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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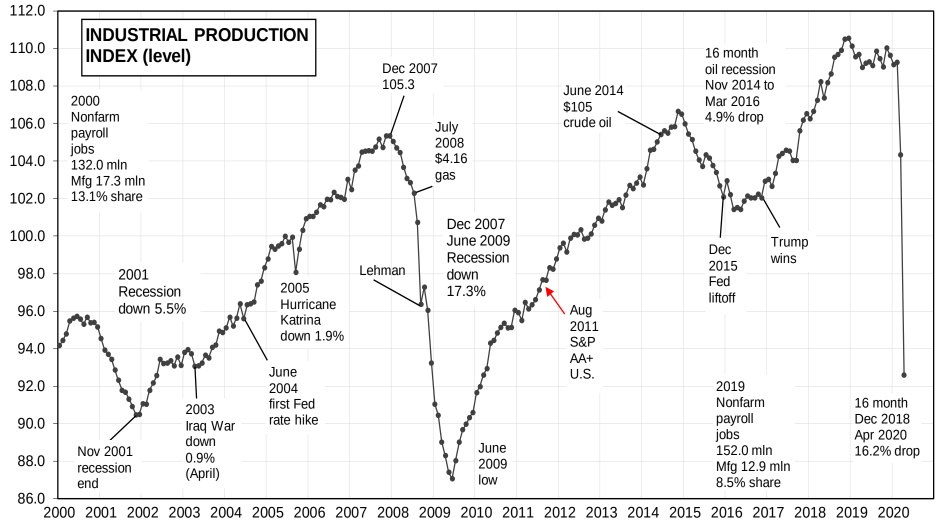
MANUFACTURING OUTPUT COLLAPSES IN APRIL MAKING THE RECESSION A RECESSION

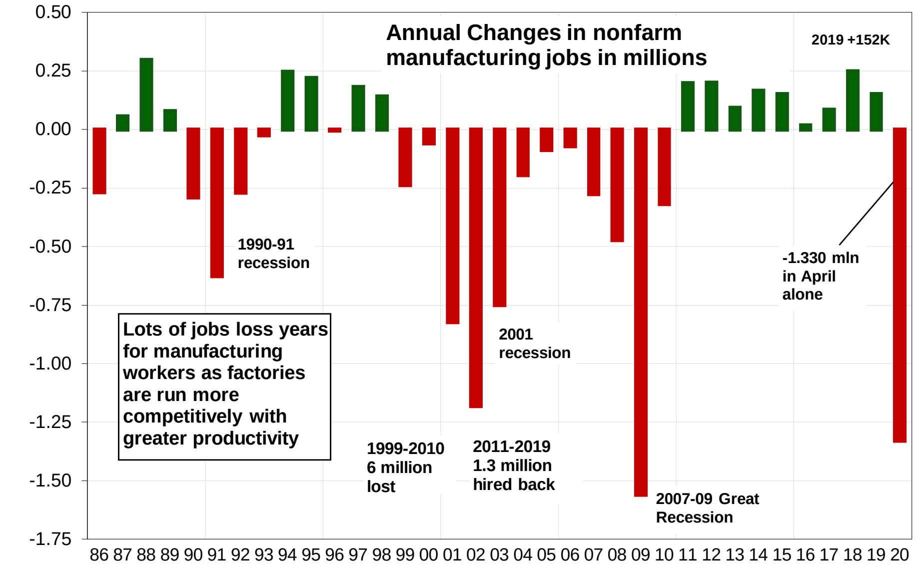


Purchasing manager executives in manufacturing thought their sector of the economy was in a recession from August to December last year even before the coronavirus pandemic leveled the broader economy early in 2020. Turns out they were a little early but eventually right. Just like our own forecasts. Job losses are the heart of every recession, but manufacturing production still defines the economy's best of times to worst of times in every recession. This is true amazingly even though manufacturing workers of just 11.488 million in April are 10.5% of the 109.308 million total private nonfarm payroll jobs in the country. Unemployment may be close to the Great Depression's scary 25% level where you look around and see one out of four of your neighbors are out of a job. But industrial production in the Great Depression in the 1930s fell 53.6% which is more than the stunning reversal of fortune for America's factories in 2020 with the Federal Reserve's own industrial production index falling 15.3% from 109.3 in February to 92.6 in April.

