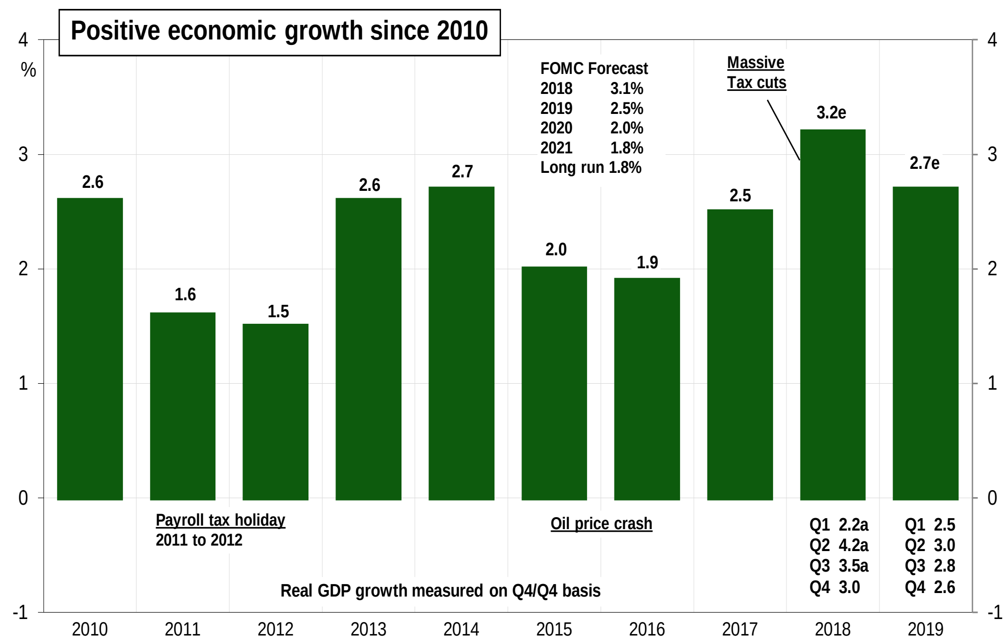
Financial Market Weekly

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

MUFG Bank, Ltd.
A member of MUFG, a global financial group

30 NOVEMBER 2018

GDP: SAME AS IT EVER WAS… FOR NOW



The second look at third quarter real GDP stayed the same as the initial report a month ago at 3.5%. Most everyone outside the Trump administration expects growth to slow down next year when the money from the Tax Cuts and Jobs Act runs out. If growth is 3.0% in the fourth quarter then it will be 3.2% this year-faster than the 2.7% "record" in 2014 under Obama before oil prices collapsed. Oil prices are falling again so look out for new oil & gas drilling activity that shows up in GDP as business investment spending on structures.

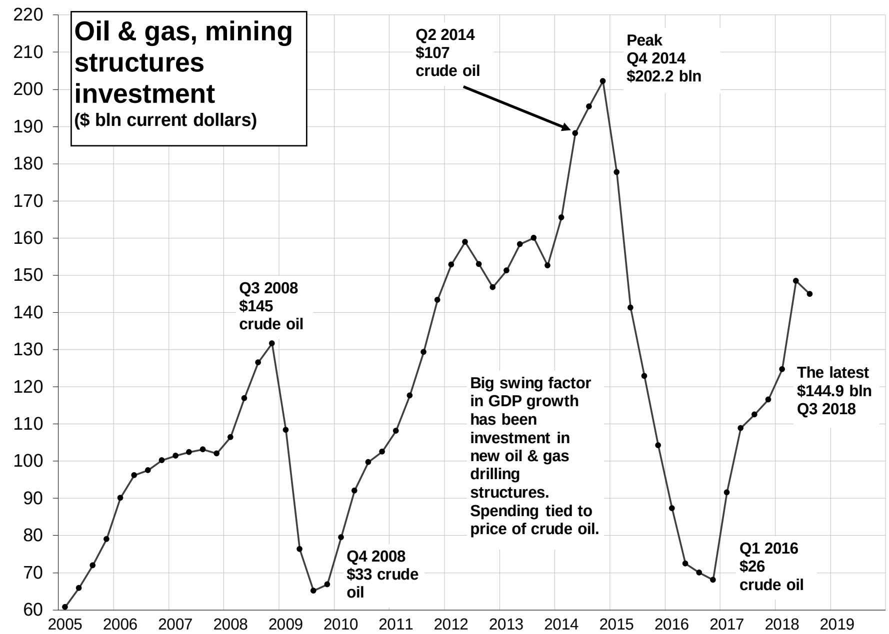
Next year we see a slowdown in growth, but only from 3.2% in 2018 to 2.7% in 2019. We are a touch on the high side, as the Fed median forecast is 2.5%.

