2015 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE
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Your Eye on the Future

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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.

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About The Outlook

The Equipment Leasing & Finance Foundation (the Foundation) recognizes that with the wide variety and increasing complexity of economic data available to the public, the best way to utilize key equipment investment 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.

The Foundation partnered with Keybridge LLC to produce this economic outlook, highlighting key trends in equipment investment and placing them in the context of the broader U.S. economic climate. The outlook report also includes an analysis of domestic capital spending as well as an evaluation of how capital spending is affected by various related and exogenous factors, both currently and in the foreseeable future. Additionally, the outlook includes custom leading indicators for 12 equipment and software verticals. The Foundation-Keybridge U.S. Equipment & Software Investment Momentum Monitor ("Momentum Monitor"), described below, is published on a monthly basis.

This report is the full 2015 Annual Outlook, and quarterly updates will be provided in April, July, and October of 2015. This research 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.

About the Momentum Monitor

Business leaders require actionable forward-looking intelligence to make strategic decisions. Accordingly, the Foundation commissioned Keybridge LLC to develop a series of custom leading indicators for the equipment sector. The Momentum Monitor consists of indices for 12 equipment and software investment verticals. These indices are designed to identify turning points in their respective investment cycles with a 3 to 6 month lead time.

The Momentum Monitor is based on Keybridge's extensive research which shows that not all movements in economic data are reliable signals of future economic trends. Keybridge has operationalized its research by constructing indices, each comprised of between 10 to 20 high-frequency indicators. These indicators undergo rigorous testing to determine the optimal thresholds at which their short-term fluctuations are economically meaningful. In simpler terms, the Momentum Monitor sifts out the "noise" in the data and identifies the dominant trends. As a result, each Momentum Monitor index is statistically optimized to signal turning points in the investment cycle without giving false readings of shifts in momentum.

SUMMARY

2015 is poised to be a breakout year for the U.S. economy, with growth expected to top 3%. Although harsh winter weather led to a GDP decline of 2.1% in the first quarter of 2014 — putting the economy in a deep hole to begin the year — growth has been robust in subsequent months. The economy expanded at a 4.6% clip in Q2 and a solid 3.9% rate in Q3, marking the strongest six-month period in more than a decade. Growth was broad-based in Q3, as government spending accelerated and consumer spending, residential investment, exports, and business investment all made positive contributions. Steady strengthening in the labor market continued through the autumn, as the economy added 835,000 jobs in September, October, and November. Oil prices have fallen by roughly 45% since June, which has reduced gasoline prices and will likely boost consumer spending in the coming months. Moreover, with CPI remaining well under 2% and oil prices sharply lower due in part to increased domestic supply and reduced global demand, inflation pressures remain muted.

Although 3% GDP growth is simply the average pace of growth over the period from 1970 to 2007, the U.S. economy has not attained this rate since 2005 — or, put another way, the country has endured nine straight years of subpar growth. In 2015, however, key "bright spots" bode well for above-average growth, including a rapidly improving labor market, lower oil prices, greater access to credit, and fiscal healing. Meanwhile "wild cards" that could hinder growth include weakness in the global economy, potential political gridlock, and geopolitical risks. Overall, we expect the strengthening labor market to propel GDP growth to 3.3% in 2015, which is slightly above consensus forecasts.

Equipment and software investment increased 9.3% in Q3 of 2014 after expanding 9.6% in Q2. Looking ahead, we expect growth in equipment and software investment to moderate somewhat, as it is unlikely to keep up the strong pace seen in Q2 and Q3. We expect growth to be 5.9% in 2014 and forecast 6.0% growth in 2015. Our outlook for individual equipment and software verticals over the next year is mixed:

- Agriculture Machinery investment could see continued moderate declines over the next 3 to 6 months.
- Construction Machinery investment should moderate over the next 2 quarters.
- Materials Handling Equipment investment growth may experience some moderation over the next 3 to 6 months.
- All Other Industrial Equipment investment will likely remain strong over the next 3 to 6 months.
- Medical Equipment investment growth is expected to be little changed over the next two quarters.
- Mining & Oilfield Machinery will likely slow or potentially experience negative growth in investment over the next three to six months, given recent declines in oil prices.
- Aircraft investment growth is expected to remain relatively stable over the next 3 to 6 months.
- Ships & Boats investment will likely see little change in the next 2 quarters.
- Railroad Equipment investment should moderate over the next 3 to 6 months.
- Trucks investment is expected to be little changed over the next three to six months.
- Computers investment will likely experience relatively stable investment over the next three to six months.
- Software investment will likely see a slight moderation in growth over the next three to six months.

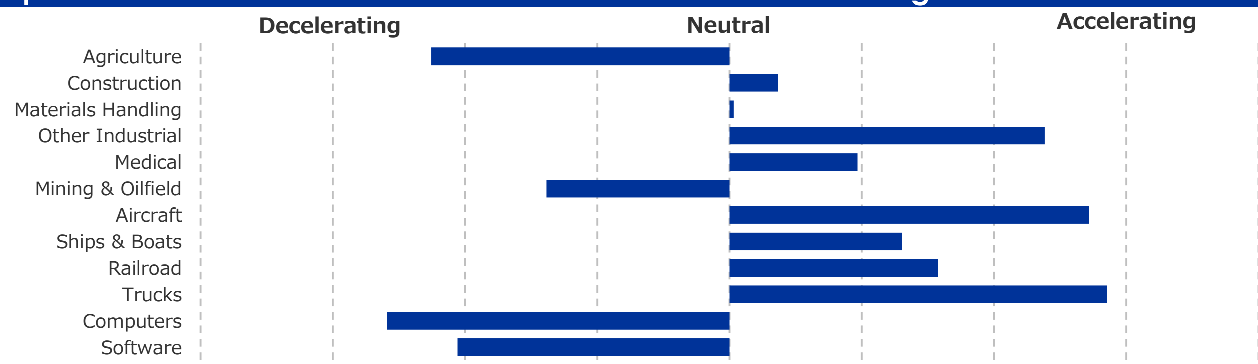
The Federal Reserve concluded its bond purchases ("QE3") in October, turning attention now to the Fed's first interest rate increase. We expect the Fed to begin raising short-term interest rates late in the second quarter of 2015, but we also acknowledge that accelerated economic recovery could cause the Fed to pull forward its first rate hike. Continued improvement in the economy should gradually loosen credit constraints and increase credit demand as businesses and households gain more confidence in the economy. However, further worsening in the global economy or destabilization in Ukraine or the Middle East could dampen confidence and disrupt financial markets. Lastly, domestic policy uncertainty caused by political gridlock is a risk to watch again in 2015, with the potential to hurt investment and growth.

