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**MUFG Bank, Ltd.**
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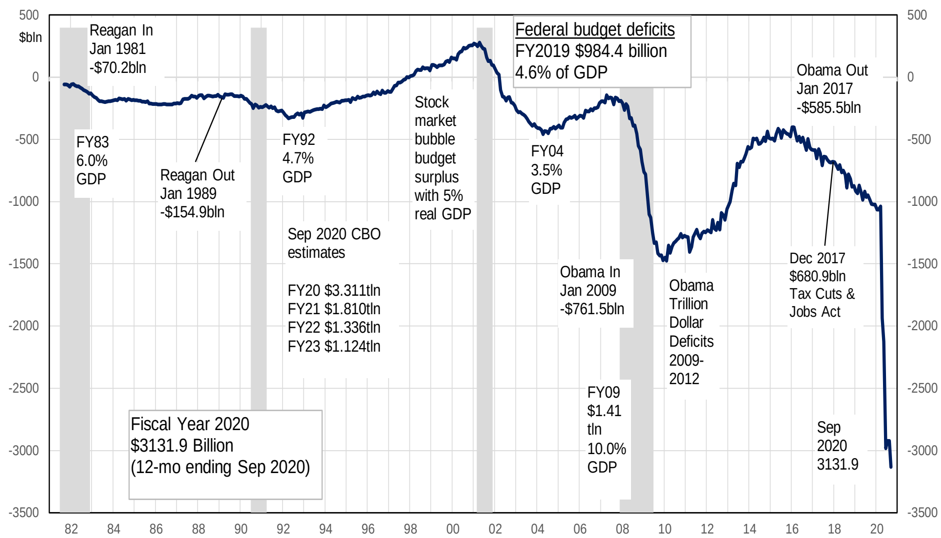
**23 OCTOBER 2020**

# FEDERAL DEFICIT $3.1 TRILLION IN FISCAL YEAR ENDING SEPTEMBER



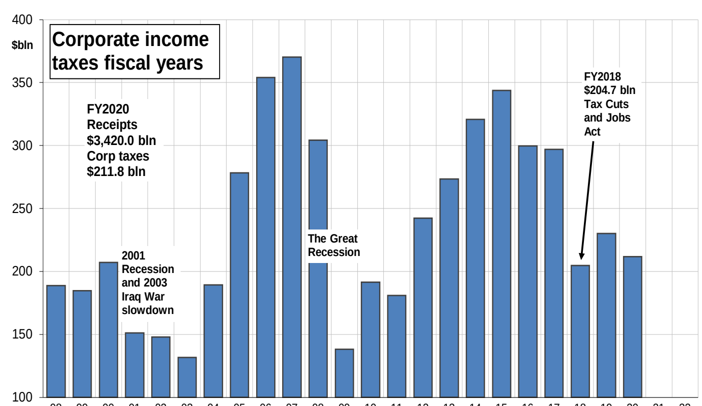

The Federal budget deficit clocked in at $3.1 trillion in the fiscal year (FY) ending September 2020. This breaks another Obama record which was the prior worst budget deficit of $1.4 trillion in FY2009. Assuming there is no blue wave coming that could bring about another $2 trillion in fiscal stimulus for FY2021, the budget deficit could be expected to drop back about $2 trillion to a little over $1 trillion in the new fiscal year ending September 2021. Leaving Federal government revenues aside for the moment, which did better than expected in this short and deep pandemic recession, Federal outlays rose $2.105 trillion or 47.3% to $6.551 trillion in FY2020. So much for Congress not liking government spending, although it was an emergency after the economy shut down for a time starting in mid-March as the pandemic hit consumers and businesses hard. Most of the $2.105 trillion increase in Federal outlays took place in the second half of the year.

| Federal Government: Where's the Money Coming From? | | | | | | |
|---|---|---|---|---|---|---|
| FY20/FY19 | | | | | | |
| % change | Fiscal Years $billons | Sep 2020 | Sep 2019 | Sep 2018 | Sep 2017 | Sep 2016 |
| -1.2 | Budget Receipts | 3,420.0 | 3,462.2 | 3,328.7 | 3,314.9 | 3,266.8 |
| -6.4 | Income taxes | 1,608.7 | 1,717.9 | 1,683.5 | 1,587.1 | 1,546.1 |
| -8.0 | Corporation taxes | 211.8 | 230.2 | 204.7 | 297.0 | 299.5 |
| 5.4 | Social retirement taxes | 1,261.7 | 1,197.4 | 1,121.1 | 1,111.9 | 1,062.3 |
| 5.3 | Unemployment insurance | 43.1 | 40.9 | 45.0 | 45.8 | 48.8 |
| -12.3 | Excise taxes | 86.8 | 98.9 | 95.0 | 83.8 | 95.0 |
| 5.7 | Estate and Gift Taxes | 17.6 | 16.7 | 23.0 | 22.8 | 21.4 |
| -3.2 | Customs Duties | 68.6 | 70.8 | 41.3 | 34.6 | 34.8 |
| 37.7 | Miscellaneous | 116.5 | 84.6 | 110.5 | 127.7 | 154.8 |

