Q3 Update July 2012

2012 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.

Equipment Leasing & Finance Foundation
1825 K Street • Suite 900
Washington, DC 20006
www.leasefoundation.org
202-238-3429
Kelli Jones Nienaber, Executive Director

Prepared for the Equipment Leasing & Finance Foundation by

Dr. Robert Wescott ▪ Adam Karson

KEYBRIDGE RESEARCH

2012 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE FOUNDATION
Your Eye On The Future

TABLE OF CONTENTS

ABOUT THIS STUDY

The Equipment Leasing & Finance Foundation (the Foundation) recognized that with the wide variety and increasing complexity of economic data available to the public, the best way to utilize key equipment leasing data is to have it all in one place, where business leaders can access it easily and quickly, thus assisting them in making the best business decisions.

Partnering with Keybridge Research LLC, the Foundation was able to produce this economic outlook report specific to our industry. This report includes the second update of the 2012 annual outlook and an initial look at 2013. This report will be followed by additional of quarterly updates throughout the year.

Industry-specific data within the report include "Key Signposts," which are leading indicators for the direction of growth in equipment investment. The outlook report also includes an analysis of capital spending in the United States as well as an evaluation of how capital spending is affected by various related and exogenous factors in play in the current time frame and the foreseeable future.

Q3 2012 Equipment Leasing & Finance U.S. Economic Outlook July 2012

SUMMARY

The economy has slowed recently, evidenced by weaker than expected job creation in the past three months. Investment continues to grow, but at a slower rate than previous quarters. In particular, growth in equipment & software investment fell to an annualized rate of 3.5% in the first quarter, down from 7.5% in Q4 2011. Overall, we revised our 2012 outlook for equipment & software investment downward, from 6.9% to 6.4%. Our initial projection for 2013 growth is 8.0%.

Sector-level trends are consistent with our April outlook:

- *Agriculture equipment* investment is likely to decelerate in the next three to six months.
- *Computers & Software equipment* investment should remain healthy, but is likely to slow down somewhat.
- *Construction equipment* investment is projected to continue to grow at a strong pace as the housing market rebounds.
- *Industrial equipment* investment likely grew at a below-average pace in Q2 2012, but could pick up by late 2012 or early 2013.
- *Medical equipment* is likely to be relatively flat on a year-year basis.
- *Transportation equipment* investment should remain solidly positive, but is unlikely to maintain the rapid growth rates of 2011.

- Credit market conditions have stabilized in the past several weeks after fears of Greece exiting the EU caused tensions to spike. The subsequent flight to safety by investors pushed long-term U.S. Treasury rates to all-time lows. For example, the yield on 10-year Treasuries dropped below 1.5%. The Federal Reserve recently announced an extension of its “Operation Twist” program, which is aimed at lowering long-term interest rates even further. However, with rates still near historical lows, the benefits of additional monetary easing are likely to be marginal. As economic conditions slowly improve, demand for business loans will continue to grow, and supply constraints for large businesses should ease further. However, small businesses are reportedly having some difficulties in accessing capital. Conditions remain favorable for purchasing versus leasing, as the cost of borrowing is near record lows. Our baseline assumption is that Europe will continue to muddle through its economic crisis, causing global demand for U.S. Treasuries to moderate. As a result, tensions in global credit markets will ease somewhat, and U.S. interest rates should marginally increase by the end of 2012.

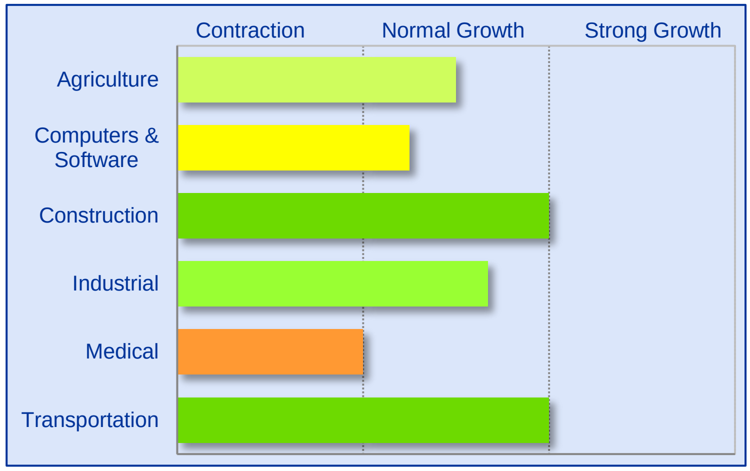
- The U.S. economy slowed in the first quarter of 2012 to an annualized growth rate of 1.9%, down from 3.0% in the fourth quarter of 2012. High oil prices have plagued economic growth for more than a year—after prices peaked in March, job creation slowed significantly, while real disposable income has been relatively flat and retail sales contracted in April and May. Although oil prices have dropped sharply in the past month, it will take several months for these lower prices to translate into higher consumer spending. The European crisis and the slowdown in emerging markets remain significant headwinds for 2012, and the prospect of a “fiscal cliff” in the U.S. at the end of 2012 is causing increased uncertainty for growth prospects in 2013.

- Overall, our macro outlook for 2012 has not changed materially from April. We are modestly downgrading our 2012 real GDP growth forecast from 2.3% to 2.2%, and dropping our inflation expectations to an average rate of 2.3% from 2.4%. However, shifts in risks should be a net positive for the U.S.—notwithstanding a collapse of the EU (which is unlikely in our view) lower oil prices are likely to outweigh any international headwinds. Pent up consumer demand, along with a rebounding housing market will be the main growth drivers over the next 6 to 12 months. Subsequently, our first look at 2013 calls for average annual growth of 2.8%.

