# Financial Market Weekly

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

**MUFG | 1251 Avenue of the Americas**
**New York, New York 10020**

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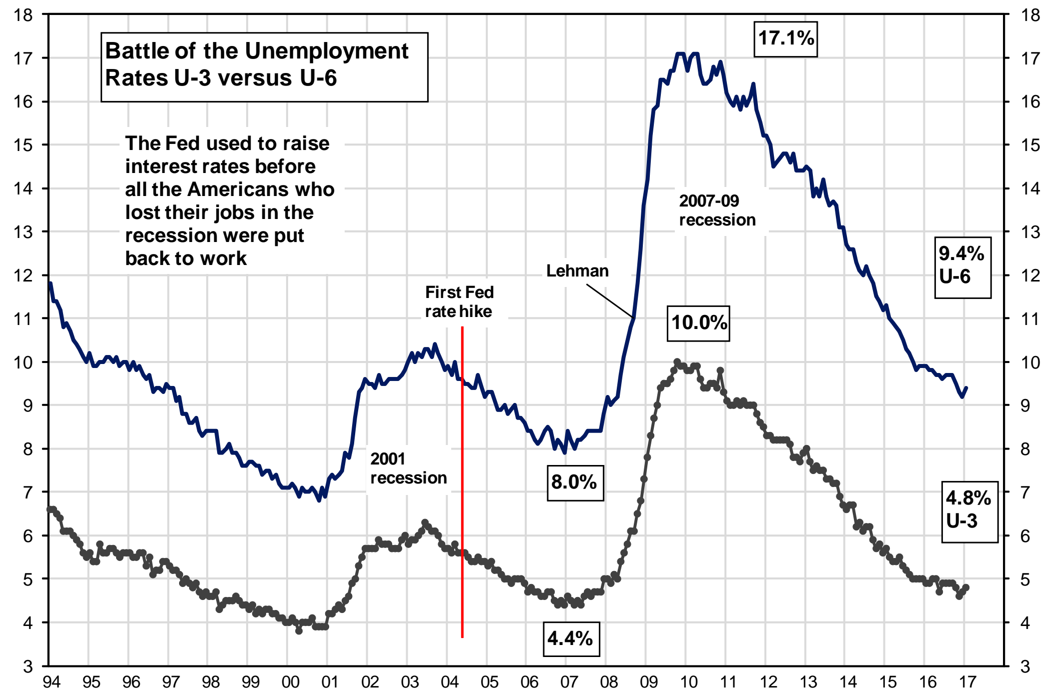
## MORE EVIDENCE THAT THE UNEMPLOYMENT RATE IS OVER 20%




This week we will present additional evidence that the unemployment rate is over 20%. Actually, we lied. We don't have any evidence that shows unemployment is that high. None. Zero. Nothing. The highest unemployment ever recorded was thought to be 25% in 1933 the worst of the Great Depression. Is it 1933? Did they even have light bulbs back then? Is the economy today remotely comparable to the 1930s? Does it look like we are in a Great Depression now? No, of course not.

> Trump quote Sep 28, 2015
> "5.3 percent unemployment -- that is the biggest joke there is in this country. … The unemployment rate is probably 20 percent, but I will tell you, you have some great economists that will tell you it's a 30, 32. And the highest I've heard so far is 42 percent." Such a phony number.

Until we make America great again, this week we will take a look at the U-6 unemployment rate which people use at times to bolster their argument that unemployment is actually at higher levels. At higher levels that are troubling for the economic outlook. Unemployment at higher, worrying levels that has Trump's economic team looking for ways to boost employment. Bring manufacturing and factories back from overseas. Cut government regulation. "Another terrible job-killing rule," Trump said last week when he signed a resolution, that deep-sixed