Equipment & Software Investment Outlook

Foundation-Keybridge U.S. Equipment & Software Investment Momentum Monitor

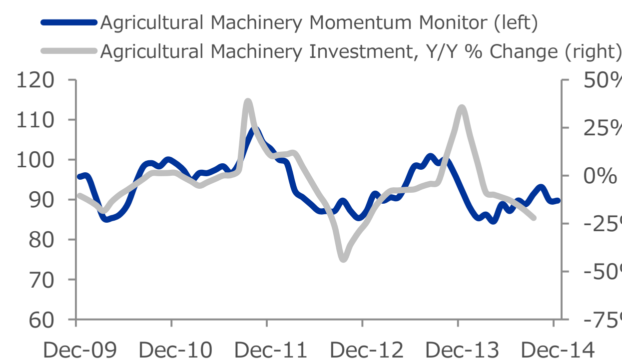
Equipment and software investment increased 9.3% in Q3 2014 following a solid 9.6% pace in the second quarter. Taking into account October's slight decline in capital good shipments, we expect equipment and software investment growth to slow in Q4, and we project an overall growth rate of 5.9% in 2014. Looking ahead to 2015, our forecast is for equipment and software investment to post 6.0% annual growth. Several factors — first and foremost the steadily improving economy — could boost confidence and end the "negative psychology" seen in recent years that has resulted from lackluster growth. However, geopolitical risks and political gridlock remain key threats to business confidence and investment.

Equipment Vertical Momentum Relative to 10-Year Historical Average

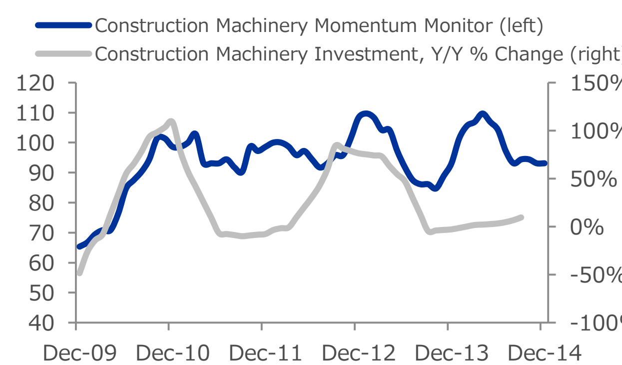


The chart above summarizes the current values of each of the 12 Equipment & Software Investment Momentum Indices relative to the index values for each quarter over the last 10 years. Verticals for which momentum is below the 10-year median are "decelerating," verticals for which momentum is near the 10-year median are "neutral," and verticals for which momentum is near the 10-year maximum are "accelerating." Note that the current momentum trend for each vertical may differ from the current investment volume. For example, a vertical for which the *level* of investment activity is low — but which is exhibiting signs of a comeback in the near future based on the *momentum* suggested by its leading indicators — will be labeled "accelerating" (and vice-versa).

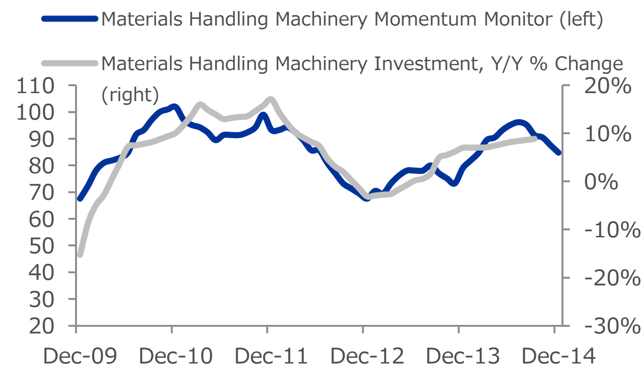
Agricultural Machinery: Investment in Agricultural Machinery contracted at an annualized rate of 60.3% in Q3 2014 and is down 22.1% from one year ago. The Agriculture Momentum Index was unchanged at 89.7 (revised) from November to December. Agriculture Equipment Sales increased nearly 4% and Cattle Exports surged in October, yet the Food Export Price Index declined. Overall, the Index suggests that investment could see continued moderate declines over the next three to six months.



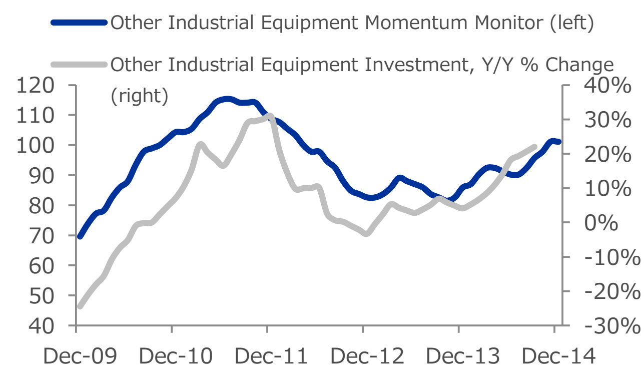
Construction Machinery: Investment in Construction Machinery rebounded at a 13.9% annualized rate in Q3 2014 and is up 9.5% year-over-year. The Construction Momentum Index held steady at 93.1 (revised) from November to December. Shipments of Mobile Homes declined and Housing Starts in the West dropped 11%, offsetting an increase in Multifamily Housing Permits. Overall, the Index's recent movement suggests that investment growth could moderate over the next six months.



