

Financial Market Weekly

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

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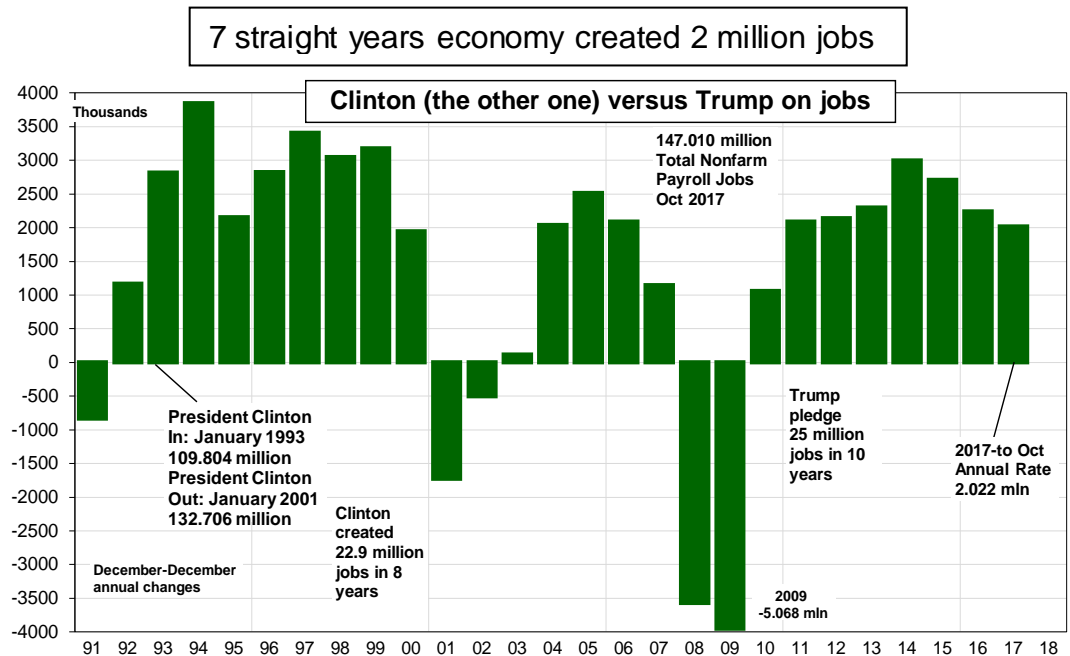
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LOST JOBS FROM THE STORM FOUND, BUT NO WAGES FOR AMERICAN WORKERS

Breaking economy news. The monthly employment situation report, the biggest economic number known to traders in the world, with three key parts: 261K payroll jobs in October, new 4.1% unemployment rate low for this recovery, and zero wages as in 0.0% change in average hourly earnings this month.

The economy is at full employment, or rather it is almost there, as the new Fed Chairman said in yesterday's press conference with the President. "Jay, you know more than anyone

how low unemployment is..." "Yep, yep, I do." No wonder [Powell won the casting call](#). Administration aides said Trump felt most comfortable with Jay Powell among the five candidates for Fed Chair, Yellen, Warsh, Powell, Taylor, Cohn, and we can see why.



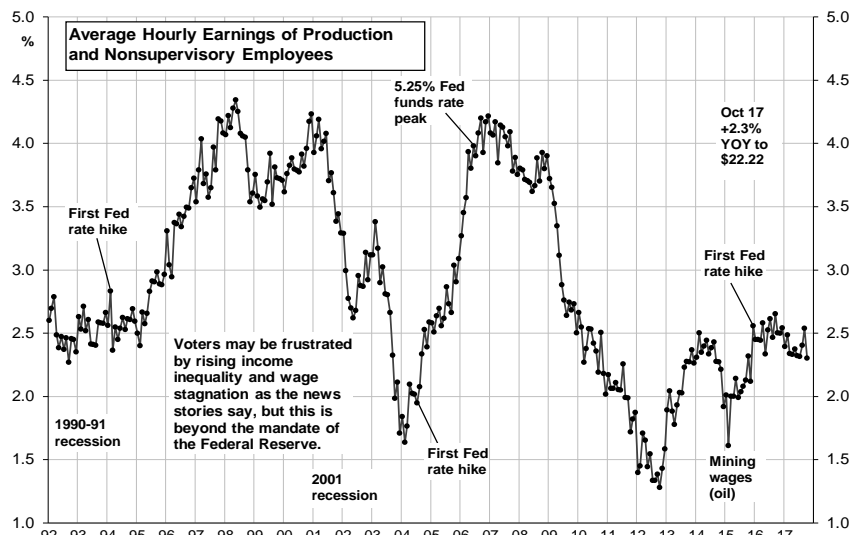
	Oct	Sep	Aug	Jul	Jun	May
Payroll jobs (000s)	261	18	208	138	210	145
Unemployment rate %	4.1	4.2	4.4	4.3	4.4	4.3
Unemployment (3 decimal)	4.065	4.220	4.442	4.350	4.357	4.294
Participation rate %	62.7	63.1	62.9	62.9	62.8	62.7
Average hourly earnings	\$26.53	\$26.54	\$26.42	\$26.39	\$26.27	\$26.22
MTM % Chg	0.0	0.5	0.2	0.5	0.2	0.2
YOY % Chg	2.4	2.8	2.6	2.6	2.5	2.5
Production Worker earnings	\$22.22	\$22.23	\$22.14	\$22.09	\$22.03	\$21.99
MTM % Chg	0.0	0.4	0.2	0.3	0.2	0.1
YOY % Chg	2.3	2.5	2.4	2.3	2.3	2.4

