MMBI RSM US MIDDLE MARKET BUSINESS INDEX

A REAL ECONOMY PUBLICATION

U.S. Chamber of Commerce

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RSM US LLP and The Harris Poll have collected data on middle market firms from a quarterly survey that began in the first quarter of 2015. The survey is conducted four times a year in the first month of each quarter: January, April, July and October. The survey panel, the Middle Market Leadership Council, consists of approximately 1,500 middle market executives, and is designed to accurately reflect conditions in the middle market. The data is weighted to ensure that it corresponds to the U.S. Census Bureau data on the basis of industry representation.

A reading above 100 for the MMBI indicates that the middle market is generally expanding; below 100 indicates that it is generally contracting. The distance from 100 is indicative of the strength of the expansion or contraction.

This report was fielded Oct. 3 to Oct. 21, 2022, and based on the responses of 408 participants.

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RSM US LLP and the U.S. Chamber of Commerce have joined forces to present the RSM US Middle Market Business Index (MMBI)—a first-of-its-kind middle market economic index developed by RSM in collaboration with Moody's Analytics, the financial intelligence provider. We publish the MMBI quarterly to give voice to the middle market and raise awareness of this crucial, yet underrepresented, segment of the economy.

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TWO YEARS OF RISING PRICES CLEARLY HAVE TAKEN A TOLL ON OVERALL BUSINESS CONDITIONS AS WELL AS EXPECTATIONS AROUND REVENUES, NET EARNINGS AND HIRING.

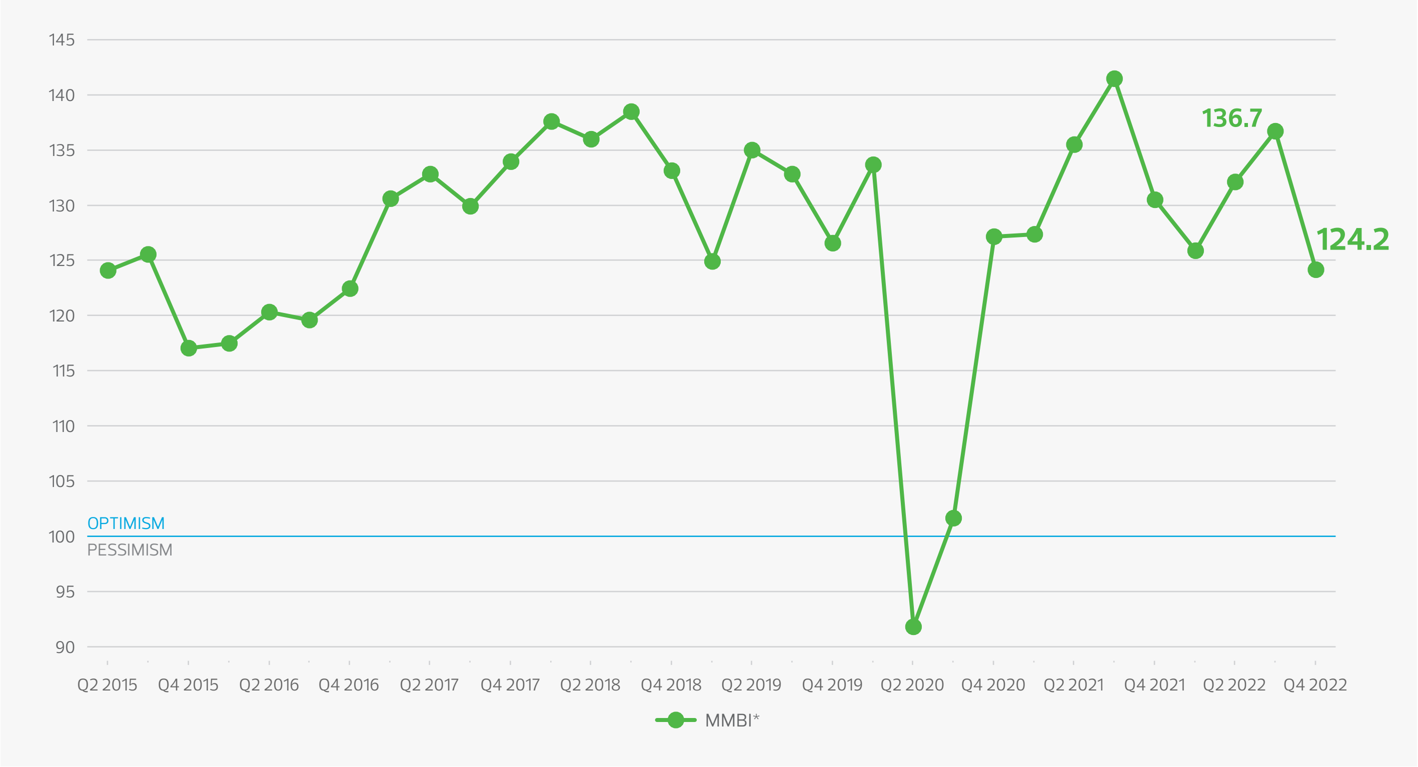
JOSEPH BRUSUELAS, CHIEF ECONOMIST, RSM US LLP

Joseph Brusuelas is the chief economist for RSM US LLP. Brusuelas has 20 years of experience analyzing U.S. monetary policy, labor markets, fiscal policy, economic indicators and the condition of the U.S. consumer. As co-founder of the award-winning *Bloomberg Economics Brief*, Brusuelas was named one of the 26 economists to follow by the *Huffington Post*. In addition, he was named 2020 Middle Market Thought Leader of the Year by The Alliance of Merger & Acquisition Advisors. A member of the *Wall Street Journal*'s forecasting panel, Brusuelas regularly briefs members of Congress and other senior officials regarding the impacts of federal policy on the middle market and the factors by which middle market executives make business decisions.

> “The year’s final Middle Market Business Index shows that persistently high inflation is souring businesses’ perceptions about the strength of the economy in the near term. With respondents showing revenue, earnings and hiring expectations falling, it is absolutely critical that policymakers do all they can to put a stop to inflation.”
>
> **— Neil Bradley, U.S. Chamber Executive Vice President and Chief Policy Officer**

RSM US MIDDLE MARKET BUSINESS INDEX

Business conditions deteriorated in the final quarter of the year as the top-line MMBI eased to 124.2 from 136.7 the previous quarter.



Source: RSM US LLP

*Seasonally adjusted

RSM US MIDDLE MARKET BUSINESS INDEX SHOWS DETERIORATING CONDITIONS

BY JOSEPH BRUSUELAS, RSM US CHIEF ECONOMIST

BUSINESS CONDITIONS in the real economy deteriorated in the final quarter of the year as the top-line RSM US Middle Market Business Index eased by 12.5 points to 124.2 from 136.7.