Investment was better after a second look, although the results won't totally assuage the concern of Fed officials. In the press statement from the November 7-8 Fed meeting they said

	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18p	Q3 18r
REAL GDP	1.8	3.0	2.8	2.3	2.2	4.2	3.5	3.5
REAL CONSUMPTION	1.8	2.9	2.2	3.9	0.5	3.8	4.0	3.6
CONSUMPTION	1.2	2.0	1.5	2.6	0.4	2.6	2.7	2.5
Durables	0.1	0.6	0.5	0.9	-0.2	0.6	0.5	0.3
Nondurables	0.3	0.6	0.3	0.6	0.0	0.6	0.7	0.7
Services	0.8	0.8	0.7	1.2	0.5	1.4	1.5	1.5
INVESTMENT	0.8	1.0	1.5	0.1	1.6	-0.1	2.0	2.5
Business Plant	0.4	0.1	-0.2	0.0	0.4	0.4	-0.3	-0.1
& Equipment and	0.5	0.6	0.6	0.6	0.5	0.3	0.0	0.2
Intellectual Property	0.3	0.3	0.1	0.0	0.6	0.5	0.4	0.2
Homes	0.4	-0.2	0.0	0.4	-0.1	-0.1	-0.2	-0.1
Inventories	-0.8	0.2	1.0	-0.9	0.3	-1.2	2.1	2.3
EXPORTS	0.6	0.4	0.4	0.8	0.4	1.1	-0.5	-0.6
IMPORTS	-0.7	-0.4	-0.4	-1.7	-0.5	0.1	-1.3	-1.4
GOVERNMENT	-0.1	0.0	-0.2	0.4	0.3	0.4	0.6	0.4
Federal defense	0.0	0.2	-0.1	0.1	0.1	0.2	0.2	0.2
Fed nondefense	0.0	-0.1	0.0	0.2	0.1	0.0	0.0	0.0
State and local	-0.1	-0.2	-1.0	0.2	0.1	0.2	0.4	0.2

Below line: Percentage point contributions to Q3 18 3.5% real GDP
Third estimate for Q3 is Friday, December 21

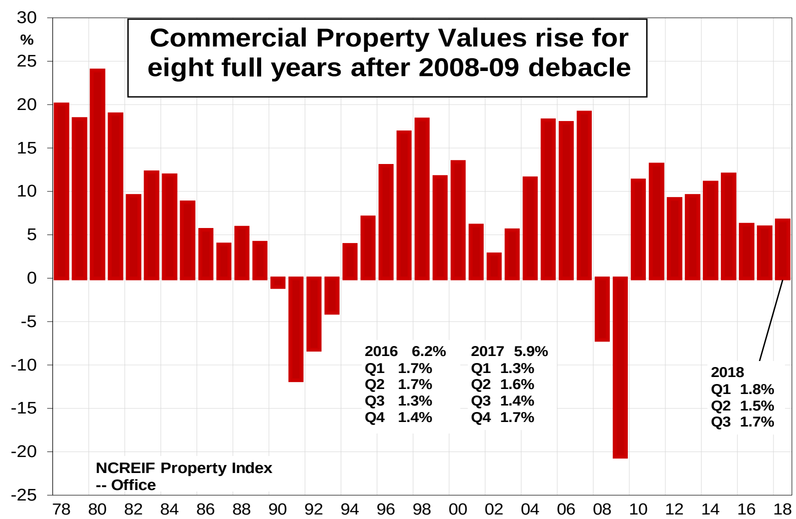
business investment had moderated where at the September meeting they said investment had grown strongly. What a difference a day makes, huh? Anyway, business spending on structures in Wednesday's GDP report for the third quarter was less of a drag, equipment spending was better, offset by less of a contribution by intellectual property (software, R&D).



Seems like a good time for companies to build more offices, at least office valuations continue to rise. Commercial property values are rising almost 7% annualized so far in 2018 which is the ninth year since prices collapsed in 2008-09.

Office building isn't the only category of business investment on structures. The biggest swing factor the last fifteen years or so is oil & gas drilling structures. Oil & gas drilling is our short name for the category for the construction expenditures which in current dollars was $144.9 billion in Q3 2018 with a 22.4% share of total business spending on structures of $646.2 billion. The "official" name of oil & gas drilling is Mining exploration, shafts, and wells, with a footnote saying, "includes petroleum and mineral exploration." Petroleum. And how. Sometimes it seems like all the business investment in America in recent years is related to fracking energy, even if every structures category is contributing to 2018 growth except manufacturing.