For today's employment report, the economy is at full employment so the only thing that matters for Fed policy and bond market yields is inflation. And the inflation data in today's report is average hourly earnings, the wage data, which was zero today. Average hourly earnings rose 2.4% the last year to \$26.53 per hour in October, and this is less than the 2.9% year-on-year change reported last month for September. No wages, no cost-push inflation, bond traders or their artificial intelligence robotic counterparts on the desk reasoned. 10-yr Treasury yields were 2.34% before the release of the employment report at 830am New York time and fell 2 bps to 2.32% just minutes later. Glad we have risk management to measure and monitor these volatile markets. Whew.

So no wages, no inflation, and the jobs creation was less than the 310K consensus forecast. But even though the 261K payroll jobs increase was a glass half-full, there were 90K of upward revisions to August/September. In fact, that 33K surprise hurricane job loss number a month ago for September is now revised to an 18K gain.

Payroll jobs in year nine following the recession

Dec. 2016	Totals	millions	Oct 17	Sep 17	Aug 17	10 months Dec 16 to Oct 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment		261	18	208	1685	2240
123.026	Total Private (ex-Govt)		252	15	184	1623	2039
19.794	Goods-producing		33	18	73	334	64
0.617	Mining		-2	1	5	51	-75
12.343	Manufacturing		24	6	44	138	-16
0.942	Motor Vehicles & parts		3	-3	23	1	17
6.783	Construction		11	11	24	147	155
103.232	Private Service-providing		219	-3	111	1289	1975
27.374	Trade, transportation, utilities		6	42	9	60	331
15.881	Retail stores		-8	7	-2	-66	203
3.180	General Merchandise		-8	0	0	-56	37
3.097	Food & Beverage stores		-2	-6	3	-26	37
5.048	Transportation/warehousing		8	25	7	73	92
1.465	Truck transport		0	2	-1	9	10
0.668	Couriers/messengers		6	4	5	16	31
0.943	Warehousing and storage		3	2	3	18	63
0.557	Utilities		0	0	0	-4	0
2.762	Information		-1	-3	0	-46	0
8.364	Financial		5	13	10	119	176
2.605	Insurance		-7	12	-1	29	46
2.169	Real Estate		11	5	7	49	59
1.311	Commercial Banking		1	-4	0	4	17
0.933	Securities/investments		0	1	-1	17	18
20.416	Professional/business		50	22	47	454	534
2.962	Temp help services		18	8	9	114	32
2.259	Management of companies		4	0	2	28	35
1.427	Architectural/engineering		4	2	4	43	27
2.032	Computer systems/services		4	2	6	38	87
1.126	Legal services		-1	1	0	0	5
1.000	Accounting/bookkeeping		0	0	2	8	32
22.871	Education and health		41	22	46	383	553
5.077	Hospitals		3	5	7	54	119
3.604	Educational services		8	14	26	76	85
15.744	Leisure and hospitality		106	-102	-9	235	331
1.950	Hotel/motels		2	5	-3	12	11
11.549	Eating & drinking places		89	-98	-9	184	276
22.299	Government		9	3	24	62	201
2.200	Federal ex-Post Office		3	0	2	-4	30
5.085	State government		2	-5	-2	6	-4
2.414	State Govt Education		-1	-2	-3	12	3
14.395	Local government		2	7	26	61	160
7.945	Local Govt Education		5	7	33	47	69

