Financial Market Weekly

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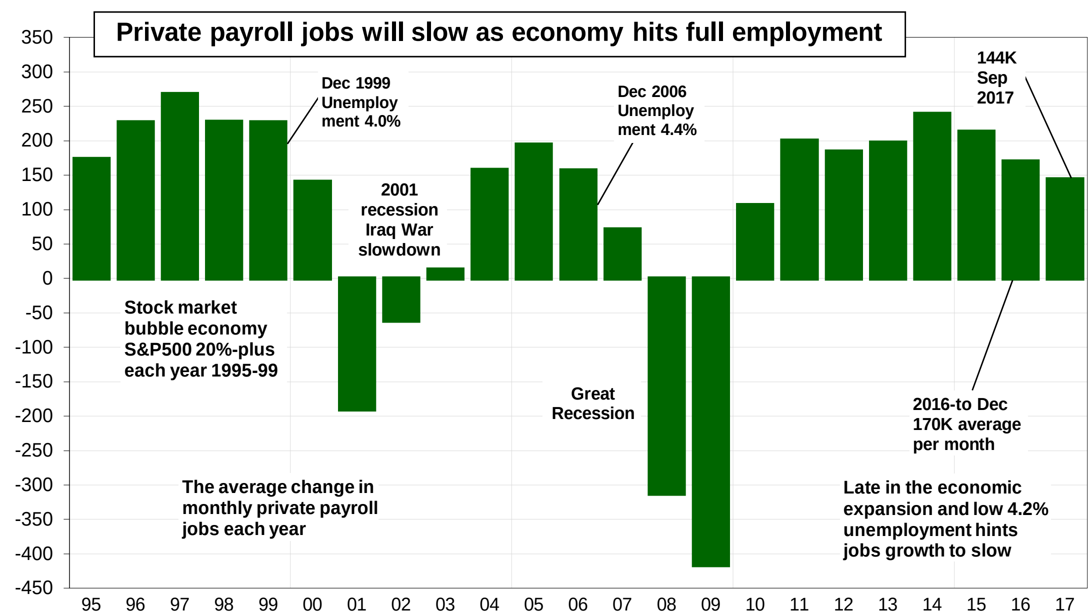
6 OCTOBER 2017

FORGET THE STORM SURGE JOB LOSSES, WAGE INFLATION IS BACK!

250K 2014, 226K 2015, 187K 2016, 148K 2017, total jobs naturally slow after nine years of growth and cannot be upped with tax cuts

Breaking economy news. The monthly employment situation report for September. You can forget about will-they, won't-they hike rates in December, they're going because they are behind the curve when it comes to their assessment of the labor market.



Payroll jobs fell 33K in September as Hurricane Harvey hit the Texas coast, but there is little sign of economic weakness anywhere else in this report. The Fed has waited way too long in this cycle to normalize rates and now look at the economy. Too much central bank fiddling around while Rome is burning. The labor market is on fire generating enough heat to

	Sep	Aug	Jul	Jun	May	Apr
Payroll jobs (000s)	-33	169	138	210	145	207
Unemployment rate %	4.2	4.4	4.3	4.4	4.3	4.4
Unemployment (3 decimal)	4.220	4.442	4.350	4.357	4.294	4.404
Participation rate %	63.1	62.9	62.9	62.8	62.7	62.9
Average hourly earnings	$26.55	$26.43	$26.39	$26.27	$26.22	$26.18
MTM % Chg	0.5	0.2	0.5	0.2	0.2	0.2
YOY % Chg	2.9	2.7	2.6	2.5	2.5	2.5
Production Worker earnings	$22.23	$22.14	$22.09	$22.03	$21.99	$21.96
MTM % Chg	0.4	0.2	0.3	0.2	0.1	0.3
YOY % Chg	2.5	2.4	2.3	2.3	2.4	2.3

finally push up wage inflation. The unemployment rate fell from 4.4% in August to 4.2% in September igniting a free for all on the part of employers to offer big wages to get whoever is left out there on the sidelines to come join their companies. Please.

