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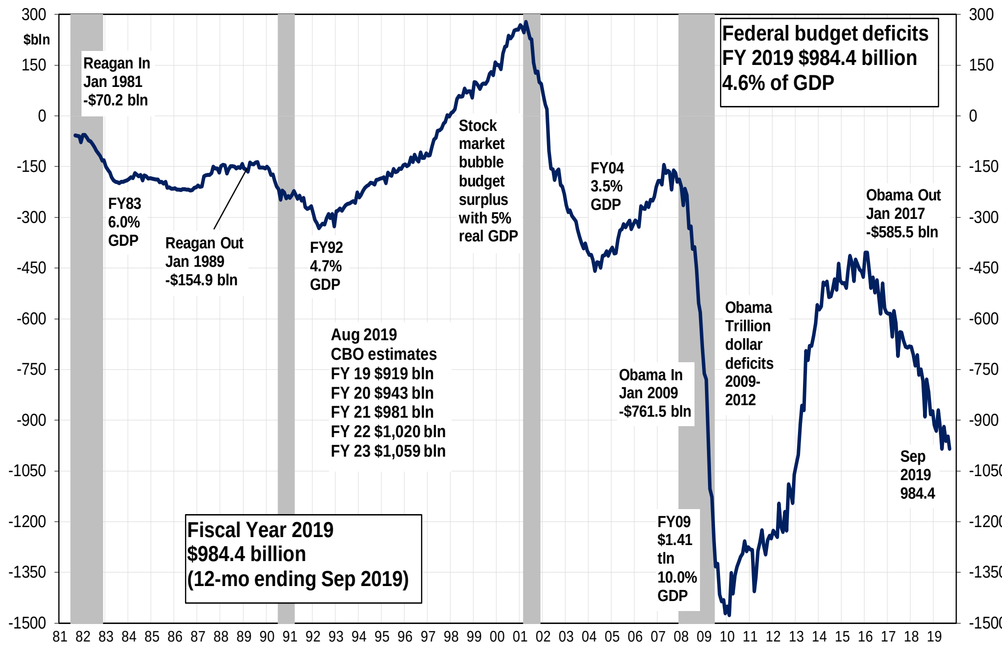
25 OCTOBER 2019

FISCAL YEAR 2019 FEDERAL BUDGET DEFICIT JUST MISSES A TRILLION DOLLARS



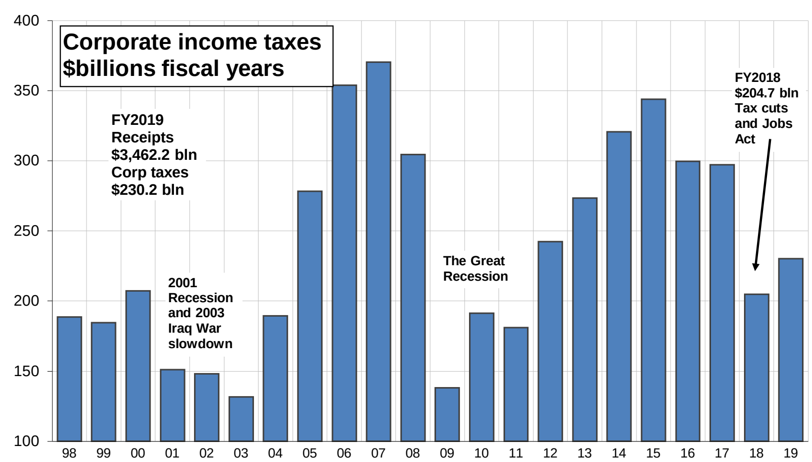
The Treasury budget deficit for fiscal year (FY) ending September 2019 was released late on Friday afternoon. To bury the news maybe. Seems late this year, the October 25 release. The fiscal year results for last year came out on October 15. The joint press release from the U.S. Treasury and Office of Management and Budget (OMB) downplayed the budget results that were worse than last year (instead comparing the numbers to their July midsession review forecasts), and emphasized that the President's economic agenda was working with the lowest unemployment rate in 50 years and sustained year-on-year gains in wages for workers. Not sure how a deficit of $700 billion, $1.3 trillion, or $984 billion would have made a difference in wages or where the unemployment rate was going to go on its own. Without Washington's help.

