Q2 Update April 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 first update of the December 2012 annual outlook, and 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.

Q2 2012 Equipment Leasing & Finance U.S. Economic Outlook — April 2012

SUMMARY

Investment continues to be a main driver of U.S. economic growth. In particular, the expiration of tax benefits pulled forward investment and gave a boost to the fourth quarter 2011 figures. While this may give the appearance of a comparatively weak first quarter of 2012, on a year-year basis, equipment & software investment should continue to grow at a healthy pace. Due to a slight downgrade of growth prospects for the first quarter of 2012, equipment & software investment is expected to grow by about 7% this year (down from 8% to 10% projected in December).

Sector-level trends are relatively unchanged from the December outlook:

- *Agriculture equipment* investment is likely to decelerate slightly in the next three to six months.
- *Computers & Software equipment* investment will remain healthy, but is likely to slow down somewhat.
- *Construction equipment* investment is likely to slow in the immediate near term, but could be buoyed by the energy and housing sectors later in 2012.
- *Industrial equipment* investment will likely be hampered by macro-trends, which may cause some deceleration in growth from what appears to be a recent peak in the growth rate.
- *Medical equipment* is on watch for a leveling-off in investment spending, and decline on a year-year basis.
- *Transportation equipment* investment should remain solidly positive, but is unlikely to maintain the rapid growth rates of 2011.

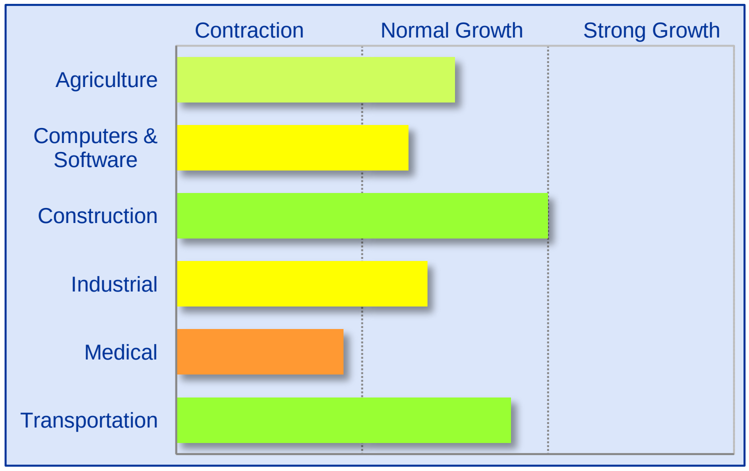
- Credit market conditions are improving slowly as demand for financing grows and supply constraints gradually ease. Conditions remain favorable for purchasing versus leasing, though the expiration of tax benefits may provide a marginal boost to leasing activity. Otherwise, the Fed Funds Rate is near record lows and is likely to remain low through 2012. Paradoxically, the easing of tensions in Europe sent U.S. Treasury rates higher, as investors left riskless assets in search for higher yields. Notwithstanding external shocks, U.S. interest rates are likely to continue to slowly drift upwards throughout the year as the economy gains traction.
- For the overall economy, 2011 ended on a high note as fourth quarter GDP grew at a 3.0% annual rate. However, the growth for the year came in at an anemic 1.7%. More recently, employment has picked up significantly in the past three months, cheap natural gas is giving a boost to industrial production, though consumer demand remains tepid, and investment is showing signs of slowing down after a strong rebound in 2010-2011. A triple threat of headwinds continues to drag down growth—high oil prices, uncertainty surrounding the Eurozone debt crisis, and a slowdown in China and other emerging markets.
- Overall, our macro outlook for 2012 calls for a slow improvement, as we expect high oil prices to be a significant drag particularly during the first two quarters of the year. We are forecasting real GDP growth of 2.3% (down from 2.4% in December), and for inflation to average 2.4% for the year. Due to a surge in investment spending in the second half of 2011, Q1 2012 investment may look comparatively weak—not necessarily a drag on growth, but it will not provide the lift that it did for much of 2010 and 2011. Looking to the second half of the year, notwithstanding an external shock, the U.S. is poised for faster growth driven by pent up demand in the consumer and business sectors.

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

Summary

Equipment investment continued to grow at a strong pace, and ended the year up 10.4% from 2010. The latest data suggests that the expiration of tax credits for bonus depreciation and expense allowances drew forward some capital spending into the fourth quarter that may have otherwise taken place in 2012. As a result, while we expect healthy year-year growth in equipment investment to continue, the annualized growth rate from Q4 2011 to Q1 2012 may look surprisingly weak. Growth rates at the sector level will continue to vary, but all forms of equipment investment are likely to see slightly slower growth than 2011.

