Q3 update — July

2015 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

TABLE OF CONTENTS

Summary **1**

Equipment & Software Investment Outlook **2**

Foundation-Keybridge U.S. Equipment & Software Investment Momentum Monitor 2

Equipment & Software Investment Annual Growth Forecast 5

U.S. Capital Investment and Credit Markets **6**

Recent Trends in Capital Investment 6

Recent Trends in Credit Markets 7

Update on Fed Policy 8

Overview of the U.S. Economy **9**

Recent Trends in the U.S. Economy 9

Economic Tailwinds 10

Economic Headwinds 11

Additional Factors to Watch 11

Projections for Key Economic Indicators 12

Quarterly Data **13**

Monthly Data **14**

Appendix **15**

About the Outlook 15

About the Momentum Monitor 15

How to Read the Momentum Monitor 16

About Keybridge 17

SUMMARY

Equipment & Software Investment Outlook: Equipment and software investment growth increased from 1.6% in Q4 2014 to 3.8% in the first quarter of 2015. Headwinds to faster growth included sharp cuts to the energy sector, the strong U.S. dollar, and a faltering manufacturing sector. We expect these headwinds to limit Q2 investment growth but mostly ease in the second half of 2015. Overall, we forecast equipment & software investment to grow 5.0% in 2015, down from 5.8% in 2014. Growth prospects for individual equipment and software verticals are mixed:

- Agriculture Machinery investment growth will likely remain weak or negative over the next three to six months.
- Construction Machinery investment growth should remain steady over the next three to six months.
- Materials Handling Equipment investment growth could slow over the next three to six months.
- All Other Industrial Equipment investment growth may decline further over the next three to six months.
- Medical Equipment investment growth is expected to remain strong over the next three to six months.
- Mining & Oilfield Machinery investment should remain weak over the next three to six months.
- Aircraft investment growth may remain steady or moderate slightly over the next three to six months.
- Ships & Boats investment growth may moderate in the next three to six months.
- Railroad Equipment investment growth rates may decline over the next three to six months.
- Trucks investment growth could ease somewhat over the next three to six months.
- Computers investment growth rates should remain steady over the next three to six months.
- Software investment growth will likely remain stable over the next three to six months.

U.S. Capital Investment & Credit Markets: Capital spending has been a weak spot in the economy, as businesses have shown some hesitancy to invest. Despite a poor start to the year, we expect a strengthening economy to encourage greater borrowing from businesses and households. Moreover, credit conditions continue to gradually improve, and financial stress is at a historically low level. Finally, the Fed delayed an interest rate hike in June but is expected to raise rates later this year. As noted in previous Outlooks, expectations of higher rates will likely encourage households and businesses to "pull forward" investments in coming months.

Weak business investment has hurt industry confidence, but steady growth in new business volume and a rising propensity to finance suggest another year of positive growth for the equipment finance industry. The struggling manufacturing and energy sectors are obstacles to growth, yet an improving economy should provide a lift to business investment and equipment finance activity during the second half of 2015.

Overview of the U.S. Economy: The economy contracted by 0.2% in the first quarter of 2015, following Q4's modest 2.2% growth. Housing investment picked up, while consumer spending slowed and net exports, government spending, and business investment all declined. The labor market, however, continues to steadily strengthen; job growth accelerated this spring, while initial claims for unemployment insurance are near 15-year lows, a sign of labor market health. Meanwhile, inflation is expected to remain subdued in coming months, yet should slowly rise as oil prices stabilize.

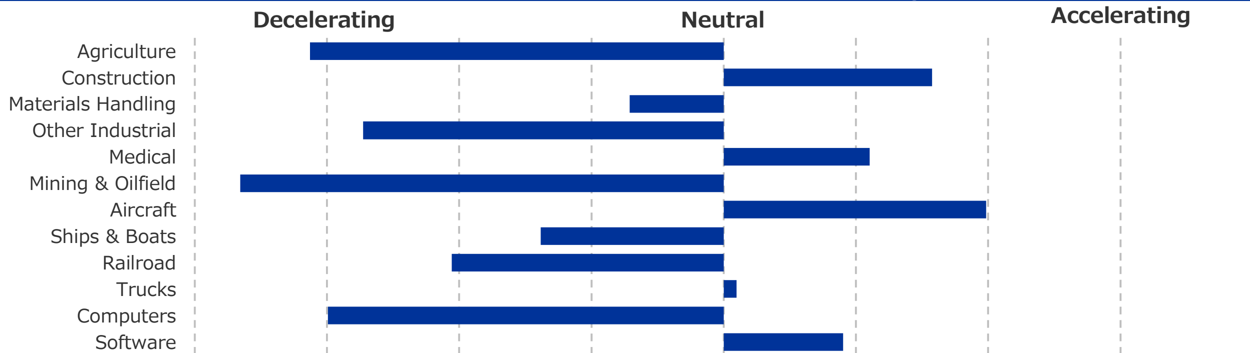
The labor market is still the brightest spot in the U.S. economy and likely will be the core driver of growth this year. Additionally, improved consumer spending, faster wage growth, and a nascent housing rebound are economic tailwinds — and should support a moderate rebound in GDP. Conversely, a struggling energy sector and lingering weakness in manufacturing present headwinds to growth. Looking ahead, the U.S. dollar, the global economy, and oil prices will be key factors to watch over the rest of the year. Overall, we expect 2.6% growth in 2015, as the economy regains its footing after a weak first quarter.

EQUIPMENT & SOFTWARE INVESTMENT OUTLOOK

After slowing to 1.6% in Q4 2014, equipment and software investment growth picked up slightly to 3.8% in the first quarter of 2015. Cuts to the energy sector and continued weakness in manufacturing were largely behind Q1's underwhelming growth, and we expect these headwinds from early 2015 to limit annual equipment and software investment growth to 5.0% this year. The strong dollar and low oil prices remain trends to watch, along with global economic growth.

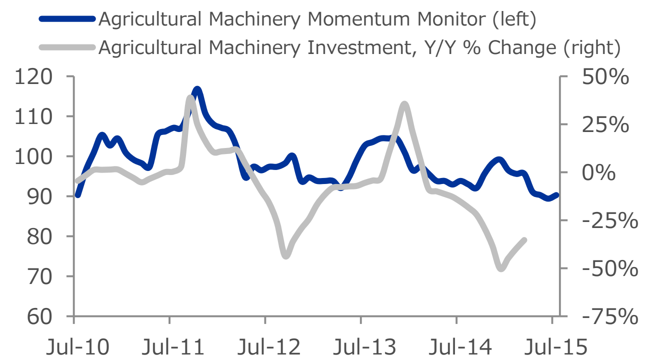
Foundation-Keybridge U.S. Equipment & Software Investment Momentum Monitor

*For more information on how to interpret the Momentum Monitor, please refer to the Appendices on pages 15-16.