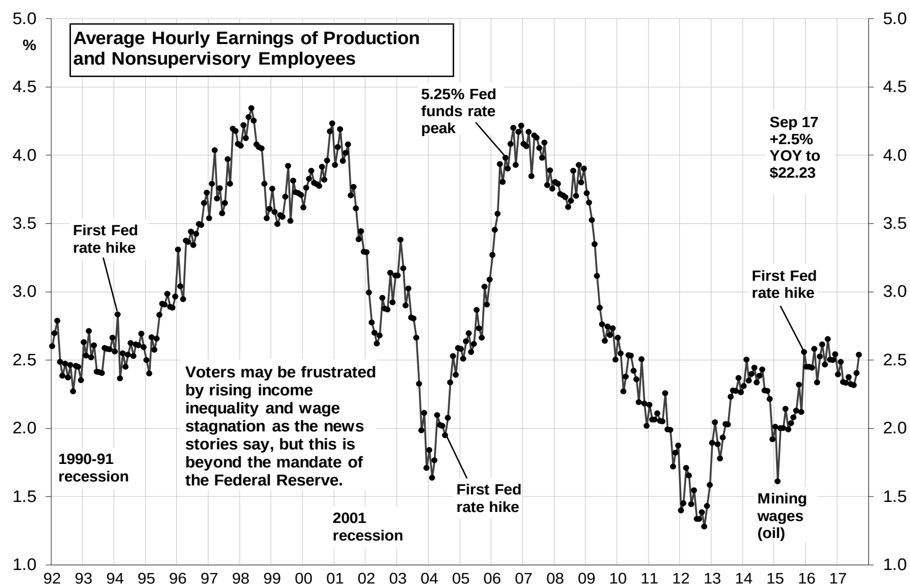
Before today, it looked like the wage trend had been put to sleep, but now employers finally get it and are having to pony up on the rewards for work to get anyone to come to work for them. Happy Friday indeed. Maybe it will be. Average hourly earnings were steady at 2.5% the last five months coming in this morning, and then bang, at 830am we found out September average hourly earnings are up 2.9% and August was revised up to 2.7%. What the heck? Isn't any of this data reliable? These night and day changes are unbelievable.

Bond yields moved up a little on the news. 10-yr Treasury yields were trading at 2.37% and traded as high as 2.40% fifteen minutes later. Fed funds futures odds were 74% on the chance of a December Fed rate hike to 1.50%, and traded as high as 82% before closing at 76%.

Net, net, hurricane jobs losses are temporary but the tightening of labor market conditions last forever and right now the jobs market is as tight

Payroll jobs in year nine following the recession

Dec. 2016 Totals millions		Sep 17	Aug 17	Jul 17	9 months Dec 16 to Sep 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment	-33	169	138	1334	2240
123.026	Total Private (ex-Govt)	-40	164	133	1296	2039
19.794	Goods-producing	9	66	-20	285	64
0.617	Mining	2	6	1	55	-75
12.343	Manufacturing	-1	41	-11	104	-16
0.942	Motor Vehicles & parts	-3	24	-27	-3	17
6.783	Construction	8	19	-9	128	155
103.232	Private Service-providing	-49	98	153	1011	1975
27.374	**Trade, transportation, utilities**	26	2	0	31	331
15.881	Retail stores	-3	-7	-11	-72	203
3.180	General Merchandise	-3	1	5	-50	37
3.097	Food & Beverage stores	-7	-2	-5	-30	37
5.048	Transportation/warehousing	22	8	8	63	92
1.465	Truck transport	0	-2	2	6	10
0.668	Couriers/messengers	4	4	4	9	31
0.943	Warehousing and storage	5	4	0	18	63
0.557	Utilities	0	0	-1	-4	0
2.762	**Information**	-9	-4	-3	-55	0
8.364	**Financial**	10	8	11	109	176
2.605	Insurance	11	2	7	37	46
2.169	Real Estate	6	5	-2	37	59
1.311	Commercial Banking	-3	-1	-1	3	17
0.933	Securities/investments	0	-1	4	16	18
20.416	**Professional/business**	13	43	43	391	534
2.962	Temp help services	6	8	13	92	32
2.259	Management of companies	-4	1	0	19	35
1.427	Architectural/engineering	1	3	1	37	27
2.032	Computer systems/services	4	5	4	35	87
1.126	Legal services	1	1	-4	3	5
1.000	Accounting/bookkeeping	1	4	4	10	32
22.871	**Education and health**	27	45	51	346	553
5.077	Hospitals	5	6	5	50	119
3.604	Educational services	14	24	13	66	85
15.744	**Leisure and hospitality**	-111	0	50	129	331
1.950	Hotel/motels	-1	-3	-2	5	11
11.549	Eating & drinking places	-105	9	52	106	276
22.299	Government	7	5	5	38	201
2.200	Federal ex-Post Office	-1	0	-2	-11	30
5.085	State government	2	2	6	15	-4
2.414	State Govt Education	3	0	6	20	3
14.395	Local government	5	5	1	36	160
7.945	Local Govt Education	2	9	-6	12	69