Key Signposts "Heat Map" Growth Chart



Agriculture Equipment: Consistent with our December 2011 outlook, agriculture equipment investment slowed down in the fourth quarter (dropping to 7% year-year after averaging 12% for the first three quarters). Despite the recent slowdown, agriculture investment still grew at 11.6% for the year. The lone leading indicator for this subsector continues to suggest that the pace of agriculture equipment investment will moderate in the coming months. The current Farm Bill is set to expire at the end of September 2012, and legislative action—other than a temporary extension of the current bill—appears unlikely before the November elections. Overall, we expect annual growth in agriculture investment to remain around 6-8% during the first half of the year.

Computers & Software: The leading indicators for computer & software investment are up recently, but are contracting on a year-year basis. The data indicate that the year-year growth rate of investment, which averaged 11% in 2010-2011, is more likely to be in the 5% to 10% range—slightly lower than forecasted in December.

Construction Equipment: Investment in construction equipment has more than doubled since 2009, and is 26% above its pre-recession peak. Analysis of the key sign posts suggests that the year-year growth rate is likely to ease from the 30%+ rates seen in 2010-2011. A slowly improving housing sector and oil and gas drilling will help drive demand, and could be enough to keep year-year growth rates above 15% for the next three to six months (equivalent to negative quarter-quarter annualized figures for Q1 and possibly Q2).

Industrial Equipment: Investment in industrial equipment has been expanding since mid-2009 but is still about 5% below its pre-recession peak. Two out of three indicators suggest that investment will continue to grow, albeit at a slower pace than in recent quarters, and one indicator points to a rising risk of zero growth or even a mild contraction. Given these mixed signals, we expect industrial equipment investment to moderate to 8%-10% year-year growth in the first half of the year—or, a mild contraction on a quarter-quarter basis.

Medical Equipment: Investment in medical equipment contracted during the third and fourth quarters of 2011, which was signaled by two out of three indicators. Looking forward, trends in the key sign posts suggest that the decline in investment will continue, with year-year growth between 0% and -2% in Q1 and Q2.

Transportation Equipment: Investment has more than doubled since 2009, but is still 22% below its pre-recession peak. The signposts are providing a mixed picture, which suggests that recent rapid growth (averaging above 47% year-year growth over the past eight quarters) is likely to subside. Most recently, year-year growth has dropped from 40%+ to 20%-25%. The data suggest this easing of strong positive momentum may continue, but transportation equipment investment will continue to grow at a 15%+ year-year rate for the next three to six months (equivalent to an average of about 15% quarter-quarter annualized growth rate for Q1 and Q2).

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			***Average Growth (6% to 8%)***
Texas Index of Leading Indicators (SA)	121.6 (Jan)	Up 0.7% over the past 6 months, and up 2.3% year-year	Average growth
Computers & Software			***Below Average Growth (5% to 10%)***
ISM Nonmanufacturing Composite Index (SA)	57.3 (Feb)	Up 9% in the past 3 months, but still down 3% year-year	Below average growth
Business Roundtable CEO Economic Outlook Survey	96.9 (Q1)	Strong gain in Q1 suggests solid growth for the next 3-6 months	Below average growth
Construction Equipment			***Above Average Growth (15% or higher)***
HMI: Sales of New Single-Family Detached Homes Index (SA), Next Six Months	36 (Mar)	Up 38% in the past year and showing signs of continued improvement	Above average growth, but trending down
New Private Housing Building Permits (SAAR, Thousand Units)	715 (Feb)	Up 34% year-on-year, and up 14% over the last six months	Above average growth, but trending down
Industrial Equipment			***Slowing Growth (8% to 10%)***
Capacity Utilization (SA)	78.7% (Feb)	Up 2.2% from last year, but has stalled at current level; Suggests growth rate likely peaked	Investment growth rate likely peaked in '11 Q1; Growth likely to slow to normal levels
Manufacturers' New Orders (SA, $Mil)	2,724 (Jan)	Down sharply in January, as expiring tax benefits pulled investment forward into 2011	Investment growth rate likely peaked in '11 Q1; Growth likely to slow to normal levels
Industrial Production Index (SA)	96.2 (Feb)	Up 4% year-year, but stalled near current level; Suggests growth rate likely peaked	Investment growth rate likely peaked in '11 Q1; Growth likely to slow to normal levels
Medical Equipment			***Slow to Negative Growth (-2% to 2%)***
Hospital In-patient Days (Thousands)	55,594 (Q4)	Down 1% year-year and signs of continued downward momentum	Slow to negative growth
PPI: Medical & Diagnostic Labs	109.1 (Feb)	Up only 1% year-year due to a slowdown in recent momentum	Slow to negative growth
Nursing & Residential Care Facilities Total Revenue ($Mil)	49,637 (Q4)	Up only 0.6% year-year as recent momentum has turned negative	Slow to negative growth
Transportation Equipment			***Above Normal Growth (15% or greater)***
Philadelphia Fed Business Outlook Survey, Future Activity	32.9 (Mar)	Down 44% year-on-year, and highly volatile in recent months	Slowing down from peak growth levels, but still has positive momentum
Real PCE: Motor Vehicles & Parts (SAAR, Bil.Chn.2005$)	372.2 (Q4)	Up 5% year-on-year, and recent momentum is relatively strong	Slowing down from peak growth levels, but still has positive 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 year ended on a high note as GDP grew at an annual rate of 3.0% in the fourth quarter of 2011. Growth was driven by investment and consumption, with downward momentum from net exports and a large drop in government spending. However, despite a strong finish, the economy grew by only 1.7% for the year.