While that reading remains at a level that signals expansion and reflects the resilience of the broader economy, two years of rising prices clearly have taken a toll on overall business conditions as well as expectations around revenues, net earnings and hiring.

On a seasonally adjusted index, the latest quarterly change is significant at both the 0.10 and 0.05 levels.

While the middle market index does not imply that the economy is in recession—we think a reading below 110 tends to indicate that—an array of economic indicators implies the American economy is decelerating into the end of the year. That slowdown underscores our estimation of a 65% probability of a recession over the next 12 months.

Persistent inflation that has spread into the service and housing sectors is leading the Federal Reserve to aggressively raise its policy rate. By the end of its increases, the Fed will almost certainly have raised its policy rate by more than 500 basis points over a 15-month period as it tries to restore price stability.

The U.S. economy does not descend slowly into recession. Rather, it tends to fall off a cliff. We think the lagging impact of rate hikes, which have already resulted in significant financial tightening, will become apparent in a sharp drop-off early next year, after the traditional holiday spending period ends.

In our estimation, middle market firms need to prepare for a pronounced slowdown in demand in the near term.

It is important that firms during this time continue to make critical investments in capital expenditures to bolster productivity during the imminent period when the economy is weak and inflation begins to ebb.

We recognize that increasing uncertainty around revenues and net earnings during downturns often discourages investment.

Still, the economy has not reached that point. Roughly 50% of respondents in the MMBI survey said they intended to increase capital expenditures over the next six months; that solid showing follows eight straight quarters in which a majority said they intended to do so. This data is encouraging and represents a much-needed reality check for all middle market firms.

The split between businesses' expectations of a poor economy and their intention to keep investing follows the "second-hand pessimism" narrative that is developing. It holds that businesses feel badly about the economy, but they are continuing to hire, raise wages and invest as if the economy is in solid shape. This divergence between feelings and actions is helping keep the economy afloat because actions speak louder than words when it comes to growth.

Yet this outlook may not last. Businesses facing rising uncertainty will be tempted to pull back on critical investments in their firms and personnel.

That would be a significant suboptimal business decision and lead to reduced productivity and output.

Boosting innovation and technological capability during a downturn is a necessary component of business operations; to eschew those investments is simply a non-starter.

Beneath the headline

All 10 components of the RSM US Middle Market Business Index declined from the third quarter to the fourth, reflecting growing pessimism about the economy.

This shift in outlook is a function of the recent deterioration in business conditions. A sharp increase in respondents reporting a reduction in revenue and profit from the previous quarter should serve as a bellwether for firms to begin preparing for the end of the business cycle.

Persistent and elevated inflation has eroded consumer purchasing power and dampened business confidence. We can observe that erosion in the current outlook on the economy, hiring, revenues and net earnings.

The outlook for staffing soured in the fourth quarter as well. Just over half of respondents reported plans to increase hiring over the next six months, the lowest rate since mid-2020.

The share planning to reduce head count rose from 6.5% in the third quarter to 14.1% in the fourth, also the highest figure since 2020. The period of above-trend job growth driven by the recovery from the pandemic is drawing to a close.

Pricing pressures did not intensify in the fourth quarter, according to MMBI respondents. The 53% of respondents who raised prices from the third to fourth quarter is the lowest share since the first half of 2021, when surging and concentrated consumer demand quickly overwhelmed global supply chains. Respondents reported a similar easing when asked about prices paid for the inputs used in their operations.

Perhaps the biggest takeaway from the pricing data is that the ability to pass along price increases to consumers is beginning to ebb. Roughly 53% of respondents noted an increase in prices received, down from 69% in the third quarter.

Previously we noted that the ability to pass along price increases was most likely the primary catalyst behind the improvement in top-line sentiment during the third quarter. At the same time, executives told RSM that being able to pass along those higher prices was not sustainable and at one point would come to an end.

That end appears to be approaching.

TEMPORARY PANDEMIC-ERA WORK PATTERNS NOW APPEAR TO BE THE NEW NORMAL, MMBI DATA SHOWS

MIDDLE MARKET COMPANIES appear to be permanently adopting the remote and hybrid work practices that were driven by safety measures during the height of the COVID-19 pandemic, MMBI data shows.

Nearly three-quarters (74%) of executives polled said their companies had rolled out a hybrid work option, up nine points from the fourth quarter of 2021. Meanwhile, 33% of midsize firms had employees working remotely in the fourth quarter of this year who had not been doing so prior to the health crisis, down only three points from 36% a year earlier, according to responses to special questions in the survey.

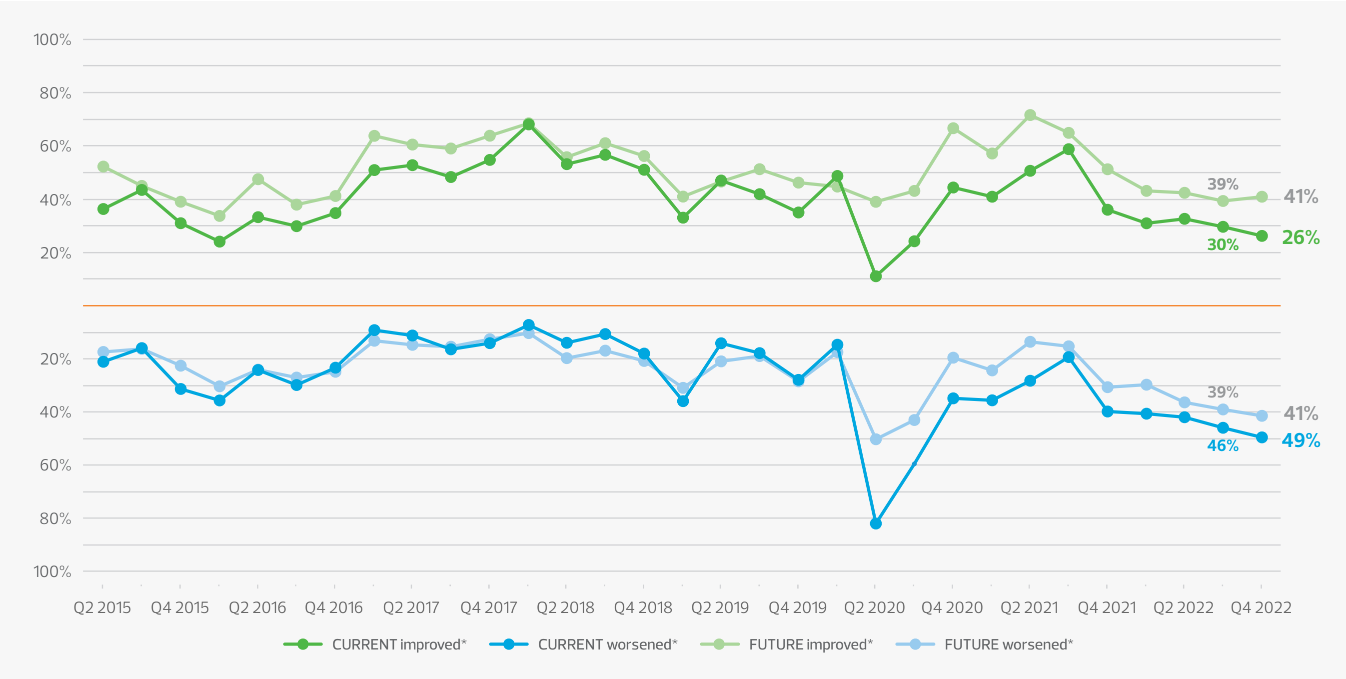
More than half (54%) of businesses had made remote work a permanent option for some employees on a full-time basis, up from 48% a year earlier. Only one-quarter of respondents said their organizations were requiring remote workers to return to the office.