as a drum. The drop in the unemployment rate from 4.4% to 4.2% shows that companies are in a race to bring in new talent and have all but scooped up anyone that was still unemployed from the recession.

Businesses aren't panicking exactly but they are starting to throw more money at their workforces both to keep them and to hire them. Average hourly earnings are up 2.9% today where we thought they were rising just 2.5% before this morning's report. This economy is heating up and the Fed can be confident about the need to move interest rates up further at a gradual pace.

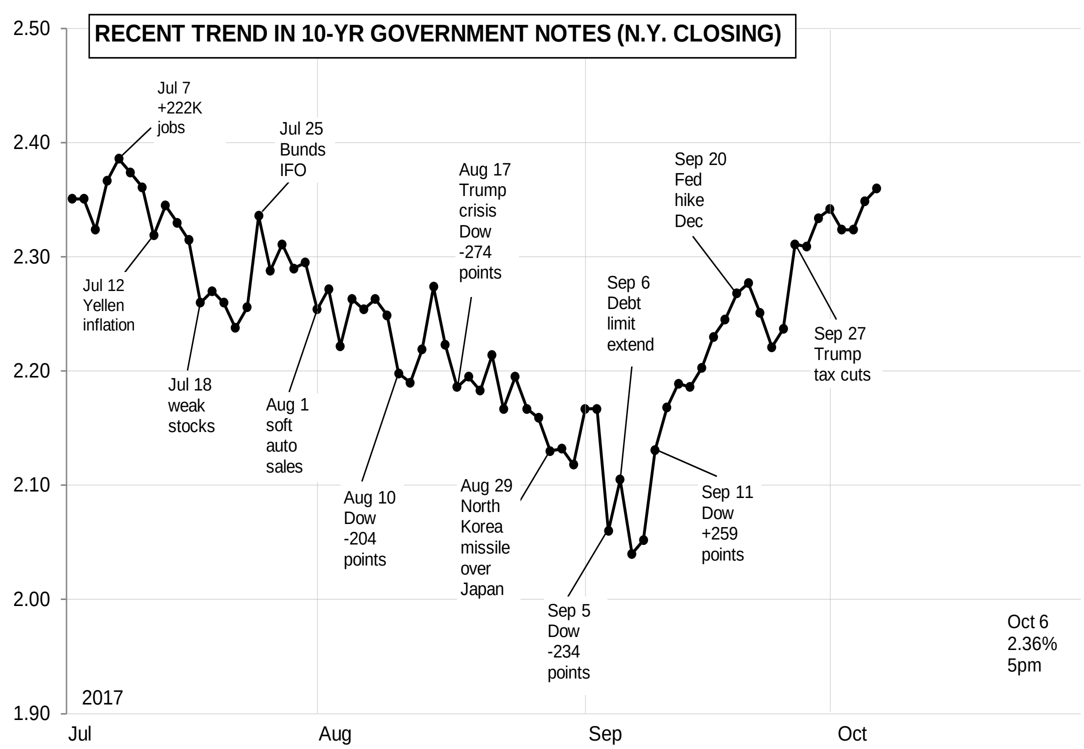
Fed Chair Yellen looks like a genius this morning with wages starting to heat up just like the economics textbooks say they should when the economy moves beyond full employment. Maybe this win today against the Doves around her questioning the need for additional rate hikes with inflation under target will up the odds on her reappointment as Fed Chair.