KEY SIGNPOSTS FOR EQUIPMENT INVESTMENT: THREE- TO SIX-MONTH OUTLOOK

Summary

Key Signposts "Heat Map" Growth Chart



Equipment investment slowed in Q1 2012 to an annualized rate of 3.5%, down from 7.5% in Q4 2011 (10.4% for the year). The recent slowdown in economic activity indicates that equipment investment continued to lose momentum in Q2, but forward-looking indicators suggest growth will stabilize and potentially improve in the second half of the year. Overall, all sectors of equipment investment are likely to see slightly slower growth than occurred in 2011.

Agriculture Equipment: We underestimated the rate of growth for agriculture equipment investment in the first quarter, which came in at 15.9% year-year compared to our forecast of 6%-8%. The lone leading indicator for this subsector continues to suggest that the pace of investment will moderate, which we think will be the case during the second half of the year. The current Farm Bill passed the Senate but now faces an uphill battle in the House, and passage before the November elections is far from certain. Overall, we continue to project that the annual growth rate in agriculture investment will average 6-8% over the next six months.

Computers & Software: Leading indicators have decelerated in the past several months, signaling that the annual growth rate for computer & software investment is likely to decline in the near term. The data indicate that the year-year growth rate of investment, which increased 11.6% in Q1 2012, is more likely to be in the 7% to 10% range in Q2 and could drop to about 5% in Q3.

Construction Equipment: Investment in construction equipment has grown at an annual rate of 20% or more for eight straight quarters, but the growth rate dropped to 20.7% in Q1 from an average of 43% in the prior seven quarters. Leading indicators suggest that year-year growth will remain relatively strong, but will slow somewhat relative to the rapid growth experienced in 2011. Low natural gas prices have slowed down drilling-related investment, but the housing sector is showing signs of strength moving into the second half of the year. Overall, we expect investment in construction equipment to grow at 15%+ year-year during the next six months.

Industrial Equipment: Investment in industrial equipment contracted on a quarter-to-quarter basis in Q1 2012, but was up 7% from one year ago. Looking ahead, leading indicators provide an ambiguous signal for the direction of industrial equipment investment. In the short term, we give more credence to declining new orders and consequently expect a slowing trend, but for the longer term we interpret rising industrial production and capacity utilization nearing 80% as signs of growth. Overall, we expect industrial equipment investment to hold steady near 7% year-year growth in the next three to six months.

Medical Equipment: Investment in medical equipment was virtually flat on a year-year basis in the first quarter. Looking forward, trends in the key signposts suggest that investment will continue to move sideways, with year-year growth between -2% and 2% in Q2 and Q3.

Transportation Equipment: The latest key signpost data improved slightly, suggesting that investment should continue to grow over the next three to six months. The year-year growth rate in transportation equipment investment has slowed in recent quarters, but we expect it will increase at a 15%+ year-year rate for the next three to six months.

Key Signposts for Equipment Investment

(Estimated growth rate ranges are on a year-year basis)

Leading Indicator	Most Recent Data Point	Recent Trend	3-6 Month Signal & Annualized Growth Rate Range
Agriculture Equipment			***Slowing Growth (6% to 8%)***
Texas Index of Leading Indicators (SA)	124.1 (Mar)	Up 4.8% over the past 6 months, but up only 1.7% year-year	Slowing growth
Computers & Software			***Below Average Growth (5% to 10%)***
ISM Nonmanufacturing Composite Index (SA)	53.7 (May)	Down 6% in the past 3 months, but still above 50 (signaling an overall expansion)	Normal growth
Business Roundtable CEO Economic Outlook Survey	89.1 (Q2)	The Index fell slightly from Q1 to Q2, signaling slower growth	Slowing growth
Construction Equipment			***Above Average Growth (15% or higher)***
HMI: Sales of New Single-Family Detached Homes Index (SA), Next Six Months	34 (Jun)	Up 127% in the past year, though growth has slowed recently	Above average growth
New Private Housing Building Permits (SAAR, Thousand Units)	780 (May)	Up 25% year-on-year, and up 10% over the last six months	Above average growth
Industrial Equipment			***Slowing Growth (6% to 10%)***
Capacity Utilization (SA)	79.0% (May)	Up 2.7% from last year, but has stalled at current level; Suggests growth rate likely peaked	Growth likely to slow, but still above average
Manufacturers' New Orders (SA, $Mil)	3,249 (Apr)	Down 3.9% in April, but up 22% in the past 6 months	Growth likely to slow, but still above average
Industrial Production Index (SA)	97.3 (May)	Up nearly 5% year-year, but stalled near current level; Suggests growth rate likely peaked	Growth likely to slow, but still above average
Medical Equipment			***Slow to No Growth (-2% to 2%)***
Hospital In-patient Days (Thousands)	57,807 (Q1)	Flat year-year, but recent data suggest that momentum is building	Slow growth
PPI: Medical & Diagnostic Labs	108.8 (May)	Flat over multiple periods, suggesting a sideways movement in investment	No growth
Nursing & Residential Care Facilities Total Revenue ($Mil)	50,043 (Q1)	Picked up recently; now up 2.2% year-year	Slow growth
Transportation Equipment			***Above Normal Growth (15% or higher)***
Philadelphia Fed Business Outlook Survey, Future Activity	15 (May)	Down 56% from April to May, and down 25% year-year	Slowing down from peak growth levels, but still strongly positive
Real PCE: Motor Vehicles & Parts (SAAR, Bil.Chn.2005$)	392 (Q1)	Up 6.5% year-on-year, and recent momentum is relatively strong	Picking up momentum