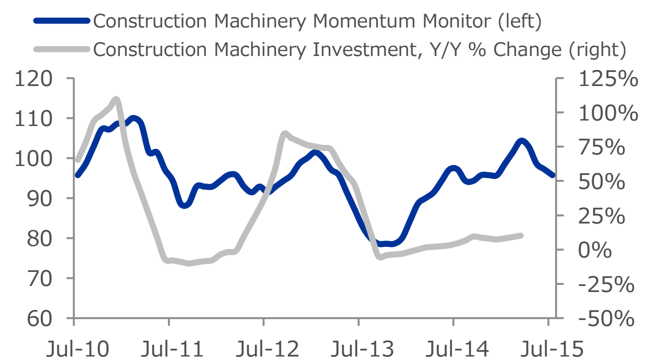


The chart above summarizes the current values of each of the 12 Equipment & Software Investment Momentum Indices relative to the index values for each quarter over the last 10 years. Verticals for which momentum is below the 10-year median are "decelerating," verticals for which momentum is near the 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).

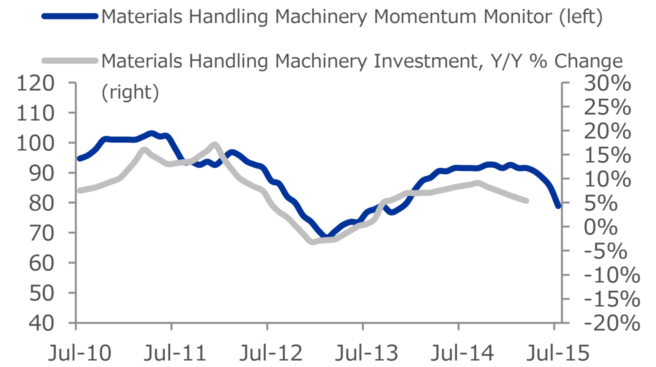
Agricultural Machinery: Investment in Agricultural Machinery slipped at an annual rate of 2.8% in Q1 2015, the fifth consecutive contraction, and is down 35.4% from one year ago. The Agriculture Momentum Index increased from 89.4 (revised) in June to 90.3 in July. An 81% surge in Cattle Exports and continued increases in National Average Precipitation offset declines in Broiler Exports, Food Export Prices, and Food Industrial Production. Overall, the Index points to continued weak or negative investment growth over the next three to six months.



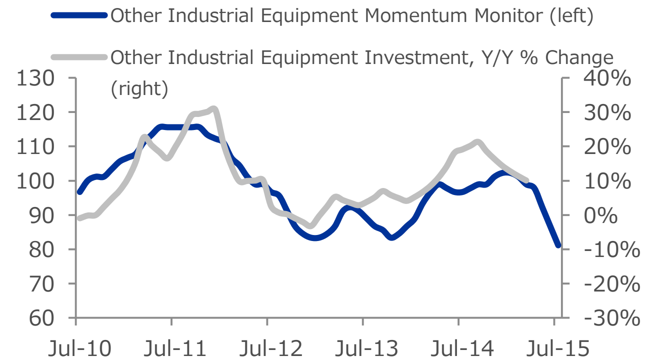
Construction Machinery: Investment in Construction Machinery rebounded at a 39.5% annual rate in Q1 2015 and is up 10.2% year-over-year. The Construction Momentum Index decreased from 97.1 (revised) in June to 95.7 in July. Housing Starts in the West fell 12.5% in May. However, Multifamily Housing Permits hit a 15-year high in May, and Real Personal Consumption Expenditures jumped 0.6%. Overall, the Index's elevated position points to steady growth over the next three to six months, despite a moderate decline this month.



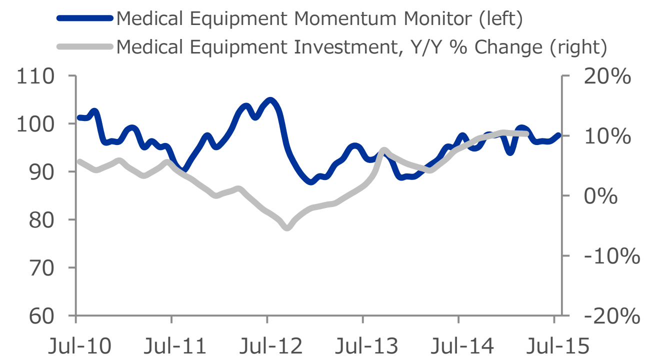
Materials Handling Equipment: Investment in Materials Handling Equipment declined at a 5.4% annual rate in Q1 2015 — the largest decrease since 2009 — but remains up 5.4% year-over-year. The Materials Handling Momentum Index fell from 85.3 (revised) in June to 78.9 in July, the lowest level since December 2013. Industrial Production has not increased for six months and slipped 0.2% in May, and the S&P Industrials Index fell 1.8% in June. The Index's recent trend continues to indicate that investment growth may slow over the next three to six months.



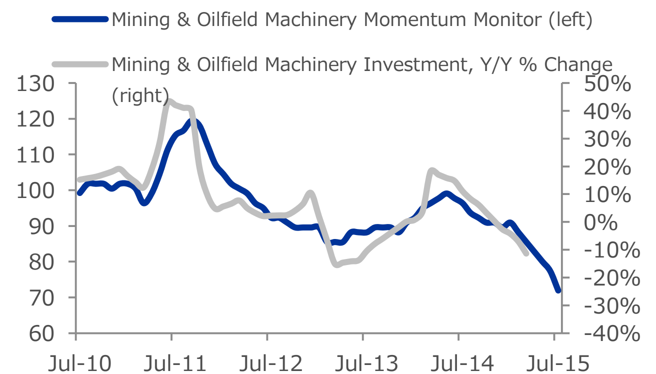
Other Industrial Equipment: Investment in All Other Industrial Equipment increased at a 4.2% annual rate in Q1 2015 and is up 10.0% year-over-year. The Other Industrial Equipment Momentum Index declined from 86.7 (revised) in June to 81.1 in July, a 5-year low. Although the ISM Manufacturing Index ticked up for the second straight month, the MNI-Chicago Production Index fell 13% in May. Overall, the Index suggests that investment growth will decline further over the next three to six months.