33K of job losses is the red herring headfake news headline from this month's employment report because this economy is heating up. There is a dwindling pool of labor for companies to draw on and wages are starting to heat up which means inflation will rise in the months ahead. Bet on it. The economy is stronger than the market thinks. Inflation is going up, and interest rates need to go up too.

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 closed higher at 2.36% this week versus 2.33% the prior week. The upward move felt higher as the yields fell suddenly Friday morning, after the strong employment report bond selloff, following the Yen we guess on some rumors there would be another North Korean missile this weekend. Yields were unable to close higher than the July selloff with July 7's 2.39% level still holding "the record."



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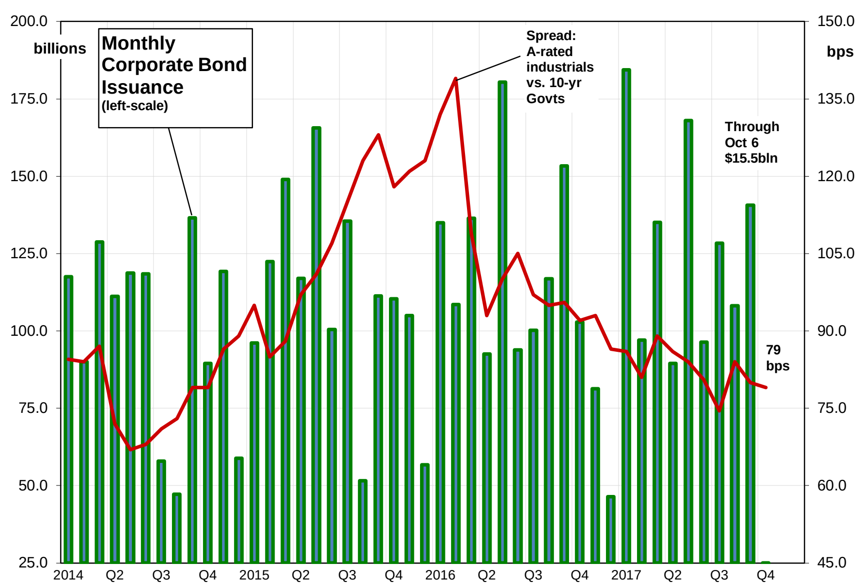
FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	4-Oct	27-Sep	20-Sep	13-Sep	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2465.467	2465.427	2465.448	2465.468	479.782
Federal agency debt securities	6.757	6.757	6.757	6.757	0.000
Mortgage-backed securities	1768.160	1768.160	1770.524	1782.346	0.000
Primary credit (Discount Window)	0.000	0.012	0.002	0.002	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	1.707	1.708	1.708	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	3.620	0.037	0.037	0.087	62.000
Federal Reserve Assets	4507.0	4502.2	4505.4	4518.1	961.7
3-month Libor %	1.35	1.33	1.32	1.32	2.82
Factors draining reserves					
Currency in circulation	1582.848	1580.243	1580.714	1580.720	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	178.738	220.083	168.025	125.668	0.000
Reserve Balances (Net Liquidity)	2228.518	2178.840	2229.409	2360.190	24.964
Treasuries within 15 days	0.000	10.947	10.947	0.000	14.955
Treasuries 16 to 90 days	45.116	27.613	27.613	38.559	31.549
Treasuries 91 days to 1 year	324.881	323.377	323.377	323.378	69.272
Treasuries over 1-yr to 5 years	1133.395	1144.897	1144.900	1144.904	170.807
Treasuries over 5-yrs to 10 years	328.882	325.425	325.430	325.435	91.863
Treasuries over 10-years	633.192	633.168	633.180	633.193	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