Recession	Recession Length	Industrial Production Decline	Industrial Production Low	Industrial Production % Decline
Dec 07 to Jun 09	18 months	18 months	Jun 09	17.3
Mar 01 to Nov 01	8 months	17 months	Nov 01	5.5
Jul 90 to Mar 91	8 months	6 months	Mar 91	4.2
Jul 81 to Nov 82	16 months	16 months	Dec 82	9.3
Jan 80 to Jul 80	6 months	5 months	July 80	6.6
Nov 73 to Mar 75	16 months	18 months	May 75	13.0
Aug 29 to Mar 33	43 months	36 months	July 1932	53.6

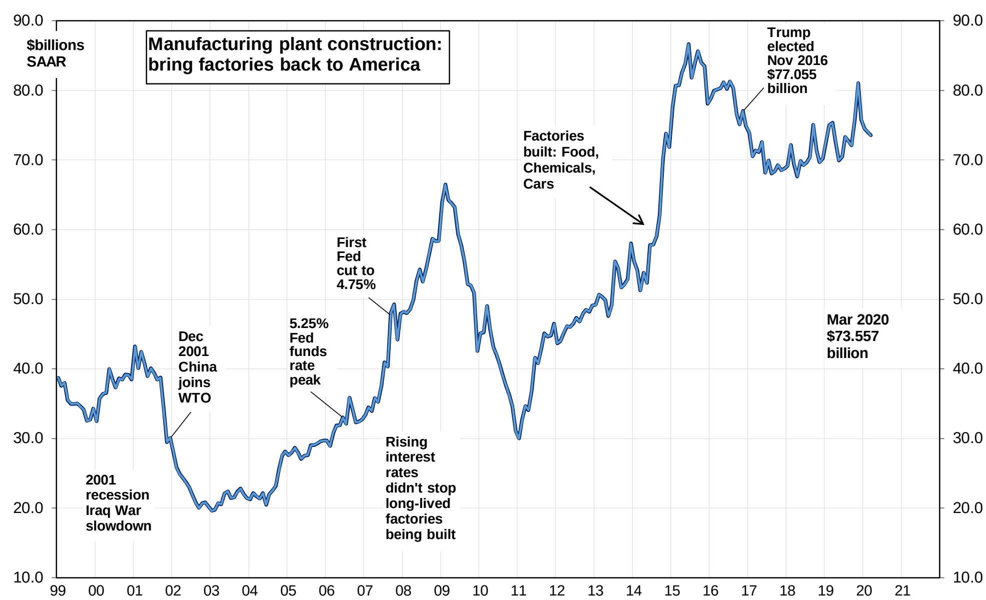
You can blame it on the off-shoring of American factories the last two decades, eveyone else seems to be doing so (even if they like the cheap refrigerators and air conditioners), but the recession indicator of industrial production is doing some strange things. We hope that this coincident indicator of economic downturns isn't going haywire keeping in mind industrial production in Japan was always quite cyclical moving up and down in business/economic cycles before flaming out. The problem is that industrial production in the USA fell in 2014-16, over a sixteen month period actually, and there was no recession. Production fell after the oil price crash in 2014, and that 4.9% decline was almost as much as the 5.5% drop during the entire 2001 recession. This is really the first time there was a false positive indication of an American recession from the industrial production index.

What is happening now, like in just the last two months, is clearly off the scale of what economists could have ever imagined could possibly happen to the economy. This is a good thing in a way as we can explain it away as a coronavirus pandemic recession that can hit bottom once the health crisis subsides or the states and their factories start to open back up… for now anyway.



History has not been kind to factory workers in the earlier two recessions of the 2000s. Manufacturing firms may have taken advantage of those two recessions to cut overhead permanently when demand for their goods plummeted. And ongoing productivity gains meant factories that stayed in the USA, despite the higher costs of production, didn't have to hire everyone back. Over the 12 year period from 1999 to 2010, 6 million manufacturing workers lost their jobs, while over the 9 year period from 2011 to 2019, 1.3 million workers were hired back to work in factories.