Unemployment benefits for the regular state programs were $196.0 billion this year an increase of $169.0 billion from last year. Fed additional unemployment of $275.0 billion was for gig workers and included the $600 additional weekly checks for a time. (The extra $40 billion of funding for $300 weekly unemployment checks is about exhausted and comes from FEMA disaster money in the Department of Homeland Security.) Food stamps were about $22 billion greater this year and totaled $85.6 billion. Making our military stronger with more defense spending, although not recession related, added $36.4 billion more this year, and totaled $690.4 billion. Defense spending was $565.4 billion in FY2016 before President Trump. Under the Treasury Department is the $149.5 billion Coronavirus Relief Fund for the states, and the Economic Impact Payments ($1,200 checks) totaled $275 billion. The Small Business Administration is up over $575 billion with its PPP checks which looks like none of the money is getting returned thank you very much. We could go on, but will finish with the Department of Education where the Student Loan Office is $91.5 billion higher than last year. The Administration just says about $38 billion is due to the CARES Act and August Presidential Memorandum suspending principal and interest payments through December 31 year.

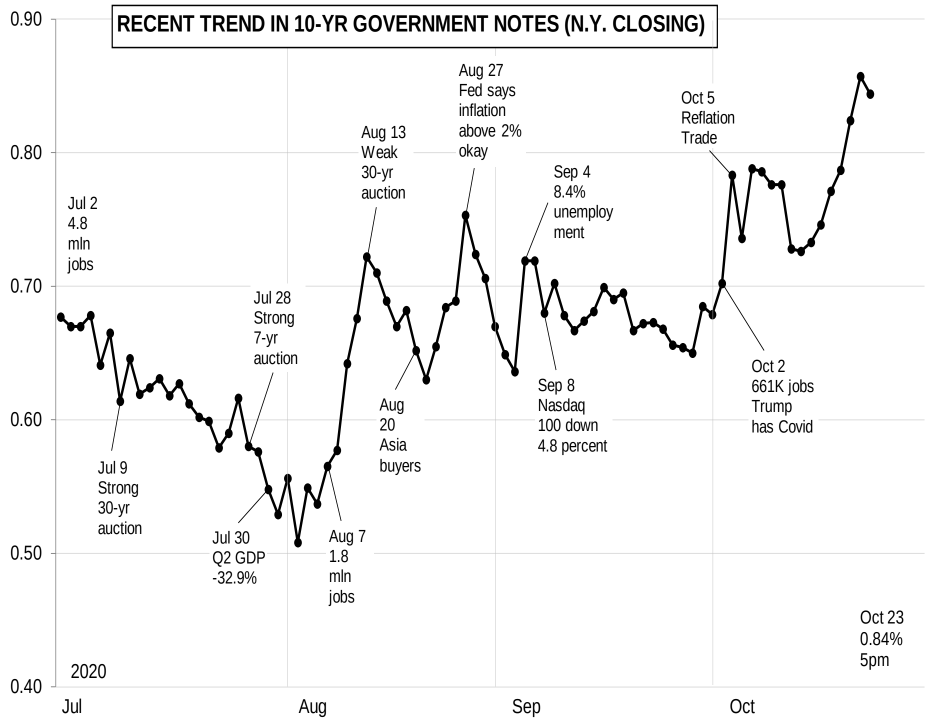
| **Federal Government Spending ($bln)** <br> **Where to cut?** | 4 Qtrs FY20 <br> Q4 19-Q3 20 | 4 Qtrs FY19 <br> Q4 18-Q3 19 | Fiscal Year <br> Changes | Fiscal Year <br> % chg |
|---|---|---|---|---|
| TOTAL BUDGET OUTLAYS | 6,551.872 | 4,446.611 | 2,105.261 | 47.3 |
| Legislative | 5.367 | 4.957 | 0.410 | 8.3 |
| Judicial | 8.251 | 7.987 | 0.264 | 3.3 |
| Agriculture | 184.223 | 150.121 | 34.102 | 22.7 |
| Commodity Credit Corporation | 16.884 | 21.389 | -4.505 | -21.1 |
| Food Stamps | 85.642 | 63.465 | 22.177 | 34.9 |
| Child Nutrition | 22.745 | 23.273 | -0.528 | -2.3 |
| Commerce | 15.918 | 11.324 | 4.594 | 40.6 |
| Defense | 690.419 | 653.987 | 36.432 | 5.6 |
| Military Personnel | 161.413 | 156.270 | 5.143 | 3.3 |
| Operation Maintenance | 278.865 | 271.694 | 7.171 | 2.6 |
| Procurement | 139.056 | 124.698 | 14.358 | 11.5 |
| Research Development | 99.875 | 89.281 | 10.594 | 11.9 |
