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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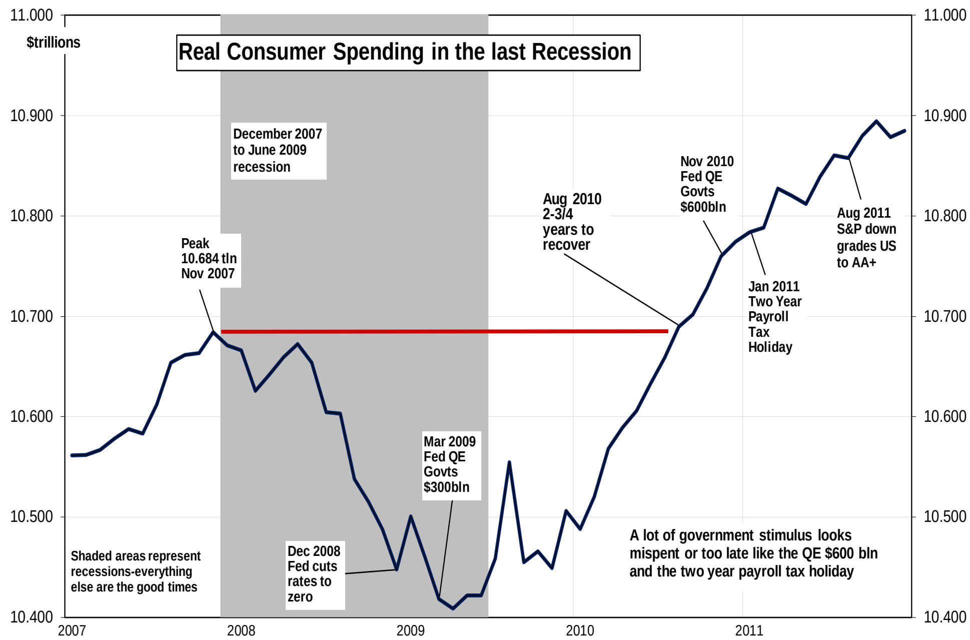
CONSUMER SPENDING STILL NOT BACK TO NORMAL HEADING INTO THE HOLIDAYS AND SHUTDOWNS



How did it go down last time in the Great Recession for the consumer. Study history so we don't repeat the same mistakes. Real consumer spending is famously two-thirds of the economy where in Q3 2020 real GDP was $18.583 trillion. It is often thought that consumer spending is already more than before the pandemic in total with food at home purchases offsetting dining out purchases and the like. But that is not true, and it probably shouldn't be with nonfarm payroll employment down 9.8 million jobs or 6.5% from February 2020 before the pandemic hit.

In the Great Recession from December 2007 to June 2009, real consumer spending fell and it took 2-3/4 years, all the way out to August 2010, to return to the prior peak. Real consumer spending this time around peaked in January 2020, so 2-3/4 years would mean recovery would take until October 2022. Back in the last recession, the Fed threw a lot of stimulus at the economy hoping to win over the hearts and minds of companies and consumers. It's never really clear whether all the policy easing steps were necessary or would the economy have come back on its own. Can't run trials on the economy like with vaccines. The Fed cut rates to zero in December 2008, but like the stock market, maybe the announcement effect of the Fed's dramatic QE $300 billion Government securities purchases in March 2009 helped stop the decline in real consumer purchases of goods and services.

It is interesting that the two-year payroll tax holiday from Congress to boost consumer purchases did not start until January 2011. Day late and a dollar short. Actually, the estimate at the time was the holiday was worth about $120 billion of stimulus over a year's time, by cutting payroll taxes 2 percentage points from 6.2% withheld to 4.2%, which reminds us what happened to the current administration's payroll tax cut? We forgot to check out our paycheck stubbs to see how much we gained. The 2011-12 tax holiday put a maximum of about $2,000 in some workers pockets and to this day, because consumer spending remained soft in 2011 and 2012, economists say tax cuts don't work as they are temporary and most will save the money and not spend it.