2011 ended on a high note, with the U.S. economy growing at an annual rate of 3.0%. So far in 2012, labor markets have gained momentum, consumers have regained confidence, manufacturing and investment remain strong, and the housing sector may be poised for a turnaround. Despite these positive developments, serious headwinds remain that will continue to exert downward pressure on growth.

So far in 2012, there is mounting evidence that the U.S. economy could be gaining momentum:

- Labor market conditions have strengthened, especially compared to clear weakness in the first half of 2011. In the last three months, the U.S. economy has created 752,000 private sector jobs and the unemployment rate stands at a three-year low of 8.3%.
- Consumer confidence has rebounded significantly as job growth has improved and equity markets are up, and after the political debacle surrounding the debt ceiling debate and credit downgrade of U.S. Treasury debt by Standard & Poor's last year.
- Manufacturing and investment also continue to show strength, and a number of signals indicate that the housing market may have hit bottom.
- Credit conditions continue to ease, providing businesses access to investment financing. Compared to a year ago, banks have significantly eased lending standards, demand for business loans has improved, and equipment leasing volume is up more than 21%.

However, the headwinds that curtailed growth in 2011 are still exerting downward pressure on economic growth. First and foremost, high oil prices are dampening real disposable income, consumer spending, and businesses' hiring plans. Growth is also muted by the European debt crisis and the slowdown in emerging markets.

Review of Key Economic Indicators

- **Consumer spending** continues to improve, but at a slower pace than in late 2010. Adjusted for inflation, personal consumption expenditures increased at a 2.1% annual rate in the fourth quarter of 2011, following an increase of 1.7% in the third quarter. However, the relatively slow growth rates during the year were not surprising in the context of high oil prices.
- **Investment spending** has been a key engine of U.S. economic growth in 2010-2011. Investment spending for Equipment & Software, the main capital spending category, increased at a 7.5% annual pace in the fourth quarter, following a 16.2% gain in the third quarter. The rebound of investment in nonresidential structures (including office buildings, plans, and retail space) hit a bump as it decreased at a 0.9% annual pace in the fourth quarter compared with a 14.4% increase in the third quarter. Residential investment (new home building and additions) jumped unexpectedly, increasing at an annual rate of 11.6% in the fourth quarter following an increase of 1.3% in the third quarter of 2011.
- **Government spending** was a significant drag on economic growth throughout 2011. Real federal government expenditures decreased at an annual rate of 6.9% in the fourth quarter after increasing at a 2.1% annual rate in the third quarter. In response to intense budget pressures, state and local government spending declined steadily throughout the year and fell at an annual rate of 2.2% in the fourth quarter.

Key Points:

- *Consumer spending has slowed as oil prices have increased.*
- *Investment spending continues to show strength.*
- *Government spending remains a headwind.*
- *Exports are growing at a slower pace, but outstripped imports during the middle half of 2011.*
- *Employment is showing signs of improved momentum.*
- *Inflation is likely to dip before rebounding this summer.*

- **Exports** (after adjusting for inflation) increased at an annual rate of 2.7% in the fourth quarter, compared to 4.7% in the third quarter.
- **Employment** improved slowly in 2011 and has picked up in recent months. Revised payroll figures showed the net creation of more than 1.8 million jobs in 2011, including 2.1 million private sector jobs, and net layoffs of 265,000 jobs in the government sector. In the past three months, the U.S. economy has generated a net of 734,000 jobs—227,000 jobs in February, 284,000 in January, and 223,000 in December. Private sector payrolls were up 752,000 in the past three months, and government payrolls decreased by 18,000, led by losses at the federal level while state and local government payrolls were flat. The unemployment rate has remained at 8.3% for the first two months of 2012.
- **Inflation** remains fairly well contained so far in this business cycle. Oil prices pushed inflation near 4% in 2011, but inflation has since slowed to about 2.9% in February. "Core inflation" (i.e., excluding food and energy costs) is up from historical lows to 2.2% year-year.