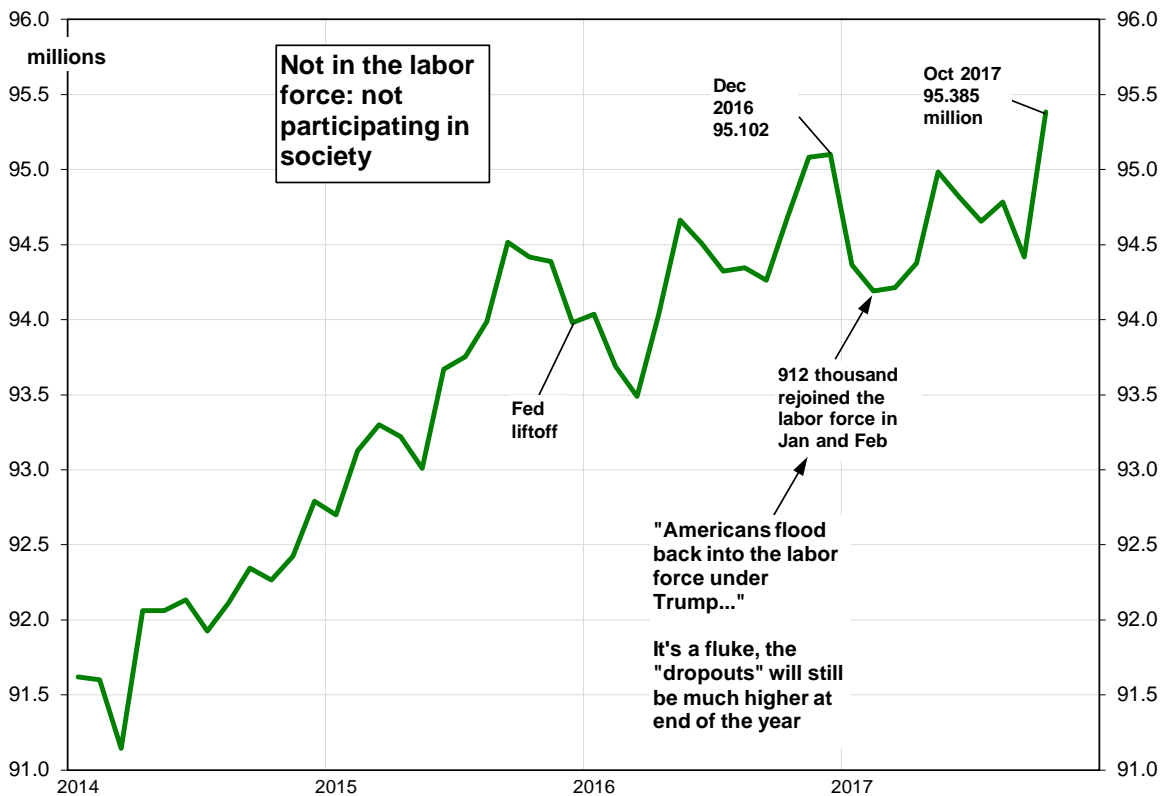


Net, net, the labor markets continue to tighten up with the new low in the unemployment rate of 4.1% today. The Fed's models tell them that inflation will rise again at some point in the future with labor in such short supply and interest rates need to move up to more normal levels. The Fed funds rate is at least 100 bps too low as even the Fed doves who are concerned about low inflation grudgingly admit, so a rate hike in December remains a good bet in our view. Market-based Fed funds futures say the odds of a move at year-end are over 80%.

Payroll jobs were less than expected today, but we better get used to it, because labor is in short supply, and companies are having trouble hiring the skilled help they need or even a candidate they want to train. Time will tell if this long economic expansion under Trump's economics team can beat the 10 year record for economic growth during the Clinton presidency in the 90s. We've never seen an economy in America that runs out of gas and stops because it runs out of workers, but the risks this time around are very real as the economy moves deeper and further beyond full employment.

The only blemish in the report is that wages remain relatively lackluster for this point in the economic cycle with help-wanted signs posted in every shop window on Main Street. Part of the subpar wage story is low inflation itself of course as many large corporations index overall annual wage increases to the rate of inflation. 2% inflation last year engenders 2% wages this year. (If you're lucky.) It is also possible the retiring baby boom generation is leaving the workforce and taking their big paychecks with them which may be keeping wages rising 2% each year and not 3%. Stay tuned. Story developing.

