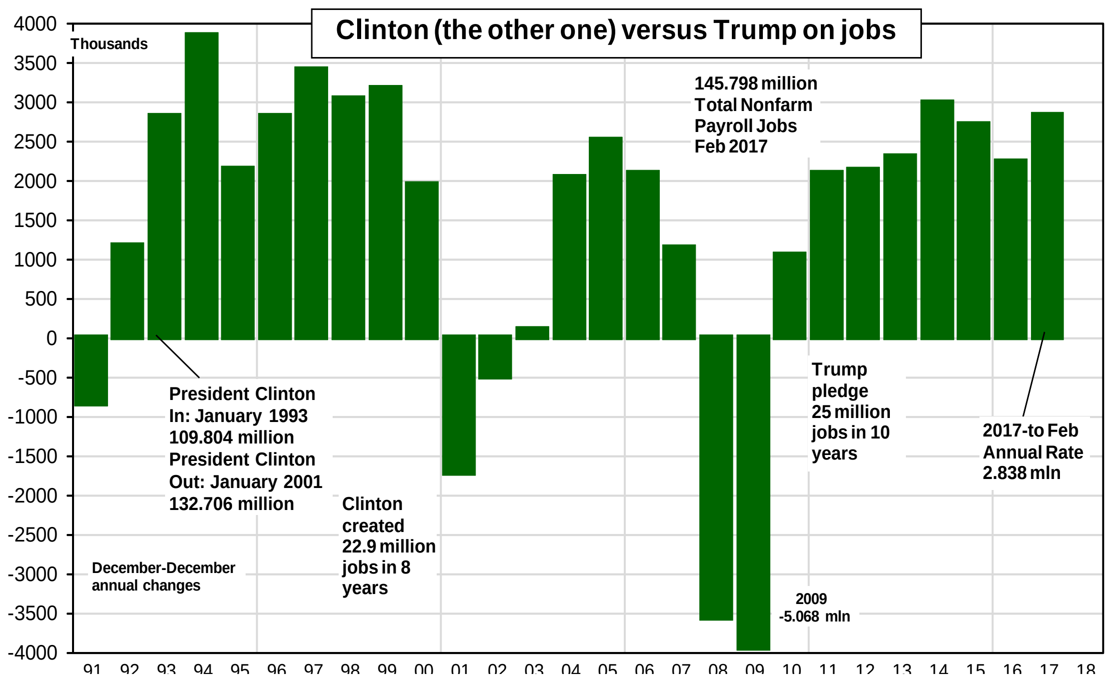
Financial Market Weekly

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

10 MARCH 2017

235K jobs, 4.7% rate, 2.8% wage, hike, hike hike, 50 bps anyone, anyone



The all-important monthly employment report. 235K payroll jobs, unemployment fell a tenth to 4.7%, and wages are rising 2.8%. Pretty darn good. Nothing wrong with this economy that the new president needs to fix, although there will probably be some mention from Washington that 28K in manufacturing jobs were brought back in February in Trump's first month in office. 235K is really something, we just hope it wasn't a mirage with one of the warmest February's on record. This has been a mild winter and probably accounts for a lot of the new construction jobs 58K in February on top of 40K in January. But for now the labor market looks strong enough to ensure a Fed rate hike from 0.75 to 1.0% on March 15, we think the economy is strong enough to handle it. Heck, CPI inflation, real inflation Americans pay for out of their wallets and purses, is 2.5% which means money is still free and the Fed way, way, way behind the curve. We expect policymakers will probably remain on the slow side when it comes to rates normalization at least through February 3, 2018. Bet on it.

