Q4 update - October

2014 Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future

EQUIPMENT LEASING & FINANCE

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Your Eye on the Future

Celebrating 25 Years

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, new for 2014, 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 Q4 report is the third and final update to the 2014 Annual Outlook, and will be followed by the 2015 Annual Outlook in December. 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

The U.S. economy grew at a 4.6% annual rate in the second quarter of 2014, as businesses and consumers caught up on foregone spending during the harsh winter. The Q2 gains were broadly dispersed; consumer spending, business investment, housing, and government spending all contributed positively to growth. At just 142,000, August job growth fell below expectations; however, the solid labor market gains seen earlier this year still point to a rapidly mending labor market. Meanwhile, year-on-year inflation moderated in August to 1.7%, down from July's 2.0%. Overall, the economy appears to be exhibiting gradually improving health, although serious headwinds remain.

Following a largely weather-induced contraction in the first quarter, nearly every sector contributed to second quarter growth. The biggest contributions came from consumer spending (1.75 percentage points) and the change in private inventories (1.4 percentage points), which had dragged down growth by nearly 1.2 percentage points in the previous quarter. Additionally, while net exports trimmed growth in Q2 due to higher imports, an 11.1% bounce-back in exports was welcome news. July's trade report pointed to continued export growth, as the trade gap narrowed to a six-month low. The consumer outlook for Q3 is more mixed, as real consumer spending slipped 0.2% in July but retail sales increased 0.6% in August. Looking ahead, overall growth in 2014 will remain stuck in the low 2 percent range — held back by the Q1 contraction.

Overall, we expect solid growth over the second half of the year, while the Q1 contraction will limit 2014 growth to 2.2%.

Growth in equipment and software investment rebounded from a 0.4% contraction in Q1 2014 to expanding 9.6% in Q2. Looking ahead, we expect continued growth in Q3 as shipments of durable goods accelerated in July and August, with an overall forecast of 5.5% growth in 2014. Our outlook for individual equipment and software verticals remains mixed:

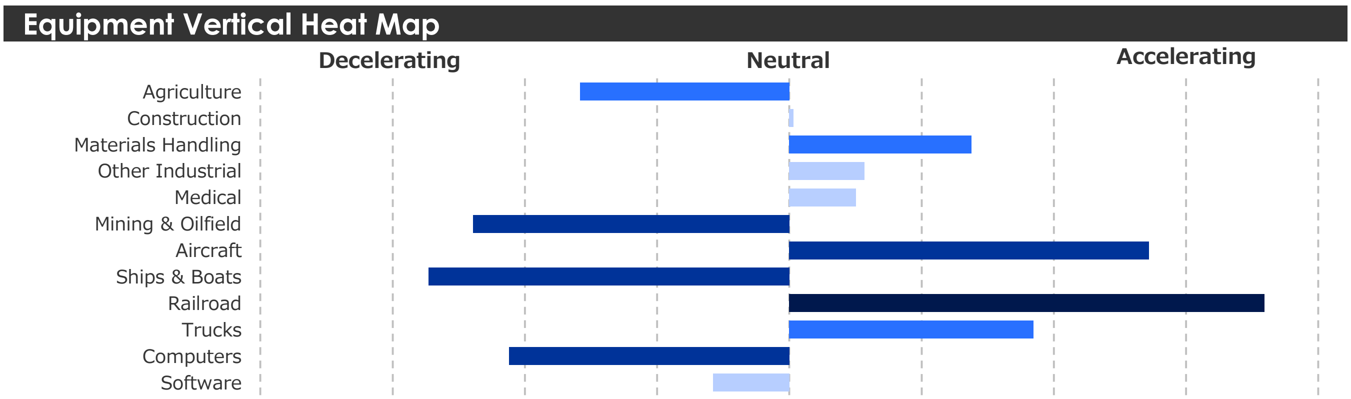
- Agriculture Machinery investment will likely see year-on-year contraction through the rest of 2014, as both farm yields and commodity prices remain modest.
- Construction Machinery investment is expected to experience moderate growth over the next 2 quarters.
- Materials Handling Equipment investment will likely experience stronger growth over the next 3 to 6 months.
- All Other Industrial Equipment investment will likely see continued solid growth over the next 3 to 6 months as the "re-shoring" of manufacturing continues to be a dominant economic story in 2014.
- Medical Equipment investment is expected to experience slowing growth near the end of the year.
- Mining & Oilfield Machinery will likely see slower growth following a strong first half of 2014.
- Aircraft investment will likely experience stronger growth towards the end of year.
- Ships & Boats investment will likely slow after rebounding solidly in Q2 2014.
- Railroad Equipment investment is likely to accelerate over the next 3 to 6 months.
- Investment in Trucks is expected to exhibit modest growth through the year, reflecting improved economic conditions.
- Computers investment will likely remain muted following strong replacement demand seen in recent quarters.
- Software investment will likely see continued moderate growth in the next 3 to 6 months as companies continue to make investments in software and cloud technologies.

Credit market conditions remain highly accommodative, and the Federal Reserve has laid out a plan to gradually raise interest rates, likely beginning sometime in 2015. With the Fed's bond-buying program ("QE3") all but certain to conclude in October, the timing of the first interest rate hike is now the central debate within the Fed, along with the added question mark of how and when the Fed will shrink its massive balance sheet. Fed policy uncertainty has largely been a non-factor in 2014, and this trend is expected to continue — but worsening geopolitical risks could increase both uncertainty and market volatility. Overall, demand replacement, rather than expansions, continues to drive most equipment investment.

