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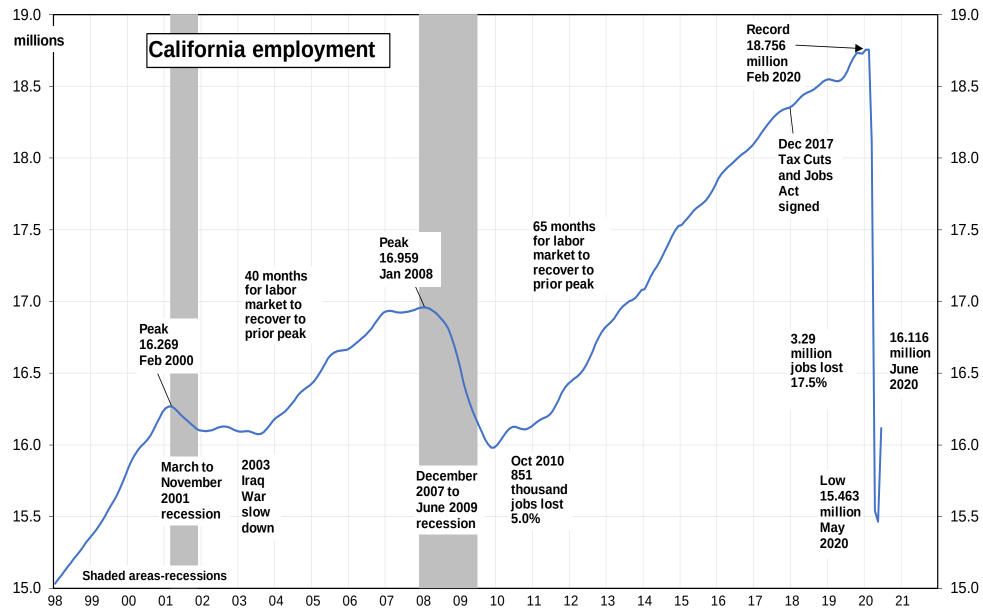
24 JULY 2020

CALIFORNIA ECONOMY: BIGGEST STATE IN THE UNION

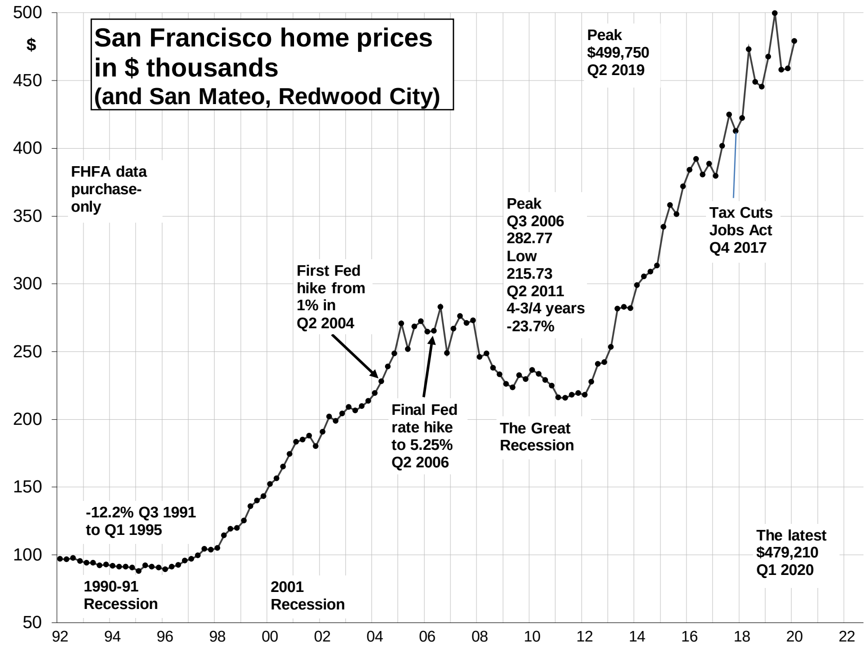


The economy runs a little hotter out on the West Coast. More inflation, more jobs, higher home prices. It is the biggest state in the Union so we thought we would take a look at a few economic indicators in the Golden State. Is it leading or lagging the rest of the country? This is the quickest recession in history, appearing almost out of nowhere, so hopefully it won't be true what happened in the last two recessions with the very gradual labor market recoveries that took years. After the 2001 recession it was 40 months before California jobs to returned to the prior peak. After the 2007-09 recession it took 65 months for California jobs to return to the prior peak. At the peak of the jobs market in February this year, the best economy in 50 years, California payroll employment was 18.756 million which is 12.3% of the total payroll jobs nationwide of 152.463 million. We don't know about February, but at this writing the U.S. population is 330.013 million which means less than half were working in the best economy of 50 years.