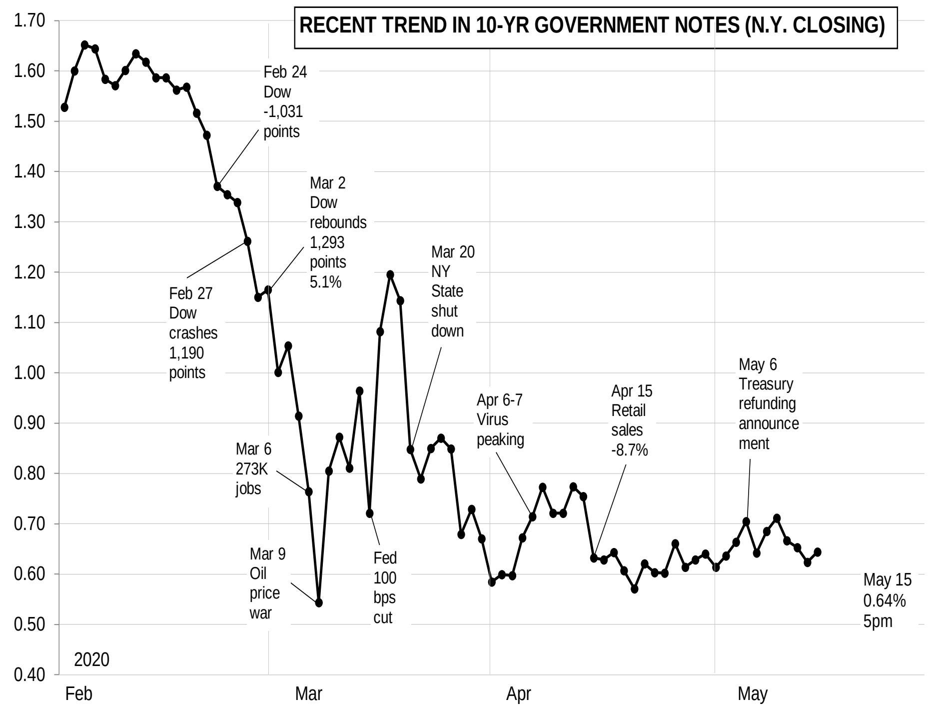
Meanwhile, if you think the pandemic health crisis and U.S. economic war with China will bring factories back to the USA, we haven't seen it yet. But we will certainly keep watching. The graph here is on factories put in place and each month is an annual rate. There were a lot of factories built starting in late 2014 with Chemicals, Autos and Food plants leading the way. But there has been little activity



since the 2016 elections although the $73.557 billion annual rate in March 2020 is still at a high level. We will see how far plant construction falls in this recession which looks to be of fairly short duration at least, after manufacturing plant construction fell in half during the 2001 and 2007-09 recessions.

MARKETS OUTLOOK

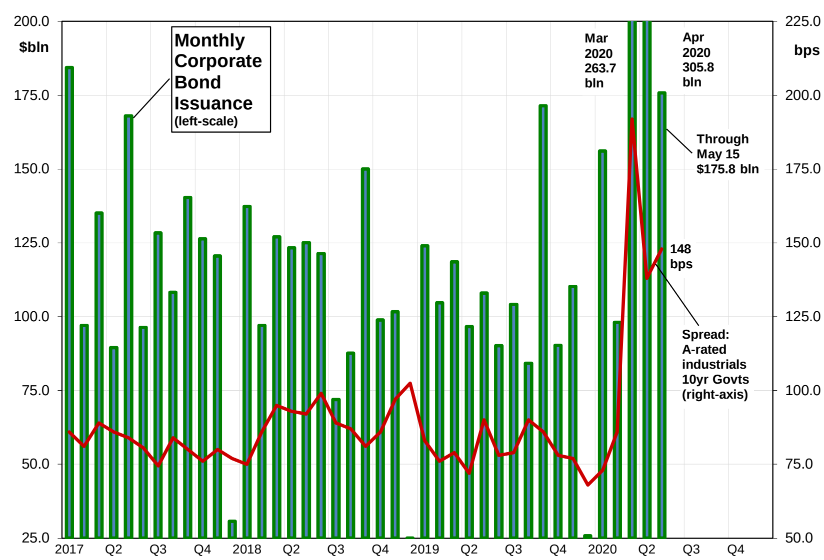
	29-Mar 2019	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021
30-Yr Treasury	2.81	2.53	2.11	2.39	1.32	1.30	1.30	1.40	1.50	1.60
10-Yr Note	2.41	2.01	1.67	1.92	0.67	0.70	0.70	0.80	0.90	1.00
5-Yr Note	2.23	1.77	1.55	1.69	0.38	0.30	0.40	0.60	0.70	0.80
2-Yr Note	2.26	1.76	1.62	1.57	0.25	0.20	0.30	0.30	0.40	0.40
3-month Libor	2.60	2.32	2.09	1.90	1.45	0.40	0.30	0.20	0.20	0.20
Fed Funds Rate	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	15	25	5	35	42	50	40	50	50	60