The point is that historically, consumer spending does better in recessions than the volatile swing factor which is business investment spending. We would call real consumer spending of 2.5 to 3.0 percent normal. In 2000, real consumer spending was 5.1% before the 2001 recession thanks to the stock market bubble where the S&P 500 rose over 20% each year from 1995 to 1999 [19.53% in 1999 but who is counting]. Real consumer spending in the short March 2001 to November 2001 recession only slowed to 2.5% partly due to the way the intra-year downside moves even out over the full year averages for growth in the table above. Real consumer spending was weaker in the Great Recession with a 0.2% decline in 2008 and -1.3% in 2009. Although consumer spending rose 1.7% in 2010, it wasn't enough growth for Congress or the Federal Reserve as they continued to add even more stimulus. Despite the two-year payroll tax holiday in 2011 and 2012, it wasn't until 2014 that real consumer spending grew more than 1%-something. Real consumer spending was 3.0% in 2014 and 3.8% in 2015 before the last presidential election cycle in 2016.

GDP vs. Consumer Spending in the Last Two Recessions

Annual %	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP	4.1	1.0	1.7	2.9	3.8	3.5	2.9	1.9	-0.1	-2.5	2.6
Consumer	5.1	2.5	2.6	3.2	3.8	3.6	3.1	2.2	-0.2	-1.3	1.7

	Seasonally adjusted at annual rates					Change $bil and %	
	2019		2020			2019 Q4	2019 Q4
	Q3	Q4	Q1	Q2	Q3	2020 Q3	2020 Q3
Gross domestic product (GDP)	**19,141.7**	**19,254.0**	**19,010.8**	**17,302.5**	**18,583.5**	**-$670.5 bln**	**-3.5%**
Personal consumption expenditures	**13,301.3**	**13,353.7**	**13,118.4**	**11,860.3**	**12,915.9**	**-437.8**	**-3.3**
Durable goods	**1,797.8**	**1,811.7**	**1,752.0**	**1,744.6**	**2,028.8**	**217.1**	**12.0**
Motor vehicles and parts	535.1	539.2	495.9	497.3	574.3	**35.1**	**6.5**
Furnishings and household equipment	414.4	417.3	413.2	404.7	461.1	**43.8**	**10.5**
Recreational goods and vehicles	605.9	613.0	620.6	674.0	748.4	**135.4**	**22.1**
Nondurable goods	**3,023.9**	**3,018.2**	**3,070.6**	**2,947.9**	**3,151.5**	**133.3**	**4.4**
Food and beverages consumed at home	991.6	987.1	1,055.9	1,040.9	1,053.8	**66.7**	**6.8**
Clothing and footwear	412.2	418.0	375.9	318.1	411.3	**-6.7**	**-1.6**
Gasoline and other energy goods	444.8	441.6	421.3	342.0	400.0	**-41.6**	**-9.4**
Services	**8,541.5**	**8,584.9**	**8,365.3**	**7,306.9**	**7,913.5**	**-671.4**	**-7.8**
Housing and utilities	2,199.5	2,199.1	2,197.4	2,220.6	2,225.4	**26.3**	**1.2**
Health care	2,234.0	2,260.2	2,161.7	1,782.7	2,111.0	**-149.2**	**-6.6**
Transportation services	447.4	447.8	414.8	267.3	334.4	**-113.4**	**-25.3**
Recreation services	502.6	506.7	457.7	246.0	341.2	**-165.5**	**-32.7**
Food services and accommodations	847.1	847.0	771.0	514.1	680.1	**-166.9**	**-19.7**
Financial services and insurance	858.2	865.8	861.4	859.0	869.9	**4.1**	**0.5**