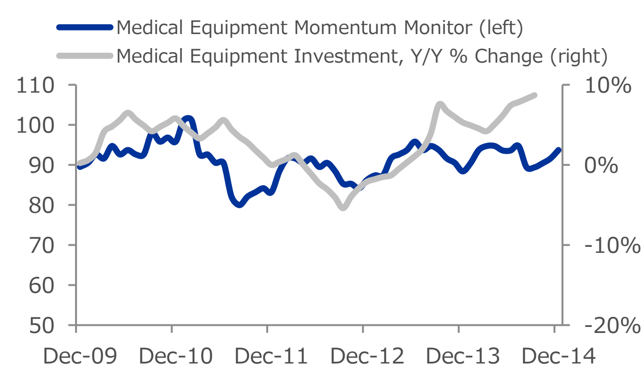
Materials Handling Equipment: Investment in Materials Handling Machinery increased at a 16.5% annualized rate in Q3 2014 — the fastest pace in three years — and is now up 8.9% year-over-year. The Materials Handling Momentum Index declined from 87.6 (revised) in November to 84.8 in December. Export Prices of Material Handling Equipment positively contributed to the Index; however, the Chicago Business Barometer and the 10-Year Treasury Spread both decreased sharply. The Index's recent trend indicates that growth may experience some moderation over the next three to six months.



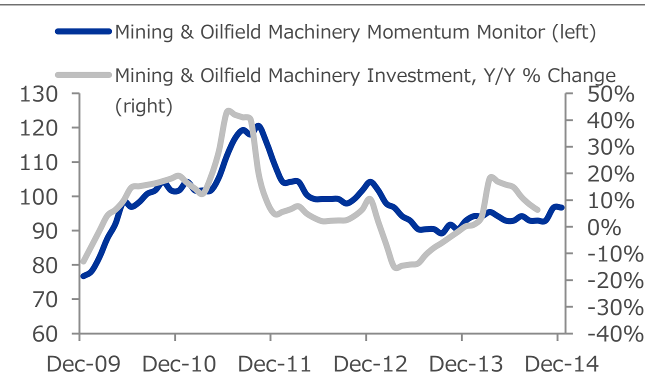
Other Industrial Equipment: Investment in All Other Industrial Equipment expanded at a 35.8% annualized rate in Q3 2014 and is now up 22.0% year-over-year, an eleven-quarter high. The Other Industrial Equipment Momentum Index was unchanged at 101.1 from November to December, the highest level in more than two years. New Orders of Industrial Machinery declined 4%, while Machinery Industrial Production and the Chicago Prices Paid Index posted modest gains. Overall, the Index's recent movement suggests that growth will remain strong over the next three to six months.



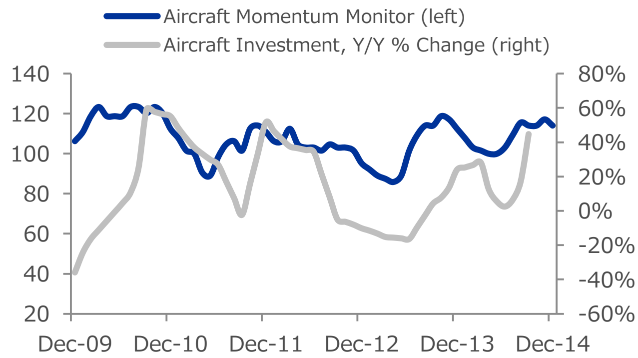
Medical Equipment: Investment in Medical Equipment increased at a 14.9% annualized rate in Q3 2014 and is now up 8.7% year-over-year, the largest annual increase in over six years. The Medical Equipment Momentum Index increased from 91.6 (revised) in November to 93.7 in December. Federal Outlays for Medicare surged 55% in October, and the S&P Global Healthcare Index Fund gained nearly 3%. However, New Orders for Nondefense Capital Goods continued to decline. Overall, the Index suggests that growth in medical equipment investment will be little changed over the next three to six months.



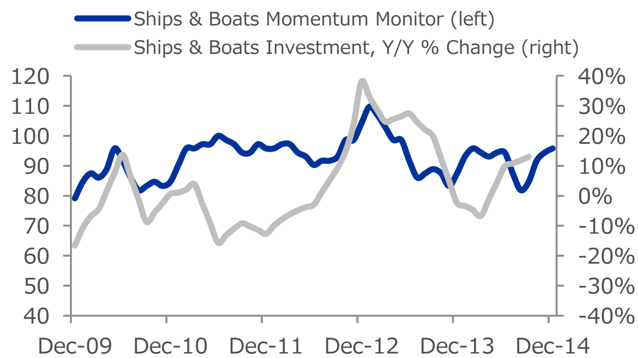
Mining & Oilfield Machinery: Investment in Mining & Oilfield Machinery expanded at a 5.2% annualized rate in Q3 2014 and is now up 6.3% year-over-year. The Mining & Oilfield Machinery Momentum Index held steady at 96.7 (revised) from November to December. A 3% decline in Natural Gas Industrial Production was a drag on the Index, yet New Orders of Oil & Gas Machinery and Coal Production both increased. Combined with rapidly declining oil prices, the Index suggests slow or potentially negative growth in investment over the next three to six months.



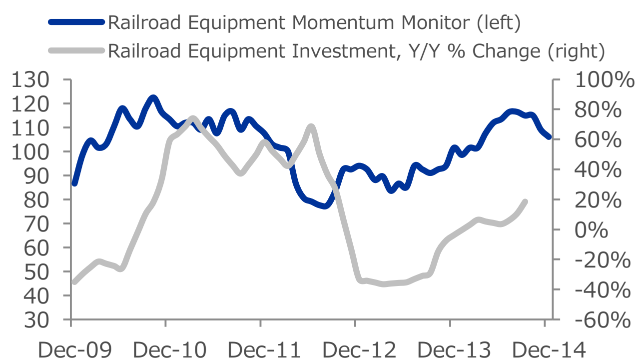
Aircraft: Investment in Aircraft surged at a 336.3% annualized rate in Q3 2014 and is now up 44.8% on a year-over-year basis — the largest increase in over two years. The Aircraft Momentum Index slipped from 117.2 (revised) in November to 114.1 in December. New Orders of Defense Aircraft jumped 45% in October, yet Vehicle Miles Traveled declined 8% and Shipments of Nondefense Aircraft & Parts fell 2%. Overall, the Index suggests little change in Aircraft investment growth over the next three to six months.