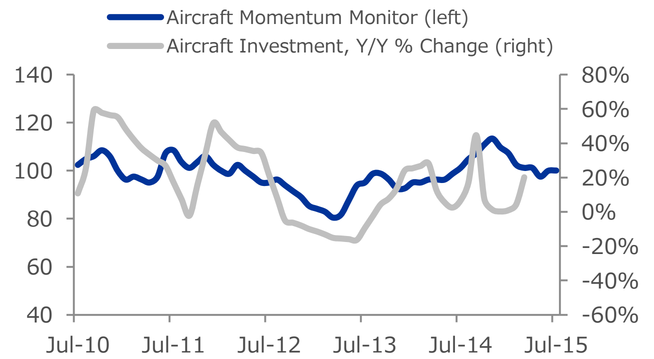
Medical Equipment: Investment in Medical Equipment increased at a 4.6% annual rate in Q1 2015 and is up 10.3% year-over-year, the second largest annual increase since 2008. The Medical Equipment Momentum Index increased from 96.3 (revised) in June to 97.6 in July. Social Security Disability Benefits declined 3.1% in June, yet New Orders of Electro-medical Instruments were up 2.3%. Overall, the Index suggests that growth in medical equipment investment is likely to remain strong over the next three to six months.



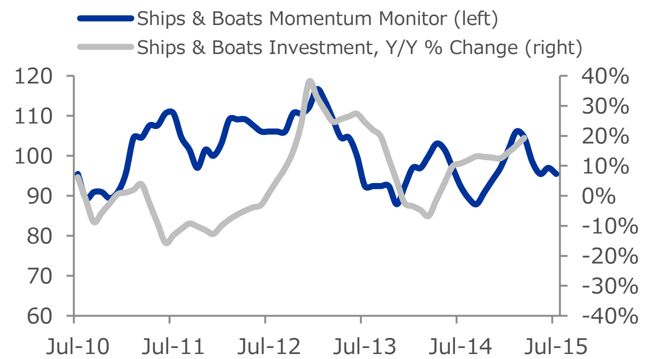
Mining & Oilfield Machinery: Investment in Mining & Oilfield Machinery decreased at a 25.7% annual rate in Q1 2015 and is now down 11.3% year-over-year, a seven-quarter low. The Mining & Oilfield Machinery Momentum Index dropped from 77.3 (revised) in June to 71.9 in July. Mining Employment fell for the sixth straight month in June and is now at its lowest level since the end of 2012. Conversely, the ISM Manufacturing Index ticked up 0.7 points in June. The Index suggests continued weak investment over the next three to six months.



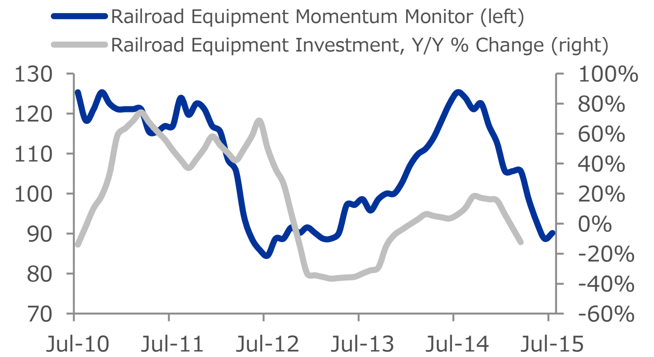
Aircraft: Investment in Aircraft expanded at a 35.6% annual rate in Q1 2015 and is up 20.1% on a year-over-year basis. The Aircraft Momentum Index was essentially unchanged from 100.0 in June to 100.1 in July. Civilian Aircraft Exports increased nearly 5% in April, yet the Transportation Services Freight Index declined 2% and Shipments of Non-Defense Aircraft fell 4.6% in May. Overall, the Index's recent movement suggests steady or slightly softer aircraft investment growth over the next three to six months.



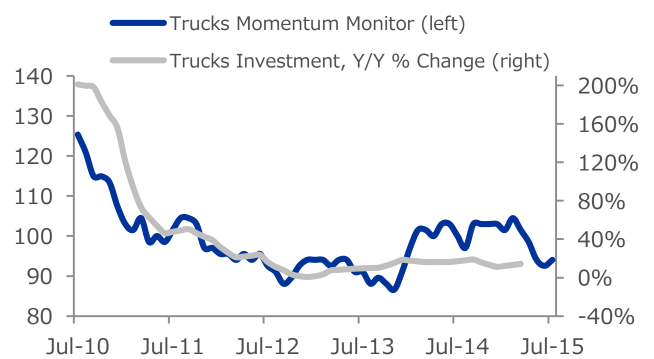
Ships & Boats: Investment in Ships & Boats increased at an annual rate of 16.9% in Q1 2015, and is up 19.3% year-over-year, a 6-quarter high. The Ships & Boats Momentum Index dipped from 97.0 (revised) in June to 95.5 in July. New Orders of Ships & Boats dropped 9% in May, while Grain & Oilseed Milling Shipments increased for the third straight month. Overall, the Index suggests that investment growth may slow over the next three to six months.



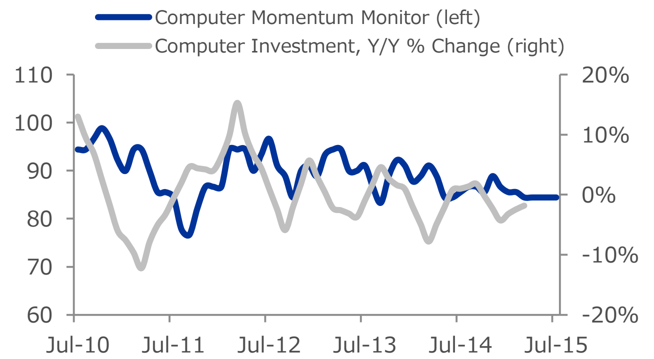
Railroad Equipment: Investment in Railroad Equipment plummeted at a 56.0% annual rate in Q1 2015, a 9-quarter low, and is now down 12.2% year-over-year. The Railroad Equipment Momentum Index increased slightly from 88.7 (revised) in June to 90.1 in July. Machine Tool Orders declined 3.8% in April; however, the Unemployment Rate fell to its lowest level since April 2008. Overall, the Index continues to suggest negative growth in railroad equipment investment over the next three to six months.