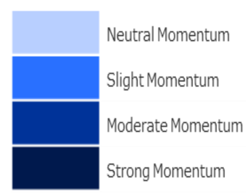
EQUIPMENT & SOFTWARE INVESTMENT OUTLOOK

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

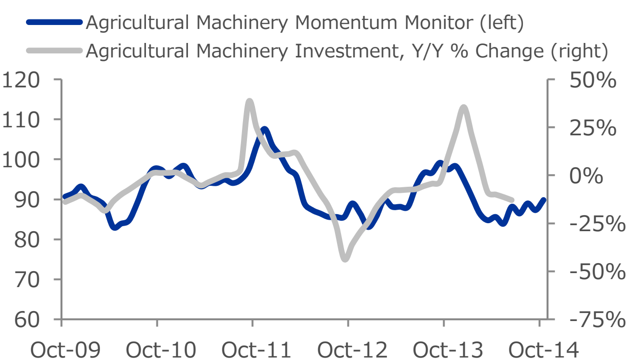
Equipment and software investment increased at a 9.6% annualized rate in Q2 2014 after slipping 0.4% in the first quarter. The increase marks a “bounce back” from the harsh winter weather in Q1 and also reflects improving underlying economic fundamentals and reduced policy uncertainty. Continued improvements in the economy are likely to boost capital spending over the next few months, and overall we expect equipment and software investment to grow 5.5% in 2014 as economic conditions solidify and business confidence continues to recover. However, geopolitical risks are a wild card in the equipment and software investment outlook and have the potential to undermine confidence and halt investment if situations in volatile areas around the globe worsen in the coming months.



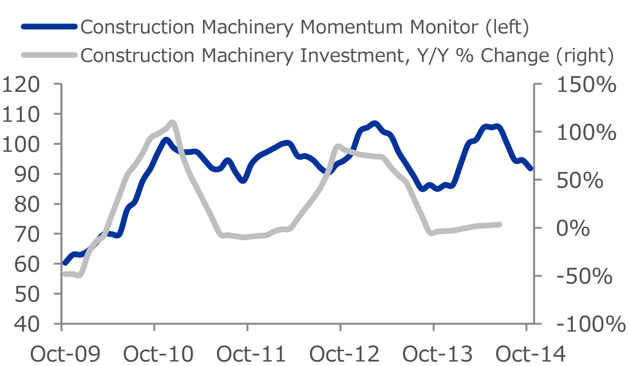
The Equipment Vertical Heat Map summarizes the latest movements in each of the 12 Equipment & Software Investment Momentum Indices. Verticals exhibiting strong recent momentum are shaded darker, while verticals exhibiting weak recent momentum are shaded lighter. The heat map provides a snapshot of the expected trends in equipment & software investment over the next 3 to 6 months. Note that trends in equipment financing activity may differ from overall investment volumes. The legend to the right provides an interpretation of the heat map color-coding.



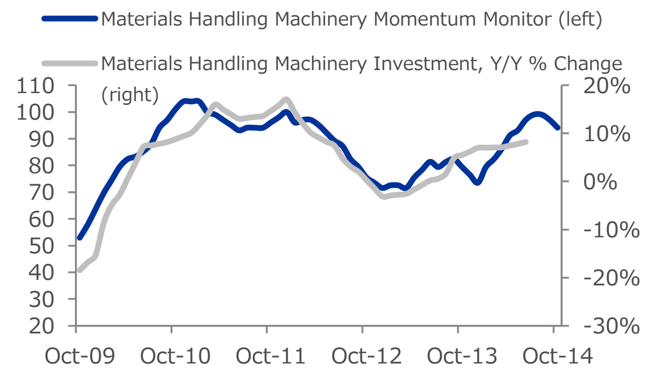
Agricultural Machinery: Investment in Agriculture Machinery contracted at an annualized rate of 47.0% in Q2 2014 and is down 12.9% from one year ago. This downturn was anticipated by a decline in the Momentum Index from Q4 2013 to Q1 2014. Recently, the Index increased from 87.3 (revised) in September to 89.8 in October. While a decline in Farm Machinery Shipments weighed on the Index, a surge in both Cattle and Broiler Exports were positive offsets. Overall, while the Index remains subdued, its mild upward trend points to a continued contraction in investment over the next three to six months.



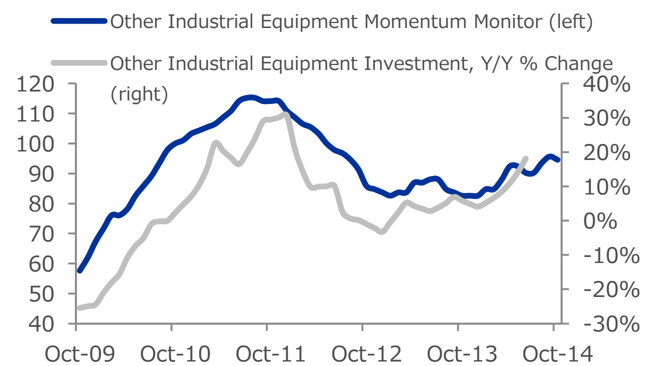
Construction Machinery: Investment in Construction Machinery decreased at a 6.1% annualized rate in Q2 2014, yet is up 3.4% year-over-year. The Construction Momentum Index decreased from 94.5 (revised) in September to 91.8 in October. While Consumer Sentiment increased hit a fourteen-month high in September, Housing Starts dropped 14.4%. Overall, the Index’s recent movement suggests that growth could enter a new “mini cycle” of expansion and moderation over the next 6 months.



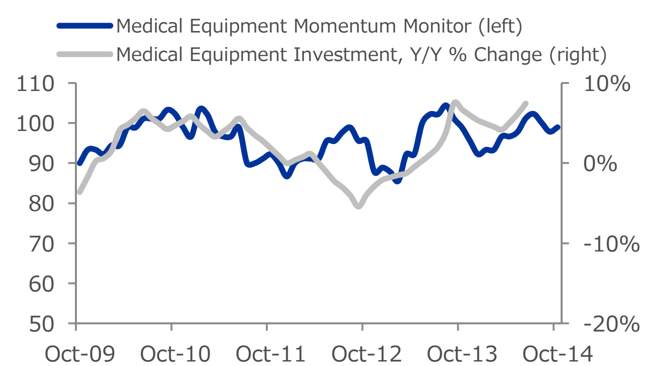
Materials Handling Equipment: Investment in Materials Handling Machinery increased at an 11.4% annualized rate in Q2 2014 and is now up 8.2% year-over-year. The Materials Handling Momentum Index fell from 97.1 (revised) in September to 94.1 in October. While the Chicago Business Barometer rebounded sharply in August, slight declines in Industrial Production, the ZEW Survey, and the Manufacturing Supplier Deliveries Index pulled down the Index. The Index's recent pattern indicates that growth may peak and then moderate over the next 3 to 6 months.