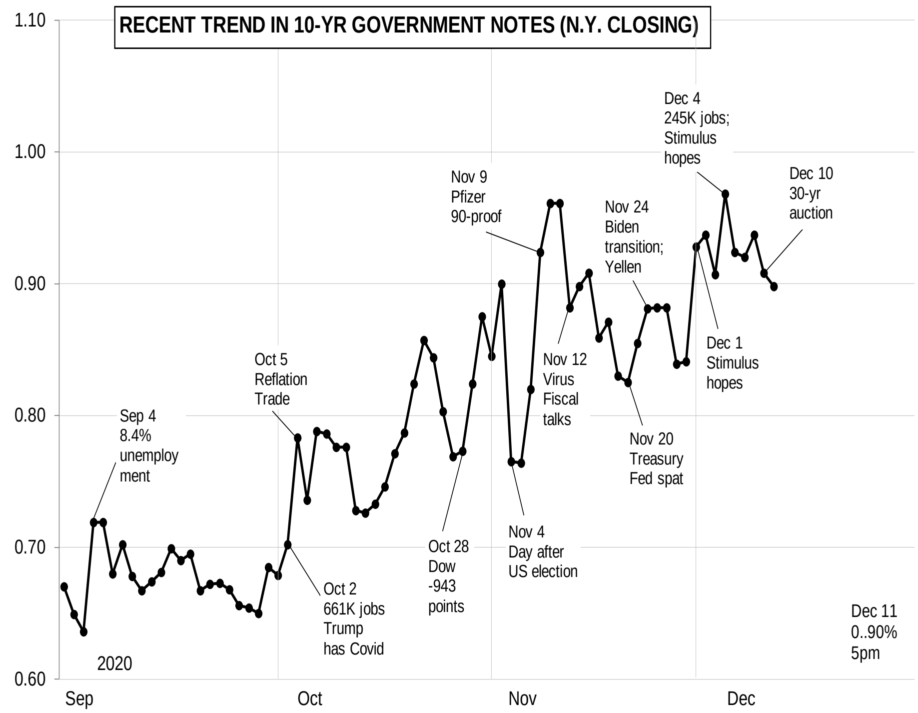
What is happening with real consumption expenditures in the current recession? Finally. Getting to the part on how can we make money on this economic analysis. Real GDP is down 3.5% from the Q4 2019 peak to the latest Q3 2020 data, keeping in mind the worst point of the Great Recession had real GDP down 4.0%. This recession has hurt the consumer almost as bad as the broader economy with consumption down 3.3% the last three quarters. Food at home is up 6.8% or $66.7 billion from Q4 2019 to Q3 2020 and it is much larger than food services and hotels/motels which fell 19.7% or $166.9 billion over the period.

Motor vehicles and home furnishings/appliances did better up 6.5% and 10.5%, respectively this year, but there are many losers. Recreation services are down 32.7% which are sports, movie theaters, museums, and transportation services (airlines, Taxis, commuting) are down 25.3%. Health care spending rallied back in the third quarter, but is still down 6.6% which is a big $149.2 billion.

The economic outlook depends on the path of the virus and we can already see that consumer spending on services where there is close contact has been hit harder than in any normal recession. We are optimistic that the virus threat will be largely gone by this time next year, but there is a long way to go.

MARKETS OUTLOOK

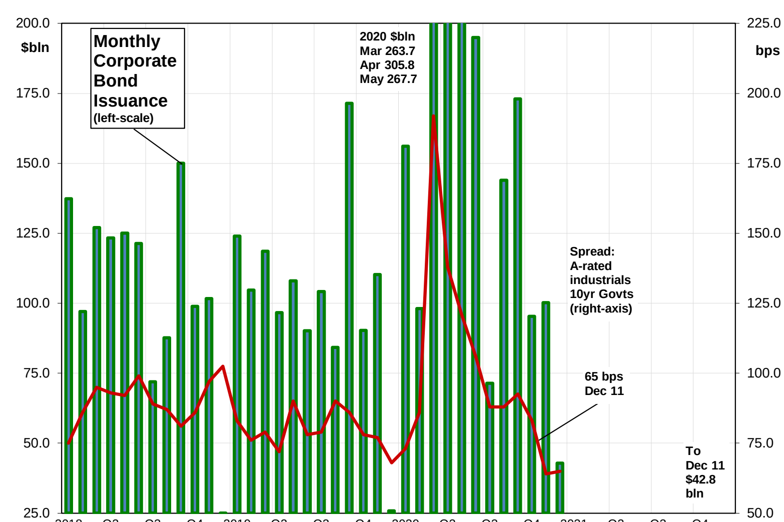
	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	30-Sep 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
30-Yr Treasury	2.11	2.39	1.32	1.41	1.46	1.40	1.40	1.50	1.60	1.70
10-Yr Note	1.67	1.92	0.67	0.66	0.69	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.55	1.69	0.38	0.29	0.28	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.62	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 0.90% this week after 0.97% last week. Bond yields retraced that Hail Mary effort last Friday when yields climbed on the soft 245K jobs report which meant, which meant, Washington fiscal stimulus was on the way. Disappointed. Again. No closer to a fiscal package this week either. Something to do with money for state and local governments. Yields dropped 5 bps from 0.97% last Friday to 0.92% on Monday: no Brexit deal headlines before the NY open. Yields came down further on the strong 30-yr auction results Thursday, bonds and stocks affected alike by too-much, free-money liquidity. Yields fell as low as 0.87% Friday with Brexit and virus news, but the announcement of a one-week, stopgap budget agreement to keep the government open turned it around.