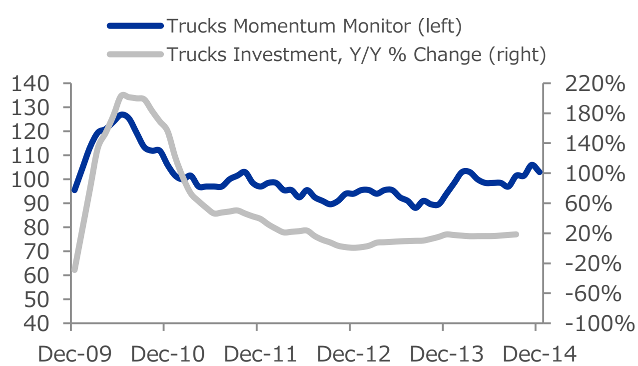
Ships & Boats: Investment in Ships & Boats expanded at an annualized rate of 41.2% in Q3 2014 and is now up 13.0% year-over-year. The Ships & Boats Momentum Index ticked up from 94.4 (revised) in November to 95.8 in December. While the Change in Nonfarm Employment hit a three-year high in November, the Chemicals Trade Balance and the ISM Manufacturing Employment Index declined in October. Overall, the Index suggests little change in investment growth the next three to six months.



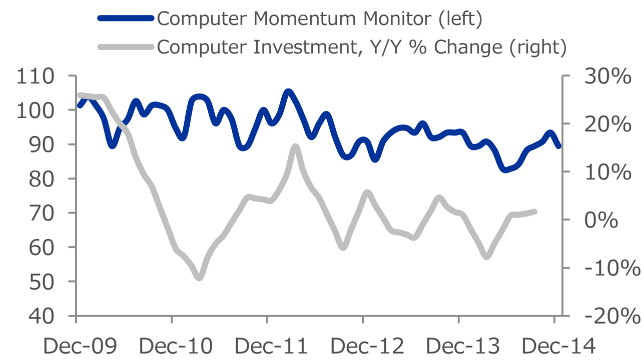
Railroad Equipment: Investment in Railroad Equipment rebounded at a 62.0% annualized rate in Q3 2014, the largest increase in nearly three years, and is up 18.4% year-over-year. The Railroad Equipment Momentum Index declined from 109.0 (revised) in November to 106.0 in December. While Machine Tool Orders dropped 35% in October, Coal Production and Mining Exports both rebounded in October. Overall, the Index suggests that growth in railroad equipment investment may moderate over the next three to six months.



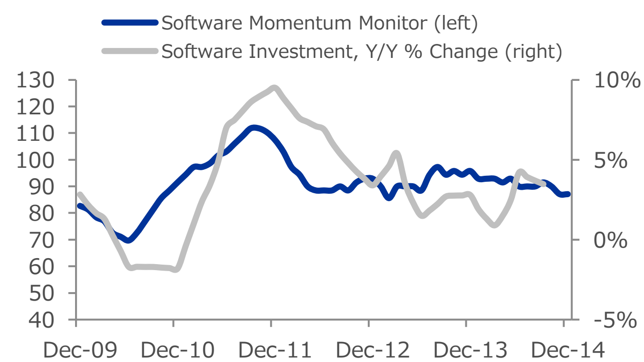
Trucks: Investment in Trucks increased at a 12.7% annualized rate in Q3 2014 and is now up 18.6% year-over-year. The Trucks Momentum Index ticked down from a four-year high of 106.0 (revised) in November to 103.0 in December. Although Housing Permits were a boost to the Index, declines in Housing Starts, Light Truck & Utility Vehicle Shipments, and Energy Materials Industrial Production pulled down the Index. Overall, the Index's recent movement indicates little change in truck investment over the next three to six months.



Computers: Investment in Computers increased at an annualized rate of 10.5% in Q3 2014 and is up 1.7% on a year-over-year basis. The Computers Momentum Index declined from 93.4 (revised) in November, an eleven-month high, to 89.5 in December. The Value of Consumer Goods continued to decline, and Computer & Electronic Industrial Production slipped. However, the Morgan Stanley High-Tech 35 Index increased 4%, and Consumer Expectations hit a seven-year high. Overall, the movement of the Index suggests relatively stable investment in computers over the next three to six months.



Software: Investment in Software increased at a 4.4% annualized rate in Q3 2014 and is up 3.5% year-over-year. The Software Momentum Index was unchanged at 87.1 from November to December. The Richmond Fed Survey on Equipment Spending rebounded in November, while the ISM Manufacturing Employment Index fell 5%. Overall, the Index points to a slight moderation in investment growth over the next three to six months.



Equipment & Software Investment Annual Growth Forecast

Year/Year % Growth Rates

Sector	10-Year Average	Last 4 Quarters	Next 4 Quarters
Agricultural Machinery	-0.1%	-22.1%	-8 – -2%
Construction Machinery	13.2%	9.5%	6–10%
Materials Handling Equipment	2.4%	8.9%	4–8%
Other Industrial Equipment	3.9%	22.0%	12–18%
Medical Equipment	4.5%	8.7%	5–8%
Mining & Oilfield Equipment	13.2%	6.3%	-3 – +3%
Aircraft	6.6%	44.8%	18–25%
Ships & Boats	3.6%	13.0%	8–14%
Railroad Equipment	8.9%	18.4%	6–12%
Trucks	19.1%	18.6%	16–22%
Computers	7.0%	1.7%	2–5%
Software	4.1%	3.5%	2.5–4%

Source: Macrobond Financial, Keybridge (forecasts)