10-year Treasury yields moved around more this week. We left this line in from last week's write-up even though it isn't true. The bond market might as well have coronavirus and no disrespect intended. Pretty exciting for the stock market falling Wednesday with Powell warning on the economy, following through Thursday morning after another week of 3 million jobless claims, before rallying back 835 points from the lows starting at 10am in the morning. Stocks didn't completely break down so it seems like just another test of the month and a half sideways range. Bond yields aren't moving higher yet with the U.S. Treasury's extraordinary demands and that's good because the Fed is cutting next week's QE Treasury purchases to $6 billion per day from $7 billion daily this week.

CORPORATES: UNITED HEALTH, DISNEY, HONEYWELL, ROYAL CARIBBEAN

Corporate bond offerings were $69.9 billion in the May 15 week versus $103.4 billion in the May 8 week. On Friday, Lockheed Martin sold $1.15 billion 10s/30s. It priced a $400 million 1.85% 10-yr (m-w +20bp) at 125 bps (A3/A-). The aerospace defense company will use $400 million of the proceeds to redeem a portion of its $900 million 3.35% 2021 notes, and the rest for its $1.25 billion 2.5% 2020 notes. Corporate bond yields (10-yr Industrials rated A2) were 148 bps above 10-yr Treasuries Friday versus 147 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets June 9-10, 2020 to consider its monetary policy. Fed Chair Powell really stuck his foot in it, we mean his remarks on Wednesday at 9am (we are working from home, forever it looks like, so we were not up yet that early in the morning on a business day to listen in real-time) were interpreted to mean that the economy is doomed unless there is more fiscal stimulus coming from Congress. Powell's speech was supposed to be on "Current Economic Issues" which is kind of a bland title and not the same as screaming why the heck are we in a recession and the sky is falling and the skies are growing darker and what can the Federal Reserve do about it. Nothing apparently. We inserted the final paragraph of his prepared remarks below. Nothing to criticize here however as he sums it up. We can't see anything the Fed can do about current conditions and Powell's repeating the mantra that the Fed can lend not spend is sounding old, tired and unhelpful in this extraordinary national emergency. They need to buy the debt the Treasury is selling to finance the recovery whether they acknowledge this explicitly or not. This week's final Fed news was an update on the "majority of Americans can't come up with $400 in an emergency" survey. And we'll get to that optimistic news in a minute. The Fed added some lending facilities to its balance sheet. Not enough to move the dial on the economy.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	13-May	6-May	29-Apr	22-Apr	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	4057.268	4020.191	3971.419	3909.352	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1783.761	1605.380	1604.720	1622.487	0.000
Repurchase agreements	157.354	172.700	158.202	157.500	126.750
Primary credit (Discount Window)	24.239	26.494	31.759	33.742	23.455
MMLF	39.820	42.763	46.277	48.810	
PDCF	10.288	14.903	25.504	31.526	
Commerical Paper Funding Facility	4.292	3.988	3.372	2.732	
Paycheck Protection Facility	40.580	29.181	19.488	8.009	
Corporate Credit Facility	0.305				
Central bank liquidity swaps	440.934	444.885	438.953	409.712	62.000
Federal Reserve Assets	6982.7	6769.9	6703.2	6621.4	961.7
3-month Libor %	0.39	0.45	0.69	1.02	2.82
Factors draining reserves					
Currency in circulation	1929.840	1921.765	1910.511	1895.994	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	47.500				
Reverse repurchases w/others	13.825	1.175	1.450	10.825	0.000
Reserve Balances (Net Liquidity)	3263.431	3165.605	3539.660	3521.444	24.964
Treasuries within 15 days	102.681	104.760	55.294	58.869	14.955
Treasuries 16 to 90 days	217.461	213.636	249.856	243.599	31.549
Treasuries 91 days to 1 year	561.643	558.517	535.821	528.185	69.272
Treasuries over 1-yr to 5 years	1584.494	1568.584	1572.472	1536.392	170.807
Treasuries over 5-yrs to 10 years	686.628	675.810	665.596	659.309	91.863
Treasuries over 10-years	904.361	898.885	892.381	882.997	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

	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Total FY 2020
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	85.849	1,949.6
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	470.6	2,646.4
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	431.5	2,056.3
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	39.0	589.8

