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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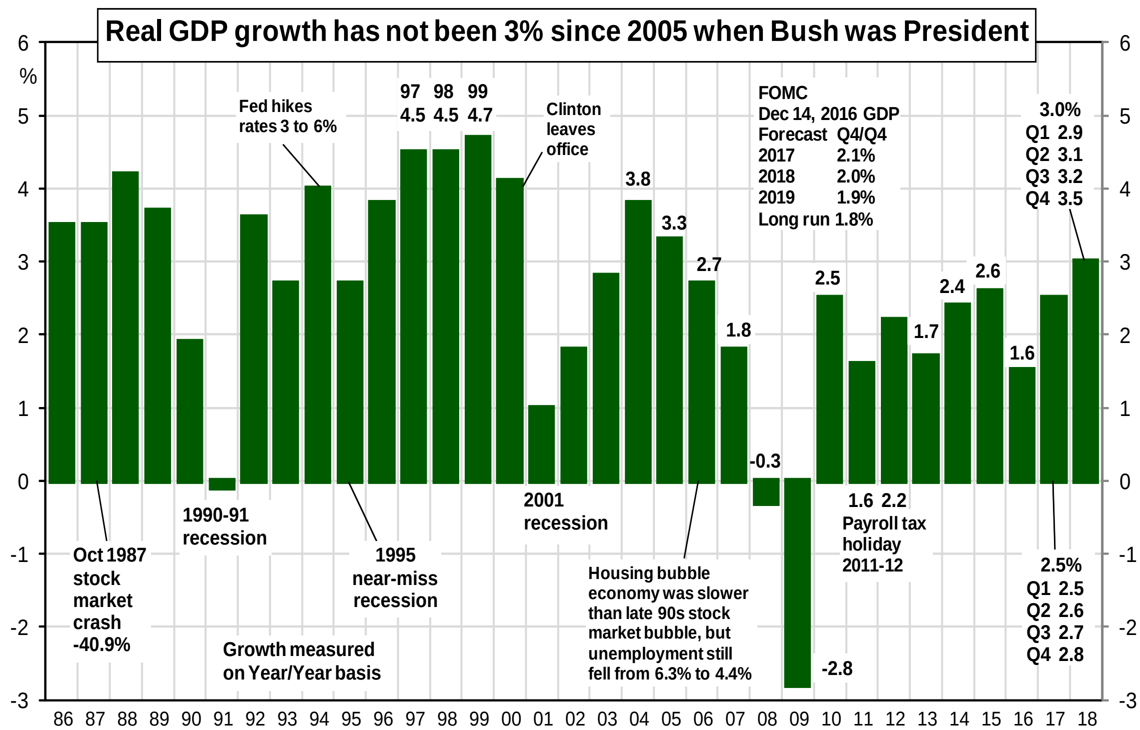
GDP 1.9% IN FINAL QUARTER OF OBAMA YEARS: 1.6% FOR ALL OF 2016



Q4 2016 real GDP was reported on Friday: up 1.9% for Q4 and 1.6% for all of 2016. Presidents tend to get evaluated on how much economic growth occurred on their watch even if much of this growth cannot be traced back directly to Executive Branch policies or decisions. For the Obama years from 2009 to 2016, average real GDP growth was 1.5%. The weak 1.5% growth however downplays the nation's relative prosperity by the end of those eight years with the unemployment rate ending at 4.7% (It was 7.8% in January 2009 when Obama took office). Unemployment was as high as 10.0% in October 2009 at the peak just a handful of months after the recession ended. 4.7% unemployment is low and means most Americans have jobs-full employment being the best measure of the nation's prosperity always. Macroeconomics, the study of the business/economic cycle anyway, does not have a lot to say about the "quality" of the jobs out there. Presidential candidate Clinton in August 1992 vowed to create 8 million jobs "good ones" over four years; he made good on the pledge's numbers anyway, mostly due to the high level of unemployment when he took office (9.3 million out of work) and favorable demographic tailwinds.