Federal Government: Where's the Money Coming From?					
FY19/FY18					
% change	Fiscal Years $billons	Sep 2019	Sep 2018	Sep 2017	Sep 2016
4.0	Budget Receipts	3,462.2	3,328.7	3,314.9	3,266.8
2.0	Income taxes	1,717.9	1,683.5	1,587.1	1,546.1
12.5	Corporation taxes	230.2	204.7	297.0	299.5
6.8	Social retirement taxes	1,197.4	1,121.1	1,111.9	1,062.3
-9.1	Unemployment insurance	40.9	45.0	45.8	48.8
4.1	Excise taxes	98.9	95.0	83.8	95.0
-27.4	Estate and Gift Taxes	16.7	23.0	22.8	21.4
71.4	Customs Duties	70.8	41.3	34.6	34.8
-23.4	Miscellaneous	84.6	110.5	127.7	154.8

It just missed a trillion dollars this year: $984.4 trillion or 4.6% of GDP which was $205 billion more than last year. The Obama trillion-dollar deficit years following the Great Recession were from 2009 through 2012. One trillion dollars might still be noticed during the presidential campaign even if a trillion dollars is less relative to the economy's increased size today than it was back in 2009. Bernanke once said a deficit that is 4% of GDP is sustainable. The $984 billion budget deficit was easily financed in the markets judging by the level of interest rates that are sharply lower than a year ago. 10-year Treasury yields averaged 1.7% in September versus 3.0% in September 2018. The extra $205 billion stimulus of deficit spending with the budget deficit moving out from $779 billion in FY2018 didn't provide a lot of stimulus for real economic activity. The consensus for Q3 2019 real GDP is 1.5% in the report out 830 EDT Wednesday, October 30.

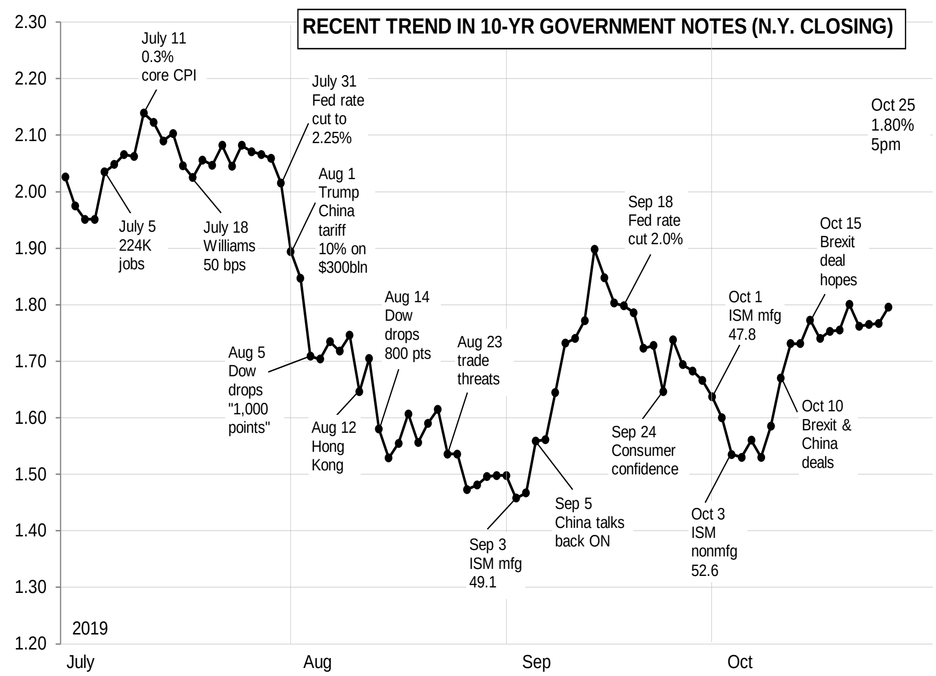
The Tax Cuts and Jobs Act has passed through the data. The biggest corporate tax cut in history had lowered corporate income taxes to $204.7 billion in FY 2018, but corporate tax receipts rose to $230.2 billion in FY 2019. The effort to rein in Federal government spending this year didn't work. Budget outlays rose 8.2% or $338.8 billion to $4.446 trillion in FY 2019. What was behind the $338 of additional government spending? Medicare was $71 billion of it, and Medicaid was $20.3 billion, and healthcare spending will continue to climb. Social security retirement benefits added $55 billion. Defense spending is back to war levels under Obama and Bush, rising $53.3 billion in FY 2019. Interest on the Public debt rose $51.4 billion. There was a $25.4 billion drop in Housing and Urban Development from a FHA Mortgage insurance Capital Reserve account change. Most spending is mandatory.