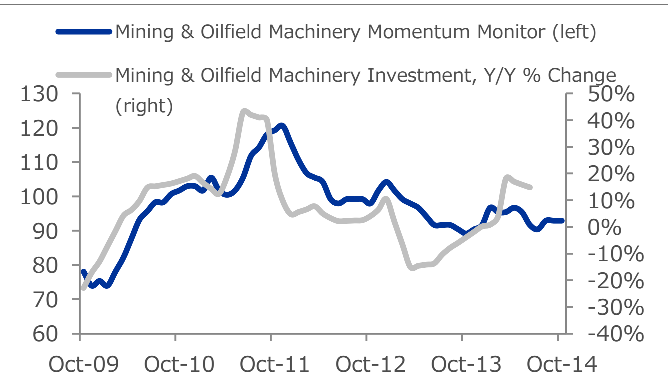
Other Industrial Equipment: Investment in all Other Industrial Equipment expanded at a 36.1% annualized rate in Q2 2014, the fastest rate in a year, and is now up 18.1% year-over-year. The Other Industrial Equipment Momentum Index slipped from 95.7 (revised) in September, a two-year high, to 94.6 in October. The ISM Manufacturing Index hit a three-year high in August, yet Industrial Supplies Exports fell 5.3% and Machinery Industrial Production growth moderated. Overall, the Index's recent movement suggests that growth will remain strong but moderate slightly.



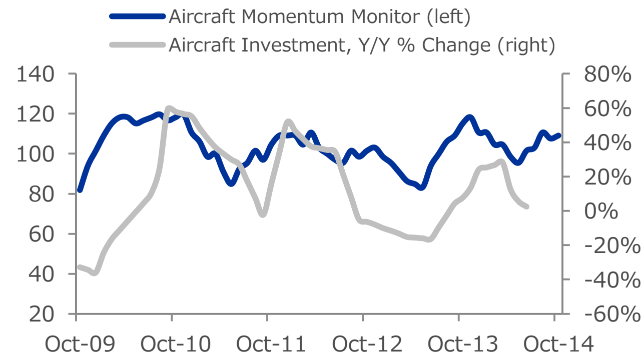
Medical Equipment: Investment in Medical Equipment increased at a 14.3% annualized rate in Q2 2014 and is now up 7.5% year-over-year. The Medical Equipment Momentum Index ticked up from 97.9 (revised) in September to 99.0 in October. Medicaid Personal Transfer Receipts increased 1.4% in July, while Social Security Disability Benefits rebounded 7.3% in August. However, the CPI for Physicians' Services plunged in August, the third consecutive decline, and Federal Health Outlays were down nearly 20% in August. Overall, the Index continues to suggest that growth in medical equipment investment will slow over the next three to six months.



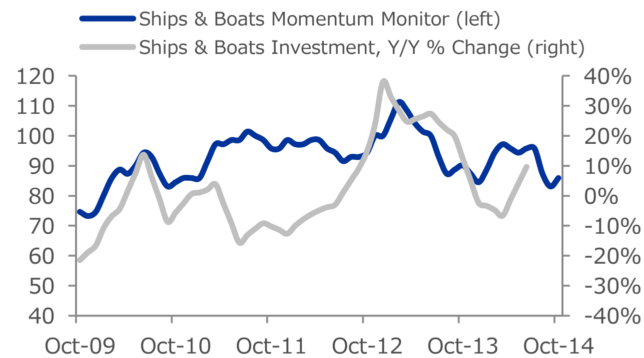
Mining & Oilfield Machinery: Investment in Mining & Oilfield Machinery increased at a 21.0% annualized rate in Q2 2014 and is now up 14.8% year-over-year. The Mining & Oilfield Machinery Momentum Index was unchanged at 92.9 (revised) from September to October. An increase in the ISM Index for Manufacturing balanced out declines in Natural Gas Industrial Production and Unfilled Orders for Mining, Oil Field, & Gas Machinery. Overall, the Index continues to suggest that investment will moderate over the next three to six months.



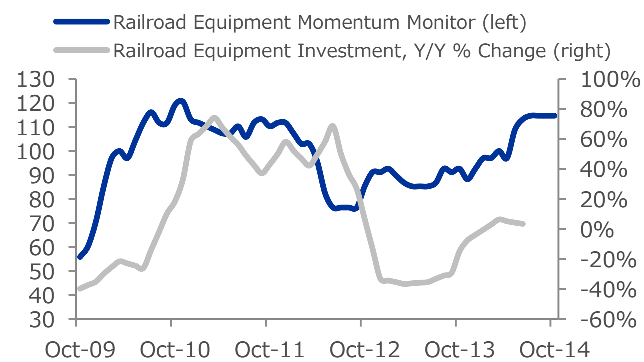
Aircraft: Investment in Aircraft contracted sharply at a 69.7% annualized rate in Q2 2014, yet is still up 2.5% on a year-over-year basis. The Aircraft Momentum Index increased from 107.6 (revised) in September to 109.1 in October. The Freight Transportation Services Index and the Economic Policy Uncertainty Index declined for the third straight month, yet the ISM Nonmanufacturing New Orders Index fell in August. Overall, the Index suggests moderately accelerating investment in Aircraft over the next three to six months.