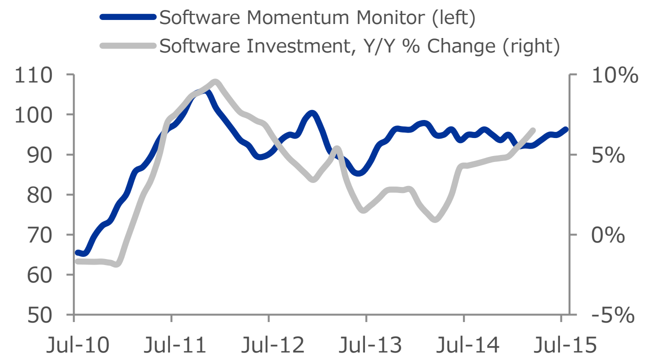
Trucks: Investment in Trucks rebounded at a 31.7% annual rate in Q1 2015 and is up 14.3% year-over-year. The Trucks Momentum Index increased modestly from 92.5 (revised) in June to 94.0 in July. Housing Permits jumped 7.4% and Shipments of Light-Duty Trucks increased, yet New Orders of Vehicles slipped 1.3%. Overall, the Index continues to suggest that growth in truck investment could ease somewhat over the next three to six months.



Computers: Investment in Computers contracted at an annual rate of 32.5% in Q1 2015 and is down 1.8% on a year-over-year basis. The Computers Momentum Index held steady at 84.4 (revised) from June to July. Consumer Expectations increased 4.3% in June, while Capacity Utilization for Computer & Electronic Product Manufacturing fell for the seventh month. Overall, the movement of the Index suggests little change in computer investment growth over the next three to six months.



Software: Investment in Software increased at a 7.9% annual rate in Q1 2015 and is now up 6.5% year-over-year, the largest yearly increase since 2012. The Software Momentum Index increased from 94.9 in June to 96.3 in July. Consumer Revolving Credit increased 1.0%, while the ISM Services Employment Index fell 2.6 points in June. Overall, the Index points to relatively stable investment growth over the next three to six months.



Equipment & Software Investment Annual Growth Forecast

Year-on-Year % Growth Rates

Sector	10-Year Average	Last 4 Quarters	Next 4 Quarters
Agricultural Machinery	-2.8%	-35.4%	-6 – 0%
Construction Machinery	12.6%	10.2%	7–12%
Materials Handling Equipment	2.2%	5.4%	2–6%
Other Industrial Equipment	4.2%	10.0%	6–12%
Medical Equipment	4.4%	10.3%	6–10%
Mining & Oilfield Equipment	12.5%	-11.3%	-8 – -2%
Aircraft	6.0%	20.1%	8–16%
Ships & Boats	3.3%	19.3%	8–14%
Railroad Equipment	8.5%	-12.2%	2–8%
Trucks	18.4%	14.3%	9–16%
Computers	6.4%	-1.8%	1–5%
Software	4.0%	6.5%	4–8%

Source: Macrobond Financial, Keybridge (forecasts)

U.S. Capital Investment and Credit Markets

Following a weak fourth quarter, equipment and software investment growth picked up modestly in Q1 2015. However, cuts to the energy sector and weakness in the industrial sector curbed business confidence and investment growth, and these headwinds are likely to limit capital spending again in the second quarter. We expect business confidence to improve as the economy rebounds from a disappointing Q1, which will encourage greater investment over the second half of 2015.

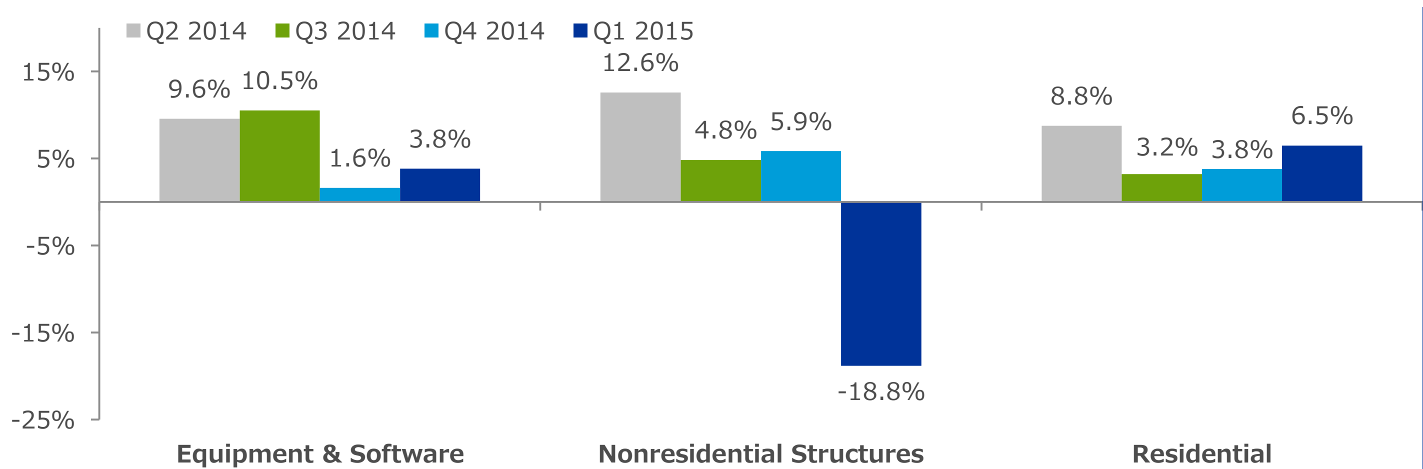
The U.S. credit system is largely healed, and credit availability and demand continue to gradually rise. The weak first quarter presented a short-term headwind to borrowing, but stronger growth over the remainder of the year should encourage greater borrowing from businesses and households in the second half of 2015. Finally, after more than six years of zero interest rates, the Fed is poised to begin raising rates this fall or winter. The first hike will likely cause some market volatility, but it may also encourage businesses and consumers to pull forward investments and lock in rates before they rise again.

Recent Trends in U.S. Capital Investment

Equipment and Software Investment growth picked up slightly to a 3.8% annual rate in Q1 2015, following modest growth of 1.6% in the fourth quarter of 2014. Growth was led by Residential Investment, which expanded 6.5%. On the down side, Investment in Nonresidential Structures plummeted 18.8% in Q1, largely because of sharp drops in energy sector investment.