CORPORATES: BANKS/FINANCIALS, CHARLES SCHWAB, TOYOTA, CODELCO

Corporate bond offerings were $24.8 billion in the December 11 week versus $22.9 billion in the December 4 week. On Monday, CVS Health Corp. sold $2.0 billion 7s/10s. It priced a $1.25 billion 1.875% 10-yr (m-w +15bp) at 95 bps (Baa2/BBB). The pharmacy health care provider (9,900 drugstores) will use the proceeds to refinance existing debt. Corporate bond yields (10-yr Industrials rated A2) were 65 bps above 10-yr Treasuries Friday versus 60 bps last week.



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FEDERAL RESERVE POLICY

The Fed meets December 15-16, 2020 to consider its monetary policy. No action is expected. They will put out new forecasts as they do every quarter.

Federal Reserve officials have already deployed all their recession-fighting weapons for this economic downturn, and additional actions of any consequence for Wall Street or for Main Street are not expected at the final meeting of 2020. The Federal Reserve eased its monetary policy dramatically as the recession unfolded rapidly in March this year, and they will not retreat until the goals of maximum employment and 2% inflation have been achieved. Fed Chair Powell has said in recent speeches and in testimony that the 3.5% record low for unemployment before the recession earlier this year was a good thing that drew in new workers from the outer fringes of the labor market that normally are unable to participate fully in society. You can bet your bottom dollar that the Fed Chair will continue with these easy money policies until he is sure that the conditions of maximum employment are met once again or at least that the economy is on its way to returning to the best economy in fifty years at the start of 2020.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	11-Dec	2-Dec	25-Nov	18-Nov	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	4630.538	4614.410	4606.580	4584.423	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2003.656	2003.621	2003.592	2051.176	0.000
Repurchase agreements	1.000	1.000	1.000	1.000	126.750
Primary credit (Discount Window)	1.952	1.992	2.428	2.167	23.455
MMLF	4.449	4.492	5.192	5.242	
PDCF	0.250	0.250	0.240	0.255	
Commerical Paper Funding Facility	8.557	8.563	8.557	8.557	
Paycheck Protection Facility	52.776	54.879	56.003	57.523	
Corporate Credit Facility (CCF)	46.138	46.078	45.982	45.838	
Municipal Liquidity Facility	16.359	16.556	16.555	16.554	
Main Street Lending Program	44.821	43.783	43.371	42.894	
Term Asset-Backed Facility (TALF II)	12.463	12.118	12.294	12.293	
Central bank liquidity swaps	9.565	8.449	7.845	7.141	62.000
Federal Reserve Assets	7291.5	7270.7	7265.1	7291.9	961.7
3-month Libor %	0.22	0.23	0.23	0.22	2.82
Factors draining reserves					
Currency in circulation	2066.759	2067.772	2066.001	2060.288	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	0.003	0.001	0.000	0.103	0.000
Reserve Balances (Net Liquidity)	3147.656	3101.235	3143.863	3033.228	24.964
Treasuries within 15 days	41.310	56.723	78.785	84.836	14.955
Treasuries 16 to 90 days	345.014	335.898	290.750	284.427	31.549
Treasuries 91 days to 1 year	637.152	630.853	668.914	664.873	69.272
Treasuries over 1-yr to 5 years	1737.549	1726.236	1711.895	1700.839	170.807
Treasuries over 5-yrs to 10 years	830.650	829.664	826.697	824.797	91.863
Treasuries over 10-years	1038.864	1035.037	1029.539	1024.651	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 spigot is full-on for the provision of liquidity that greases the gear box of the economy as well with $80 billion of U.S. Government securities purchases per month keeping bond yields and mortgage rates lower for now which helps the housing market even if it may be causing a return of the speculative housing price bubble seen over a decade ago. Fed officials could possibly tinker with the maturity mix of these Treasury purchases and buy more bonds than short-term notes to drive yields lower, but we don't see the need for this as pressing at this time with 10-Treasury yields already fairly low and trading below 1.0%. Fed officials could also give guidance on what it would take for them to reduce the purchases or even expand the purchase program and buy even more debt, but this too is not something that needs to be explained to the public in detail at this time. Monetary policy is running smoothly at this time and we don't see any reason to alter the policy setting or give additional guidance about what they might do in the future. Fed policy depends on the economy and the economy depends on the course of the virus. We expect overall monetary policy from the Federal Reserve to remain fully supportive of the economy in 2021 and no change is expected with millions and millions of Americans out of work.