	Feb	Jan	Dec	Nov	Oct	Sep
Payroll jobs (000s)	235	238	155	164	124	249
Unemployment rate %	4.7	4.8	4.7	4.6	4.8	4.9
Unemployment (3 decimal)	4.703	4.780	4.716	4.646	4.848	4.945
Average hourly earnings	$26.09	$26.03	$25.98	$25.91	$25.90	$25.81
MTM % Chg	0.2	0.2	0.6	-0.3	0.3	0.6
YOY % Chg	2.8	2.6	2.9	2.7	2.7	2.5
Production Worker earnings	$21.86	$21.82	$21.80	$21.74	$21.72	$21.68
MTM % Chg	0.2	0.1	0.3	0.1	0.2	0.3
YOY % Chg	2.5	2.3	2.5	2.5	2.5	2.7

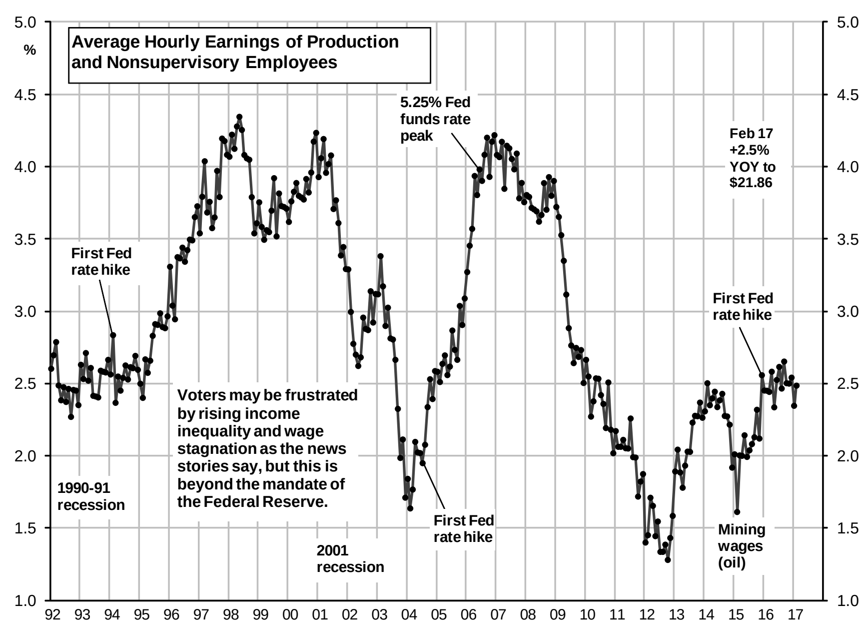
235K payroll jobs in February following up on 238K in January so the labor market in 2017 has turned it up a notch after a somewhat slower pace of jobs created in October 124K, November 164K, and December 155K. Not sure what accounts for the difference maybe employers were watching the presidential election and the tweets and the stock market in the fourth quarter last year, but for now, America is back and as great again as it is ever going to be when it comes to helping new workers getting paychecks and putting food on the table. Of those 28K manufacturing jobs 9K were in food manufacturing plants, and 7K were in factories producing machinery.

In conclusion, the economic tide is strong enough to raise all the boats with widespread jobs in construction, manufacturing, education, leisure and hospitality. Only retail stores shed workers, 26K of them, and the news headlines have been chock full of store closings for many retail chains. The Fed can rest assured the labor market is all but dead-on when it comes to full employment with the drop of the unemployment rate being accompanied by a rising participation rate as those not in the labor force decided to drop back in by the tune of 176K formerly lost souls.

Team Trump will likely claim credit for a change in tone in the country, those raised animal spirits that help make economic growth quicken,