How to Use the Key Signposts

Key Signposts are leading indicators for turning points in the equipment investment cycle, and also the direction of growth in equipment investment. "Turning Points" are defined as any point where the annualized growth rate is at a two-year high or low. The signposts are designed to analyze the 6 largest subsectors of equipment investment, as defined by the U.S. Department of Commerce's National Income & Product Accounts. These indicators have been chosen based on their ability to consistently and accurately identify future trends in equipment investment with a lead-time of 3 to 6 months. For each investment subsector, the signposts should be interpreted together—providing either reinforcing or counter-balancing signals. There are three components of the signpost analysis that can be used to identify the direction of growth in major sectors of the equipment financing industry:

(1) The summary provides a narrative for each investment sector.
(2) The "heat map chart" shows which investment sectors are poised to contract, or grow at a normal or strong pace.
(3) The data table lists the most recent sign post data, recent trends, and the investment growth signal provided by each indicator.

U.S. MACRO OUTLOOK

Overview

The U.S. economy slowed in the first quarter of 2012 to an annualized growth rate of 1.9%, down from 3.0% in the fourth quarter of 2011. As high oil prices reached a peak in March, job creation slowed significantly, real disposable income fell flat, and retail sales contracted in April and May. Although oil prices have dropped sharply in the past month, it will take a few months to translate into higher consumer spending, and households will also rebuild the savings they drew down while oil prices were high. Meanwhile, headwinds from the Eurozone crisis, the slowdown in emerging markets, and the potential of a U.S. "fiscal cliff" scenario (i.e., the rollback of the Bush tax cuts at the end of 2012 and $1.2 trillion in automatic budget cuts that will occur over a 9-year period as a result of the 2011 bipartisan agreement to raise the debt ceiling) continue to hamper growth and increase uncertainty.

The U.S. economy slowed in Q1 2012 to an annualized growth rate of 1.9%, down from 3.0% in Q4 2011. High oil prices led to weak job creation in the past three months and retail sales contracted in April and May. More recently, oil prices have fallen about 25%, which should lead to stronger consumer spending in the second half of the year. International pressures from the Eurozone crisis and a slowdown in emerging markets remain headwinds to U.S. growth. The U.S. "fiscal cliff" is the major risk for 2013.

Overall, our macro outlook for 2012 has not changed materially from April. We are modestly downgrading 2012 real GDP growth forecast from 2.3% to 2.2%, and dropping our inflation expectations to 2.3%. However, we consider the shift in risks as a net positive for the U.S.—lower oil prices should outweigh any headwinds from the Eurozone and emerging markets. The manufacturing and housing sectors, along with pent-up consumer demand, will be the main growth drivers over the next six months. Looking ahead to 2013, we expect Congress to extend the Bush tax cuts (at least for the middle class) and defer automatic budget cuts, which would help pave the way for improved growth of 2.5% to 3.0%.

Review of Key Economic Indicators

- **Consumer spending** continues to improve, and picked up from late 2011. Adjusted for inflation, personal consumption expenditures increased at a 2.5% annual rate in the first quarter of 2012, following an increase of 2.1% in the fourth quarter of 2011. Retail sales declined 0.2% in April and May as high gasoline prices continued to ripple through the economy.
- **Investment spending** continues to grow, but contributed less to economic growth than in recent quarters. Investment spending for Equipment & Software, the main capital spending category, increased at a 3.5% annual pace in the first quarter of 2012, following a 7.5% gain in the fourth quarter of 2011. Investment in nonresidential structures (including office buildings, plans, and retail space) decreased at a 1.9% annual rate in the first quarter compared with a 0.9% decline in the fourth quarter of last year. Residential investment (new home building and additions) increased 20.0% in the first quarter following an increase of 11.6% in the fourth quarter of 2011.

Key Points:

- *Consumer spending has slowed as oil prices have increased.*
- *Investment spending has slowed, but residential investment appears poised for sustained growth.*
- *Government spending remains a headwind.*
- *Exports are growing at a slower pace due to international pressures.*
- *Job growth slowed in the past three months.*
- *Inflation likely hit a low point and should increase slightly by the year's end.*

- **Government spending** continued to drag down economic growth in the first quarter of 2012. Real federal government expenditures decreased at an annual rate of 5.9% in the first quarter after declining 6.9% in the fourth quarter of 2011. State and local government spending decreased at an annual rate of 2.7% in the first quarter, following a decline of 2.2% in the fourth quarter.
- **Exports** (after adjusting for inflation) increased at an annual rate of 4.2% in the first quarter of 2012, compared to 2.7% in the fourth quarter of 2011.
- **Employment** picked up in early 2012 but has since hit a soft patch. Through the first five months of 2012, the U.S. economy has created 823,000 jobs, including 847,000 in the private sector and net layoff of 24,000 in the government sector. In the past three months the pace of job growth has slowed significantly—overall, 69,000

jobs were created in May, 77,000 in April, and 143,000 in March. All of this job growth has come from the private sector; private payrolls were up 289,000 in the past three months, which is slightly above the monthly job creation in January and February of this year, but still well below optimal levels. Government payrolls have declined 27,000 in the past three months, led by losses at the local level. The unemployment rate has held relatively steady, and stands at 8.2% as of May.