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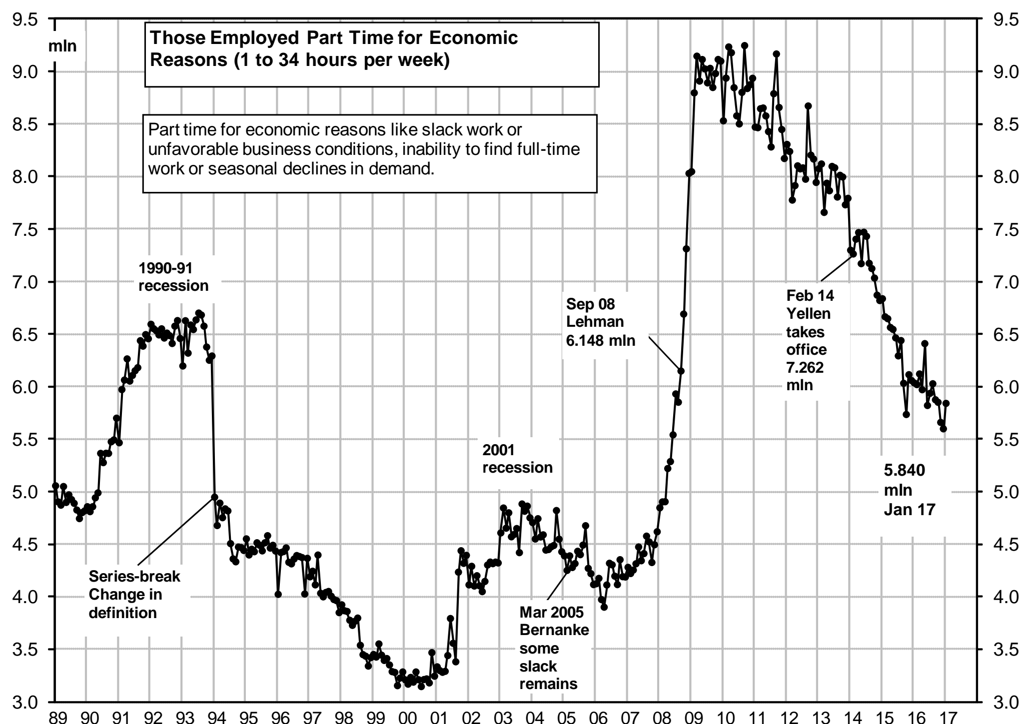
Obama's "Stream Protection Rule," and that will help "save thousands of American jobs in the mining industry."

President Trump is not that far off. We mean maybe his thinking the electorate wants change because unemployment is over 20%. Economic hard times. U-6 unemployment was as high as 17% during the Great Recession. We hate to call it the "Great Recession" as it makes Fed officials even more cautious when it comes to raising interest rates. The greater it is the longer it will take the economy to move past it, at least in their minds. Take a look at car sales. We're past it. Interest rates are low making saving for the future unaffordable. Retirees living off of the interest on their savings, well, can't. But we digress.

**U-3 to U-6 mainly involuntary part-timers**

| 000s | Rate | Unemployed | Labor Force | Adds | Jan 2017 |
|---|---|---|---|---|---|
| U-3 | 4.8 | 7,635 | 159,716 | - - - | Traditional unemployment |
| U-4 | 5.1 | 8,167 | 160,248 | 532 | Discouraged |
| U-5 | 5.8 | 9,287 | 161,468 | 1,220 | Others Marginally Attached |
| U-6 | 9.4 | 15,127 | 161,468 | 5,840 | Part time for eco reasons |

U-6 unemployment was 17% at the peak, but today it is 9.4%. Behind this 9.4% U-6 unemployment rate is 15.1 million people. However, 39% of these 15.1 million so-called unemployed actually have jobs (part-time). With a paycheck, it is hard to call these part-timers a sign of a weak economy. We hate to think that the Fed Chair used these elevated numbers of part-timers who want full-time work as a sign the labor market was not at "full employment," and that there was still a role for monetary policy to play, i.e. keeping rates low would help the labor market.




