

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 July 5 to July 26, 2022, and based on the responses of 407 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.



U.S. Chamber of Commerce



THE MAJOR ECONOMIC NARRATIVE EMERGING FROM THE DATA IS THAT ROBUST OVERALL ACTIVITY CONTINUES TO SUPPORT STRONG BUSINESS SENTIMENT.

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.

This publication represents the views of the author(s), and does not necessarily represent the views of RSM. This publication does not constitute professional advice.

“This quarter’s index is a strong indication that companies continue to feel good about their own business operations, despite persistent negative attitudes on the overall economy. Inflation challenges remain top of mind, and as labor costs continue to push up, we’re going to continue to see these inflationary pressures in the economy,” said Neil Bradley, executive vice president, chief policy officer and head of strategic advocacy at the U.S. Chamber of Commerce.

RSM US MIDDLE MARKET BUSINESS INDEX

RSM US Middle Market Business Index surges to 138.5 despite elevated inflation.



Source: RSM US LLP

*seasonally adjusted

RSM US MIDDLE MARKET BUSINESS INDEX SURGES TO 138.5 DESPITE ELEVATED INFLATION

BY JOSEPH BRUSUELAS, RSM US CHIEF ECONOMIST

BUSINESS CONDITIONS in the American real economy imply no recession in the third quarter as the middle market remains on a path for growth, even as the market grapples with elevated inflation. Top-line sentiment among midsize company executives improved to a seasonally adjusted index reading of 138.5, up 7.3 points from the second quarter. That change is significant at both the 0.10 and 0.05 levels. An economy displaying such a robust reading, along with business conditions that have produced 3.4 million jobs over the first seven months of the year and unemployment of 3.5%, is not consistent with a recession.

The major economic narrative emerging from the data is that robust overall activity continues to support strong business sentiment. This upside, however, is clearly tempered by elevated prices and rising wages that have likely soured firms' outlook on the economy now and over the next six months. Even so, with revenues and net earnings still solid, and a majority of MMBI respondents indicating they should improve, the prospect of a recession has probably been pushed into 2023.

Of the 10 underlying components that make up the MMBI, seven increased from the second quarter to the third, while three declined. The three declining components asked respondents their expectations for the next six months, and their downbeat outlook aligns closely with macroeconomic data elsewhere; businesses and households are feeling increasingly pessimistic about risks linked to inflation and the economy.

Despite two consecutive declines in quarterly gross domestic product in the first half of 2022, business conditions appear impressively resilient just over the horizon. Forty-eight percent of respondents said gross revenues improved in the third quarter, and 60% stated they expect them to do so over the next six months. Half of survey participants indicated net earnings improvement in the third quarter, and 59% said they expect improvement in the near term.



Passing price hikes downstream

Perhaps more importantly, a majority of survey respondents indicated they are passing along price increases—and for now, the ability to do so is clearly bolstering revenues, net earnings and forward-looking expectations of both. Only 7% of respondents said they had difficulty passing along price increases, which is remarkable given the inflation shock still cascading through the economy. That figure constitutes good news, given the very difficult straits that middle market firms are navigating at the current time.

On net, respondents reported increases in revenue and profit from the previous quarter, with both at their highest rates in a year. Some of this growth, particularly the reported increase in revenue, was driven by higher selling prices. More than 7 in 10 survey respondents, the highest on record, reported hiking their average selling prices. In our estimation, middle market firms' ability to pass along these price increases without creating conditions for demand destruction downstream underscores the resilience in the real economy.

Just as important, and a continued source of optimism inside the middle market and real economy, are responses around capital outlays. Forty-one percent of survey participants increased productivity-enhancing

capital expenditures during the third quarter, and 53% indicated they expect to do so over the next six months. It is critical that middle market firms increase their investment in both technology and their people to boost efficiencies and output during a time of tight labor supply and high inflation.

Wage pressure and tight labor

For service-providing industries, which have an outsize presence in the middle market, the primary source of inflationary pressure comes from wages. The share of respondents reporting an increase in employee compensation rose to 2 in 3, representing a record high. Wage hikes are compelling businesses to pass along rising input costs to their customers. According to the government's employment cost index, wages were up 5.2% in the second quarter compared to a year earlier. Wage pressure will continue to keep business decision-makers on edge, underscored by the declining share of MMBI respondents, on net, who said they intend to increase hiring levels over the next six months.