- **Inflation** dropped recently, mainly due to the year-year effects of lower oil prices. Headline inflation was 1.7% year-year as of May, and "core" inflation (i.e., excluding food and energy costs) increased from historical lows to 2.3% year-year.

2012-2013 U.S. Economic Outlook

Some economists have revised their 2012 GDP forecasts downward slightly to reflect the stalled job creation that has occurred in the past few months. However, the latest poll from *The Economist* magazine shows that the consensus GDP growth forecast is actually up from 2.1% last quarter to 2.2%, and inflation expectations are also up from 2.1% to 2.2%. The consensus outlook for 2013 calls for 2.3% growth. Our 2012 outlook is relatively unchanged from a quarter ago—we expect 2.2% real GDP growth in 2012, and for inflation to average 2.3% for the year. While the Eurozone crisis and a slowdown in emerging markets remain serious risks, lower oil prices should help support growth during the second half of the year.

Our first look at 2013 suggests that growth will improve to 2.5% to 3.0% due to stronger consumer demand, an improving housing market, and a growing manufacturing sector. The major risk for 2013 is the so-called "fiscal cliff" in which the scheduled fiscal consolidation and rollback of tax cuts would have a major impact on the U.S. economy and likely result in another recession. The Congressional Budget Office estimated that the current fiscal path would cut 5% off of GDP in 2013. However, we think the "fiscal cliff" scenario is unlikely to occur and that a bargain eventually will be struck to "kick the can down the road" on taxes and budget cuts before the year is over.

While growth remains sub-par, several key economic indicators are improving and the shift of risk factors favors faster than expected growth in the second half of 2012 and first half of 2013. The key considerations affecting our forecast are:

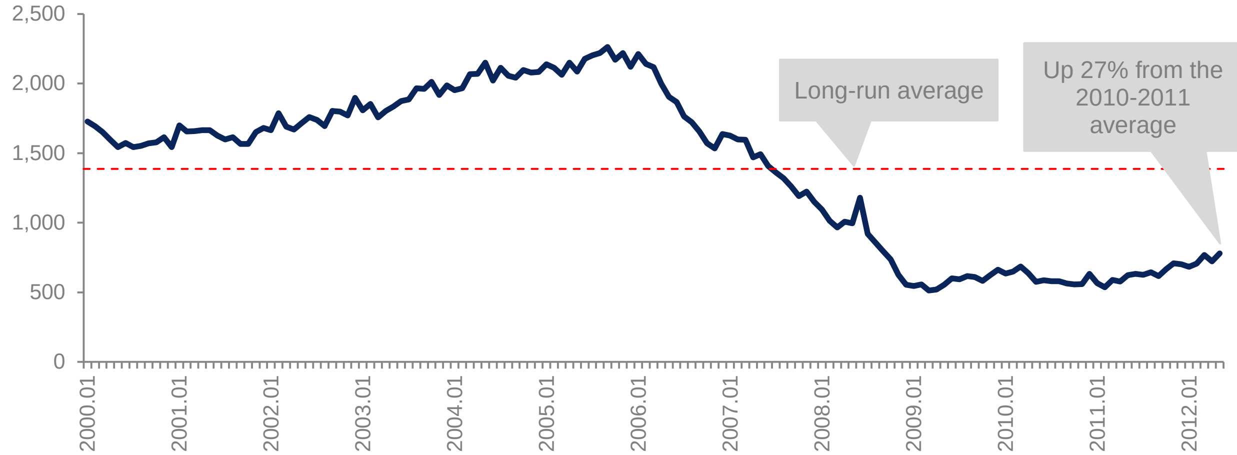
- **Housing Construction:** The most important reason why growth could surprise on the upside is that we believe that housing activity has now clearly bottomed out and could ramp up somewhat faster than most observers believe. Residential investment spending has averaged 5.3% of GDP over the past 40 years, but in the deep housing recession of the past five years, this ratio dropped as low as 2.4%. Recent data indicate a strong rebounded; residential investment spending increased at a 20% annual rate in Q1 2011, to 2.6% of GDP. Other measures also suggest that the housing market is reviving. Housing prices were up in 17 out of the 20 largest U.S. cities in the second half of 2011 according to the Federal Housing Finance Agency ("FHFA"). This same data shows that housing prices nationwide were up 0.8% in April 2012 after a 1.6% increase in March, the last two months for which data is available. Moreover, the National Association of Home Builders' widely-watched housing index jumped to 28 in May 2012—its highest level in 5 years. A rebound in housing prices helps to stimulate housing starts (which are up 19% in the past 12 months), but even more importantly, it provides a lift for all homeowners, including the 11 million American households that are currently under water with their mortgages. In fact, the effect of the confidence-boosting aspects of rising housing prices on economic growth could be even more important than the direct effect of increased residential construction activity.

- **Falling Oil Prices:** A second factor that could give economic growth an upward boost in coming quarters of 2012 is energy prices, which have begun to decline in recent months. Rising energy prices in 2011 and early 2012 subtracted roughly 1.5% from real disposable income, and contributed to relatively weak consumer spending throughout 2011 and early 2012. If oil prices remain at current levels (currently about $82 a barrel, West Texas Intermediate prices) in coming months, year-on-year headline inflation should remain low and could give a percentage point boost to real income in the second and third quarters of 2012, with a commensurate gain in consumer spending likely.

