KEYBRIDGE
Public Policy Economics

COVID-19 and the U.S. Economy

Implications for the Equipment Finance Industry

Prepared For:
Equipment Leasing & Finance Foundation

Presented By:
Dr. Rob Wescott
Jeff Jensen

Presented:
April 15, 2020

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future

Welcome

Kelli Nienaber, Executive Director
Equipment Leasing & Finance Foundation

EQUIPMENT LEASING & FINANCE FOUNDATION
Your Eye on the Future

ELFA
EQUIPMENT LEASING AND FINANCE ASSOCIATION

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future
+11,00.00
2020 Equipment Leasing & Finance U.S. Economic Outlook - Q2 Update
Download for FREE!
2020
Q2 Update - April
Equipment Leasing & Finance
U.S. Economic Outlook
EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future
www.leasefoundation.org

Today’s Speakers

KEYBRIDGE
Public Policy Economics

Dr. Rob Wescott

Jeff Jensen

Agenda for Today

1	Effects on U.S. Economy and Financial Markets
2	Effects on Oil Sector
3	Effects on Equipment Finance Industry
4	Government Response
5	Key Questions and Takeaways

KEYBRIDGE Public Policy Economics

Effects on U.S. Economy and Financial Markets

Coronavirus injects fear into economic decision-making. It is also severely hurting travel and tourism, restaurants, recreation, sports, and high-human contact businesses.

KEYBRIDGE
Public Policy Economics

Economic Effects? Coronavirus brings both negative demand-side effects and negative supply-side effects.

Demand-side effects

Consumption

Less spending on travel/tourism and human contact services

Shelter-in-place sharply cuts spending

Investment Softens

Lower cash flow, defer investment projects

Exports Down

Weaker global demand

Supply-side effects

Supply Chain Disruptions

Shortage of critical parts; production slowed

Labor Supply Down

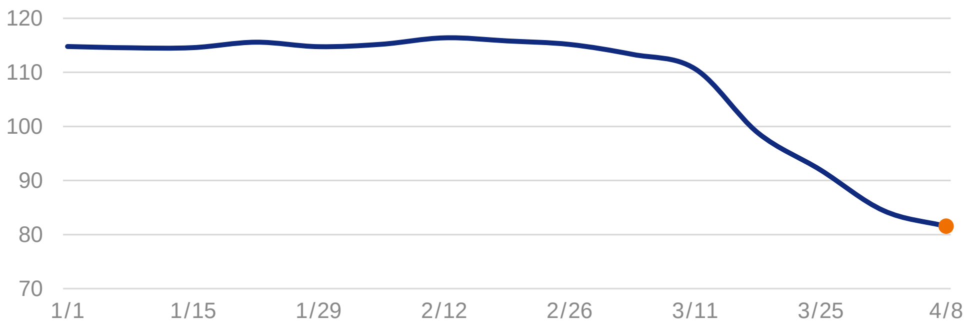
Factories shut down, workers furloughed, about 1/3 without pay

Inventories Cannot be Rebuilt

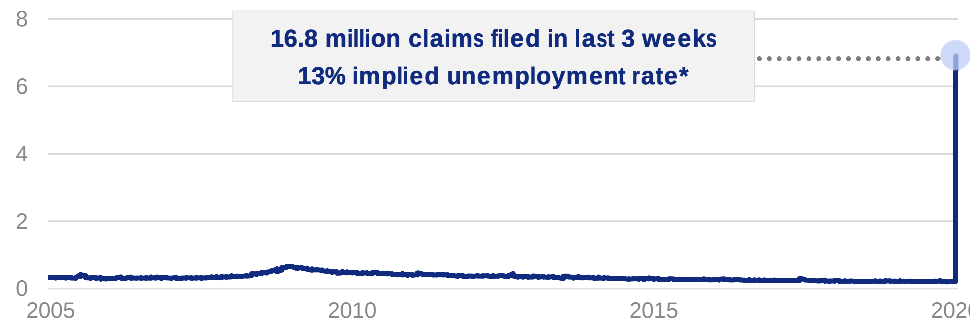
Goods cannot be replaced on shelves

Consumer sentiment has dropped as the U.S. faces a historic labor market crisis. The result is a drop-off in consumption that impacts both new purchases and routine rent and utility payments.

Morning Consult Consumer Sentiment
Daily Index

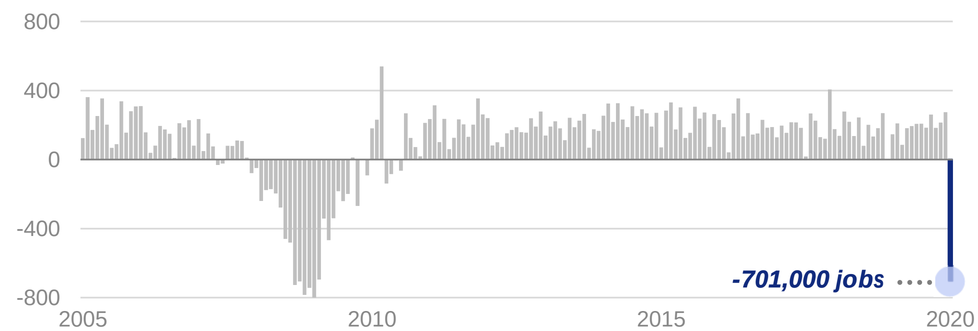


U.S. Unemployment Claims
Millions



Google Trends Search Index: "Can't pay"
100 = Peak Search Volume

Monthly Change in Non-Farm Payrolls
Thousands

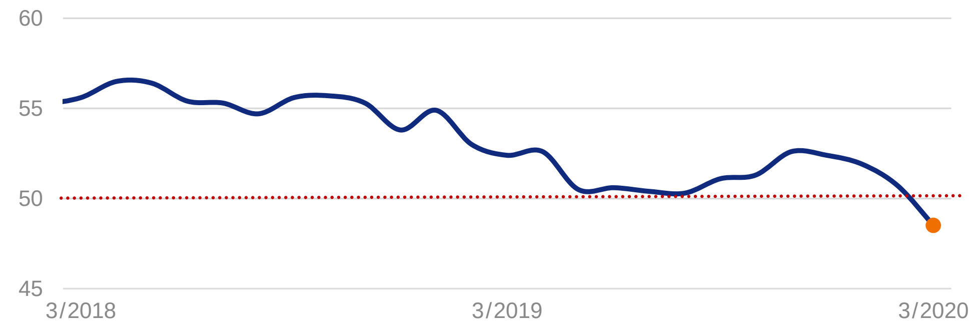


Source: Morning Consults, Google Trends, U.S. Bureau of Labor Statistics. | * implied unemployment rate per NYT Analysis

