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Capital Expenditures Outlook

As of January 31, 2021

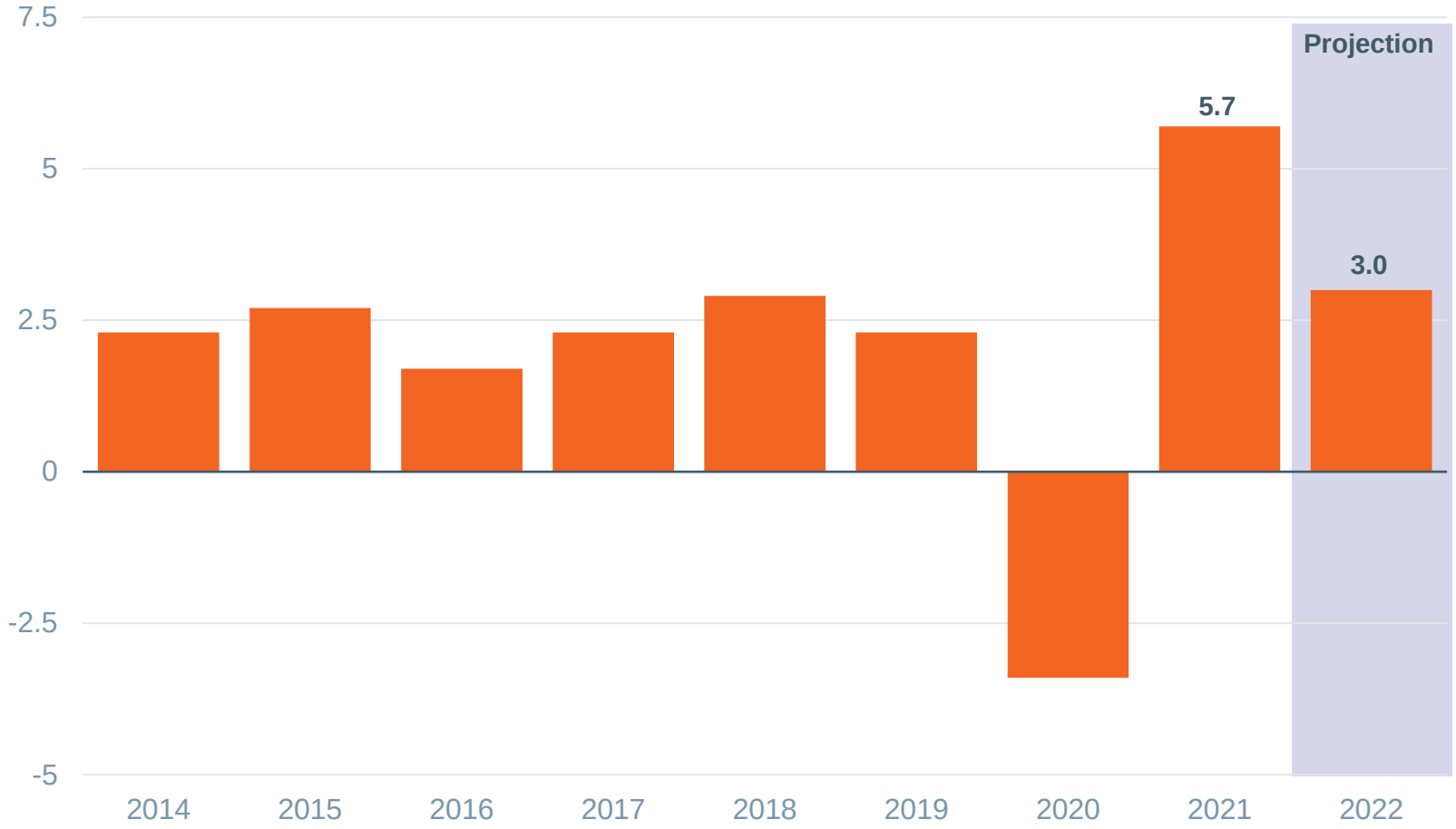
Key Takeaways

- We expect GDP growth to moderate to 3.0% in 2022 from its rapid pace in 2021 (5.7%) but to remain above trend.
- A tech-led business capital expenditure (capex) recovery is underway and separates the overall performance of business spending in this cycle compared with previous cycles
- Conditions for further strength in capex remain in place: company bank balances remain elevated, credit conditions remain supportive, and our expectations are that the Federal Reserve (Fed) rate hike cycle will be gradual
- The bipartisan infrastructure bill should be supportive of capex for several years
- Risks to the capex outlook include the potential for a more-aggressive-than-expected rate hike cycle and uncertainty around structural shifts in consumer behavior in the post-pandemic economy
- We expect solid capex to bolster GDP growth and productivity in the year ahead, though the pace may slow after a rapid run-up in 2021

Economic Growth Set to Decelerate in 2022

In the U.S., we expect growth to slow from the strong bounce seen in 2021 as fiscal stimulus recedes. Our projection of 3.0% in 2022 remains above trend and is driven by consumer spending, business capex, and inventory rebuilding.

Real gross domestic product (GDP, %)