President takes Office		Unemployment
Clinton	Jan 1993	7.3%
Bush	Jan 2001	4.2%
Obama	Jan 2009	7.8%

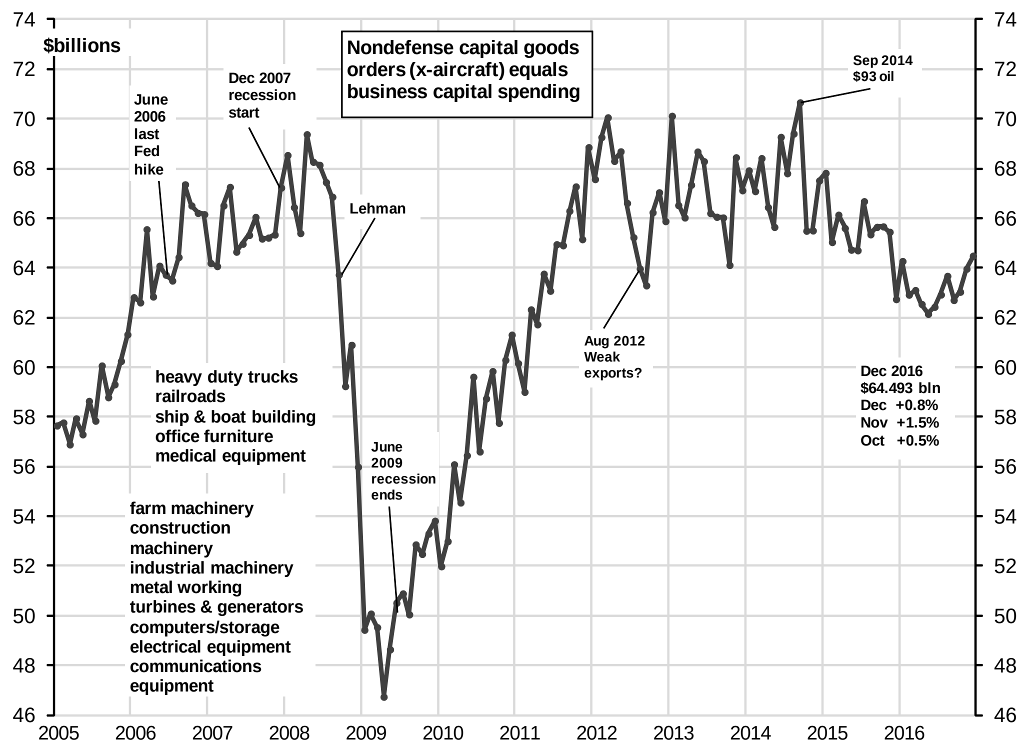
Where we are in the business cycle plays a big part in how much credit a president gets for improving economic conditions: where the unemployment rate is when the President takes office. More growth means more jobs at least until the economy reaches the goal line of full employment. Growth remains an important metric of the economy's well-being and President Trump has boasted that his goal is to push real GDP growth to 4 percent to Make America Great Again. Maybe we are in the minority here but we will not judge his Administration a failure if growth does not reach that level. We still think he has inherited the best economy of any president looking back to President Clinton in the early 90s. President Bush also "inherited" a good economy with low 4.2% unemployment even if the March to November 2001 recession started a couple of months later.

Year-on-year growth	2014	2015	2016	2017e	2018e
REAL GDP	2.4	2.6	1.6	2.5	3.0
CONSUMPTION	2.0	2.2	1.8	1.8	1.8
Durables	0.5	0.5	0.4		
Nondurables	0.4	0.4	0.4		
Services	1.1	1.3	1.0		
INVESTMENT	0.7	0.8	-0.3	0.6	0.9
Business Plant	0.3	-0.1	-0.1	0.1	0.2
& Equipment and	0.3	0.2	-0.2	0.1	0.2
Intellectual Property	0.2	0.2	0.2	0.2	0.2
Homes	0.1	0.4	0.2	0.2	0.3
Inventories	-0.1	0.2	-0.4	0.0	0.0
EXPORTS	0.6	0.0	0.0	0.5	0.3
IMPORTS	-0.7	-0.7	-0.2	-0.6	-0.7
GOVERNMENT	-0.2	0.3	0.2	0.2	0.7
Federal defense	-0.2	-0.1	0.0	0.0	0.2
Fed nondefense	0.0	0.1	0.1	0.1	0.2
State and local	0.0	0.3	0.1	0.1	0.3