U.S. Capital Investment and Credit Markets

Review of Recent Trends

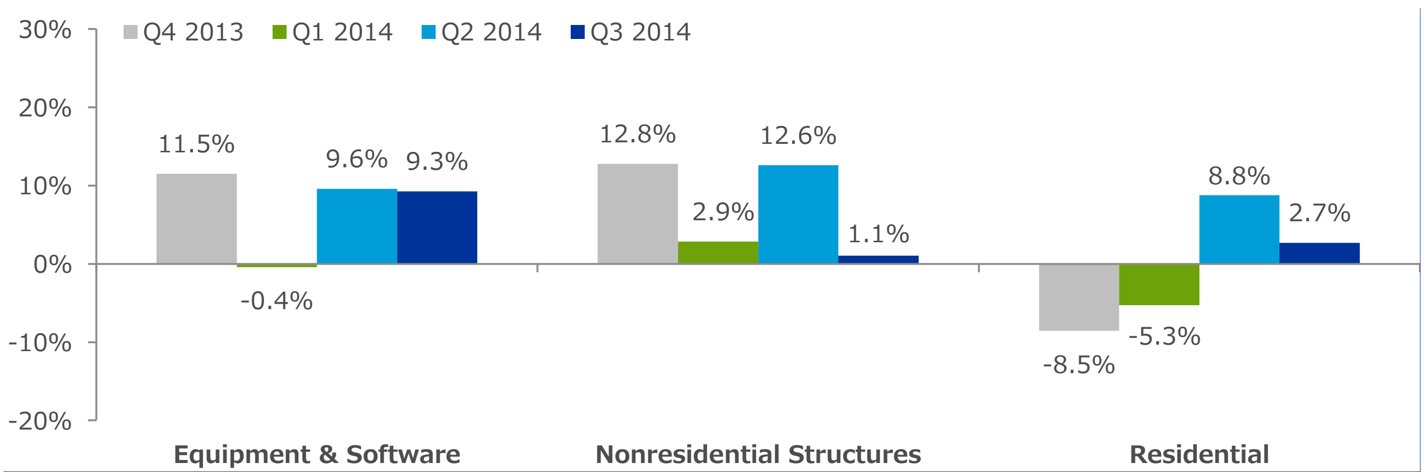
Equipment and Software Investment expanded at a 9.3% annualized rate in Q3 of 2014 following a strong 9.6% jump in the second quarter. Residential investment increased 2.7%, down from 8.8% growth in Q2. Similarly, investment growth for Nonresidential Structures also decelerated, falling from 12.6% in Q2 to 1.1% in Q3.

Following a 69.7% contraction in the second quarter (annualized rate), Aircraft investment surged 336.3% in Q3, the fastest rate of the major equipment and software verticals. At -60.3%, Agricultural investment saw the greatest deceleration out of the 12 verticals — its third consecutive drop. Other key movements included an eleven-quarter high in Railroad Equipment investment growth (62.0%) and a rebound in Construction Machinery investment (13.9%) following a contraction in Q2.

Equipment and software investment remained strong in Q3, although both structures and residential investment decelerated sharply from the second quarter. The steadily improving economy is likely to drive solid equipment and software investment growth in 2015, yet growth may slow moderately relative to the last two quarters. Credit supply and demand continue to improve for businesses of all sizes, but uncertainty stemming from both domestic and foreign factors poses a threat in 2015. Lastly, financial stress remains subdued as businesses and households gain confidence.

Investment Growth Rates

Quarter-Quarter, Seasonally Adjusted Annualized Growth Rate



Source: Macrobond Financial

2014 is shaping up to be a solid year for equipment finance. Although data are still pending for Q4, we project overall annual equipment & software investment growth will be 5.9%, which is above the industry's 15-year average of 4.1%. New business volumes are up 7.9% year-over-year, although the latest ELFA Monthly Leasing and Financing Index (MLFI-25) reports that new business volumes fell from $9.4 billion in September to $8.3 billion in October. Portfolio performance has also been strong; charge-offs as a percent of net receivables remained at 0.2%, while the credit approval ratio ticked down to 78.3%. Additionally, the ELFF Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) increased from 60.4 in October to 64.2 in November, a six-month high. In particular, the index showed industry executives gaining confidence in the future. Compared to October, a larger percentage of respondents expected business conditions to strengthen, capex to increase, and economic conditions to improve over the next four months.

While contributing to growth, business investment has been relatively modest in recent years. However, this sector appears to be poised to accelerate in 2015. Corporations have access to more than $2.5 trillion in cash, and corporate profits (up 3.8% from a year ago) have increased for three consecutive quarters. A key factor to watch is capacity utilization, which is nearing the 80% level that is historically correlated with a pickup in investment spending. Capacity utilization has hovered around 79% for much of the year; eclipsing 80% in 2015 could trigger a new round of investment in equipment as businesses expand capacity to meet demand.

The Federal Open Market Committee ("FOMC"), the Fed's primary policymaking committee, officially ended its bond-buying program ("QE3") at the conclusion of its October policy-setting meeting. With the era of quantitative easing concluded, the timing of the first interest rate hike is the debate to watch at the Fed. For Fed "hawks," the consistently strong job gains seen in recent months and an unemployment rate below 6% are incompatible with zero interest rates. A continuation of positive market news (e.g., 3%+ GDP growth in Q4, robust job growth, and increased upward pressure on wages) would further embolden Fed hawks to press for an interest rate hike sooner than many observers anticipate. We expect the Fed to begin raising rates late in the second quarter of 2015. However, stronger-than-expected data in the coming months could pull forward the first rate increase to late winter or springtime, which could potentially surprise markets.

Additional Factors to Watch

Several other factors will impact credit markets in 2015, most notably the strengthening U.S. economy. As the economy continues to steadily recover from the recession, we expect business confidence to increase and lending standards to be further eased. For both consumers and businesses, the scars of the financial crisis are fading and the significant deleveraging of the past few years appears to have run its course. However, geopolitical risks and the faltering global economy continue to threaten consumer and business confidence, and the recent renewal of partisan fighting between Congressional Republicans and President Obama suggests a return to heightened domestic policy uncertainty in 2015.

Summary of Credit Conditions

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

- **Credit Supply & Pricing:** Continuing a trend through 2014, the supply of credit across multiple sectors is gradually improving. The October Fed Loan Officer survey showed a modest loosening of standards for commercial and industrial ("C&I") loans for businesses of all sizes, as well as continued easing of commercial real estate loans. Amid the global economic slowdown, the benchmark 10-year Treasury rate fell to 2.15% in mid-October and now stands at 2.22%.