California Labor Market Trends

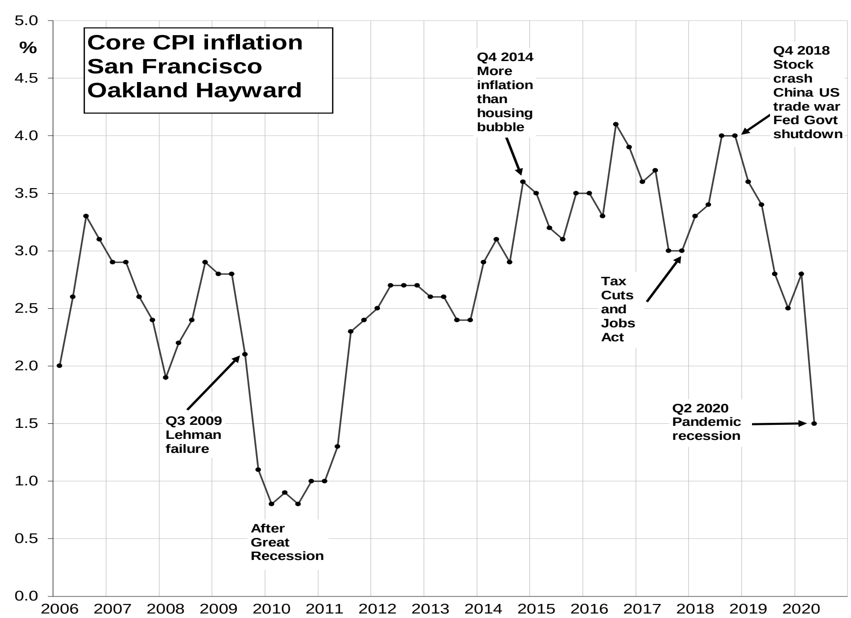
Thousands	Feb 2020	June 2020	Change	% Chg
Employment	18,756	16,117	-2,639	-14.1
Unemployed	759	2,831	2,072	--
Rate	3.9	14.9	11.0	
Payroll employment	17,604	15,671	-1,933	-11.0
Mining/Logging	22.7	22.3	--	--
Construction	896.9	848.9	-48.0	-5.4
Manufacturing	1,315.7	1,217.9	-97.8	-7.4
Trade/Trans/Utilities	3,063.9	2,780.4	-283.5	-9.3
Information	588.2	512.3	-75.9	-12.9
Financial activities	851.7	831.3	-20.4	-2.4
Professional/Business	2,743.2	2,534.9	-208.3	-7.6
Education/Health	2,853.8	2,653.8	-200.0	-7.0
Leisure/Hospitality	2,055.3	1,423.1	-632.2	-30.8
Other services	581.3	441.2	-140.1	-24.1

California employment fell 17.5% at the worst point a month ago in May and now in June, the job losses are 14.1%. Nonfarm payroll employment counted by company surveys fell 11.0% from February through June. Leisure and Hospitality jobs fell by 30.8% or 632 thousand workers on the same basis. Professional and business employment fell by 208 thousand or 7.6% and Trade, Transportation, Utilities lost 283 thousand jobs which we suspect was in large part due to the retail sector. So-called Information jobs that California is famous for was pretty hard hit falling 12.9% which is 75 thousand workers: publishing, motion pictures, broadcasting, data processing, hosting services etc.



California is also famous for being at the epicenter of the subprime housing crisis in the last recession. Fed Chairman Bernanke famously said that the recession originated with the housing bubble blow up and indeed California jobs growth slowed in 2007 before the U.S. recession where the unemployment rate was already rising in the state.