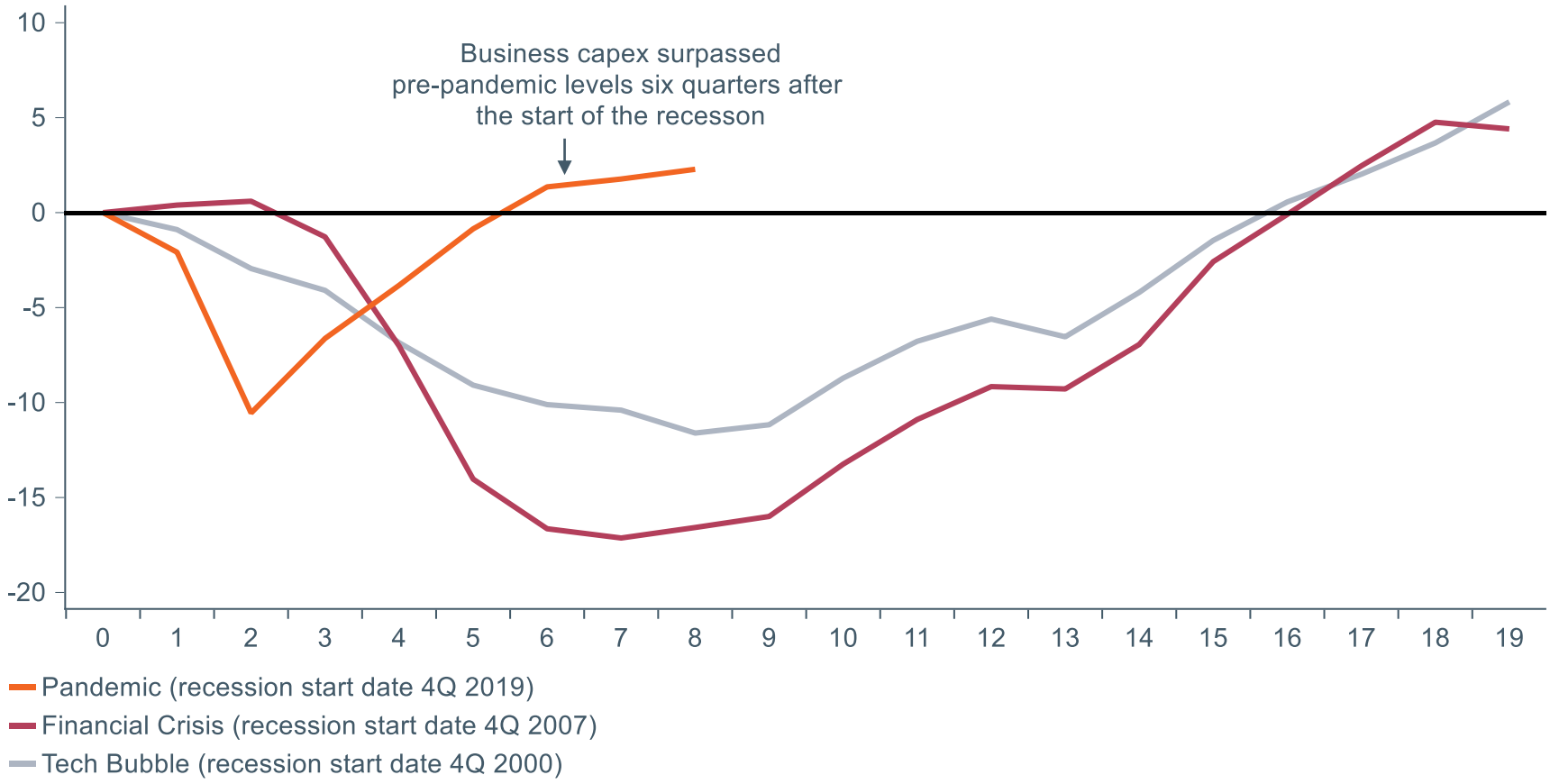


Data as of November 30, 2021. Sources: Bureau of Economic Analysis, WTIA.

Capex Rebound has been Swift

Business capex recovered to pre-COVID levels as of 2Q 2021, just six quarters after the start of the recession (compared to an average of 11 quarters in the recessions since 1957). In the two most recent recessions (below) capex did not recover the previous peak until 17 quarters later.

Business capex (cumulative % change in the quarters after the start of recessions)

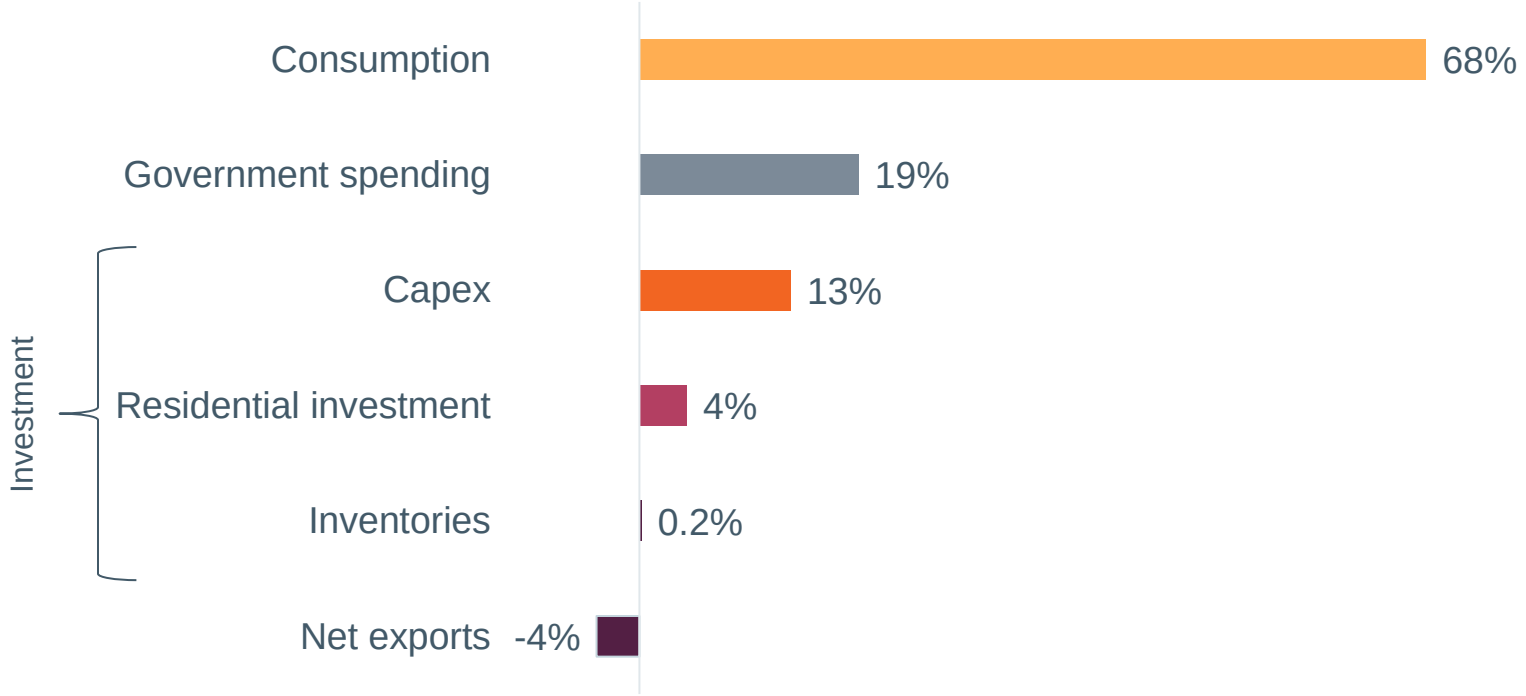


Data as of 4Q 2021. Sources: Macrobond, Bureau of Economic Analysis.

Business Capex: An Important Driver of GDP

Business capex accounts for a significant 13% of GDP. Along with consumption, it is a key driver of private demand in the U.S. economy.

Shares of GDP by component (%, average 2000-2019)