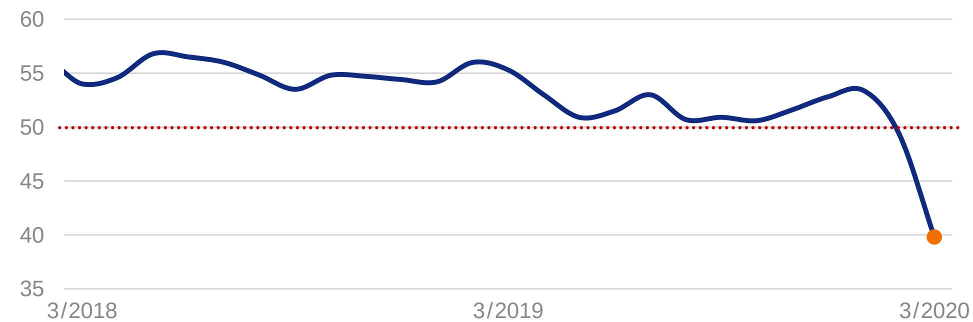
KEYBRIDGE Public Policy Economics

Business concerns are widespread across the economy. Business activity is contracting, small business confidence is at its lowest point since 2016, and financial stress is rising quickly.

U.S. Manufacturing PMI
Above 50 = Expansion

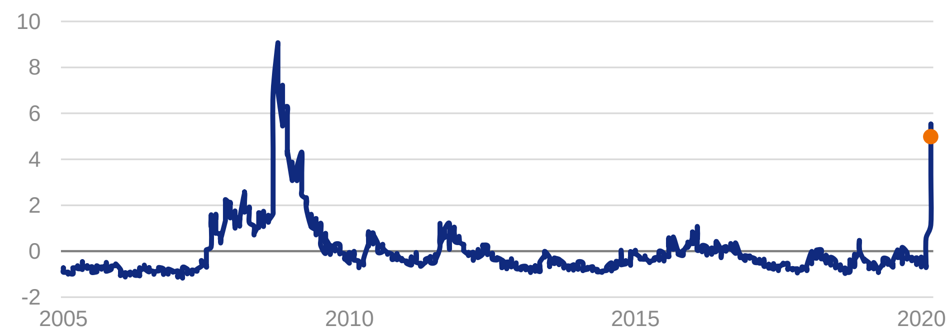


U.S. Services PMI
Above 50 = Expansion



NFIB Small Business Optimism Index

St. Louis Fed Financial Stress Index



Source: IHS Markit, National Federation of Independent Businesses, Federal Reserve

Specifically, human contact industries are likely to be most severely impacted by COVID-19, while the oil industry deals with a COVID-induced cratering of demand.

Tourism and Hospitality	Hotels are experiencing collapsing demand, with layoffs expected to exceed four million. A quick recovery is unlikely.
Restaurants	Most are taking a large hit to revenues and laying off staff; solvency rates to be impacted soon given tight operating margins.
Travel	Domestic passenger air travel is down 95% Y/Y. Boeing has shut down all aircraft production for weeks.
Oil	Massive demand shock could lead to a 30 million b/d glut. As a result, prices have plunged and storage capacity is nearing its limit.
Personal Services	Barbershops, movie theaters, and other personal services may see losses continue even after lifting of stay-at-home orders.

Financial Effects? So far, cutting rates has not been effective at battling the virus, so the Fed is now buying corporate bonds, bond ETFs, MBS, and Treasuries to try to keep markets running smoothly.

Interest Rates

- 150 basis point FOMC cut since March 3
- Secondary Market Corporate Credit Facility — buying corporate bonds and bond ETFs
- Trying to ensure smooth functioning of money market and commercial paper markets.

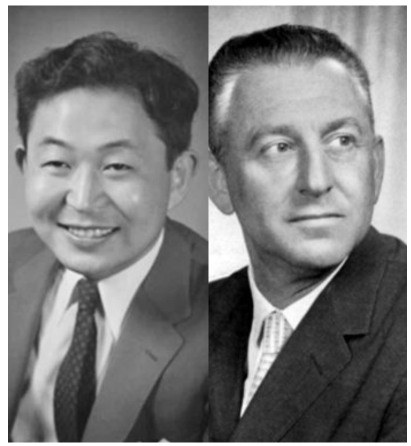
Stock Market

- Corporations on track for sharp losses in 2020
- Companies will lose key sales in China, Europe
- Top concerns: airlines, hotels, cruise lines, energy, retailing

Commodities & Currencies

- Oil prices down sharply as demand falls, hurting producers
- Weak commodities will also hurt emerging markets
- Positive for safe havens ($, U.S. Treasuries, yen, gold)

One nagging financial effect to worry about is the so-called “negative wealth effect”. If the DJIA were to stay in the 23,000 range, it would represent an ~$8 trillion loss in market capitalization.

Change in Equity Wealth		Ando/Modigliani Wealth Effect		Consumption Impact
	X		=	
▼ $8 Trillion?		3 - 4%		▼ $240-$320 bn

