2021

Q3 Update - July

Equipment Leasing & Finance U.S. Economic Outlook

EQUIPMENT LEASING & FINANCE

FOUNDATION

Your Eye on the Future

EQUIPMENT LEASING & FINANCE ECONOMIC OUTLOOK

July 2021

Key Trends to Monitor

Global Vaccine Deployment

Supply Chain Issues

Labor Costs

EXECUTIVE SUMMARY

Equipment and Software Investment: E&S investment jumped again in the first quarter and is well above its pre-pandemic level. Businesses across the country have continued to invest to adapt to a post-pandemic economy, which should support growth for the rest of the year.

Momentum Monitor: Investment momentum readings are now above the long-term average in all 12 verticals tracked by the Foundation's Momentum Monitors, reflecting sustained demand for new equipment and the healthy outlook for equipment and software investment.

Manufacturing Sector: The manufacturing sector is still facing record levels of demand, even as the pandemic hamstrings key manufacturing centers around the world. However, industrial output in the U.S. has been constrained by acute shortages of key inputs and elevated prices.

Small Businesses: Main Street has emerged from the pandemic having suffered less damage than many expected, in part due to historic federal relief efforts. Consumers are spending again, capacity limits and distancing requirements have largely been lifted, and the outlook is as bright as it has been since the pandemic began. However, many firms are contending with newfound difficulty hiring workers, especially in lower-wage sectors such as retail and leisure & hospitality.

Fed Policy: Federal Reserve officials have, for the most part, reached consensus agreement that inflation pressures will prove to be transitory. However, given the speed and magnitude of the economic rebound, the Fed has hedged a bit and signaled that rate hikes could begin in 2023.

U.S. Economy: America is finally open for business. Though concerns about the pandemic still linger, states have by and large lifted COVID-era restrictions. Consumers are spending, businesses are investing, and people are ramping up travel plans for both work and pleasure. While the outlook is mostly positive, notable headwinds remain, including two — supply chain issues and services exports — that stem from the rest of the world's continued struggles with COVID-19 and comparatively slower vaccination push. Additionally, the risk of sustained high inflation and the expiration of federal support measures are key factors to watch this summer and fall. All told, however, the economic rebound is quite strong, and the summer months should yield continued strong growth for both the economy and equipment finance industry.

2021 Annual Projections

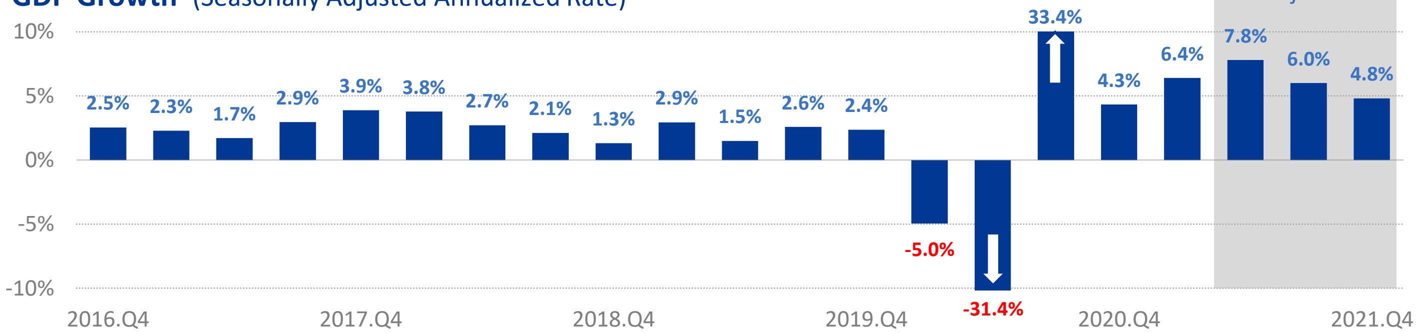
6.1%
GDP Growth

13.3%
E&S Investment Growth

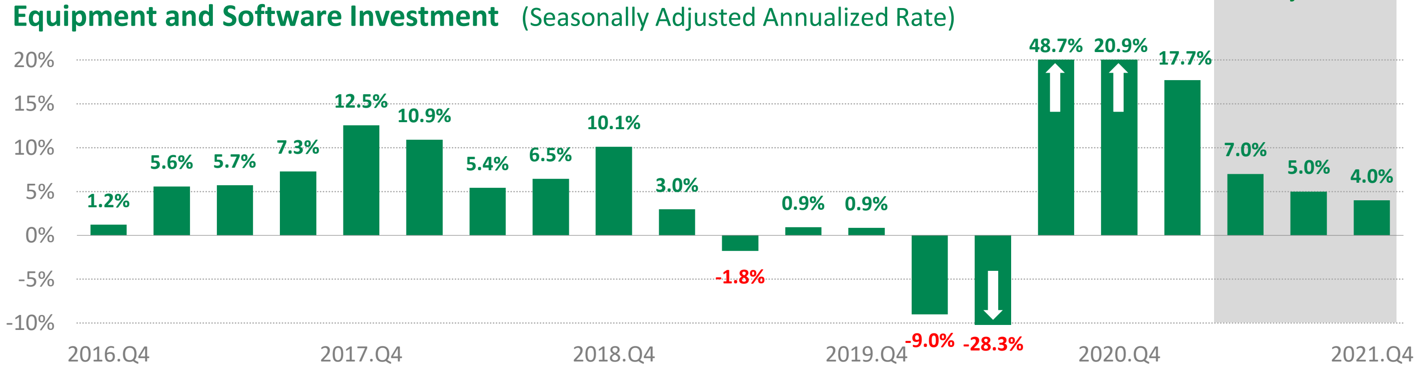
3.0%
Inflation

0 bp
Change in Fed Funds Rate from Current Range

GDP Growth (Seasonally Adjusted Annualized Rate)



Equipment and Software Investment (Seasonally Adjusted Annualized Rate)



Source: U.S. Bureau of Economic Analysis; Keybridge LLC

MOMENTUM MONITORS

Sectoral Performance

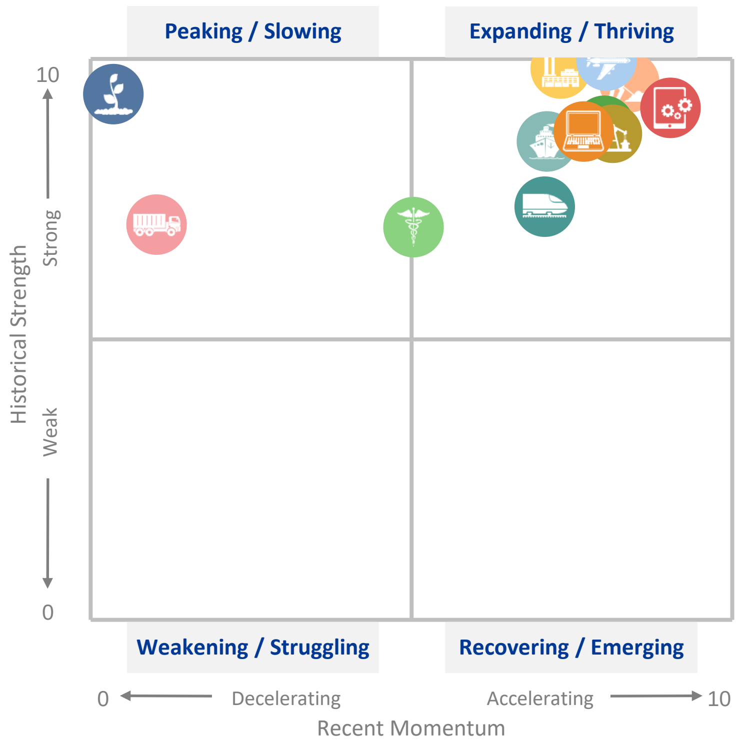
E&S investment growth surge continues in Q4