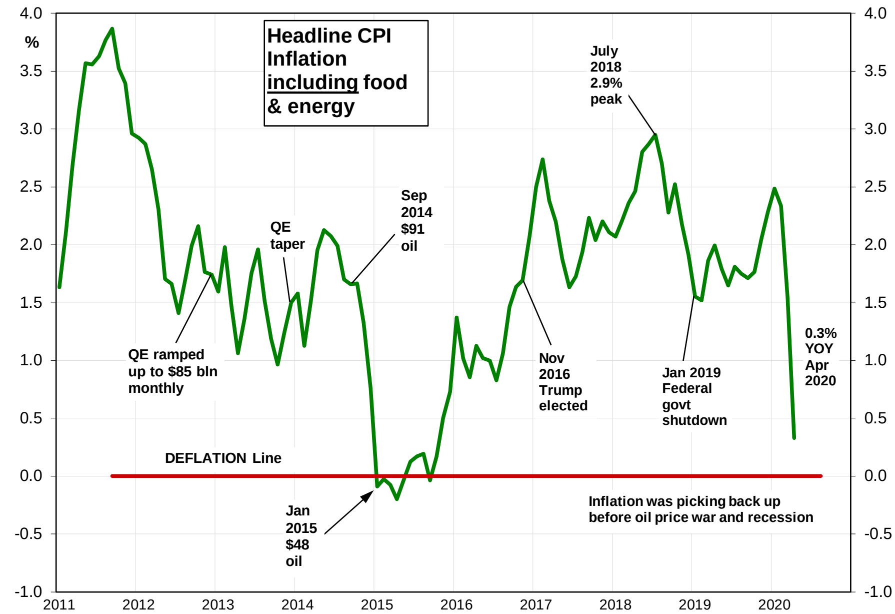
Fed Chair Powell Wednesday, May 13, 2020 final remarks

We ought to do what we can to avoid these outcomes, and that may require additional policy measures. At the Fed, we will continue to use our tools to their fullest until the crisis has passed and the economic recovery is well under way. Recall that the Fed has lending powers, not spending powers. A loan from a Fed facility can provide a bridge across temporary interruptions to liquidity, and those loans will help many borrowers get through the current crisis. But the recovery may take some time to gather momentum, and the passage of time can turn liquidity problems into solvency problems. Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery. This tradeoff is one for our elected representatives, who wield powers of taxation and spending.

OTHER ECONOMIC NEWS THIS WEEK

No Great Depression is complete without deflation: consumer prices falling down (Tuesday)

Breaking economy news. Someone tell the stock market. Inflation is crashing and that is a bad thing not a good thing. Quit buying stocks. CPI inflation fell 0.8% in April to a 0.3% year-on-year increase. A lot of this was due to plunging energy prices. Crude oil prices averaged $16.70 in April down from $31.07 in March. But other prices of the goods and services consumers buy have gone haywire since the coronavirus lockdown sent consumers home in the middle of March.



Food at home prices jumped 2.6% in April alone and are now up 4.1% the last year. Does that include the tip for your shopper? Other prices are falling because consumers have stopped buying them showing the power of supply and demand. Prices of apparel, motor vehicle insurance, airline fares, and hotels/motels are falling sharply. As a result, core CPI inflation fell for a second month in a row which hasn't happened before and we looked back over the last three decades. After falling 0.4% in April, core CPI prices are now rising just 1.4% year-on-year and it will be years before the Fed worries about too much inflation again.