Federal Government Spending ($bln)			Fiscal	Fiscal
Where to cut?	4 Qtrs FY19	4 Qtrs FY18	Year	Year
	Q4 18-Q3 19	Q4 17-Q3 18	Changes	% chg
TOTAL BUDGET OUTLAYS	4,446.584	4,107.744	338.840	8.2
Legislative	4.957	4.670	0.287	6.1
Judicial	7.959	7.779	0.180	2.3
Agriculture	150.121	136.715	13.406	9.8
Commodity Credit Corporation	21.389	10.878	10.511	96.6
Food Stamps	63.465	68.493	-5.028	-7.3
Child Nutrition	23.273	22.829	0.444	1.9
Commerce	11.324	8.562	2.762	32.3
Defense	653.979	600.675	53.304	8.9
Military Personnel	156.270	145.827	10.443	7.2
Operation Maintenance	271.695	256.656	15.039	5.9
Procurement	124.698	112.667	12.031	10.7
Research Development	89.281	76.975	12.306	16.0
Military Construction	7.412	6.705	0.707	10.5
Education	104.364	63.707	40.657	63.8
Office of Federal Student Aid	69.397	45.917	23.480	51.1
Energy	28.936	26.481	2.455	9.3
Health Human Services	1213.805	1120.500	93.305	8.3
Medicare	782.548	711.499	71.049	10.0
Medicaid States Grants	409.421	389.157	20.264	5.2
Homeland Security	56.327	68.374	-12.047	-17.6
Housing Urban Development	29.188	54.665	-25.477	-46.6
Interior	13.907	13.210	0.697	5.3
Justice	35.107	34.521	0.586	1.7
Labor	35.810	39.638	-3.828	-9.7
State Unemployment Benefits	27.205	28.135	-0.930	-3.3
State	28.000	26.385	1.615	6.1
Transportation	80.715	78.494	2.221	2.8
FAA	16.670	15.999	0.671	4.2
Federal Highway Admin.	45.712	45.064	0.648	1.4
Treasury	689.496	629.448	60.048	9.5
TARP	1.453	2.226	-0.773	-34.7
IRS	166.004	145.209	20.795	14.3
Earned Income Credit	59.209	58.640	0.569	1.0
Child Tax Credit	28.898	18.597	10.301	55.4
Interest on Public Debt	572.913	521.553	51.360	9.8
Veterans Affairs	199.573	178.509	21.064	11.8
Corps of Engineers	6.454	5.082	1.372	27.0
Other Defense Civil Programs	60.931	55.368	5.563	10.0
Environmental Protection	8.064	8.085	-0.021	-0.3
Exec. Office of President	0.422	0.382	0.040	10.5
International Assistance	23.578	21.656	1.922	8.9
NASA	20.179	19.754	0.425	2.2
National Science Foundation	7.255	7.166	0.089	1.2
Personnel Management	103.138	98.802	4.336	4.4
Small Business Admin.	0.456	0.046	0.410	--
Social Security Admin.	1101.833	1039.902	61.931	6.0
Retirement Benefits	888.080	833.038	55.042	6.6
Federal Disability Payments	145.020	143.731	1.289	0.9
Other Independent Agencies	19.610	7.770	11.840	152.4