Equipment and Software investment jumped 17.7% (annualized) in Q1 2021, the third straight quarter of double-digit growth.

Of the 12 investment verticals tracked by the Foundation, nine saw investment rise in the first quarter while three saw investment weaken. Seven verticals experienced double-digit investment growth, including Construction Machinery, Medical Equipment, Mining & Oilfield Machinery, Railroad Equipment, Trucks, Computers, and Software.

Looking ahead, nine verticals are showing signs of accelerating investment as the economy reopens, according to the Foundation's Equipment & Software Momentum Monitors. Three other verticals are showing signs of peaking, though investment growth should remain healthy in these sectors over the next six months. As Americans slowly return to pre-pandemic patterns of spending, businesses around the country are investing in equipment and software to adapt to a new post-pandemic normal.

Momentum Monitor Sector Matrix



For more information on how to interpret the Momentum Monitor, please refer to the Appendix B (p. 14). A full breakdown of each industry vertical is available at https://www.leasefoundation.org/industry-resources/momentum-monitor/

Movements to Monitor

Equipment Vertical	Q2 Investment Growth Q/Q	Q2 Investment Growth Y/Y	Next 6 Months	Short-Term Outlook
Materials Handling Equipment	+2%	+12%	▲	Materials Handling equipment continues to benefit from the resurgence in consumer demand as the economy reopens and should be a bright spot for investment in 2021.
Construction Machinery	+31%	+4%	▲	Construction machinery investment growth surged again in Q1 and has now seen double-digit growth for three straight quarters. Historic demand for new homes should support more growth this year.
Other Industrial Equipment	+10%	+1%	▲	The global manufacturing boom has supported demand for industrial equipment, and despite recent supply chain headwinds investment growth should accelerate in the months ahead.
Mining & Oilfield	+20%	-21%	▲	A quicker-than-expected recovery of mobility in the U.S. has driven domestic oil prices to $75/bbl. Sustained, higher prices should encourage investment in mining & oilfield equipment.

Credit Supply

Credit supply loosened somewhat in Q1

Most banks adopted a "wait and see" approach toward business lending standards in the first quarter, but some eased standards.

- Overall, lending standards for C&I loans were basically unchanged for 75–80% of banks. For loans to large- and middle-market firms, a net 15% of banks reported easing lending standards, while for smaller firms a net 13% reported easing standards.
- Fewer banks tightened standards on commercial real estate ("CRE") loans. A net 14% of banks reported tightening standards for construction and land development loans in Q1, down from 23% in Q4.

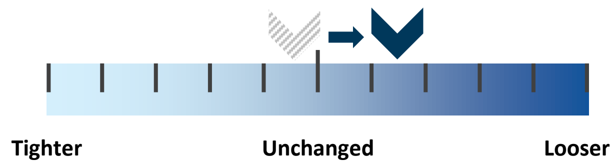
For consumers, credit conditions improved in Q1 as banks eased standards for consumer credit and residential loans.

- A net 18% of banks reported easing standards on auto loans, while a net 27% reported easing standards on credit cards.
- Meanwhile, 5-19% of banks reported easing standards across residential real estate ("RRE") loan types, though most banks (75-92%) kept RRE loan standards unchanged.

Net Change in Credit Supply Conditions

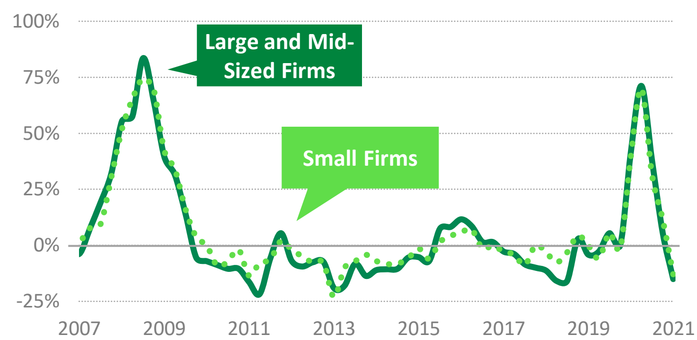
Fed Senior Loan Officer Survey

More banks report loosening in Q1



Tightening Standards on C&I Loans

Percent of Respondents

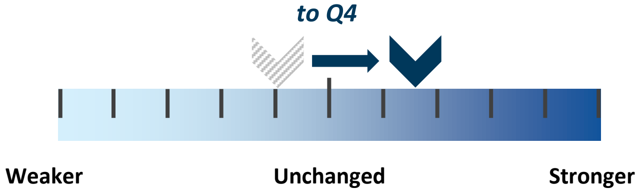


Source: Federal Reserve Senior Loan Officer Survey

Net Change in Credit Demand Conditions

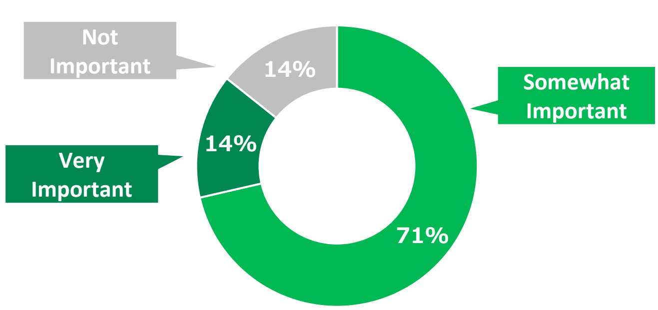
Fed Senior Loan Officer Survey

Demand largely grows compared to Q4



Falling Business Investment as Reason for Weaker Demand

Fed Senior Loan Officer Survey, Percent of Respondents



Source: Federal Reserve Senior Loan Officer Survey

Credit Demand

Demand shows signs of recovery

Demand for business loans was mixed in Q1.

- On net, 7% of banks reported weaker C&I loan demand among medium & large firms in the first quarter, while a net 3% reported weaker demand among small firms. Of those reporting weaker demand, most cited "decreased customer investment in plant or equipment" as a reason.
- However, a greater share of banks reported stronger demand for CRE loans, particularly construction and land development loans and multifamily residential loans.