| Military Construction | 8.885 | 7.412 | 1.473 | 19.9 |
| Education | 204.415 | 104.364 | 100.051 | 95.9 |
| Office of Federal Student Aid | 160.912 | 69.397 | 91.515 | 131.9 |
| Energy | 32.046 | 28.936 | 3.110 | 10.7 |
| Health Human Services | 1503.953 | 1213.805 | 290.148 | 23.9 |
| Medicare | 924.285 | 782.548 | 141.737 | 18.1 |
| Medicaid States Grants | 458.469 | 409.421 | 49.048 | 12.0 |
| Homeland Security | 91.963 | 56.327 | 35.636 | 63.3 |
| Housing Urban Development | 33.190 | 29.188 | 4.002 | 13.7 |
| Interior | 16.416 | 13.908 | 2.508 | 18.0 |
| Justice | 39.607 | 35.107 | 4.500 | 12.8 |
| Labor | 477.530 | 35.810 | 441.720 | -- |
| State Unemployment Benefits | 195.977 | 27.205 | 168.772 | -- |
| Fed Additional Unemployment | 275.021 | 0.000 | 275.021 | -- |
| State | 32.859 | 28.000 | 4.859 | 17.4 |
| Transportation | 100.342 | 80.715 | 19.627 | 24.3 |
| FAA | 30.362 | 16.670 | 13.692 | 82.1 |
| Federal Highway Admin. | 48.742 | 45.712 | 3.030 | 6.6 |
| Treasury | 1151.724 | 689.496 | 462.228 | 67.0 |
| TARP | 0.676 | 1.453 | -0.777 | -53.5 |
| Coronavirus Relief Fund | 149.466 | 0.000 | 149.466 | -- |
| IRS | 448.968 | 166.004 | 282.964 | -- |
| Earned Income Credit | 57.577 | 59.209 | -1.632 | -2.8 |
| Child Tax Credit | 27.779 | 28.898 | -1.119 | -3.9 |
| Economic Impact Payments | 275.000 | 0.000 | 275.000 | -- |
| Interest on Public Debt | 522.652 | 572.913 | -50.261 | -8.8 |
| Veterans Affairs | 218.394 | 199.573 | 18.821 | 9.4 |
| Corps of Engineers | 7.631 | 6.454 | 1.177 | 18.2 |
| Other Defense Civil Programs | 65.264 | 60.931 | 4.333 | 7.1 |
| Environmental Protection | 8.723 | 8.064 | 0.659 | 8.2 |
| Exec. Office of President | 0.402 | 0.422 | -0.020 | -4.7 |
| International Assistance | 21.678 | 23.569 | -1.891 | -8.0 |
| NASA | 21.524 | 20.179 | 1.345 | 6.7 |
| National Science Foundation | 7.278 | 7.255 | 0.023 | 0.3 |
| Personnel Management | 105.625 | 103.138 | 2.487 | 2.4 |
| Small Business Admin. | 577.412 | 0.456 | 576.956 | -- |
| Social Security Admin. | 1153.914 | 1101.833 | 52.081 | 4.7 |
| Retirement Benefits | 940.221 | 888.080 | 52.141 | 5.9 |
| Federal Disability Payments | 144.198 | 145.020 | -0.822 | -0.6 |
| Other Independent Agencies | 17.650 | 19.609 | -1.959 | -10.0 |