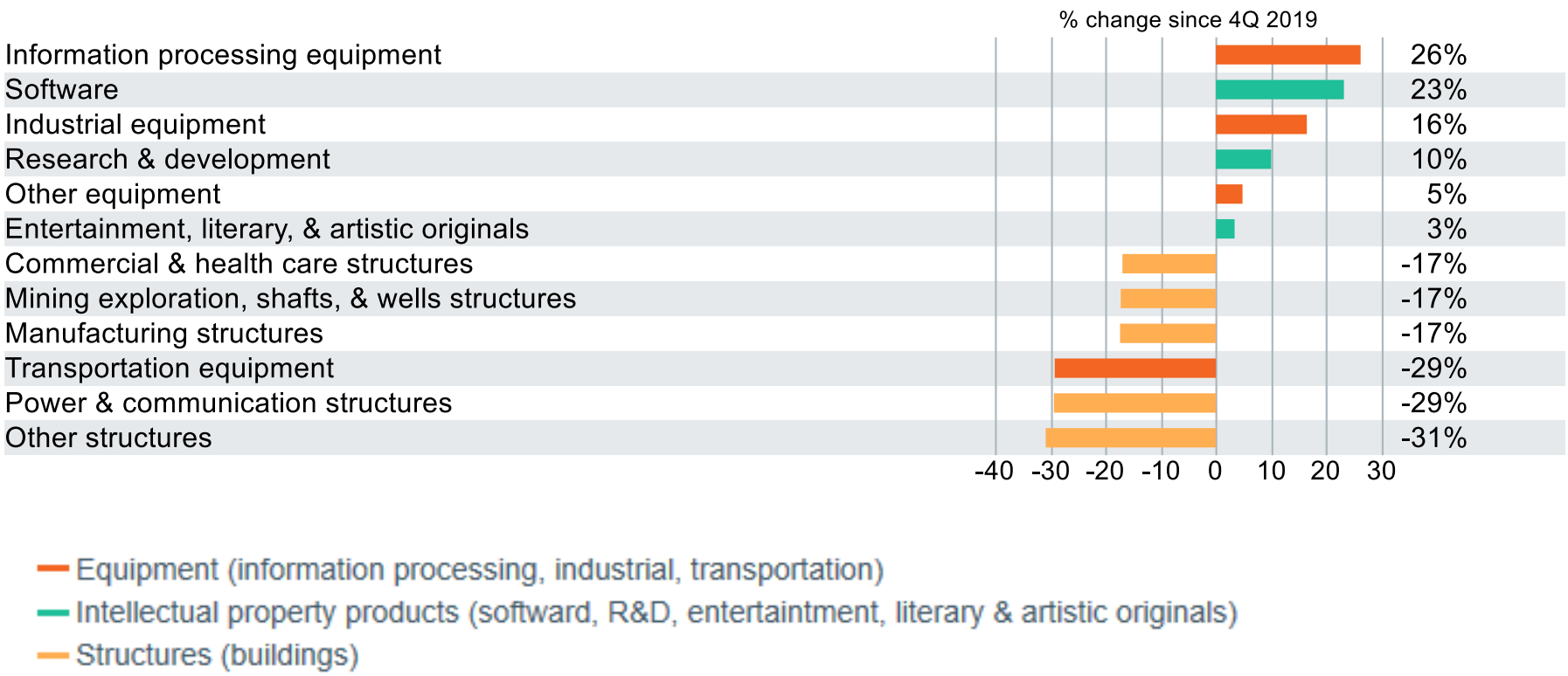


Data as of 4Q 2019. Sources: Macrobond, Bureau of Economic Analysis, WTIA.

Firms' Capex on Technology Soared in Wake of Pandemic

Business capex has been led by spending on software and information processing equipment (such as computers) as firms turn to technology to adapt to the pandemic environment and increase efficiency. Investment in new structures is well below pre-recession peaks and continues to decline.

Subcomponents of business capex (% change from 4Q 2019 to 3Q 2021)

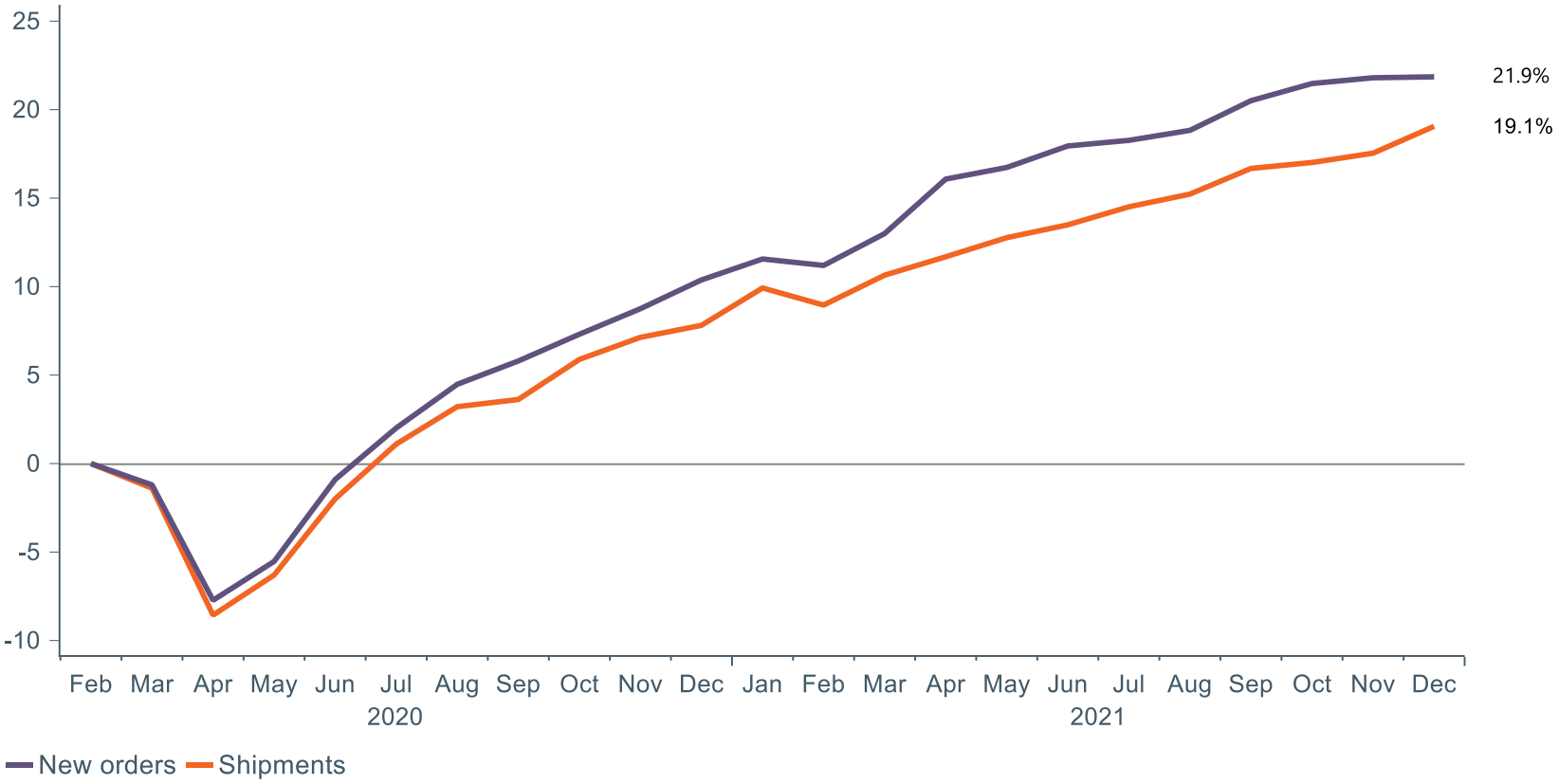


Data as of 4Q 2021. Sources: Macrobond, Bureau of Economic Analysis.

Indicators of Capex on Equipment Remain Elevated

Nondefense capital goods ex-aircraft* shipments (an indicator for business equipment investment) and new orders (a forward- looking indicator) remained solid through 2021. The inflection higher in shipments suggest a tentative easing of supply chain disruptions in December.