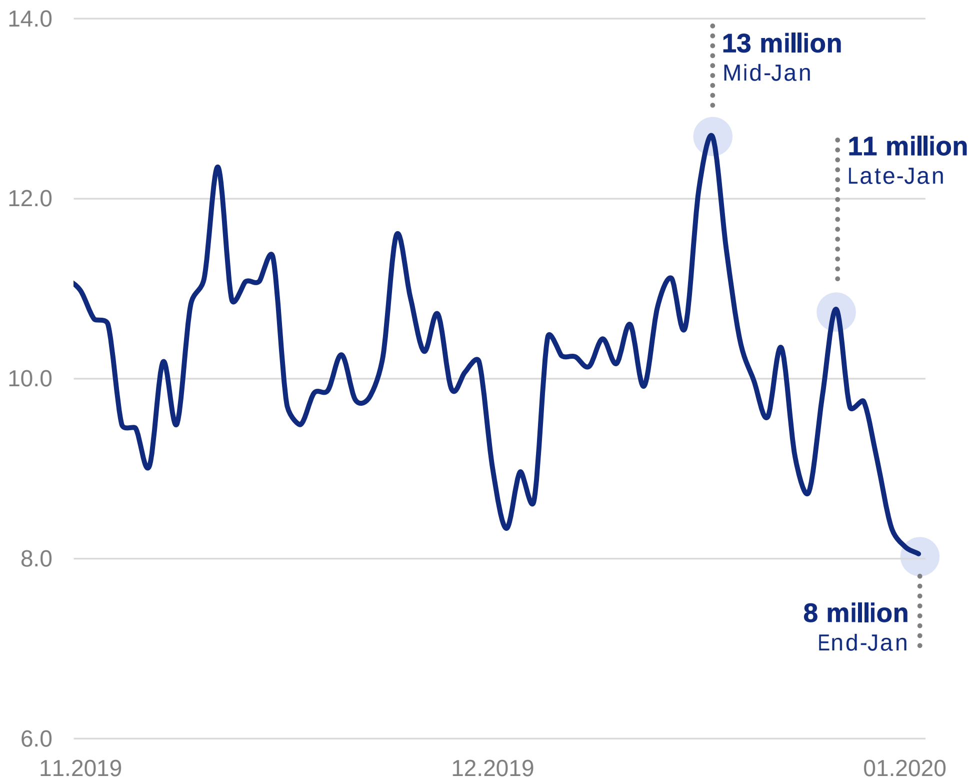
In a typical recession, consumption might decline by $200 billion

Effects on Oil Sector

Global oil markets have experienced twin demand and supply shocks, with falling demand due to the virus and the Saudi-Russia price war that sent production soaring in early March.

China Oil Imports

7-day moving average, million barrels/day



Source: Bloomberg visualization of Kepler data

The end of OPEC+?

(And can the U.S. do anything to end the standoff?)

Saudi Arabia

- Wanted Russia to agree to additional production cuts to **stabilize prices**
- Retaliated against Russia's refusal by **cutting prices and increasing output**
- Promised to raise **production by up to 300,000 barrels/day**

Russia

- Wants to reduce **U.S. production**
- Promised to **raise production by up to 500,000 barrels/day**
- Can meet budget needs with a much lower oil price than Saudi Arabia – **can likely withstand a longer confrontation**

A new deal?

- On April 12, major oil-producing nations agreed to cut production by 8.5 million b/d.
- However, even if producers follow through on these cuts, they would offset only ~30% of the global demand collapse.

The resulting crash in global oil prices has at least one clear loser: heavily-indebted U.S. shale producers who, according to a Dallas Fed survey, need much higher prices to cover costs.

Cushing OK WTI Spot Price

Dollars/barrel

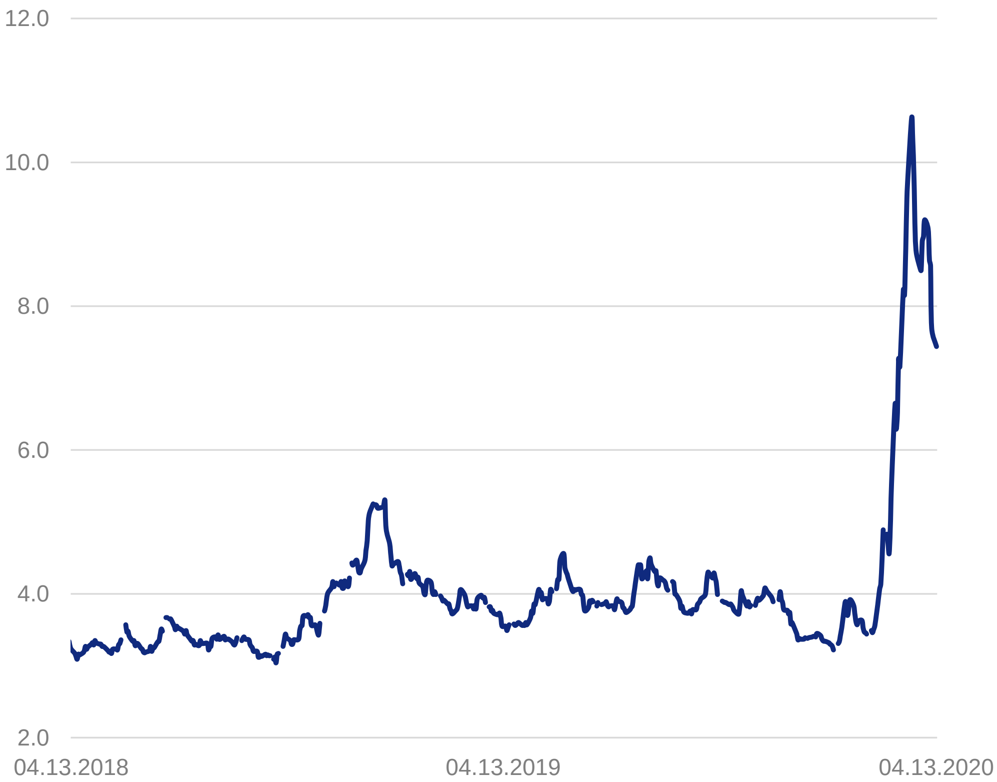
*In the Eleventh Federal District (Texas and parts of New Mexico and Louisiana)

Source: U.S. Energy Information Administration; Dallas Fed Energy Survey (2019 Q4)

Meanwhile, the high-yield bond market has seized up as investors react to the virus, restricting credit for struggling producers and setting the stage for a large-scale shakeout in the U.S. shale industry.

High-yield – 10-year Treasury Spread

Percentage points



Source: BofA ICE Data Indices, Bloomberg

Bankruptcy filings by exploration and production companies **jumped 51%** in 2019 after oil prices eased in 2018.

Speculative-grade debt already makes up **more than 60%** of total American shale sector debt maturing between 2020 and 2024.

By some estimates, U.S **oil production** could **fall by 30%** in 2020 compared to 2019 if prices remain in the $20s/barrel.