Oil & gas is responsible for half of the 12.6% increase in business investment on structures in 2018.



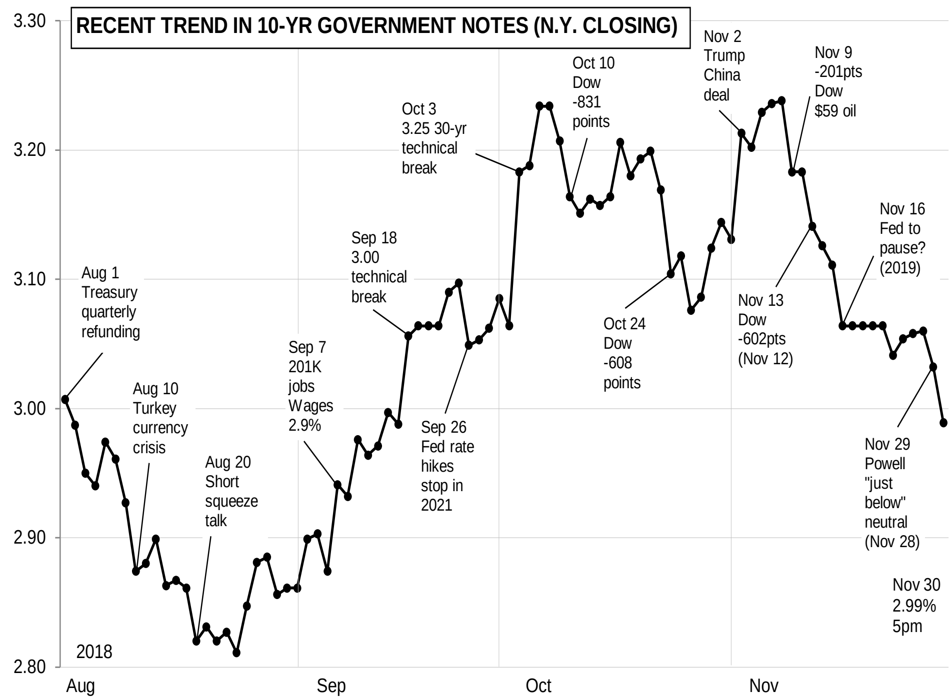
Oil & gas drilling can't keep building new structures with $50 oil, can it? Crude oil prices were $75 at the start of October. This is a very important swing factor for economic growth where the peak in current dollars was $202.2 billion in Q4 2014 which fell to just $68.0 billion in Q4 2016, erasing a lot of GDP spending: 202.2 minus 68.0 worth equivalent to 0.7% of 2017's $19,485 trillion nominal/current GDP economy. Investment in tomorrow leads to sustainable economic growth. Stay tuned.

Structures ($billion)	Q1 16	Q2 16	Q3 16	Q4 16	YOY%	Q1 17	Q2 17	Q3 17	Q4 17	YOY%	Q1 18	Q2 18	Q3 18	%
	531.2	539.7	555.1	556.7	3.3	577.5	588.3	585.3	590.6	6.1	614.9	644.1	646.2	12.6
Commercial and health care	159.7	167.2	176.8	180.6	23.0	179.7	181.1	179.9	181.6	0.6	189.2	189.4	190.7	6.7
Manufacturing	76.2	77.6	76.2	72.9	-7.5	68.3	66.2	64.5	64.2	-11.9	63.7	61.1	63.9	-0.6
Power and communication	104.5	110.6	118.9	121.0	11.9	122.4	116.3	112.7	109.8	-9.3	116.6	121.3	120.1	12.5
Mining exploration, shafts, and wells	87.3	72.4	70.0	68.0	-34.7	91.6	108.9	112.5	116.5	71.3	124.7	148.5	144.9	32.5
Other structures *	103.5	111.9	113.2	114.3	13.1	115.6	115.8	115.7	118.5	3.7	120.7	123.7	126.6	9.1

* Religious, educational, vocational, lodging, railroads, farm, and amusement and recreational structures, other — Annual rate