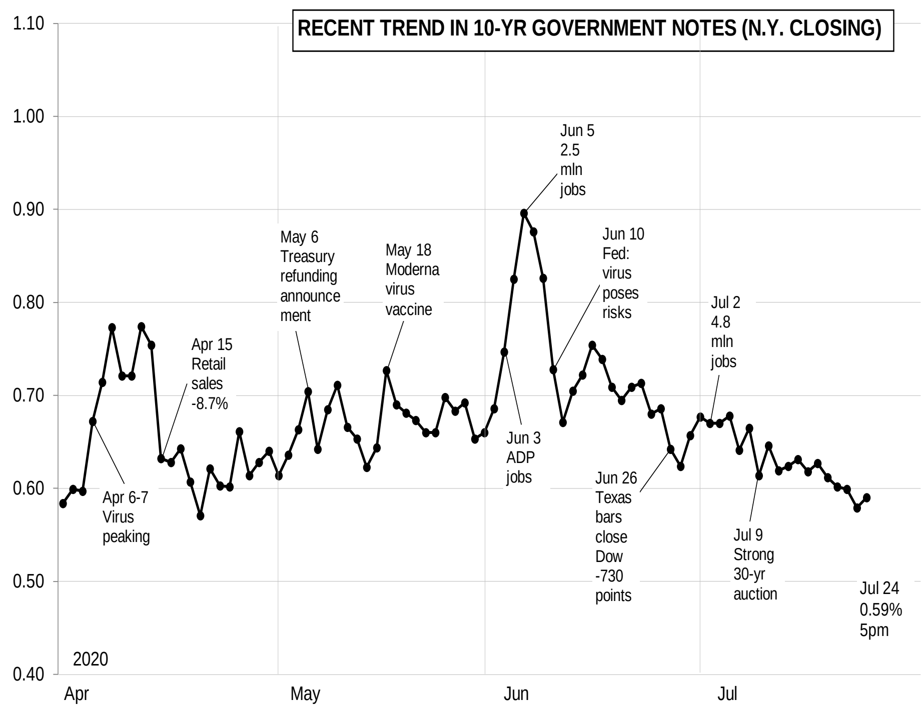
Housing is an important sector of the economy even if there are just 795 thousand residential housing construction jobs as part of the overall economy in the U.S. How are home prices doing currently way out West in California? Maybe it is unfair, but we chose one of the hottest real estate markets in the state and nation, San Francisco, to graph here. The Tax Cuts and Jobs Act signed in December 2017 put a $10,000 cap on the federal tax deduction for property taxes. The interest deduction on mortgages was reduced to loans of $750,000 from $1 million. This legislation slowed the advance of home prices in San Francisco somewhat in 2018 and 2019. Finally, inflation pressures have come down and core CPI inflation in the San Francisco area has fallen to 1.5% in the second quarter. Inflation had been faster at 4% before this recession which was faster than the housing bubble economy in the mid-2000s somehow. For the moment, California is weathering the pandemic recession before the second wave.



MARKETS OUTLOOK

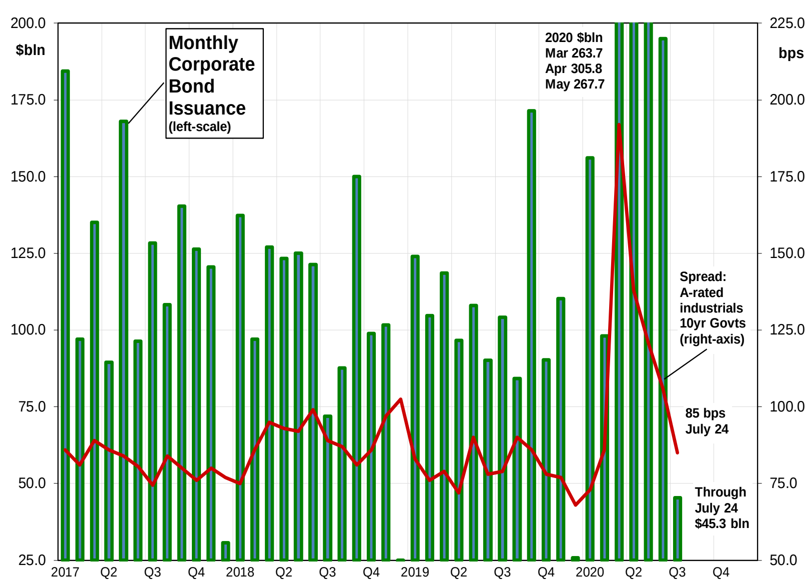
	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
30-Yr Treasury	2.53	2.11	2.39	1.32	1.41	1.40	1.40	1.50	1.60	1.70
10-Yr Note	2.01	1.67	1.92	0.67	0.66	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.77	1.55	1.69	0.38	0.29	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.76	1.62	1.57	0.25	0.15	0.20	0.20	0.20	0.30	0.30
3-month Libor	2.32	2.09	1.90	1.45	0.30	0.30	0.30	0.20	0.20	0.20
Fed Funds Rate	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	25	5	35	42	51	50	50	60	60	70