We are still worried about our stock portfolio even if the market isn't because perhaps 20% of the returns under Trump have been due to the "biggest tax cut in history." Or at least the PE ratio would have been even higher into the stratosphere than the 26.80 PE on Friday. Corporate tax receipts have not been too bad dropping 8.0% to $211.8 billion in FY2020. Corporate taxes had fallen 31.7% in FY2018 from pre-Trump $299.5 billion in FY2016. Hard to forecast ahead, but the Biden website says the corporate tax rate going up to 28% after the 2017 cut from 35 to 21 percent.



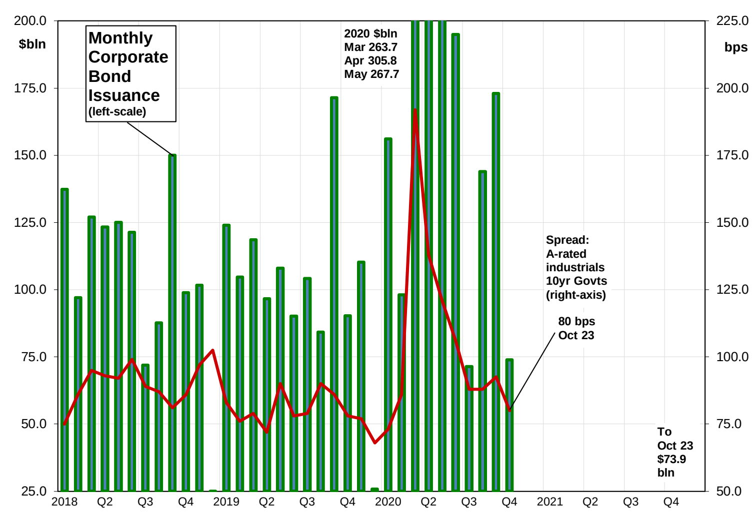
## MARKETS OUTLOOK

| | 30-Sep 2019 | 31-Dec 2019 | 31-Mar 2020 | 30-Jun 2020 | 30-Sep 2020 | Q4 2020 | Q1 2021 | Q2 2021 | Q3 2021 | Q4 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| 30-Yr Treasury | 2.11 | 2.39 | 1.32 | 1.41 | 1.46 | 1.40 | 1.40 | 1.50 | 1.60 | 1.70 |
| 10-Yr Note | 1.67 | 1.92 | 0.67 | 0.66 | 0.69 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 |
| 5-Yr Note | 1.55 | 1.69 | 0.38 | 0.29 | 0.28 | 0.30 | 0.30 | 0.40 | 0.50 | 0.60 |
| 2-Yr Note | 1.62 | 1.57 | 0.25 | 0.15 | 0.13 | 0.20 | 0.20 | 0.20 | 0.30 | 0.30 |
| 3-month Libor | 2.09 | 1.90 | 1.45 | 0.30 | 0.23 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| Fed Funds Rate | 2.00 | 1.75 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 2s/10s spread | 5 | 35 | 42 | 51 | 56 | 50 | 50 | 60 | 60 | 70 |




Bond yields closed 0.84% this week after 0.75% last week. Yields broke above 0.80% late Tuesday night apparently reflecting technical selling. After retracing to 0.80%, the next move higher in yields was Thursday starting around 9am ET. The second push higher that morning came at 1050am when Pelosi said they were just about there on a fiscal stimulus deal. Hope springs eternal. The talks are between Pelosi and the White House though and not the Senate Republicans. Yields climbed from 0.82% as Pelosi spoke to 0.87% by the end of the day Thursday which was more or less the yield high for the week. If bond yields are moving up on a Blue Wave or expectations for a strengthening recovery, Q3 2020 real GDP due out Thursday, October 29 could help with a consensus forecast of 32%. Stay tuned.

## CORPORATES: T-MOBILE USA, BANNER HEALTH, UNITED AIR, HONDA




Corporate bond offerings were $24.8 billion in the October 23 week versus $17.0 billion in the October 16 week. On Monday, Ross Stores sold $1.0 billion 5s/10s. It priced a $500 million 1.875% 10-yr (m-w +20bp) at 115 bps (A2/BBB+). The off-price retailer of apparel and home accessories will use the proceeds to fund the early settlement of its pending tender offers to purchase for cash some of its outstanding senior notes. Corporate bond yields (10-yr Industrials rated A2) were 80 bps above 10-yr Treasuries Friday versus 81 bps last week.

# FEDERAL RESERVE POLICY

The Fed meets November 4-5, 2020 to consider its monetary policy. The press conference will come on Thursday after the elections on Tuesday, November 3. Real GDP for the third quarter will be released 830am ET Thursday, October 29 showing growth is back for now. Not sure it matters for monetary policy whether GDP growth rises 30 or 40 percent after falling 31.4 percent in the second quarter. Fed officials and Fed Chair Powell in particular liked that 3.5% unemployment rate at the start of the year and it could be some time before we see those days again. We hope bond yields stay higher at 0.80% so Powell gets a chance to be questioned on what this means for the economic outlook, do higher bond yields impede the recovery, etc. We always thought Fed officials would buy more U.S. government securities if bond yields went higher although it would probably take a 10-year yield up closer to 1.25% to see much Fed reaction. They continue to buy $80 billion Treasuries per month or $960 billion per year which goes a long way to financing the Federal budget deficit.