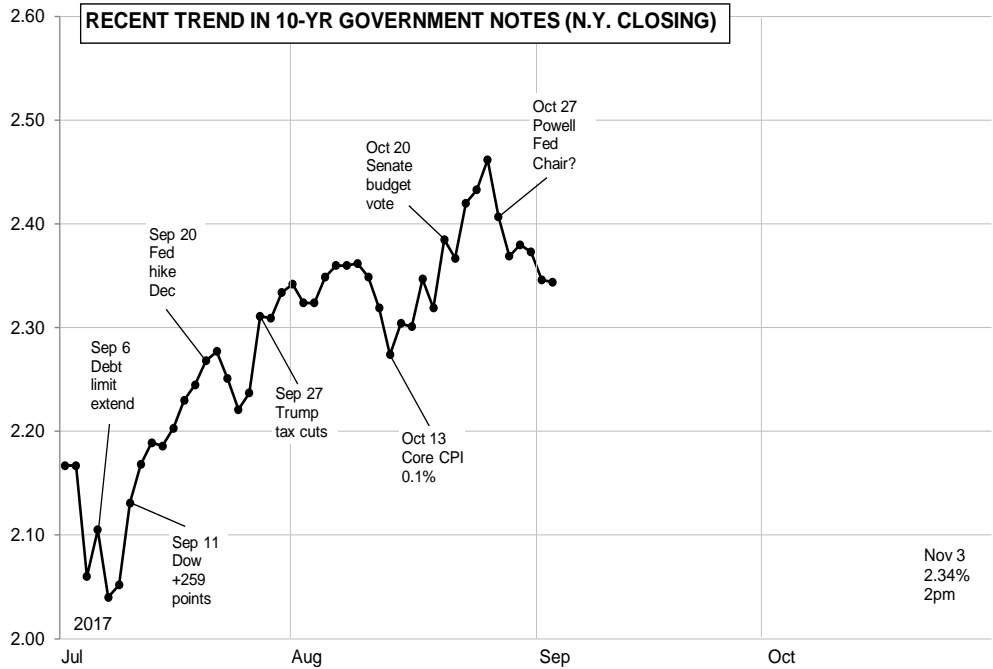
Record Numbers of Americans Left Jobs for Sidelines in October
Well "Cry Me a River." This is not a sign of economic weakness.



MARKETS OUTLOOK

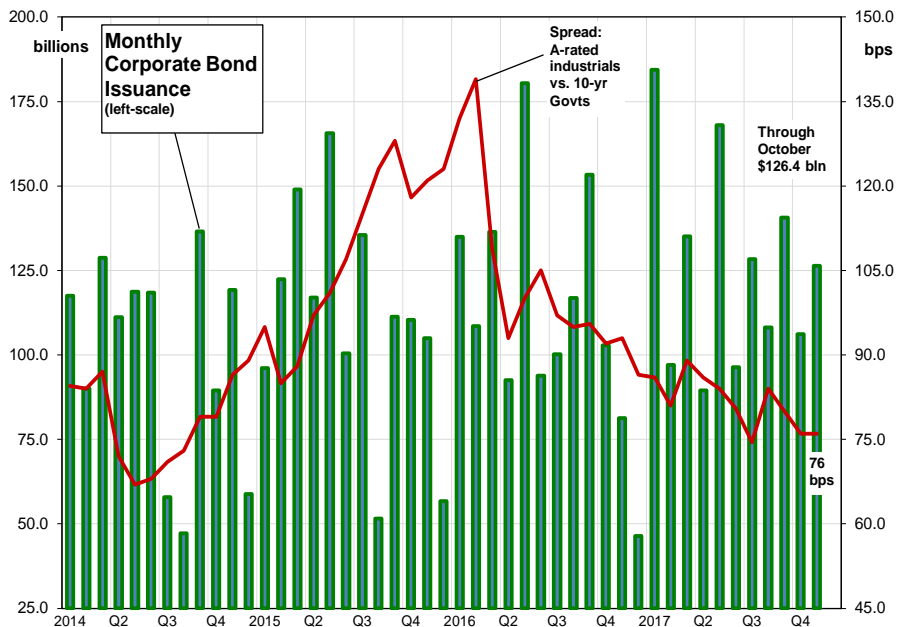
	29-Sep 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q1 2020
30-Yr Treasury	2.86	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.33	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.94	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	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 Friday at 2.34%. Traders seemed to have their fill of news this week, and by Friday's 261K payroll jobs report and 0.0% wages, there was little attempt to reprice yields further. Powell was chosen as Fed Chair, Bank of England raised rate 25 bps to 0.50% on Thursday, House Republicans released their \$1.5 trillion corporate and individual tax cut plan which is complex and hard to analyze. Individuals may not know what it means till they crank up the tax prep software in April 2019.



CORPORATE BONDS: GM, FORD, WASTE MANAGEMENT, AMGEN, GATX

Corporate offerings were \$25.5 billion in the November 3 week versus \$37.1 billion in the October 27 week. On Tuesday, Celgene Corp. sold \$3.0 billion 5s/10s/30s. It priced \$1.0 billion 3.45% 10-ys (m-w +20bp) at 110 bps (Baa2/BBB+). The global biopharmaceutical company will use the proceeds to repay existing debt and for general corporate purposes. Corporate bonds (10-yr Industrials rated A2) were 76 bps above 10-yr Treasuries this week versus 77 bps last Friday.



