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

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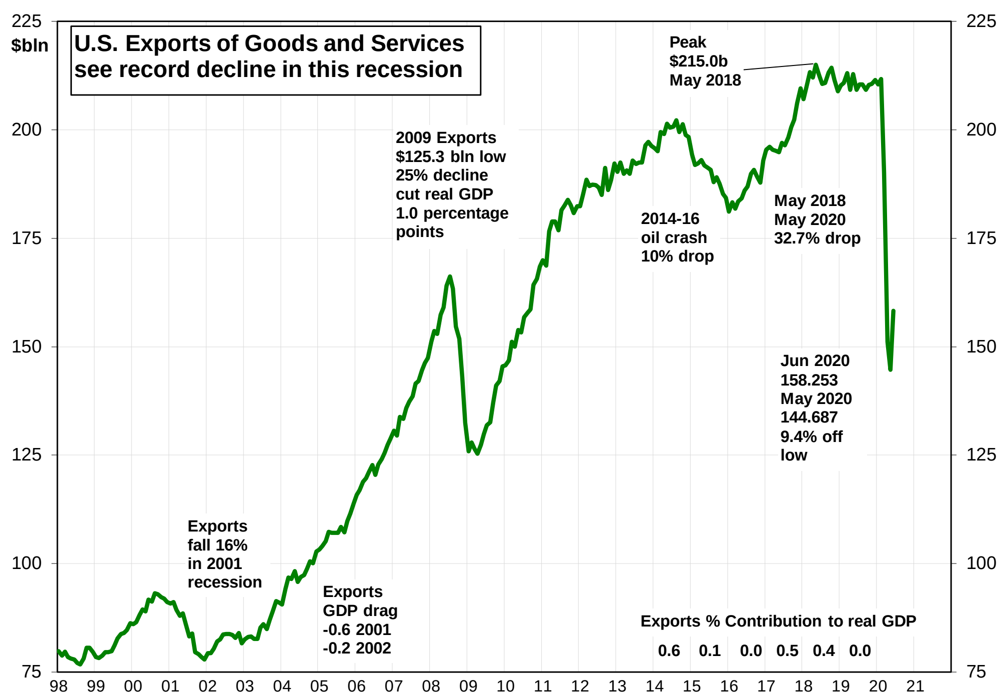
DEMAND RETURNS TO THE ECONOMY, WHAT ABOUT AMERICA'S TRADE WITH THE WORLD?

