

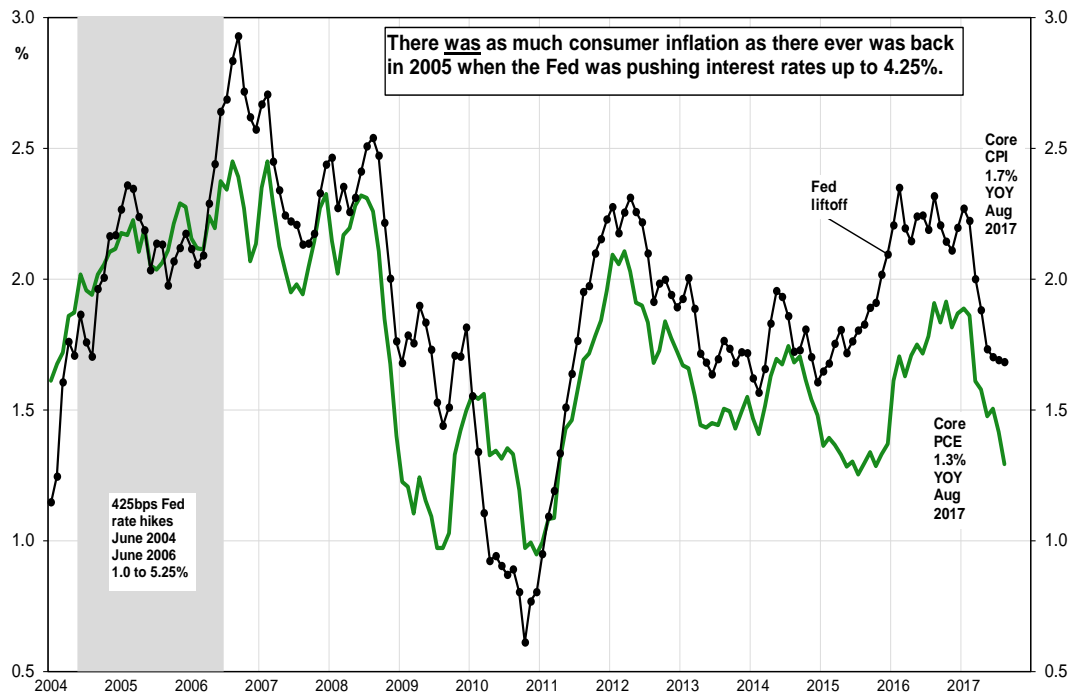
**CHRISTOPHER S. RUPKEY, CFA**  
**MANAGING DIRECTOR**  
**CHIEF FINANCIAL ECONOMIST**  
**ECONOMIC RESEARCH OFFICE (NEW YORK)**  
**(212) 782-5702**  
**crupkey@us.mufg.jp**

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MUFG | 1251 Avenue of the Americas  
 New York, New York 10020  
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## YELLEN: NO INFLATION, THEN NO DECEMBER RATE RATE HIKE

Fed Chair Yellen was speaking on inflation, uncertainty and monetary policy on Tuesday. The word uncertainty is key here because the Fed under Chair Yellen rarely makes a move in the face of uncertainty. She expects inflation to come back and all that, yada, yada, yada, but it's right there up top in the speech. The



Committee may need to reassess that path of rates, gradual, and as drip-drip, water torture slow as it already is, the Committee will reassess the path of rates if inflation doesn't pick back up.

Is it us or has this Fed gone completely off the rails in terms of over analyzing the data's micro moves? Let's see, the core PCE inflation rate is 1.4% [1.3% in August now reported on Friday] and the Fed's target is 2.0%, why again is it crucial to the nation's well-being that inflation move up 0.6 percentage points? Heck, 0.6 percentage points is a rounding error in an economy with 325 million people and nominal GDP spending of nearly 20 trillion dollars.