FEDERAL RESERVE POLICY

The Fed met October 31 – November 1 to consider its monetary policy. There was little news in the press statement and no hidden clues that they were going to raise rates at the December meeting. They said the economy was “solid.”

Meanwhile, there is a new Fed Chairman, Jay Powell, the current Fed governor, who, if confirmed by the Senate, will take office on February 3, 2018 which is Fed Chair Yellen’s last day. He is an interesting pick by the President as he is not an economist by training. We used to call the Fed Chairman “the Nation’s Chief Economist,” but that will be less true going forward. He is said to be a candidate that will continue to execute Yellen’s monetary policy plans, but we would not take that

as a given. Our feeling is that he backed up Yellen’s statements 100% as a loyal foot-soldier without giving away much as to whether he personally approved of the Fed’s policy actions in recent years. He is a lawyer of course. We will see. We won’t really know if anything changes until we see if the committee changes its interest rate forecasts next year, maybe by the March meeting, though early for a new direction, possibly the June 2018 meeting could see some changes perhaps, and certainly by the September meeting we will know if there is a change under Powell. At the moment the committee sees three rate hikes in 2018 ending the year at 2.25%.

We can recall one memorable quote of Powell’s. He gave a [Remarks on Monetary Policy speech](#) on April 8, 2015 before the first Fed rate hike in December that year. The unemployment rate was 5.5%. Good and low enough for us. It peaked at 10.0% years earlier in October 2009. His comment was about how the economy was still healing from the crisis years after the recession ended. Moving rates up gradually, he finished with, would “give our economy the best chance to make up lost ground.” The reality is growth never made up for lost ground, never grew faster than potential, and yet the unemployment rate fell anyway. We made it to full employment with 2% growth. They had the wrong model and talked the economy down for too long.

They also make a mistake by insisting they have an effect on the economy by moving the Fed funds rate up/down/around within a 1-1/4 to 3 percent range. The exact setting of the Fed funds rate between 1 and 3 percent does nothing to the economy: it’s not restrictive and it’s not supportive. Moving the Fed funds rate 25 bps higher to 1.5% does not slow the economy. The decision to do so does not need to be made dependent on the economy and cautiously assessed. They are overstating their powers. Make interest rates great again is our advice for the incoming Fed Chair and do it sooner rather than later. The economy is stronger than they think down there in Washington. Bet on it.

Selected Fed assets and liabilities						Sep 10
Fed H.4.1 statistical release						2008**
billions, Wednesday data						pre-LEH
	1-Nov	25-Oct	18-Oct	11-Oct		
Factors adding reserves						
U.S. Treasury securities	2459.827	2465.727	2465.641	2465.554	479.782	
Federal agency debt securities	6.757	6.757	6.757	6.757	0.000	
Mortgage-backed securities	1770.630	1770.563	1777.945	1768.160	0.000	
Primary credit (Discount Window)	0.001	0.015	0.009	0.000	23.455	
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000	
Asset-backed TALF						
Maiden Lane (Bear)	1.712	1.711	1.705	1.706	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						
Federal Reserve Assets	4502.8	4508.2	4516.6	4506.3	961.7	
3-month Libor %	1.38	1.37	1.36	1.36	2.82	
Factors draining reserves						
Currency in circulation	1589.253	1584.028	1585.186	1585.496	834.477	
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	
Reverse repurchases w/others	87.165	112.057	121.457	129.805	0.000	
Reserve Balances (Net Liquidity)	2281.472	2241.618	2255.104	2267.739	24.964	
Treasuries within 15 days	11.043	8.701	8.701	0.000	14.955	
Treasuries 16 to 90 days	28.456	39.496	39.494	45.116	31.549	
Treasuries 91 days to 1 year	345.643	321.809	321.808	324.884	69.272	
Treasuries over 1-yr to 5 years	1111.513	1133.435	1133.422	1133.408	170.807	
Treasuries over 5-yrs to 10 years	329.644	328.941	328.922	328.902	91.863	
Treasuries over 10-years	633.529	633.345	633.294	633.243	101.337	