**Selected Fed assets and liabilities**

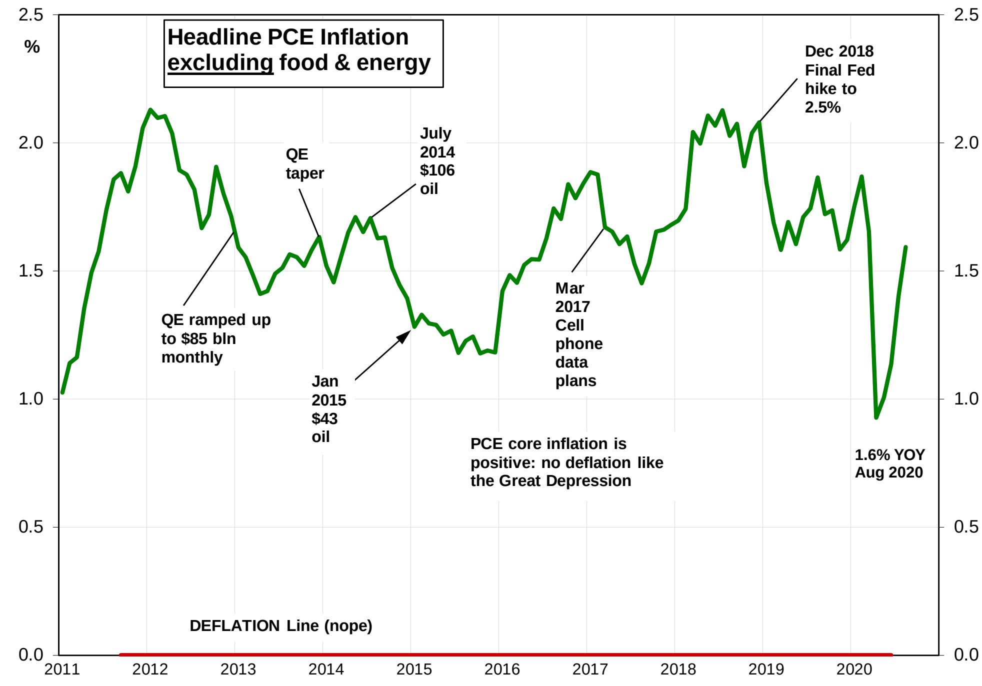
| Fed H.4.1 statistical release<br>billions, Wednesday data | 21-Oct | 14-Oct | 7-Oct | 30-Sep | Sep 10 2008** pre-LEH |
|---|---|---|---|---|---|
| **Factors adding reserves** | | | | | |
| U.S. Treasury securities | 4509.778 | 4484.978 | 4469.848 | 4445.477 | 479.782 |
| Federal agency debt securities | 2.347 | 2.347 | 2.347 | 2.347 | 0.000 |
| Mortgage-backed securities (MBS) | 2047.235 | 2046.838 | 1982.789 | 1982.775 | 0.000 |
| Repurchase agreements | 1.000 | 1.000 | 0.000 | 0.000 | 126.750 |
| Primary credit (Discount Window) | 3.146 | 2.769 | 2.939 | 3.437 | 23.455 |
| | | | | | |
| MMLF | 5.740 | 6.119 | 6.292 | 7.088 | |
| PDCF | 0.193 | 0.193 | 0.233 | 0.233 | |
| Commerical Paper Funding Facility | 8.559 | 8.559 | 0.859 | 8.589 | |
| Paycheck Protection Facility | 64.126 | 65.577 | 66.426 | 67.573 | |
| Corporate Credit Facility (CCF) | 45.378 | 45.300 | 45.164 | 45.042 | |
| Municipal Liquidity Facility | 16.550 | 16.549 | 16.548 | 16.547 | |
| Main Street Lending Program | 40.893 | 40.547 | 40.076 | 39.718 | |
| Term Asset-Backed Facility (TALF II) | 11.762 | 11.716 | 11.715 | 11.715 | |
| Central bank liquidity swaps | 7.642 | 7.478 | 15.838 | 23.895 | 62.000 |
| Federal Reserve Assets | 7225.9 | 7199.8 | 7123.1 | 7103.7 | 961.7 |
| 3-month Libor % | 0.21 | 0.23 | 0.23 | 0.23 | 2.82 |
| **Factors draining reserves** | | | | | |
| Currency in circulation | 2042.729 | 2042.774 | 2038.364 | 2032.544 | 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 | 0.000 | 0.110 | 0.850 | 0.000 |
| **Reserve Balances (Net Liquidity)** | 2890.130 | 2907.734 | 2863.357 | 2743.245 | 24.964 |
| Treasuries within 15 days | 79.660 | 49.893 | 60.673 | 56.106 | 14.955 |
| Treasuries 16 to 90 days | 264.999 | 284.509 | 281.358 | 238.394 | 31.549 |
| Treasuries 91 days to 1 year | 656.206 | 656.000 | 648.353 | 694.799 | 69.272 |
| Treasuries over 1-yr to 5 years | 1701.341 | 1697.513 | 1686.755 | 1673.536 | 170.807 |
| Treasuries over 5-yrs to 10 years | 805.291 | 797.937 | 797.112 | 788.868 | 91.863 |
| Treasuries over 10-years | 1002.280 | 999.126 | 995.597 | 993.773 | 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)




Many Fed speakers and not sure what we learned. There were three officials who said negative rates would not work here for us in America, Fed Vice Chair Quarles, St. Louis Fed President Bullard, and Chicago Fed President Evans. Evans said in one news headline "he's not bothered by 2.5 to 2.75 percent inflation for a year." PCE inflation for September is due out Friday, October 30, and core PCE inflation (the Fed's monetary policy cannot do much to influence food or energy prices) is expected to rise 0.2% to 1.7% year-to-year.