Yellen repeated her central thesis that inflation would move back closer to the 2% target over the medium term. Okay. The laws of gravity and economics haven't been repealed yet; an economy at

full employment sets off the sparks of inflation eventually. Indeed, the Committee's median expectations are for interest rates to move up close to 3% by the end of 2019 as core PCE inflation moves up to 2%. Core PCE inflation this year will end at 1.5% the forecasts say, and interest rates end up at 1.5%. Core PCE inflation in 2018 will end at 1.9% the forecasts say, and interest rates will end up at 2.25%. Core PCE inflation in 2019 will end at 2.0% the forecasts say, and interest rates will end up at 2.75%.

Core PCE inflation moves up and so will interest rates. So simple a reasoning even a child could guide the nation's monetary policy. Though we wouldn't recommend the President appoint a child to run the Federal Reserve when Yellen's four-year term finishes on February 3, 2018. Hey, you never know.

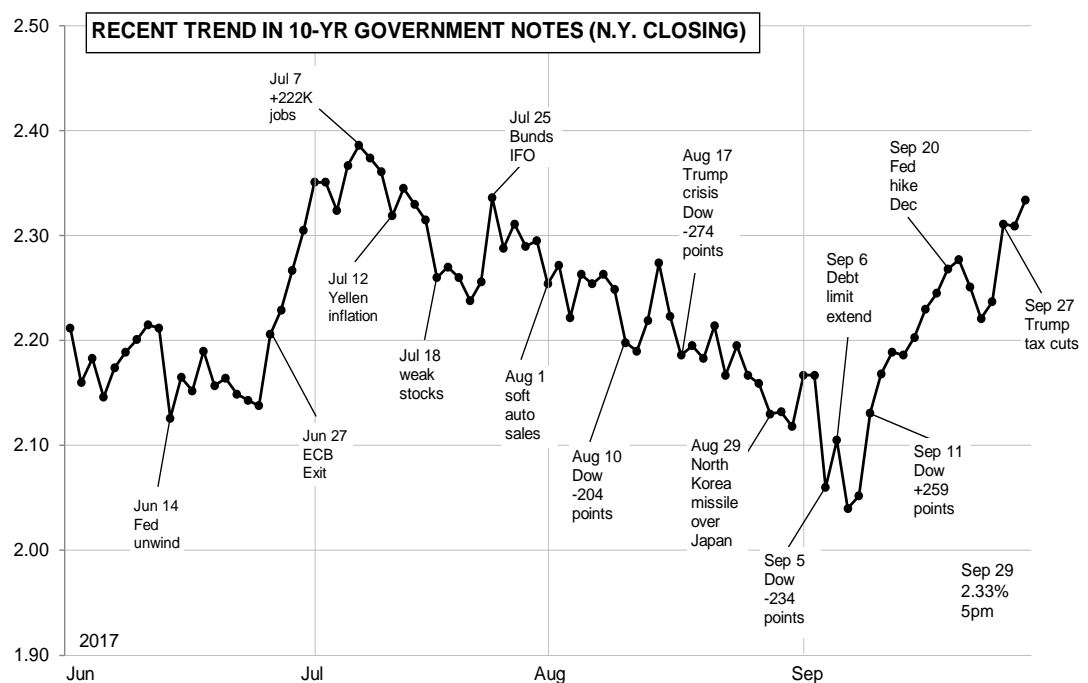
Net, net, Yellen gave the markets a shot across the bow warning today that the gradual pace of rate hikes are conditional, highly conditional on inflation returning to the 2.0% target. Only 4 out of 16 members didn't want to raise rates a third time later this year in last week's forecasts, and Yellen seemed to lean-in and give voice to the worries of the Doves on the Committee that inflation continues to undershoot target and that this could be a possible warning sign for the economic outlook.

No inflation, no rate hike. Bet on it. For as long as Yellen remains in office she is determined to proceed gradually and cautiously because there is a lot of uncertainty, and the Fed has not completely met its objectives. Inflation, inflation anyone? We better get some more inflation or the Fed may just take a pass this December when it comes to that final rate hike this year.