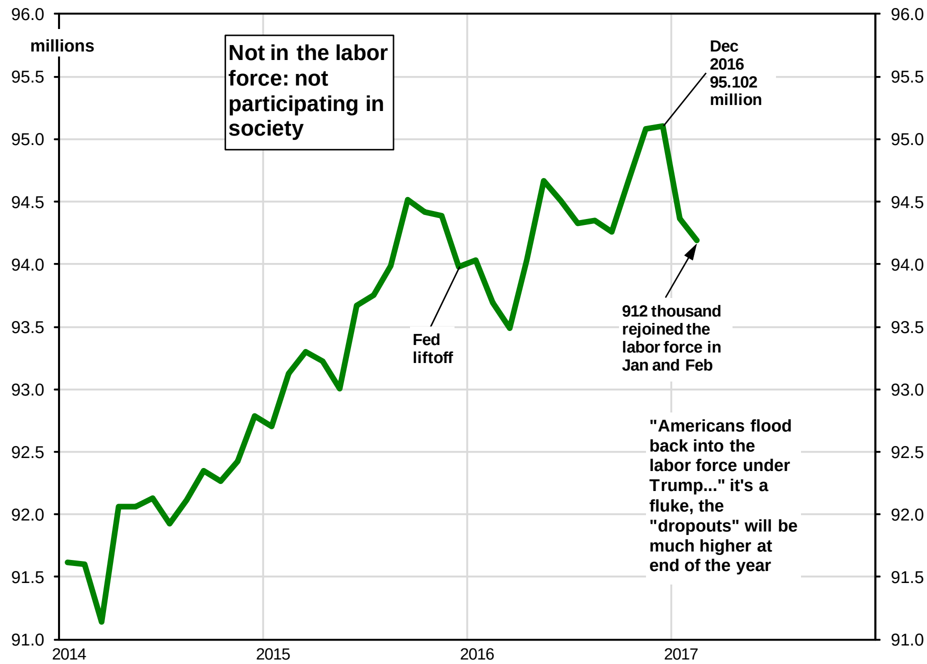
Payroll jobs in year eight following the recession

Dec. 2015 Totals millions		Feb 17	Jan 17	Dec 16	12 months Dec 15 to Dec 16	12 months Dec 14 to Dec 15
143.085	Nonfarm Payroll Employment	235	238	155	2240	2713
120.987	Total Private (ex-Govt)	227	221	150	2039	2561
19.730	Goods-producing	95	54	32	64	253
0.691	Mining	8	4	2	-75	-151
12.359	Manufacturing	28	11	18	-16	68
0.925	Motor Vehicles & parts	-4	3	1	17	33
6.628	Construction	58	40	12	155	336
101.257	Private Service-providing	132	167	118	1975	2308
27.043	**Trade, transportation, utilities**	-8	35	28	331	379
15.678	Retail stores	-26	40	13	203	186
3.143	General Merchandise	-19	-5	-11	37	30
3.060	Food & Beverage stores	-1	3	-3	37	10
4.956	Transportation/warehousing	9	-10	13	92	185
1.455	Truck transport	11	-5	3	10	13
0.638	Couriers/messengers	1	-10	8	31	30
0.880	Warehousing and storage	-2	7	3	63	106
0.557	Utilities	-1	0	0	0	3
2.762	**Information**	0	-3	-6	0	25
8.188	**Financial**	7	32	22	176	146
2.559	Insurance	3	10	9	46	55
2.110	Real Estate	5	12	4	59	41
1.294	Commercial Banking	1	3	2	17	11
0.916	Securities/investments	-1	1	2	18	25
19.882	**Professional/business**	37	46	36	534	538
2.930	Temp help services	3	7	-17	32	97
2.224	Management of companies	5	4	6	35	35
1.400	Architectural/engineering	5	6	5	27	9
1.944	Computer systems/services	6	11	7	87	97
1.121	Legal services	-1	0	4	5	5
0.968	Accounting/bookkeeping	0	-3	0	32	12
22.318	**Education and health**	62	21	50	553	644
4.958	Hospitals	6	2	10	119	136
3.518	Educational services	29	-5	11	85	86
15.413	**Leisure and hospitality**	26	24	5	331	517
1.939	Hotel/motels	4	-3	2	11	30
11.273	Eating & drinking places	17	20	15	276	417
22.098	Government	8	17	5	201	152
2.170	Federal ex-Post Office	2	4	7	30	24
5.089	State government	-3	4	-3	-4	31
2.411	State Govt Education	-3	1	4	3	25
14.235	Local government	9	9	0	160	89
7.875	Local Govt Education	5	7	11	69	28



MUFG

the change in tone has brought people back into the labor force in droves. 95.102 million not in the labor force in December falling 736K in January and 176K in February, the Trump economics team has created opportunity and brought 912K back into the labor force to participate in the economy. We can hear the claims now for what the change down in Washington has done. The final nail in the coffin that argues against on-the-bench Fed inaction next week is the drop in involuntary part-time workers from 5.840 million in January to 5.704 million in February. Part of U-6 unemployment that makes people think the economy is secretly weak.