Shipments and new orders for core durable goods (non-defense capital goods ex-aircraft, % change since February 2020)



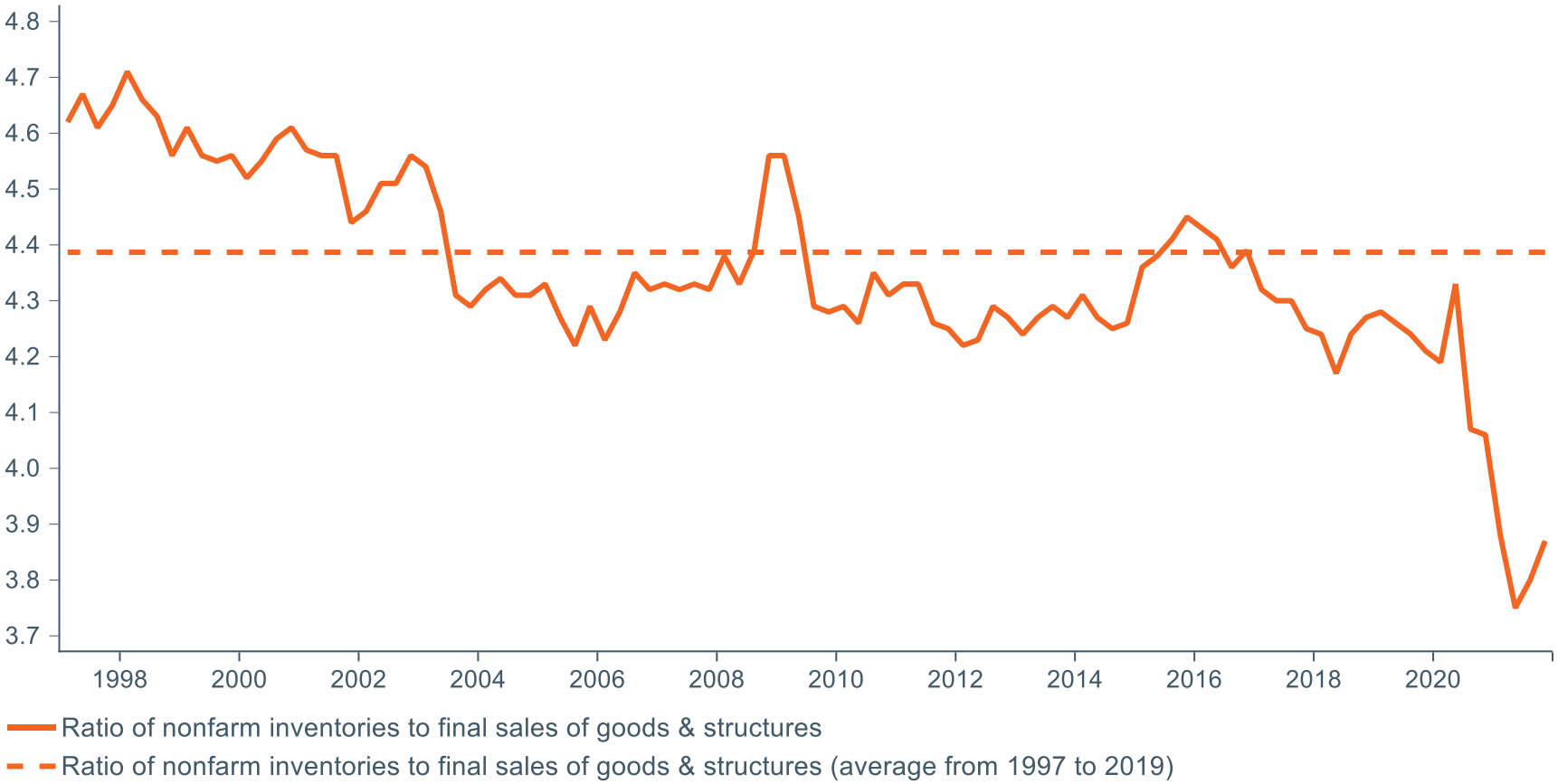
Data as of December 31, 2021. Sources: Macrobond, Census Bureau.

Nondefense capital goods (ex-aircraft) include: small arms and ordnance; farm machinery and equipment; construction machinery; mining, oil, and gas field machinery; industrial machinery; vending, laundry, and other machinery; photographic equipment; metalworking machinery; turbines and generators; other power transmission equipment; pumps and compressors; material handling equipment; all other machinery; electronic computers; computer storage devices; other computer peripheral equipment; communications equipment; search and navigation equipment; electromedical, measuring, and control instruments; electrical equipment; other electrical equipment, appliances, and components; heavy duty trucks; railroad rolling stock; ships and boats; office and institutional furniture; and medical equipment and supplies.

Low Inventory Levels Suggest Support for Further Capex

Strong demand for goods during the pandemic has pushed business inventories relative to sales down to near-record lows, and well below the long-term pre-pandemic average. Rebuilding of inventories should be supportive of further capex, particularly in areas like industrial equipment.

Inventory-to-sales ratio and long-term average

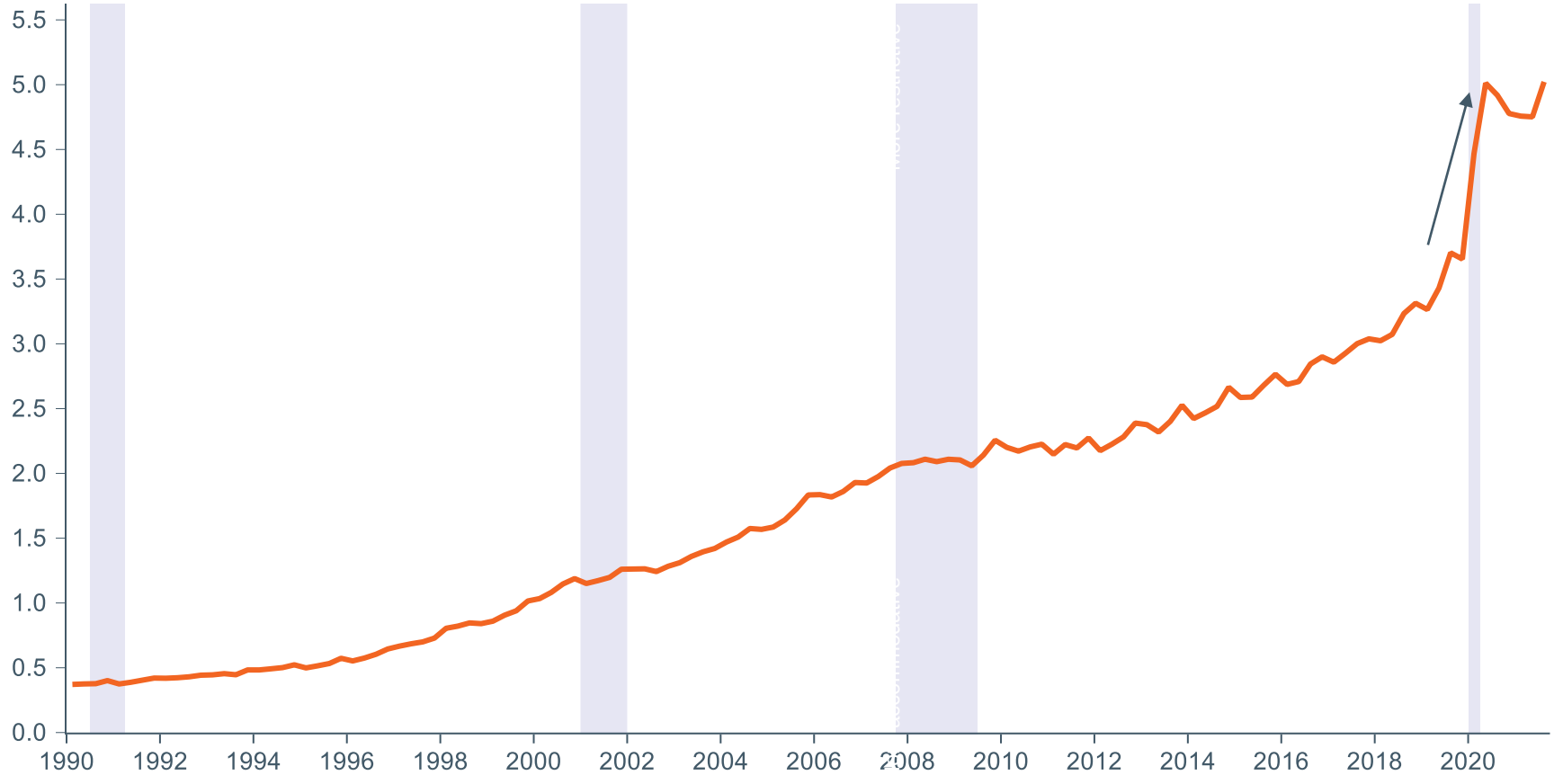


Data as of 4Q 2021. Sources: Macrobond, Bureau of Economic Analysis.