## MARKETS OUTLOOK

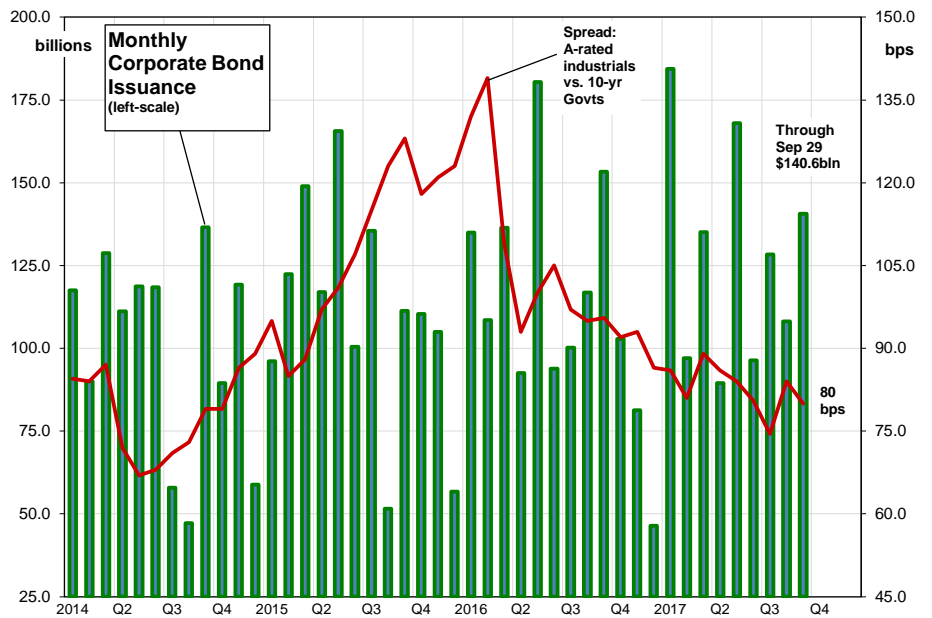
	29-Sep 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q1 2020
30-Yr Treasury	2.86	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.33	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.94	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70	3.90
2-Yr Note	1.48	1.60	1.85	2.10	2.40	2.60	2.85	3.10	3.35	3.35	3.60	3.85
3-month Libor	1.33	1.65	1.90	2.20	2.45	2.70	2.95	3.20	3.45	3.35	3.70	3.95
Fed Funds Rate	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75
2s/10s spread	85	90	85	90	80	80	65	60	45	55	30	15

10-year Treasury yields kicked higher this week. Yellen's speech on inflation uncertainty was Tuesday, and Treasury supply of 2-years, 5-years, and 7-years was Tuesday through Thursday. But it was the tax cut proposals from the Trump administration that pushed yields up 7 bps to 2.31% on Wednesday. The Federal budget deficit may be \$150 billion wider over each of the next ten years.



## CORPORATE BONDS: EQT CORP., CK HUTCHISON, CLOROX, AEP, NETAPP

Corporate offerings were \$22.0 billion in the September 29 week versus \$18.7 billion in the September 22 week. On Tuesday, Clorox Co. priced \$400 million 3.1% 10-yrs (m-w +15bp) at 87.5 bps (Baa1/A-). The consumer products company, bleach, Glad bags, Pine-Sol, Fresh-Step cat litter, will use the proceeds to repay 5.95% notes due October 2017. Corporate bonds (10-yr Industrials rated A2) were 80 bps above 10-yr Treasuries this week versus 84 bps last Friday.