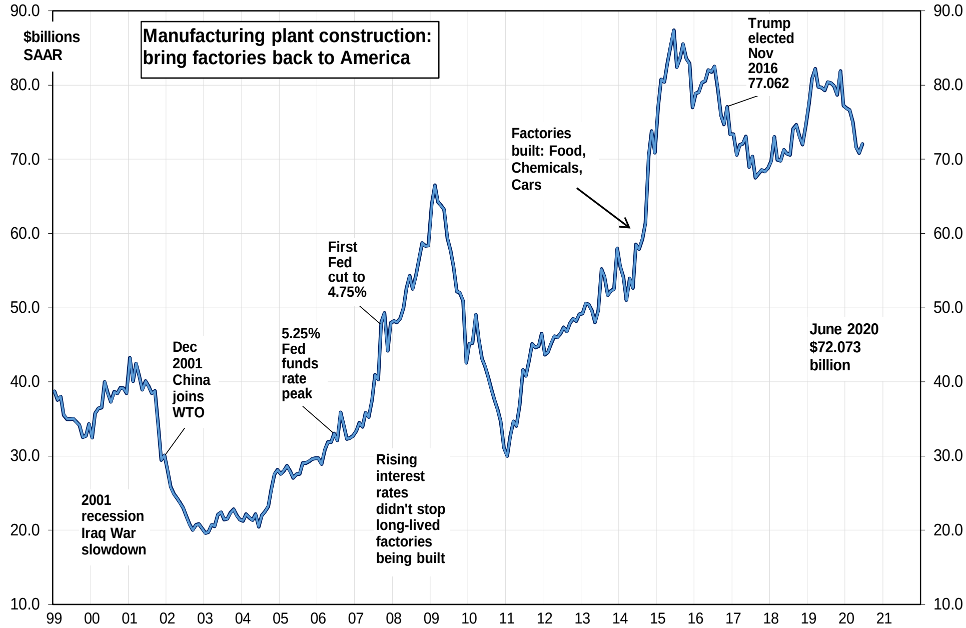


The economy's recovery from recession is looking V-shaped for some indicators like retail sales, residential housing construction, and existing home sales. America's trade balance is harder to read, but the exports side is important for economic growth and manufacturing production and factory jobs. Much of America's factory output of goods is exported. President Trump shifted his focus back to the trade war this week. The one where he says the country has been ripped off by its trading partners for years. Trump said in a speech in Minnesota on Monday that "we will create tax credits for companies that bring jobs from China back to America, and we'll impose tariffs on companies that leave America to produce jobs overseas." What about companies who shifted jobs offshore years ago and won't move them back?

Exports have experienced four major declines over the last two decades. Exports fell 16% in the 2001 recession and dragged growth down by 0.6 percentage point that year. Exports tumbled 25% in the Great Recession and dragged GDP growth down by one percentage point. Exports dropped 10% during the 2014-16 oil crash slowdown and exports added nothing to growth in 2016.

Exports peaked in May 2018 during the escalation of America's trade war with China before tumbling during the pandemic as much 32.7% before rebounding from the May 2020 low point. Exports mirror the sideways trend and then sharp drop in the manufacturing sector as shown in the Fed's industrial production series which illustrates the close relationship between manufacturing and exports.

Purchasing managers at U.S. manufacturing firms are saying the exports picture is improving which would be remarkable if true given the latest IMF forecasts in June for the growth of America's ten largest trading partners around the world. For 2020, Canada down 8.4%, Mexico down 10.5%, and Germany's GDP falls 7.8%, to take just a few. Only China is up… 1.0%.



Bringing the jobs back from overseas is easier said than done. Trade is down worldwide, but the table here shows how factory jobs may leave China, but many simply go to other low cost producers. In the first six months this year versus the first half of 2019, U.S. imports of goods from China are down while Vietnam imports are up 8.5%, Taiwan imports up 6.4%, Malaysia imports have increased 8.0%, Thailand imports rose 10.2% and newcomer Indonesia's imports are up 1.0%. The flows are not one-to-one as the five countries where imports rose total $7.5 billion against the 17.1% decline in U.S. imports from China which totals $37.5 billion.

America isn't building significantly more factories yet. Manufacturing plant construction was $77.062 billion (annual rate) when Trump was elected in November 2016 and it is $72.073 billion today. The last major surge in manufacturing facilities built was around 2015 which was mostly chemicals, cars, and some food factories.