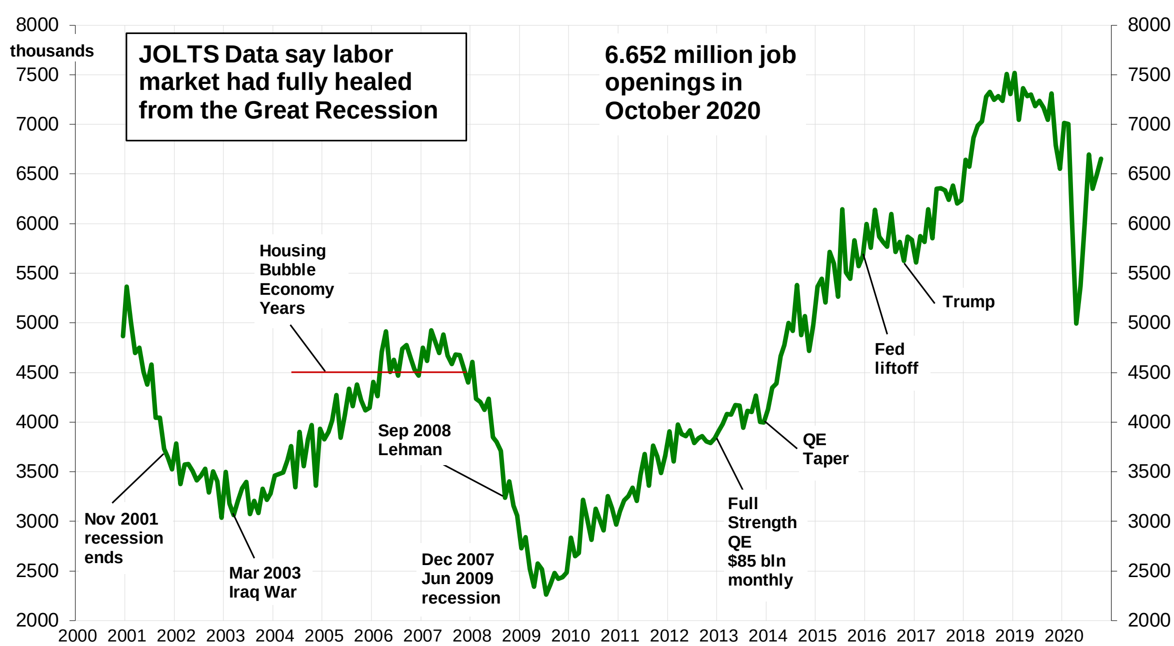
OTHER ECONOMIC NEWS THIS WEEK

Job openings creep up, but labor market far from normal (Wednesday)

Breaking economy news. Job openings data, that are always a month late, with a total of 6.652 million workers needed at the end of October which is an increase of 158 thousand versus the help wanted in September. Healthcare and social assistance job openings increased 122 thousand, and state and local government required 23 thousand more workers or 230 thousand in total. That's interesting because the job losses for state and local education in Friday's report of November payroll employment fell 21 thousand after falling 91 thousand in October and 215 thousand in September. Quite the puzzle this mismatch between openings and actual hiring. The job openings may be creeping up, but the labor market is far from normal.

Basically, there are more opportunities out there and companies appear to be hiring, but the help wanted signs might disappear later in the year as the coronavirus shutdowns in many states has upturned the labor market which is to say caused it to turn down again. There must be a lot of churn in the jobs turnover data as hotels and restaurants needed to hire 700 thousand in October versus 840 thousand in October 2019. Meanwhile almost 2.8 million restaurant and hotel employees have lost their jobs counting from February through November in the monthly payroll jobs data.