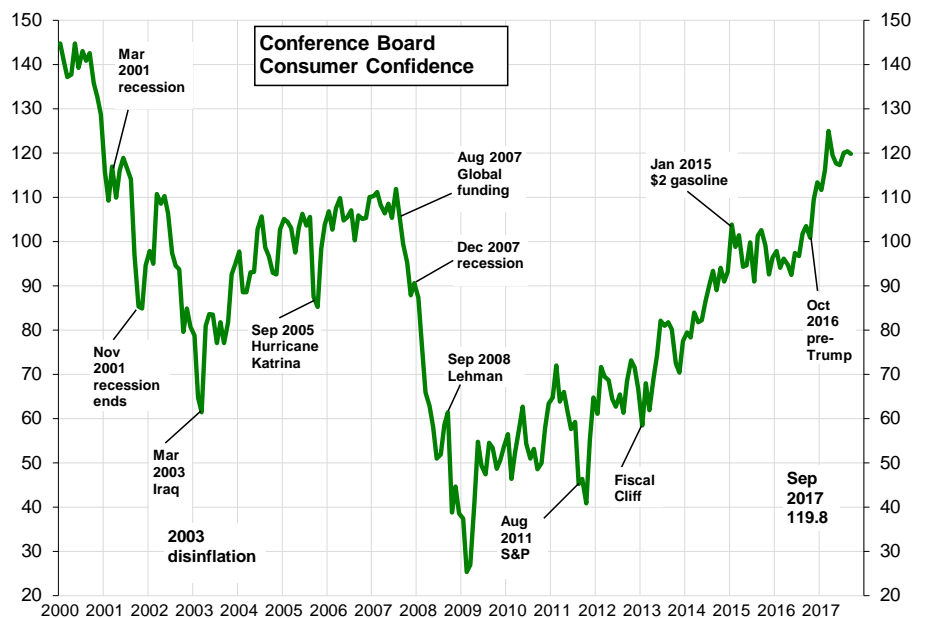


## OTHER ECONOMIC NEWS THIS WEEK

### Confidence steadies as American jobs not as plentiful

Breaking economy news. Consumer confidence steadies from the euphoria early this year when Trump took office. The stock market's initial high this year made in early March on the President's State of the Union address held for many months. Stocks eventually moved to higher levels, but confidence has not moved higher and now it has steadied.

Part of this month's slight decline in consumer confidence from 120.4 in August to 119.8 in



September is the labor market perhaps. Jobs are still plentiful even if not quite so available. To our mind this means the economic expansion has hit the wall of full employment where certainly job creation will slow and make it harder for the Trump economics team to boost growth. This is already one of the longest economic expansions in history and any attempt to make the economy run any faster at this late stage of the race is probably doomed to failure as it would break the laws of economics. Expansions don't die of old age but they don't run marathons this late in life with the baby boom generation retiring and spending less.

Net, net, the Trump administration is counting on consumers to do their parts when it comes to hitting those ambitious goals of stronger economic growth with greater prosperity for all. Confidence has steadied for now from those hopes and dreams many had back in March when President Trump gave his State of the Union address. Confidence has steadied and consumers have reported that jobs are not as plentiful. The failure of the Trump administration and of Congress to pass legislation may be starting to weigh on confidence. An incoming President only really has six months to enact changes and get things done before the forces against change start to make any forward progress nearly impossible. Confidence has stopped rising which matches the slowdown in auto sales this year from 18 million to now 16 million at annual rates. If your one leading economic indicator for the outlook was car sales, you wouldn't think it would be possible to change the economy's 2 percent growth story and make the economy run faster.

The consumer's mind isn't set in stone and greater spending may surely be around the corner, but for the first time we are starting to wonder if the failure to enact legislation down in Washington is starting to take a toll on confidence. The lesson of history is that big changes send consumers and businesses to the sidelines until they can figure things out. We worry that the tax reform proposals and the size of these cuts to the revenue side of the Federal budget are going to scare the daylights out of the country that has been schooled to think that a \$20 trillion national debt is way too much government spending. Stay tuned. Story developing.