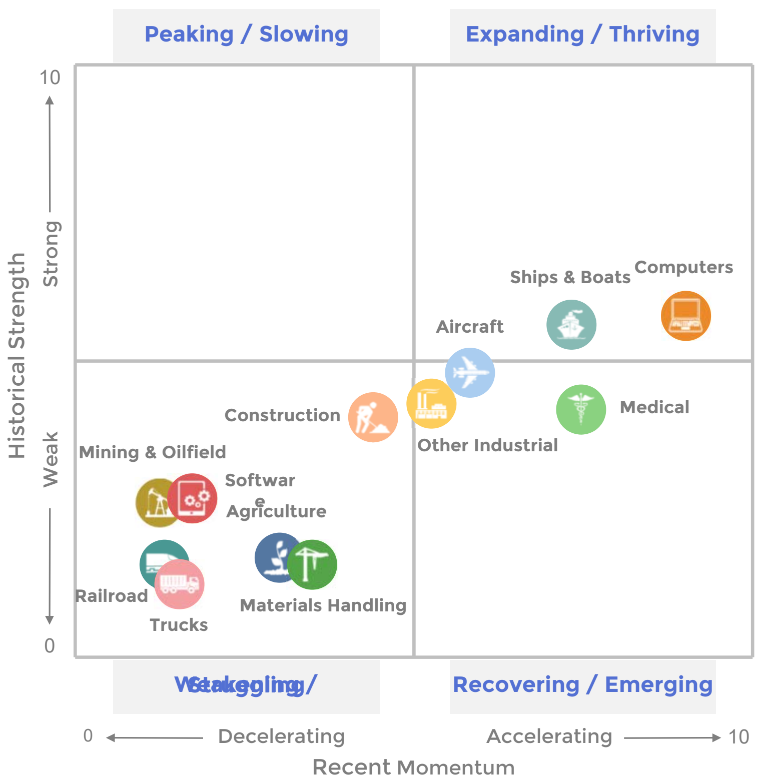
The **U.S. Energy Department** is already planning to buy 30-77 million barrels of domestic crude to **prop up** the industry and is considering **diplomatic intervention** into the Saudi-Russia spat.

Effects on Equipment Finance Industry

Momentum in some verticals improved in April, but this trend is unlikely to continue. Investment in most verticals will likely decline this year, but computers and medical equipment are potential bright spots.

Momentum Monitor Sector Matrix

April 2020



Source: Equipment Leasing & Finance U.S. Economic Outlook – Q2 Update

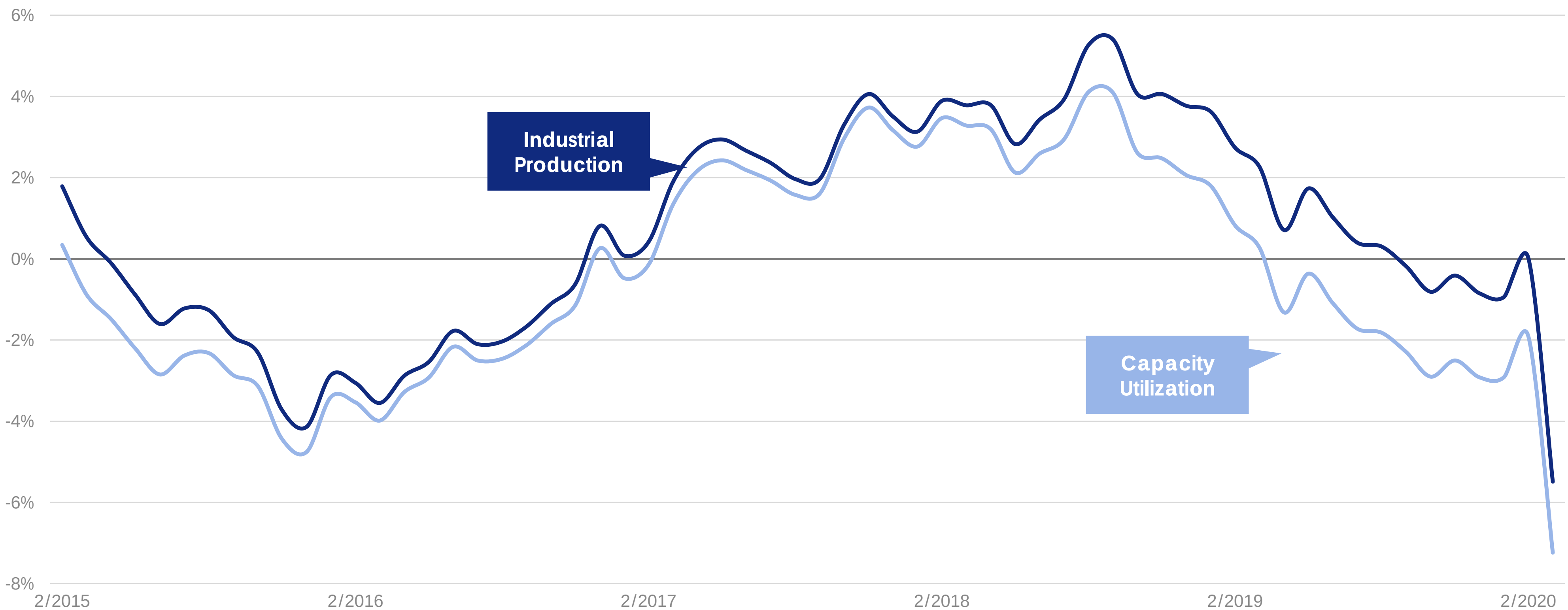
Movements to Monitor

Equipment Vertical	Investment Growth		Next 6 Months
	Q/Q	Y/Y	
Computers	+30%	+7.9%	▲
Medical Equipment	-2.3%	+0.5%	▲
Mining & Oilfield	+22%	+0.8%	▼
Trucks	-8.2%	+1.8%	▼

Manufacturing was beginning to show signs of revival in February after contracting throughout much of 2019. However, this recovery proved to be short-lived due to the pandemic.