10-yr year yields closed at 0.59% this week versus 0.63% last week. Bond yields drifted lower starting Tuesday at the New York open. Yields almost reached 0.55% early Friday morning before rebounding to close at 0.59%. The low close was Thursday as a sell-off in tech shares sent the broader indexes lower. There is major news next week at least on the surface, but the market is trading like the summer holidays are in full swing. The Fed meeting press conference with Powell is 230pm ET next Wednesday afternoon. First look at real GDP in the second quarter is Thursday, July 30 at 830am ET, but whether the hole is down 30 or 40 percent seems beside the point now. If the economy falls 30% it may rise 30% in Q3 judging just from the V-shaped recovery in retail sales through June before the second wave.



CORPORATES: MOSTLY BANK OF AMERICA, TOYOTA MOTOR, FLIR SYSTEMS

Corporate bond offerings were $7.0 billion in the July 24 week versus $12.9 billion in the July 17 week. On Wednesday, Lennox International sold $600 million 5s/7s. It priced a $300 million 1.7% 7-yr (m-w +20bp) at 130 bps (Baa3/BBB). The climate control solutions company will use the proceeds to repay its domestic credit facility and for general corporate purposes including share repurchases. Corporate bond yields (10-yr Industrials rated A2) were 85 bps above 10-yr Treasuries Friday versus 89 bps last week.



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FEDERAL RESERVE POLICY

The Fed meets July 28-29, 2020 to consider its monetary policy. You've been asking about it and here it is. Can't wait to discuss. The 3-month Libor replacement which is based on actual market transactions rather than the averaged (made-up) postings from a disinterested panel of banks. It certainly looks like SOFR (secured overnight financing rate from the parallel universe of the Treasury repo market) is better than Libor. Those observable market transactions still aren't enough to push the SOFR rate around much day to day. Borrowers will like it because somehow it is lower than the 3-month Libor yield and every little bit helps when it is your job to reduce interest costs. (Wish we could switch the reference rate on our home's adjustable rate mortgage to SOFR… without a spread.) New York Fed President John Williams and Bank of England Governor Andrew Bailey gave a joint presentation on Libor's coming demise at the end of 2021. The looming deadline for change was 537 days away when they did the webinar on July 13. SOFR is just an overnight rate unlike the 3-month term of Libor. FNMA and Freddie Mac SOFR-linked securities are using the 30-day average SOFR rate produced by the NY Fed and graphed here. The two men said there is still a lot of work to do in the remaining 537 days before the transition. There would be more work and any mistakes would be potentially more expensive to fix if there was any chance that there was ever going to be a "floating rate" again. The Fed left rates at zero for seven years in the last recession, and who knows how long they will let them sit down there this time before floating back to life again.