- **Rising Capacity Utilization:** Capacity utilization dropped down to the 60s at the depth of the deep recession of 2008-09, but since that time it has been steadily rebounding and is now closing in on the 80%, an important milestone (79.0% in May). Historically, once capacity utilization is in the 80s, companies feel increased pressure to expand their plants and invest in new equipment. New orders for capital goods tend to boost hiring and increase economic growth. Industries that are doing well and that are adding to capacity include autos and transportation, mining activity, steel, chemicals, and many industrial sectors that are benefiting from the availability of cheap natural gas.

Rebounding Housing Market

Building Permits (Seasonally Adjusted, Thousands of Units)



- **European Crisis:** Against these positive factors, one must weigh the effects of a worsening European growth outlook. The Greek problem is continuing to undermine confidence in the region and is taking a toll on bank lending activity. Meanwhile, lending costs in Italy and Spain reached dangerous levels, potentially threatening their solvency. As a block, Europe remains responsible for roughly a quarter of all U.S. exports; as a result, Europe's current recessionary conditions are having negatively affecting U.S. hiring and investment. The recent parliamentary vote in Greece restored some level of confidence that the country will remain in the EU and abide by its bailout obligations. Also, the latest European summit may help ease financial tensions by allowing bailout funds to flow directly to banks rather than piling debt onto already stressed government balance sheets. However, long-term structural changes to the monetary union remain elusive.

- **China Hard-Landing:** The growth slowdown in China could also have a modest downward impact on the U.S. economy. U.S. exports to China are only responsible for about 0.7% of U.S. GDP—this means that even if U.S. exports to China fell by 10%, it would shave less than 0.1% off U.S. GDP. Keybridge's composite leading indicator for China and "hard-landing signposts" continue to indicate a soft landing, but we cannot rule out the possibility of a recession.

- **U.S. Fiscal Cliff:** Looking into 2013, a major issue is if and how Congress deals with the potential fiscal cliff scenario. Under current law, the budget cuts and tax hikes that will occur at the end of 2012 would send the U.S. economy back into recession in the first half of 2013. Fortunately, there appears to be a consensus to avoid this unnecessary outcome, but this consensus may not result in a robust, long-term solution to the U.S. fiscal outlook. We believe the most likely scenario is yet another missed opportunity for short-term job creation measures and prudent long-term fiscal planning. Instead, we expect an 11th hour deal to extend the tax cuts (at least for low- and middle-income populations), temporarily defer the automatic spending cuts, and postpone difficult budget decisions. While this may avoid a recession, counterproductive partisan debates could have a negative effect on confidence (similar to the debt ceiling debacle of 2011), which would further weaken an already fragile economy.

Summary of 2012-2013 U.S. Economic Outlook

2012 has been marked by rapidly shifting headwinds that buffeted growth in the first and second quarters. In particular, high oil prices were the main culprit for a recent deceleration in job creation. The Eurozone crisis and the slowdown in emerging markets have also had a marginal downward impact on growth. However, with lower oil prices now working through the system, Greek voters choosing to stay in the EU (for now), a relatively successful European summit, and China poised to avoid a hard-landing scenario, we continue to expect a pick-up in growth during the second half of the year and first half of 2013. Overall, our revised 2012 outlook is for 2.2% growth (down from 2.3%), which is in line with the consensus view. In 2013 we expect growth to accelerate to 2.5%-3.0%.

- As more workers re-enter the workforce, unemployment will likely remain above 8.0% through 2012.
- We expect inflation to move up slightly by the end of the year, and average 2.3% for the year.
- The biggest risks for 2012 are a surge in oil prices resulting from rising tensions in the Middle East, a disorderly default on Greek debt, and a "hard landing" scenario in China.
- The top risk for 2013 is a "fiscal cliff" scenario.

Projections for Key Economic Indicators

Indicator	2011	2012e	2012 Quarterly Estimates				2013e
			Q1e	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	1.7%	2.2%	1.9%	1.9%	2.5%	3.0%	2.8%
Real Investment in Equipment & Software (SAAR %)	10.4%	6.3%	3.9%	3.3%	5.8%	7.5%	8.0%
Inflation (annualized rate)	3.1%	2.3%	2.8%	2.0%	2.2%	2.3%	2.8%
Federal funds (effective, end of period)	0.07%	0.17%	0.13%	0.16%	0.18%	0.19%	0.25%
10-year Treasury Rate (end of period)	2.0%	2.5%	2.2%	1.6%	2.2%	2.5%	3.5%
Total Payrolls (in thousands)	+1,840	+2,027	+677	+250	+500	+600	+3,000