Culturally, the shifts in work patterns seemed to be having either a positive effect (39%) or no effect (38%) on the majority of businesses, while 24% said they've had a negative impact. ■

For full results of the special questions around workplace and hiring, please look for our MMBI special report, due out in the coming weeks.

GENERAL ECONOMY PERFORMANCE

Nearly half (49%) of respondents said the economy had worsened in the fourth quarter, and 41% expected a continued downturn over the next six months.



First, thinking about the general economy this quarter versus last quarter, how would you describe the current general economy? Would you say the general economy has…?

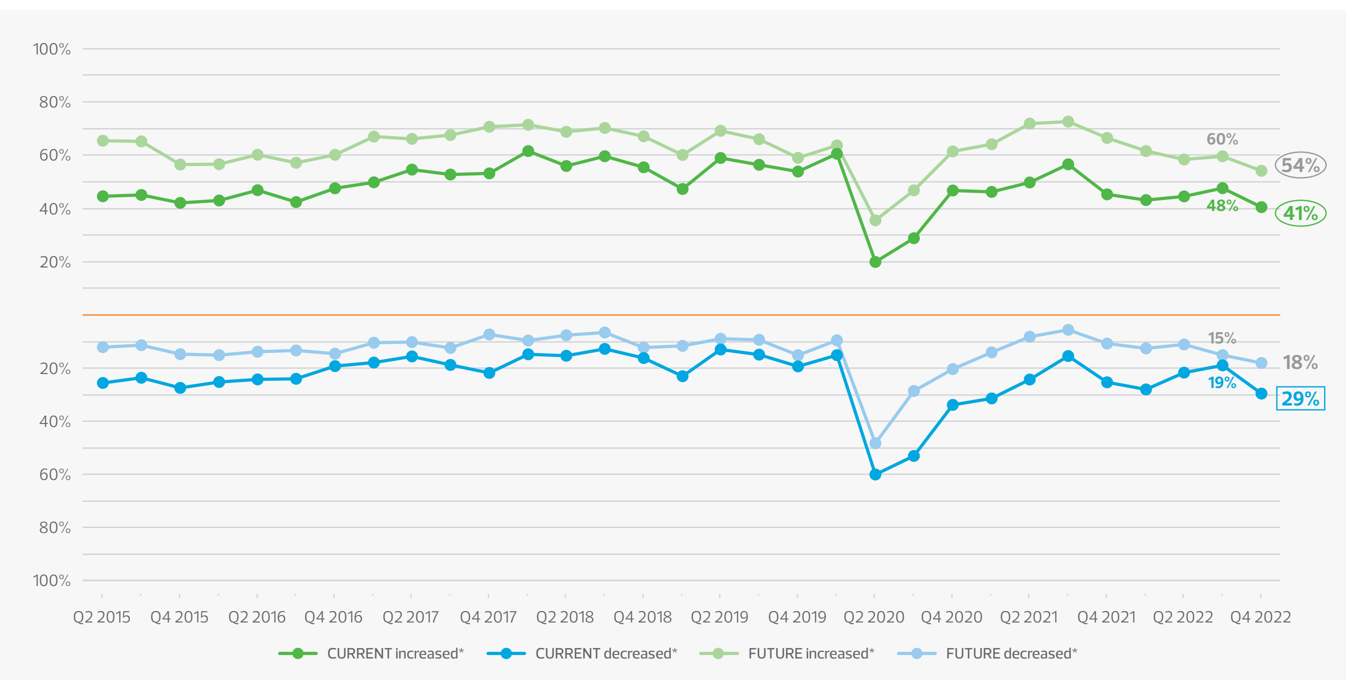
What are your expectations regarding the general economy over the next six months? Do you expect the general economy will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

GROSS REVENUES PERFORMANCE

Twenty-nine percent of companies saw revenue fall in Q4, significantly more than the 19% in Q3; 41% saw an increase.



Thinking about your organization's gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds? Would you say gross revenues/all incoming funds have…?