This is not new this finger-pointing at involuntary part-time employment as the fly in the ointment of a better economic outlook. Back in 2005 it was then Fed governor Bernanke who cited this statistic as a sign there was still slack in the labor market. Greenspan did not listen to him however (then why are we listening to the ghost of Ben Bernanke, and Yellen now?). When Bernanke cited slack conditions in the labor market in March 2005 there were 4.388 million employed part time for economic reasons. This was slightly elevated from the 2001 recession and frankly just the way the labor market has evolved over time and Greenspan did not see this as a reason to halt the measured pace of rate hikes. 200 basis points per year. The gold standard. The Greenspan Fed lifted rates starting in June 2004 from the 1.0% level to 2.5% in March 2005 when Bernanke made his "some slack remains" speech. The Greenspan Fed didn't pause; they just kept going with rate hikes. Anyway, we don't see this labor market indicator right now as a reason not to return interest rates to normal levels. The public thinks normal is at least 3% and wonders why the Fed funds rate is not there already.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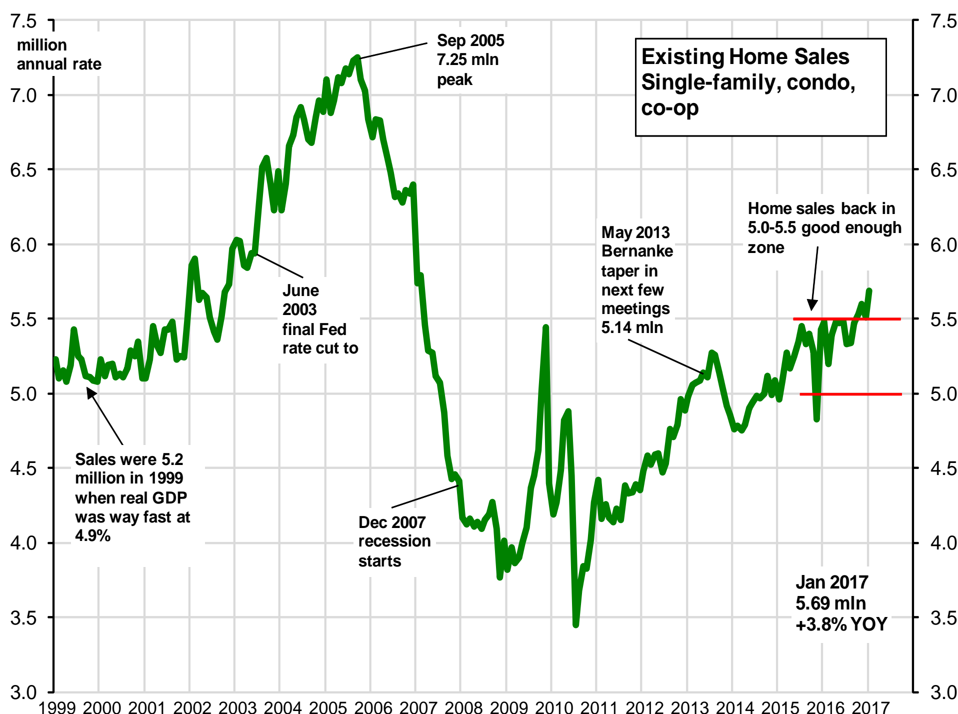
## MARKETS OUTLOOK