Everything but everything in this report today tells Yellen just to do it. By their own reckoning of the natural rate of interest they are behind the curve. 0.2% natural rate plus 1.9% PCE inflation equals a Fed funds rate of 2.1%. Way way behind the curve these Fed officials, do we hear 50 bps anyone, anyone? At the very least we expect their forecasts in 2017 to step it up a notch and tell the world markets they are going three more times in 2017 with follow-up rate hikes in June, and September and December to finish the year at 1.75%. Team Fed let's go. The economy is great again, make interest rates for savers great again. The economy is better and stronger than you think. Bet on it.

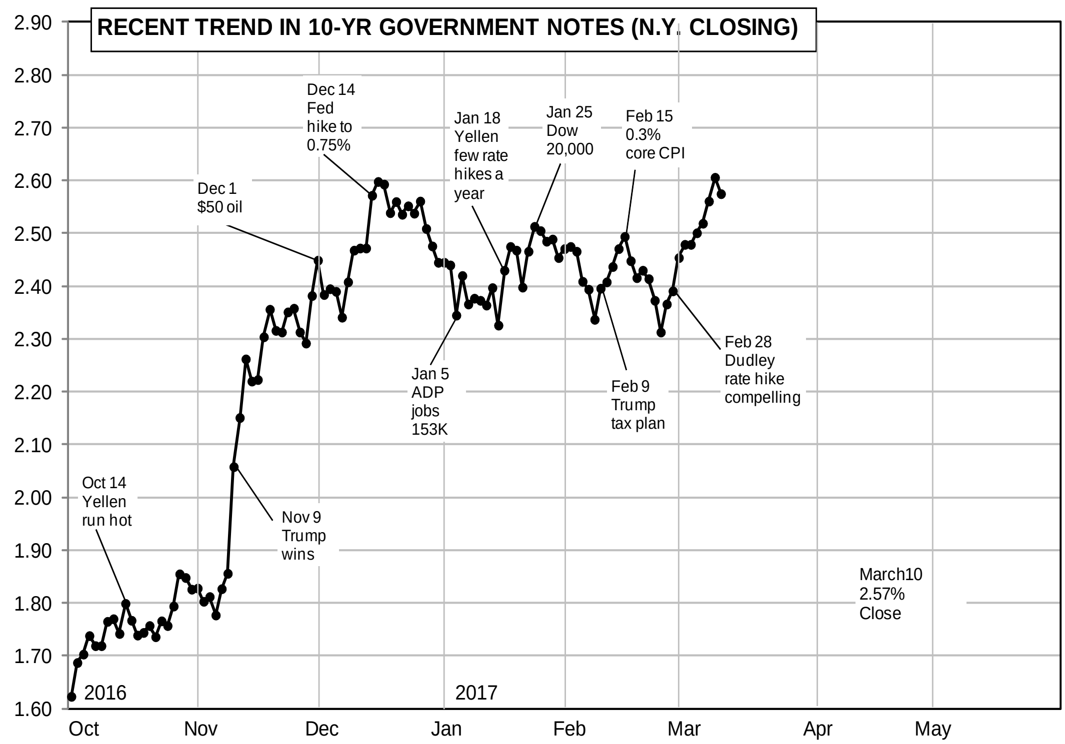
P.S. One final point, we were engaging in hyperbole when talking about drop-outs coming back to the labor force as being something which was a positive change in the economy for the better. We expect the drop outs to go back up as the year progresses, and next year, and the year after, and…

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 were 2.61% before the great jobs report and fell a few bps to 2.58% for some reason: sell the rumor, buy the fact maybe. At least 2-yr yields fell as well and the curve did not flatten. We hate to think of the curve flattening here as the Fed funds rate “moves up” as it hurts our sky-high forecast call for bond yields with 10-yr Treasuries ending 3.0% this year and 3.7% at the end of 2018.