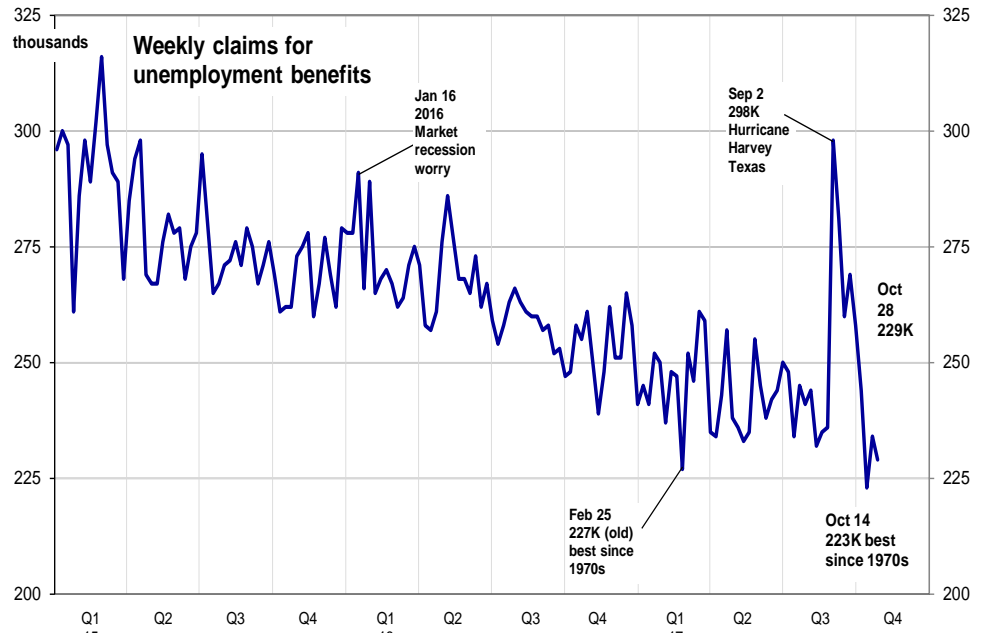
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

Don't blink or you'll miss it: the great balance sheet unwind has begun. The Fed's Treasury security holdings dropped \$5.9 billion to \$2.459 trillion this week.

OTHER ECONOMIC NEWS THIS WEEK

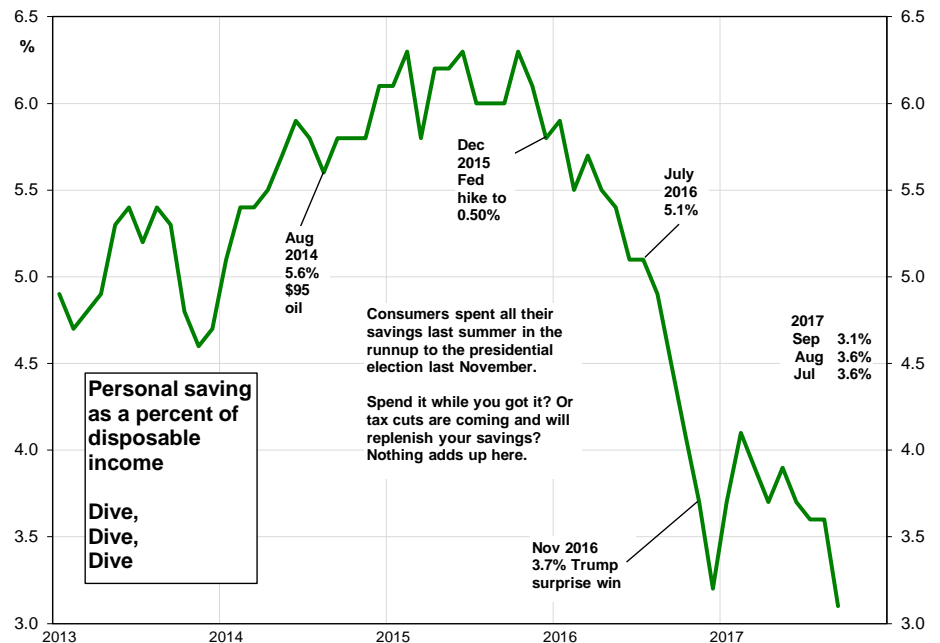
Unemployment claims are lower (better) than before the hurricanes

Unemployment claims fell 5K to 229K in the October 28 week. Hurricane Harvey hit Texas in the September 2 week, and Hurricane Irma hit Florida in the September 16 week, but claims fell back quickly. Claims show a better labor market and the monthly employment report said the same thing, with unemployment falling a tenth to a new low of 4.1% this cycle. Payroll jobs rose 261K in October with 90K of upward revisions to August/September.



Consumer spending jumps but for how long; inflation has weak heartbeat

Breaking economy news. The September monthly personal income report. Consumer spending snapped back rising 1.0% in September from 0.1% in August. August real spending fell 0.1% and is up 0.6% in September. We already got the full third quarter results for consumer spending in last Friday's GDP report where consumers bought 2.4% more goods and services down from the second quarter splurge of 3.3%. The third quarter was looking anemic



until September car sales jumped to an 18.5 million (annual rate) from 16.0 million in August.