Percentage point contributions to 2016 1.6% real GDP

For the outlook, we don't need too many heroic changes in assumptions to get economic growth near to 3% by 2018. The strong dollar-weak commodities trend comes to a stop and investment and exports expand; Government spending adds a few tenths to growth across all levels Federal and State and local. Consumption expenditures are off their prior pace somewhat despite individual tax cuts as the aging expansion (year nine starts July) creates fewer new payroll jobs with the economy at full employment and consumers have already bought record amounts of cars and SUVs. The President's role in these economic expansions is probably less than one would think despite the election campaign rhetoric. Since the 90s, Democrats have taken office in economic bad times, but we would not jump to the conclusion that the outgoing Republican Administrations (Bush and Bush) were responsible for the economic weakness or recession. We will see how far Trump gets on his pledge to push growth to 4% and create 25 million jobs the next ten years. We had a good-sized tax cut in 2011-12 and no additional economic growth. Payroll taxes were cut from 6.2% to 4.2% in 2011 and 2012 ($2,136 max per individual on first $106,800 of earnings) and real GDP growth was just 1.6 and 2.2 percent, respectively over those two years. Stay tuned. Story developing.

Durable goods orders "Investment" has turned the corner for now.



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

10-yr Treasury yields closed at 2.48% on Friday, having been 2.51% earlier in the morning before real GDP came in weaker at 1.9% versus 2.2% expected. The low yield point was 2.38% on Monday with Trump's TPP news. Dow industrials closed above 20,000 the first time on Wednesday on better earnings and the Trump news starting on Tuesday was more pro-business.

FEDERAL RESERVE

The Fed meets January 31 to February 1 to consider its monetary policy. No action is expected. We are not even sure whether there will be any action at the March 14-15 meeting with its regularly scheduled press conference with Chair Yellen. The median Fed forecast from December was for three rate hikes in 2017. Yellen said the timing depends on the economy whatever that means. We recommend they eliminate the guesswork now the economy is at full employment and tell the public they will raise rates at a "measured pace" of four times per year for the foreseeable future like the Greenspan Fed did and Yellen as a participant voted for. The Committee will make its annual reassessment of its Statement on Longer-Run Goals and Monetary Policy Strategy. This time last year they made a big deal about changing the statement language to read that inflation being below the 2% target was equally as costly to society as it is when it is above target. This may have enabled another year of foot-dragging on the decision to move rates up. The reality is few in society know or care that PCE inflation is 1.4% YOY in November and thus under target.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	25-Jan	18-Jan	11-Jan	4-Jan	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2463.462	2463.504	2463.548	2463.591	479.782
Federal agency debt securities	16.180	16.180	16.180	16.180	0.000
Mortgage-backed securities	1744.594	1750.940	1741.398	1741.391	0.000
Primary credit (Discount Window)	0.000	0.046	0.004	0.035	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)	1.707	1.705	1.704	1.707	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	0.465	0.615	2.626	5.563	62.000
Federal Reserve Assets	4498.9	4506.7	4498.5	4498.8	961.7
3-month Libor %	1.04	1.03	1.02	1.01	2.82
Factors draining reserves					
Currency in circulation	1499.320	1503.245	1504.110	1509.068	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	108.360	130.118	158.820	266.468	0.000
Reserve Balances (Net Liquidity)	2137.012	2118.818	2110.927	1998.165	24.964
Treasuries within 15 days	7.356	7.356	3.103	3.105	14.955
Treasuries 16 to 90 days	34.350	34.350	41.249	41.249	31.549
Treasuries 91 days to 1 year	153.339	153.341	150.765	150.766	69.272
Treasuries over 1-yr to 5 years	1233.263	1233.270	1232.315	1232.322	170.807
Treasuries over 5-yrs to 10 years	405.066	405.075	402.988	402.996	91.863
Treasuries over 10-years	630.088	630.113	633.127	633.154	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

Analyst Certification

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