The Fed meets October 31 – November 1 to consider its monetary policy. They are still in no hurry, Greenspan raised rates 200 bps a year, Bernanke recommended 100 bps per year, so these non-press conference Fed meetings are a nonstarter when it comes to changing rates. After today's strong employment report, they should be raising rates 100 bps per year at a measured pace, none of this uncertainty, "we're not on a preset course" stuff. Headline CPI inflation is 1.9%, put the Fed funds rate 100 bps above that to start with. Fed funds futures now show a 76% chance of a rate hike at the December Fed meeting, so we would assume they hike rates then. The 75 bps increase in rates forecast for 2018 they forecast in September may depend on the next Fed Chair which may be announced by the next Fed meeting. It is hard to know if Fed officials on the Committee will become more independent in their views after Yellen (who is still a candidate of course), or whether the next Fed Chair can control their votes—Greenspan-style. Fischer is gone by the next Fed meeting, but Quarles has been confirmed.

CORPORATE BONDS: ENBRIDGE, DEERE, GENERAL MILLS, ENEL FIN INTL

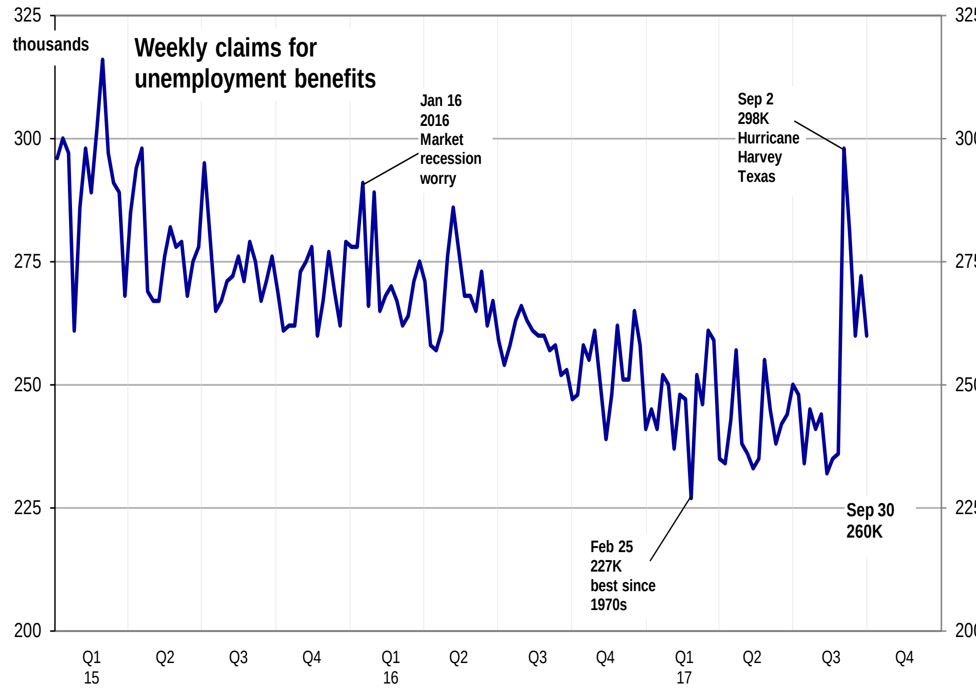
Corporate offerings were $15.5 billion in the October 6 week versus $22.0 billion in the September 29 week. On Thursday, PepsiCo, Inc. sold $4.0 billion 3.5s/10s/FRNs. It priced $1.5 billion 3.0% 10-yrs (m-w +15bp) at 68 bps (A1/A+). The soft drink and snacks company will use the proceeds for general corporate purposes, including the repayment of commercial paper. Corporate bonds (10-yr Industrials rated A2) were 79 bps above 10-yr Treasuries this week versus 80 bps last Friday.