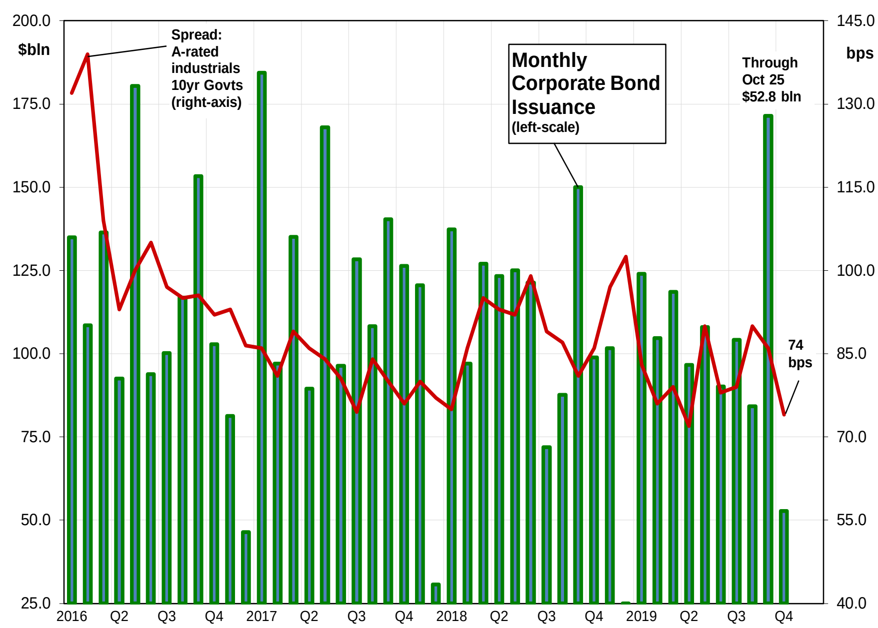
MARKETS OUTLOOK

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



Treasury yields moved sideways with a slightly higher close this week at 1.80%. There was some positive Brexit news, and news the US and China will sign phase one of their trade agreement, maybe with some intellectual property protections thrown in, when Trump and Xi meet November 16-17 at APEC in Chile. The Fed meets Wednesday, October 30, so we assume we will have to take down our "protest" 2.0% Fed funds rate for Q4 2019 in the forecast table above. The odds of a 25 bps rate cut to 1.75% are over 90%. Market odds of a fourth 25 bps rate cut this year to 1.5% in December are about 30%. The Fed hasn't tried to slow the market down on its rate cut calls yet.

CORPORATE BONDS: HALF WERE BANKS, DELTA AIR, UNITED RENTALS



Corporate offerings were $18.8 billion in the October 25 week versus $12.7 billion in the October 18 week. On Thursday, Norfolk Southern sold $800 million 10s/30s. It priced a $400 million 2.55% 10-yr (m-w +15bp) at 83 bps (Baa1/BBB+). The rail transportation company will use the proceeds to repay existing indebtedness and stock buybacks. Corporate bond yields (10-yr Industrials rated A2) were 74 bps above 10-yr Treasuries Friday versus 77 bps last Friday.

FEDERAL RESERVE POLICY

The Fed meets October 29-30 to consider its monetary policy. Market odds of a 25 bps rate cut to 1.75% are over 90%. One of the reasons Fed officials have come up with for cutting interest rates is "uncertainty." Caterpillar said its earnings outlook was affected by uncertainty on Wednesday before the market opened which caused Dow stock futures to fall 175 points briefly.

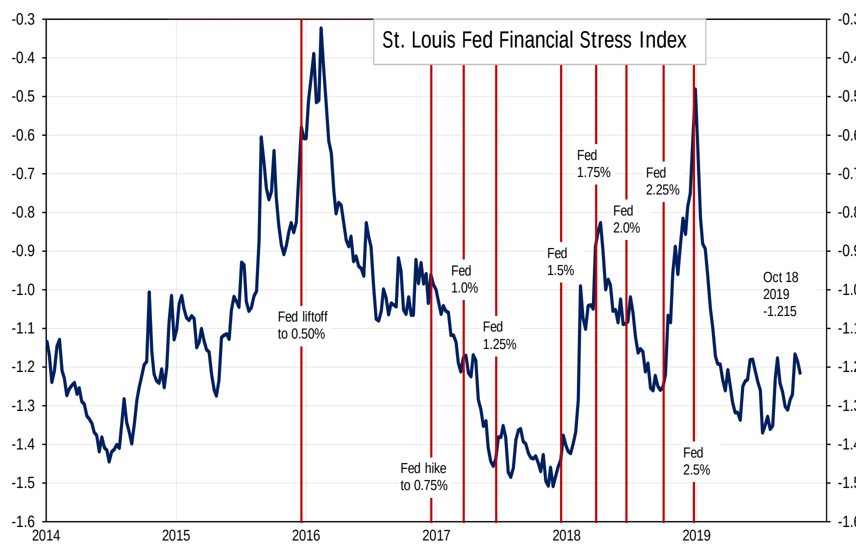
Selected Fed assets and liabilities Fed H.4.1 statistical release billions, Wednesday data	23-Oct	16-Oct	9-Oct	2-Oct	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	2149.188	2123.085	2121.485	2117.130	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1457.914	1463.137	1467.273	1467.260	0.000
Repurchase agreements	178.204	197.700	178.650	181.050	126.750
Primary credit (Discount Window)	0.005	0.000	0.001	0.031	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	0.043	0.043	0.039	0.973	62.000
Federal Reserve Assets	4016.9	4014.6	3998.2	3993.3	961.7
3-month Libor %	1.94	2.00	1.98	2.06	2.82
Factors draining reserves					
Currency in circulation	1773.219	1772.562	1769.136	1765.667	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	18.290	1.803	1.469	3.054	0.000
Reserve Balances (Net Liquidity)	1451.555	1469.871	1528.394	1486.710	24.964
Treasuries within 15 days	15.736	15.683	0.028	0.128	14.955
Treasuries 16 to 90 days	77.195	63.032	77.561	77.461	31.549
Treasuries 91 days to 1 year	276.315	267.651	267.176	267.176	69.272
Treasuries over 1-yr to 5 years	852.320	849.095	849.095	848.695	170.807
Treasuries over 5-yrs to 10 years	302.406	302.407	302.408	302.345	91.863
Treasuries over 10-years	625.216	625.217	625.217	621.326	101.337