2012 Economic Outlook

The consensus forecast for growth in 2012 suggests a modest improvement over 2011—the latest poll from *The Economist* magazine shows an average forecast of 2.1% growth in the U.S., with a relatively wide range of 1.5% to 2.7% due to a number of lingering uncertainties. Inflation is expected to average 2.1% for the year.

While we recognize multiple downside risks, our baseline forecast for 2012 is slightly more optimistic than the consensus, but is still not exuberant by any means. The year will be marked by a "tug of war" between positive cyclical forces and triple headwinds from high oil prices, the European debt crisis, and a slowdown in emerging markets. Overall, we expect the real GDP to grow at 2.3% in 2012 (down slightly from 2.4% forecasted in December) and for inflation to average 2.4% for the year.

Positive cyclical forces driving growth include:

- **Labor Markets Rebounding:** The private sector created more than 2 million jobs in 2011, and 752,000 in the past three months. While the public sector has been a drag, it is showing signs of bottoming out. Jobless claims have remained under the key threshold of 400,000 since November, and the most recent four-week moving average dipped to 365,000, the lowest since May 2008. The unemployment rate stands at 8.3%, and is likely to drift sideways as more workers re-enter the job market.
- **Cheap Natural Gas:** As a result of a glut of fractured gas from domestic shale deposits, natural gas prices have dropped to sustained lows. In particular, industrial gas prices were down 14.2% year-year as of February, and spot prices are currently around $2.20 per million BTU. In turn, cheap feedstock has fueled a resurgence of heavy manufacturing, as U.S. petrochemical plants are now globally cost-competitive. In fact, the U.S. is building new petrochemical plants for the first time in several generations.
- **Restocking Inventories:** While there was a modest inventory build-up towards the end of 2011, inventory-to-sales ratios are still low by historical standards. If growth gains traction and manufacturers' confidence improves, even a modest build-up in inventories could add significantly to GDP growth.
- **Consumer Deleveraging is Easing:** Deleveraging will continue, but signs indicate the trend has slowed considerably and is no longer a significant headwind for the consumer sector. In fact, consumer revolving credit has increased nearly 1% in the past three months, driven by upper and upper-middle income households, signaling a willingness of consumers to take on additional debt.
- **Rebound in Construction:** Construction in general has shown signs of life, as the total "value of construction put in place" was up 7.1% year-year as of January—the best performing nonresidential sectors were manufacturing, power, and health care, which were up 38%, 24%, and 10%, respectively. In the residential sector, national housing prices may decline further but many markets throughout the country have turned the corner as housing affordability remains near historical lows. Thanks in part to a mild winter, January's

residential construction was up 5.9% year-year, and the National Association of Home Builders Housing Market Index is up 81% from the previous year.

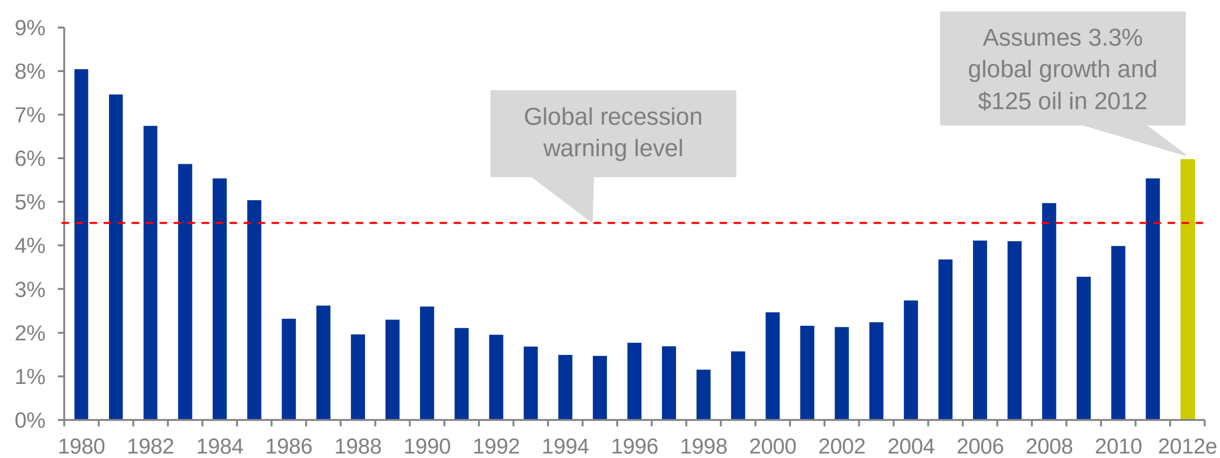
- **Inflation is Under Control:** Notwithstanding future oil price shocks, inflation is under control for the time-being, which provides flexibility for monetary and fiscal policymakers to maintain stimulative policies (e.g., low interest rates, and the extension of tax cuts and unemployment benefits) without the fear of short-term repercussions in the bond market.