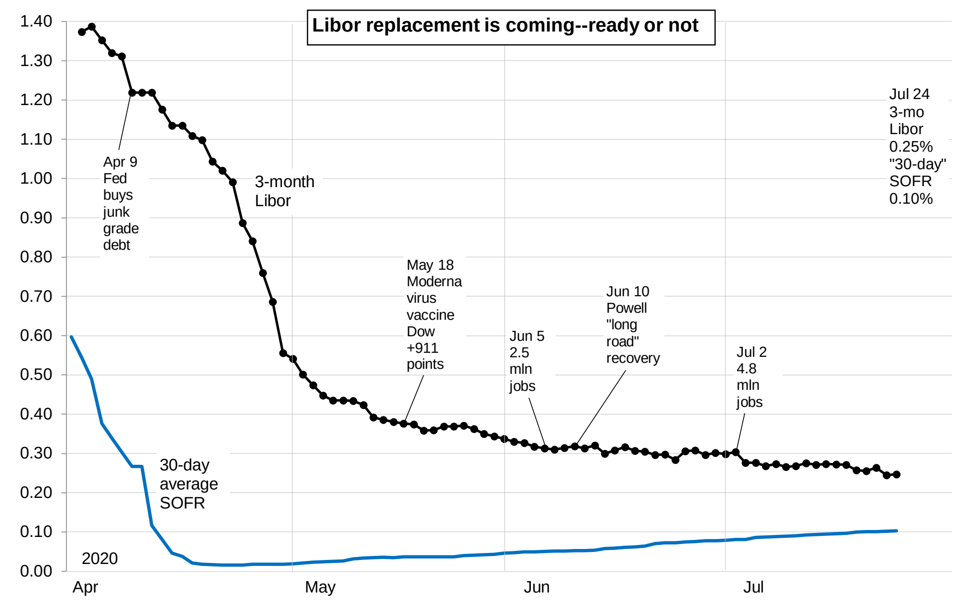
Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	22-Jul	15-Jul	8-Jul	1-Jul	pre-LEH
Factors adding reserves					
U.S. Treasury securities	4265.878	4253.229	4231.355	4213.220	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1970.600	1948.388	1911.401	1911.381	0.000
Repurchase agreements	0.000	0.000	0.000	61.201	126.750
Primary credit (Discount Window)	4.578	5.058	4.846	5.860	23.455
MMLF	17.541	18.635	18.927	20.637	
PDCF	1.899	1.699	1.874	2.486	
Commerical Paper Funding Facility	10.105	10.659	12.802	12.799	
Paycheck Protection Facility	68.503	67.989	67.685	68.133	
Corporate Credit Facility (CCF)	44.046	43.423	42.644	41.940	
Municipal Liquidity Facility	16.085	16.084	16.082	16.081	
Main Street Lending Program	37.518	37.515	37.503	37.502	
Term Asset-Backed Facility (TALF II)	9.439	9.439	8.753	8.753	
Central bank liquidity swaps	121.992	154.850	179.095	225.414	62.000
Federal Reserve Assets	7013.4	7007.2	6969.4	7057.2	961.7
3-month Libor %	0.26	0.27	0.27	0.30	2.82
Factors draining reserves					
Currency in circulation	1985.894	1981.644	1977.346	1971.855	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	114.000	114.000	114.000	114.000	
Reverse repurchases w/others	0.000	0.001	0.001	0.002	0.000
Reserve Balances (Net Liquidity)	2659.658	2732.649	2813.296	2863.196	24.964
Treasuries within 15 days	74.899	58.895	66.114	64.471	14.955
Treasuries 16 to 90 days	259.225	279.380	270.043	250.820	31.549
Treasuries 91 days to 1 year	637.534	633.384	618.085	635.460	69.272
Treasuries over 1-yr to 5 years	1607.135	1604.839	1607.239	1597.928	170.807
Treasuries over 5-yrs to 10 years	745.867	738.129	735.426	732.150	91.863
Treasuries over 10-years	941.219	938.604	934.448	932.391	101.337