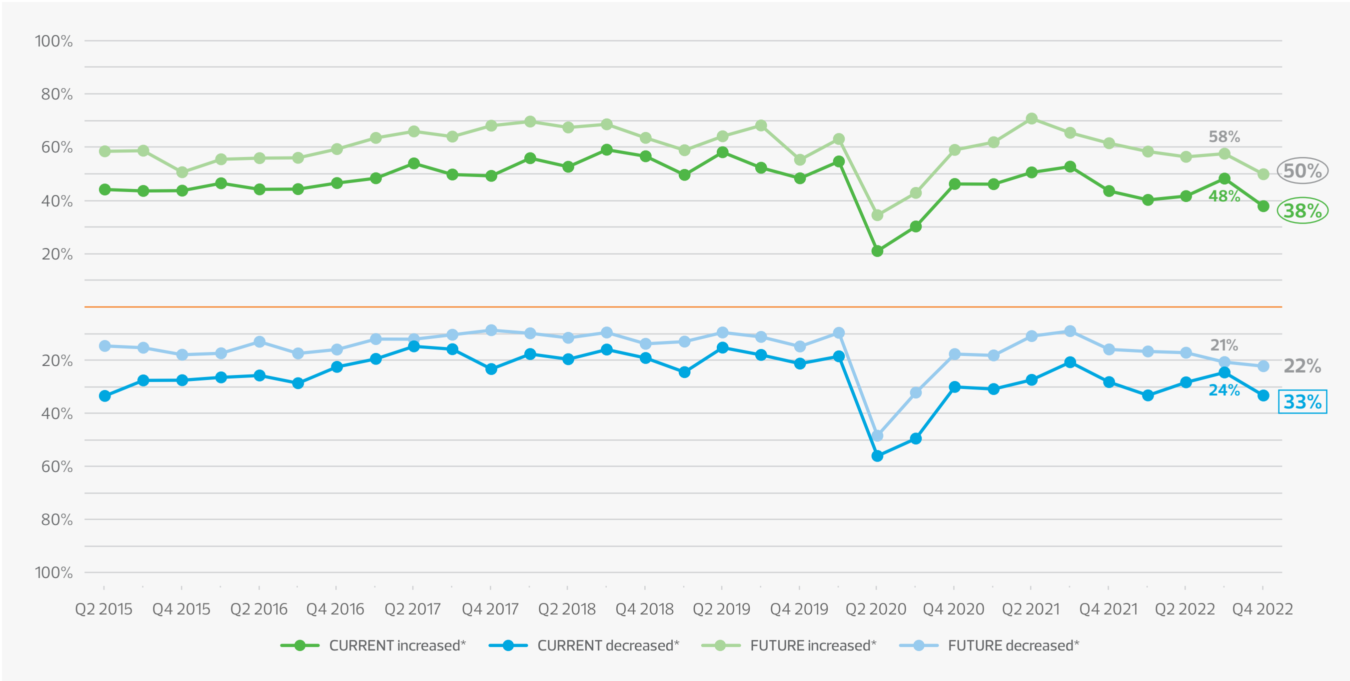
What are your expectations regarding your organization's gross revenues/all incoming funds over the next six months? Do you expect gross revenues/all incoming funds to…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

NET EARNINGS PERFORMANCE

For 33% of midsize companies, net earnings declined in the fourth quarter, significantly more than 24% in the prior period.



Thinking about your organization's net earnings (after expenses, etc.) for the most recent quarter results versus the prior quarter results, how would you describe the level of your most recent quarter net earnings results? Would you say net earnings results have…(among those not nonprofits)?

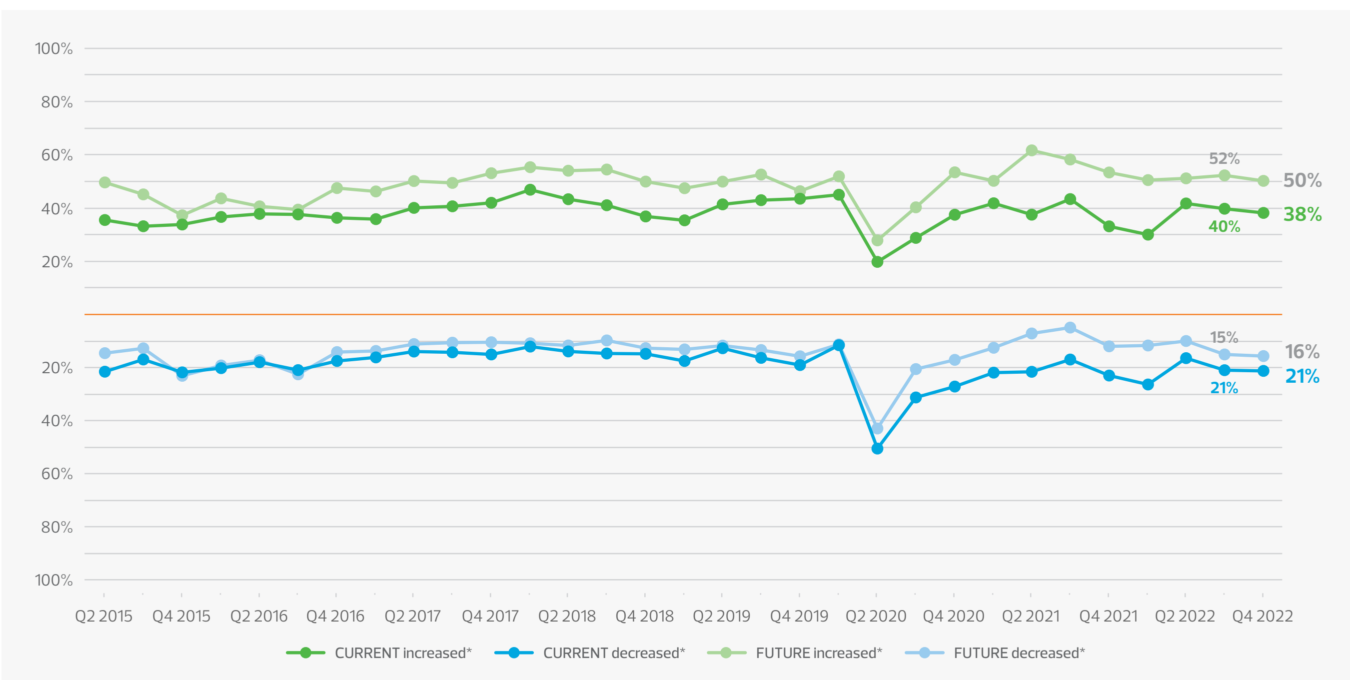
*Seasonally adjusted

What are your expectations regarding your organization's net earnings results (after expenses, etc.) over the next six months? Do you expect net earnings results to…(among those not nonprofits)?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

AGGREGATE CAPITAL EXPENDITURES/INVESTMENTS PERFORMANCE

Respondents for half of midsize companies said they would continue to boost capital outlays over the next six months, nearly on par with 52% in the prior quarter and following eight straight quarters with a majority saying they planned to do so.



Thinking about your organization's aggregate capital expenditures or investments this quarter versus last quarter, how would you describe your organization's current capital expenditures/investments? Would you say capital expenditures/investments have…?