U.S. Capital Investment and Credit Markets

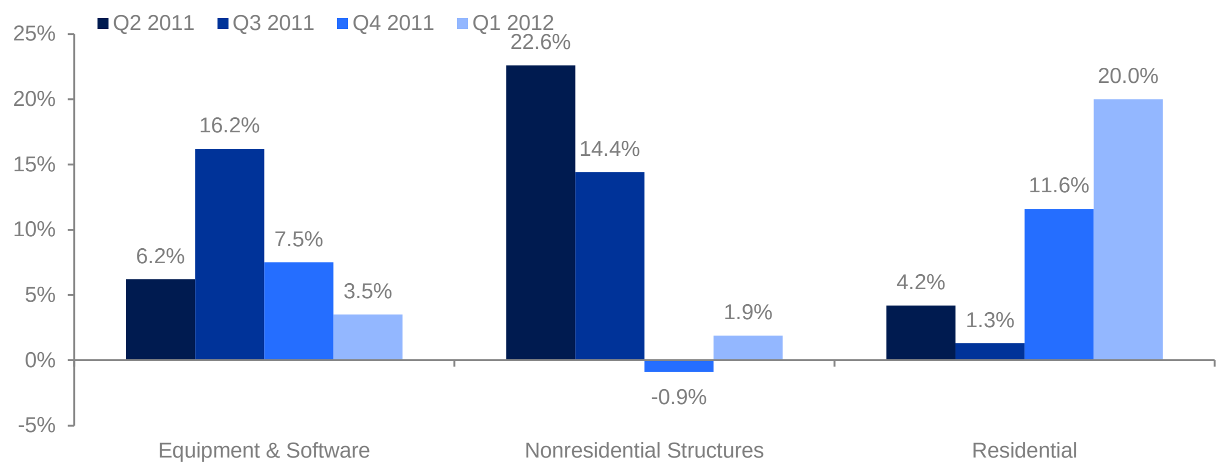
Review of Recent Trends

Investment activity grew but at a slower pace in the first quarter of 2012, as gross private investment contributed 0.81 percentage points of GDP growth, down from 2.6 percentage points in Q4 2011. The mix of investment continued to shift in the first quarter, as residential investment increased at an annual rate of 20.0%, equipment & software investment increased at a 3.5% annual rate, and investment in nonresidential structures increased by 1.9%.

Within the equipment & software category, investment in computers and industrial equipment contracted on a quarter-quarter basis, software investment grew but at a slower pace, and investment in transportation equipment accelerated.

The pace of equipment retooling is slowing down, and although the overhang of excess industrial capacity is tightening, it will still have a moderating effect on investment spending. At the sector-level, growth in investment should remain strong in the petrochemical industry, transportation, and construction. Credit conditions are generally improving, as demand for business loans has picked up slightly and lending terms are loosening. Financial stress has risen slightly in response to risks posed by the Eurozone.

Investment Growth Rates (SAAR %)



Conditions in the equipment leasing and finance industry are generally improving, though the rate of growth has slowed and confidence is waning. As of May, the Monthly Leasing and Financing Index (MLFI-25) showed that the three-month rolling average of new business volume was up only 13% from the same time last year (compared with 20%+ gains from Q1 2011 through Q1 2012). Average losses as a percent of net receivables have remained relatively flat over the past several months and were at 0.5% as of May. The credit approval ratio fell in April to 76.4% but rebounded back to 78.3% in May. While these signals suggest that leasing activity is improving at a slower pace than in 2011, the ELFA Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) fell sharply in May, reflecting both domestic and international macroeconomic and political concerns.

Overall, credit markets should continue to improve in 2012 and 2013 due to a loosening of supply constraints and modest growth in lending demand. The Eurozone crisis has and will continue to drive financial stress indicators, though we anticipate that the situation will cool off during the next several months.

- **Credit Supply & Pricing:** Credit supply is generally improving, though small businesses have a difficult time gaining access to capital. The latest Fed survey of banks' senior lending officers indicated that standards on commercial & industrial ("C&I") loans loosened after a slight tightening in the first quarter. Interest rates are at all-time lows, due to the Fed's loose monetary policy and the "flight to quality" caused by the Eurozone crisis. A third round of quantitative easing is not off

Summary of Credit Market Conditions

Factor	Conditions Compared With Last Quarter
Supply	Slight Improvement
Demand	Moderate Improvement
Financial Stress	Rising Slightly

the table, but we view it as a low probability event. The U.S. appears to be on the edge of a mild liquidity trap—where additional monetary stimulus has little impact on economic behavior. Accordingly, the recent extension of the Fed's Operation Twist program is unlikely to have a major effect on credit markets.

- **Credit Demand:** C&I loans have increased 13% year-year, including a 2.7% jump in the past three months. For the second straight quarter, banks of all sizes reported a strong increase in demand for capital after a drop in the fourth quarter of 2011. In May, the National Federation of Independent Business ("NFIB") reported that 32% of small businesses anticipated the need to borrow at least once per quarter, relatively unchanged over the past 6 months. The percentage of small businesses making capital investments edged down to 55%—still more than twice the percentage of small companies that planned to make capital expenditures. The Thomson Reuters/PayNet Small Business Lending Index has fallen for four straight months, but is still up 7.3% year-year, indicating that demand for commercial loans is still growing, but losing momentum.
- **Financial Stress:** Fears of Greece exiting the Euro, financial contagion throughout Europe, and the potential fallout for the U.S. pushed financial stress higher in the past several months. As of June, stress indicators were comparable to late 2011 when the Eurozone crisis spiked and the U.S. was reeling from debt ceiling debacle and subsequent downgrade of U.S. Treasury securities. As of Q1 2012, loan delinquencies were at a three-year low of 5.2% (1.5% for C&I loans, and 0.9% for leases), but debt as a percentage of GDP for the nonfinancial corporate sector ticked up slightly. Spreads on corporate bonds increased slightly since early 2012, due largely to rising uncertainty of growth and corporate profits. Although interest rates are likely to slowly drift upward this year, they should remain quite low by historical standards, making it easier for households and businesses to meet their debt obligations.

2012-2013 Investment Outlook

The outlook for investment in 2012 remains relatively unchanged from April. Although capacity utilization has edged up overall, there is still an excess level of capacity in many manufacturing sectors, resulting in slow investment in new plants in the near-term. With equipment retooling slowing down, the growth rate of investment in equipment & software in 2012 is likely to remain below that of 2011. However, faster economic growth in 2013 should lead to higher equipment investment levels. Growth within equipment categories will be uneven:

- Transportation and construction look to grow at a healthy pace.
- Computers & software, industrial equipment, and agriculture equipment will continue to grow but at a slower rate.
- On the low-end, signs point to flat growth in medical equipment investment.