Wage increases and higher input prices, from our perspective, are why only 30% of survey respondents stated that the economy improved in the third quarter and only 39% expect it to do so moving forward.

Cautious optimism

Data related to recent employment trends, however, remains buoyant. Nearly 6 in 10 MMBI respondents reported an increase in staff over the last three months, the highest share on record; meanwhile, those reporting a reduction in head count showed a three-year low in the third quarter.

Through July, total employment in the U.S. economy has returned to pre-pandemic levels, and we continue to make the case that labor market dynamics in the near term are likely to be characterized by a tight labor market and higher wages compared to the past generation. Any notion of labor market conditions returning to those of the jobless recoveries of the 1990s or the period following the global financial crisis of 2007–09 should be closely scrutinized and directly challenged.

Looking forward, 41% of respondents said they planned to increase borrowing over the next six months; given the expected increase in interest rates over that time, this finding requires monitoring with respect to the underlying health of the real economy.

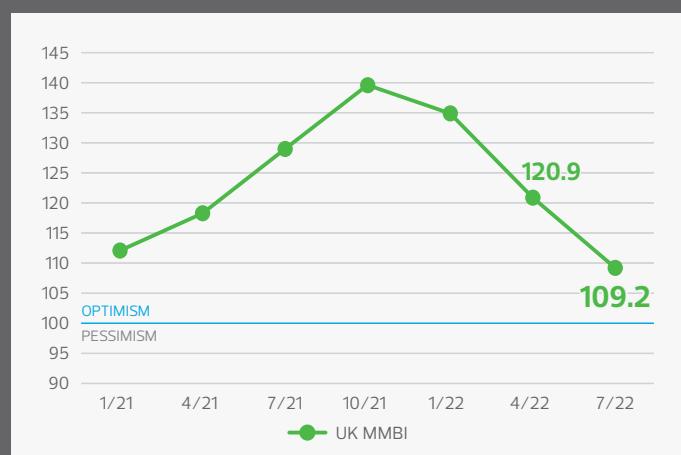
Finally, 48% of organizations surveyed said they increased inventory levels during the third quarter, and 55% stated they expect to do so in the near term, reflecting both the upcoming holiday season and the need to meet still-brisk demand for goods and services. We remain optimistic that upper-income consumers will retain the capacity to clear those levels. However, businesses with exposure to down-market households need to proceed cautiously with respect to inventory management, even as the apex of inflation is likely now in the rearview mirror. In our estimation, for the next two years inflation will not fall back anywhere near the 2% level that defines price stability. ■

UK MMBI HEADS DOWNWARD, DIVERGING FROM US RESULTS

“The U.K. economy is in for an especially tough winter. Soaring energy prices mean that inflation is likely to hit 13% in the fourth quarter and remain high through the first half of 2023, at least. This will lead to a record-breaking drop in household real incomes and an inevitable reduction in consumer spending. As a result, we expect the U.K. to enter a recession in the last quarter of this year. However, strong corporate balance sheets and a tight labor market mean we expect this recession to be mild, with a peak-to-trough drop in GDP of around 1%.”