Among households, credit demand continued to strengthen.

- A net 13% of banks on net reported stronger demand for GSE-eligible RRE loans in Q1, though this was down slightly from Q4.
- Meanwhile, on net, 10% share of banks reported stronger auto loan demand, while 2% reported stronger demand for credit card loans.

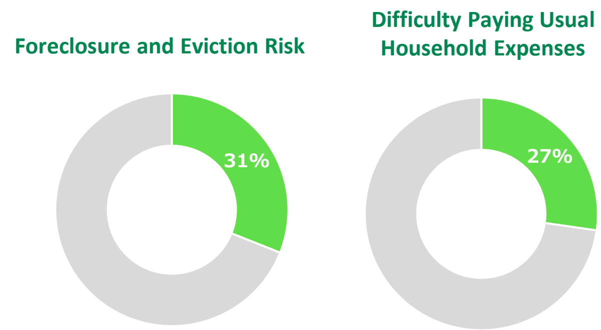
Consumer Finances

Financial stress low, but concerns remain

The effects of the March stimulus package, rising vaccination rates, low infection rates, and an improving labor market have kept consumer stress low. However, latent financial pressures may come to light as consumer protections end.

- According to survey-based estimates from the New York Fed, consumers saved 43% of their March stimulus checks and spent less than one-quarter (the rest was used to pay down debt). In the previous two rounds of stimulus, households spent a greater share to meet daily expenses.
- Not surprisingly, bankruptcies have remained historically low; there were just 33,000 consumer bankruptcies in May, roughly half the number that occurred in May 2019.
- At the same time, nearly one-third of households are worried about foreclosure or eviction in July and August, and over one-quarter faced difficulty paying usual expenses as of the first week of June *(see chart)*.

Foreclosure Risk vs. Difficulty Paying Household Expenses
Percent of households



Source: Census Bureau Household Pulse Survey; Data collected from May 27-June 7
Note: Foreclosure/eviction risk in the next two months; Difficulty paying usual household expenses in the last 7 days.

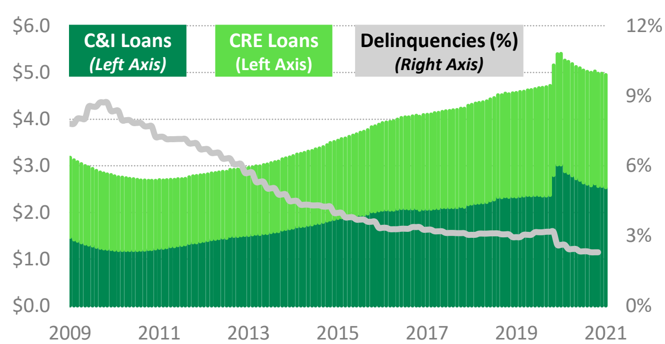
Business Finances

Financial stress falling in hard-hit industries

Financial stress among businesses has been easing due to the relaxing of business restrictions and increased consumer demand, particularly in sectors hardest-hit by the pandemic.

- Both C&I and CRE loan volumes are historically high and above their pre-pandemic trendlines, though they have been steadily declining after spiking last spring.
- Meanwhile, delinquencies have been falling over the course of the pandemic and were at an all-time low in the first quarter of 2021.
- Similarly, the Trepp CMBS Special Servicing Rate fell for the eighth consecutive month in May. Servicing rates improved sharply for the lodging and retail sectors, and industry researchers expected continued improvement in the commercial mortgage-backed securities market.

Business Loan Volume
$ Trillions



Source: Federal Reserve Board

Fed Policy Corner

Inflation expectations rise — is it temporary?

- The Fed expects higher inflation in 2021 due to pandemic-driven effects but predicts inflation will fall back to a moderate 2.1% in 2022.
- Others, including Obama Administration economist Jason Furman, worry inflation could remain at 3% or higher.
- The Fed held short-term interest near zero and pledged to continue its bond purchase program. However, officials also signaled that interest rates could rise faster and sooner than projected — possibly in 2023.

> *"I expect that as price reversals and short-run imbalances…play out, inflation will [fall] from around 3% this year to close to 2% next year and in 2023."*
>
> — John Williams, NY Fed President

> *"[The Fed] will never let inflation get to 10%, [but] the 1960s is the model for what we're going through. Inflation crept up from about 1.5% to about 5%.*
>
> *— Jason Furman, Former Chair, National Economic Council*

Main Street Outlook

Economic conditions improving for small businesses

While many small business were hurt by the pandemic, the need for additional financial support appears to be dwindling. New data suggest the number of businesses that closed permanently was significantly lower than initially feared.

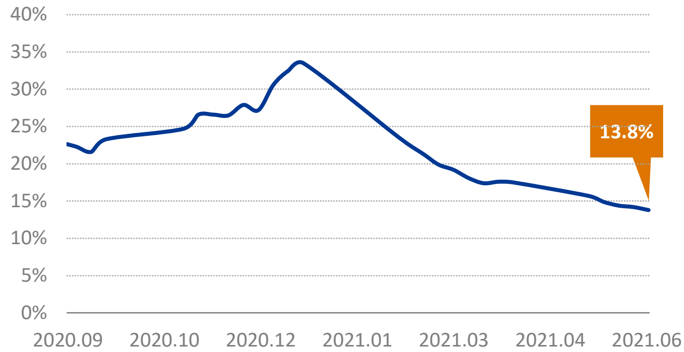
- Per the Census Bureau, as of early June the share of small businesses that expect to need additional financial assistance was at a multi-month low of 14%, down from nearly 34% in early January *(see chart).*
- A study by the NY Fed estimates that the number of "excess" small business closures (i.e., closures beyond what would be normally expected) was below 200K during the first 12 months of the pandemic, far short of forecasts.
- At the same time, small firms in certain industries were hardest hit. A separate NY Fed analysis estimates that around 35% of small firms in the leisure, hospitality, and retail industries remained closed as of early May, and only 3% of those businesses will ever ultimately reopen.

As the pandemic winds down, many consumers are returning to pre-pandemic routines flush with accumulated savings and less debt — setting the stage for a wave of new small businesses to enter the economy.

- According to the Bureau of Economic Analysis, card transactions at retail and food establishments accelerated in May to the third-highest level in nearly 18 months.
- Per an analysis by a University of Maryland economist, the number of entrepreneurs starting new businesses hit a record high in 2020, in contrast to the pace of new firm creation after the 2008-09 recession (*see chart below).*
- Small business lending has also surged; the Equifax Small Business Lending Index jumped to an all-time high in April, reflecting mounting optimism about the magnitude and staying power of the economic recovery.

Will This Business Need Additional Financial Assistance?