| | 30-Dec 2016 | Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 | Q1 2018 | Q2 2018 | Q3 2018 | Q4 2018 | Q1 2019 | Q2 2019 | Q3 2019 | Q4 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 30-Yr Bond | 3.07 | 3.10 | 3.10 | 3.20 | 3.40 | 3.60 | 3.70 | 3.80 | 4.00 | 4.10 | 4.10 | 4.20 | 4.30 |
| 10-Yr Note | 2.45 | 2.40 | 2.50 | 2.70 | 3.00 | 3.20 | 3.40 | 3.50 | 3.70 | 3.80 | 3.90 | 4.00 | 4.10 |
| 5-Yr Note | 1.93 | 2.00 | 2.10 | 2.40 | 2.70 | 3.00 | 3.20 | 3.30 | 3.50 | 3.60 | 3.70 | 3.80 | 4.00 |
| 2-Yr Note | 1.19 | 1.60 | 1.80 | 2.00 | 2.20 | 2.50 | 2.75 | 2.85 | 3.10 | 3.30 | 3.50 | 3.50 | 3.70 |
| 3-month Libor | 1.00 | 1.25 | 1.50 | 1.70 | 1.95 | 2.20 | 2.45 | 2.70 | 2.95 | 3.20 | 3.45 | 3.45 | 3.70 |
| Federal Fund Rate | 0.75 | 1.00 | 1.25 | 1.50 | 1.75 | 2.00 | 2.25 | 2.50 | 2.75 | 3.00 | 3.25 | 3.25 | 3.50 |
| 2s/10s spread | 126 | 80 | 70 | 70 | 80 | 70 | 65 | 65 | 60 | 50 | 40 | 50 | 40 |
| Libor/funds spread | 25 | 25 | 25 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 | 20 |

Bonds rallied this week closing near the 2.30% lows for the year. Disbelieving Trump economics doesn't seem to be the issue. Although Treasury secretary Mnuchin told CNBC Thursday at 7am EST that "more normalized growth is 3% or higher." This is on the lower bound of the 3 to 4 percent range talked about during the campaign and doubling GDP would be 4%. What seemed to bring down U.S. bond yields were French-politics headlines suggesting lower odds now that populist-right candidate Marine Le Pen could achieve an upset victory.

## Other News This Week

### Existing home sales break out to new highs-no mortgage rate effect yet




Breaking economy news. Existing home sales continue to shine at the start of the year and this bodes well for consumer spending which helps the economy go. Homeowners know what bottomless pit means when it comes to decorating and



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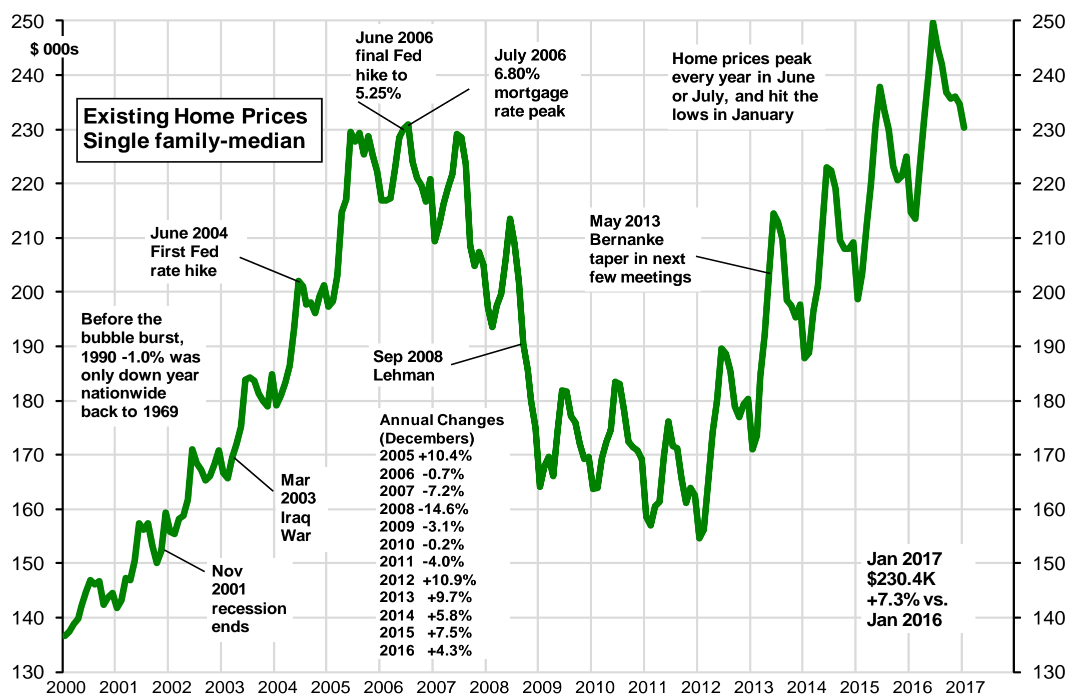
furnishing and maintaining a new home. The dollars spent out of pocket are substantial, expenditures which will boost the economic outlook this year. Team Trump is trying to boost economic growth and today's existing home sales will make the job a little easier. Home sales generate spillover spending on appliances, furnishings, lawn services, Internet, TV, the works. Homebuyers might even put an extra new car or two in the driveway.