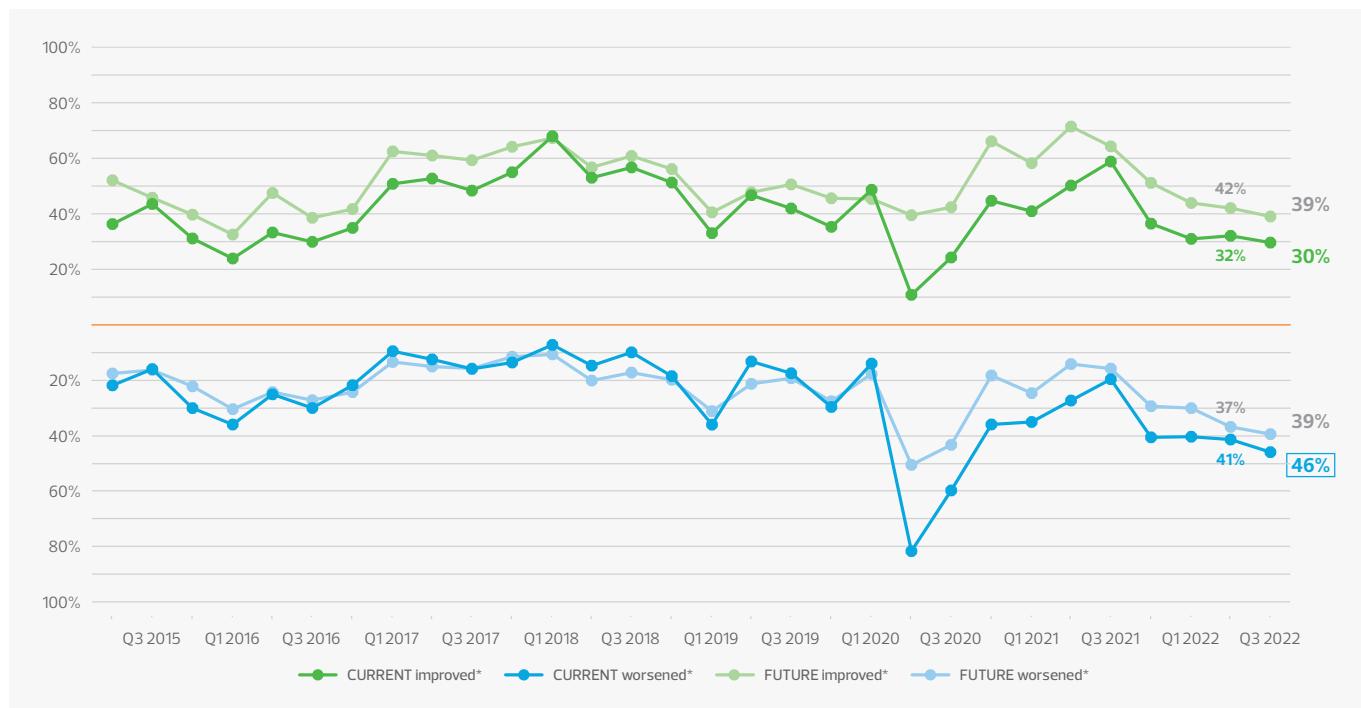
—Tom Pugh, Economist, RSM UK

RSM UK MIDDLE MARKET BUSINESS INDEX



GENERAL ECONOMY PERFORMANCE

Forty-six percent of respondents said the economy worsened during the third quarter, up from 41% in the prior period.



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...?

*seasonally adjusted

GROSS REVENUES PERFORMANCE

Gross revenues were up at 48% of respondents' companies in Q3, a four-point gain from Q2. Sixty percent see gross revenues improving over the next six months.