However, significant negative headwinds will limit growth particularly in the first half of the year, and pose additional risks for a global recession:

- **High Oil Prices:** Moving into the summer months and peak driving season, oil prices are likely to average above $100/barrel (West Texas Intermediate, or about $120/barrel for Brent Crude), resulting in national average gasoline prices in the range of $3.50 to $4.00 per gallon. This alone is already the number one concern for the U.S. and global economies as high gasoline prices put pressure on real disposable income and consumer spending. Additionally, armed conflict with Iran and/or additional unrest in the Middle East & North Africa ("MENA") region could easily push Brent Crude oil prices to $170 or higher, likely resulting in a global recession. On the other hand, if there is a calming of nerves in MENA, and Saudi Arabia is able to ramp up production, oil prices could fall and alleviate pressure on consumers—every $10 sustained drop in oil prices unleashes $40 to $50 billion of consumer spending power.

The World's Oil Bill

World Oil Consumption as a Percent of World GDP (using Brent Crude prices)



- **European Debt Crisis and Financial Market Risk:** Although progress has been made towards a Greek bailout, uncertainties remain over the plan's ability to avoid a disorderly default on Greek debt and financial crisis. Such a scenario probably would only have a limited impact on U.S. economic growth through the tightening of credit markets and pressure on corporations' international earnings.

- **Slowdown in Emerging Markets:** Warnings of a "hard-landing" in China (i.e., annual growth of below 7%) are premature in our view, but there is undoubtedly a noticeable slowdown in China as well as India and Brazil. However, we view this as a less critical threat to U.S. growth—the direct impact of a recession in China would likely subtract only a few tenths of a percent off of U.S. GDP growth.

- **Flat Wage Growth:** Slack in the labor market has kept a lid on wage growth since the recovery began, but the trend has worsened in the last three to six months. In fact, average nominal hourly earnings for manufacturing workers in February increased by only 0.8% year-year, the slowest rate of growth since 1954. Similarly, wages for information services workers—a key indicator of the services sector—are up only 1.3% year-year. At this rate, consumers are forced to dip into savings—an unsustainable trend in the mid- to long-term.

- **Political Uncertainty:** U.S. corporations' cash stockpiles hit a new record of $2.2 trillion in the fourth quarter of 2011, up 5% from Q3, and up 18% from Q4 2010. Lack of demand and uncertainty of future growth are the main culprits for this cash hoarding effect, but studies also show that companies tend to build up cash reserves during years with contested elections. In addition, pessimistic and sometimes contradictory views from the Federal Reserve have not instilled confidence in the private sector. On the bright side, if even a fraction of the additional cash stockpiled in 2011 ($341 billion) were invested in the U.S., it could generate hundreds of thousands of additional jobs.
- **Mild Fiscal Contraction in 2012, and Deeper Cuts in 2013:** There will likely be a mild fiscal contraction in 2012—in the range of 0.2 to 0.3 percentage points from real GDP. The debt ceiling negotiations did bring some deficit reduction, but virtually all of the spending cuts (except for about $25 billion) will not take effect until 2013. As we expected, the 2% payroll tax holiday was extended through the end of 2012, and Congress extended emergency unemployment benefits but reduced unemployment insurance from 99 weeks back to 73 weeks. In 2013, scheduled budget cuts could trim as much as 4.1% of GDP—while this outcome is politically infeasible, a more realistic projection suggests that fiscal consolidation will be about a 1% drag on GDP next year.