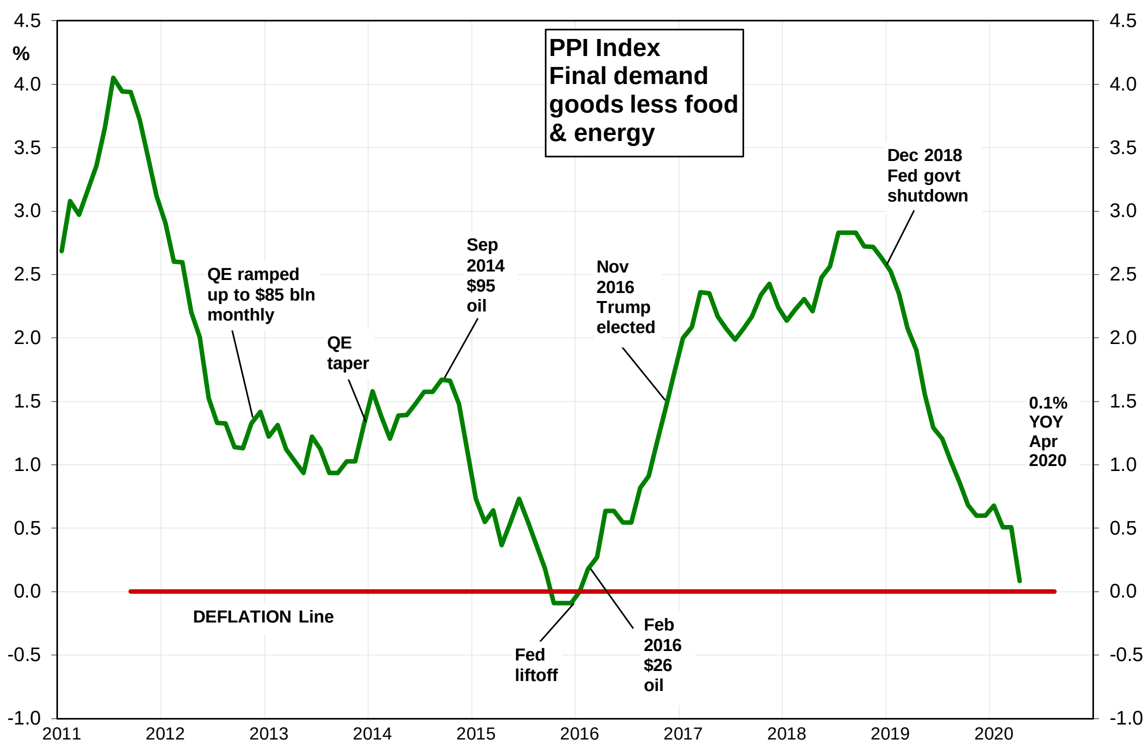
What's the stock market doing? That's all anyone wants to know after the Fed ruined the bond market and sent yields so low that they barely have a heartbeat to know they are alive. The stock market continues to move higher despite the specter of deflation that haunts the land as investors are confident the Fed has got their backs and their purchases of corporate bonds today will spread to the buying of company shares in the equity markets tomorrow if they need to. The Fed sat back and watched the Great Depression happen almost a century ago, and they aren't about to make that mistake again.

Net, net, the economic collapse has taken a dangerous turn where now it is consumer prices that are being pulled down into the abyss as consumers sitting at home have postponed their purchases. The danger is that consumers will see that prices are falling and actually stop buying goods and services to wait for even cheaper prices and a better deal which will only serve to prolong the recession and reinforce the economy's downward spiral into the unknown. Part of the reason the Great Depression lingered so long was because consumers knew they could wait till next year to buy cars and refrigerators and homes at a cheaper discount. There won't be any pent-up demand for the economic recovery following the coronavirus lockdown of the country if the consumer sits and waits. Stay tuned. Story developing.

Factory production is falling and bringing down the prices of producer goods (Wednesday)

Breaking economy news. Now it is producers that are seeing the worst downturn since the Great Depression bringing deflation to the goods they provide the economy. The producer price index of final demand goods fell the most on record in April keeping in mind the redesigned PPI index didn't start until December 2009. Final demand goods prices fell 3.3% in April dragged down by a 19.0% drop in energy prices. The economy is on deflation watch for producers and consumers now that economic demand is falling away more quickly than any time in almost the last 100 years since the Great Depression.