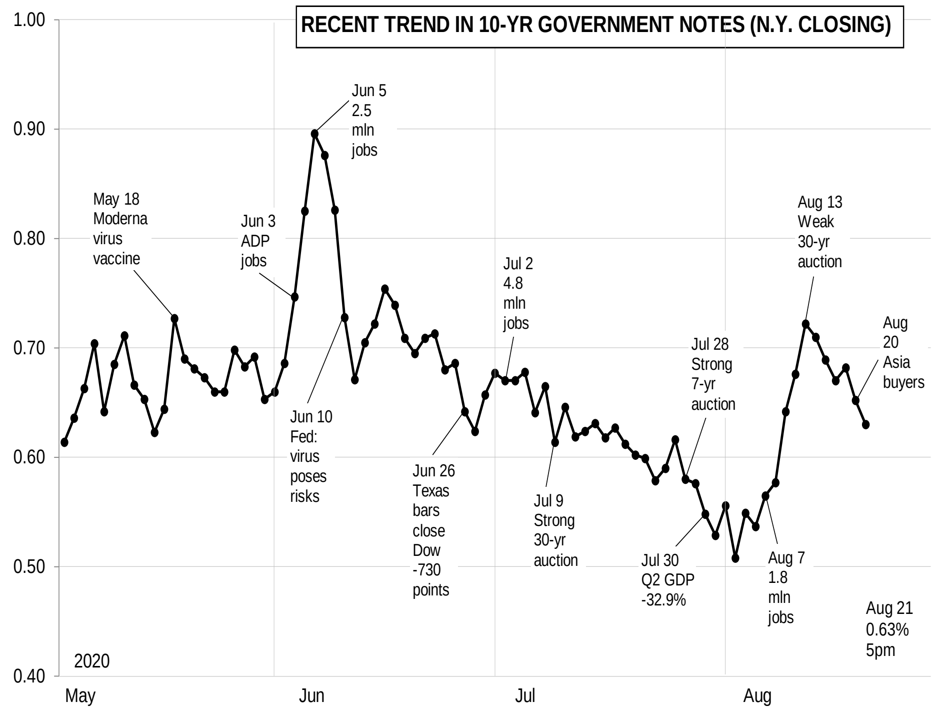
U.S. Ten Biggest Export Trade Partners 2020 Jan-June
687.1 Grand Total ($billion)
119.0 Canada
99.0 Mexico
49.5 China
33.2 Japan
29.7 United Kingdom
27.6 Germany
26.3 South Korea
22.8 Netherlands
15.2 Taiwan
14.8 France

Factories Leave China and Go Somewhere Else

US Imports $bln	2019-20 % Chg	2020 Jan-June	2019 Jan-June	Full Year 2019	Full Year 2018
China	-17.1	181.207	218.668	451.651	539.243
Japan	-21.9	56.961	72.887	143.565	142.241
South Korea	-6.6	36.595	39.183	77.470	74.244
Vietnam	8.5	33.027	30.441	66.629	49.158
Taiwan	6.4	27.671	25.995	54.253	45.732
Malaysia	8.0	19.933	18.450	40.566	39.353
Thailand	10.2	17.585	15.953	33.447	31.862
Indonesia	1.0	10.030	9.929	20.147	20.828

MARKETS OUTLOOK

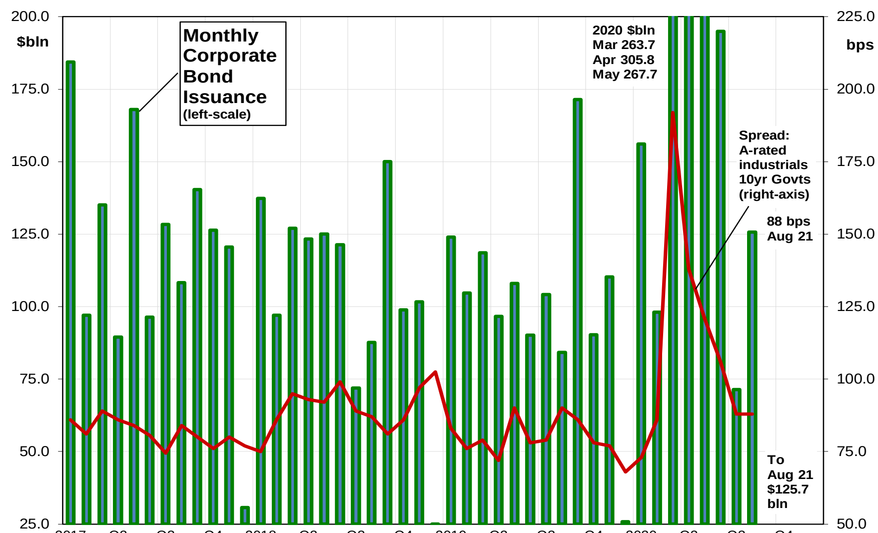
	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
30-Yr Treasury	2.53	2.11	2.39	1.32	1.41	1.40	1.40	1.50	1.60	1.70
10-Yr Note	2.01	1.67	1.92	0.67	0.66	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.77	1.55	1.69	0.38	0.29	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.76	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