Admittedly we need a lot of Fed push on the Fed funds rate to get bond yields there. The market still does not believe the Fed's forecasts of 75 bps of rate hikes this year and 75 bps in 2018 and another 75 bps to 3.0% at the end of 2019. Might have something to do with Yellen's own pessimism call it: saying the future is uncertain (yawn) and monetary policy is not on some preset course (why not?).



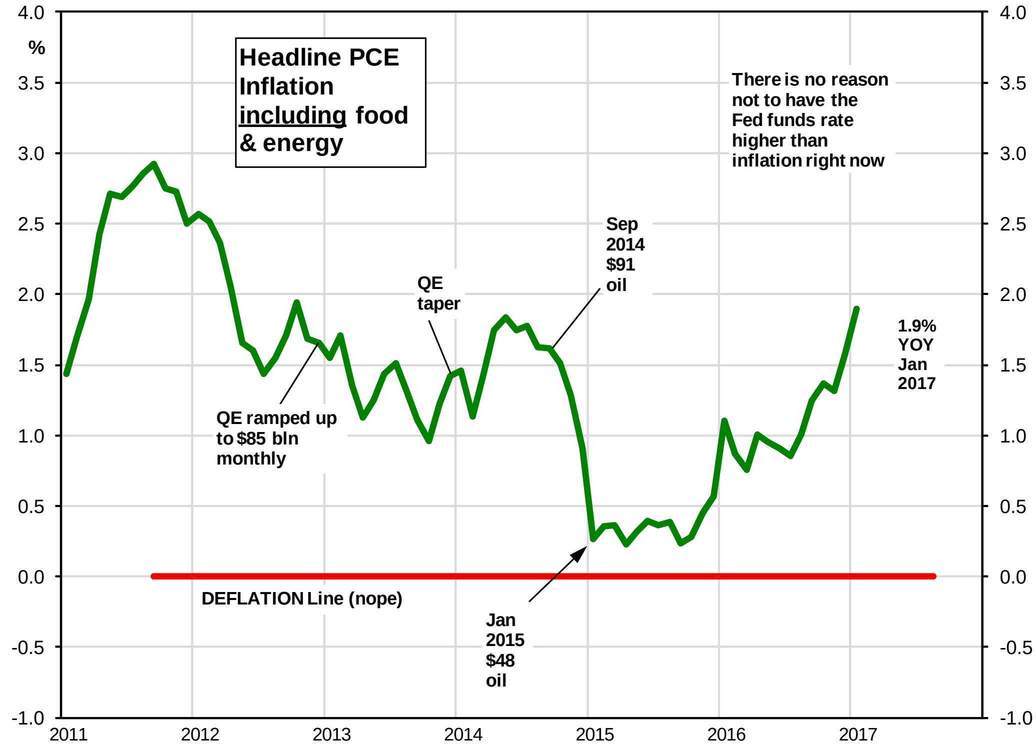
FEDERAL RESERVE POLICY

The Fed meets March 14-15 to consider its monetary policy. Yellen said last Friday a move was likely. The market moved the most a week ago Tuesday on New York Fed President Dudley saying the case for a March hike was compelling. The futures market says the odds are 100%. How could they not hike rates from 0.75% to 1.0% next week?

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	8-Mar	1-Mar	22-Feb	15-Feb	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2463.650	2463.488	2463.456	2463.446	479.782
Federal agency debt securities	13.329	13.329	13.329	14.829	0.000
Mortgage-backed securities	1763.191	1763.186	1773.621	1759.700	0.000
Primary credit (Discount Window)	0.013	0.001	0.000	0.011	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)	1.704	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	0.491	1.132	0.143	0.236	62.000
Federal Reserve Assets	4506.0	4504.3	4514.6	4500.9	961.7
3-month Libor %	1.11	1.09	1.05	1.04	2.82
Factors draining reserves					
Currency in circulation	1528.995	1521.561	1512.508	1508.844	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	212.124	156.010	177.833	105.123	0.000
Reserve Balances (Net Liquidity)	2351.131	2307.954	2243.156	2254.271	24.964
Treasuries within 15 days	0.000	0.000	13.175	13.175	14.955
Treasuries 16 to 90 days	60.468	48.558	48.558	48.558	31.549
Treasuries 91 days to 1 year	183.351	195.256	163.208	163.208	69.272
Treasuries over 1-yr to 5 years	1216.815	1216.789	1240.509	1240.508	170.807
Treasuries over 5-yrs to 10 years	376.137	376.104	372.215	363.532	91.863
Treasuries over 10-years	626.878	626.781	625.791	634.466	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