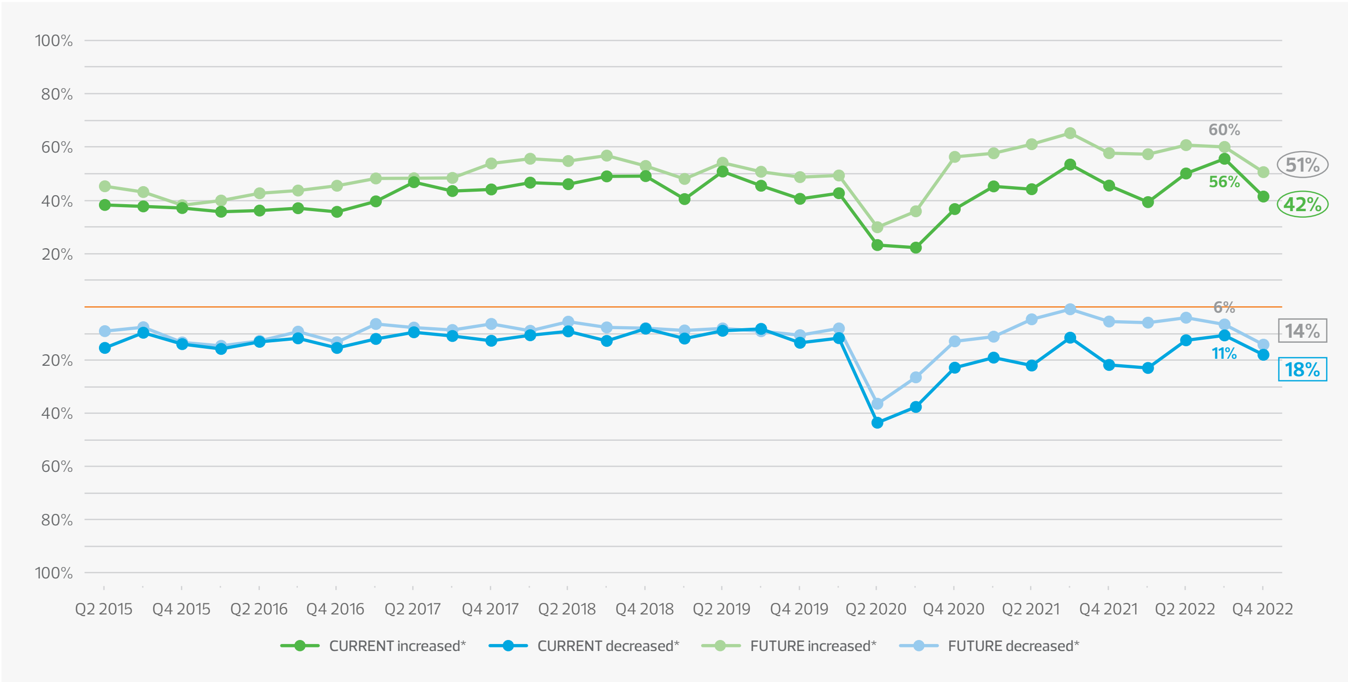
*Seasonally adjusted

What are your expectations regarding your organization's aggregate capital expenditures or investments over the next six months? Would you say capital expenditures/investments will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

OVERALL HIRING LEVELS

The number of organizations boosting their hiring dropped sharply in Q4 to 42% from 56% in Q3; 18% slowed their hiring, up seven points from the prior period.



Thinking about your organization's overall hiring levels this quarter versus last quarter, how would you describe your current hiring levels? Would you say hiring levels have…?

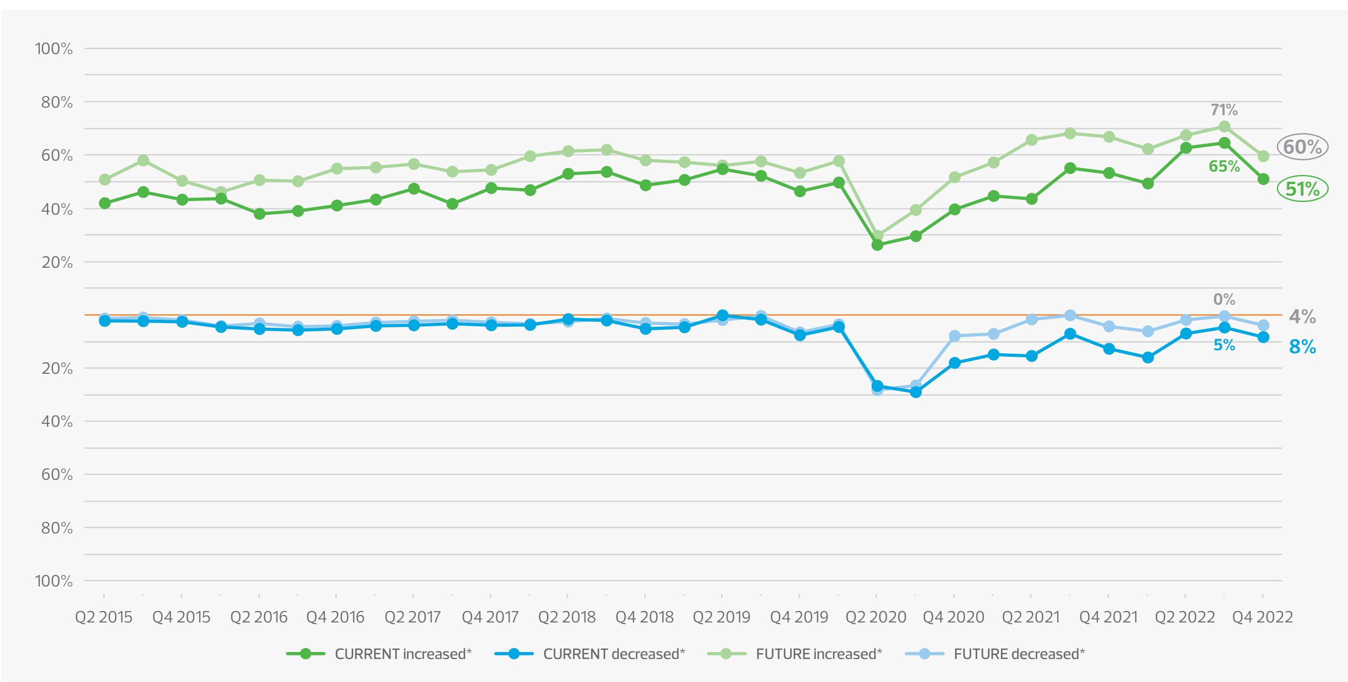
What are your expectations regarding your organization's overall hiring levels over the next six months? Do you expect hiring levels to…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

EMPLOYEE COMPENSATION

Significantly fewer (51%) of midsize companies gave raises in Q4, down from 65% in Q3. Those expecting to boost wages over the next six months fell to 60% from 71%.



Thinking about employee compensation at your organization this quarter versus last quarter, how would you describe the current employee compensation level on average? Would you say employee compensation, on average, has…?