Another month another failed yield rally. The stock market is clearly in a bubble, home prices not far behind, but the Fed is AWOL and won't raise interest rates with double-digit unemployment. What a dilemma. 10-yr year yields closed at 0.63% this week versus 0.71% last week. Yields dropped from 0.68% to 0.65% on Thursday and then fell another 2 basis points Friday. Of course, bond yields were higher at 0.68% on Thursday after stocks and bonds sold off on Wednesday as the Fed meeting minutes were not dovish enough with no sign that more easing is coming. Bond yields came back down early Thursday in the Asia session and were already 0.64% before the jump in unemployment claims at 830am ET.

CORPORATES: INTERCONTINENTAL EXCHANGE, ROPER TECH, GM, DOW

Corporate bond offerings were $33.9 billion in the August 21 week versus $51.5 billion in the August 14 week. On Thursday, Johnson & Johnson sold $7.5 billion 5s/7s/10s/20s/30s/40s. It priced a $1.75 billion 1.3% 10-yr (m-w +10bp) at 65 bps (Aaa/AAA). The company will use the proceeds for its acquisition of Momenta Pharmaceuticals. Corporate bond yields (10-yr Industrials rated A2) were 88 bps above 10-yr Treasuries Friday versus 84 bps last week.



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	19-Aug	12-Aug	5-Aug	29-Jul	pre-LEH
Factors adding reserves					
U.S. Treasury securities	4345.544	4320.093	4305.651	4293.563	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1977.897	1933.548	1933.466	1933.380	0.000
Repurchase agreements	0.000	0.000	0.000	0.000	126.750
Primary credit (Discount Window)	2.818	2.690	2.809	3.611	23.455
MMLF	10.839	11.484	12.253	14.273	
PDCF	0.693	0.693	1.163	1.788	
Commerical Paper Funding Facility	8.588	8.603	8.646	8.900	
Paycheck Protection Facility	67.800	68.177	67.820	70.816	
Corporate Credit Facility (CCF)	44.480	44.413	44.351	44.210	
Municipal Liquidity Facility	16.089	16.088	16.087	16.086	
Main Street Lending Program	37.983	37.734	37.601	37.588	
Term Asset-Backed Facility (TALF II)	10.771	10.124	10.123	9.439	
Central bank liquidity swaps	95.780	99.782	105.663	117.473	62.000
Federal Reserve Assets	7059.3	7005.9	6993.9	6997.0	961.7
3-month Libor %	0.25	0.26	0.24	0.26	2.82
Factors draining reserves					
Currency in circulation	2009.715	2006.288	2000.875	1992.869	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	0.112	0.103	0.000	0.001	0.000
Reserve Balances (Net Liquidity)	2821.849	2828.170	2753.531	2685.376	24.964
Treasuries within 15 days	62.806	116.715	119.829	75.015	14.955
Treasuries 16 to 90 days	237.795	222.451	208.908	256.470	31.549
Treasuries 91 days to 1 year	664.486	632.529	642.929	644.020	69.272
Treasuries over 1-yr to 5 years	1647.558	1642.529	1639.244	1627.218	170.807
Treasuries over 5-yrs to 10 years	762.621	754.625	745.463	746.156	91.863
Treasuries over 10-years	970.278	951.244	949.280	944.684	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)

The Fed meets September 15-16, 2020 to consider its monetary policy. If you want to look ahead, next week is the famous Jackson Hole Economic Policy Symposium with this year's theme of "Navigating the Decade Ahead: Implications for Monetary Policy." Powell will give remarks on "Monetary Policy Framework Review" at 910am ET on Thursday, August 27. If you want to focus on the past, you can look at the July 28-29 FOMC meeting minutes released on Wednesday this week at 2pm ET. According to financial news reports, the stock market apparently did look back at the past and did look at the Fed minutes, which is rare as stock investors are usually more focused on the future, looking ahead for the sharply higher corporate earnings that must surely lie right around the corner next year. Or maybe they are just interested in buying Microsoft, Alphabet, Amazon, Apple, and Facebook right now. The minutes should be less important now that the Fed Chair gives a one-hour press conference after each and every meeting. Sometimes there is some news in the minutes that affects the market however. The stock market didn't seem to like the FOMC minutes this week as it dropped right at 2pm on Wednesday.