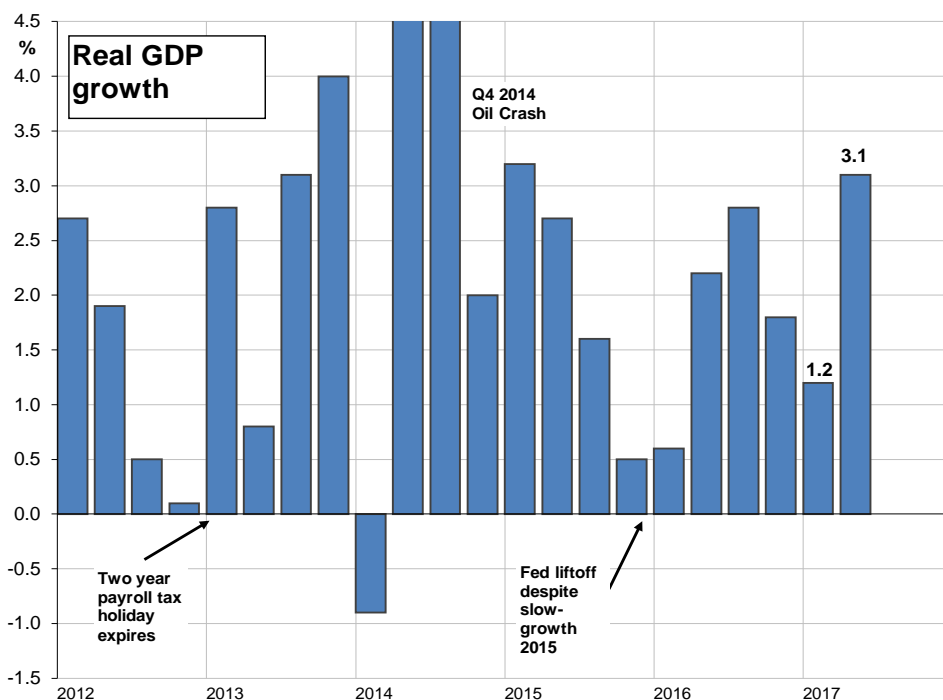
### 3.1% GDP means Washington can stop priming the pump

Breaking economy news. Third look at second quarter GDP which is good at 3.1% even if this view of the economy is getting pretty old and we are more interested in economic output for the third quarter that finishes up in a couple of days.

3.1% is not an economy that needs the support of Washington, either the biggest tax cut in history or the stimulative monetary policy with low interest rates from the Federal Reserve.

It couldn't be more ironic the proposal to allow companies to immediately write off their equipment purchases to stimulate investment in the economy. The economy is in its ninth year of expansion and any company that has not

ordered up new equipment at this late stage should probably have its management checked. Companies tend to order equipment in the early days of an economic recovery after postponing



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purchases during the recession. It couldn't be more ironic that Fed officials continue to keep rates low to encourage investment when most investment has already been made for this cycle.

Anyway, business equipment purchases rose 8.8% in the second quarter GDP report this week following on the 4.4% jump in the first quarter this year. The 3.4% decline in 2016 for equipment purchases is ancient history that was tied in part to the oil price crash in 2015 into early 2016. Business does not need new incentives to invest in the country's future that helps the economy grow.

Net, net, the President's new tax proposals are not needed to stimulate more spending in the economy with GDP growth revised up to 3.1% in the second quarter. This Administration and Congress is attempting something that no other president has tried in modern economic history. Every student in economics class at college learns one basic truth. Government increases fiscal stimulus measures during an economic recession when Americans are losing their jobs. The economy does not need a tax cut and no other Administration has cut taxes when the economy is at full employment and the national debt is \$20 trillion. We can't afford it, and the economy surely doesn't need it.

Consumers are the ones doing the heavy lifting with spending fast at 3.3% in the second quarter. But consumers abhor uncertainty and we can guarantee you consumers will not like this tax plan that seeks to radically alter the way Americans fund the Federal government and pay interest on the national debt. Tearing up the tax codes and eliminating long-standing deductions is too radical of a change and the confusion it will cause if it is passed could send consumers to the sidelines. Stay tuned. Story developing. The economy is better than the Trump economics team and Congress thinks. Don't cut taxes unless the economy is in a recession. That's the lesson of history.

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