% of respondents saying "yes" for the next six months



Source: Census Bureau Small Business Pulse Survey

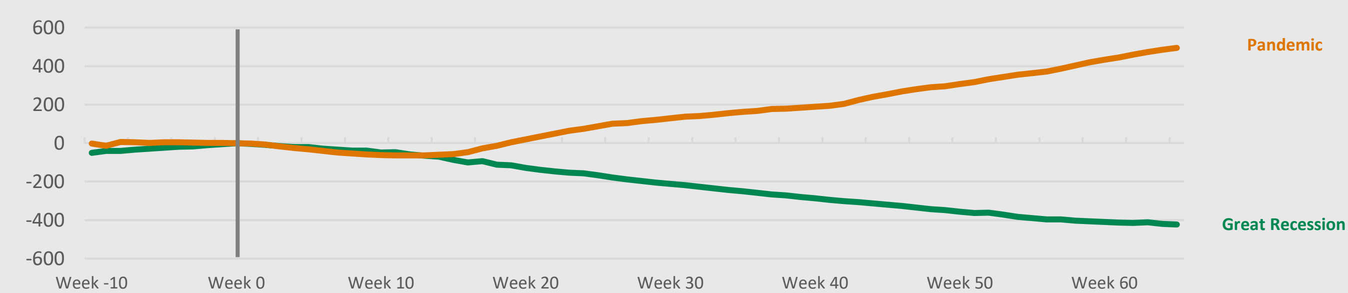
Not surprisingly, small business optimism is on the rise. The WSJ/Vistage CEO Confidence Index neared a 9-year peak in May, with 80% of small business owners reporting expectations for increased revenue and investment. Similarly, the NFIB Small Business Optimism Index is just shy of its highest reading in six months after falling in late 2020.

Despite the optimism, small firm owners are navigating new headwinds, including finding workers. Per the NFIB, nearly half of small businesses reported unfilled jobs in May, the fourth consecutive month of a record-high reading. Hiring difficulties have pushed wages higher: according to the NY Fed Survey of Consumer Expectations, the lowest salary that workers without a college degree were willing to accept for a new job in March 2021 was $61K, up more than 20% over the last year.

Still, business conditions are clearly improving for most small businesses, and consumer demand is expected to remain robust throughout the summer. Further, labor constraints should ease in most industries if the pandemic remains controlled, schools open for in-person learning in the fall, and pandemic-era unemployment benefits expire as scheduled.

Unprecedented Business Formation Suggests Promising SMB Recovery

Change from normal rates of business formation (thousands of businesses)



Source: Census Bureau Business Formation Statistics; New business applications from likely employers; Not seasonally adjusted.

MLFI-25

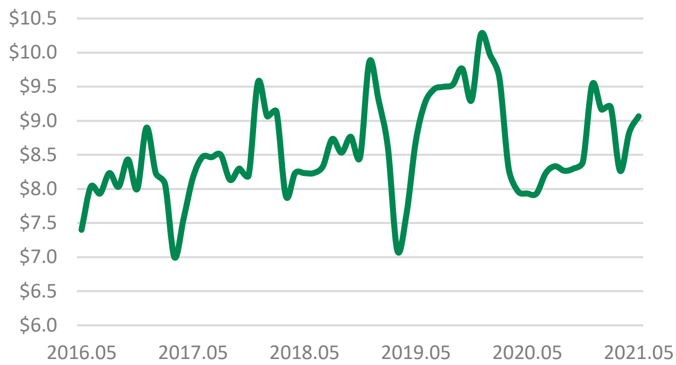
NBV recovery constrained by supply bottlenecks

ELFA's Monthly Leasing and Finance Index (MLFI-25) 3-month moving average rose 2.6% in May and was up 20% from year-ago levels *(see chart)*. The industry's recovery has been robust thus far, though continued supply chain constraints in certain sectors of the economy remain a significant concern.

- New business volume (NBV) edged down to $8.1 billion in May, the first decline after three months of growth. However, year-to-date new business volume is up 7% compared to last year, pointing to a strong recovery from the pandemic-induced downturn.
- Portfolio performance remains strong. Receivables over 30 days were 1.9%, up slightly from a pandemic-era low of 1.8% in April. Meanwhile, charge-offs were unchanged at 0.30%, down from 0.61% in May 2020 and 0.46% in May 2019.
- Total credit approvals climbed to 77.4% in May, the highest reading since December 2018.
- The total headcount of equipment finance companies was 14% below year-ago levels, though this reading was due to significant downsizing at an MLFI reporting company.

MLFI-25 New Business Volume

Billions, 3-month moving average



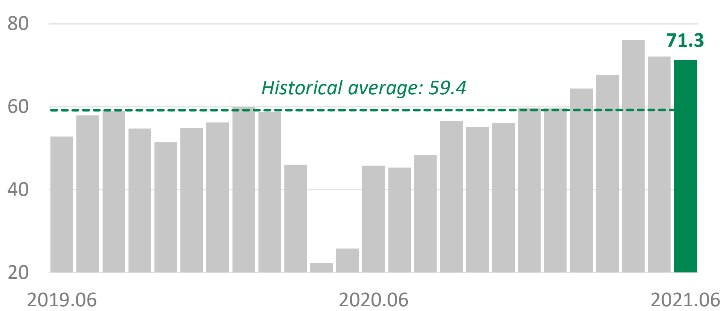
Source: ELFA

"While overall industry performance is relatively strong during the first half of this year, even more robust demand for financing is being constrained by supply chain shortages in several economic subsectors. And, with COVID-related payment modifications resolved for the most part, ELFA members report their portfolios performing well."

— Ralph Petta, President and CEO, ELFA

MCI-EFI

Industry confidence remains historically high as the economy rebounds



Source: ELFF

"Companies across all industries are investing in new projects to stay ahead and better serve their customers, while also investing in technology and programs to better serve their employees in the 'new normal' hybrid work environment."

— Alan Sikora, CLFP, CEO, First American Equipment Finance, an RBC / City National Company

In June, the Monthly Confidence Index for the Equipment Finance Industry ("MCI-EFI") edged down 0.9 point to 71.3 but remains historically strong. The Index reached a record high in April at 76.1.

- Overall, 42% of respondents expect business conditions to improve over the next four months, down from 54% in May. None believe business conditions will worsen.
- In good news, 46% expect to hire more employees over the next four months, up from 39% in May. Only 4% of firms expect to hire fewer employees, though this is up from none in May.
- Similarly, 22% now assess the U.S. economy as "excellent," up from 11% in May.
- Meanwhile, there was no change in expectations for access capital to fund equipment acquisitions in the next four months. 32% expect "more" access to capital, 68% expect the "same" access to capital, and none expect "less" access.