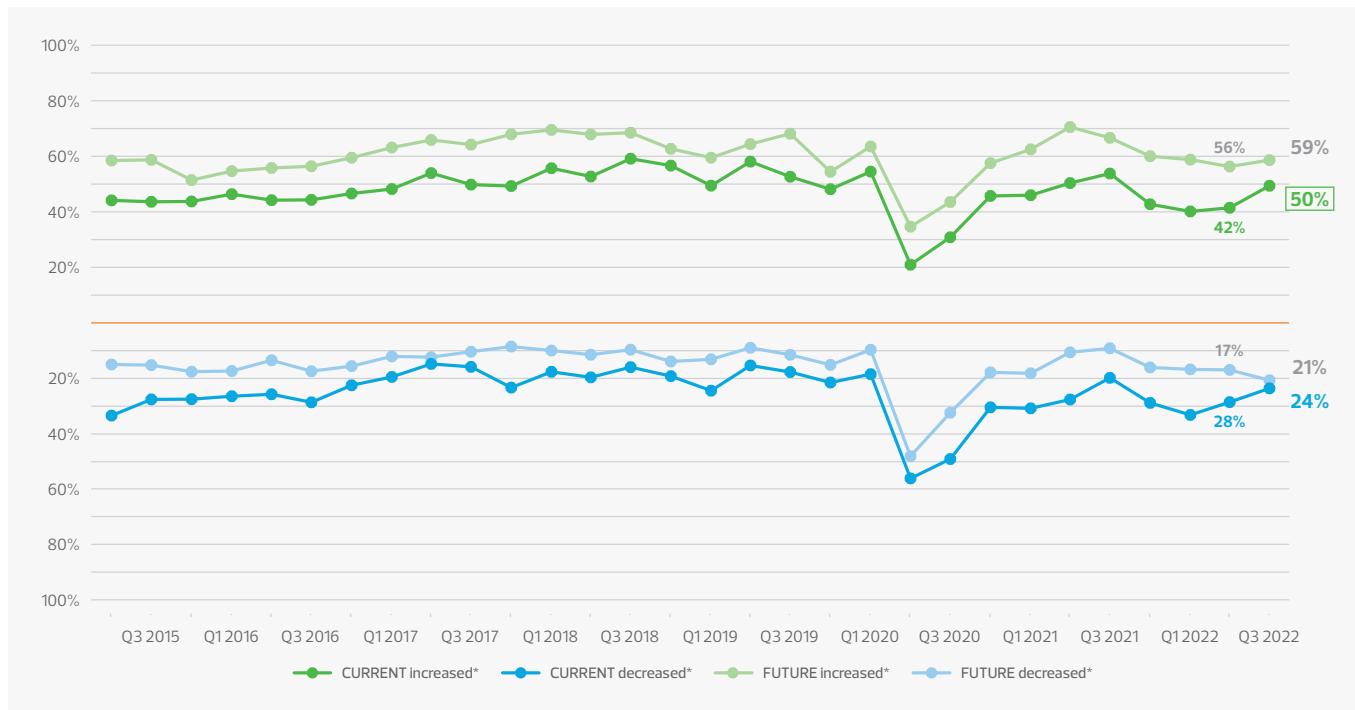
Thinking about your organization's gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds? Would you say gross revenues/all incoming funds have...?

*seasonally adjusted

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...?

NET EARNINGS PERFORMANCE

Net earnings in the third quarter were higher at half of companies represented in the MMBI, up from 42% in the second quarter.



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)?