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

MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds

PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days

CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

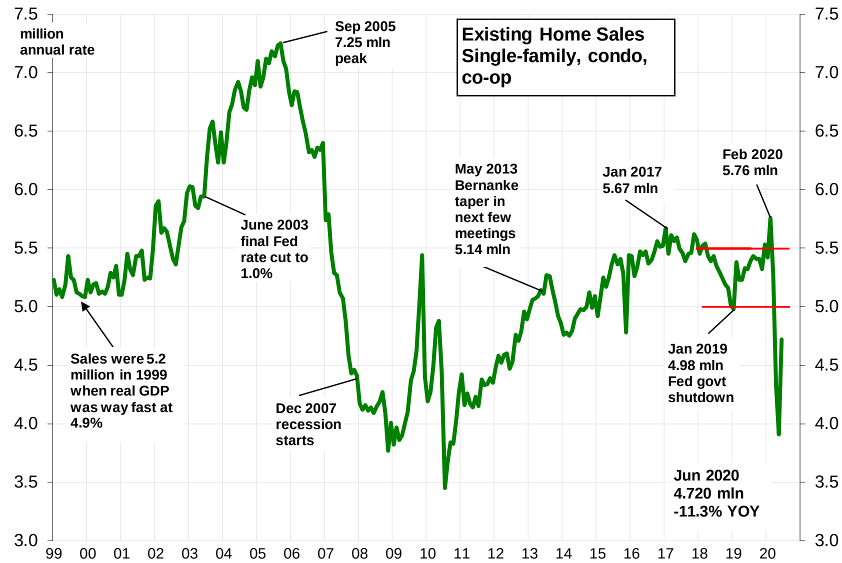


	U.S. Treasury New Cash Needs and Fed Treasury Purchases (QE)									
	Monthly Changes ($ billions)									
	Fiscal Year (FY) Ending September 2020									Total
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	FY 2020
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	138.093	87.892	68.474	2,158.2
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	699.2	685.2	102.2	3,662.4
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	628.2	449.7	-0.7	2,702.0
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	71.0	235.5	102.9	960.2
Federal Reserve's 11 Lending Facilities (month-end outstanding)					0	58.352	94.641	136.343	204.607	205.136	
Central bank liquidity swaps (month-end outstanding)					0.044	206.051	438.953	448.946	274.963	121.992	

OTHER ECONOMIC NEWS THIS WEEK

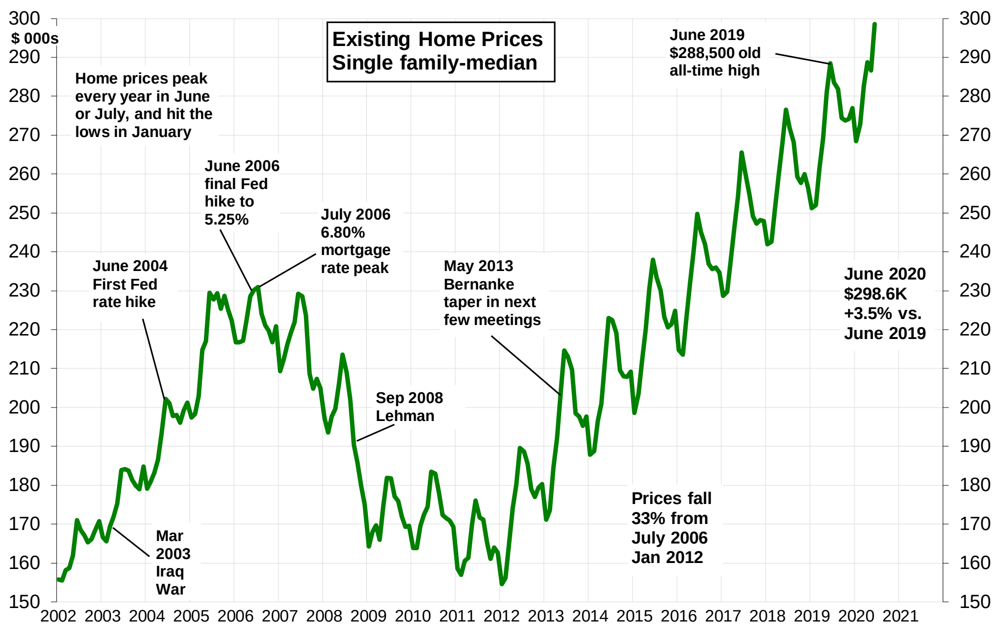
Existing home sales rebound with home prices setting a new record (Wednesday)

Breaking economy news. Existing home sales jump 20.7% in June to 4.72 million at an annual rate; sales are off the rock bottom lows for the recession in May of 3.91 million. Sales in the Northeast and Midwest lagged with gains of 4.3% and 11.1%, respectively. Sales in the larger housing markets in the South and West came back with a bang in June with gains of 26.0% and 31.9%, respectively, but for how long is the question with the spread of the coronavirus pandemic worsening in these regions during the month July.



Unlike the housing bubble recession over a decade ago, existing home prices continue to rise despite the sharp economic downturn and record, double-digit unemployment. Existing home prices jumped 4.2% in June to $298.6 thousand and are 3.5% higher than June 2019.

Net, net, existing home sales surged after the lockdowns were lifted in June on pent-up demand and better weather during the strongest selling season of the year. But the clouds on the horizon continue to darken and home buyers cannot count on the worst recession since the Great Depression being over yet with the second wave of the coronavirus pandemic still spreading into other states down in the South and out West and the unprecedented stimulus this recession from the $600 weekly checks to jobless workers on the chopping block and scheduled to end this month.



Government programs from the paycheck protection plan as well as the $600 weekly unemployment checks may be disguising the hurt the economy is feeling. Actual job losses may be much higher and more permanent, and actual spending may fall back sharply once the government support for businesses and checks to the unemployed stop coming.