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

We thought we would check in on financial market uncertainty ahead of the Fed's upcoming meeting. After all, one of the main reasons for monetary stimulus is to "improve financial conditions." One financial condition is the stock market and the S&P 500 closing up 20.5% YTD on Friday doesn't need a rate cut. Let's find out what stocks would do if the Fed did nothing this meeting. The Fed can save some ammo. The St. Louis Fed has a financial conditions index. It's got lots in it. Seven different interest rates and 6 different curves, along with some volatility indexes, but only one stock index. The Fed lifted off, raising rates from 0.25 to 0.50 percent in December 2015 during a period of high financial stress, before thinking the better of it and doing nothing for another year until after Trump was elected. Financial stress has come down again since December 2018 so they can resume their gradual pace of rate hikes cuts if "financial conditions" is your model of Fed behavior.

Donald J. Trump 10-24-19 10:20AM EDT
@realDonaldTrump
The Federal Reserve is derelict in its duties if it doesn't lower the Rate and even, ideally, stimulate. Take a look around the World at our competitors. Germany and others are actually GETTING PAID to borrow money. Fed was way too fast to raise, and way too slow to cut!

Fedwatchers don't have all that much to write about so there is some analysis on just what the Fed needs to do to stop the market from discounting a fourth rate cut this year. Powell would have to say at the press conference that maybe it's not just the economy that is in a good place, but monetary policy is also in a good place for now. We think they would be better off repeating that they seek to extend the economic expansion and are taking it on a meeting by meeting basis. Ignore what the President is asking of them. The economy will not go up like a rocket after rate cuts. Fed officials should stop trying to oversteer the markets when it is mattering less for the economy what interest rate cuts can do from such a low level of 2 percent. We hope this is the last rate cut we see from them this year.



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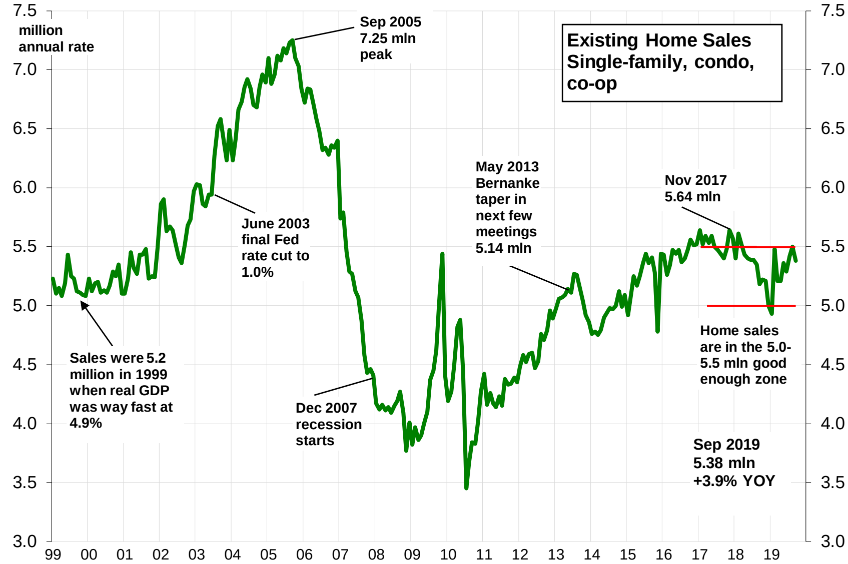
OTHER ECONOMIC NEWS THIS WEEK