Credit market conditions will remain favorable for purchasing versus leasing:

- Interest rates are near record lows, and are likely to remain low through 2012.
- Financial stress will remain sensitive to events in Europe and Congress's handling of the fiscal situation.

QUARTERLY DATA

Indicator	2010				2011				2012
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Real Gross Domestic Product (SAAR %)									
GDP	3.9%	3.8%	2.5%	2.3%	0.4%	1.3%	1.8%	3.0%	1.9%
Consumer Spending	2.7%	2.9%	2.6%	3.6%	2.1%	0.7%	1.7%	2.1%	2.5%
Gross Private Fixed Investment	31.5%	26.4%	9.2%	-7.1%	3.8%	6.4%	1.3%	22.1%	6.5%
Inv: Equipment & Software	21.7%	23.2%	14.1%	8.1%	8.7%	6.2%	16.2%	7.5%	3.5%
Inv: Industrial Equipment	1.8%	41.3%	7.8%	9.9%	12.0%	-1.0%	31.9%	17.9%	-15.2%
Inv: Transportation Equipment	210.3%	78.1%	45.2%	-0.6%	37.6%	15.1%	32.7%	19.0%	21.3%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	78.5%	77.1%	76.9%	76.6%	76.8%	77.0%	76.9%	77.1%	77.3%
Loan Delinquency Rate	3.9%	3.7%	3.3%	3.0%	2.5%	2.2%	1.8%	1.6%	1.5%
Lease Delinquency Rate	2.2%	2.0%	1.8%	1.5%	1.2%	1.1%	1.0%	0.9%	0.9%
Net Tightening of C&I Loan Standards	78.5%	77.1%	76.9%	76.6%	76.8%	77.0%	76.9%	77.1%	77.3%

Monthly Data

Indicator	2011 May	June	July	Aug	Sept	Oct	Nov	Dec	2012 Jan	Feb	Mar	Apr	May
Employment													
Change in Total Payrolls (thousands)	54	84	96	85	202	112	157	223	275	259	143	77	69
Change in Private Payrolls (thousands)	108	102	175	52	216	139	178	234	277	254	147	87	82
Unemployment Rate	9.0%	9.1%	9.1%	9.1%	9.0%	8.9%	8.7%	8.5%	8.3%	8.3%	8.2%	8.1%	8.2%
Business Activity													
Industrial Production	92.9	93.1	93.9	94.2	94.4	94.9	95.1	95.9	96.5	97.0	96.4	97.4	97.3
Capacity Utilization	76.3%	76.3%	77.0%	77.1%	77.2%	77.6%	77.7%	78.3%	78.7%	79.0%	78.5%	79.2%	79.0%
PMI Composite Index	54	56	51	53	53	52	52	53	54	52	53	55	54
NFIB Small Business Optimism Index	92.9	93.1	93.9	94.2	94.4	94.9	95.1	95.9	96.5	97.0	96.4	97.4	97.3
Consumer Activity													
Consumer Confidence	62	58	59	45	46	41	55	65	62	72	70	69	64
Retail Sales (M/M % Chg)	0.1%	0.3%	0.4%	0.2%	1.2%	0.9%	0.5%	0.0%	0.6%	1.0%	0.4%	-0.2%	-0.2%
Lending Activity													
C&I Loans (M/M % Chg)	1.1%	0.6%	1.0%	1.6%	0.3%	1.2%	0.7%	1.1%	1.3%	1.7%	0.8%	1.4%	0.6%
MLFI-25 New Business Volume (Bil. $)	5.6	7.3	5.7	5.7	7.1	6.0	6.2	10.8	5.1	5.0	6.8	6.1	6.2
MLFI-25 Avg Losses as a % of Net Rec.	0.79%	1.15%	0.73%	0.60%	0.90%	0.70%	0.70%	0.70%	0.50%	0.50%	0.70%	0.60%	0.50%
MLFI-24 Credit Approval Ratio	76.4%	78.7%	76.3%	77.6%	76.5%	76.3%	76.2%	79.3%	76.9%	78.8%	78.4%	76.4%	78.3%
Interest Rates (% end of period)													
Fed Funds Target Rate	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250	0.1250
1-Year Treasury Rate	0.22	0.18	0.19	0.20	0.10	0.13	0.12	0.12	0.12	0.13	0.18	0.19	0.20
3-Year Treasury Rate	1.01	0.79	0.81	0.55	0.33	0.42	0.41	0.41	0.36	0.30	0.43	0.51	0.38
10-Year Treasury Rate	3.32	3.05	3.18	2.82	2.23	1.92	2.17	2.08	1.89	1.83	1.98	2.23	1.95
30-Year Treasury Rate	4.40	4.22	4.38	4.12	3.60	2.90	3.16	3.06	2.89	2.94	3.08	3.35	3.12
AAA Corporate Bond Yield	5.09	4.94	5.14	4.67	4.41	3.96	3.88	4.07	3.77	3.72	3.80	4.04	3.95
BAA Corporate Bond Yield	5.90	5.70	5.90	5.59	5.48	5.22	5.19	5.32	5.16	5.07	5.08	5.30	5.15
Prices													
Headline Inflation (Y/Y % Chg)	3.1%	3.4%	3.5%	3.6%	3.8%	3.9%	3.6%	3.5%	3.0%	2.9%	2.9%	2.6%	2.3%
Core Inflation (Y/Y % Chg)	1.3%	1.5%	1.6%	1.7%	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%	2.2%	2.3%	2.3%
Oil Price (West Texas Intermediate, $/barrel)	110.04	101.33	96.29	97.19	86.33	85.61	86.41	97.21	98.57	100.24	102.25	106.19	103.33