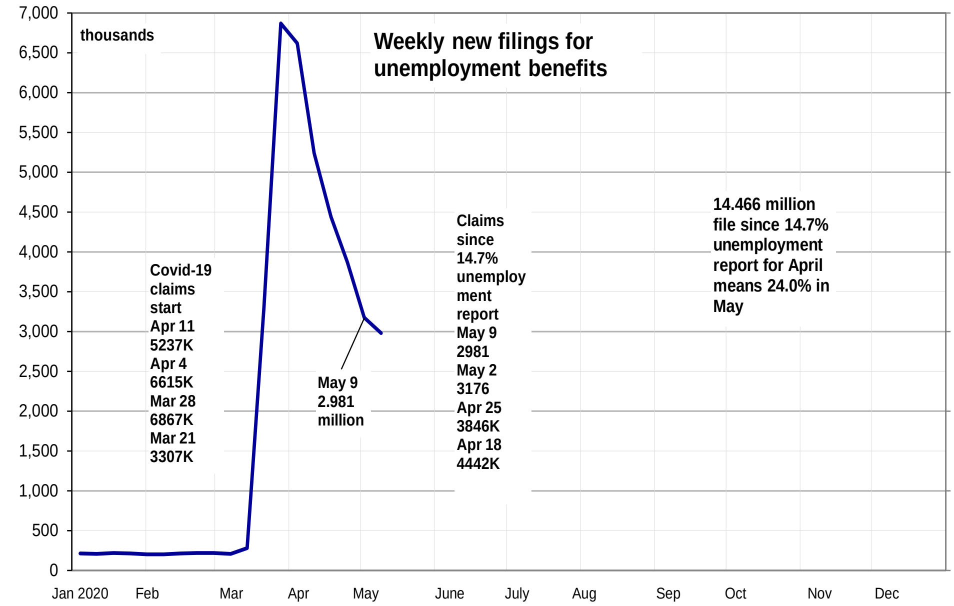
Net, net, the coronavirus recession has severely weakened demand at factories and shop floors across the country which is leading to deflation in the prices of goods that companies produce. Producer prices are stuck in the mud and are clearly not going up substantially until factory reactivation around the nation quickens demand. Factory production is falling and bringing down the prices of producer goods. Inflation isn't coming back in this economy for a long, long time. These are the worst of times for many manufacturers and it will take years for strengthening demand to bring them back to full capacity.



Soaring jobless claims pour cold water on the V-shaped recovery talk (Thursday)

Breaking economy news. Weekly jobless claims. There were 2.981 million new people applying for unemployment benefits in the May 9 week. Still? It has been eight straight weeks now of pain and woe with jobless claims in the stratosphere. This isn't a recession. This isn't a Great Depression. This is a complete economic collapse. There are 36.492 million first-time filers for unemployment benefits over the last eight weeks. Wow. Check the economy and see if it still has a pulse.

Let's do the math. 14.466 million more first-time jobless claims in the four weeks since the April 11 week which is loosely based on the April 14.7% unemployment rate with 23.078 million "unemployed." For the May jobs report due out on Friday, June 5, 23.078 million plus 14.466 million more means 37.544 million out of work or an unemployment rate of 24.0%. Mind-blowing. Buy stocks. This market is going up.



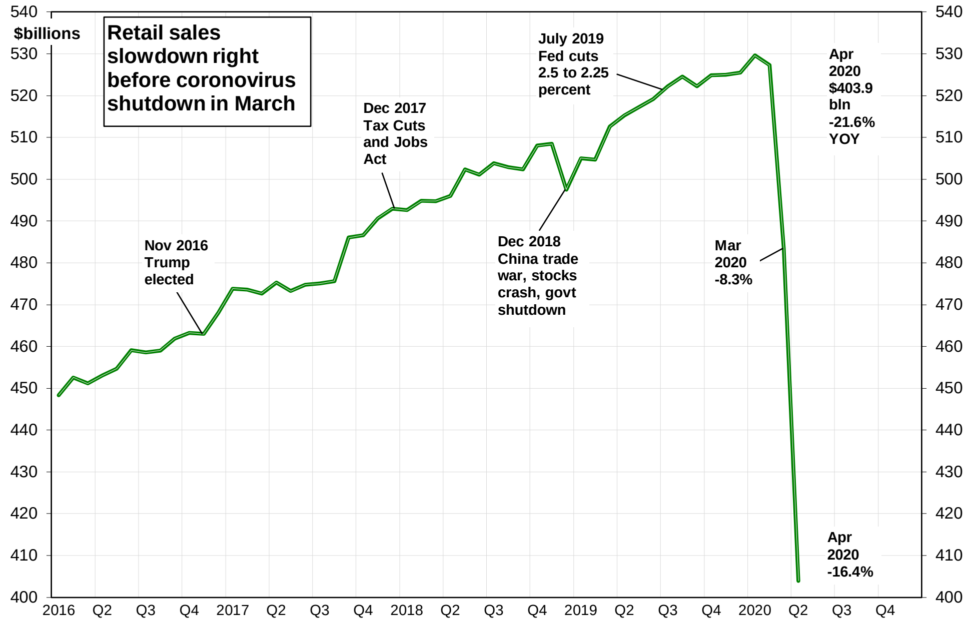
Net, net, all of Washington's fiscal stimulus measures of incentives and loans can only go so far to stem the rising tide of layoffs that companies must do to survive in this biggest contraction in the economy ever seen. No one is immune in this pandemic health crisis. Everyone's job is on the line. One in four Americans is out of work which is a number not seen since the Great Depression. This is not a business as usual recession and business won't be back to usual for years. The job layoffs are starting to spread from retailers and restaurants and bars to former safe harbors for white collar professionals like those in business administration, law firms, accountants, engineers, and architects. Payroll protection plans from congress can only go so far when companies are financially bankrupt.