Elevated Liquidity On Hand

Firms are well situated to expand capex thanks to large balances amassed since the start of the pandemic thanks to stimulus funds (Paycheck Protection Program), supportive corporate credit issuance conditions (for larger firms that can access capital markets), and reduced spending on expenses such as travel.

Nonfinancial business balances* ($, billions)



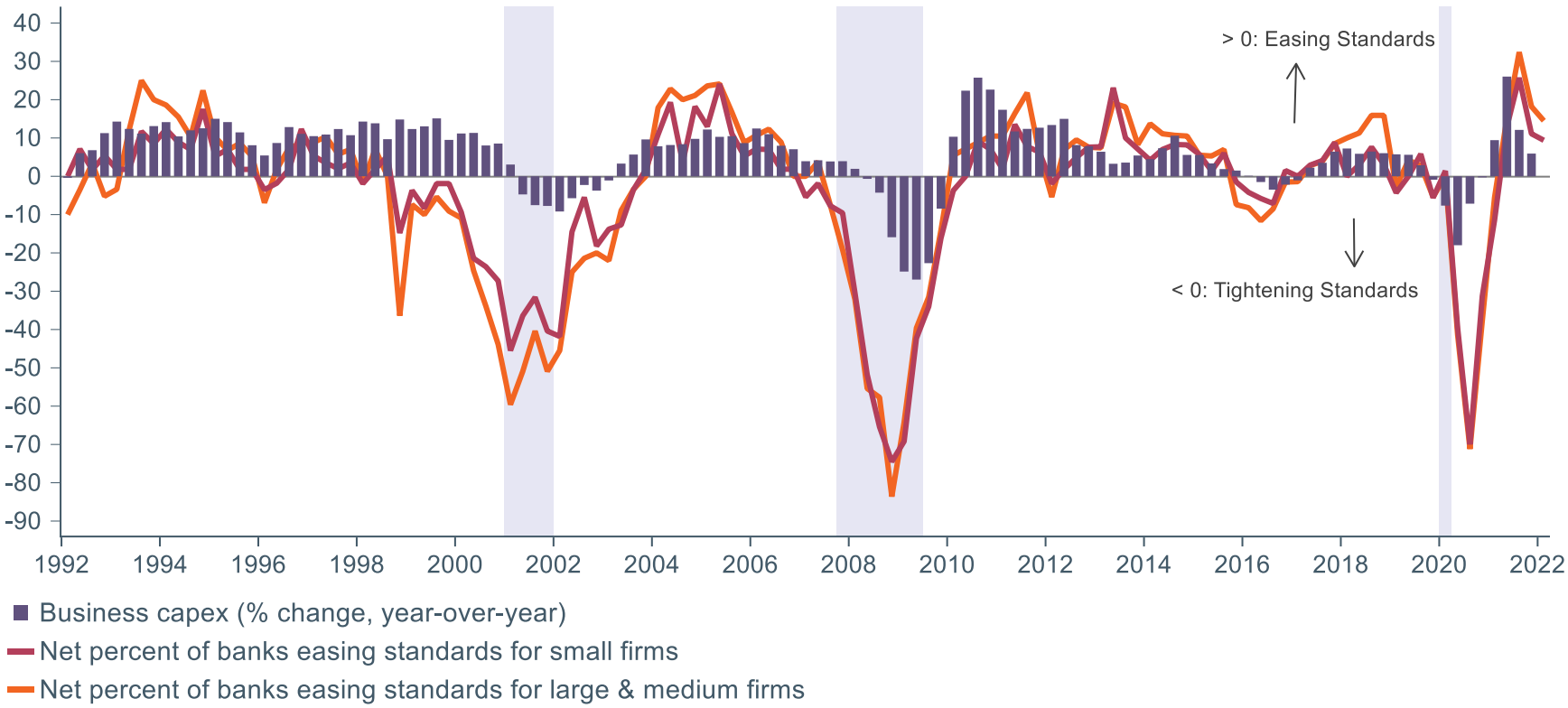
**Nonfinancial balances are calculated as the sum of checking, currency, savings, time, and money market deposits*

Data as of 3Q 2021. Sources: Federal Reserve, Macrobond.

Loan Standards Easing

The Fed's bank loan officer survey show that on net, banks are easing standards for commercial and industrial (C&I) loans, which has historically been supportive of increased capital expenditures.

Net percent of banks easing standards for C&I loans and business capex (year-over-year (y/y) % change)