The rise in the turnover of the existing home stock is setting new records since the housing bubble crash and these sales are so far looking bullet proof when it comes to those higher financing costs where mortgage rates jumped on the Trump effect last November from 3.5% to 4.3% for a time. The higher mortgage rates at 4.15% in the last week are not slowing sales activity one bit. This makes us more confident that Trump's economic policy team will be able to engineer faster growth of near 3% by late 2018 assuming they get the needed tax policy in place, maybe with some reform, less regulation and infrastructure spending.

Looks like housing still a good investment over time




It's not all about more sales turnover unless you are the neighborhood friendly realtor, also important for the outlook and for confidence is whether or not home prices are rising. This has been an incredible presidential election where somehow the economy became voters' number one issue. Incredible as in how this economy with very low unemployment and rising home prices came to be seen as a problem that Washington could fix is beyond us. Incredible, as in not credible. Over the last year, single family existing homes rose 7.3% to $230,400 in January. Our advice is if you can buy a home for $230,400 then do it. The wealth effect on consumer spending and confidence is substantial. The economy, the housing sector is not just in recovery, housing is in full bloom. The economy is better than you think.

## FEDERAL RESERVE POLICY

| Selected Fed assets and liabilities | | | | | Sep 10 |
|---|---|---|---|---|---|
| Fed H.4.1 statistical release | | | | | 2008** |
| billions, Wednesday data | 22-Feb | 15-Feb | 8-Feb | 1-Feb | pre-LEH |
| **Factors adding reserves** | | | | | |
| U.S. Treasury securities | 2463.456 | 2463.446 | 2463.436 | 2463.426 | 479.782 |
| Federal agency debt securities | 13.329 | 14.829 | 16.180 | 16.180 | 0.000 |
| Mortgage-backed securities | 1773.621 | 1759.700 | 1744.642 | 1744.636 | 0.000 |
| Primary credit (Discount Window) | 0.000 | 0.011 | 0.007 | 0.010 | 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) | 1.705 | 1.705 | 1.705 | 1.705 | 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 | 0.000 |
| Central bank liquidity swaps | 0.143 | 0.236 | 0.265 | 0.392 | 62.000 |
| Federal Reserve Assets | 4514.6 | 4500.9 | 4502.5 | 4500.1 | 961.7 |
| 3-month Libor % | 1.05 | 1.04 | 1.03 | 1.03 | 2.82 |
| **Factors draining reserves** | | | | | |
| Currency in circulation | 1512.508 | 1508.844 | 1505.331 | 1500.147 | 834.477 |
| Term Deposit Facility | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Reverse repurchases w/others | 177.833 | 105.123 | 122.934 | 133.730 | 0.000 |
| **Reserve Balances (Net Liquidity)** | 2243.156 | 2254.271 | 2237.460 | 2172.093 | 24.964 |
| Treasuries within 15 days | 13.175 | 13.175 | 7.159 | 7.159 | 14.955 |
| Treasuries 16 to 90 days | 48.558 | 48.558 | 41.249 | 41.249 | 31.549 |
| Treasuries 91 days to 1 year | 163.208 | 163.208 | 167.127 | 167.127 | 69.272 |
| Treasuries over 1-yr to 5 years | 1240.509 | 1240.508 | 1210.167 | 1210.166 | 170.807 |
| Treasuries over 5-yrs to 10 years | 372.215 | 363.532 | 407.661 | 407.659 | 91.863 |
| Treasuries over 10-years | 625.791 | 634.466 | 630.073 | 630.067 | 101.337 |
| **September 10, 2008 is pre-Lehman bankruptcy of 9-15-08 | | | | | |