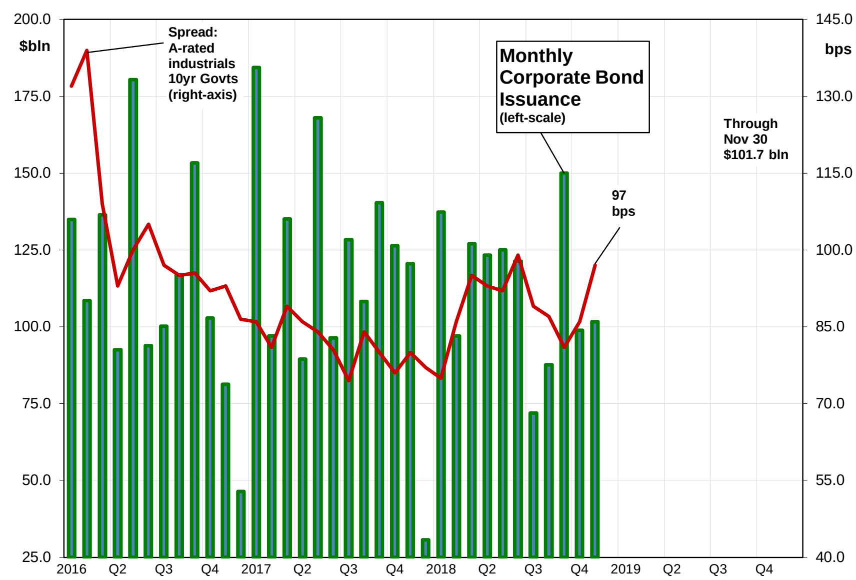
MARKETS OUTLOOK

	28-Sep 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	3.21	3.25	3.40	3.45	3.65	3.60	3.80	3.85	3.85	3.95	3.95
10-Yr Note	3.06	3.10	3.20	3.30	3.50	3.50	3.70	3.80	3.80	3.95	3.95
5-Yr Note	2.95	3.00	3.10	3.20	3.40	3.45	3.65	3.75	3.80	3.95	3.95
2-Yr Note	2.82	2.90	3.00	3.15	3.40	3.40	3.60	3.75	3.80	4.00	4.00
3-month Libor	2.40	2.70	2.95	3.20	3.45	3.45	3.70	3.90	3.90	4.20	4.15
Fed Funds Rate	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00	4.00
2s/10s spread	24	20	20	15	10	10	10	5	0	(5)	(5)
Libor/funds spd	15	20	20	20	20	20	20	15	15	20	15



Treasuries closed 2.99% on Friday down 5 bps from 3.04% the Friday before. Powell's comment Wednesday at noon saying interest rates were "just below" neutral helped stocks gain over 600 points on the day thinking the Fed rate hikes are almost done. Bond yields just sat there during New York trading. Could have been some yield curve steeping trades we guess. 10-yr yields did come down in Asia trading "Wednesday night" Thursday morning on the Powell comments to 2.99-3.00 percent by 4am EST. Bonds are certainly in rally mode from 3.25% on November 7 (trading the no-blue wave midterm election results), but one has to wonder where the rally is going with 3-month Libor 2.74% on Friday. Although the odds of a March 2019 rate hike to 2.75% were only 28% on Friday.

CORPORATE BONDS: HOME DEPOT, DOWDUPONT, CONED, MCKESSON, AON



Corporate offerings were $36.8 billion in the November 30 week versus $8.0 billion in the November 23 week. On Wednesday, McKesson sold $1.1 billion 2s/10s. It priced a $400 million 4.75% 10-yr (m-w +30bp) at 170 bps (Baa2/BBB+). The health care facilities and services company will use the proceeds for debt repayment. Corporate bond yields (10-yr Industrials rated A2) were 97 bps above 10-yr Treasuries this week versus 89 bps last Friday.

Changes in the wind for Fed policy coming soon to a theatre near you in 2019

Breaking economy news. The Fed November 7-8 meeting minutes, normally a who cares moment, shockingly seem to imply the interest rate path ahead is not as set in stone as markets think. Yes, we know futures markets aren't in complete agreement with the Fed's forecasts for three rate hikes in 2019 ending the year at 3.25% which is slightly above neutral as compared with Powell's characterization yesterday that rocketed the stock market over 600 points higher, his characterization that 2.25% rates were slightly below neutral. (100 bps swing from 2.25% to 3.25%, you wouldn't think there would be such a fuss.)

Anyway, we were surprised to learn today that maybe the Fed's gradual rates path is not set in stone and that maybe the President's tweets and voiced frustration with the Fed's rate hikes has tempered the enthusiasm of the committee under Powell to keep going. And this was before core PCE inflation fell to 1.8% year-year today which is under the Fed's 2% target.