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 | Sep | Total FY 2020 | FY 2021 Oct |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fed QE | 67.808 | 73.007 | 80.364 | 80.246 | 64.952 | 504.312 | 993.047 | 138.093 | 87.892 | 96.159 | 64.996 | 86.918 | 2,337.8 | 64.301 |
| New Cash | 166.8 | 112.5 | 50.9 | 38.5 | 199.8 | 238.7 | 1368.6 | 699.2 | 685.2 | 102.2 | 175.4 | 176.5 | 4,014.3 | 62.5 |
| Bills | 79.1 | 59.0 | -98.2 | -12.5 | 160.3 | 92.8 | 1344.3 | 628.2 | 449.7 | -0.7 | -2.2 | -47.8 | 2,651.9 | -43.6 |
| Coupons | 87.6 | 53.4 | 149.2 | 51.1 | 39.5 | 145.8 | 24.2 | 71.0 | 235.5 | 102.9 | 177.6 | 224.3 | 1,362.1 | 106.1 |
| Federal Reserve's 11 Lending Facilities (month-end outstanding) | | | | | 0 | 58.352 | 94.641 | 136.343 | 204.607 | 203.100 | 197.237 | 196.505 | | 193.201 |
| Central bank liquidity swaps (month-end outstanding) | | | | | 0.044 | 206.051 | 438.953 | 448.946 | 274.963 | 117.473 | 92.140 | 23.895 | | 7.642 |

## OTHER ECONOMIC NEWS THIS WEEK

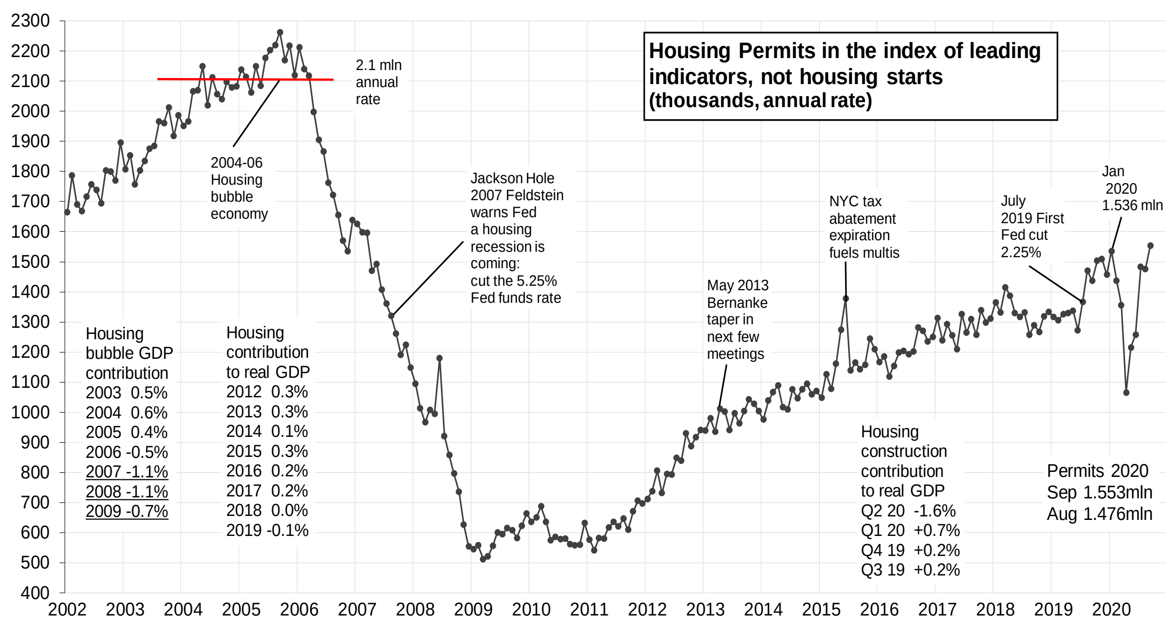
### Housing permits break 1.5 million barrier, and housing starts to follow (Tuesday)

Breaking economy news. Housing permits jump 5.2% to 1.553 million at an annual rate in September, while housing starts rose just 1.9% to 1.415 million in September. Starts follow permits as the sunshine follows rain, so the recovery from the pandemic recession continues for the residential housing sector. Housing starts were held down by multi-family starts of 5 units or more. Single-family starts continue to soar and were up 8.5% to 1.108 million in September which is the best seen since the collapse of the housing bubble over a decade ago before the last recession. There's a long way to go however with single-family home construction topping 1.8 million early in 2006. Single-family home construction was the strongest in the biggest construction region in the nation down in the South. There was a good-sized gain in the Northeast, a modest increase in the West, and a sharp decline in single-family home construction in the Midwest.

**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 |
| Sep 20 | 1415 | 1108 | 295 | 145 | 70 | 105 | 133 | 755 | 645 | 350 | 260 |
| Aug 20 | 1388 | 1021 | 346 | 87 | 58 | 245 | 159 | 711 | 548 | 345 | 256 |
| | | | | | | | | | | | |
| Sep 19 | 1274 | 906 | 357 | 168 | 60 | 158 | 117 | 693 | 520 | 308 | 209 |
| % Chgs | | | | | | | | | | | |
| Sep/Aug | 1.9 | 8.5 | ... | 66.7 | 20.7 | -32.7 | -16.4 | 6.2 | 17.7 | 1.4 | 1.6 |
| Sep/Sep | 11.1 | 22.3 | ... | 26.1 | 16.7 | 4.4 | 13.7 | 8.9 | 24.0 | 13.6 | 24.4 |