Investment Growth Rates

Quarter-on-Quarter, Seasonally Adjusted Annualized Growth Rate



Source: Macrobond Financial

- **Equipment Leasing and Financing:** Despite slower equipment & software investment growth over the last two quarters, the outlook for the equipment leasing and finance industry remains generally positive (as stated in the Foundation's 2015 Outlook Q2 Update). Through May, cumulative new business volume is up 10% from 2014 levels, according to the latest ELFA Monthly Leasing and Finance Index (MLFI-25). Charge-off rates have held steady at 0.2% for 15 consecutive months, and the credit approval ratio ticked up from 78.7% April to 79.2% in May. While it is likely true that two consecutive quarters of modest business investment could be weighing on industry confidence — the Foundation Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) eased from 67.5 in May to 63.0 in June — industry executives are

nonetheless optimistic about the rest of 2015, as no respondents predicted a decline in either business conditions or demand.

- **Equipment Verticals:** Out of the 12 equipment software verticals tracked by the Foundation, Construction investment increased at the fastest rate, surging at an annualized rate of 39% in the first quarter. On the other side of the ledger is Railroad Investment, which fell sharply at a 56% annualized rate. Other key movements included the fifth consecutive quarter of negative growth for Agricultural investment and a 32% contraction in Computer investment.
- **Other Factors:** The weak industrial core has held back business investment and expansion. Capacity utilization (a key measure of industrial activity) has declined for six straight months and, at 78.1%, is more than two percentage points below its historical average. On the other hand, the propensity to finance equipment continues to gradually rise. Combined with positive new business volume data, these steady increases in the propensity to finance suggest that the equipment finance industry remains on relatively solid footing — despite weakness in other parts of the economy.

Recent Trends in Credit Markets

A rash of soft data hurt business confidence in the first quarter and may have temporarily reduced businesses' demand for credit. For the most part, however, credit supply and demand continue to gradually improve, and financial stress remains subdued. More recent data suggests that the economy should bounce back from a weak first quarter, which in turn should spur businesses and consumers to increase their borrowing. Moreover, with less uncertainty related to domestic policies and geopolitical risks than we have typically experienced recently, a steadily improving economy should be the foundation for a healthy U.S. credit system.

Summary of Credit Conditions

Factor	Conditions Compared With Last Quarter
Supply	Little Change
Demand	Little Change
Financial Stress	Little Change

- **Credit Supply & Pricing:** The supply of credit continues to gradually improve. In the April Fed Loan Officer Survey, banks reported little change in lending standards for commercial and industrial ("C&I") loans, a slight easing of mortgage standards, and little change in standards on consumer loans.
- **Credit Demand:** Business lending continues to increase, yet recent data point to mixed trends in credit demand. Specifically, C&I loans increased 0.8% in May and are up 12.1% year-on-year, but the latest Fed Loan Officer Survey showed mixed responses on demand for C&I loans. The mixed data are in part due to differences between small business and large corporations. Specifically, the recent pickup in activity among small businesses could increase the demand for credit in the coming months. The PayNet/Thomson Reuters Small Business Lending Index ("SBLI") jumped 11 points to an all-time high in April before moderating in June, while the NFIB Small Business Optimization Index hit a six-month high in May. However, large businesses have expressed less confidence about their investment plans. The Business Roundtable CEO Economic Outlook Index fell 9.5 points to 81.3 in Q2 2015, while CEOs' capital spending expectations saw their largest drop in nearly two years.
- **Financial Stress:** An improving economy, continued job growth, and income gains are keeping financial stress in check and encouraging greater borrowing from businesses and households. Both the Kansas City and St. Louis Fed Financial Stress Indices remain below their historical average, indicating that financial stress remains subdued. Further, the

delinquency rates for both business leases and loans were unchanged in the first quarter and remain at historically low levels.

- **Other Factors:** As expected in the Q2 2015 Outlook, 10-year Treasury yields have generally increased in the second quarter and are now hovering near 2.4%. As the economy strengthens over the remainder of 2015, yields should continue to gradually increase. However, several uncertainties — including a potential Greek debt default and the timing of the first Fed interest rate increase since 2006 — could impact U.S. Treasuries in the coming months. A Greek default could disrupt global markets, which would likely drive 10-year Treasury yields back down as investors "flock to safety." Absent such a market shock, we expect treasuries to move in step with the federal funds rate, which translates into steady increases if the Fed begins raising rates in 2015, as expected.

Update on Fed Policy

The Federal Open Market Committee ("FOMC"), the Fed's policymaking committee, kept interest rates at zero in June, as negative growth in the first quarter derailed hopes of a robust economic expansion this year. Fed officials, however, expected growth to strengthen in the second quarter, and 15 out of 17 officials projected that rates will rise by the end of 2015. In light of recent trends in economic data, we expect the Fed to begin raising rates in September — particularly if the industrial core picks up this summer and Q2 GDP increases at a decent clip of 2.5% or higher. Given the gradual path of Fed officials' interest rate projections, however, we expect the Fed to keep rates steady at its October meeting before raising them another notch in December. Going forward, as indicated by Fed officials' projections, we expect rates to increase gradually — meaning that interest rate policy will remain accommodative for the foreseeable future.

Consequences of a Fed interest rate hike include increased market volatility, potential declines in the stock market, and further appreciation of the dollar — all of which could cause economic pain in the short term. However, a rate increase could potentially increase investment and housing activity in the coming months if households and businesses pull forward borrowing decisions they have long postponed due to the expectation that rates would remain low. Indeed, the first rate increase could be the shot in the arm needed to finally "pull the trigger" on major investment decisions in order to lock in the current rate before the Fed raises rates further.

OVERVIEW OF THE U.S. ECONOMY

After 2.2% growth in the fourth quarter of 2014, the U.S. economy contracted 0.2% in Q1 2015. Mirroring 2014, a weak first quarter will hold back annual growth in 2015. The slowdown reflected weakness across multiple sectors; consumer spending decelerated, while net exports, government spending, and business investment were all drags on growth. However, the factors hurting Q1 growth were mostly transitory, and a rebound is expected in the second quarter. At the same time, the labor market is still a bright spot, as job gains accelerated to 254,000 and 223,000 in May and June, respectively. Moreover, inflation remains muted and was flat year-on-year in May, yet prices are showing signs of slowly picking up.

The still-struggling manufacturing and energy sectors are the primary headwinds to growth, and the strong dollar could inflict more damage to exports. Conversely, the labor market is on solid footing, housing is gaining momentum, and consumer spending is improving; these positive trends should fuel faster growth for the rest of 2015.

Overall, we expect growth to be 2.6% in 2015 — in line with (or slightly above) consensus estimates.

Recent Trends in the U.S. Economy

Several factors were responsible for sub-zero growth in the first quarter, and this terrible start to 2015 makes it nearly impossible for the U.S. economy to achieve breakout growth this year of 3% or greater. Meanwhile, inflation has bottomed out and will begin to increase as energy prices slowly rise.