- **Credit Demand:** Strong business investment growth in the last two quarters suggests improving business confidence and increased credit demand. The October Fed Loan Officer survey reported stronger demand for C&I loans from large businesses, and as of October C&I loans were up 11.9% year-over-year. Increased confidence may also be gradually increasing small businesses' demand for credit. The NFIB Small Business Optimism Index hit a post-recession high in November, and the Thomson Reuters/PayNet Small Business Lending Index remains elevated.

  However, policy uncertainty may be weighing on large businesses' investment plans. According to the latest Business Roundtable CEO Economic Outlook Survey, the share of CEOs expecting to increase capex spending dipped for the third consecutive quarter, and 63% of responding CEOs cited U.S. tax policy as an obstacle to greater investment spending.

- **Financial Stress:** The steadily improving economy continues to alleviate financial stress and encourage greater borrowing by both businesses and households. While both the Kansas City Financial Stress Index and the St. Louis Fed Stress Index have recently ticked up, they remain below historical averages and continue to indicate subdued financial stress. For businesses, the lease delinquency rate inched up to 0.8% in the third quarter, yet remains low when viewed through a historical lens. After rising in September, corporate bond yields fell in October and steadied in November.

Largely reflecting the slowdown in the global economy, 10-Year Treasuries dropped sharply in October and remain lower than our initial forecasts, likely because of heavy inflows from European investors. Still, Treasury yields should gradually rise throughout 2015 as the economy continues to improve.

OVERVIEW OF THE U.S. ECONOMY

Review of Recent Trends

Due largely to harsh winter weather in Q1, 2014 GDP growth began in a deep hole, shrinking by 2.1%. However, since then, the U.S. economy has shown solid expansion, rebounding 4.6% in the second quarter and growing by a larger-than-expected 3.9% in the third quarter — the strongest six-month stretch in more than a decade. Growth was broad-based in Q3; government spending accelerated, while consumer spending, residential investment, exports, and business investment made positive (although not robust) contributions to growth. Steady strengthening in the labor market continued through the autumn, as the economy added 835,000 jobs from September to November — the largest three-month employment surge not fueled by temporary U.S. Census hiring since March 2006. Additionally, recent rapid declines in global oil prices will reduce gasoline prices and effectively increase the disposable income of most U.S. households, thereby providing a further boost to the U.S. economy. Finally, with CPI holding steady at 1.7% in October, inflation pressures remain muted. Overall, the economy appears poised for 3+% growth in 2015, although several potential headwinds are lurking on the horizon.

Virtually all sectors positively contributed to growth in Q3. Net exports contributed 0.78 percentage point, as exports posted a 4.9% gain and imports slipped 0.7%. Government spending was another bright spot from the Q3 report; at a 4.2% annualized rate, government expenditures grew faster than any stretch in the last five years. More specifically, the federal government grew for the first time in two years, largely due to a 16.0% surge in defense spending. Business investment also remained strong in Q3. However, some sectors were weaker than in the previous quarter. For example, nonresidential investment in structures decelerated to 1.1% in Q3, consumer spending contributed 1.51 percentage points to GDP growth (down from 1.75 in Q2), and residential investment contributed just 0.09 percentage point in Q3 (down from 0.27 in Q2).

The *Economist* Poll of Forecasters for December calls for 3.0% GDP growth in 2015, up slightly from the 2.9% average forecast in November. The Federal Reserve most recent “central tendency” forecast for growth is in the range of 2.6% to 3.0%, which is lower than its 3.0 –3.2% projection in June.

Overall, we expect the strengthening labor market to propel GDP growth to 3.3% in 2015 — slightly above consensus estimates.

Indicator	Recent Activity
Consumption	Consumer spending grew 2.2%, a slight deceleration from Q2
Equipment & Software Investment	Equipment & Software Investment expanded 9.3%, marking two consecutive strong quarters
Residential Investment	Residential Investment grew at a 2.7% rate, down from 8.8% in Q2
Government Expenditures	Government expenditures increased 4.2% in Q3, its strongest pace in five years
Net Exports	Exports expanded 4.9%, while Imports declined slightly

Inflation has softened since summer, driven largely by a dramatic 45% decline in crude oil prices. Headline CPI was unchanged at 1.7% year-over-year in October, and gasoline prices declined 3.0%, the fourth consecutive decrease. However, Core CPI (which excludes volatile food and energy prices) may be hinting at rising inflation pressures. Core CPI unexpectedly increased 0.2% in October, but, at 1.8% year-over-year, remains below the Fed’s 2% target. This divergence between headline and core inflation may widen further if oil prices continue to decline and will be a trend to watch in 2015. Additionally, wage inflation may finally be firming; the Employment Cost Index is up 2.2% from a year ago, wages and salaries were up 0.8% in Q3 (the largest quarterly increase in six years), and average hourly earnings increased by a larger-than-expected 0.4% in November. Overall, despite the recent moderation in headline inflation, rising core and wage inflation will likely put the Fed on track for a late spring 2015 interest rate increase.

Steady job gains, improved credit flows, and diminishing fiscal contraction are key trends driving our 2015 outlook.

Excluding the weather-induced contraction in Q1, 2014 has seen solid growth. Key "bright spots" include a strengthening labor market, increased access to credit, lower energy prices, and an improved fiscal climate. "Wild cards" that could curb growth include the potential for partisan fighting, a weakening global economy, and geopolitical risks. On aggregate, 2014's solid progress seems to be setting the economy up for 3+% growth in 2015 and could mark a "breakout" year for U.S. GDP.