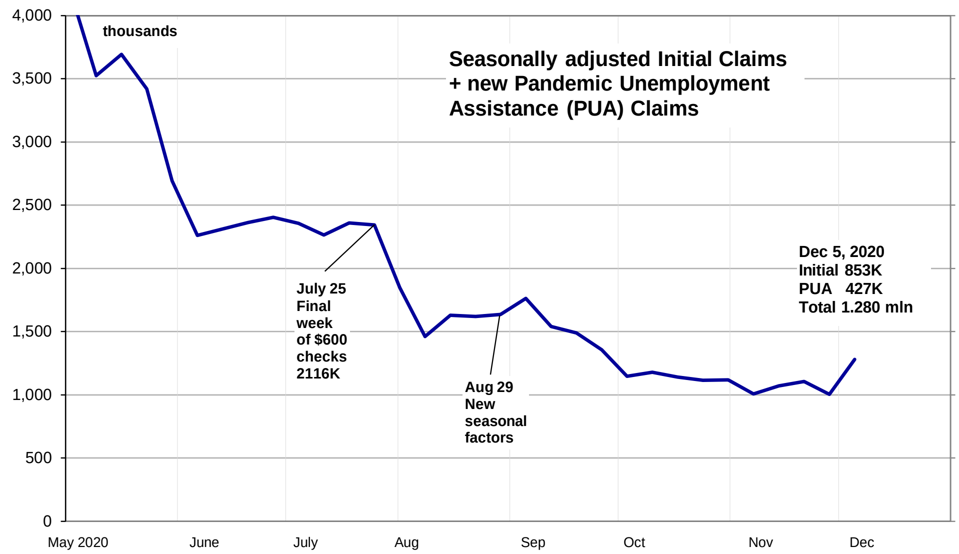
Net, net, the number of help wanted signs increased ever so slightly in October, but the labor market remains miles and miles away from the best economy in 50 years in February before the pandemic struck. October job openings are likely to disappear in a hurry relatively speaking by the end of the year with new strict stay-at-home orders issued in California this month which is the most populous state in the country. The most job openings are in the South always with 2.605 million in October, while jobs out West totaled 1.466 million this month. Stay tuned. Story developing.



Not enough jobs and not enough inflation (Thursday)

Breaking economy news. More joblessness and little inflation pressure to worry about. CPI inflation both headline and core rose 0.2% in November, but only after both indexes were unchanged the month before. Inflation cannot gain a foothold in a moribund economy that is held back by deficient demand. With many new stay-at-home orders issued in December as the spread of the virus intensifies, it is a sure bet that jobs will be hard to get and inflation pressures will continue to moderate when we get the next batch of monthly economic reports in January.

Initial unemployment claims are still coming out without an accuracy disclaimer and rose 853 thousand in the December 5 week, an increase of 137 thousand over the Thanksgiving Holiday week of November 28 with its 716 thousand initial claims. There is still a question whether these are really 853K new applications from new individuals or whether some of the numbers are reopenings of cases filed earlier. Additionally, the first week of December is always a big seasonal layoff week at the start of the winter weather, and not seasonally adjusted claims jumped over 200 thousand to 947 thousand. Gig workers or the self-employed have their own Pandemic Unemployment Assistance program for benefits that goes away on December 31 without action from Congress, and the filings here were 427 thousand in the December 5 week which is an increase of 139 thousand from the week before.



Net, net, it is still a recession out there judging by the millions of Americans who are unable to find work. Inflation rose modestly with economic growth sputtering as the virus spreads rapidly through the nation.

Mass unemployment continues to weigh on economic growth and demand so it is no wonder that Fed officials cannot light the spark that fuels inflationary fires. The economy is a long way away from the maximum employment conditions that existed before the recession struck earlier this year. If Congress continues to sit on its hands without voting on a new relief package, the plight of the nation's unemployed is going to grow darker by the hour.