We will also find out at 2pm New York time on Wednesday, March 15 how many rate hikes they think they have left to do in 2017. In December they said three rate hikes in 2017 to end the year at 1.5%. We are thinking, hoping, forecasting that they will say at this meeting that, yes, we hiked rates today, and we also think (the median forecast "thinks") that we need to do three more rate hikes this year ending 2017 at 1.75%. It will be helpful for rates normalization if they also say they see four rate hikes in 2018 and in 2019 as well: putting rates at 3.75% in December 2019. We will see. Bernanke left the building saying four rate hikes per year not the eight rate hikes "measured pace" per year from the Greenspan Fed that eventually brought down the house. (Bernanke sticking the knife in the economy and lifting the final three times to 5.25% himself.)

We will see what they do. Forever cautious, Yellen thinks the outlook is always uncertain so policy cannot be on a preset course "we don't know what we are going to do next," and is likely to put this in her opening statement of the press conference at 230pm Eastern Time. With the current forecasts Yellen cannot push the funds rate any higher than 1.5% before her final day in office expires on February 3, 2018. A new Fed Chair will be known well before that time and they are likely to normalize interest rates more quickly.



Fed Individual Forecasts				
Fed funds rate by year-end				Longer
Votes	2017 End	2018 End	2019 End	run
1	0.875	0.875	0.875	2.500
2	0.875	1.625	2.125	2.750
3	1.125	1.875	2.375	2.750
4	1.125	1.875	2.375	2.750
5	1.125	1.875	2.625	2.750
6	1.125	1.875	2.625	2.750
7	1.375	1.875	2.625	2.750
8	1.375	2.125	2.875	3.000
9	1.375	2.125	2.875	3.000
10	1.375	2.125	3.000	3.000
11	1.375	2.375	3.000	3.000
12	1.375	2.375	3.125	3.000
13	1.625	2.625	3.125	3.000
14	1.625	2.625	3.250	3.000
15	1.625	3.000	3.250	3.500
16	1.750	3.250	3.625	3.750
17	2.250	3.375	3.875	
Median	1.375	2.125	2.875	3.000
Meeting	Dec 2017	Dec 2017	Dec 2017	Dec 2017

Analyst Certification

The views expressed in this report accurately reflect the personal views of **Christopher S. Rupkey**, the primary analyst responsible for this report, about the subject securities or issuers referred to herein, and no part of such analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.

About MUFG Union Bank, N.A.

MUFG Union Bank, N.A., is a full-service bank with offices across the United States. We provide a wide spectrum of corporate, commercial and retail banking and wealth management solutions to meet the needs of customers. We also offer an extensive portfolio of value-added solutions for customers, including investment banking, personal and corporate trust, global custody, transaction banking, capital markets, and other services. With assets of $115.4 billion, as of December 31, 2015, MUFG Union Bank has strong capital reserves, credit ratings and capital ratios relative to peer banks. MUFG Union Bank is a proud member of the Mitsubishi UFJ Financial Group (NYSE: MTU), one of the world's largest financial organizations with total assets of approximately ¥295.8 trillion (JPY) or $2.5 trillion (USD)1, as of December 30, 2015. The corporate headquarters (principal executive office) for MUFG Americas Holdings Corporation, which is the financial holding company and MUFG Union Bank, is in New York City. The main banking office of MUFG Union Bank is in San Francisco, California.