> Monetary policy was not on a preset course; if incoming information prompted meaningful reassessments of the economic outlook and attendant risks, either to the upside or the downside, their policy outlook would change. Various factors such as the recent tightening in financial conditions, risks in the global outlook, and some signs of slowing in interest-sensitive sectors of the economy on the one hand, and further indicators of tightness in labor markets and possible inflationary pressures, on the other hand, were noted in this context. Participants also commented on how the Committee's communications in its postmeeting statement might need to be revised at coming meetings, particularly the language referring to the Committee's expectations for "further gradual increases" in the target range for the federal funds rate. Many participants indicated that it might be appropriate at some upcoming meetings to begin to transition to statement language that placed greater emphasis on the evaluation of incoming data in assessing the economic and policy outlook; such a change would help to convey the Committee's flexible approach in responding to changing economic circumstances.

The minutes said that they might revise the language soon that refers to Fed official's expectations for "further rate increases." Why would you drop the words unless you weren't expecting that many more rate increases? They also doubled down on their insistence that their policy moves be driven by the data. The risks either to the upside (faster rate hikes) or downside (fewer rate hikes) would guide their decision-making. But when they listed the risk factors, what stands out is how there are greater downside risks than upside risks. The upside risk has long been a tightening labor market and falling unemployment rate. But then they listed some downside economic risks that could halt the gradual rate hikes in their tracks. The killer downside risk is that there are "some signs of slowing" in interest-sensitive sectors of the economy. Bingo! They are saying the rate hikes and expectations of additional rate hikes next year are already slowing the economy in ways that raising the costs of borrowing does in every tightening cycle. In other words, maybe their current policy is already more restrictive than they would have thought.

Year-ends for Interest Rates

Percent %	2018	2019	2020	2021
Eurodollar futures	2.7975	3.025	3.0	2.975
Fed's Sept forecast	2.5	3.25	3.5	3.5

Eurodollar futures price where 3-month Libor will be in the future.
Friday, November 30, 2018 3-month Libor 2.74%

Net, net, we are not sure whether the recent Trump criticism of Powell has made Fed officials reflect on the need for further rate hikes or not, but they sure are more concerned about the downside risks to the outlook from tighter financial conditions (stock market turmoil), slowing world economy risks, and a slowdown in sectors hurt already by higher interest rates like car sales and the housing market. Stay tuned. Story developing. The path of Fed rate hikes in 2019 is increasingly uncertain and it looks like for the first time that the Fed is getting cold feet. Fewer rate hikes are coming next year. Bet on it.

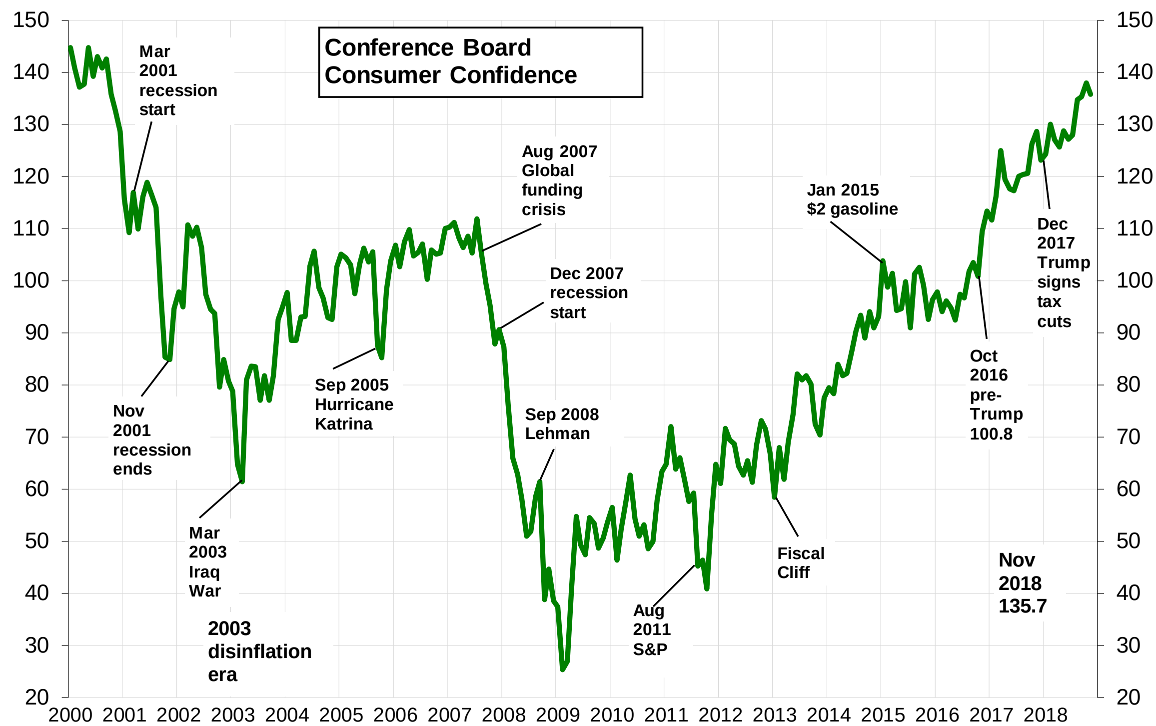
OTHER ECONOMIC NEWS THIS WEEK

Consumer confidence is less over the top but still over the top (Tuesday)