Industrial Production and Capacity Utilization

Year-over-year percent change

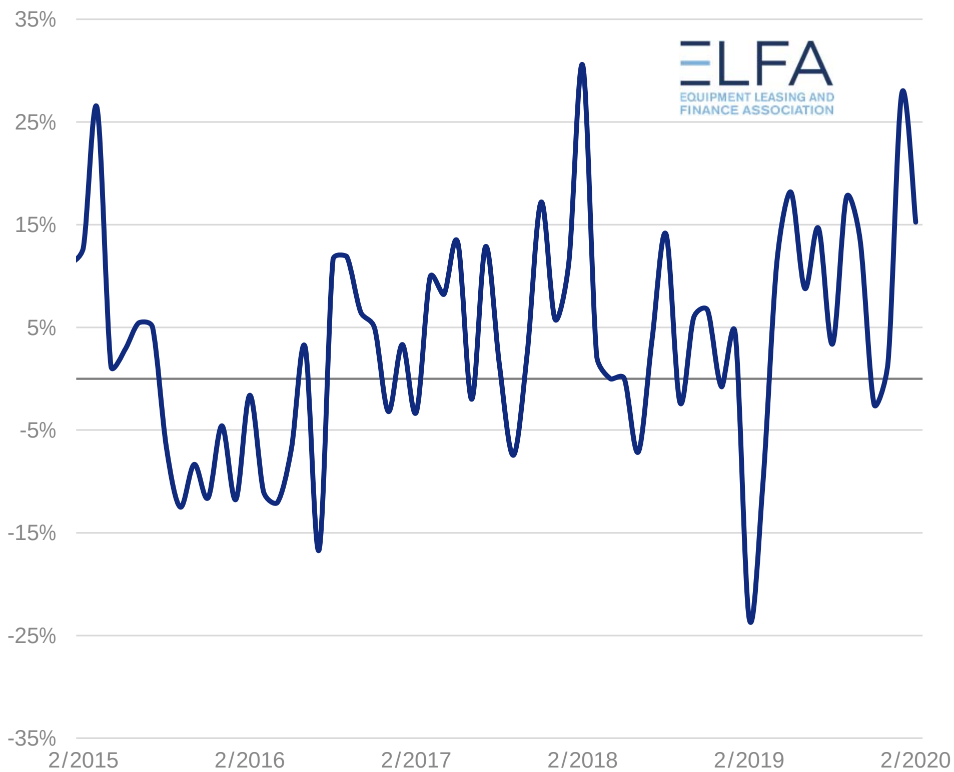


Source: Federal Reserve Board of Governors

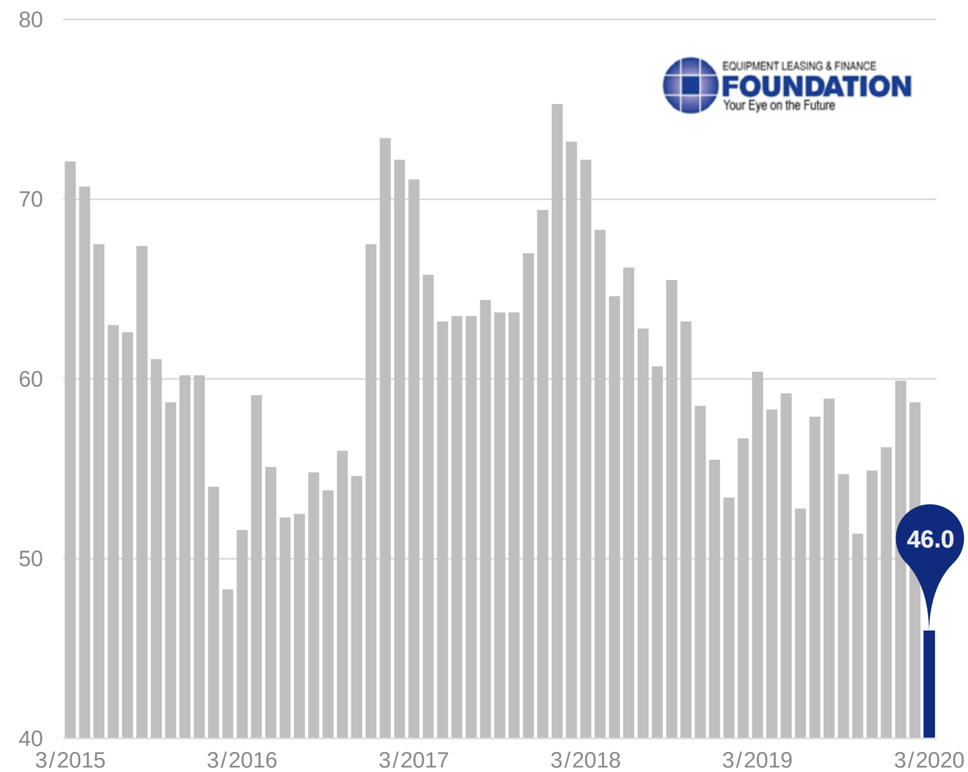
While coronavirus effects have yet to appear in the MLFI-25, the industry's Monthly Confidence Index dropped to the lowest level in since the series began in 2009.

MLFI-25 New Business Volume

Year-over-year percent change



Monthly Confidence Index - Equipment Finance Industry



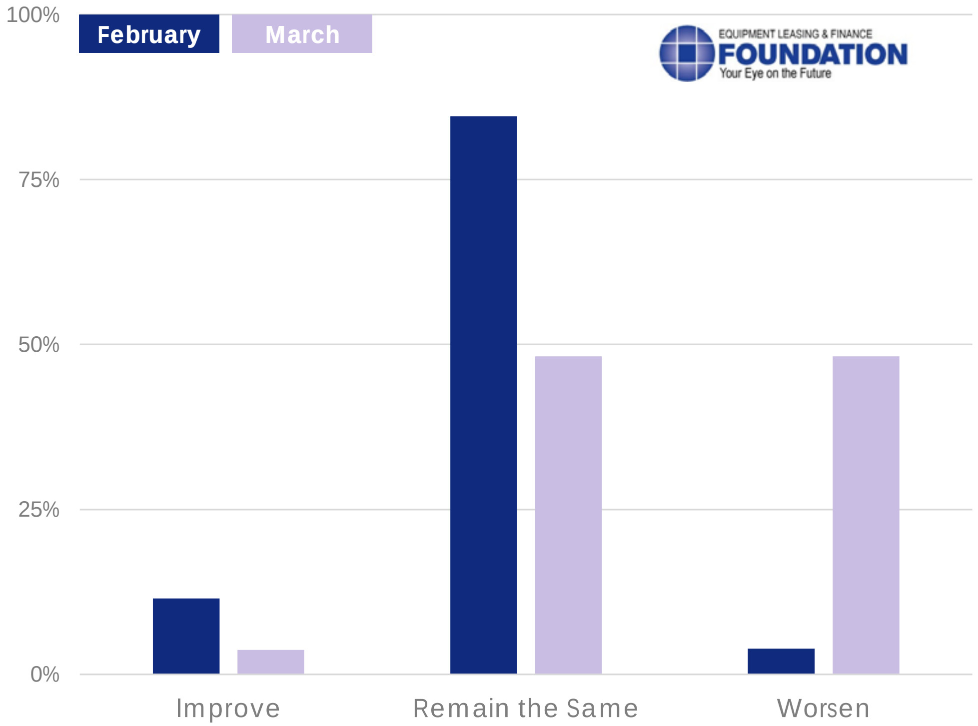
Source: Equipment Leasing & Finance Association; Equipment Leasing and Finance Foundation