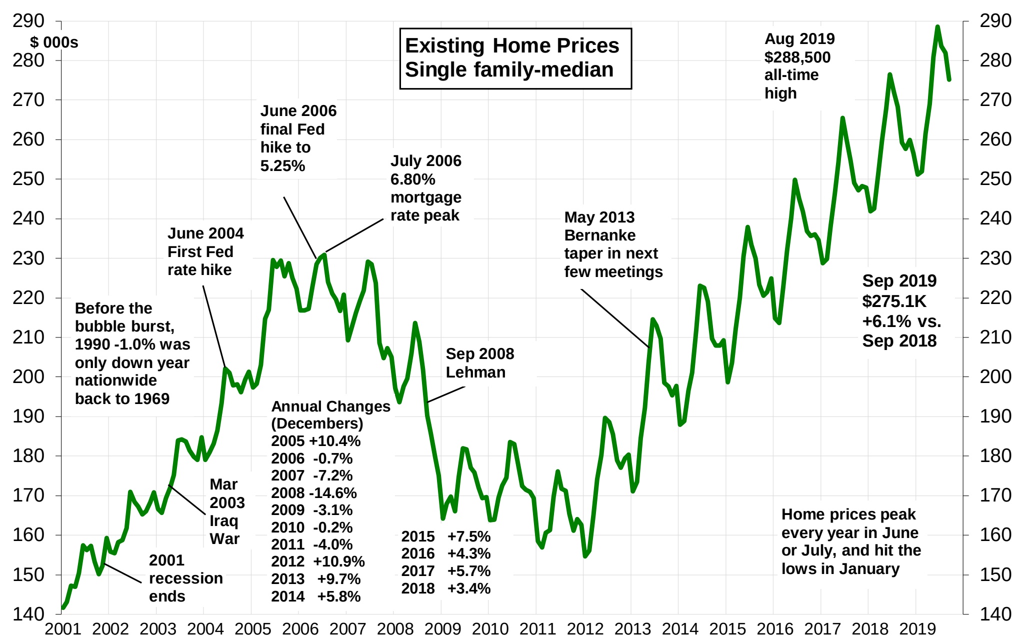
Existing home sales off slightly from year's highs (Tuesday)



Breaking economy news. It's not a recession. We wouldn't shout it from the roof tops, it's not that important to the economic outlook, but existing home sales fell 2.2% from the 5.50 million 2019 high for the year in August to 5.38 million in September. The largest declines were in the Midwest and in the South.

The slight fall-off in home sales didn't do much to dent home prices which remain as relatively unaffordable as ever. Single-family existing home prices are declining after the seasonal peak reached in the summer each year, but at $275,100 in September, prices are 6.1% higher than last year. Don't call it a housing bubble yet, but home prices continue to rise faster than worker earnings which are increasing closer to just 3% this year. You need to earn around $110,000 to buy these homes, and that is not minimum wages that's for sure as it takes a paycheck of over $50 an hour if you can get it.

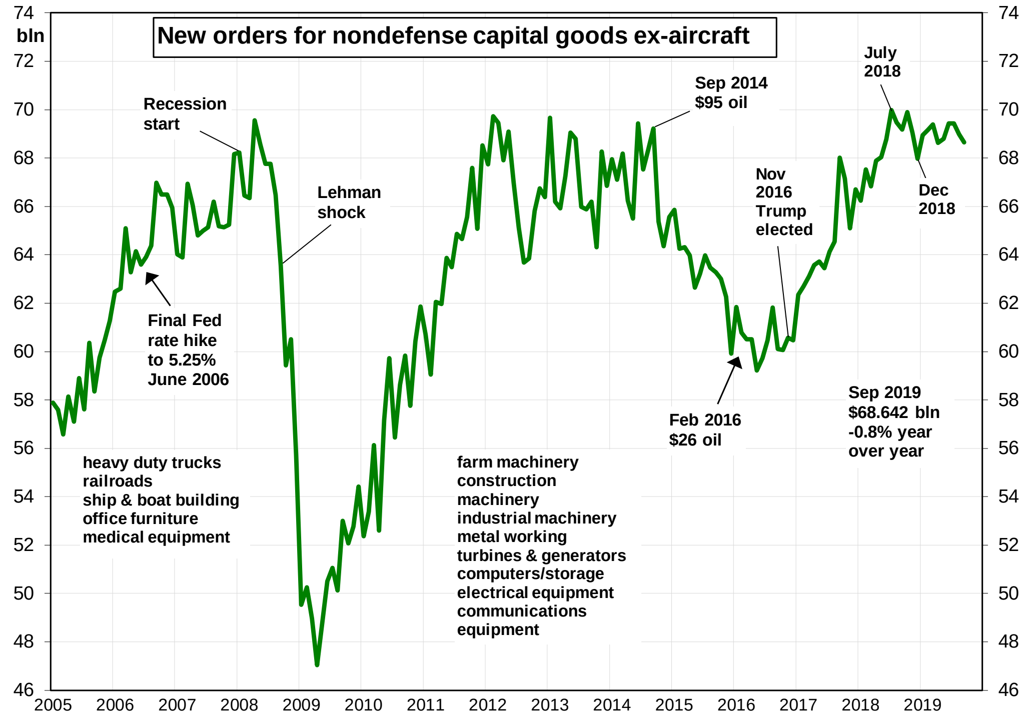
Net, net, existing home sales weakness in September is consistent with the drop in retail sales at shops and malls as well which will stiffen the spines of those Fed officials who were not thinking about a rate cut next week and gives them the cover they need to vote for additional monetary stimulus. A third rate cut is coming next week, bet on it.