- **Labor Market:** The foundation for stronger growth in 2015 is the labor market recovery. In fact, this is the dominant macroeconomic story of 2014. Job gains have exceeded 200,000 for ten consecutive months, the unemployment rate dropped to a six-year low in November, and initial claims for unemployment recently hit fourteen-year lows. The economy is on track to create nearly 3 million jobs in 2014, which will boost incomes, consumer spending, and household formation. Labor market normalization should continue through 2015, yet the pace of monthly job gains could slow somewhat, as employers play less post-recession employment "catch-up" than occurred in 2014.
- **Consumer Spending:** The combination of renewed consumer confidence, strong job growth, and loosening loan standards should support a healthier rebound of consumer spending in 2015. First, consumers are growing more upbeat about the economy. Consumer sentiment (Univ. of Michigan) rose to 88.8 in November — the highest reading since July 2007. Similarly, the Conference Board's Consumer Confidence Index jumped 5.5 points to 94.1 in October, a seven-year high, before easing somewhat in November. Second, although the economy is far from the "credit boom" days that preceded the 2008-09 recession, consumers now appear confident enough to begin accumulating more short-term debt. Consumer credit is nearing pre-recession levels, with auto loans growing robustly and credit card debt finally rebounding after languishing for years.
- **Housing Market:** To date, the recovery of the housing market has been disappointingly soft — indeed, this has been a central "missing piece" from a full recovery. However, after six years of halting gains, the housing sector appears to be poised for revival. The key driver is likely to be the continued strength of the labor market, which should boost household formation rates. Several fundamentals for a housing recovery are in place: mortgage loan volumes are increasing, home prices are rising, affordability measures are still relatively high, and rising equity prices have helped push household wealth to record highs. The prospect of rising interest rates in 2015 may encourage first-time homebuyers to finally "pull the trigger," which would have positive ripple effects on the market for existing homeowners as well as the construction industry.
- **Government Spending:** The past three years witnessed significant and painful fiscal consolidation. In particular, the combined effects of the expiration of the 2% payroll tax holiday, sequestration, and the government shutdown sharply suppressed GDP growth in 2013. More recently, fiscal contraction has eased, and for the first time in two years, federal spending was a positive contributor to GDP in Q3 of 2014. Looking ahead, the Republican takeover of the Senate could lead to further increases in defense spending in 2015 through sequester exemptions (although additional spending cuts could occur elsewhere in the government). Furthermore, state and local governments' budgets are now the healthiest they have been since the recession of 2008-09, which could potentially trigger new infrastructure spending and construction jobs. Accounting for nearly two-thirds of total government spending, state and local governments are likely to be a plus for 2015 growth rather than the drag they have been in recent years.

Additional Factors to Watch

Our sector-level analysis repeats many of the same themes as in recent quarters, but the following "wild cards" may also have a significant effect on the U.S. economy in the next 12 months:

- **Oil Prices:** Since mid-June, crude prices have plunged to their lowest levels in five years. These price declines have reduced prices for gasoline and other fuels and boosted consumers' disposable income, but the scale of these benefits will depend on how far oil prices fall and how long they remain low. A sustained drop in oil prices could add 0.5 or even 0.8 percentage point to 2015 GDP, because the U.S. is still a net importer of oil. However, it would also likely decrease investment in some equipment verticals (e.g., mining and oilfield equipment, railroad equipment).
- **Global Growth and Exports:** Despite solid export growth in Q2 (11.1%) and Q3 (4.9%), the slowing world economy and a strong dollar may dampen global demand for U.S. products. Although slowing global growth could modestly curb 2015 GDP, it is not likely to knock the U.S. economy off its current positive trajectory. Furthermore, as low oil prices help the U.S. economy, they will also help other advanced economies, particularly Western Europe, China, and Japan. By mid-2015, we may see a notable uptick in global growth due to low oil prices — with foreign growth shrinking as a risk for U.S. growth.
- **Senate Shift:** The new Republican majority in the U.S. Senate will undoubtedly affect policy debates, but its effect on the economy is unclear. It is possible that a Republican majority will trigger a shift towards cooperation in advance of the 2016 election, as both parties attempt to convince the electorate of their ability to govern. Conversely, continued budget fights and political gridlock between Republicans and President Obama also remain very possible.
- **Geopolitical Risks:** Tied to the global economy, geopolitical risks are still key factors to watch. While some, such as the Ebola outbreak in sub-Saharan Africa, appear unlikely to have a significant impact on the U.S. economy, others — particularly, Russia's military action in Ukraine and the surrounding region — could hurt the economies of Western Europe and, to a lesser extent, the United States.

Projections for Key Economic Indicators

Indicator	2013	2014e	2015 Quarterly Estimates				2015e
			Q1e	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	2.2%	2.3%	3.2%	3.0%	2.8%	2.8%	3.3%
Real Investment in Equipment & Software (SAAR %)	4.2%	5.9%	5.0%	4.9%	6.1%	5.0%	6.0%
Inflation (annualized rate)	1.5%	1.6%	1.0%	1.1%	1.2%	1.9%	1.3%
Federal funds (effective, end of period)	0.15%	0.15%	0.15%	0.40%	0.90%	1.15%	1.15%
10-year Treasury Rate (end of period)	2.9%	2.3%	2.5%	2.8%	3.0%	3.2%	3.2%
Total Payrolls (in thousands)	+2,331	+2,900	+705	+690	+675	+665	+2,735

Note: SAAR% refers to the annualized rate of change in seasonally adjusted data from one quarter to the next, which is the Bureau of Economic Analysis' standard method for reporting growth in the national accounts data.