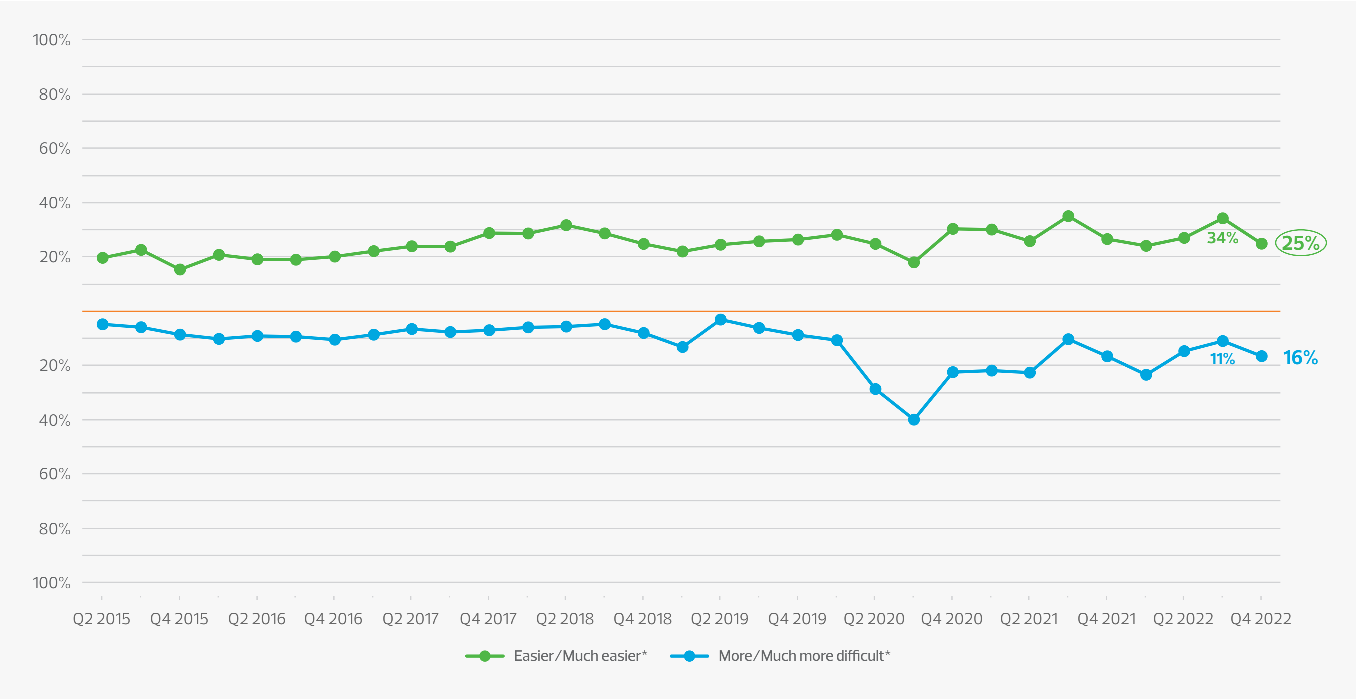
What are your expectations regarding your organization's employee compensation over the next six months? Would you say employee compensation, on average, will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

ACCESS TO CREDIT

One-fourth of executives said their organizations had a tougher time getting loans in Q4, down from 34% in Q3.



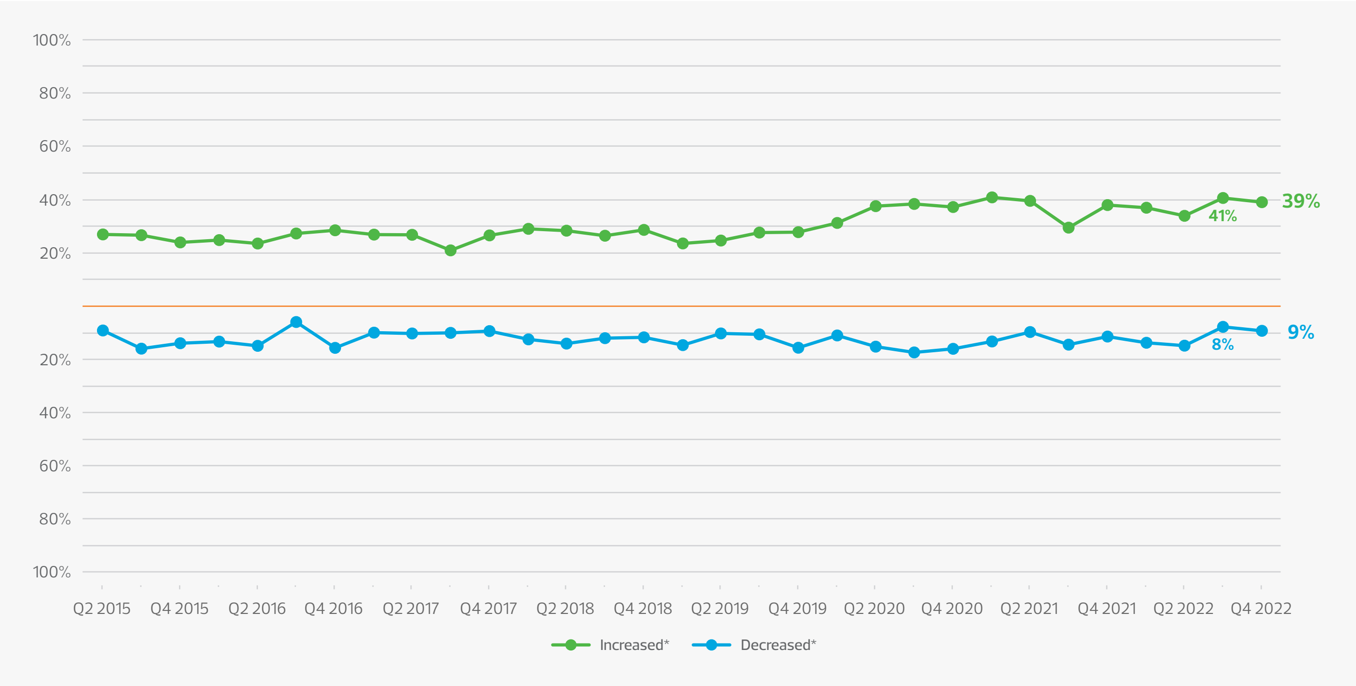
Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit? Would you say that accessing credit is…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

PLANNED BORROWING

Slightly fewer companies expect to borrow money over the next six months: 39% compared to 41% in the prior quarter.