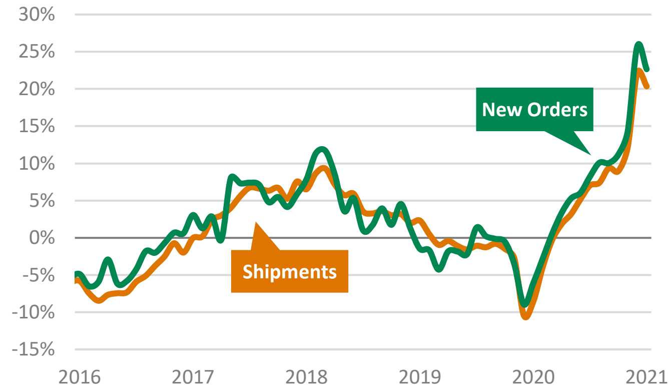
Manufacturing Focus

New Orders and Shipments Growth Nearing a Peak?

In May, both shipments and new orders of core capital goods eased on an annual basis after surging in April. However, these key metrics of manufacturing activity remain elevated and are well above pre-pandemic levels (*see chart*).

- New orders for nondefense, non-aircraft capital goods (a leading indicator of industry performance) remained roughly unchanged in May but were up 23% compared to last year.
- Shipments of nondefense capital goods excluding aircraft (a concurrent indicator of industry performance) edged up 0.9% in May and are up 20% Y/Y.
- Business investment should remain strong as the economic rebound continues.

Shipments vs. New Orders of Core Capital Goods
Year-on-year percent change



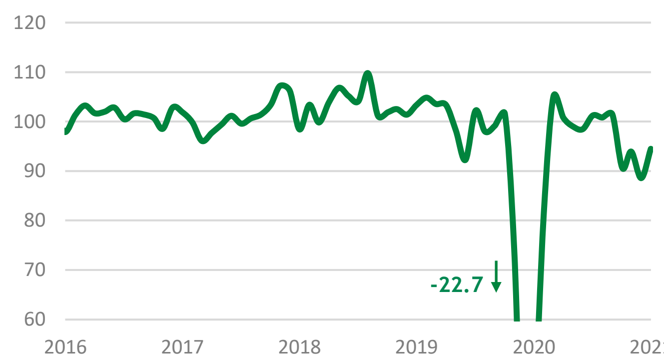
Source: Census Bureau

Industrial Production Gains in May

Industrial Production rose 0.8 point to 99.9 in May, the highest level since the onset of the pandemic.

- Industrial production for consumer goods, business equipment, business supplies, and materials all experienced solid improvements in May.
- Industrial production for durable goods increased by nearly 3%, driven by a 5.7% increase in the production of motor vehicles and parts (*see chart*). Meanwhile, the increase in business equipment production was led by gains in transit equipment and information processing equipment.

Industrial Production
Motor Vehicles and Parts



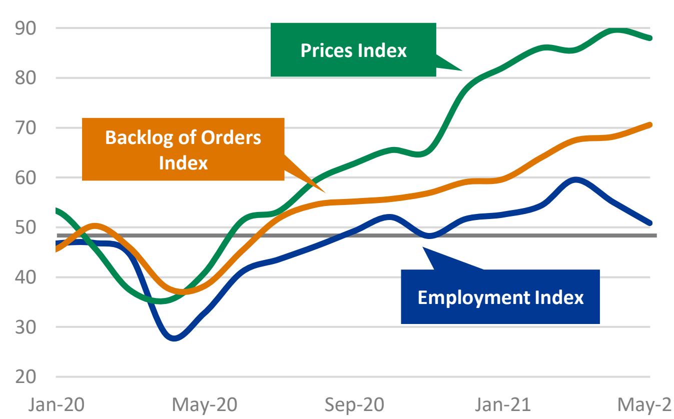
Source: Federal Reserve Board of Governors, G17 report

Factories Continue to Face Production Constraints

In May, the ISM Manufacturing PMI Backlog of Orders Index rose to 68, the highest level since 1993, while the ISM Prices Index eased slightly but remains near a decade high. Meanwhile, the ISM Employment Index dipped to 51, illustrating ongoing hiring issues in the industry (*see chart*) .

- Factories are struggling to hire workers. The Census Bureau reports that there were 851,000 unfilled manufacturing jobs in early April, a record since the series began in 2000.
- Several commodity prices, including lumber and copper, have declined from multiyear highs, suggesting that recent surges were cyclical and due to the economic recovery.
- These supply chain constraints have led to a substantial backlog of orders. Manufacturers' unfilled orders of durable goods excluding transportation reached a series high in May.

Manufacturing PMI Indices
Above 50 = expansion



Source: Institute for Supply Management

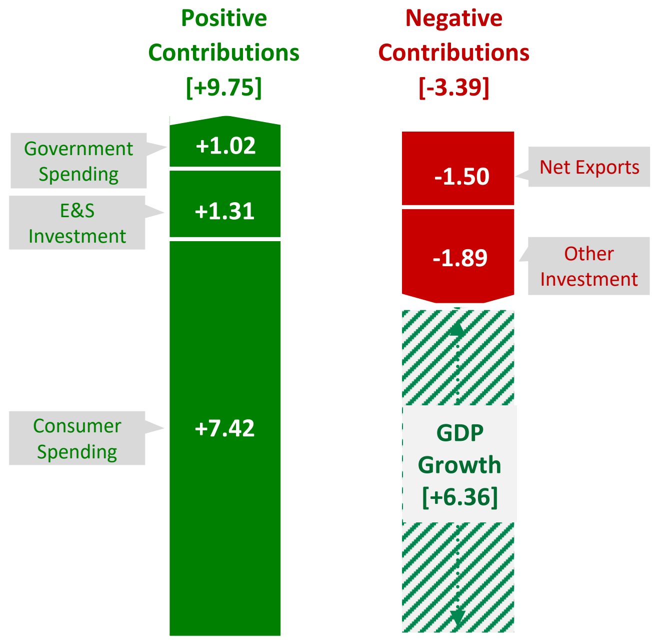
Faster Growth in Q1 Sets Stage for Summer Boom

Economy Expands at 6.4% Rate in Q1

The U.S. economy expanded at a robust 6.4% (revised) annualized pace in Q1, an acceleration from Q4. GDP was just 0.9% below its level at the end of 2019, indicating that the U.S. economy will exceed its pre-pandemic level in Q2.

- **Consumer spending**, the economy's largest component, jumped 11.4% (annualized) in Q1. Spending growth was largely due to expenditures on durable goods, which rose 49%. Growth in spending on nondurable goods (15%) and services (4.2%) also improved.
- **Equipment and software (E&S) investment**, a subset of overall business investment and the lifeblood of the equipment finance industry, surged 18% after similarly strong growth in Q4.
- **Net exports** made another large, negative contribution to GDP in Q1 thanks to weak demand for U.S. exports.
- **Government spending** rose at a 5.7% rate in Q1, driven almost entirely by federal nondefense spending stemming from the Consolidated Appropriations Act in late December and the American Rescue Plan in mid-March.
- **Other investment** fell in Q1 due to a declines in private inventories and nonresidential structures investment. Meanwhile, resident investment rose.