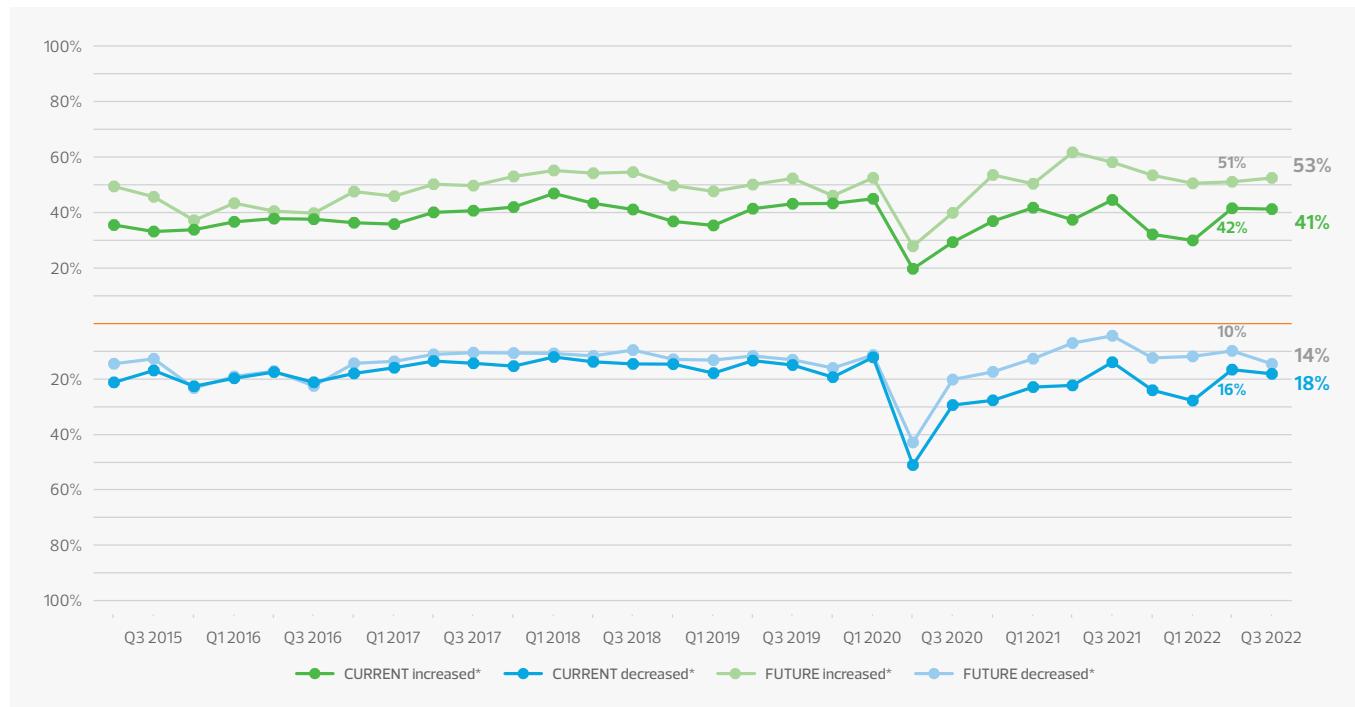
*seasonally adjusted

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

Capital outlays eased slightly, with 41% of executives indicating their organizations made investments in Q3. The outlook remains relatively robust with 53% indicating that they will be making capital expenditures in the next six months.



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...?