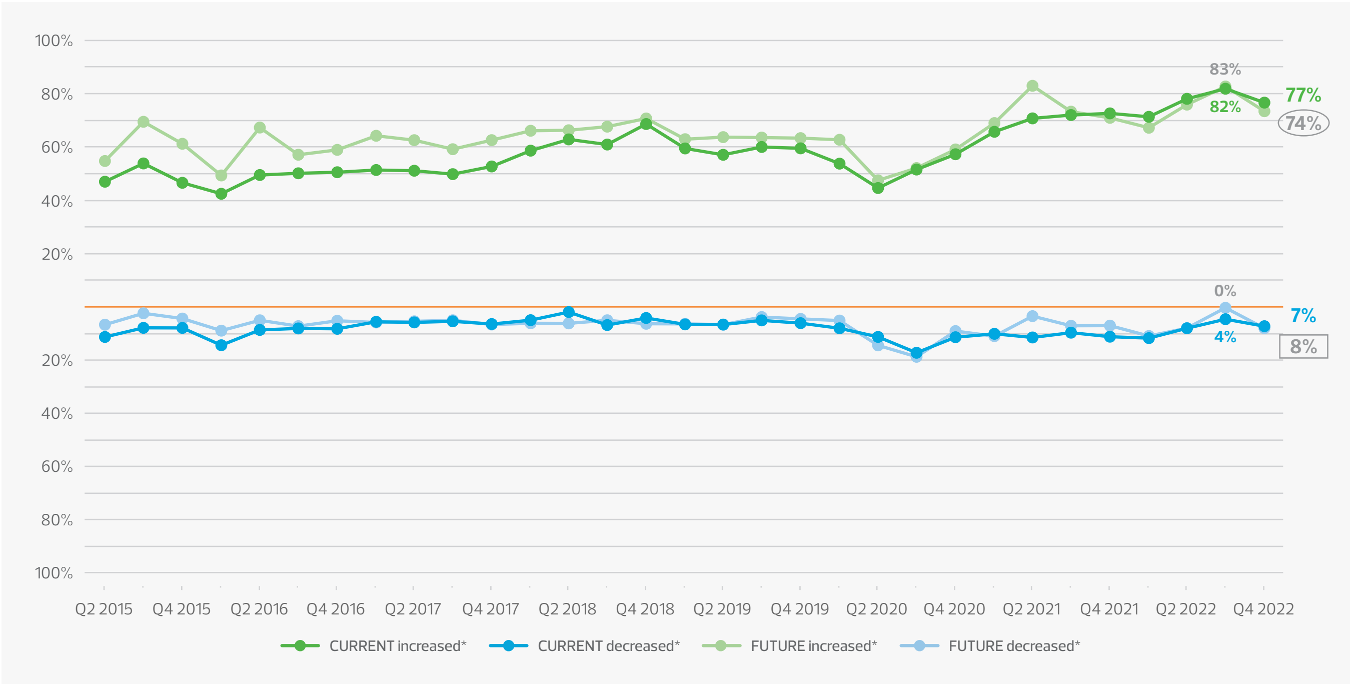
What are your expectations regarding your organization's planned borrowing over the next six months? Would you say your organization's borrowing will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

AMOUNT PAID FOR GOODS AND SERVICES

Goods and services remained more costly for an overwhelming majority of midsize firms, with 77% paying more in Q4, down from 82% in Q3.



Thinking about the prices that your organization pays for all goods and services, except labor, this quarter versus last quarter, how would you describe the current general level of prices paid? Would you say prices paid, on average, have…?

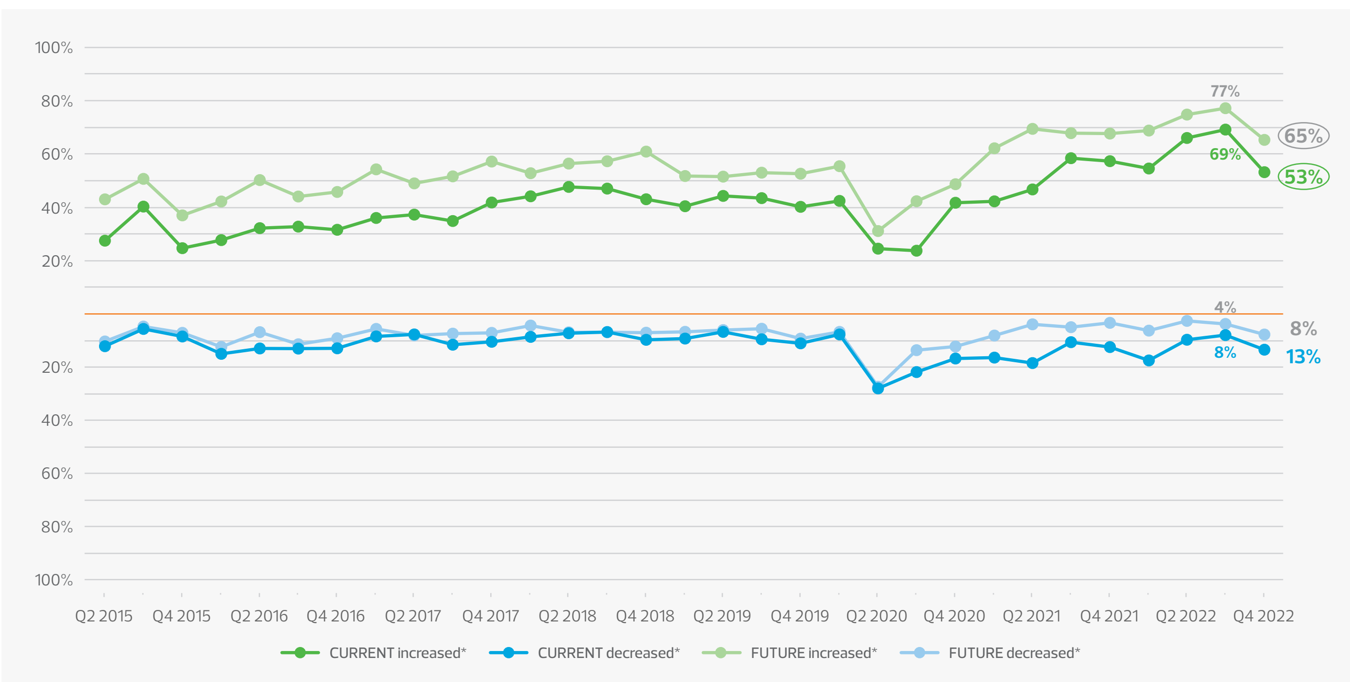
What are your expectations regarding the general level of prices that your organization will pay for all goods and services, except labor, over the next six months? Would you say prices paid, on average, will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

AMOUNT RECEIVED FOR GOODS AND SERVICES

Middle market companies had a harder time passing higher costs on to customers in Q4; 53% received more for goods and services, down sharply from 69% in Q3.