Contributions to GDP Growth
Q1 2021



Source: Bureau of Economic Analysis (BEA)

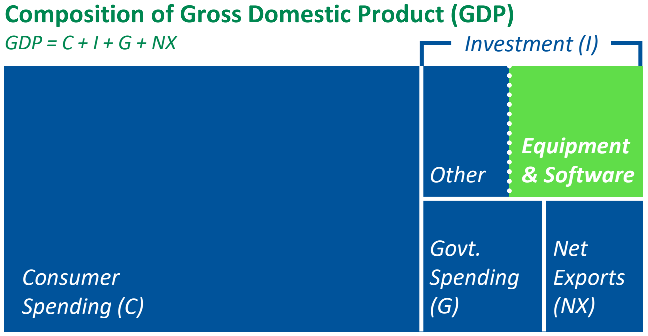
America is Open for Business

Business Restrictions Relaxed as Pandemic Wanes

With two-thirds of U.S. adults having received at least one dose of vaccine as of July 4th and daily COVID-19 cases and deaths near pandemic-era lows, most states and localities have dropped capacity constraints and gathering limits for vaccinated Americans. This has led to increases in both consumer demand and businesses' ability to meet this demand. Meanwhile, federal stimulus efforts and a heightened savings rate over the past 15 months have left many consumers with more money in their bank accounts, which they appear eager to spend as life gets back to normal.

While the economy should continue to boom this year as long as the pandemic remains in check, there are several potential headwinds and factors to monitor in the months ahead. For example, demand for U.S. exports remains exceptionally weak as much of the rest of the world continues to struggle with COVID-19. In addition, many U.S. employers report difficulty finding workers — particularly in the retail and leisure & hospitality sectors, where wage growth is rising at nearly twice the national rate. Finally, a combination of high input costs and strong consumer spending are quickly driving up prices, though economists are split on whether the rise in inflation will be temporary or sustained.

Composition of Gross Domestic Product (GDP)
GDP = C + I + G + NX



Source: Keybridge LLC, based on BEA data

2021 Growth Forecasts

Consumer Spending Driving Economic Recovery

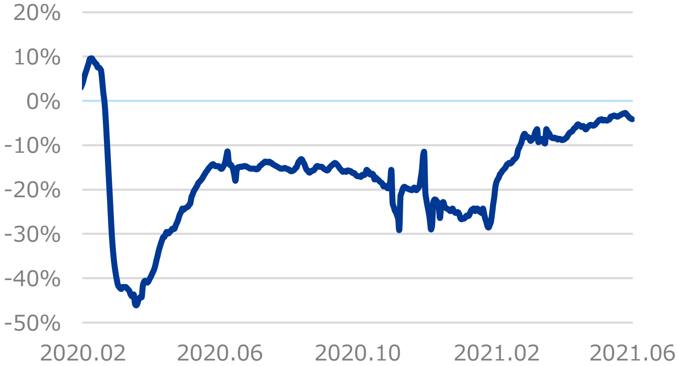
Consumer Mobility and Spending Have Returned

Thanks to rising vaccination rates, falling infections, and easing business restrictions, consumer mobility is approaching pre-pandemic levels. Though it hasn't yet fully recovered, in late June Google's retail and recreation mobility index reached its highest level since the pandemic began *(see chart).* Similarly, TSA checkpoint travel numbers reached the highest level since before the pandemic impacted travel, though they were generally 20–30% below 2019 levels throughout June.

As mobility improves, consumers are beginning to spend accumulated savings. Per Wells Fargo, consumers amassed $2.4 trillion in excess savings since the pandemic began, suggesting there is significant "dry powder" in the economy. Indeed, per Visa's Spending Momentum Index, 52% of consumers are spending more than they did during the same period in 2019. Much of this spending is driven by higher-income consumers; an analysis from consumer-data firm Affinity Solutions shows that households earning over $200K spent 16% more on restaurants in May compared to April. We expect spending to remain robust over the rest of the year.

Google Mobility: Retail and Recreation

% relative to pre-pandemic baseline, 7-day moving average



Source: Google

> *"Vaccines are the key to the economic rebound. Consumers increasingly feel safer being out and about, and many are in the mood to spend after cutting back over the last year. Rising inflation remains a risk, however."*
>
> **Dr. Robert Wescott, President, Keybridge**

Surge in Business Investment Likely to Continue

Firms Increase Capital Spending to Meet Heightened Demand

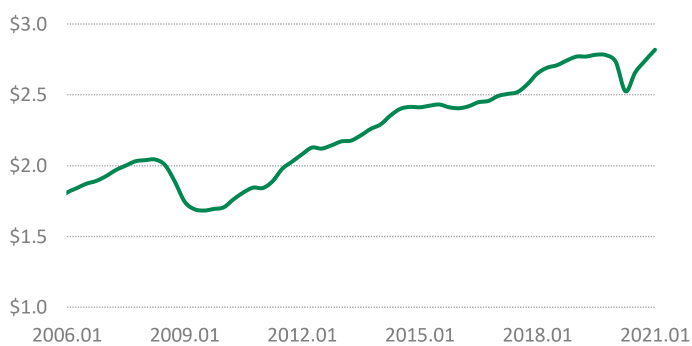
Due in part to tight labor supply and rising wages, firms are investing in new capital to increase capacity and improve efficiency and productivity.

- According to the Commerce Department, nonresidential fixed investment (of which equipment and software investment is a main component) grew at an annualized rate of 11.7% Q1 and has now surpassed its pre-pandemic peak *(see chart).* The growth was led by gains in software and technology equipment spending.
- Additionally, a December survey from the Richmond Fed found that roughly half of CFOs from large firms and one-third of CFOs from small firms are using or planning to use automation to reduce dependence on labor.
- The Business Roundtable's CEO Economic Outlook Capital Investment Subindex was at the third-highest level ever, signaling that American firms are confident about the staying power of the recovery.
- Increased capital spending is also likely driven by order backlogs and supply chain disruptions, which have led to increased manufacturing activity in some sectors.

Overall, the business investment expansion is likely to continue. Economists at Morgan Stanley, for example, expect capital spending to rise to 116% of pre-pandemic levels within three years — by comparison, it took ten years for investment to reach that level after the 2008–09 recession. Put simply, the 2020 recession was far deeper than most, but firms that survived are looking to expand.

Real Private Nonresidential Fixed Investment

Trillions of 2012 Dollars (SAAR)



Source: Bureau of Economic Analysis

Supply Chains Remain Snarled

Rising Input Costs, Delivery Delays, and Widespread Shortages Continue to Constrain Growth

Though U.S. consumers appear eager to spend on goods and services, some economic sectors are experiencing acute supply chain constraints that have worsened in recent weeks. Manufacturing firms have borne the brunt of these issues, in part due to the ongoing global shortage of semiconductors. Demand for an array of goods requiring these chips has far outstripped supply over the last year, and there are few signs that this imbalance will resolve itself any time soon. U.S. auto manufacturers were forced to shutdown production early in 2021 due to semiconductor shortages, and further shutdowns are taking place in July for the same reason.