It takes courage to go out and put a down payment on the biggest purchase that the consumer will make in their lives, and right now, confidence seems to be in short supply. Existing home sales transactions are recorded at closing which means the September sales could have occurred in July or August when there was financial market turmoil due to the escalation of the US-China trade war. We will see if the Fed's 180 degree turnaround on interest rates this year will yet boost home sales back to new 2019 highs especially now that the financial turbulence in August is over. Stay tuned.

Business investment in equipment is off a little. No recession though. (Thursday)

Breaking economy news. Durable goods orders fell 1.1% in September after rising 0.3% in August and 2.1% in July. Our proxy for business capex investment spending on equipment is nondefense capital goods orders excluding aircraft and these fell 0.5% in September and 0.6% in August.



There doesn't appear to be any need for companies to rush out and buy more equipment due to the ongoing uncertainty over the business climate caused by the U.S.-China trade war. It is good that China is agreeing to buy more agriculture goods, but that doesn't amount to a hill of beans for the demand for long-lasting durable goods equipment and machinery that helps companies manufacture and sell their goods and services to consumers and other businesses. Manufacturing may be in a recession according to purchasing manager surveys, but new orders continue to remain at fairly high levels that are not consistent with a recession and these orders are well above the lows of December during the stock market meltdown and Federal government shutdown.

Looking at the orders data overall, machinery rose 0.2%, computers rose 1.4%, communications equipment up 1.5%. Motor vehicles and equipment were down 1.6% in September after falling 1.6% in August however. The GM strike started in mid-September.

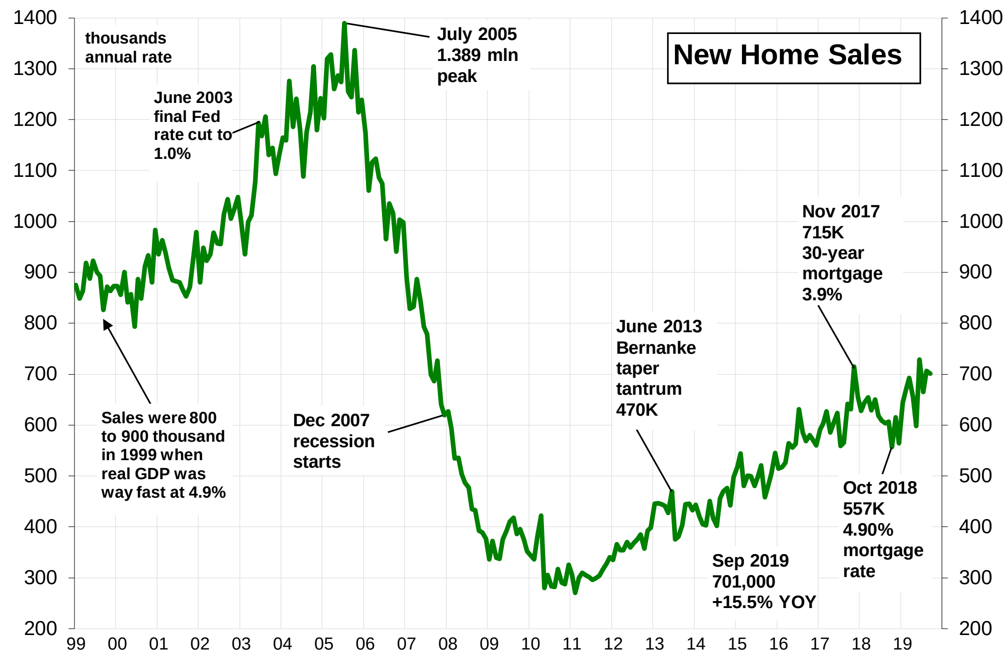
Net, net, business investment has weakened further since the Fed last met which argues for one more insurance-style rate cut to try and get out in front of those trade war uncertainty risks that have made companies more cautious. Businesses are ordering up less equipment, but they continue to hold on tight to their workers with weekly unemployment claims remaining low, so the news was not all bad today.

There is no recession unless businesses move from the cautious uncertainty stage to where they actually lay off workers. There's no reality in the fears over the economic outlook. The market's fear over recession and forecasts for recession are running ahead of the actual economic data.