Summary of 2012 Economic Outlook

The consensus forecast for relatively weak growth of 2.1% in 2012 is driven by marginally improving cyclical trends, and a series of negative factors. Compared to the consensus forecast, we generally reiterate our views from the December annual report, with a slightly revised forecast of 2.3% growth for 2012 (down from 2.4%).

One quarter into the year, there are additional signs for increased optimism, but not enough to overcome the weight of high oil prices. However, if the U.S. can sustain growth in an environment of high oil prices, and notwithstanding additional external shocks, cyclical forces are poised to push growth higher by Q3 and Q4.

- As more workers re-enter the workforce, unemployment will likely remain above 8.0%.
- We expect inflation to ease to 2% or lower by April, but then bounce back to 3% by the end of 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.

Projections for Key Economic Indicators

Indicator	2010	2011	2012e	2012 Quarterly Estimates			
				Q1e	Q2e	Q3e	Q4e
Real GDP (SAAR %)	3.0%	1.7%	2.3%	2.0%	1.9%	2.8%	3.2%
Real Investment in Equipment & Software (SAAR %)	4.4%	10.4%	6.9%	2.0%	6.1%	7.7%	9.2%
Inflation (annualized rate)	1.6%	3.1%	2.4%	2.6%	2.0%	2.4%	2.5%
Federal funds (effective, end of period)	0.18%	0.07%	0.17%	0.13%	0.16%	0.18%	0.19%
10-year Treasury Rate (end of period)	3.3%	2.0%	2.9%	2.0%	2.3%	2.5%	3.0%
Total Payrolls (in thousands)	+1,027	+1,840	+2,350	+650	+400	+600	+700

U.S. CAPITAL INVESTMENT AND CREDIT MARKETS

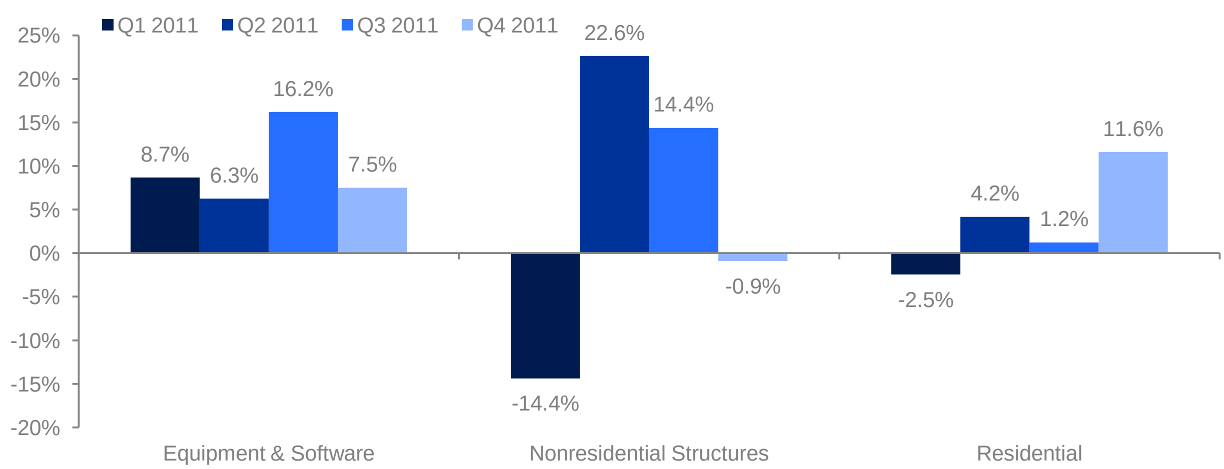
Review of Recent Trends

Investment activity continued to drive growth in Q4 2011, as gross private investment contributed 2.6 percentage points of GDP growth. The mix of investment shifted in the fourth quarter, as residential investment increased at an 11.6% annual rate, equipment & software investment increased at a 7.5% annual rate, and investment in nonresidential structures shrank by 0.9%.

Within the equipment & software category, investment computers, software, industrial equipment, and transportation equipment all showed continued strength.

The investment sector has been the key factor contributing to U.S. economic growth in 2010-2011. While credit conditions are slowly improving, and demand has picked up slightly, investment is likely to grow at a more moderate pace in 2012. The pace of retooling of equipment is slowing down, and an overhang of excess industrial capacity will likely preclude major investments in property & plants in the short-term.