The service sector has not escaped supply chain issues, either. Food, packaging materials, paper goods, and lumber all saw sharp price increases as firms contended with far stronger demand than expected so soon after the worst of the pandemic. Though prices for some of these goods have come down in recent weeks, supply chain disruptions are expected to continue for the foreseeable future, as evidenced by the Baltic Dry Index (a measure of global container shipping costs) which recently reached its highest reading in a decade *(see chart).*

A final factor to monitor is vaccination rates, especially in commodities-producing nations in the developing world, where outbreaks have forced partial shutdowns of ports for weeks on end. All told, supply chain constraints are unlikely to be fully resolved for several months and can be expected to be a drag on growth for the remainder of the year.

Baltic Dry Index

Composite Index of Container Shipping Costs

Source: Baltic Exchange, Macrobond Financial

Services Exports Remain Depressed

Global Vaccination Rates Will Guide Recovery

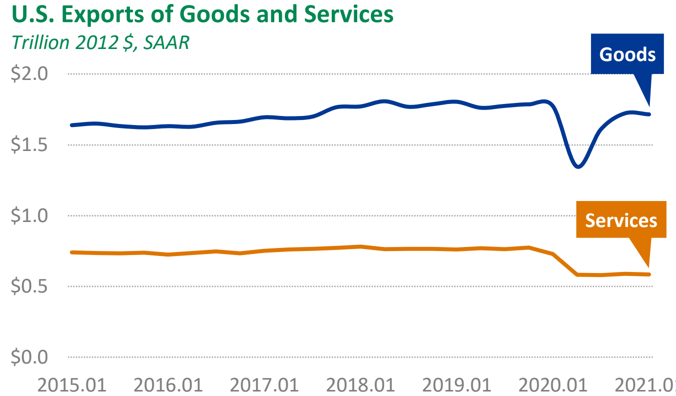
Much like the diverging recoveries among U.S. households, foreign trade is facing a K-shaped recovery of its own. After exports of both goods and services collapsed 20–25% in Q2 2020, the global manufacturing boom has caused a remarkable rebound in goods exports, which were only slightly below their mid-2019 level at the end of March. On the other hand, exports of U.S. services — which account for roughly one-third of total exports and play an important role in the U.S. economy — are still 24% below their mid-2019 level and have not improved thus far this year *(see chart)*.

The lack of recovery in services trade reflects two realities of the global recovery from the pandemic:

- Smaller stimulus and relief responses in other countries have led to relatively slower economic recoveries (and thus demand for U.S. exports).
- The relatively sluggish vaccination efforts to date in many countries have constrained business trips and tourism spending in the United States. Until global vaccination rates improve and the pandemic is controlled — particularly given the more virulent Delta Plus variant — U.S. services exports are likely to struggle.

U.S. Exports of Goods and Services

Trillion 2012 $, SAAR



Source: Department of Labor

> *"The K-shaped recovery in goods vs. services exports is a function of tepid international travel and differences in vaccination rates. Until other countries catch up, U.S. services exports are unlikely to materially improve."*
>
> **Jeff Jensen, Vice President, Keybridge**

Expiration of UI Benefits

Will Lower Benefits Reduce Labor Market Friction?

A key area of uncertainty in the recovery is the available worker shortage that many firms face, particularly in the retail and leisure / hospitality sectors. There are likely multiple contributing factors to this friction, but as vaccination rates rise and the economy reopens, federal enhancements to state unemployment insurance (UI) benefits have received more scrutiny. While benefits differ by state, UI typically replaces less than half of wages. In 2020, Congress expanded UI eligibility and added $600/week to payments, causing some unemployed workers to earn more from UI than from a paycheck. The additional benefits have been scaled back to $300/week and will end on September 6, but some policymakers and economists, citing recent surveys of employers, have argued that the extra cash is discouraging work and have pushed for an earlier expiration. Others are more skeptical, citing a variety of empirical research published earlier in the pandemic.

To date, 26 states, most led by Republican governors, have announced an early end to additional UI payments. The effects of this policy change are not yet clear, though it is plausible that the move may coax some employees off the sidelines given low case counts and strong wage growth. Regardless, the effect of expiring UI benefits on both the labor market and consumer spending is a factor to watch.

Inflationary Pressures

Is Higher Inflation Here to Stay?

As the last edition of this report foreshadowed, inflation has spiked thanks to a host of pandemic-related factors. Core CPI inflation (which strips out the effects of volatile food and fuel prices, which also have been spiking) recently reached its highest level since the early 1990s *(see top chart)*. The debate about whether inflation is here now has shifted to a debate about whether inflation is here to stay or is merely transitory.

Inflation hawks argue that the trillions in stimulus injected into the economy over the last 15 months, along with a coming rise in owner-equivalent rent, will lead to higher inflation in the 3–5% range for the next 1-2 years or more. Inflation doves argue that most of the price increases seen in recent months are due to one-off factors (e.g., supply chain issues and order backlogs) that are unlikely to persist beyond this fall. We believe the possibility of sustained higher inflation is real and should not be discounted, particularly given the economic and financial consequences of operating a business in a higher inflation environment.

Expiration of Housing Support

Will there be a wave of foreclosures or evictions?

Recently, the Biden administration announced that federal eviction and foreclosure moratoria that have been in place since spring 2020 will expire at the end of July. While there is considerable uncertainty about what the effect of this policy change will be, the expiration raises the possibility of a wave of foreclosures or evictions later this year. Indeed, according to the Census Bureau's Household Pulse Survey, nearly one-in-six renters say it is "very likely" that they will have to leave their house in the next two months due to an eviction, and per BLS there are nearly 7 million fewer people working in June 2021 compared to February 2020.

Given the policy change, beginning in August it will be up to state and local governments to determine whether to provide further support to renters, landlords, and/or homeowners. A few states have already indicated they will do so, but it appears likely that many will not. While the housing market must be allowed to normalize eventually, lifting support measures before millions of renters are financially able to pay rent (and back payments) due to higher unemployment could exacerbate the K-shaped nature of the recovery and negatively impact the residential real estate market. We should have a good indication of whether a foreclosure or eviction wave is imminent later this year.