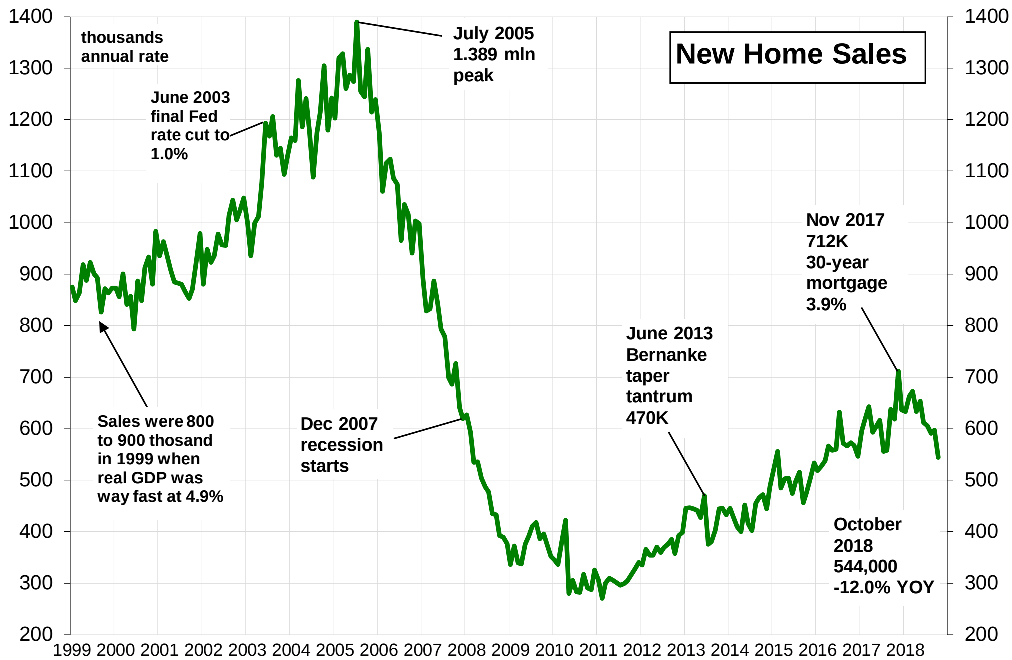
Breaking economy news. Consumer confidence came off the highs of the entire economic expansion in October. The best level for this long recovery road from the recession was 137.9 in October, and now confidence has fallen a couple points to 135.7 in November. Big deal. Virtually meaningless for the economic outlook, at least an outlook that suggests caution ahead. The Tax Cuts and Jobs Act boosted consumer sentiment as the confidence survey was 123.1 in December 2017 when Trump signed the legislation. Consumers haven't run out of money and confidence yet which means economic growth remains on track.

Why is confidence so high? It's jobs, jobs, jobs with consumers saying employment opportunities are the highest in history or darn near it for you fact-checkers in the audience. 46.6% say jobs are plentiful which is the best for this economic recovery that finishes ten years next June. Back in the stock market bubble economy of the late 90s, the peak was 55.8% said jobs were plentiful in July 2000. Economic growth was faster back then at nearly 5% for many quarters.

Net, net, all systems are go for the economy as far as consumer confidence is concerned. Confidence in the middle of the fourth quarter is off just ever so slightly from the record high for this expansion just a month earlier. Midterm elections, trade wars with China and the world, stock market turbulence, nothing, but nothing seems to get the consumer down. Consumer spending is two-thirds of economic growth so without consumers there wouldn't be much economic growth to look forward to, kind of like trying to fly an airplane without an engine. Stay tuned. Story developing. It's developing well. Fed officials will view the highly confident consumer as a reason to keep on the gradual path for interest rate hikes at the final meeting of the year in December. The economy is in no need of monetary stimulus with consumer confidence at such high levels. Rate hikes are coming. December 19. Bet on it.