As far as the contents of the minutes, there was a passage where Fed officials ruled out interest rate caps for now and perhaps this sent bond yields up all of 2-3 basis points higher to the 0.69% high of the day on Wednesday. It was odd that the minutes said, "a majority of participants commented on yield caps and targets," which makes one wonder if the others simply didn't care enough to comment. Anyway, it is common sense that in the current low yield environment, and with the Fed buying almost $1 trillion government securities a year, that a yield caps and target policy would only have a "modest benefit." They also discussed "the current stance of monetary policy and the circumstances under which they might increase monetary policy accommodation or clarify their intentions regarding policy." "Several participants" apparently wanted more accommodation right now. Not sure if that meant buying more than the current $80 billion per month of Treasuries.

U.S. Treasury New Cash Needs and Fed Treasury Purchases (QE)
Monthly Changes ($ billions)
Fiscal Year (FY) Ending September 2020

	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Total FY 2020
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	138.093	87.892	96.159	51.981	2,237.9
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	699.2	685.2	102.2	175.6	3,838.0
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	628.2	449.7	-0.7	-2.2	2,699.8
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	71.0	235.5	102.9	177.6	1,137.8
Federal Reserve's 11 Lending Facilities (month-end outstanding)					0	58.352	94.641	136.343	204.607	203.100	197.243	
Central bank liquidity swaps (month-end outstanding)					0.044	206.051	438.953	448.946	274.963	117.473	95.780	

OTHER ECONOMIC NEWS THIS WEEK

Housing construction says the economy is out of recession (Tuesday)

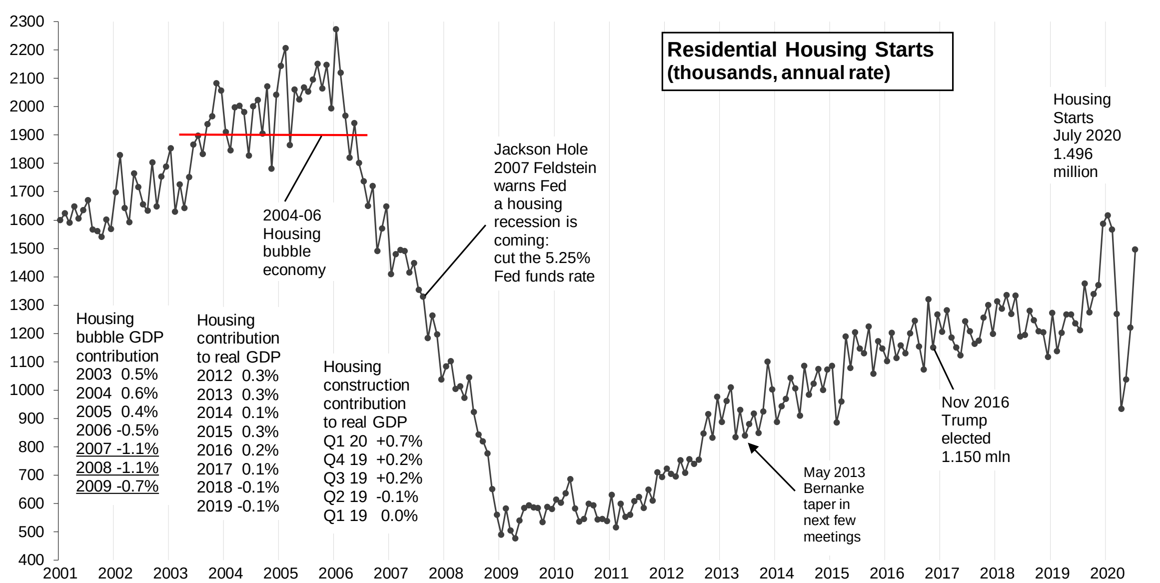
Breaking economy news. Housing starts jumped 22.6% in July to 1.496 million at an annual rate and are working hard on erasing the sharp drop seen during the pandemic recession where homebuilding reached the low of 934 thousand in April at the worst point during the first full month of the coronavirus lockdown of America. Rentals are booming as well as multi-family construction with 5 units or more units was up 56.7% to 547 thousand in July. Single-family construction rose 8.2% in July to 940 thousand at an annual rate. Today's residential housing construction data are telling us that the economy is out of recession.