The Fed meets March 14-15 to consider its monetary policy. They hiked rates in December 2015 the first time, and then a second time, a year later, in December 2016. Is it too much to ask the Committee to speed up the rates normalization process by hiking rates a third time to 1.00% is all on March 15 this year? Just 1%. Not quite three weeks from now. Let's see the Laubach-Williams (Williams her former research director at the San Francisco Fed) model of real neutral interest rates says it "should naturally be" 0.22% right now. Add to it the current PCE inflation rate (includes food & energy) of 1.7%, and the neutral Fed funds rate should be 2%. It's at 0.75% now so the Fed is 125 bps behind the curve. Yellen has been leaning on this natural rate concept as yet another argument to keep rates low, and now, lo and behold it is moving higher. They have run out of reasons to keep rates low to aid the recovery. The recovery from the recession that ended in June 2009.

## More business and consumer confidence, policymakers less certain

Breaking economy news. The Fed minutes from the January 31-February 1 meeting were released Wednesday afternoon at 2pm EST. Extra, Extra, Read All About It. No breaking news here. Fed officials in the meeting minutes are not giving off signals that they are behind the curve. If the Fed is not behind the curve and does not see signs the economy is overheating then there is certainly no rush to hike rates in the immediate future. A rate hike may be coming soon, but soon does not mean March 15. Next meeting. If a March rate hike is on the table, it's only because every meeting is "Live."

Net, net the Fed is taking cover here saying while a rate hike is coming fairly soon in the minds of many on the committee, there is no need to put March on the table. Policymakers cannot see through the fog of uncertainty here with fiscal policy initiatives still in doubt, and there are upcoming reports on inflation and the all-important jobs report to sift through first. Until the fog lifts, they are not ready to telegraph the exact timing of the next rate hike.

We still believe they plan to hike rates three times this year, just not in the near future. Or at least the committee is split, don't forget there were several who only wanted to raise rates twice in 2017. At the last meeting the minutes said that only one member thought a rate hike could occur "relatively soon." One is the loneliest number that we've ever known.

All the other views expressed were offsetting, one group saying no hurry as inflation won't heat up so quickly such that Fed officials couldn't respond, while the other camp said if inflation picks up the

committee might have to communicate to the public that a faster pace of rate hikes could be necessary. It all comes down to the March 1 PCE inflation report for January in our view. The market consensus is headline PCE inflation will move up to target at 2.0% in January from 1.6% year-to-year right now. But it has to happen first. The Fed will not step up the pace of raising interest rates this year until it sees the whites of the eyes of inflation. The PCE inflation report due out on March 1 is key. Stay tuned. Story developing.

Policy "action" paragraph

Many members continued to see only a modest risk of a scenario in which the unemployment rate would substantially undershoot its longer-run normal level and inflation pressures would increase significantly. These members expressed the view that inflation was likely to rise toward 2 percent gradually, and that policymakers would likely have ample time to respond if signs of rising inflationary pressures did begin to emerge.

Other members indicated that if the labor market appeared to be tightening significantly more than anticipated or if inflation pressures appeared to be developing more rapidly than expected as resource utilization tightened, it might become necessary to adjust the Committee's communications about the expected path of the federal funds rate.

One member noted that, even if incoming data on the economy and inflation were consistent with expectations, taking the next step in reducing policy accommodation relatively soon would give the Committee greater flexibility in calibrating policy to evolving economic conditions.

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