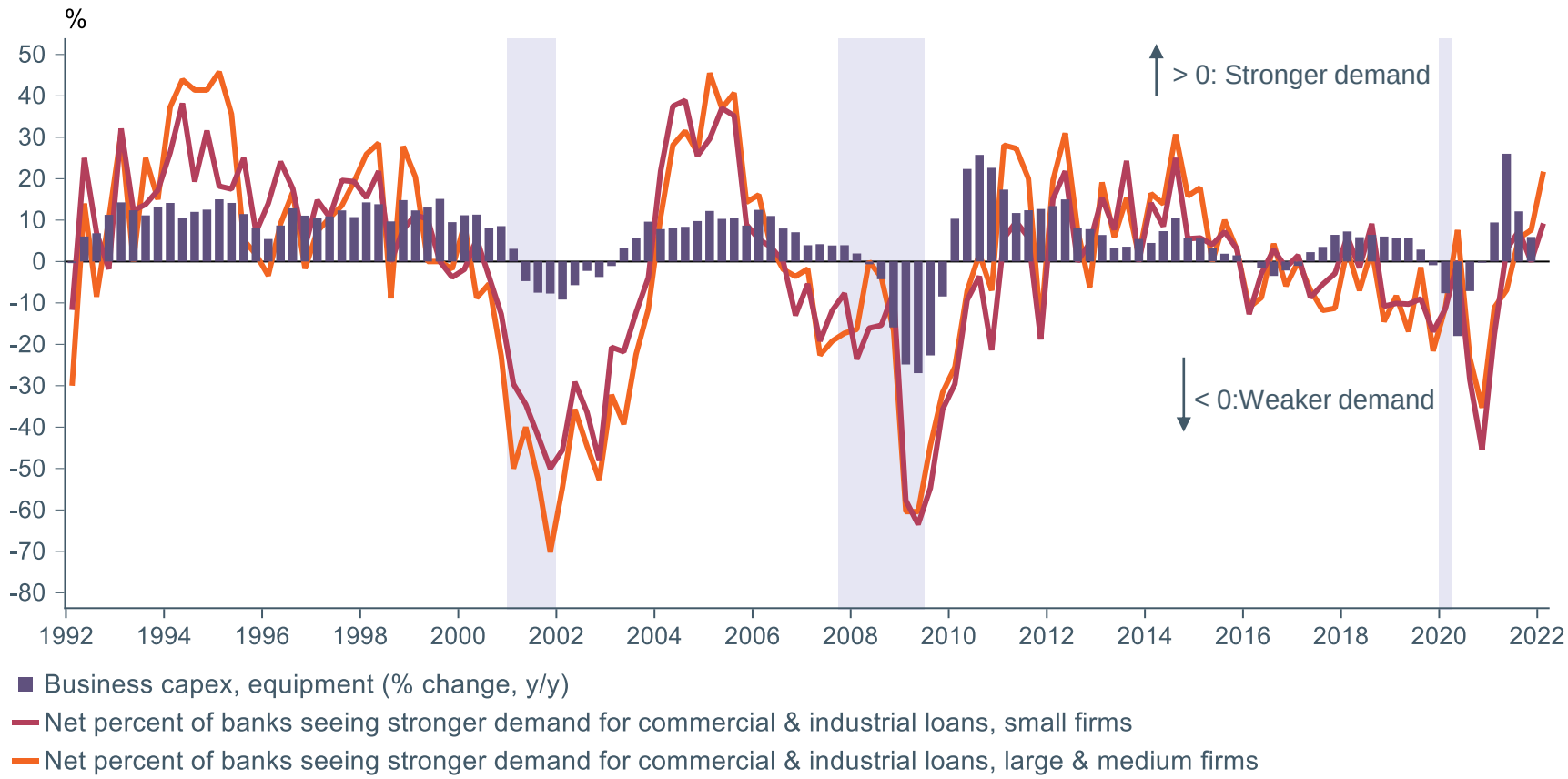


Data as of 4Q 2021. Sources: Macrobond, Bureau of Economic Analysis, Federal Reserve.

Loan Demand Improving Notably for Larger Firms

Banks report strong improvement in demand for C&I loans from large and medium-size firms. Demand for loans from small firms softened slightly in 3Q 2021 but ticked back up in 4Q 2021. Softer loan demand may not be a sign of slower capex to come, as pandemic boosted cash balances noted earlier may allow some firms to fund capex projects directly.

Net percent of firms reporting strengthening demand for C&I loans and business capex (% y/y)

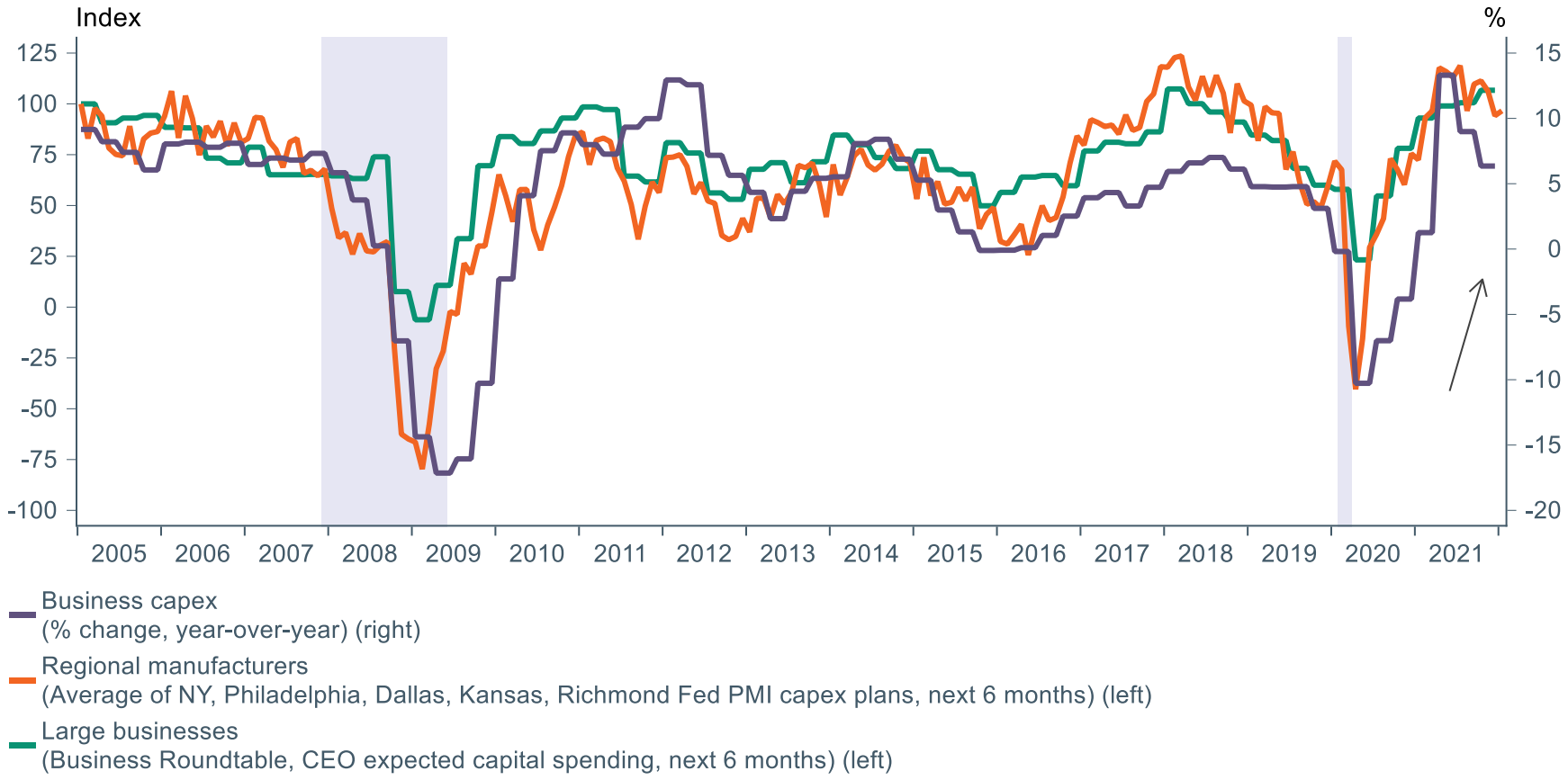


Data as of 4Q 2021. Sources: Macrobond, Bureau of Economic Analysis, Federal Reserve.

Capex Plans Solid for Large Firms and Manufacturers

Surveys of manufacturing firms in several Federal Reserve districts and a national survey of large firms (Business Roundtable) show plans for future capex at elevated levels.