Regionally, it looks like it is true that the pandemic stresses have many fleeing the cities for the suburbs. We don't know where they found the land, but home builders in the Northeast started on the construction of 74 thousand new single-family homes in July which is the highest construction activity in the last year not counting 76 thousand last month in June. Nowhere else in the country has seen such a pop in single-family home construction. Only the West however is seeing construction that is significantly short of where building was at the start of the year before the pandemic hit and this may reflect the second wave spread of the virus to many states in the region starting in mid-June and continuing well through July.

Housing Starts Total, Single-Family, Multi-Family

	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Jul 20	1496	940	547	157	74	201	132	830	528	308	206
Jun 20	1220	869	349	116	76	190	133	623	466	291	194
Jul 19	1212	875	326	96	60	174	124	624	470	318	221
% Chgs											
Jul/Jun	22.6	8.2	…	35.3	-2.6	5.8	-0.8	33.2	13.3	5.8	6.2
Jul/Jul	23.4	7.4	…	63.5	23.3	15.5	6.5	33.0	12.3	-3.1	-6.8

Net, net, one of the economy's most important leading indicators is telling us that not only is the pandemic recession over, the economic outlook is actually growing brighter by the day. New home construction is literally bursting at the seams and builder confidence is the highest in decades. Rock-bottom low mortgage rates are one of the key ingredients of this resurgence in residential housing construction showing that the Federal Reserve stimulus is working its magic on the interest rate sensitive areas of the economy. This recession is over. Bet on it. Homebuilders are.



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A million-plus join the unemployment rolls (Thursday)