Investment Growth Rates (SAAR %)



After rebounding in 2011, conditions in the equipment leasing and finance industry continued to improve during the first several months of 2012. As of February, the Monthly Leasing and Financing Index (MLFI-25) shows that the three-month rolling average of new business volume is up 21% from the same time last year. Meanwhile, average losses as a percent of net receivables have fallen to a pre-recession level of 0.5%, and the credit approval ratio is up to 79.8%—consistent with 2006-07 levels. All three signals point to increasing demand, improving credit quality of borrowers, and easing credit standards.

Overall, credit markets should continue to improve in 2012 due to a moderate loosening of supply constraints, modest growth in lending demand, and significant reduction in financial stress indicators:

- **Credit Supply & Pricing:** Credit markets eased in 2011 on an absolute and relative basis. Interest rates continue to hover at all-time lows, but rates increased slightly in recent months as the "fear factor" from the European debt crisis eased. Although the latest Fed survey of banks' senior lending officers indicated that standards on commercial & industrial ("C&I") loans tightened slightly, this comes after six straight quarters of loosening. The market is backing off expectations for a third round of quantitative easing, but it is not off the table if the economy were to turn down again, say, because of a spike in oil prices. At the same time, the Fed is setting the stage to soak up excess liquidity in the financial system through "reverse repo" arrangements—in other words, the Fed may be easing its foot off the accelerator pedal.

Summary of Credit Market Conditions

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

- **Credit Demand:** C&I loans have increased 12.2% year-year, including a 1.3% jump in February and 3.6% growth in the past three months. However, lending levels are still 15% below the peak in 2008. In January 2012, banks of all sizes reported a strong increase in demand for C&I loans after a drop in the fourth quarter of 2011. In February, the National Federation of Independent Business ("NFIB") reported that 32% of small businesses anticipating the need to borrow at least once per quarter, relatively unchanged over the past 6 months. The percentage of small businesses making capital investments ticked up to 57%—more than twice the percentage of small companies that planned to make capital expenditures. The Thomson Reuters/PayNet Small Business Lending Index is also up nearly 20% year-year, indicating healthy demand for commercial loans.

- **Financial Stress:** Financial stress has eased considerably since the fourth quarter of 2011 when the Eurozone crisis reached a height and the U.S. was still reeling from the debt ceiling debacle and subsequent downgrade of U.S. Treasury securities. As of Q4 2011, loan delinquencies were at a three-year low of 5.3% (1.6% for C&I loans, and 0.9% for leases), and net deleveraging in the nonfinancial corporate sector appears to have leveled-off. Spreads on corporate bonds narrowed slightly since the end of 2011 as the Eurozone crisis has cooled down and U.S. corporate earnings remain strong. Although interest rates are likely to slowly drift upward this year, rates will still be low by historical standards, making it easier for households and businesses to meet their debt obligations.

2012 Investment Outlook

The outlook for investment in 2012 remains relatively unchanged from December. Excluding the mining sector which has seen utilization rates jump over 90% for the past seven months, manufacturing capacity utilization has crept up slowly to 77%. With an excess level of capacity in many manufacturing sectors, there is little need for investment in new plants in the near-term. Similarly, the growth rate of investment in equipment in 2012 is likely to be slightly below that of 2011. However, growth within equipment categories will be uneven:

- Energy, transportation, and construction look to grow at a healthy pace.
- Computers & software, industrial equipment, and agriculture equipment will likely ease somewhat.
- On the low-end, signs point to a deceleration in medical equipment investment.

The expiration of some capital expenditure tax benefits may provide a marginal boost to leasing activity, but overall, credit market conditions will remain favorable for purchasing versus leasing:

- Interest rates are near record lows, and are likely to remain low through 2012.
- The Federal Reserve is taking additional measures to bring down long-term rates.
- Financial stress has diminished, raising the relative attractiveness for purchasing versus leasing.

QUARTERLY DATA

Indicator	2009	2010				2011			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real Gross Domestic Product (SAAR %)									
GDP	3.8%	3.9%	3.8%	2.5%	2.3%	0.4%	1.3%	1.8%	3.0%
Consumer Spending	0.4%	2.7%	2.9%	2.6%	3.6%	2.1%	0.7%	1.7%	2.1%
Gross Private Fixed Investment	36.8%	31.5%	26.4%	9.2%	-7.1%	3.8%	6.4%	1.3%	22.1%
Inv: Equipment & Software	11.7%	21.7%	23.2%	14.1%	8.1%	8.7%	6.3%	16.2%	7.5%
Inv: Industrial Equipment	0.0%	1.8%	41.3%	7.8%	9.9%	12.0%	-1.0%	31.9%	17.9%
Inv: Transportation Equipment	39.3%	210.3%	78.1%	45.2%	-0.6%	37.6%	15.1%	32.7%	19.0%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	78.5%	77.6%	76.3%	75.9%	75.6%	75.8%	75.9%	75.8%	75.9%
Loan Delinquency Rate	4.3%	4.0%	3.7%	3.3%	2.9%	2.5%	2.2%	1.8%	1.6%
Lease Delinquency Rate	2.2%	2.2%	2.0%	1.8%	1.5%	1.2%	1.1%	1.0%	0.9%
Net Tightening of C&I Loan Standards	-5.5%	-7.1%	-8.8%	-10.5%	-10.5%	-16.4%	-21.8%	-5.9%	5.4%