Indicator	Recent Activity
Consumption	Consumer spending grew 2.1%, down from 4.4% in Q4
Equipment & Software Investment	Equipment & Software Investment increased a modest 3.8%, up from 1.6% in Q4
Residential Investment	Residential Investment growth picked up to 6.5%
Government Expenditures	Government expenditures decreased 0.6%, the second consecutive contraction
Net Exports	Exports dropped 5.6%, and Imports jumped 7.1%

- **Q1 GDP:** The U.S. economy declined 0.2% in the first quarter of 2015, as a mix of temporary factors — including harsh winter weather on the East Coast, a port strike on the West Coast, and a strong dollar that harmed exports — cut into growth. Consumer spending increased 2.1% yet decelerated from Q4's 4.4% growth rate (which was an 8-year high). Other positive contributions came from residential investment (6.5% expansion) and change in inventories (0.45 percentage point increase relative to Q4). Meanwhile, business investment, net exports, and government spending all declined in the first quarter. An 18.8% drop in structures investment — driven by a sharp decline in oil drilling activity — caused business investment to decrease 2.0%. A large drop in exports and an increase in imports caused net exports to cut 1.89 percentage points from growth, which is the largest quarterly drag on growth due to net exports in three decades. Finally, state & local government spending fell 1.0%, while federal government spending was flat.
- **Inflation:** After low oil prices and a strong dollar slowed price growth in the second half of 2014, we are now seeing signs of modest inflationary pressures. The Consumer Price Index ("CPI") has now increased for four consecutive months, and,

at 0.4%, May's increase marked the largest monthly gain since February 2013. While CPI was unchanged on a year-over-year basis in May, we expect inflation to gradually move towards the Fed's 2% target over the remainder of 2015. Core CPI — which excludes the volatile food and energy components — also points to modest inflation. Core CPI rose 0.1% in May and is up 1.7% year-on-year.

Looking ahead, key factors to watch will be: (1) the trajectory of oil prices, (2) the strength of the dollar, which exerts downward pressure on import prices, and (3) wage growth, which is showing some signs of a pick-up. Both oil prices and the U.S. dollar now seem to be stabilizing, which adds to inflationary pressures.

- **Growth Forecasts:** The June Economist Poll of Forecasters calls for 2.3% GDP growth in 2015, down from the 2.6% average forecast in May. The Federal Reserve's June "central tendency" forecast for growth is in the range of 1.8% to 2.0%, a shift down from its March 2.3 – 2.7% projection.

Economic Tailwinds

Despite a bad start in the first quarter, a strong labor market points to solid economic fundamentals, and recent pick-ups in consumer spending, housing activity, and wages suggest that growth will rebound over the rest of 2015.

- **Labor Market:** The stronger labor market has remained a key growth driver this year (as it was in 2014), as evidenced by a variety of indicators. First, despite March's slower job growth of 119,000 net jobs, April (187,000), May (254,000), and June (223,000) put the economy back on track with solid employment gains. Second, initial unemployment claims have remained below 300,000 for 16 straight weeks, signaling that businesses are looking to expand. Finally, job openings reached an all-time record of 5.4 million in April and sustained this elevated level in May — high enough to signal that not only are businesses increasing their hiring, but they may also need to raise wages in order to attract top candidates. As states in previous outlooks, solid job growth is the primary driver of higher incomes and improved consumer confidence and spending.
- **Consumer Spending:** Consumer cautiousness limited growth in the first quarter, as extra income from low gas prices failed to translate into increased spending. However, the lack of a Q1 bounce in consumer spending after several months of plummeting gasoline prices could have been due in part to a lagged response time, as recent data suggest the positive effects of fuel savings are starting to materialize. For example, retail sales jumped 1.2% in May, and real personal consumption expenditures increased 0.6%. Moreover, auto sales accelerated to a 17.8 million annual rate in May — a 10-year high — and consumer revolving credit (which primarily consists of credit card spending) increased 11.6% in April, its second fastest rate since 2007. Consumer spending accounts for roughly two-thirds of GDP, and as such, an improved consumer outlook should translate into faster growth over the rest of the year.
- **Housing Recovery:** A housing rebound may be finally taking hold, and after years of stagnancy, housing could contribute positively to growth in 2015. Existing home sales increased 5.1% in May to return to pre-recession levels, and housing permits hit an eight-year high. In addition, the June Housing Market Index published by the National Association of Home Builders reported record confidence, and household formation accelerated at the end of 2014. As home prices continue to climb, the housing recovery, if sustained, would help boost consumers' wealth, confidence, and spending.
- **Wage Growth**: For months, wage growth failed to accompany strong job gains. However, recent data suggest that a tightening labor market may finally be pushing up wages. The Employment Cost Index was up 2.6% year-on-year in the

first quarter, the fastest pace since 2008. Average hourly earnings, however, have been more mixed; May earnings were up 2.3% from a year prior — the fastest year-on-year growth in four years — but growth slipped to 2.0% in June.

Economic Headwinds

Several trends that were responsible for the GDP contraction in the first quarter have lingered into Q2. While we expect these headwinds to ease in coming months, they remain potential obstacles to growth. Specifically:

- **Manufacturing Weakness:** Several factors — including the strong dollar and the disruptive West Coast Port strikes — hurt U.S. manufacturers' competitiveness and dampened exports earlier this year. Manufacturing data remained soft in the second quarter, and as of May, industrial production has declined or flat-lined for six consecutive months — a highly unusual occurrence that typically only occurs during a recession. Additionally, new orders of durable goods fell 2.2% in May, the third decline in four months and evidence that businesses are still spending cautiously. However, some indicators are showing signs of turning around, including the ISM Manufacturing Index (which ticked up in both May and June after six months of negative or flat growth) and the Philadelphia Fed's Manufacturing Outlook (which reported improved manufacturing activity in June).

- **Energy Sector:** Tumbling oil prices spurred sharp cutbacks in energy sector investment, which has dragged down overall business investment and manufacturing activity over the last six months. According to Baker Hughes, the oil rig count has plummeted 60% since last October, a truly staggering pullback in just a few short months. Similarly, industrial production for oil & gas drilling fell by half from September to May, and reduced investment in oil rigs and wells caused business investment in structures to contract nearly 20% in the first quarter. Looking forward, gradual increases in the price of oil should quell panic in the energy industry and allow investment to slowly recover. Since falling to around $43 in March, the WTI crude oil price rebounded back to the $60 range at the end of June before moderating in early July.