Large business and regional manufacturer capex plans (index)

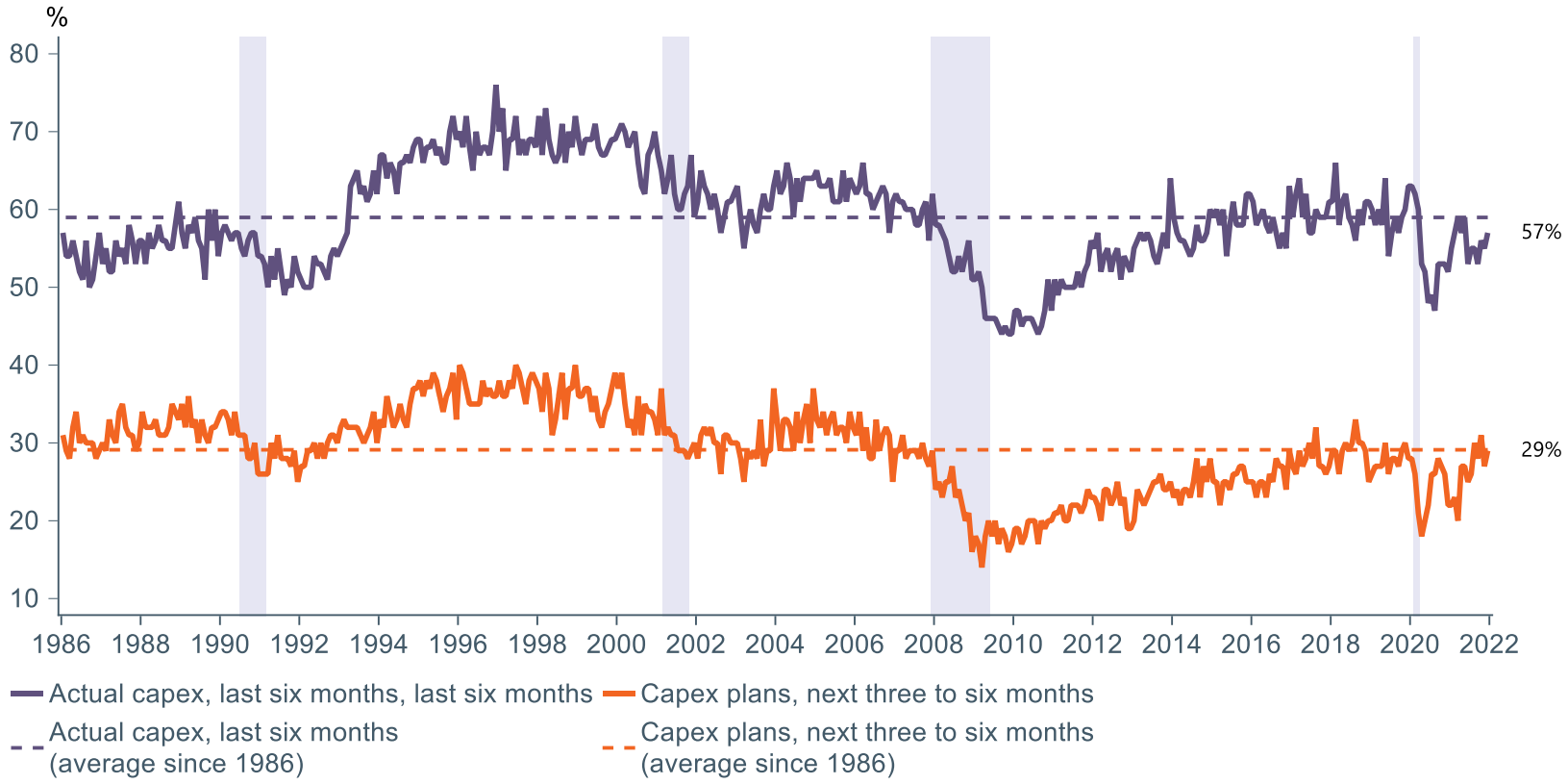


Data as of 4Q 2021 for large businesses, 4Q 2021 for business capex, January 30, 2021, for regional manufacturers. Sources: Macrobond, Business Roundtable, Federal Reserve Banks of New York, Philadelphia, Dallas, Richmond, Kansas.

Small Businesses More Cautious on Capex

Small businesses have been harder hit by the pandemic and capex spending has been muted relative to February 2021, though plans for future capex have recovered from the lows.

National Federation of Independent Business (NFIB) Survey: net percent of small businesses making or planning capital expenditures (%)

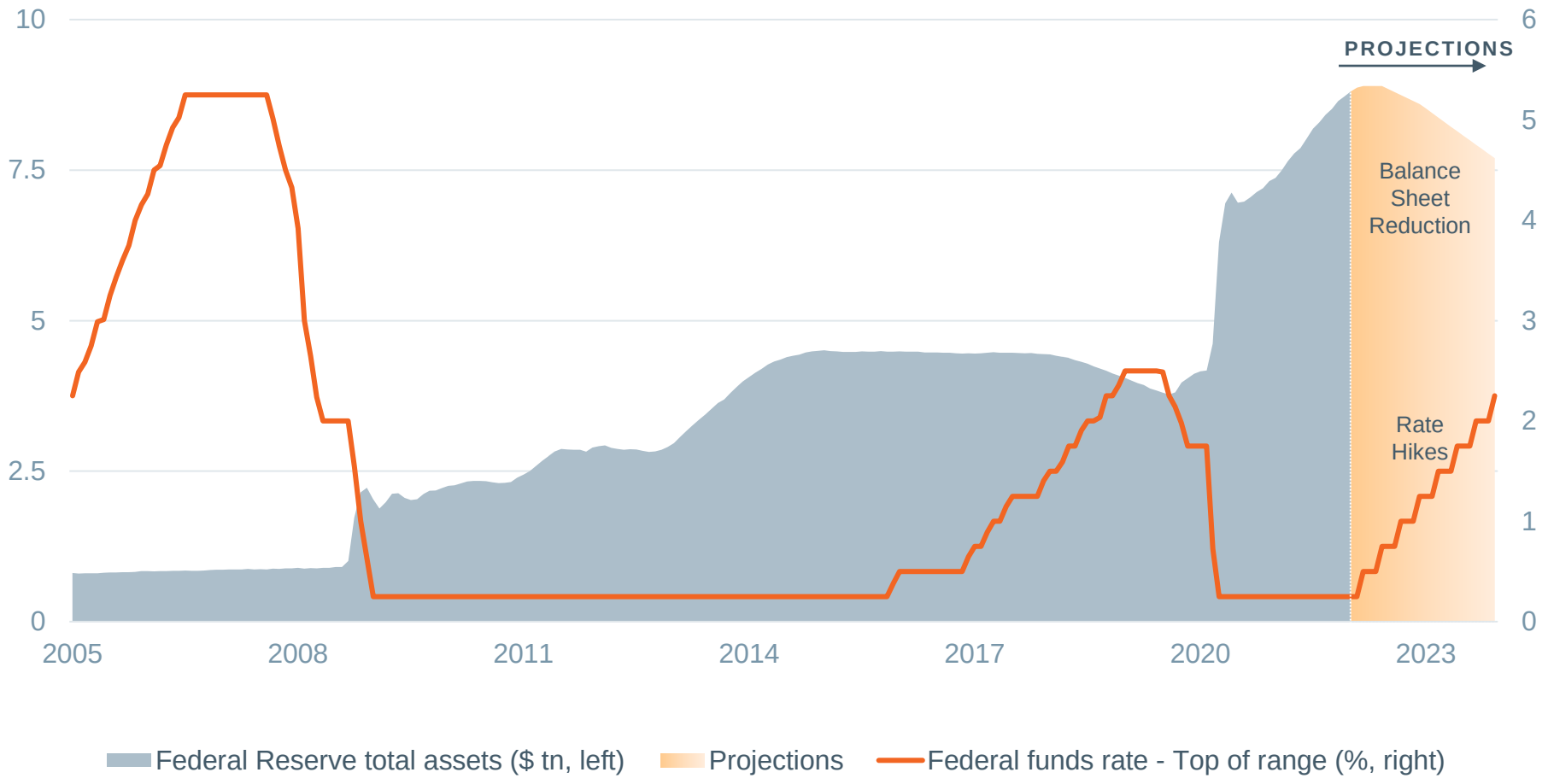


Data as of October 31, 2021. Sources: Macrobond, National Federation of Independent Business.