New home sales weaker, still falling off, after upward revision (Wednesday)



Breaking economy news. New home sales tumbled 8.9% in October to 544 thousand, and September was revised upward to 597 thousand from the original estimate of 553 thousand. New home sales were down in all regions: in the Northeast -18.5% to 22 thousand, the Midwest was -22.1% to 60 thousand, South -7.7% to 313 thousand, and the West was -3.2% to 149 thousand. The weakness in the South may in part be due to recent hurricanes including Hurricane Michael making landfall on October 10 in the Florida Panhandle. Because the South is the biggest market for new homes in the country, the slide in October sales for the South accounted for 49% of the nationwide 8.9% drop in October.

Net, net, if new homes sales are a leading indicator, the weakness this year does not portend well for the 2019 economic outlook. The Fed's policies seek to influence interest-rate sensitive areas of the economy and the evidence from sales is that interest rates may have gone too high already. The Fed's 2.25% Fed funds rate is not high historically, but the backup in long-term rates and mortgages has been significant.

Trade deficit still going the wrong way. Exports up 7.8% in October relative to a year ago. Imports up 10.0% in October versus year earlier levels.

ADVANCE TRADE STATISTICS FOR OCTOBER

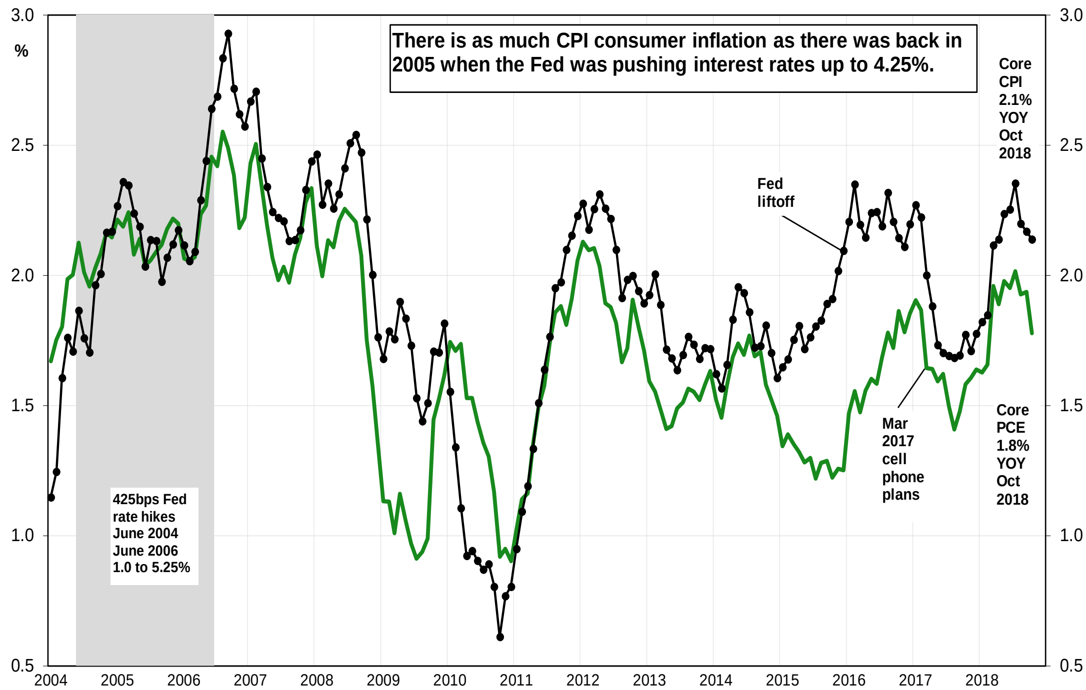
	Monthly				Percent changes		
	October	September	August	October	Oct 18	Sep 18	Oct 18
Trade	2018	2018	2018	2017	Sep 18	Aug 18	Oct 17
Balance	-77,246	-76,251	-75,357	-67,629			
Exports	140,517	141,303	138,518	130,324	-0.6	2.0	7.8
Foods, Feeds, & Beverages	10,263	11,010	11,968	10,555	-6.8	-8.0	-2.8
Industrial Supplies (1)	47,071	46,911	44,140	41,534	0.3	6.3	13.3
Capital Goods	46,984	47,496	46,417	44,014	-1.1	2.3	6.7
Automotive Vehicles, etc.	12,580	12,948	12,785	12,728	-2.8	1.3	-1.2
Consumer Goods	18,001	17,762	17,616	16,356	1.3	0.8	10.1
Other Goods	5,617	5,177	5,594	5,138	8.5	-7.5	9.3
Imports	217,764	217,554	213,875	197,953	0.1	1.7	10.0
Foods, Feeds, & Beverages	12,294	12,143	12,305	11,720	1.2	-1.3	4.9
Industrial Supplies (1)	49,022	49,471	49,655	42,754	-0.9	-0.4	14.7
Capital Goods	57,025	60,063	57,683	55,089	-5.1	4.1	3.5
Automotive Vehicles, etc.	31,834	31,107	31,711	29,538	2.3	-1.9	7.8
Consumer Goods	57,357	55,435	53,471	50,154	3.5	3.7	14.4
Other Goods	10,231	9,334	9,050	8,698	9.6	3.1	17.6

(1) Includes petroleum and petroleum products.