OTHER ECONOMIC NEWS THIS WEEK

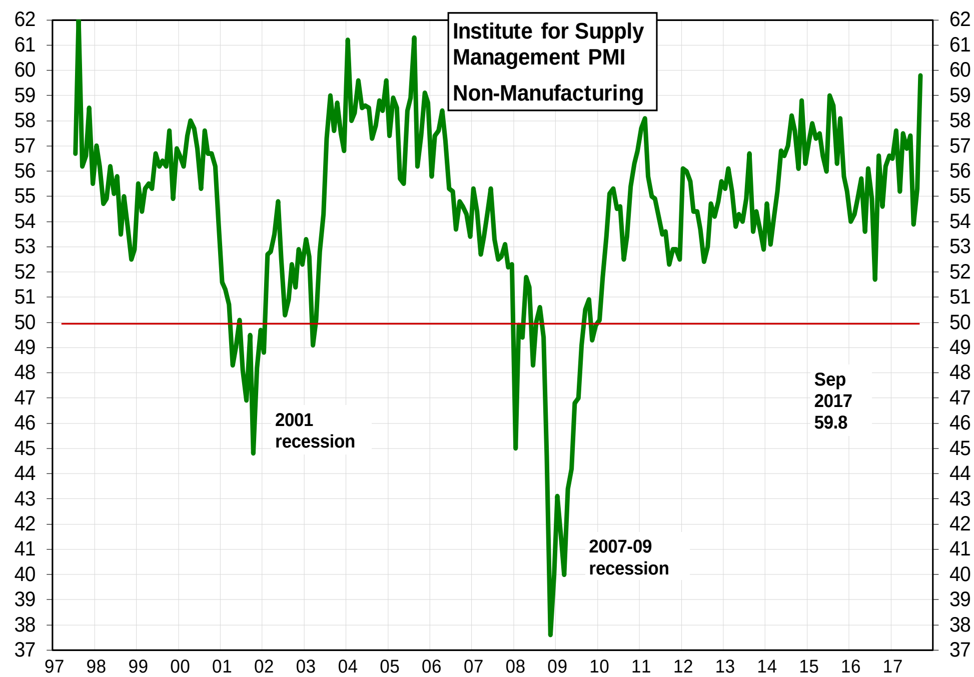
Unemployment claims normalize further after the storms

Unemployment claims fell 12K to 260K in the September 30 week. We expect claims to come back down below 250K where they were before Hurricane Harvey hit Texas sending claims as high as 298K in the September 2 week. Payroll jobs fell 33K in September very close to the -35K Hurricane Katrina reading in September 2005 after unemployment claims rose about 100K, from 320K to 420K, a little worse than the Hurricane Harvey claims rise of roughly 65K.



Buck up. The services sector isn't tired yet. This economy's got wheels.

Breaking economy news. The ISM nonmanufacturing survey shows executives are the most optimistic since the recession ended. The index jumped 4.5 points to 59.8 in September. So much for the idea that the economy was slowing down in its ninth year of expansion since the end of the recession. Now the index has been a little on the unstable side as it collapsed 3.5 points in July, a move that is not completely explainable. But for whatever reason, the index is pointing to stronger growth and a better outlook later this year. If the Fed doesn't have a rate hike on the agenda at the December meeting it sure ought to. This economy is showing no sign of slowing down and it is inappropriate to continue monetary stimulus this late into the recovery. No other Federal Reserve in history has kept on trying to prime the pump this late in the cycle.



Net, net the surge in confidence among service-sector executives has reached new heights at the end of the third quarter and this bodes well for a strong finish for the economy this year. Washington may not have its act together, but boy the economy sure does. Things are looking up. The Federal Reserve is right to overlook the current statistics that reflect a temporary slowdown due to the back-to-back Hurricanes in Texas and Florida because confidence in the business sector hasn't been this good in years.

There were 15 industry sectors seeing growth and just two that are in decline. The two unlucky industries are Arts, Entertainment & Recreation; and Mining. Oil & gas drilling is going straight up, so we hope they got their survey results right. Recreation and other amusements (don't laugh) may have been off a little due to the hurricanes down South this month.

We hope the Fed hears the message that purchasing managers are giving them today. Quit telling people that the economy is not okay because inflation isn't 2%. No one believes you. A normal economy needs normal interest rates. We expect policymakers, whoever is left, to vote for a rate hike to 1.5% at the final meeting this year in December. The economy is stronger than even we think. Bet on it.

Analyst Certification

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