Employees in many low-wage job positions also have an incentive to quit work or remain at home as long as the additional $600 per week, $31,200 a year, unemployment benefits boost in the Cares Act remains in effect through the end of July.

Soaring jobless claims pour cold water on the V-shaped recovery talk. Economic growth might get a boost from pent-up demand, but the labor markets have dug themselves a deeper hole that will be harder to climb back out of. Corporate profits will be a no-show as well as an unprecedented number of business models have been thrown under the bus and this will make it harder for many formerly successful businesses to reactivate themselves.

As consumers step away, so does the economy (Friday)

Breaking economy news. Retail sales plunged over the proverbial cliff as retail spending at shops and malls, furniture stores, barber shops, and restaurants collapsed. The fight against the coronavirus pandemic certainly has claimed another victim: the U.S. economy. This isn't a recession, and it cannot even really be called a depression as the fall is so fast and swift that this downturn defies everything economists have seen in the last century.



In April then, retail sales are down a mind-blowing 61.7% at an annual rate in the second quarter which makes those scary negative 40% GDP forecasts a little more likely. Maybe consumer spending will pick up from this point as the country starts opening back up, but it has a long way to go before consumer purchases on goods and services get back anywhere close to the peak in January this year. This is the quickest, steepest, deepest recession in the nation's history and we have never seen Washington policymakers and elected officials so surprised and simply unable to come up with a credible plan to rescue the economy that is in virtual freefall. If the paycheck protection plan was ever able to put money in people's pockets you would never know it with retail sales tumbling 16.4% in April.

Net, net, consumers couldn't get out to shop last month as the pandemic virus fight kept them at home, and the result is an economy that has simply collapsed. We have never seen economic data like this before in history. It is sobering if not downright scary. Maybe congress is right to watch and wait before undertaking additional fiscal stimulus, but today's retail sales data prove Americans are hurting. They aren't spending because they don't have any money because they aren't working.

Retail spending, actual dollars, each month

	$million	% to	Percent Changes %		
	Apr 2020	Total	Apr	Mar	Year/year
Total Retail Sales	403,946	100.0	-16.4	-8.3	-21.6
Motor vehicles/parts	68,532	17.0	-12.4	-25.7	-32.9
Furniture/furnishings	3,301	0.8	-58.7	-21.1	-66.5
Electronics/appliances	2,827	0.7	-60.6	-11.0	-64.8
Building materials/garden	31,996	7.9	-3.5	-0.5	0.4
Food & beverage	70,953	17.6	-13.1	26.9	12.0
Health/personal care	26,710	6.6	-15.2	5.0	-10.4
Gasoline stations	24,573	6.1	-28.8	-16.5	-42.8
Clothing/accessories	2,371	0.6	-78.8	-49.4	-89.3
Sporting goods, books	3,422	0.8	-38.0	-17.8	-48.9
General merchandise	50,834	12.6	-20.8	7.1	-14.9
Department stores	6,085	1.5	-28.9	-22.2	-47.0
Miscellaneous retailers	7,683	1.9	-24.7	-14.1	-30.6
Nonstore retailers (internet)	78,383	19.4	8.4	4.9	21.6
Eating & drinking places	32,361	8.0	-29.5	-29.7	-48.7

If you were looking for a bottom to the recession or light at the end of the tunnel, it isn't to be found in today's retail sales report. The states may be opening back up in May, but consumers are going to be slow to reengage and spend like they did just a few months ago when the economy was the best in 50 years. The economy right now is the worst in history, and the only ray of hope is that spending cannot fall much further. Clothing store sales down 78.8% in April. Eating and drinking places down 29.5% in April. Sporting goods, hobbies, book stores down 38.0% this month. Electronics and appliance stores down 60.6%. Furniture sales down 58.7%. Only Internet sales, so-called nonstore retailers, rose this month by 8.4%. Even grocery store sales fell 13.2% after rising 28.6% a month ago in March in the first month of the pandemic. You know it's bad out there when the public is starving themselves or maybe there are simply grocery store shortages in April with the shelves empty after the consumer stocked up in March. Stay tuned. Better days lie ahead.

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