Thinking about the prices that your organization received for all of its goods and services this quarter versus last quarter, how would you describe the current general level of prices received? Would you say prices received by your organization, on average, have (among those not nonprofits)…?

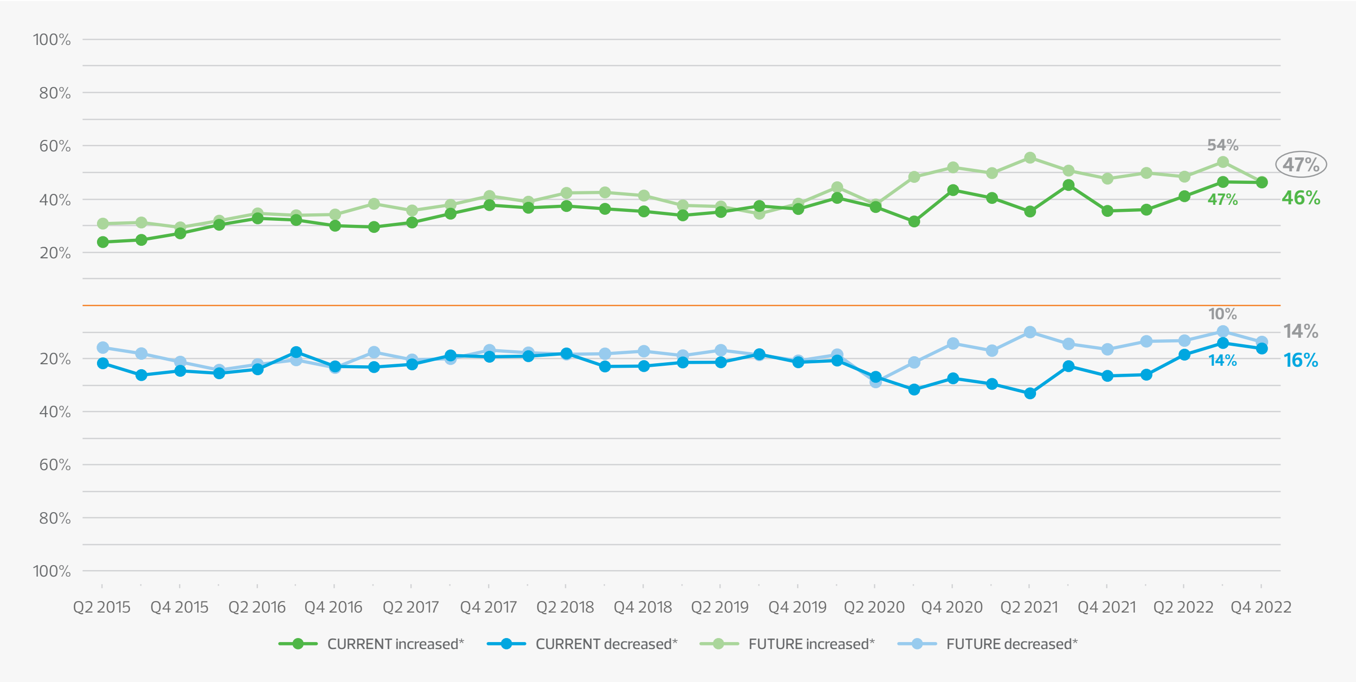
What are your expectations regarding the general level of prices that your organization will receive for all goods and services over the next six months? Would you say the prices received by your organization, on average, will…(among those not nonprofits)?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*Seasonally adjusted

INVENTORY LEVELS

Fewer (47%) midsize companies planned to stockpile inventory over the next six months in Q4, down from 54% in Q3 and roughly on par with those doing so currently.



Thinking about your organization's inventory levels this quarter versus last quarter, how would you describe current inventory levels? Would you say inventory levels have…?

*Seasonally adjusted

What are your expectations regarding your organization's planned inventory levels over the next six months? Would you say your inventory levels will…(among those that have inventory)?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

How the MMBI is constructed

The MMBI is born out of the subset of questions in the survey that ask middle market executives to report the change in a variety of indicators. Middle market executives are asked a total of 20 questions patterned after those in other qualitative business surveys, such as from the Institute of Supply Management and the National Federation of Independent Businesses.

The 20 questions relate to changes in various measures of their business, such as revenues, profits, capital expenditures, hiring, employee compensation, prices paid, prices received and inventories. Middle market executives are asked to report the change from the previous quarter and to state the likely direction of these same indicators six months ahead. See a sample of the questions in the table.

The MMBI is a composite index computed as an equal weighted sum of the diffusion indexes for 10 survey questions plus 100 to keep the MMBI from becoming negative. The index is designed to capture both current and future conditions, with five questions on middle market executives' recent experience and five on their expectations for future activity.

RSM US Middle Market Business Index questions

- What are your expectations regarding the general economy?
- What are your expectations regarding your organization's gross revenues?
- How would you describe the level of your organization's most recent quarter net earnings results?
- What are your expectations regarding your organization's aggregate capital expenditures or investments?
- What are your expectations regarding your organization's overall hiring levels?
- How would you describe your organization's current employee compensation level on average?
- How would you describe current access to credit?
- What are your expectations regarding your organization's planned borrowing?
- How would you describe the current general level of prices received?
- What are your expectations regarding your organization's planned inventory levels?

ON THE
MIDDLE MARKET MIND

WE ASKED middle market executives to describe a top business problem facing their organization. Here's what they had to say.

"The need to prioritize digital transformation initiatives, despite resistance to internal change and budgetary limitations."
— Health care executive

"Investing in becoming cybersecure and adapting business operations to the world of digital first."
— Educational services executive

"Accelerating digital transformation with the current IT budget, as well as managing inflation and supply chain security."
— Finance and insurance executive

"Developing responsible and sustainable strategies to be more efficient in business operations."
— Construction executive

"We need to build a modern and reliable working space to offer flexibility to our employees to keep up their performance."
— Retail executive

"Balancing the remote working process for the organization."
— Finance and insurance executive

"Company is facing recruitment problems to manage business productivity and growth."
— Manufacturing executive

"One of the main issues is finding bright and qualified employees."
— Accommodations and food services executive

"We need to update our employees' benefits plan and cover all of their issues to deliver them a more flexible workspace."
— Arts, entertainment and recreation executive

"Our biggest problem right now is the unpredictable condition of the market."
— Transportation and warehousing executive

For more information on RSM, please visit **rsmus.com**.

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