KEYBRIDGE Public Policy Economics

Within the March MCI-EFI, executives remain reasonably upbeat about the economy (with just 4% rating it as "Poor"), but expectations of future business conditions worsened significantly.

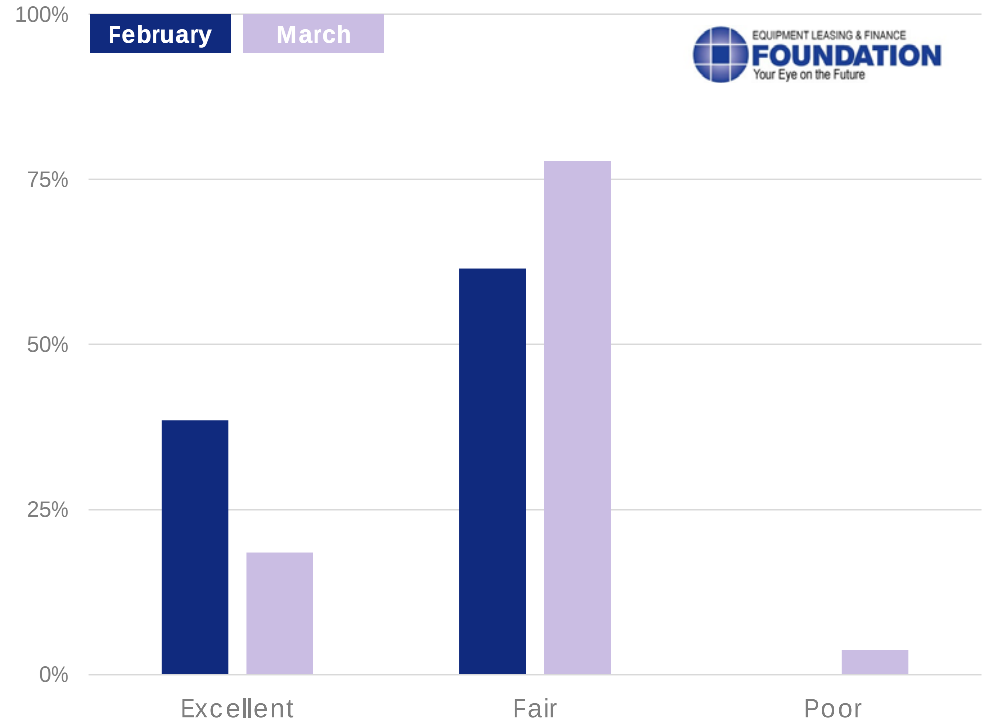
Expectations of Business Conditions

Over next 4 months; subset of ELFF MCI-EFI



Evaluation of the Current U.S. Economy

Subset of ELFF MCI-EFI



Source: Equipment Leasing & Finance Foundation Monthly Confidence Index – Equipment Finance Industry (MCI-EFI)

Meanwhile, Main Street has been hit exceptionally hard. Employment and employee hours have plummeted, while half of small businesses will be unable to operate under current conditions past May.

Small Businesses Hours Worked

Down 60% from year-ago levels

Small Businesses Employees Working

Down 63% year-on-year

Small Business Optimism

Largest monthly decline in NFIB's survey history

Fighting for Survival

*50% of small businesses can't operate under current conditions for more than 2 months**

Source: Homebase, National Federation of Independent Businesses | * survey conducted March 30

The U.S. economy is in recession and will suffer a historically deep contraction Q2. However, a timely and well-coordinated policy response could limit long-term effects if the virus is contained.

Keybridge 2020 Industry Forecasts

Indicator	2018	2019	2020 Quarterly Estimates				2020e
			Q1e	Q2e	Q3e	Q4e	
Real GDP *(SAAR %)*	*2.9%*	*2.3%*	-4 to -8%	-30 to -40%	5 to 10%	5 to 10%	**-5.0 to -9.4%**
Real Investment in Equipment & Software *(SAAR %)*	*7.7%*	*3.4%*	-5 to -10%	-40 to -50%	5 to 10%	5 to 10%	**-8.6 to -13.5%**
Inflation *(year-on-year %)*	*2.4%*	*1.9%*	1.3%	-0.5%	0.5%	1.0%	**0.6%**
Federal Funds Target Rate *(upper bound, end of period)*	*2.5%*	*1.75%*	0.25%	0.25%	0.25%	0.25%	**0.25%**
Total Payroll Growth *(thousands)*	*2314*	*2133*	-212	-22,000	7,000	10,000	**-5,212**

Government Response

Government response has been a mix of "bottom up" and "top down" policies. While bottom-up policies tend to grab the headlines, top-down policies are critical for mitigating longer-term fallout.

Bottom Up

Targets consumers to alleviate financial stress

CARES Act

- $1,200 payments to adults ($500/child) for most American households (phased out for higher earners)
- An extra $600/week for unemployed workers (16 weeks)
- Pandemic Unemployment Assistance for non-payroll workers (i.e. gig workers, freelancers, etc.)