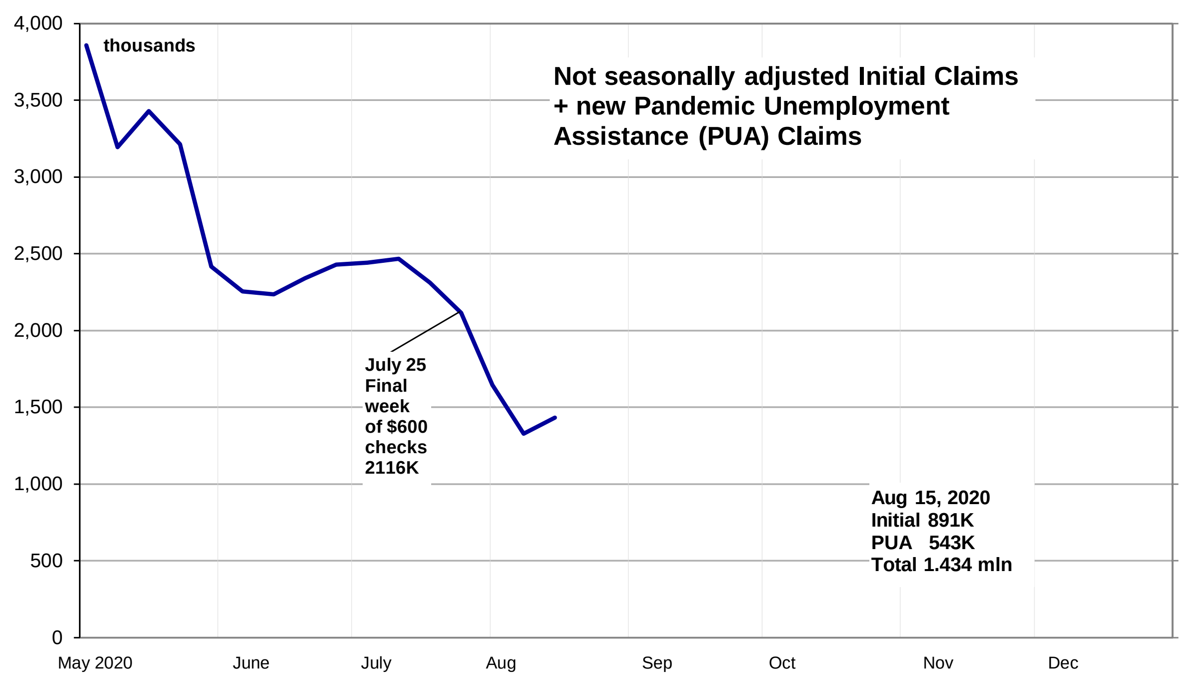
Breaking economy news. Initial unemployment claims jumped 135 thousand to 1.106 million in the August 15 week. It looks like the economy has experienced a dead cat bounce and now that the $600 weekly unemployment checks have gone away, growth has run into a wall and business conditions are stalling out once again. This economy doesn't have enough fuel to make it on its own without the support of the Federal government. We were hoping that this would be one of the shortest recessions in history at just a couple of quarters long. But today's elevated level of workers still being made redundant hints that the job losses may be spreading from low-wage service industry workers to white collar and professional workers. GDP growth may be 25 or 30 percent in the third quarter but it seems to have hit a wall in August which calls into question those forecasts looking for growth at all in the fourth quarter.

Net, net, new jobless filings are rising again which means the economy isn't out of the woods yet with many businesses across the country still in full or partial shutdown and unable to pay all their employees or make the mortgage rent and keep the lights on. The stock market rally on investor confidence that the worst of the recession is behind us may be premature.

Congress has pulled its support from jobless workers at the wrong time and cash registers aren't going to be ringing as loudly when store sales even at big box retailers are reported for August.

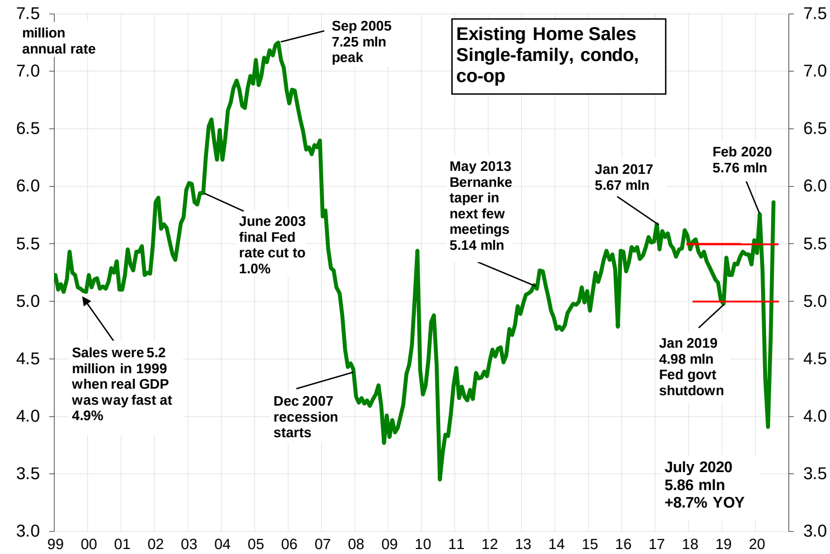
The president’s new plan for $300 weekly unemployment checks is getting off the ground very slowly with many states confused about the need to reprogram their computers when there is only a limited amount of diverted FEMA disaster funds to pay out to jobless workers.

