
Clothing/accessories	22,271	4.2	-3.1	2.7	0.0
Sporting goods, books	6,376	1.2	0.1	0.0	-1.8
General merchandise	60,188	11.4	0.5	0.4	2.1
Department stores	10,960	2.1	0.1	-0.6	-5.5
Miscellaneous retailers	10,178	1.9	2.3	-1.4	9.5
Nonstore retailers (internet)	62,751	11.8	0.3	-0.1	8.4
Eating & drinking places	61,683	11.6	1.2	1.2	7.4

Factory production sputters on global warming and Boeing (Friday)

Breaking economy news. The Fed's very own economic statistic measuring factory output around the country for over a century. January industrial production fell again by 0.3% this month to start the year after the 0.4% drop in December. Look no further for reasons for the decline than the warmer than seasonal temperatures and a "major manufacturer significantly slowed production of civilian aircraft." Frankly it could have been worse given the warning from Treasury Secretary Mnuchin that the administration's 3.0% growth forecast for 2020 could see a hit by as much as 0.5 percentage point due to Boeing. Can we just call the major civilian aircraft company Boeing? Manufacturing production fell 0.1% in January, but would have been up 0.3% if we exclude aircraft production.

			Industrial Production		
Percent changes			January 2020		
Nov	Dec	Jan	YOY		Weight
0.9	-0.4	-0.3	-0.8	Total Index	100.0
1.0	0.1	-0.1	-0.8	Manufacturing	75.4
-0.5	1.5	1.2	3.1	Mining	14.3
2.1	-6.2	-4.0	-6.2	Utilities	10.4
			Manufacturing payroll jobs 12.9 million -12K YOY 9.9% of Private Payroll Jobs		

Net, net, factory output cooled with the warmer than seasonal temperatures for a second month and the Boeing production slowdown of the 737 Max weighing down output even further. The good news is that the weather and hopefully the civilian aircraft production schedules are just temporary in nature which means the manufacturing recession is looking less like a recession as the purchasing managers said in a January report. Stay tuned. Story developing. Our best guess is that the factory production slowdown for much of 2019 is not worsening and that growth of industrial output will pick back up again as we head into spring.



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.

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by MUFG Bank, Ltd. (collectively with its various offices and affiliates, "MUFG Bank") or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG Bank. MUFG Bank hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. While MUFG Bank believes that any relevant factual statements herein and any assumptions on which information herein are based, are in each case accurate, MUFG Bank makes no representation or warranty regarding such accuracy and shall not be responsible for any inaccuracy in such statements or assumptions. Note that MUFG Bank may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and MUFG Bank is under no obligation to ensure that such other reports are brought to your attention.

Copyright 2020 MUFG All Rights Reserved

The articles and opinions in this publication are for general information only, are subject to change, and are not intended to provide specific investment, legal, tax or other advice or recommendations. The information contained herein reflects the thoughts and opinions of the noted authors only, and such information does not necessarily reflect the thoughts and opinions of MUFG or its management team. We are not offering or soliciting any transaction based on this information. We suggest that you consult your attorney, accountant or tax or financial advisor with regard to your situation. Although information has been obtained from sources we believe to be reliable, neither the authors nor MUFG vouch for its accuracy, and such information may be incomplete or condensed. Neither the authors nor MUFG shall be liable for any typographical errors or incorrect data obtained from reliable sources or factual information.

About Mitsubishi UFJ Financial Group, Inc.'s U.S. Operations including MUFG Americas Holdings Corporation

The U.S. operations of Mitsubishi UFJ Financial Group, Inc. (MUFG), one of the world's leading financial groups, has total assets of $339.7 billion at March 31, 2019. As part of that total, MUFG Americas Holdings Corporation (MUAH), a bank holding company and intermediate holding company, has total assets of $170.7 billion at March 31, 2019. MUAH's main subsidiaries are MUFG Union Bank, N.A. and MUFG Securities Americas Inc. MUFG Union Bank, N.A. provides a wide range of financial services to consumers, small businesses, middle-market companies, and major corporations. As of March 31, 2019, MUFG Union Bank, N.A. operated 351 branches, consisting primarily of retail banking branches in the West Coast states, along with commercial branches in Texas, Illinois, New York and Georgia, as well as 22 PurePoint® Financial Centers. 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. MUAH is owned by MUFG Bank, Ltd. and Mitsubishi UFJ Financial Group, Inc. MUFG Bank, Ltd., a wholly owned subsidiary of Mitsubishi UFJ Financial Group, Inc., has offices in Argentina, Brazil, Chile, Colombia, Peru and Canada as well as branches, agencies and representative offices in the U.S. Visit https://www.unionbank.com/ or https://www.mufgamericas.com/ for more information.

About MUFG

Mitsubishi UFJ Financial Group, Inc. (MUFG) is one of the world's leading financial groups. Headquartered in Tokyo and with over 360 years of history, MUFG has a global network with over 3,000 locations in more than 50 countries. The Group has over 180,000 employees and offers services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group aims to "be the world's most trusted financial group" through close collaboration among our operating companies and flexibly respond 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 stock exchanges. For more information, visit https://www.mufg.jp/english.