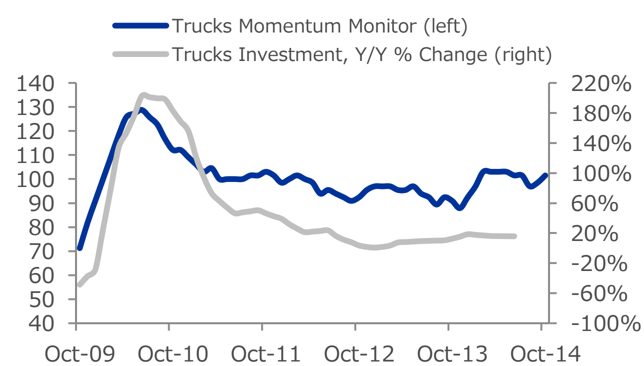
Ships & Boats: Investment in Ships & Boats rebounded at an annualized rate of 31.5% in Q2 2014 and is now up 9.6% year-over-year. The Ships & Boats Momentum Index rebounded from its four-year low in September, increasing from 83.1 (revised) to 85.9 in October. Shipments of both Mobile Homes and Ships & Boats increased 13.1% and 2.8%, respectively, yet the Change in Nonfarm Payrolls disappointed in August as just 142,000. Overall, the Index points to slower growth over the next three to six months.



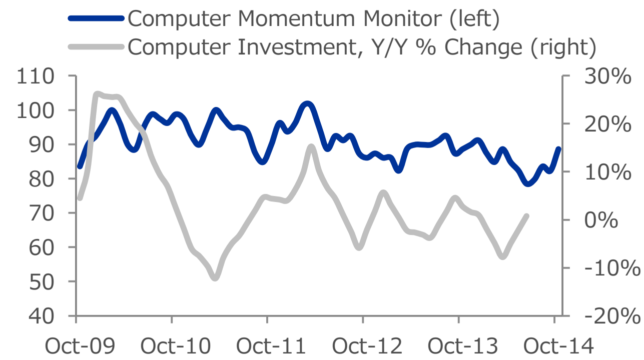
Railroad Equipment: Investment in Railroad Equipment declined at a 2.1% annualized rate in Q2 2014, but remains up 3.5% year-over-year. The Railroad Equipment Momentum Index was unchanged from its September multi-year high of 114.7 in October. Although Mining Exports jumped11.8% in July and the Unemployment Rate ticked back down to 6.1% in August, Machine Tool Orders dropped 12.6%. Overall, the Index continues to signal an acceleration of railroad equipment investment over the next three to six months.



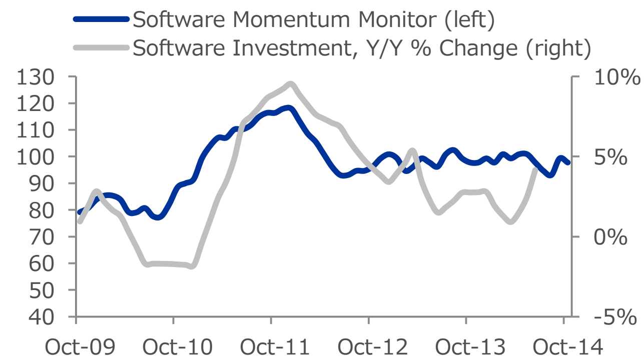
Trucks: Investment in Trucks increased at a 25.7% annualized rate in Q2 2014 and is now up 15.7% year-over-year. The Trucks Momentum Index increased from 98.5 (revised) in September to 101.5 in October. Continued gains in the ISM Manufacturing Index, a 21.8% jump in Light Trucks & Vehicle Shipments, and a 7.3% increase in New Orders of Motor Vehicle Parts & Trailers all contributed positively to the Index. Overall, the Index's recent movement indicates upward momentum in truck investment over the next three to six months.



Computers: Investment in Computers rebounded at an annualized rate of 26.1% in Q2 2014 and is up 0.8% on a year-over-year basis. The Computers Momentum Index accelerated from 82.3 (revised) in September to 88.6 in October, its highest level in seven months. Appliance, Television, and Camera Retail Sales rebounded 4.5% in July, and the Consumer Expectation Index hit a ten-month high in September. Additionally, Defense Communications Equipment Shipments surged nearly 30% in July. Overall, the movement of the Index suggests improving but still sluggish growth in computer investment over the next three to six months.



Software: Investment in Software increased at a 4.3% annualized rate in Q2 2014 and is up 4.2% year-over-year. The Software Momentum Index moderated from 99.3 (revised) in September to 97.8 in October. The ISM Nonmanufacturing Index for Employment reached its highest level since early 2006, yet Travel Services Exports and the PPI for Software Publishers both slipped. Overall, the Index points to little change in the growth rate of investment over the next three to six months.



Equipment & Software Investment Growth Forecast

Year/Year % Growth Rates

Sector	10-Year Average	2014 Q2	Next 12 Months
Agricultural Machinery	0.8%	-12.9%	-9.6%
Construction Machinery	13.2%	3.4%	7.3%
Materials Handling Equipment	2.2%	8.2%	5.8%
Other Industrial Equipment	3.3%	18.1%	16.8%
Medical Equipment	4.5%	7.5%	5.5%
Mining & Oilfield Equipment	13.4%	14.8%	5.7%
Aircraft	5.8%	2.5%	3.3%
Ships & Boats	4.1%	9.6%	1.4%
Railroad Equipment	8.8%	3.5%	8.0%
Trucks	19.3%	15.7%	24.7%
Computers	7.3%	0.8%	1.0%
Software	4.2%	4.2%	4.1%

Source: Macrobond Financial, Keybridge (forecasts)