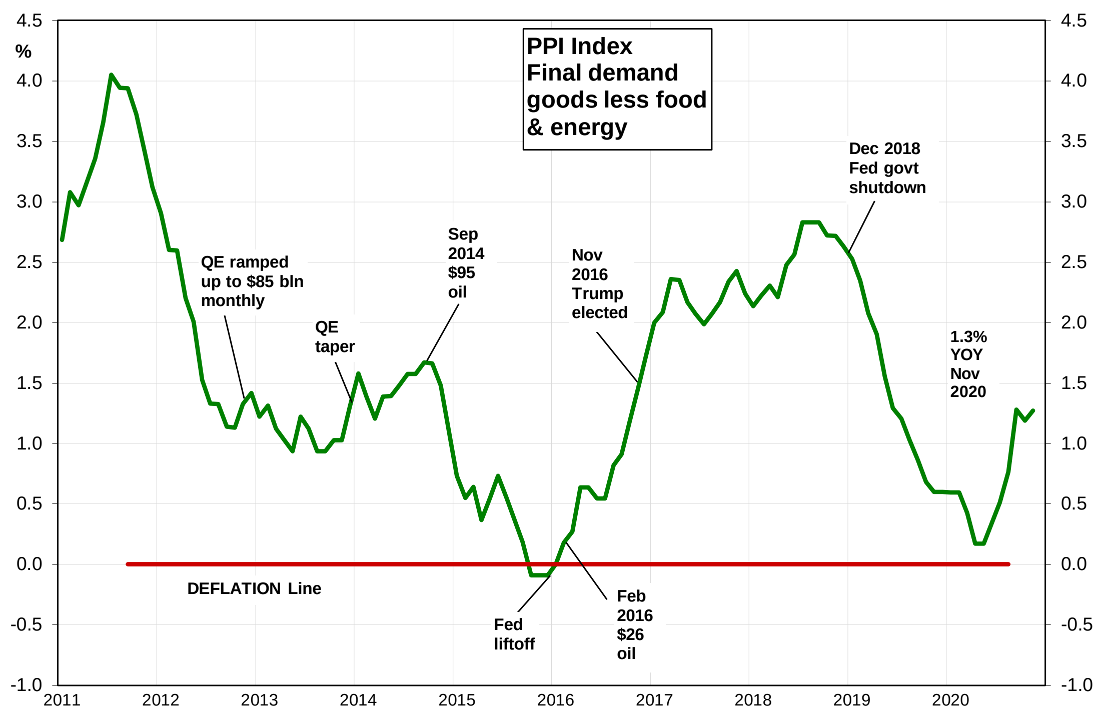
		Monthly Percent Changes			YOY %
Weight	CPI inflation	Sep 2020	Oct 2020	Nov 2020	Nov 2020
100.0	Total	0.2	0.0	0.2	1.2
14.2	Food	0.0	0.2	-0.1	3.7
7.9	Food at home	-0.4	0.1	-0.3	3.6
5.7	Energy	0.8	0.1	0.4	-9.4
79.0	Ex-food & energy	0.2	0.0	0.2	1.6
3.7	New vehicles	0.3	0.4	-0.1	1.6
2.5	Used cars/trucks	6.7	-0.1	-1.3	10.9
2.7	Clothing	-0.5	-1.2	0.9	-5.2
1.6	Medical care goods	0.0	-0.8	-0.3	-1.1
33.5	Shelter	0.1	0.1	0.1	1.9
4.9	Transportation	-0.9	0.1	1.8	-3.4
7.3	Medical care services	0.0	-0.3	-0.1	3.2

Producer prices cool as pent-up demand purchases slow (Friday)

Breaking economy news. PPI inflation, or the Producer Price index for final demand as the BLS has now re-branded it, rose just 0.1% in November which is a more modest advance after gains of 0.3% in October and 0.4% in September. November producer prices of core goods rose a moderate 0.2% after an unchanged reading in October, so it was really the 0.3% drop in trade services which cooled PPI inflation overall, whatever trade prices are. The report says, "Trade indexes measure changes in margins received by wholesalers and retailers," if that helps clarify anything.

Old-fashioned PPI inflation was for goods, but today's report with the 0.2% increase for goods ex-food and energy didn't point to any specific commodities that were behind the increase. In fact, pharmaceutical preparations declined. The report did say prices of processed young chickens were moving up, but these are not core prices. Final demand goods prices overall rose 0.4% in November and have risen every month since that huge 3.0% drop in April at the height of the pandemic shutdowns.

Net, net, the economy was clearly making up for lost time giving factory inflation a boost the last few months after the coronavirus lockdowns at the start of the year, but now that the demand has been met, producer prices are seeing less upward pressure. There are no factory inflation pressures building, either due to shortages or to stronger manufacturing demand, that could possibly lead to more inflation at the consumer level so Fed officials looking for something to boost inflation closer to the 2% target are going to be disappointed in today's report. Stay tuned. Story developing. Producer prices have cooled as the pent-up demand purchases slow and new headwinds emerge from many states issuing new stay-at-home orders as the virus spreads.



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