State policies

- California: moratorium on evictions through May 31
- New York: waived deposit and withdrawal credit card and ATM fees

Top Down

Targets employers to avoid layoffs

Targets lenders to keep liquidity flowing

CARES Act

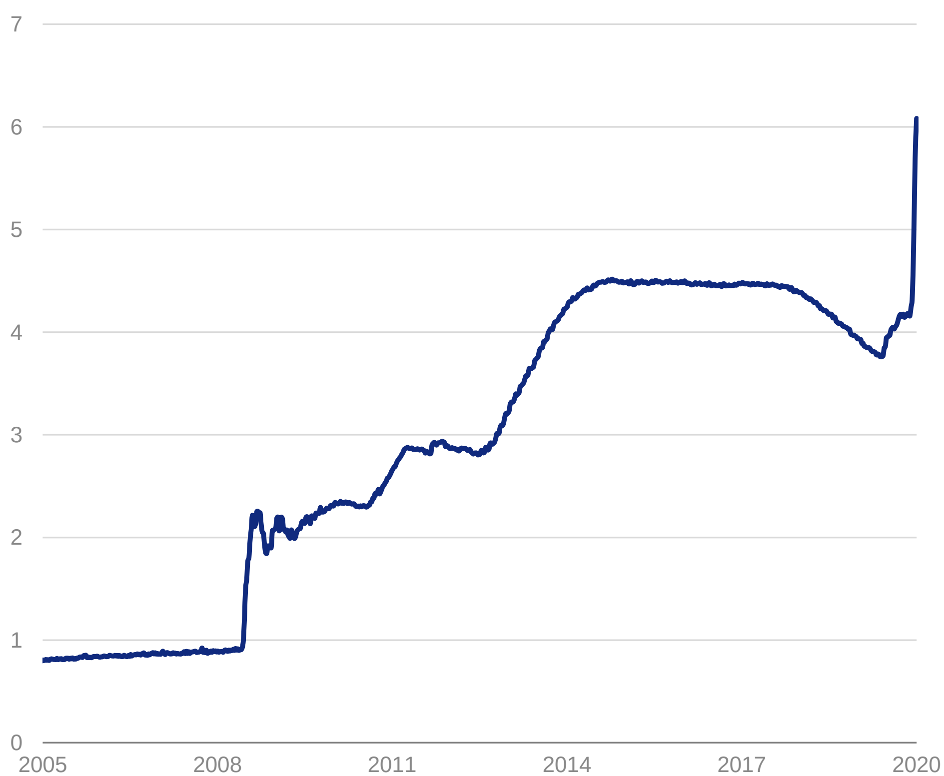
- Forgivable SBA loans for firms that maintain payrolls
- $270 billion in tax relief directed at businesses
- $50 billion + fund to keep airlines solvent

Federal Reserve policies

- Main Street Lending Program targeting small- and medium-sized firms
- Purchasing debt backed by SBA emergency small-business lending program
- Secondary Market Corporate Credit Facility to purchase corporate bonds and ETFs

The Federal Reserve has been proactive, quickly ramping up bond purchases and establishing a variety of lending and liquidity facilities to keep financial markets operating smoothly.

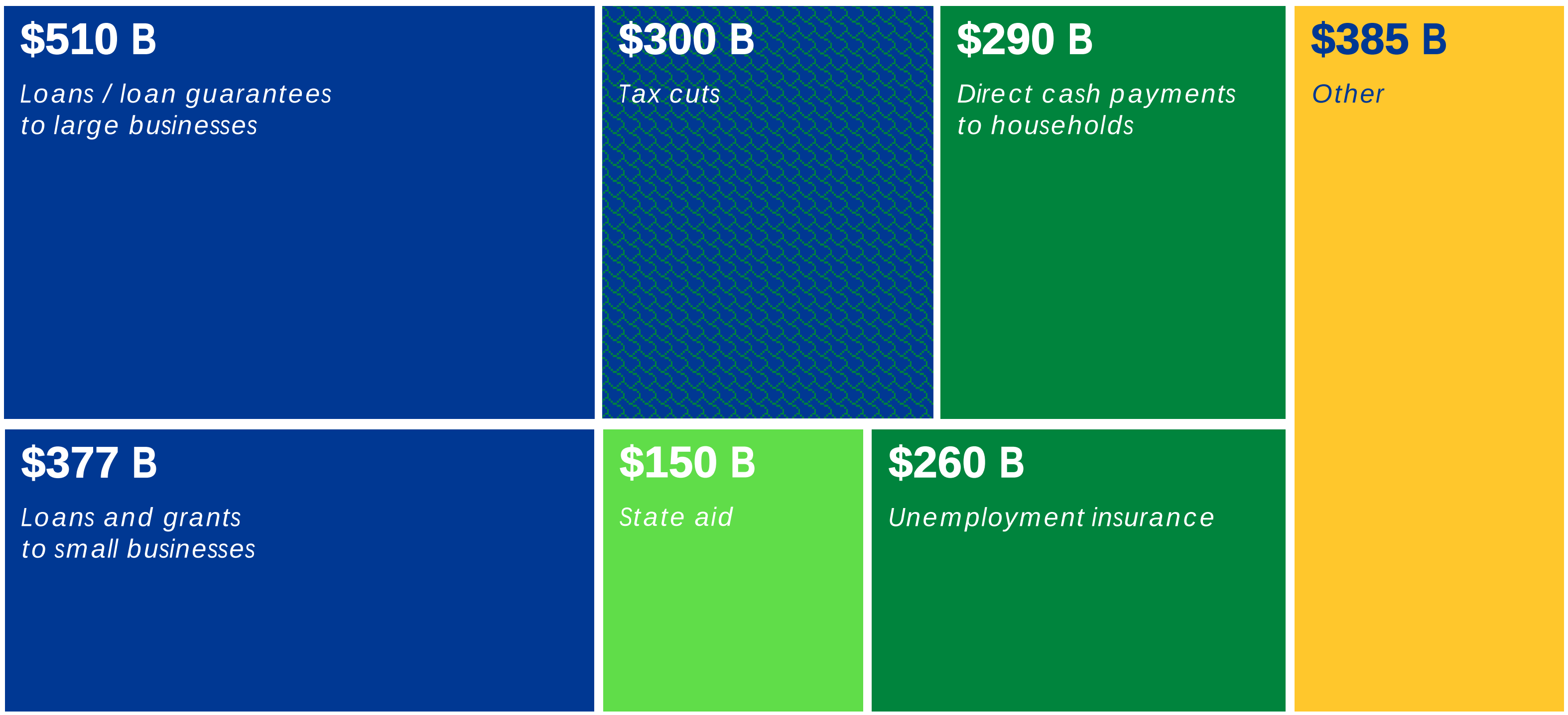
Federal Reserve Assets
$ Trillions



Source: Federal Reserve

Meanwhile, congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, providing $2.3 trillion in fiscal stimulus to consumer, businesses, and states.