Consumer's still got it, while Fed's inflation target slip-sliding away (Thursday)

Breaking economy news. The October personal income report for October. Personal income rose 0.4% and consumers spent all their money and more with personal spending up 0.6%, so the savings rate fell a tenth to 6.2%.

Meanwhile, the rising inflation trend this year has been stopped in its tracks at the Fed's 2% target line which breaks the economic rule that a tighter labor market leads to more wages and more inflation. Core consumer inflation has backed off the 2% target to 1.9% in August and September, and now is lower today at 1.8% year-on-year. Observable inflation on goods and services prices that can actually be observed on a price list or some other means is even lower at 1.5% year-on-year in October. If the trade tariffs are going to bring higher inflation to the American consumer it is not evident yet in these latest data. If inflation is short of the Fed's goal they are not going to raise interest rates above neutral levels for the economy. Unless inflation goes above 2%, the economy can't be considered to be all that hot.



Net, net, the consumer has a lot of momentum in terms of spending power that can keep the economy humming with growth of over 3% this quarter. Spending on services is over the top in October, and real consumer spending is so strong, that the Q4 results will be 2.4% already even if consumers don't spend a dime more in November and December. The consumer is on a hot streak with strong purchases of 4.0% in the second quarter and 3.6% in the third quarter.

The economy is going to finish the year on a strong note despite the headwinds of trade war tensions, slower world growth, and stock market turbulence. Spending on purchases can only grow stronger the next two months with gasoline prices at the pump on the decline putting extra dollars in consumer pockets. Stay tuned. Story developing. Regardless of what the President tells them, Fed officials will be more determined than ever to raise rates a fourth time this year in December. Interest rates are slightly below neutral levels and even with inflation on the wane, the economy doesn't still need the Fed's foot down on the gas. The economy has been running for nearly ten years now and certainly doesn't need the Federal Reserve to keep going.

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 Americas Holdings Corporation

Headquartered in New York, MUFG Americas Holdings Corporation is a financial holding company and bank holding company with total assets of $148.1 billion at December 31, 2016. Its main subsidiaries are MUFG Union Bank, N.A. and MUFG Securities Americas Inc. MUFG Union Bank, N.A. provides an array of financial services to individuals, small businesses, middle-market companies, and major corporations. As of December 31, 2016, MUFG Union Bank, N.A. operated 365 branches, comprised primarily of retail banking branches in the West Coast states, along with commercial branches in Texas, Illinois, New York and Georgia, as well as two international offices. MUFG Securities Americas Inc. is a registered securities broker-dealer which engages in capital markets origination transactions, private placements, collateralized financings, securities borrowing and lending transactions, and domestic and foreign debt and equities securities transactions. MUFG Americas Holdings Corporation is owned by MUFG Bank, Ltd. and Mitsubishi UFJ Financial Group, Inc., one of the world's leading financial groups. MUFG Bank, Ltd. is a wholly owned subsidiary of Mitsubishi UFJ Financial Group, Inc. Visit http://www.unionbank.com/ or http://www.mufgamericas.com/ for more information.

About MUFG (Mitsubishi UFJ Financial Group, Inc.)

MUFG (Mitsubishi UFJ Financial Group, Inc.) is one of the world's leading financial groups, with total assets of approximately $2.6 trillion (USD) as of December 31, 2016. Headquartered in Tokyo and with approximately 350 years of history, MUFG is a global network with more than 2,200 offices in nearly 50 countries. The Group has more than 140,000 employees and about 300 entities, offering services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group's operating companies include MUFG Bank, Mitsubishi UFJ Trust and Banking Corporation (Japan's leading trust bank), and Mitsubishi UFJ Securities Holdings Co., Ltd., one of Japan's largest securities firms.

Through close partnerships among our operating companies, the Group aims to "be the world's most trusted financial group," flexibly responding to all of the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York (MUFG) stock exchanges. Visit www.mufg.jp/english/index.html.