U.S. Capital Investment and Credit Markets

Review of Recent Trends

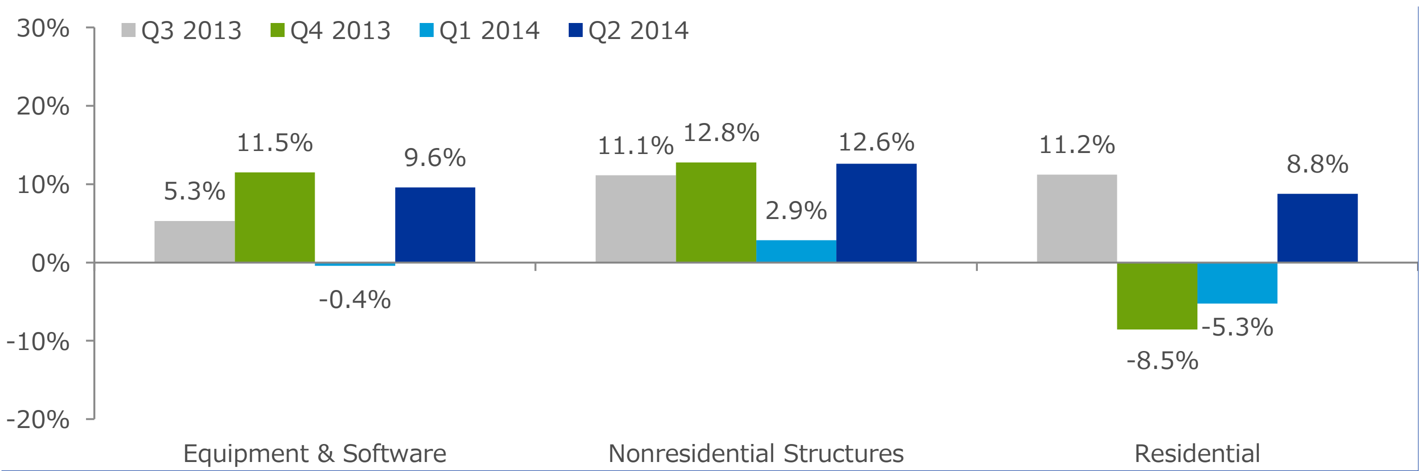
Equipment and Software Investment expanded at a 9.6% annualized rate in Q2, rebounding from a slight contraction in Q1 2014. Residential investment grew at an 8.8% annualized rate after two quarters of contracting. Investment in Nonresidential Structures increased at a 12.6% annualized rate, an acceleration from 2.9% growth in Q1.

At a 36.1% annualized rate, investment in Other Industrial Equipment expanded at the fastest rate of the major equipment and software verticals. The vertical with the fastest deceleration was Aircraft, which decreased at an annualized rate of 69.7% following a 34.4% contraction in Q1. Other key movements included a 47.0% decline in Agricultural investment and strong rebounds in Ships & Boats (31.5%) and Computer investment (26.1%).

Equipment and software, structures, and residential investment all accelerated in the second quarter following a weak Q1. Equipment and software investment is expected to steadily grow over the next 6 months across most verticals due to a gradually strengthening economy and continued replacement demand. Credit supply and demand continue to improve, and small-business lending may finally be turning around. Lastly, financial stress remains under control across multiple sectors.

Investment Growth Rates

Quarter-Quarter, Seasonally Adjusted Annualized Growth Rate



Source: Macrobond Financial

August's Equipment Leasing & Finance Association's Monthly Leasing and Financing Index (MLFI-25) reported new business volume of $7.2 billion — down 9% from July. On a cumulative year-to-date basis, however, new business volumes for 2014 are up 5.9% from 2013. At 0.2%, losses as a percentage of net receivables held steady for the fifth consecutive month, while the credit approval ratio slipped 0.8 percentage points to 79.5%. The Equipment Leasing & Finance Foundation's Monthly Confidence Index for the Equipment Finance Industry (MCI-EFI) was at 60.2 in September, up from 58.9 in August. In the latest survey, only 3% of respondents believe business conditions will worsen over the next four months, unchanged from August.

At the conclusion of its September 16-17 meeting, the Federal Open Market Committee ("FOMC"), the Fed's primary policymaking committee, announced another $10 billion "measured reduction" in its asset purchases, keeping the program on track to end in October. The Fed also noted moderate growth in economic activity yet stressed that significant slack remained in the labor force and that inflation is running below the Fed's 2% target. Despite predictions that the Fed would alter its language on interest rate policy, the Fed reiterated that it will keep interest rates low "for a considerable time" after its bond-purchasing program ends. FOMC officials' projections for the federal funds target rate confirm this approach; fourteen out of seventeen officials predict that the first interest rate hike will occur in 2015. Furthermore, in an effort to clearly communicate its plans, the Fed also released a statement on the policy normalization process yet stressed that its approach could change based on economic data.

Additionally, recent FOMC statements, minutes, and Fed official speeches point to a growing divide between “Doves” and “New Hawks.” In fact, the gradually strengthening economy is emboldening Fed “hawks,” who are growing more outspoken within the FOMC; Philadelphia Fed President Charles Plosser dissented during both the July and September FOMC meetings, while fellow hawk and Dallas Fed President Richard Fisher also dissented during the September meeting. The growing outspokenness of Fed hawks and continued economic growth could potentially cause the first interest rate hike to occur earlier than the mid-2015 timetable that markets expect. Unsurprisingly, Fed officials’ interest rate projections showed a faster pace of rate increases than seen previously. This interest rate debate, along with discussions over how and when to scale down the Fed’s massive balance sheet, is set to intensify in the coming months.

In addition to Fed policy, other key factors impacting our credit outlook include improving business confidence and loosening lending standards. Overall, business confidence has improved, while equipment replacement demand continues to drive capex across most verticals. Economic policy uncertainty remains subdued, while industry confidence has stayed relatively elevated over the past few months. Reduced policy uncertainty, along with a strengthening economy, should further boost confidence and encourage borrowing. Similarly, the economic recovery will likely lead lenders to continue loosening supply constraints, thus expanding access to credit. In a reversal of recent years’ trends, in 2014 business uncertainty has largely stemmed from geopolitical risks rather than domestic policy concerns. While conflicts in Ukraine and the Middle East have not yet caused major disruptions or plummeting confidence, these are key risks to monitor over the next several months.

Summary of Credit Conditions

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

- **Credit Supply & Pricing:** The supply of credit across multiple sectors continues to improve. The Q3 Federal Reserve survey of banks’ senior lending officers showed an ongoing loosening of standards for commercial and industrial (“C&I”) loans for businesses of all sizes. Despite ticking up in this month, the benchmark 10-year Treasury rate has hovered around 2.6%, suggesting that capital is likely to remain inexpensive for the foreseeable future.