Additional Factors to Watch

In addition to the major themes impacting the economy in 2015, there are several other trends to watch. The three wild cards described below have the potential to sway growth this year:

- **Strong Dollar:** While a strong dollar reflects the relative strength of the U.S. economy compared to the rest of the world, it also makes exports more expensive to foreign consumers — harming competitiveness of the already-reeling U.S. manufacturing sector. The dollar appreciated 26% between June 2014 and March 2015, which was a significant contributor to the first quarter's extraordinarily weak net exports figure (the worst in over 30 years). Although the dollar has fallen 4% from its March high, it remains up 20% year-on-year and could be a continued headwind to U.S. exports.

- **Global Economy:** A divergence between major economic players makes the global economy a trend to watch this year. Europe is finally gaining momentum, as Eurozone GDP expanded 0.4% in Q1 (the fastest rate in nearly two years) and manufacturing PMI's have steadily improved in recent months. On the other hand, China's economic growth continues to slow as the economy transitions from investment-led to consumer-led growth. First quarter growth decelerated to 7.0%, the slowest rate in six years, while exports slipped 2.5% year-on-year in May, the third straight decline. Overall, if growth in Europe stagnates and China's economy continues to struggle relative to historical levels, the global economy would present a major challenge to U.S. growth, particularly for exports.

- **Greek Default:** Following the breakdown of negotiations between Greece and its creditors (the IMF, Eurozone countries, and the European Central Bank), Greece failed to make its June 30th payment to the IMF and rejected a new bailout proposal in a July 5th referendum. Now, Greece has until July 12th to avoid bankruptcy, increasing the likelihood of a Greek debt default and potential exit from the Eurozone. Consequences of default range from social unrest and financial market panic to dampened confidence in the Euro and a precedent for future exits from the Eurozone.

Projections for Key Economic Indicators

Indicator	2013	2014	2015 Quarterly Estimates				2015e
			Q1	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	2.2%	2.4%	-0.2%	3.4%	3.6%	3.4%	2.6%
Real Investment in Equipment & Software (SAAR %)	4.2%	5.8%	3.8%	4.2%	5.8%	5.6%	5.0%
Inflation (year-on-year %)	1.5%	1.6%	-0.1%	0.0%	1.3%	1.8%	0.8%
Federal Funds Target Rate (lower bound, end of period)	0.00%	0.00%	0.00%	0.00%	0.25%	0.50%	0.50%
10-year Treasury Rate (end of period)	2.9%	2.2%	1.9%	2.4%	2.7%	2.9%	2.9%
Total Payroll Growth (in thousands)	+2,331	+3,116	+586	+664	+725	+700	+2,675

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	2013				2014				2015
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Real Gross Domestic Product (SAAR %)									
GDP	2.7%	1.8%	4.5%	3.5%	-2.1%	4.6%	5.0%	2.2%	-0.2%
Consumer Spending	3.6%	1.8%	2.0%	3.7%	1.2%	2.5%	3.2%	4.4%	2.1%
Gross Private Fixed Investment	7.6%	6.9%	16.8%	3.8%	-6.9%	19.1%	7.2%	3.7%	2.4%
Inv: Equipment & Software	5.9%	-0.9%	5.3%	11.5%	-0.4%	9.6%	10.5%	1.6%	3.8%
Inv: Agricultural Machinery	65.3%	-36.3%	-37.8%	415.4%	-66.2%	-46.9%	-60.2%	-15.3%	-2.8%
Inv: Construction Machinery	4.8%	-12.3%	-10.1%	7.4%	26.1%	-6.6%	14.0%	-0.6%	39.5%
Inv: Materials Handling Equipment	0.6%	6.9%	13.7%	7.1%	1.0%	11.4%	17.4%	-0.3%	-5.4%
Inv: All Other Industrial Equipment	2.9%	-3.2%	19.3%	-1.2%	21.3%	36.1%	32.6%	-22.0%	4.2%
Inv: Medical Equipment	10.1%	1.0%	9.6%	1.0%	5.4%	14.2%	18.3%	4.7%	4.6%
Inv: Mining & Oilfield Machinery	-44.1%	35.8%	42.8%	-7.1%	8.2%	20.9%	4.9%	-34.4%	-25.7%
Inv: Aircraft	-42.6%	-25.6%	9.4%	406.2%	-34.4%	-69.7%	334.8%	16.5%	35.6%
Inv: Ships & Boats	10.7%	-31.0%	26.1%	-5.8%	-7.5%	32.4%	42.3%	-8.0%	16.9%
Inv: Railroad Equipment	-12.2%	9.3%	-5.5%	-5.8%	31.6%	-2.0%	60.7%	-14.2%	-56.0%
Inv: Trucks	28.2%	27.5%	4.3%	15.6%	18.4%	28.2%	13.8%	-11.3%	31.7%
Inv: Computers	-12.3%	-11.7%	6.7%	25.7%	-39.0%	26.1%	11.2%	-1.8%	-32.5%
Inv: Software	9.2%	-8.1%	7.2%	3.7%	1.5%	4.3%	8.9%	5.0%	7.9%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	65.8%	66.3%	66.3%	66.2%	67.3%	67.0%	66.8%	67.7%	68.8%
Loan Delinquency Rate	1.1%	1.0%	1.0%	0.9%	0.9%	0.8%	0.8%	0.7%	0.7%
Lease Delinquency Rate	0.8%	0.9%	0.9%	0.9%	0.8%	0.7%	0.8%	0.7%	0.7%
Net Tightening of C&I Loan Standards	-7.4%	-19.1%	-18.1%	-8.3%	-13.7%	-11.1%	-10.7%	-10.5%	-5.5%