All is not well for the economic outlook if 1.4 million are sacked this week (Thursday)

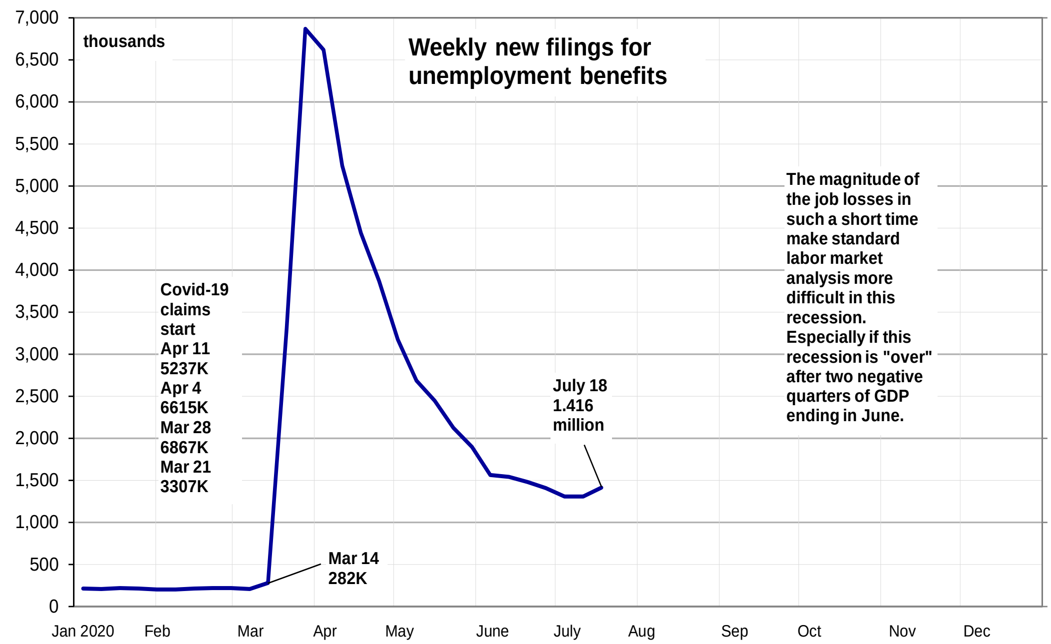
Breaking economy news. First-time jobless claims were 1.416 million in the July 18 week. The data may look good as they are not getting much worse. But looks can be deceiving as the number of layoffs is still greater than any single week during the Great Recession over a decade ago. Back in March 2009, there were 665 thousand who filed one week for benefits because they had been made redundant by cost-cutting companies and businesses.

Don't look at the flow, look at the pool for the weekly unemployment claims if you want to know the true story. There were 1.416 million new applications this week, but a staggering 31.8 million receiving jobless benefits in the latest data covering the July 4 week. There's plenty of job seekers in the pool and it is just slightly lower than 32.0 million a week earlier.

Net, net, today's sky-high jobless claims are evidence that there is no gradual and uneven recovery for the labor market. Washington policymakers looking for signs that additional stimulus is necessary can judge for themselves with the millions and millions of jobless workers getting unemployment benefits. The economy cannot carry on for long if it has to drag almost 32 million unemployed workers with it.

Something remains terribly wrong with the economic statistics coming out of Washington where 22 million nonfarm payroll jobs disappeared in March and April, and even with 7.5 million gained back in May and June, there are still 15 million without work. That's one labor market story we can tell about a partial recovery but it doesn't jibe with the almost 32 million receiving jobless benefits.

It's a good thing that the stock market is back up on the year and looking for a better tomorrow for the sales and earnings of U.S. companies because the picture provided by the jobless claims data remains one of an approaching economic apocalypse worse than any other time in history except perhaps the Great Depression.