New home sales remain strong with mortgage rates dirt cheap (Thursday)

Breaking economy news. New home sales fell 0.7% to 701 thousand in September. They had been a little higher at 713 thousand in August until revised lower to 706 thousand in today's report. New homes sales are one leading economic indicator that keeps on winning as it shows home buyers remained highly confident in recent months despite the ongoing trade war between the U.S. and China.

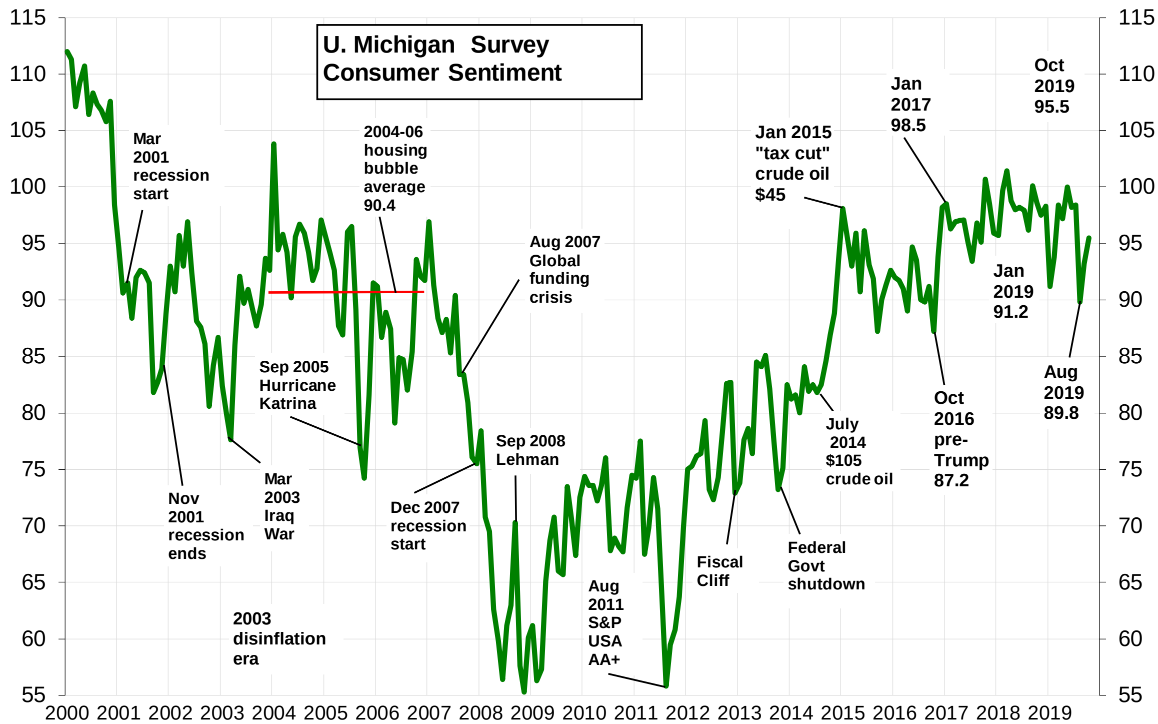
Businesses may be more cautious on whether to invest in the future and purchase new machinery equipment, but don't tell that to the consumer as they are all in when it comes to making the biggest financial decision of their lives which is the purchase of a new home. There can't be too much wrong with the economic outlook if the trend of new home sales continues to move higher as who would buy a new home if a recession was knocking at the economy's door? Answer: no one. The economy's better than you think.



Net, net, for the housing markets, mortgage rates giveth and they also taketh away, and right now the cost of borrowing money to buy a new home is dirt cheap and low mortgage rates are the gift that just keeps on giving for home buyers and homebuilders alike. The icing on the cake for home buyers is the drop in new home prices in September. The median price of a new home is $299,400 in September which is 8.8 percent cheaper than $339,000 in September 2018. Get em while they're hot. What a deal. Get your new home today.

Consumer sentiment holding pattern for now (Friday)

Breaking economy news. Consumers are holding their breath as they wait to see how the economic outlook and jobs market turns out. The economy is still in a good place consumers feel for now. Based on the latest survey, consumers are not overly optimistic or unduly pessimistic and this makes us think their pullback in spending in September was just a speed bump on the road to prosperity. The consumer is more than willing to go it alone if necessary when it comes to the heavy lifting of the economy that is required for growth as business investment spending weakens due to the uncertainty caused by trade war tensions. They have got jobs and they have got wages. What's not to like? Life is good.



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