Headline inflation rose 0.4% to 1.6% year-on-year with the surge in gasoline prices following the hurricanes down south this month. The good news is 1.6% is closer to the Fed's 2% objective, the bad news is that it's not going to last. Gasoline prices have come back down. Core PCE inflation remains in the doldrums at 1.3% year-on-year the same as in August, and is well off the 1.9% core

inflation rate at the start of the year in January. The Fed doves are not going to be happy with this no-inflation report.

Net, net, the economy's barreling ahead into the third quarter on the backs of the consumer with plenty of spending momentum left over from September's surge in spending to power the economy forward in the fourth quarter. Consumer spending is rising 1.6% in the fourth quarter even if spending is unchanged in October, November, December.

There is a question of whether the momentum will last however as it looks like consumers dipped into their piggy banks to buy those heavily discounted cars and SUVs with the September saving rate falling to 3.1% in September from 3.6% in August and 4.4% in September 2016. Relying on consumer savings to move the economy forward is not going to last for long. Maybe the Trump miracle 3% growth economy is just another fake news feed where faster growth is living on borrowed time and is built on shifting sands without a solid foundation.

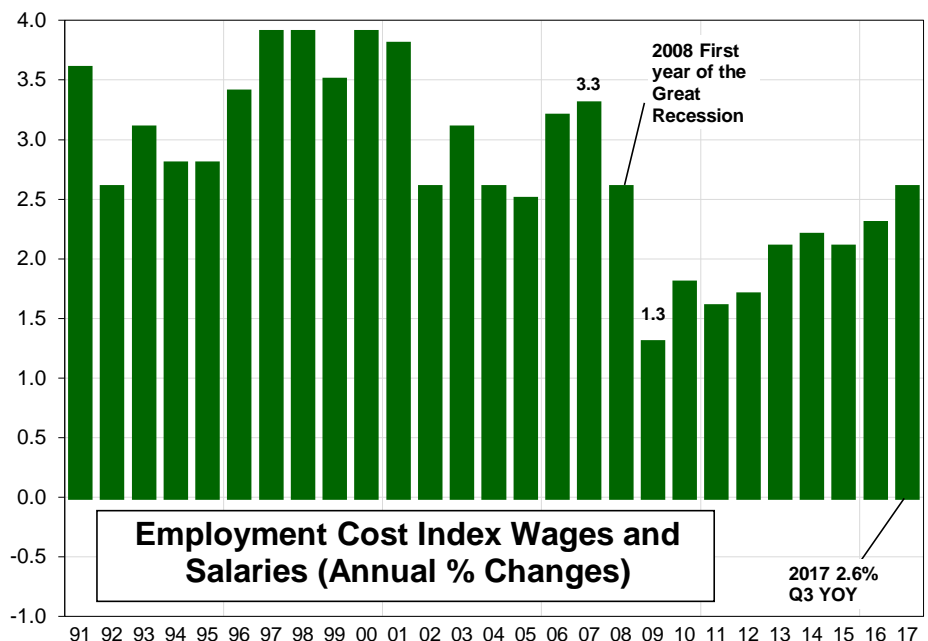
The mystery of low inflation continues however despite the stronger spending as core PCE inflation rose just 0.1% in September and remains at the low for the year of 1.3% year-on-year. Core PCE inflation has registered five consecutive months of 0.1% monthly changes showing the link between a fully employed economy and inflation remains broken. Core inflation will come back to 1.5% or so once the cell phone data plan effect washes out of the year-on-year data in March 2018, a long time to wait.

We expect the Fed to raise rates in December no matter who is named to the man the helm, but the outlook for three rate hikes in 2018 is in doubt unless inflation warms up closer to the Fed's expectations. Fed official forecasts see 1.5% core PCE inflation this year and 1.9% in 2018. Stay tuned. Story developing. Watch it develop here.

Income inequality and your stagnant wages 7 tenths higher today

Income inequality and your stagnant wages 7 tenths higher today. Stuff that in your wallets and handbags.

Breaking economy news. The employment cost index for the third quarter, what you cost your employer, rose 0.7%, which sounds okay we guess. But the year-on-year rise is 2.5%. The Trump Administration's fallback for the reason tax cuts are necessary



are that it will bring about a better living wage for Americans even if it doesn't boost economic growth and create more jobs, jobs, jobs. The final fallback of course after growth and jobs and wages is that massive tax cuts will simply stuff more cash in workers' pockets.

The employment cost index is divided into wages and benefits and the trend is roughly the same with benefits up 2.4% the last year and wages or salaries up 2.5%. It also breaks out private industry and state and local government. Government workers have wages rising just 2.0% the last twelve months, but benefits are running higher, just ask the many bankrupt states, with a 3.0% gain the last year.