- **Credit Demand:** Business investment rebounded in Q2, and other indicators point to continued growth in credit demand. The Q3 Fed survey showed a continued pick-up in loan demand, and C&I loans continue to increase, up 1.0% from year-ago levels in August. Additionally, recent data point to a turnaround in small business lending; the Thomson Reuters/PayNet Small Business Lending Index increased to its highest level in over seven years in July, while the NFIB Small Business Optimism Index has returned to 2007 levels. Larger businesses, however, signaled a slight easing in investment spending, in part due to uncertainty surrounding geopolitical risks; 39% of CEOs in the latest BRT CEO Economic Outlook Survey expected to increase capital spending over the next six months — down from 44% in Q2.

- **Financial Stress:** Cleaner balance sheets and an improving economic picture appear to be reducing financial stress, and businesses and households are growing more comfortable with borrowing. Both the FRB St. Louis and FRB Kansas Financial Stress Indices are hovering near all-time lows. For households, the financial obligation ratio ticked down in Q1 and remains near historical lows. Similarly, for businesses, the lease delinquency rate fell further to 0.7% in Q2, down 11 basis points from the prior quarter. Corporate bond yields continue to decline from their peaks in late 2013, and the spread between corporate grade and treasuries remains narrow.

In a continuation of recent trends, demand for U.S. Treasuries has stayed strong, keeping the 10-year Treasury yield around 2.6%. As noted in last quarter’s outlook, uncertainty surrounding geopolitical risk – particularly in Ukraine and the Middle East – and Fed policy is keeping U.S. government debt attractive. However, 5- and 10-year Treasury yields have recently begun to tick up. Overall, we see improving economic fundamentals increasing investment and financing activity through the end of the year.

OVERVIEW OF THE U.S. ECONOMY

The U.S. economy grew at a 4.6% annual rate in the second quarter of 2014, as disruptions caused by harsh winter weather gradually faded. The Q2 gains were broadly dispersed; consumer spending, business investment, housing, and government spending all contributed to growth. At just 142,000, August job growth fell below expectations; however, the solid labor market gains seen earlier this year still point to a rapidly mending labor market. Meanwhile, year-on-year inflation moderated in August to 1.7%, down from July's 2.0%. Overall, the economy appears to be exhibiting gradually improving health, although serious headwinds remain.

Following a largely weather-induced contraction in the first quarter, nearly every sector contributed to second quarter growth. The biggest contributions came from consumer spending (1.75 percentage points) and the change in private inventories (1.4 percentage points), which had dragged down growth by nearly 1.2 percentage points in the previous quarter. Additionally, while net exports trimmed growth in Q2 due to higher imports, an 11.1% bounce-back in exports was welcome news. July's trade report pointed to continued export growth, as the trade gap narrowed to a six-month low. The consumer outlook for Q3 is more mixed, as real consumer spending slipped 0.2% in July but retail sales increased 0.6% in August. Looking ahead, overall growth in 2014 will likely hover around 2.2% — held back by the Q1 contraction.

The September average of the Economist Poll of Forecasters for 2014 GDP growth was unchanged from August at 2.0%, while the Federal Reserve's most recent "central tendency" forecast for growth is in the range of 2.0% to 2.2% — a slight downward revision from the Fed's June 2014 forecast.

Overall, we expect solid growth over the second half of the year, while the Q1 contraction will limit 2014 growth to 2.2%.

Indicator	Recent Activity
Consumption	Consumer spending expanded at a 2.5% pace, led by durable good purchases
Equipment & Software Investment	Equipment & Software Investment rebounded 9.6% in Q2, the second strongest growth rate in over two years
Residential Investment	Residential Investment grew at a 8.8% rate after declining for two-straight quarters
Government Expenditures	Government expenditures increased 1.7% in Q2, driven by greater state and local government spending
Net Exports	Exports rebounded sharply in Q2, while Import growth accelerated from Q1

After reaching 2.1% in May, Headline CPI inflation has since moderated, a boost to Fed Chair Janet Yellen and other Fed "Doves" who have argued that inflation is not a current risk. Headline CPI inflation fell 0.2% in August — the first monthly decline since April 2013 — to 1.7%, driven by significant drops in energy prices. In particular, gasoline prices decreased 4.1% in August, reflecting this summer's declining oil prices. Furthermore, the personal consumption expenditures ("PCE") price index — the Fed's preferred inflation gauge — was up only 1.5% year-over-year in August, further evidence that inflation worries will not lead the Fed to change their policy stance. Looking ahead, an escalation of the conflicts in Ukraine or the Middle East could cause energy prices to spike, reversing recent declines and pushing up inflation. Currently, however, the Fed is showing little concern over possible inflation pressures; in their September projections, Fed officials expect inflation to remain below their 2% target through 2017 and even slightly lowered their inflation expectation for 2015.

A solidifying economic recovery, downside risks stemming from geopolitical conflict, and continued accommodative monetary policy are key trends dictating our outlook for 2014.

Most economic data of the past few months has been quite strong, let by a general solidification in the industrial sector. Industrial production rose for six consecutive months through July, while manufacturing output jumped 0.7% in July, highlighting the sector as a strong performer in 2014. Additionally, auto sales surged to a 17.5 million annualized rate in August, a nine-year high. Finally, both the ISM Manufacturing and Non-Manufacturing Indexes hit multi-year highs in August, further suggesting improved confidence and expansion. However, August's industrial production report highlighted the unevenness of the recovery; industrial production dipped 0.1%, and manufacturing output fell 0.4%.