Stay tuned. We can't even be sure this recovery is sustainable as the economy got a huge boost from consumers' wallets lined with $500 billion of stimulus from Washington from those $1,200 and $600 checks. That money is gone and with it the prospects for a lasting economic recovery where everyone on Main Street benefits. At the moment, only stock market investors are riding high as the Federal Reserve's money printing benefits Wall Street more than Main Street.



Home prices soar as city dwellers flee for suburbs and mortgage rates tumble (Friday)

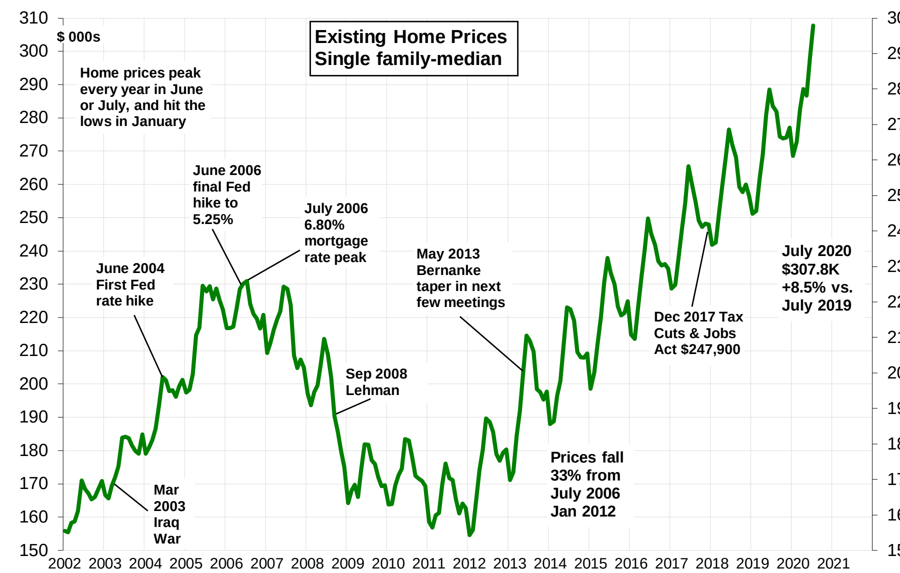
Breaking economy news. Blame it on pent-up demand from home buyers cooped up during the pandemic lockdown or maybe on the Federal Reserve's easy money policy creating wealth for many Americans by fueling a stock market bubble, but there is one heck of a gold rush going on in the housing markets right now. The biggest recession since the Great Depression was supposed to lead to a crash in the housing market, but instead it is creating a new housing bubble with existing home sales and prices soaring.



Existing home sales jumped 24.7 percent to 5.86 million in July which is a new record high since the last housing bubble peak in activity back in the mid-2000s. Single-family home prices jumped a second month in a row this summer with median prices nationwide of $307,800 and are 8.5 percent higher than last year. The rock-bottom lows in mortgage rates has set off a feeding frenzy among stay-at-home buyers who have been let out finally as the pandemic's spread has lessened.

Stay at home means you need to buy a home first and that's what thousands and thousands of home buyers are doing. It's not just shell-shocked city dwellers moving out of course as home prices are jumping nationwide. Out in the West single-family home prices are up 11.8% from a year ago, and on the same basis, homes in the South are up 9.9%, the Midwest is up 8.0%, and the Northeast is rising 3.8%. Better buy your new home today or you are going to be shut out of the market permanently is what the existing home sales and prices data are saying today.

Net, net, this doesn't look like any recession we have ever seen if you look at soaring home sales and prices. While delinquency rates on mortgages are jumping due the huge numbers of jobless workers without paychecks, other workers with jobs, plenty of cash, and record-low mortgage rates, are sending home prices soaring through the roof. The differences in income inequality and the range between the haves and the have nots in society have never been so great with wealthier Americans buying every house on the block with a for-sale sign out in front of it across the country while others losing their $600 unemployment checks are wondering where they are going to live tonight. Stay tuned. Story developing. A bubble in the stock market begets a bubble in the housing market. Bet on it.



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