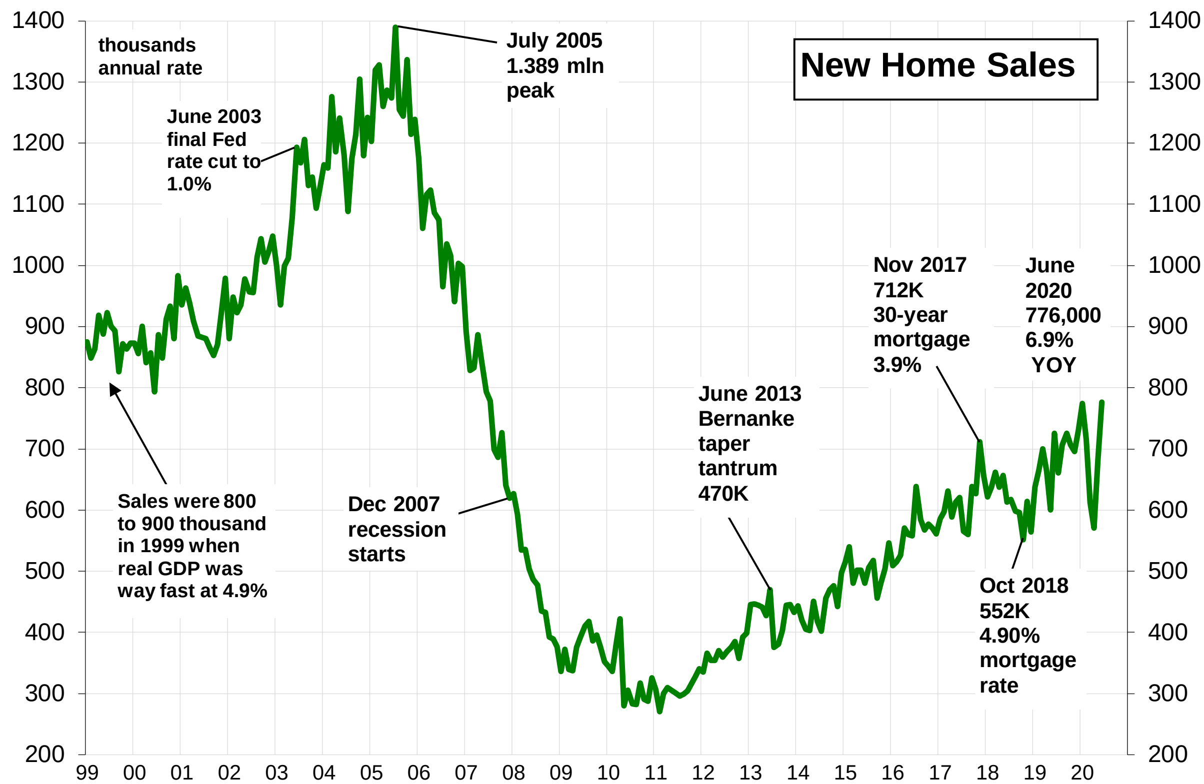
The fact that many companies are beating their earnings estimates based on cost cuts and job layoffs seems beside the point for many investors buying stocks today. All we know is that demand in the economy can't return to the best economy in 50 years if the country can't find work for the nearly 32 million jobless Americans on the public dole receiving benefits. Bet on it.

Another V-shaped economic indicator that won't last: new home sales (Friday)

Breaking economy news. First it was retail sales looking like the V-shaped recovery no one was expecting for the economy and now today it is new home sales. New home sales jumped 13.8% in June to a 776 thousand annual rate. New home sales, powered by the delayed purchases of locked down home buyers, are now the highest since the housing bubble burst over a decade ago. The old record was 774 thousand in January this year which took place even before mortgage yields plummeted when the Fed hit the panic button and dropped rates 150 bps in March.

Home sales were especially strong in the Northeast which is the region that had been locked down the earliest as the coronavirus pandemic spread out of control. New home prices have rebounded which is good for consumer confidence. The median sales price was $329,200 in June which is a return to where it was in the first three months of this year. These new home prices had dropped to $307,100 in April and $310,200 in May at the height of the pandemic shutdown of the economy.

Net, net, the country opened back up in June and pent-up demand helped to send new home sales soaring in the strongest selling season of the year when new home prices hit their highs. This is great news today for the economy, but we do not expect the sales to last as the pent-up demand gets satisfied, the economy takes a hit from the second wave of the coronavirus pandemic in the states down in the South and the West, and the fiscal stimulus spending from Washington looks less likely at the moment as there are too many views on just what the economy needs next. The South is the biggest market with 434 thousand of sales in June which is 55.9% of the 776 thousand sales nationwide. Today's report on new home sales counts as good news, but we don't expect it to last. There's always a recession and doom and gloom in some sector of the economy. Bet on it.



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