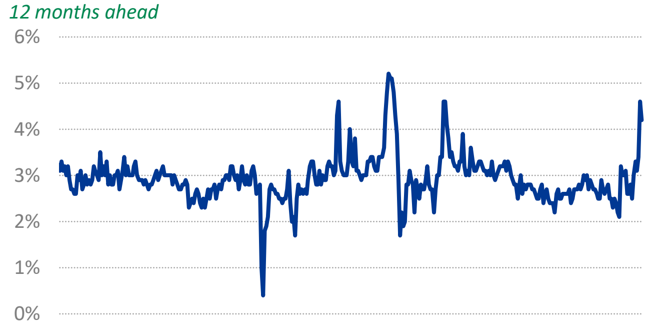
Core Consumer Price Index

% change Y/Y

Source: Bureau of Labor Statistics

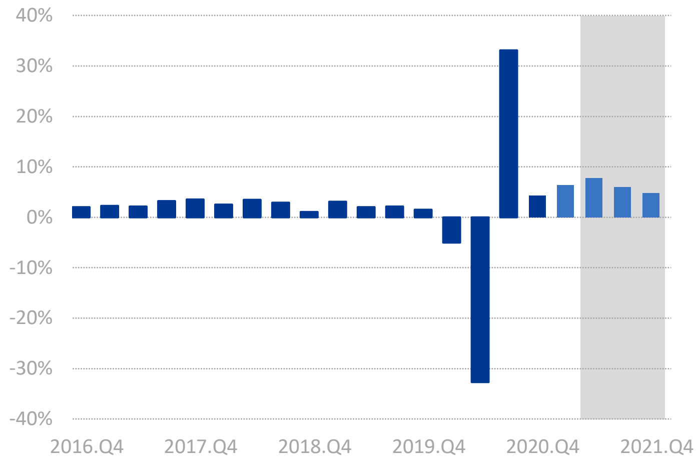
Inflation Expectations

12 months ahead



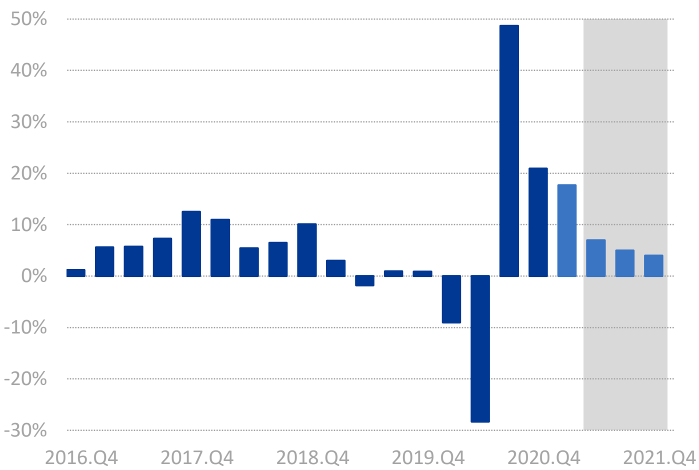
Source: University of Michigan Survey of Consumer Sentiment

Real GDP Growth (% SAAR)



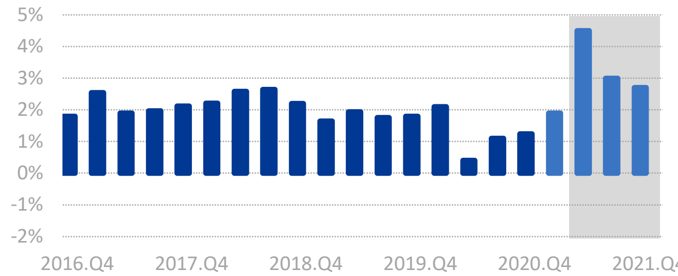
Source: Bureau of Economic Analysis; Keybridge LLC

Real E&S Investment Growth (% SAAR)



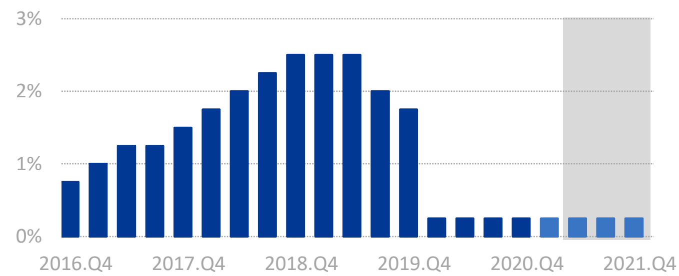
Source: Bureau of Economic Analysis; Keybridge LLC

CPI Inflation (year-on-year %)



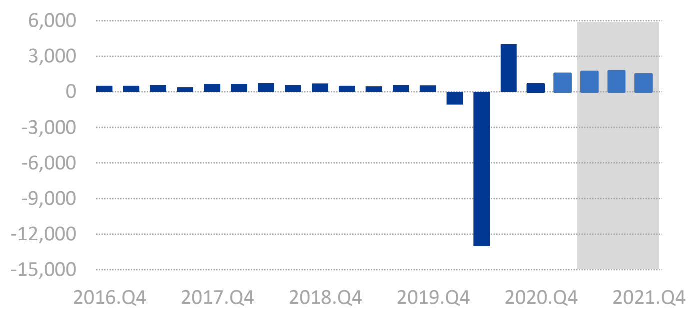
Source: Bureau of Labor Statistics; Keybridge LLC

Fed Funds Target (upper bound, end of period)



Source: Federal Reserve Board of Governors; Keybridge LLC

Total Payroll Growth (thousands)



Source: Bureau of Labor Statistics; Keybridge LLC

INDICATOR,	2019	2020	2021 QUARTERLY ESTIMATES				2021e
			Q1	Q2e	Q3e	Q4e	
Real GDP (SAAR %)	*2.2%*	*-3.5%*	6.4%	8.0%	6.0%	4.8%	**6.1%**
Real Investment in Equipment & Software (SAAR %)	*3.5%*	*-2.1%*	17.7%	7.0%	5.0%	4.0%	**13.3%**
Inflation (year-on-year %)	*1.8%*	*1.2%*	1.9%	4.5%	3.0%	2.7%	**3.0%**
Federal Funds Target Rate (upper bound, end of period)	*1.75%*	*0.25%*	0.25%	0.25%	0.25%	0.25%	**0.25%**
Total Payroll Growth (thousands)	*2,011*	*-9,416*	1,554	1,702	1,750	1,500	**6,506**

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.

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 3–6-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.

How to Read the Momentum Monitor

The Momentum Monitor Matrix summarizes the current values of each of the 12 Equipment & Software Investment Momentum Indices based on two factors: Recent Momentum (x-axis) and Historical Strength (y-axis):

- "Recent Momentum" indicates a vertical's recent acceleration or deceleration in the past month relative to its average movement during the previous 3 months. Ratings closer to "0" indicate rapid deceleration, while ratings near "10" represent rapid acceleration.
- "Historical Strength" reflects a vertical's strength in the past month relative to its typical level since 1999. Ratings closer to "0" represent an indicator that is weaker than average, while ratings closer to "10" represent an indicator that is stronger than average.

The matrix consists of four quadrants based on readings for each vertical's recent momentum and historical strength. If a vertical falls in the top-left quadrant, its momentum reading is higher than average, but positive movement has slowed (and perhaps reversed) in recent months — suggesting that investment levels may fall over the next 1-2 quarters. Verticals in the bottom-right quadrant, however, have momentum readings that are below average, but recent movement shows promise — suggesting that investment levels may rise over the next 1-2 quarters.