CARES Act Funding Breakdown



Source: U.S. Senate, Bloomberg News

At the core of small business relief in the CARES Act is the Paycheck Protection Program (PPP), which is intended to provide relief for businesses while incentivizing employers to maintain payrolls.

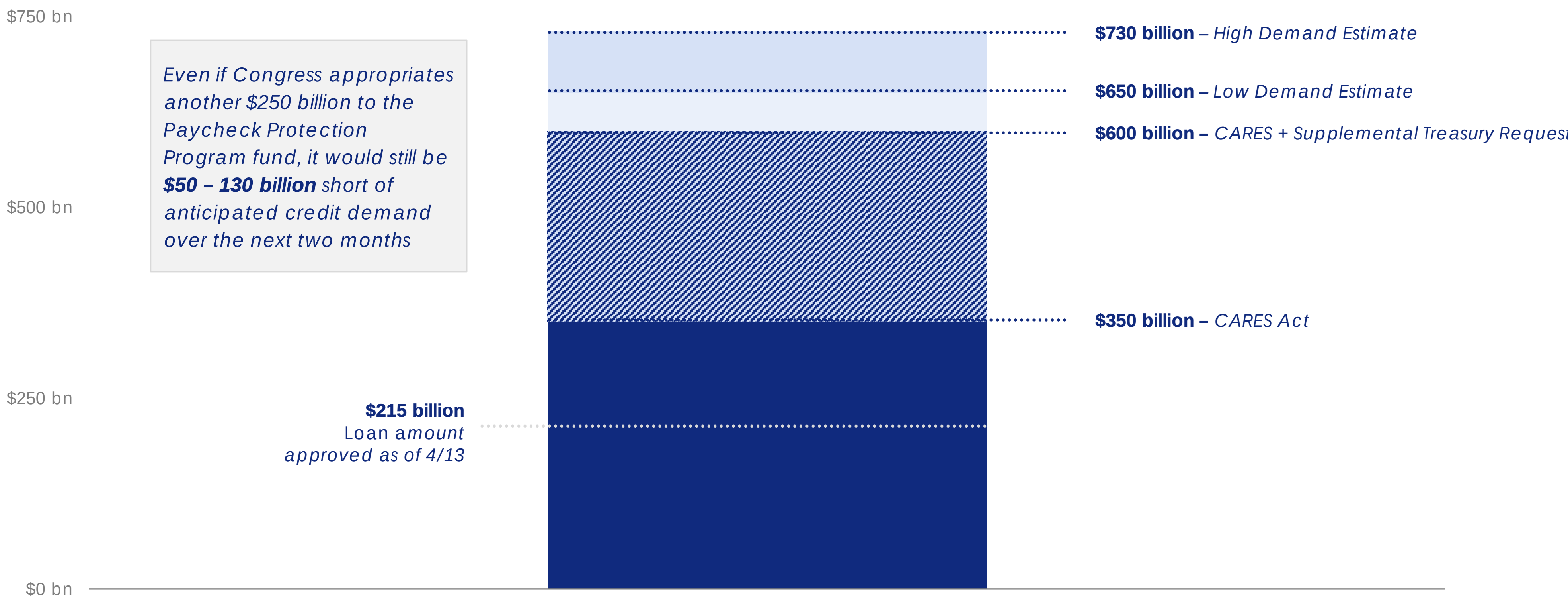
- **Accessible to companies with under 500 employees.** Independent contractors and sole proprietors are also eligible to apply.
- **Companies apply for loans through their private lenders.** The Small Business Administration (SBA) processes the loans.
- **Designed to cover eight weeks of payroll.** Companies can apply for loans 2.5X weekly payroll (up to $10 million).
- **Loans are forgivable under certain conditions.** Businesses must maintain employment levels and spend at least 75% of the loan on payrolls.
- **Demand has been robust.** As of 4/13, SBA had process 880,000 loans worth $215 billion from more than 4,500 participating lenders.

Visit ELFA for all COVID resources: **www.elfaonline.org/covid-19**

However, without a sizable infusion of funds, the program will fall short of meeting demand (and still only covers expenses through early June).

Paycheck Protection Program Funding Gap

Appropriated Funding vs. Estimated Demand*



* Estimated demand based off Keybridge calculations of small business payrolls based off data from the Bureaus of Economic Analysis, Bureau of Labor Statistics, and Census Bureau

Key Questions and Takeaways

The shape of the economic recovery — be it U-shaped, V-shaped, or L-shaped — is contingent on the answers to these key questions.

What can we learn from China's recovery?

How will states cover the shortfall?

Will fiscal policy be big enough – and quick enough – to facilitate a second-half rebound?

Will there be additional waves?

Key Takeaways

A global recession is already underway. Although China is slowly forging a recovery path, Europe's economy is being ravaged by the virus and emerging markets (India? Latin America?) may be next to suffer sharp downturns.

The U.S. economy is also already in recession. The service sector, historically a resilient engine of growth, is leading the downturn, particularly in industries that rely on human contact (e.g., travel and tourism, restaurants, entertainment, personal services).

This is likely to be a very tough year for the equipment finance industry. After slowing to the weakest growth since 2016 last year, E&S investment is expected to plunge along with the rest of the U.S. economy. Industries like computers and medical devices may be more resilient, however.

Small businesses are at heightened risk. Bigger corporations have more financial room to stave off short- and medium-term shocks. A major shakeout in energy is coming, but this will likely lead to consolidation benefiting larger firms. Look for lingering pain in travel and tourism, accommodation, and traditional retailing.


EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future
+11,00.00
2020 Equipment Leasing & Finance U.S. Economic Outlook - Q2 Update
Download for FREE!
2020
Q2 Update - April
Equipment Leasing & Finance U.S. Economic Outlook
EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future
www.leasefoundation.org