QUARTERLY DATA

Indicator	2012		2013				2014		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Real Gross Domestic Product (SAAR %)									
GDP	2.5%	0.1%	2.7%	1.8%	4.5%	3.5%	-2.1%	4.6%	3.9%
Consumer Spending	1.9%	1.9%	3.6%	1.8%	2.0%	3.7%	1.2%	2.5%	2.2%
Gross Private Fixed Investment	1.6%	-5.3%	7.6%	6.9%	16.8%	3.8%	-6.9%	19.1%	5.1%
Inv: Equipment & Software	1.0%	7.0%	5.9%	-0.9%	5.3%	11.5%	-0.4%	9.6%	9.3%
Inv: Agricultural Machinery	-46.9%	32.8%	65.3%	-36.3%	-37.8%	415.4%	-66.2%	-46.9%	-60.3%
Inv: Construction Machinery	410.8%	-0.2%	4.8%	-12.3%	-10.1%	7.4%	26.1%	-6.6%	-13.9%
Inv: Materials Handling Equipment	-5.3%	-1.1%	0.6%	6.9%	13.7%	7.1%	1.0%	11.4%	16.5%
Inv: All Other Industrial Equipment	2.0%	10.0%	2.9%	-3.2%	19.3%	-1.2%	21.3%	36.1%	35.8%
Inv: Medical Equipment	-14.3%	9.5%	10.1%	1.0%	9.6%	1.0%	5.4%	14.2%	14.9%
Inv: Mining & Oilfield Machinery	1.2%	-27.8%	-44.1%	35.8%	42.8%	-7.1%	8.2%	20.9%	5.2%
Inv: Aircraft	-55.0%	153.5%	-42.6%	-25.6%	9.4%	406.2%	-34.4%	-69.7%	336.3%
Inv: Ships & Boats	61.1%	113.9%	10.7%	-31.0%	26.1%	-5.8%	-7.5%	32.4%	41.2%
Inv: Railroad Equipment	-34.6%	-72.1%	-12.2%	9.3%	-5.5%	-5.8%	-31.6%	-2.0%	62.0%
Inv: Trucks	0.5%	-13.0%	28.2%	27.5%	4.3%	15.6%	18.4%	28.2%	12.7%
Inv: Computers	-23.3%	44.7%	-12.3%	-11.7%	6.7%	25.7%	-39.0%	26.1%	10.5%
Inv: Software	2.1%	3.5%	9.2%	-8.1%	7.2%	3.7%	1.5%	4.3%	4.4%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	65.2%	66.1%	65.9%	66.3%	66.4%	66.2%	67.3%	67.0%	67.1%
Loan Delinquency Rate	1.3%	1.2%	1.1%	1.0%	1.0%	0.9%	0.9%	0.8%	0.8%
Lease Delinquency Rate	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	0.8%	0.7%	0.8%
Net Tightening of C&I Loan Standards	-9.5%	-7.6%	-7.4%	-19.1%	-18.1%	-8.3%	-13.7%	-11.1%	-10.7%

Note: SAAR% refers to the annualized rate of change in seasonally adjusted data from one quarter to the next, which is the Bureau of Economic Analysis' standard method for reporting growth in the national accounts data.

Monthly Data

Indicator	2013 Nov	2013 Dec	2014 Jan	2014 Feb	2014 Mar	2014 Apr	2014 May	2014 Jun	2014 Jul	2014 Aug	2014 Sep	2014 Oct	2014 Nov
Employment													
Change in Total Payrolls (thousands)	274	84	144	222	203	304	229	267	243	203	271	243	321
Change in Private Payrolls (thousands)	272	86	166	201	200	278	228	260	239	200	249	236	314
Unemployment Rate	7.0%	6.7%	6.6%	6.7%	6.7%	6.3%	6.3%	6.1%	6.2%	6.1%	5.9%	5.8%	5.8%
Business Activity													
Industrial Production	101.4	101.6	101.3	102.3	103.1	103.2	103.7	104.0	104.3	104.1	105.0	104.9	-
Capacity Utilization	78.5%	78.5%	78.1%	78.6%	79.1%	79.0%	79.1%	79.2%	79.2%	78.8%	79.2%	78.9%	-
PMI Composite Index	57.0	56.5	51.3	53.2	53.7	54.9	55.4	55.3	57.1	59.0	56.6	59.0	58.7
NFIB Small Business Optimism Index	92.5	93.9	94.1	91.4	93.4	95.2	96.6	95.0	95.7	96.1	95.3	96.1	98.1
Consumer Activity													
Consumer Confidence	72.0	77.5	79.4	78.3	83.9	81.7	82.2	86.4	90.3	93.4	89.0	94.1	88.7
Personal Consumption (M/M % Chg)	0.5%	0.0%	-0.3%	0.4%	0.6%	-0.1%	0.1%	0.3%	0.0%	0.6%	0.0%	0.2%	-
Retail Sales (M/M % Chg)	0.1%	0.1%	-0.9%	0.9%	1.5%	0.6%	0.4%	0.4%	0.3%	0.6%	-0.1%	0.5%	0.7%
Lending Activity													
C&I Loans (M/M % Chg)	0.3%	1.0%	0.7%	2.3%	1.3%	1.1%	0.7%	0.7%	1.1%	0.9%	0.5%	0.5%	-
MLFI-25 New Business Volume (Bil. $)	6.6	10.7	6.0	5.4	7.1	8.1	7.0	9.1	7.9	7.2	9.4	8.3	-
MLFI-25 Avg Losses as a % of Net Rec.	0.3	0.3	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	-
MLFI-25 Credit Approval Ratio	76.3%	78.7%	77.8%	76.4%	78.3%	78.2%	76.9%	80.9%	80.3%	79.5%	79.7%	78.3%	-
Interest Rates (% end of period)													
Fed Funds Target Rate (Lower Bound)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1-Year Treasury Rate	0.12	0.13	0.12	0.12	0.13	0.11	0.10	0.10	0.11	0.11	0.11	0.10	0.13
3-Year Treasury Rate	0.58	0.69	0.78	0.69	0.82	0.88	0.83	0.90	0.97	0.93	1.05	0.88	0.96
10-Year Treasury Rate	2.72	2.90	2.86	2.71	2.72	2.71	2.56	2.60	2.54	2.42	2.53	2.30	2.33
30-Year Treasury Rate	3.80	3.89	3.77	3.66	3.62	3.52	3.39	3.42	3.33	3.20	3.26	3.04	3.04
AAA Corporate Bond Yield	4.63	4.62	4.49	4.45	4.38	4.24	4.16	4.25	4.16	4.08	4.11	3.92	3.92
BAA Corporate Bond Yield	5.38	5.38	5.19	5.10	5.06	4.90	4.76	4.80	4.73	4.69	4.80	4.69	4.79
Prices													
Headline Inflation (Y/Y % Chg)	1.2%	1.5%	1.6%	1.1%	1.5%	2.0%	2.1%	2.1%	2.0%	1.7%	1.7%	1.7%	-
Core Inflation (Y/Y % Chg)	1.7%	1.7%	1.6%	1.6%	1.6%	1.8%	1.9%	1.9%	1.9%	1.7%	1.7%	1.8%	-
Oil Price (West Texas Int., $/barrel)	92.55	98.17	97.55	102.88	101.57	100.07	103.40	106.07	98.23	97.86	91.17	80.53	65.94

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