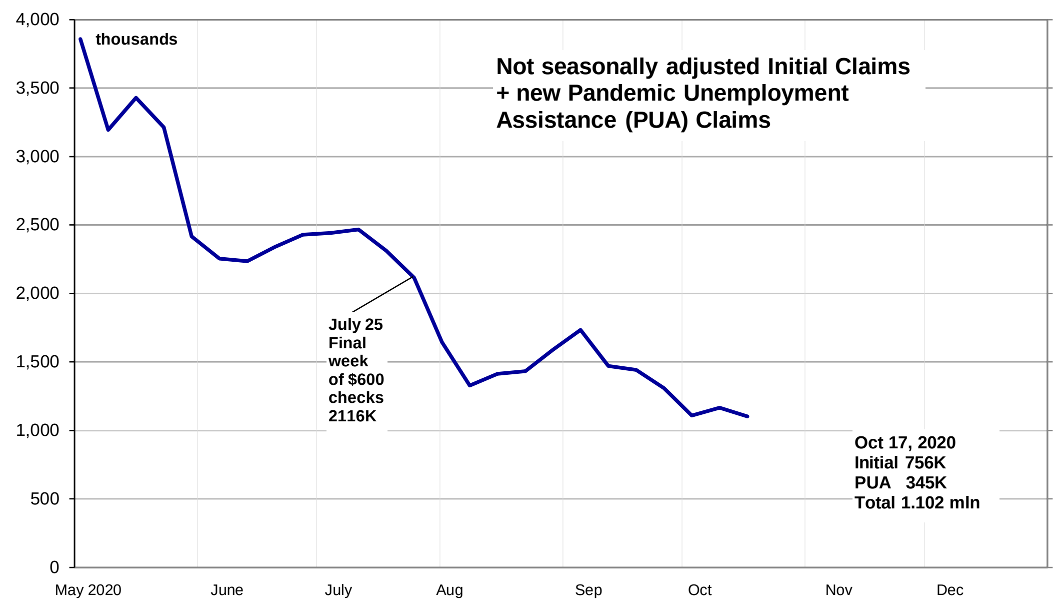
Net, net, business investment in the economy is rebounding based on residential home construction and this bodes well for the recovery from the worst downturn in the economy seen since the Great Depression. The residential housing construction outlook continues to be bolstered by record-low mortgage rates and the many more higher-income, salaried workers who are hanging on to their jobs and incomes this time than in a typical recession. The work-from-home economy has turned the real estate market upside down and there is a tremendous demand for additional housing both starter homes and larger more expensive homes as many workers are fleeing cities at a rate never seen before in the nation's history. No wonder home builders are the most confident in history. The recession may be over, but the pandemic is not, and this is jump-starting home construction to the highest level in over a decade.



## First time jobless lower, still higher than worst week of last recession (Thursday)

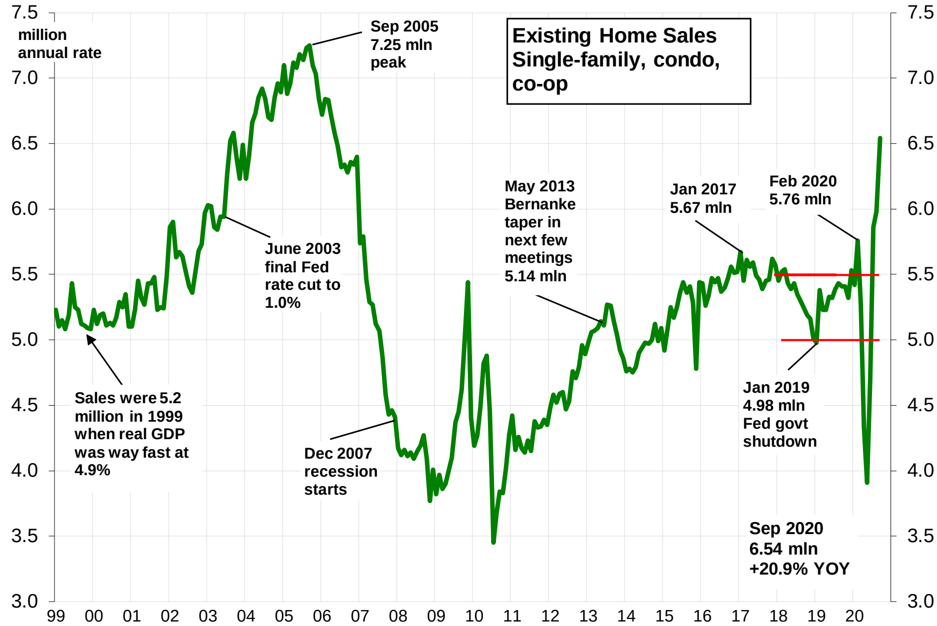
Breaking economy news. 787 thousand applied for jobless benefits in the October 17 week which, although down from 842 thousand the week before, are still higher than 665 thousand in the worst week of the last recession back in March 2009. GDP growth is roaring ahead but millions of jobless workers are being left behind. Time will tell if the still record number of people out of work will act as a brake on the economic recovery or whether the economy's fortunes depend more on the course of the virus. Gig workers are also finding times hard with 345 thousand of these applying for benefits in their own separate Pandemic Unemployment Assistance program. California is back on line after cleaning up their numbers although it is hard to see the effect. The biggest state in the union saw 158 thousand applying for benefits in the October 17 week and a total of 1.866 million received benefits in the week ended October 10.