- **Labor Market:** Recent labor market indicators have also weakened, yet the labor market continues to be a source of strength overall. The August employment report posted job gains of only 142,000, well-below expectations and the strong gains seen earlier this spring and summer. Despite August disappointing labor market data, a slowdown in job growth is not expected. First, a food store strike in Massachusetts cut out 17,000 workers from the August jobs numbers, giving a head start to the September report. Secondly, taken in context of the solid data from April–July discussed above, the August report may be more of an outlier than a signal of weak job growth to come. In each of the sixth months from February to July, job growth surpassed 200,000 — a first since 1997. Furthermore, steady declines through the summer put initial claims for unemployment insurance back at pre-recession lows. Lastly, job openings — a key indicator of dynamism in the labor market — hit a seven-year high in July.
- **Housing Market:** The housing market continues to be a source of concern, characterized by a mix of positive and negative data. The housing recovery remains "herky-jerky," as evidenced by a largely-recovered multi-family market and a disappointing single-family market in which many households are still hesitant to purchase a home. Mixed data point to a sector struggling to gain momentum; housing starts surged 22% in July before falling 14.4% in August, while existing home sales increased and new home sales declined 2.4% in July. More recently, data has been more positive. The Housing Market Index, an indicator of builders' confidence, increased to 59 in August, its highest level since November 2005, and new home sales surged 18% in August, the largest monthly increase since 1992.
- **Consumer Spending:** Lastly, consumer spending data paints a positive picture for third quarter growth. Although real consumer spending slipped 0.1% in July, it jumped 0.5% in August — evidence that consumers are stepping up spending. August retail sales, however, brightened prospects for third quarter expansion, increasing 0.6% from July. Moreover, the Reuters/University of Michigan Consumer Sentiment Index hit a fourteen-month high in mid-September, pointing to improved confidence and spending. Oil prices, which have been trending down since late-June highs, could also free up extra consumer spending. Continued increases in income and a healing credit sector also point to an improving consumer picture. After sharp declines in the aftermath of the financial crisis, consumer credit is finally stabilizing (and, in some cases, increasing), reflecting improved confidence. Additionally, real disposable income increased 0.1% and 0.3% in July and August, which is a further indication of improving consumer fundamentals. Similarly, household net worth rose to a record-high in Q2 2014, a trend that should encourage consumers to borrow and spend. Making up two-thirds of GDP, a rebound in consumer spending could boost growth through the second half of the year.

Our sector-level analysis repeats many of the same themes as in recent quarters, but the following trends have been a useful narrative for the U.S. outlook this year:

Elections: November's midterm elections will shape policymaking in the final two years of the Obama administration, with ramifications for the 2016 presidential election. Republicans are expected to keep control of the House, and several competitive races — in Colorado, North Carolina, Iowa, Louisiana, and Kansas — are putting Democratic control of the Senate in question. Most forecasts, including those from the Washington Post, the New York Times, and the Cook Political Report, are giving a slight advantage to Republicans. While the consequences of a GOP Senate take-over are largely unknown, Republican control of both houses would likely intensify policy battles between President Obama and the GOP, potentially increasing policy uncertainty and weighing on confidence.

Strong Industrial Core: The manufacturing core is steadily improving, fueled by expansion in the industrial sector, strong auto sales, and increased competitiveness of U.S. exports. Manufacturing and industrial production expanded through most of the summer. Meanwhile, increased exports pushed the trade deficit down to a six-month low in July. Finally, at an annualized rate of 17.5 million, August auto sales were 10% above their year-earlier level.

Geopolitical Risks: Several conflicts continue to pose risks to global financial systems and confidence. With escalating tensions between Russia and the West, conflict in Syria and Iraq, and tensions between China and its neighbors in the South China Sea, there are many problems to keep business leaders up at night.

Global Growth Concerns: The European recovery continues to be stop-start, as the 18-country Eurozone grew by a meager 0.2% in the second quarter and inflation remains worryingly low. Furthermore, despite Scotland's vote to stay in the UK, the pro-independence movement, in Scotland and elsewhere in Europe, may create further economic disruptions. Data from Asia also has prompted concern; Japan's economy shrank sharply in the second quarter and it faces weak export demand abroad, while in China, lending plunged in July and industrial production slowed sharply in August. Combined, these factors could limit global demand for U.S. exports.

Projections for Key Economic Indicators

Indicator	2012	2013	2014e	2014 Quarterly Estimates			
				Q1	Q2	Q3e	Q4e
Real GDP (SAAR %)	2.3%	2.2%	2.2%	-2.1%	4.6%	3.2%	3.0%
Real Investment in Equipment & Software (SAAR %)	6.5%	4.2%	5.5%	-0.4%	9.6%	7.2%	4.1%
Inflation (annualized rate)	2.1%	1.5%	1.9%	1.5%	2.1%	1.8%	2.0%
Federal funds (effective, end of period)	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%
10-year Treasury Rate (end of period)	1.80%	2.90%	2.8%	2.7%	2.6%	2.6%	2.8%
Total Payrolls (in thousands)	+2,236	+2,331	+2,719	+569	+800	+600	+750