MONTHLY DATA

Indicator	2011											2012	
	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb
Employment													
Change in Total Payrolls (thousands)	220	246	251	54	84	96	85	202	112	157	223	284	227
Change in Private Payrolls (thousands)	257	261	264	108	102	175	52	216	139	178	234	285	233
Unemployment Rate	9.0%	8.9%	9.0%	9.0%	9.1%	9.1%	9.1%	9.0%	8.9%	8.7%	8.5%	8.3%	8.3%
Business Activity													
Industrial Production	92.5	93.1	92.7	93.0	93.1	94.1	94.4	94.5	94.9	94.9	95.8	96.2	96.2
Capacity Utilization	76.5%	77.0%	76.6%	76.7%	76.7%	77.5%	77.6%	77.7%	77.9%	77.9%	78.5%	78.8%	78.7%
PMI Composite Index	59.8	59.7	59.7	54.2	55.8	51.4	52.5	52.5	51.8	52.2	53.1	54.1	52.4
NFIB Small Business Optimism Index	94.5	91.9	91.2	90.9	90.8	89.9	88.1	88.9	90.2	92.0	93.8	93.9	94.3
Consumer Activity													
Consumer Confidence	72.0	63.8	66.0	61.7	57.6	59.2	45.2	46.4	40.9	55.2	64.8	61.5	70.8
Retail Sales (M/M % Chg)	0.4%	0.2%	-0.1%	0.0%	-0.1%	0.4%	-0.1%	0.5%	0.2%	-0.01%	-0.04%	0.03%	#N/A
Lending Activity													
C&I Loans (M/M % Chg)	0.26%	0.87%	0.81%	1.09%	0.64%	0.89%	1.61%	0.35%	1.09%	0.62%	1.05%	1.21%	1.34%
MLFI-25 New Business Volume (Bil. $)	4.1	6.2	5.1	5.6	7.3	5.7	5.7	7.1	6.0	6.2	10.8	5.1	5.0
MLFI-25 Avg Losses as a % of Net Rec.	0.95%	1.31%	0.78%	0.79%	1.15%	0.73%	0.60%	0.90%	0.70%	0.70%	0.70%	0.50%	0.50%
MLFI-24 Credit Approval Ratio	75.9%	75.4%	75.6%	76.4%	78.7%	76.3%	77.6%	76.5%	76.3%	76.2%	79.3%	76.9%	79.8%
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	0.25	0.30	0.22	0.18	0.19	0.20	0.10	0.13	0.12	0.12	0.12	0.13	0.18
3-Year Treasury Rate	1.18	1.29	1.01	0.79	0.81	0.55	0.33	0.42	0.41	0.41	0.36	0.30	0.43
10-Year Treasury Rate	3.42	3.47	3.32	3.05	3.18	2.82	2.23	1.92	2.17	2.08	1.89	1.83	1.98
30-Year Treasury Rate	4.49	4.51	4.40	4.22	4.38	4.12	3.60	2.90	3.16	3.06	2.89	2.94	3.08
AAA Corporate Bond Yield	5.09	5.15	5.09	4.94	5.14	4.67	4.41	3.96	3.88	4.07	3.77	3.72	3.80
BAA Corporate Bond Yield	5.99	6.05	5.90	5.70	5.90	5.59	5.48	5.22	5.19	5.32	5.16	5.07	5.08
Prices													
Headline Inflation (Y/Y % Chg)	2.1%	2.6%	3.1%	3.4%	3.5%	3.6%	3.8%	3.9%	3.6%	3.5%	3.0%	2.9%	2.9%
Core Inflation (Y/Y % Chg)	1.1%	1.2%	1.3%	1.5%	1.6%	1.7%	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%	2.2%
Oil Price (West Texas Intermediate, $/barrel)	89.58	102.94	110.04	101.33	96.29	97.19	86.33	85.61	86.41	97.21	98.57	100.24	102.25

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

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