Net, net, there are still millions and millions on the nation's unemployment rolls because many of the jobs lost during the steepest downturn in economic history have not yet returned. No work means no paycheck and yet spending on the part of consumers in the economic recovery is setting records for many products sold by companies. It is services that are not seeing much demand as the coronavirus has made the public cautious about social interaction. Somehow real GDP will set a record in the third quarter with growth over 30% in next Thursday's report. Economists would have never believed the economy could have rebounded with such strength if millions of Americans remained unemployed.



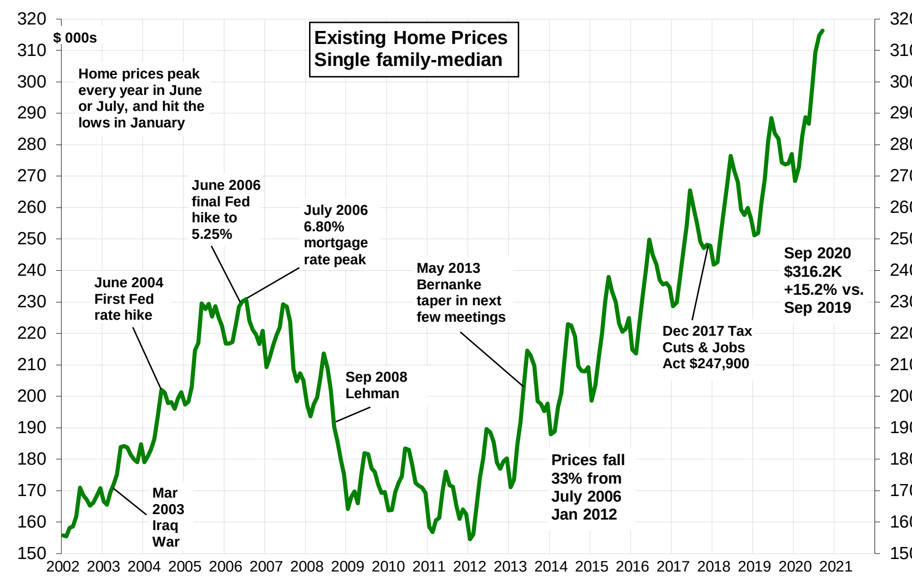

In the October 3 week, reported with a delay, 9.0 million got paid unemployment benefits under the regular state programs, 10.2 million gig workers received benefits under the pandemic unemployment assistance program that was not available in the last recession, and 3.3 million were receiving benefits after exhausting the 6-month of benefits from the regular state program in a category called Pandemic Emergency UC. All told 22.5 million are on the unemployment rolls and there must still be double-counting somewhere as the BLS counted just 12.580 million unemployed behind the 7.9% unemployment rate in September. Stay tuned. Story developing.

## It's not a recession for housing. It's a sales boom with prices soaring (Thursday)




Breaking economy news. Fueled by record low mortgage rates and a stay-at-home economy that thrives on bigger and better homes, existing home sales soared 9.4% in September to 6.54 million at an annual rate. Existing homes turnover is shooting higher and, if Fed officials are not careful, their easy money policies are going to stoke the fires of a new housing bubble. Since the lows in May this year during the height of the pandemic shutdown of the economy, Americans have gone all in on the purchase of a new home with sales up 67 percent. Sales turnover of existing homes has not been this rapid since early 2006 just past the peak of the housing bubble. Sales might be setting new records right now if it was not for the fact there is a shortage of homes available for sale. Sales are hottest on both coasts as city dwellers flee for the suburbs with sales in the Northeast up 16.2% just in the month of September and sales in the West up 9.6% in September.

Buyers want homes at any price with single-family home prices rising a staggering 15.2% the last year to $316,200. Prices should be falling this time of year from the peak selling season earlier in the summer, but the pandemic and search for more space has turned the normal selling season upside down and who knows where and when the price wars for homes will end. It certainly looks like a bubble, where the only way to know for sure is if home prices eventually crash.




Net, net, you can't have a stay-at-home economy without a home and millions of Americans are doing just that and pulling out all the stops to buy a new home and find a safe place to sit out the second wave of the coronavirus pandemic. Turnover of the existing home stock is the best since 2006 and might be even greater if not for a shortage of homes on the market. Home sales are hot, hot, hot, and tell us that this recession is definitely over. Bet on it. The best economy in fifty years at the start of the year is even better if you are in the housing sector of the economy.

## 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.



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