Monetary Policy in 2022

The Fed announced an end to Quantitative Easing (QE) purchases in March 2022. We anticipate the first increase in the fed funds rate in March 2022 and then quarterly rate hikes thereafter. Minutes from Fed meetings clearly show an inclination to reduce the balance sheet starting in 2022. We expect that to start in the second half of this year but for the Fed to proceed cautiously and communicate the policy ahead of time. Read more in our Wilmington Wire post.

Federal Reserve balance sheet (in $ trillions) and Federal Funds Rate (%)

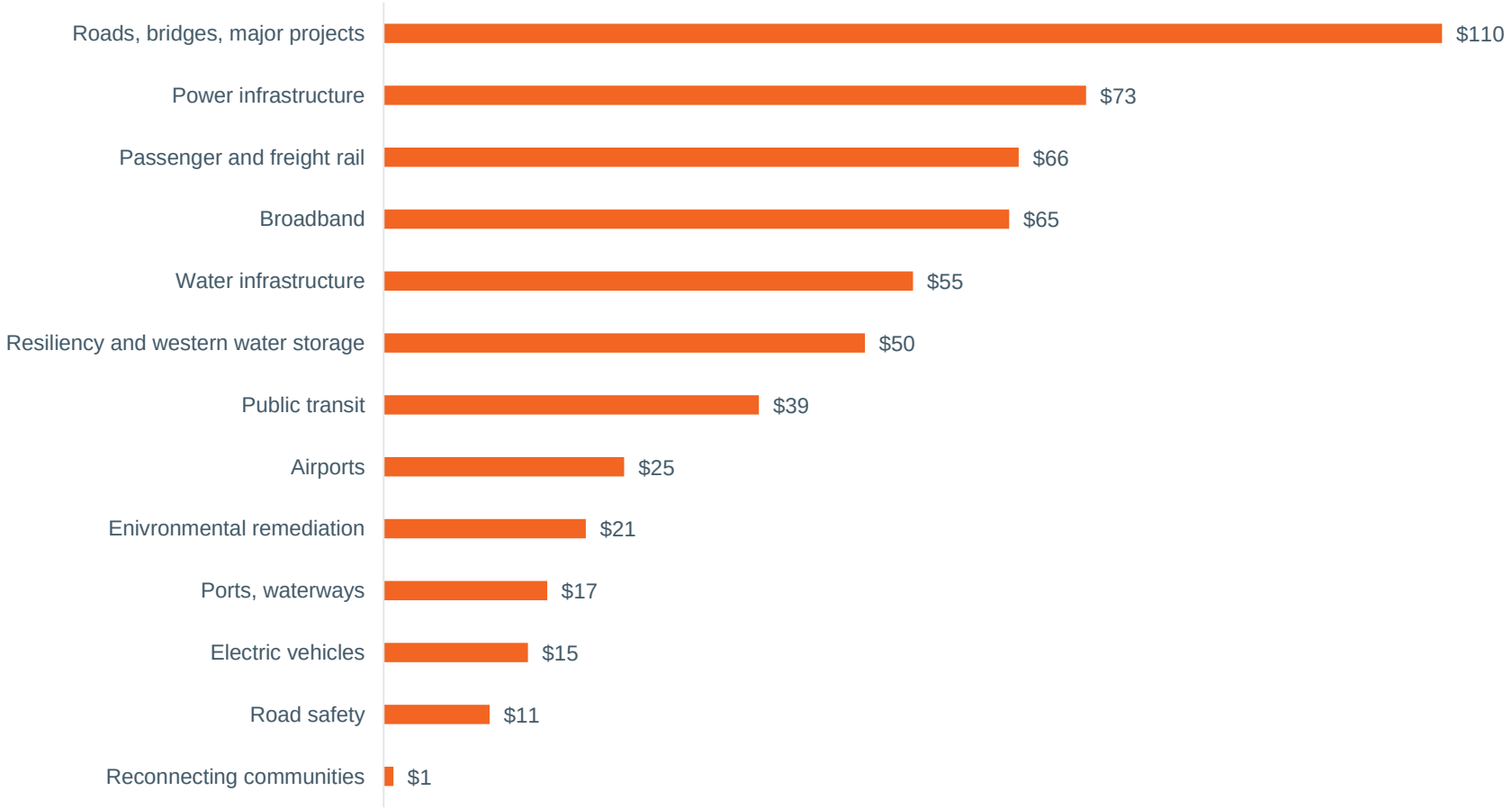


Data as of January 26, 2022. Sources: Macrobond, Federal Reserve.

Bipartisan Infrastructure Deal: $550 Billion of New Spending

The Senate passed a $1tn bipartisan bill in August 2021 with the House approving the deal and President Biden signing the bill into law in November 2021. The bill would provide $550bn in new spending, mostly focused on traditional infrastructure, which should be supportive of capex in coming years.

Bipartisan Infrastructure Bill key provisions ($, billions)



Data as of November 9, 2021. Source: Committee for a Responsible Federal Budget.

Build Back Smaller?

The $2.4tn of proposed spending in the Build Back Better Act passed by the House in November ran into a wall in the Senate with moderate Democrats like Joe Manchin hesitant to support the magnitude of spending proposed. Our current GDP forecast for 2022 assumes no further legislation is passed on this front, so smaller bills passing portions of the current proposal could create a boost to growth, dependent on details.

Key Components of Build Back Better Act as passed by the House

Spending and tax breaks	Amount ($, bn)
Family benefits • Childcare • Paid medical leave • Universal pre-K for three- and four-year-olds	**$585**
Climate and infrastructure • Clean energy and climate investment • Clean energy and electric tax credits • Clean fuel and vehicle tax credits • Infrastructure and related tax breaks	**$570**
Individual tax credits and cuts • Extend Child Tax Credit increase • Extend expanded Earned Income Tax Credit • Other individual tax changes	**$215**
Health care • Strengthen Medicaid services • Extend expanded Affordable Care Act (ACA) tax credits • Medicaid hearing benefit • Invest in health care workforce	**$340**
Other spending and tax cuts • Affordable housing • Higher education and workforce spending	**$325**
Reduce/Delay 2017 Tax Cut & Jobs Act base broadening • Increase SALT deduction cap through 2025 • Delay amortization of Research and Development (R&D) expenses until 2026	**$280**
Enact immigration reform	**$110**

Offsets	Amount ($, bn)
Increase corporate taxes • 15% minimum tax on large corporations • 15% global minimum tax & international tax reform • 1% surcharge on corporate stock buybacks	**-$830**
Increase individual taxes on high earners • Expand 3.8% net investment income tax • 5% surtax in income > $10 million, 8% on income >$25 million • Extend and expand limits on deductibility of business losses	**-$640**
Health care • Repeal drug rebate rule • Reform Part D formula, cap drug price growth, allow targeted drug price negotiations • Reduce Medicaid Disproportionate Share Hospital (DSH) payments beyond 2025	**-$325**
Establish $80,000 SALT deduction cap from 2026-2030, $10,000 cap in 2031	**-$290**
Other revenue • Reduce tax gap by funding IRS • Superfund taxes on oil, methane fee • Expand nicotine taxes • Reform tax treatment of retirement accounts • Other	**-$180**

Data as of November 18, 2021. Source: Committee for a Responsible Federal Budget.

Disclosures

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