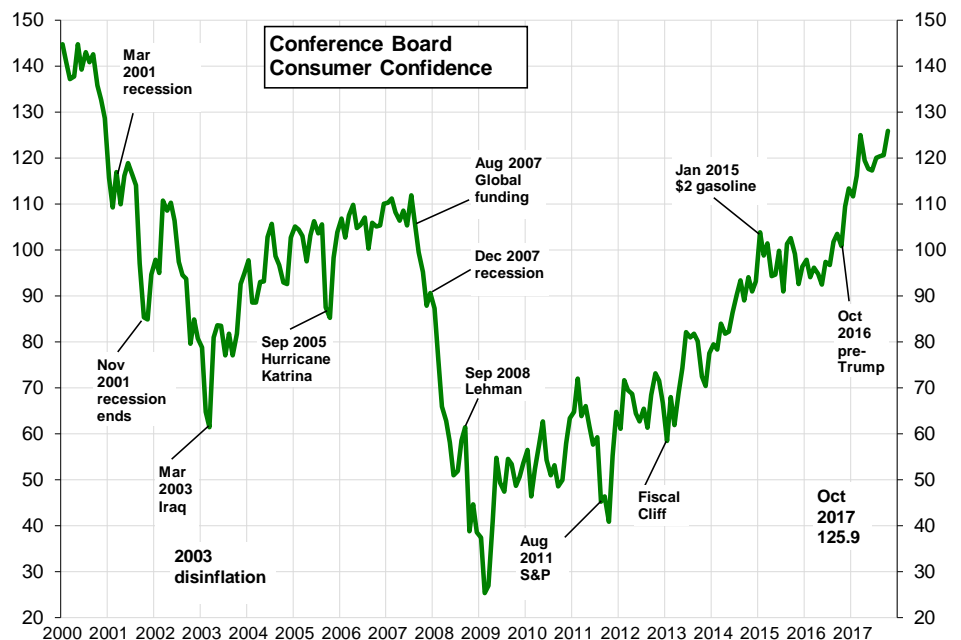
Net, net, employers are giving workers raises of 2.5% this year. It sounds like workers are not happy with their wages and are beset by signs of income inequality everywhere they look, but consumer confidence remains high. With the economy at full employment and labor starting to become scarce, it is just a matter of time before employers give workers a little more in their paychecks.

Private industry wages are 2.6% the last twelve months, which is close to the best in this long expansion since the recession. Wages at the worst point rose just 1.3% during the recession in 2009. As for the outlook, at the best point of the housing bubble economy years, private wages rose 3.3% in 2007. All we can say is if you didn't like your 2.6% raise from your employer this year, it is probably not going to be better than 3.3% in the next couple of years no matter how many massive tax cuts the economy gets to boost growth.

Stagnant wages were a big issue in the elections last year, but the reality is wages are going to be either 2% or 3%, which doesn't seem to be that big of a difference. Kind of like the argument between 2% or 3% economic growth. Growth forecasts don't seem to matter that much for living standards, even if it is important to get those massive tax cuts to pay for themselves. On paper anyway. Return to fuzzy math. Stay tuned. Story developing. The economy is better than you think.

Too late to make American confidence great again

Breaking economy news. Consumer confidence jumped 5.3 points to 125.9 in October as American spirits soar to the highest level in this recovery from the recession. You have to go back to the boom time two recessions ago in the year 2000 to find confidence readings this strong. If the consumer was concerned at all about the size of their paychecks or income



inequality or stagnant wages it is nowhere to be seen in this report. Maybe if Washington tells people enough that good times are coming it starts to become credible.

Consumer confidence is going straight up along with the stock market, and if there is a risk out there somewhere on the horizon stocks and consumers sure don't see it. It is partly income based as when it comes to your money or your health, more people are confident in their incomes than there are those who are less confident because they cannot get affordable health care. Those making \$125,000 and up saw confidence readings jumping from 147.4 in September to 160.9 in October, while the confidence readings for those making less than \$50,000 are mostly lower. For those making under \$15,000 the index is 62.8 on up to those making \$35,000 to less than \$50,000 with a confidence index reading of 113.2. A tale of two Americas here in the confidence statistics by income levels. The rich only get richer in this economy where the advancing tide is not lifting all the boats.

Net, net the economy is at full employment and the public knows it with consumer confidence literally soaring out of sight. The economy is doing great and can only get better with massive tax cuts on the way the consumer seems to say. The economy is better than we think. It must be if consumer confidence is at new highs in this economic cycle. The fourth quarter is going to be gangbusters if the confidence of consumers is any indication. Bet on it.

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