ACKNOWLEDGEMENTS

This research endeavor was guided by a steering committee of dedicated industry volunteers who gave their time and expertise by providing comments and suggestions throughout the development of the report. Their participation is appreciated greatly. They are: Carl C. Chrappa, John C. Deane, Jeffry D. Elliott, Joseph C. Lane, Robert C. Neagle, James S. Schallheim and William G. Sutton, CAE. We extend special recognition to Robert J. Rinaldi, steering committee Chair, and Richard D. Gumbrecht, Chair of the Equipment Leasing & Finance Foundation's Research Committee for their leadership in bringing this project to life.

ABOUT THE RESEARCHER

Keybridge Research LLC is an international economics and public policy consulting firm. Keybridge provides analytical support and strategic advice to a select clientele that includes Fortune 500 companies, global financial firms, G-7 governments, premier industry associations, and non-profit organizations. Our experience and expertise make us uniquely suited to assist organizations that frequently operate at the interface of business, economics, and public policy.

Founded in 2001, Keybridge's mission is to provide balanced, credible, and timely technical analysis and strategic insights that inform business decisions and drive public policy debates. Our dedication to the principles of sound analysis, clear communication, and unmatched client service guide our work and serve as the foundation of our success.

Keybridge's senior staff is comprised of experts with distinguished academic credentials and extensive experience in the areas of economics and public policy. On a day-to-day basis, Keybridge principals work closely with clients to develop strategy and conduct timely analysis. For longer-term projects and highly specialized topics, the firm leverages its network of advisers-including Nobel Prize-winning economists and world-class experts in the fields of econometrics, energy, and finance – to build project teams tailored to the client's unique needs.

Keybridge provides clients with access to a full suite of analytical services, including macroeconomic risk assessments, econometric modeling studies, policy impact studies, qualitative policy evaluations, and survey design and analysis. For clients requiring regular consultations, Keybridge offers on-going strategic advisory services in the areas of macroeconomic trends and risks, international trade and finance, and energy and environmental economics. Keybridge also assembles and manages inter-disciplinary teams of experts to conduct thought leadership projects to assist clients with building competitive advantages or reforming policy debates through the development, sharing, and application of innovative ideas. Keybridge's principals are regularly asked to present research and share insights with economic, financial, and policy audiences around the world, including corporate strategic planning committees, congressional committees, and international conferences.

KEYBRIDGE
RESEARCH

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

Future Focused Research for the Equipment Finance Industry

Presented by the Source for Independent, Unbiased and Reliable Study

The Equipment Leasing & Finance Foundation

The Equipment Leasing & Finance Foundation, established in 1989 by the Equipment Leasing Association, is dedicated to providing future-oriented, in-depth, independent research about and for the equipment finance industry. Information involving the markets, the future of the industry and the methods of successful organizations are researched to provide studies that include invaluable information for developing strategic direction within your organization.

Your Eye on the Future

The Foundation partners with corporate and individual donors, academic institutions and industry experts to develop comprehensive empirical research that brings the future into focus for industry members. The Foundation provides academic research, case studies and analyses for industry leaders, analysts and others interested in the equipment finance industry.

The Foundation's resources are available electronically at no cost to Foundation donors and for a fee to non-donors. For more information, please visit www.leasefoundation.org

An example of the resources available from the Foundation include:

- Market overview studies
- Emerging market reports
- Annual state of the industry reports
- Monthly Confidence Index(MCI) analysis
- Industry future council workbooks
- Reports on entering international markets
- Case studies, and much more

Journal of Equipment Lease Financing

Published three times per year and distributed electronically, the *Journal of Equipment Lease Financing* is the only peer-reviewed publication in the equipment finance industry. Since its debut in 1980, the Journal features detailed technical articles authored by academics and industry experts and includes Foundation-commissioned research and articles. Journal articles are available for download through the Foundation website. Subscriptions are available at www.leasefoundation.org

Web Based Seminars

Many of the Foundation studies are also presented as web seminars to allow for direct interaction, in-depth conversation and question and answer sessions with the researchers and industry experts involved in the studies. Please visit the Foundation website for details on upcoming webinars at www.leasefoundation.org

Donor Support and Awards Program

The Foundation is funded entirely through corporate and individual donations. Corporate and individual donations provide the funds necessary to develop key resources and trend analyses necessary to meet daily business challenges. Corporate and individual donors are acknowledged publicly and in print. Major giving levels participate in a distinguished awards presentation. Giving levels range from $100 to $50,000+ per year. For information on becoming a donor and to see a list of current donors, please visit, www.leasefoundation.org/donors

Stay Connected

You can connect to the Foundation in various ways:

- Subscribe to *Foundation Forecast* bimonthly newsletter
- LinkedIn: linkedin.com/groups?mostPopular=&gid=89692
- facebook: facebook.com/LeaseFoundation
- twitter: twitter.com/LeaseFoundation
- RSS: feeds2.feedburner.com/FoundationElfaOnline

1825 K Street NW • Suite 900 • Washington, DC 20006 • Phone: 202-238-3400 • Fax: 202-238-3401 • www.leasefoundation.org

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye On The Future

1825 K Street • Suite 900
Washington, DC 20006
www.leasefoundation.org
202-238-3429
Kelli Jones Nienaber, Executive Director