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	2014							2015					
	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
Employment													
Change in Total Payrolls (thousands)	286	249	213	250	221	423	329	201	266	119	187	254	223
Change in Private Payrolls (thousands)	272	243	209	235	218	414	319	202	261	117	189	250	223
Unemployment Rate	6.1%	6.2%	6.1%	5.9%	5.7%	5.8%	5.6%	5.7%	5.5%	5.5%	5.4%	5.5%	5.3%
Business Activity													
Industrial Production	104.1	104.5	104.5	105.2	105.1	106.3	106.2	105.9	105.8	105.8	105.3	105.1	-
Capacity Utilization	79.2%	79.3%	79.1%	79.4%	79.2%	79.8%	79.5%	79.1%	79.0%	78.8%	78.3%	78.1%	-
PMI Composite Index	55.7	56.4	58.1	56.1	57.9	57.6	55.1	53.5	52.9	51.5	51.5	52.8	53.5
NFIB Small Business Optimism Index	95.0	95.7	96.1	95.3	96.1	98.1	100.4	97.9	98.0	95.2	96.9	98.3	-
Consumer Activity													
Consumer Confidence	86.4	90.3	93.4	89.0	94.1	91.0	93.1	103.8	98.8	101.4	94.3	95.4	101.4
Personal Consumption (M/M % Chg)	0.3%	0.1%	0.7%	0.2%	0.4%	0.5%	0.1%	0.2%	0.0%	0.5%	0.0%	0.6%	-
Retail Sales (M/M % Chg)	0.4%	0.2%	0.6%	-0.3%	0.4%	0.5%	-0.9%	-0.8%	-0.5%	1.5%	0.2%	1.2%	-
Lending Activity													
C&I Loans (M/M % Chg)	0.8%	1.2%	1.0%	0.6%	0.4%	1.1%	1.1%	0.9%	1.0%	1.8%	0.9%	0.8%	-
MLFI-25 New Business Volume (Bil.$)	9.1	7.9	7.2	9.4	8.3	6.8	12.9	6.7	6.1	8.9	8.2	7.1	-
MLFI-25 Avg Losses as a % of Net Rec.	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	-
MLFI-25 Credit Approval Ratio	80.9%	80.3%	79.5%	79.7%	78.3%	79.1%	78.6%	78.6%	78.1%	78.7%	78.7%	79.2%	-
Interest Rates (% avg 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	0.10	0.11	0.11	0.11	0.10	0.13	0.21	0.20	0.22	0.25	0.23	0.24	0.28
3-Year Treasury Rate	0.90	0.97	0.93	1.05	0.88	0.96	1.06	0.90	0.99	1.02	0.87	0.98	1.07
10-Year Treasury Rate	2.60	2.54	2.42	2.53	2.30	2.33	2.21	1.88	1.98	2.04	1.94	2.20	2.36
30-Year Treasury Rate	3.42	3.33	3.20	3.26	3.04	3.04	2.83	2.46	2.57	2.63	2.59	2.96	3.11
AAA Corporate Bond Yield	4.25	4.16	4.08	4.11	3.92	3.92	3.79	3.46	3.61	3.64	3.52	3.98	4.19
BAA Corporate Bond Yield	4.80	4.73	4.69	4.80	4.69	4.79	4.74	4.45	4.51	4.54	4.48	4.89	5.13
Prices													
Headline Inflation (Y/Y % Chg)	2.1%	2.0%	1.7%	1.7%	1.7%	1.3%	0.8%	-0.1%	0.0%	-0.1%	-0.2%	0.0%	-
Core Inflation (Y/Y % Chg)	1.9%	1.9%	1.7%	1.7%	1.8%	1.7%	1.6%	1.6%	1.7%	1.8%	1.8%	1.7%	-
Oil Price (West Texas Int., $/barrel)	106.07	98.23	97.86	91.17	80.53	65.94	53.45	47.79	49.84	47.72	59.62	60.25	59.48

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 Q3 report is the second update to the 2015 Annual Outlook, and will be followed by one more quarterly updates in 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

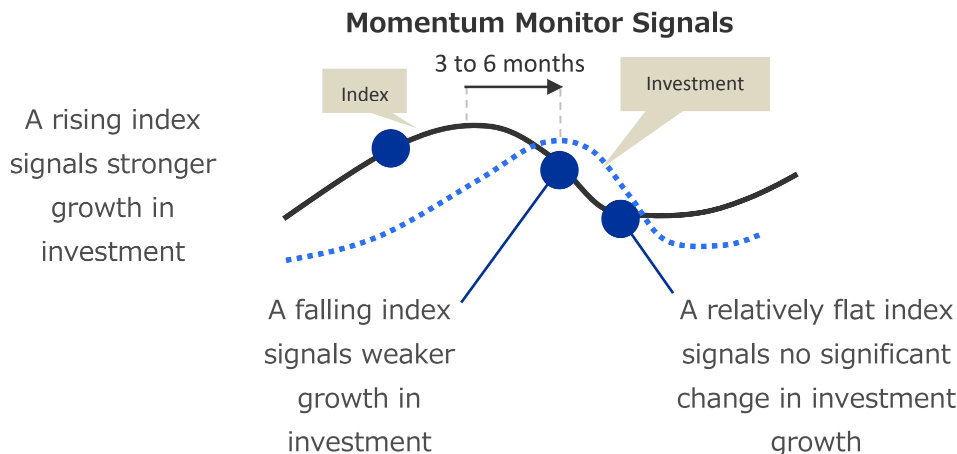
Business leaders require actionable forward-looking intelligence to make strategic decisions. Accordingly, the Foundation commissioned Keybridge LLC to develop a series of custom leading indicators for the equipment sector. The Foundation-Keybridge Equipment & Software Investment Momentum Monitor consists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

HOW TO READ THE MOMENTUM MONITOR

Each Momentum Monitor index provides a signal of the direction and magnitude of growth in equipment investment over the next 3 to 6 months. It is important to note that index values do not correspond to particular growth rates. Instead, the Momentum Monitor indices should be interpreted within the context of prior index readings and investment growth rates. For example, there are several simple rules to follow when examining the latest index values:

1. A rising index signals that growth in investment will accelerate from the current rate;
2. A falling index signals that growth in investment will decelerate from the current rate; and
3. No change in the index signals no meaningful change from the current growth rate.



To help the reader interpret the latest Momentum Monitor signals, a summary report for each equipment vertical follows a specific outline:

Materials Handling Equipment:
(1) Investment in Materials Handling Machinery inched up at a 0.3% annualized rate in Q4 2014 and is up 7.3% year-over-year. The Materials Handl (2) Momentum Index slipped from 93.5 in February to 92.5 in March. A 23% decline in the MNI-Chicago Business Barometer and a spike in Economic Policy Uncertainty offset gains in Machinery Sales, Manufacturing Sales, and the ISM Manufacturing Suppliers Deliveries Index. (4) The Index's recent trend continues to indicate that growth may moderate over the next three to six months.

(1) The first sentence reports the latest growth rate for investment in a given vertical. This provides a context for interpreting the order of magnitude of growth over the next 3 to 6 months.

(2) The second sentence explains the latest movement in the index, indicating whether momentum is accelerating or decelerating.

(3) The report then describes the specific indicators driving the latest index value. This allows readers to understand the key drivers of the outlook.

(4) Finally, the report ends with an interpretation of where investment growth is heading over the next 3 to 6 months.

ABOUT KEYBRIDGE

Keybridge is a public policy economics 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. Keybridge's experience and expertise make it 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 clients' 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.

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