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	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Real Gross Domestic Product (SAAR %)									
GDP	1.6%	2.5%	0.1%	2.7%	1.8%	4.5%	3.5%	-2.1%	4.6%
Consumer Spending	1.3%	1.9%	1.9%	3.6%	1.8%	2.0%	3.7%	1.2%	2.5%
Gross Private Fixed Investment	5.8%	1.6%	-5.3%	7.6%	6.9%	16.8%	3.8%	-6.9%	19.1%
Inv: Equipment & Software	2.3%	1.0%	7.0%	5.9%	-0.9%	5.3%	11.5%	-0.4%	9.6%
Inv: Agricultural Machinery	-38.8%	-46.9%	32.8%	65.3%	-36.3%	-37.8%	415.4%	-66.2%	-47.0%
Inv: Construction Machinery	67.9%	410.8%	-0.2%	4.8%	-12.3%	-10.1%	7.4%	26.1%	-6.1%
Inv: Materials Handling Equipment	-4.4%	-5.3%	-1.1%	0.6%	6.9%	13.7%	7.1%	1.0%	11.4%
Inv: All Other Industrial Equipment	6.3%	2.0%	10.0%	2.9%	-3.2%	19.3%	-1.2%	21.3%	36.1%
Inv: Medical Equipment	-8.0%	-14.5%	9.5%	10.1%	1.0%	9.6%	1.0%	5.4%	14.3%
Inv: Mining & Oilfield Machinery	27.6%	1.2%	-27.8%	-44.1%	35.8%	42.8%	-7.1%	8.2%	21.0%
Inv: Aircraft	-21.1%	-55.0%	153.5%	-42.6%	-25.6%	9.4%	406.2%	-34.4%	-69.7%
Inv: Ships & Boats	-36.6%	61.1%	113.9%	10.7%	-31.0%	26.1%	-5.8%	-7.5%	31.5%
Inv: Railroad Equipment	1.2%	-34.6%	-72.1%	-12.2%	9.3%	-5.5%	-5.8%	-31.6%	-2.1%
Inv: Trucks	19.2%	0.5%	-13.0%	-28.2%	27.5%	4.3%	15.6%	18.4%	25.7%
Inv: Computers	-6.1%	-23.3%	44.7%	-12.3%	-11.7%	6.7%	25.7%	-39.0%	26.1%
Inv: Software	6.7%	2.1%	3.5%	9.2%	-8.1%	7.2%	3.7%	1.5%	4.3%
Credit Conditions									
Nonfinancial Sector Debt (% of SAAR GDP)	64.8%	65.2%	66.0%	65.8%	66.3%	66.3%	66.2%	67.3%	67.2%
Loan Delinquency Rate	1.4%	1.3%	1.2%	1.1%	1.0%	1.0%	0.9%	0.9%	0.8%
Lease Delinquency Rate	0.8%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	0.8%	0.7%
Net Tightening of C&I Loan Standards	-6.9%	-9.5%	-7.6%	-7.4%	-19.1%	-18.1%	-8.3%	-13.7%	-11.1%

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 Aug	2013 Sep	2013 Oct	2013 Nov	2013 Dec	2014 Jan	2014 Feb	2014 Mar	2014 Apr	2014 May	2014 Jun	2014 Jul	2014 Aug
Employment													
Change in Total Payrolls (thousands)	202	164	237	274	84	144	222	203	304	229	267	212	142
Change in Private Payrolls (thousands)	180	153	247	272	86	166	201	200	278	228	260	213	134
Unemployment Rate	7.2%	7.2%	7.2%	7.0%	6.7%	6.6%	6.7%	6.7%	6.3%	6.3%	6.1%	6.2%	6.1%
Business Activity													
Industrial Production	100.0	100.7	100.8	101.4	101.6	101.3	102.3	103.1	103.2	103.7	104.0	104.2	104.1
Capacity Utilization	77.8%	78.3%	78.2%	78.5%	78.5%	78.1%	78.6%	79.1%	78.9%	79.1%	79.1%	79.1%	78.8%
PMI Composite Index	56.3	56.0	56.6	57.0	56.5	51.3	53.2	53.7	54.9	55.4	55.3	57.1	59.0
NFIB Small Business Optimism Index	94.1	93.9	91.6	92.5	93.9	94.1	91.4	93.4	95.2	96.6	95.0	95.7	96.1
Consumer Activity													
Consumer Confidence	81.8	80.2	72.4	72.0	77.5	79.4	78.3	83.9	81.7	82.2	86.4	90.3	92.4
Personal Consumption (M/M % Chg)	0.2%	0.3%	0.3%	0.5%	0.9%	-0.3%	0.4%	0.6%	-0.1%	0.1%	0.3%	-0.1%	0.5%
Retail Sales (M/M % Chg)	-0.2%	0.1%	0.6%	0.4%	-0.1%	-0.9%	0.9%	1.5%	0.6%	0.4%	0.4%	0.3%	0.6%
Lending Activity													
C&I Loans (M/M % Chg)	0.2%	0.4%	0.9%	0.3%	0.9%	0.5%	2.2%	1.2%	1.0%	0.6%	0.9%	1.3%	1.0%
MLFI-25 New Business Volume (Bil. $)	6.4	7.7	7.6	6.6	10.7	6.0	5.4	7.1	8.1	7.0	9.1	7.9	7.2
MLFI-25 Avg Losses as a % of Net Rec.	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2
MLFI-25 Credit Approval Ratio	79.8	78.1	78.1	76.3	78.7	77.8	76.4	78.3	78.2	76.9	80.9	80.3	79.5
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	0.13	0.12	0.12	0.12	0.13	0.12	0.12	0.13	0.11	0.10	0.10	0.11	0.11
3-Year Treasury Rate	0.70	0.78	0.63	0.58	0.69	0.78	0.69	0.82	0.88	0.83	0.90	0.97	0.93
10-Year Treasury Rate	2.74	2.81	2.62	2.72	2.90	2.86	2.71	2.72	2.71	2.56	2.60	2.54	2.42
30-Year Treasury Rate	3.76	3.79	3.68	3.80	3.89	3.77	3.66	3.62	3.52	3.39	3.42	3.33	3.20
AAA Corporate Bond Yield	4.54	4.64	4.53	4.63	4.62	4.49	4.45	4.38	4.24	4.16	4.25	4.16	4.08
BAA Corporate Bond Yield	5.42	5.47	5.31	5.38	5.38	5.19	5.10	5.06	4.90	4.76	4.80	4.73	4.69
Prices													
Headline Inflation (Y/Y % Chg)	1.5%	1.1%	0.9%	1.2%	1.5%	1.6%	1.1%	1.5%	2.0%	2.1%	2.1%	2.0%	1.7%
Core Inflation (Y/Y % Chg)	1.8%	1.7%	1.7%	1.7%	1.7%	1.6%	1.6%	1.6%	1.8%	1.9%	1.9%	1.9%	1.7%
Oil Price (West Texas Int., $/barrel)	107.98	102.36	96.29	92.55	98.17	97.55	102.88	101.57	100.07	103.40	106.07	98.23	97.86

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