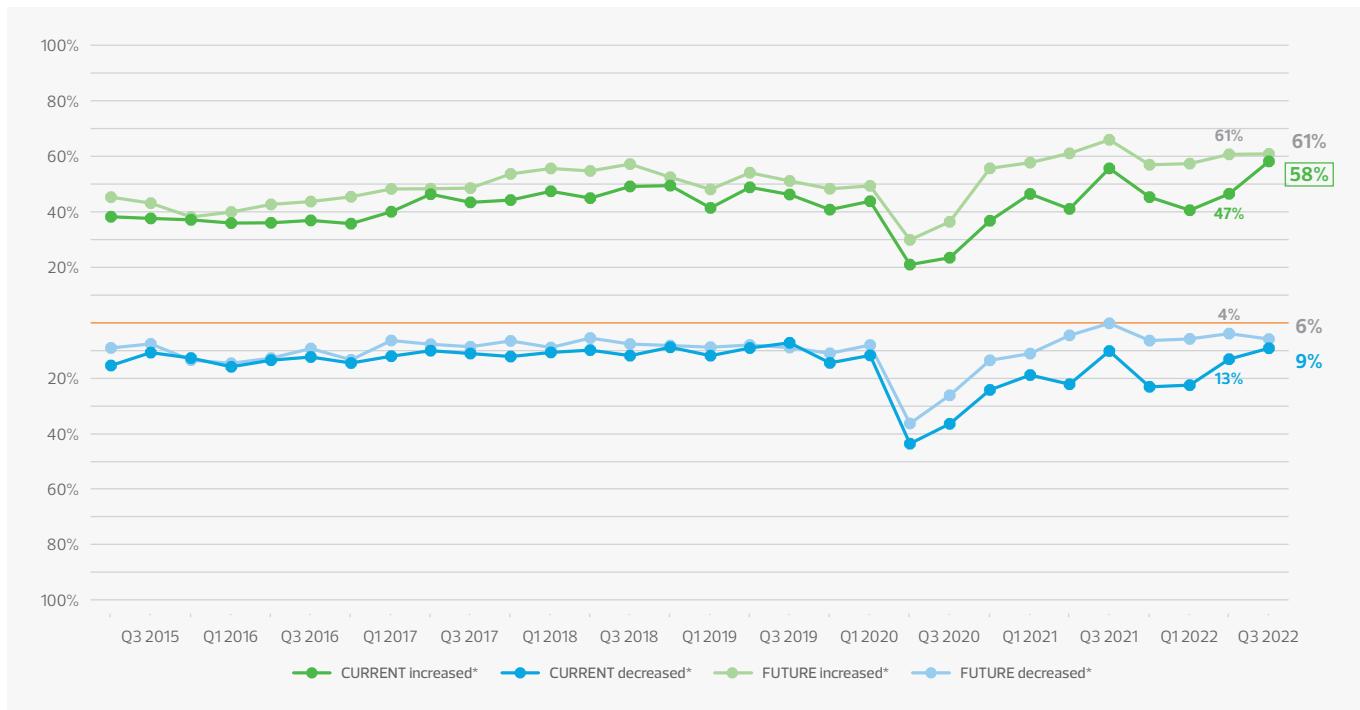
*seasonally adjusted

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

Those businesses hiring more workers rose sharply to 58% in the third quarter from 47% in 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...?

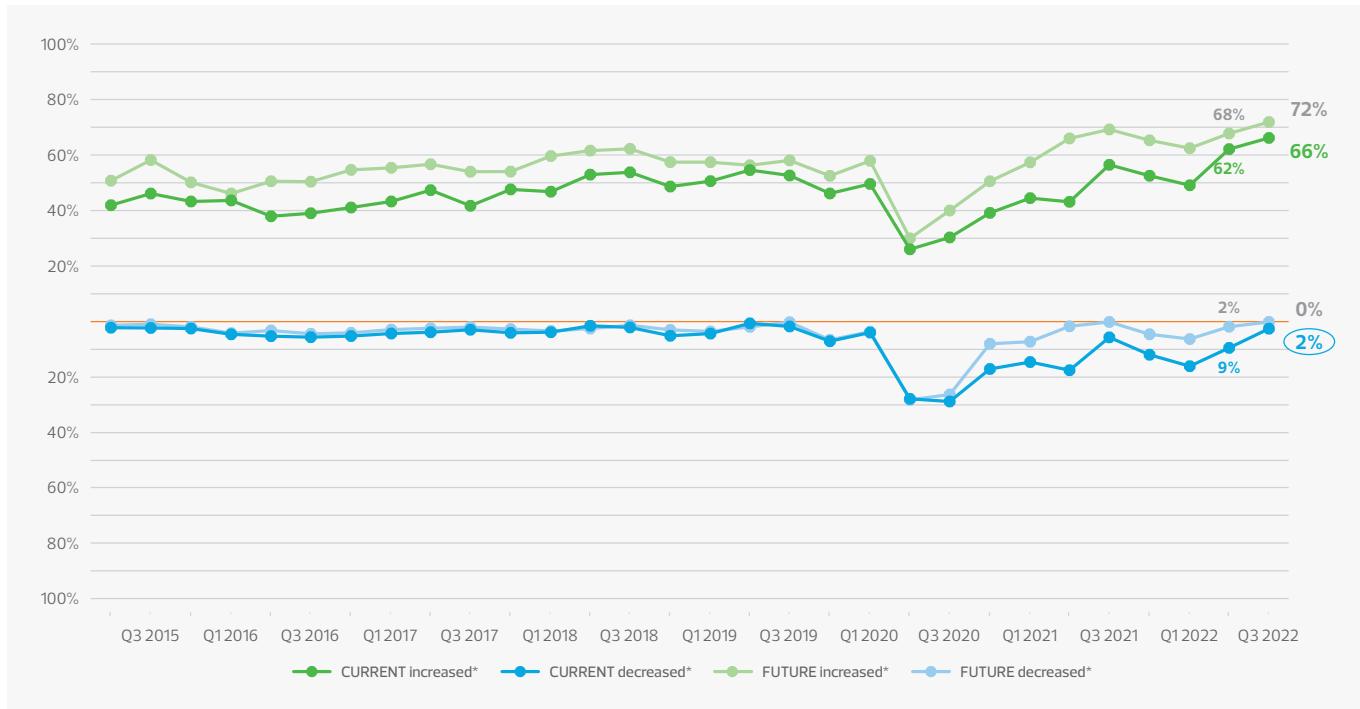
*seasonally adjusted

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

EMPLOYEE COMPENSATION

Two-thirds of respondents said their businesses paid workers more in Q3, up from 62% in Q2; 72% said they expect to boost compensation over the next six months.



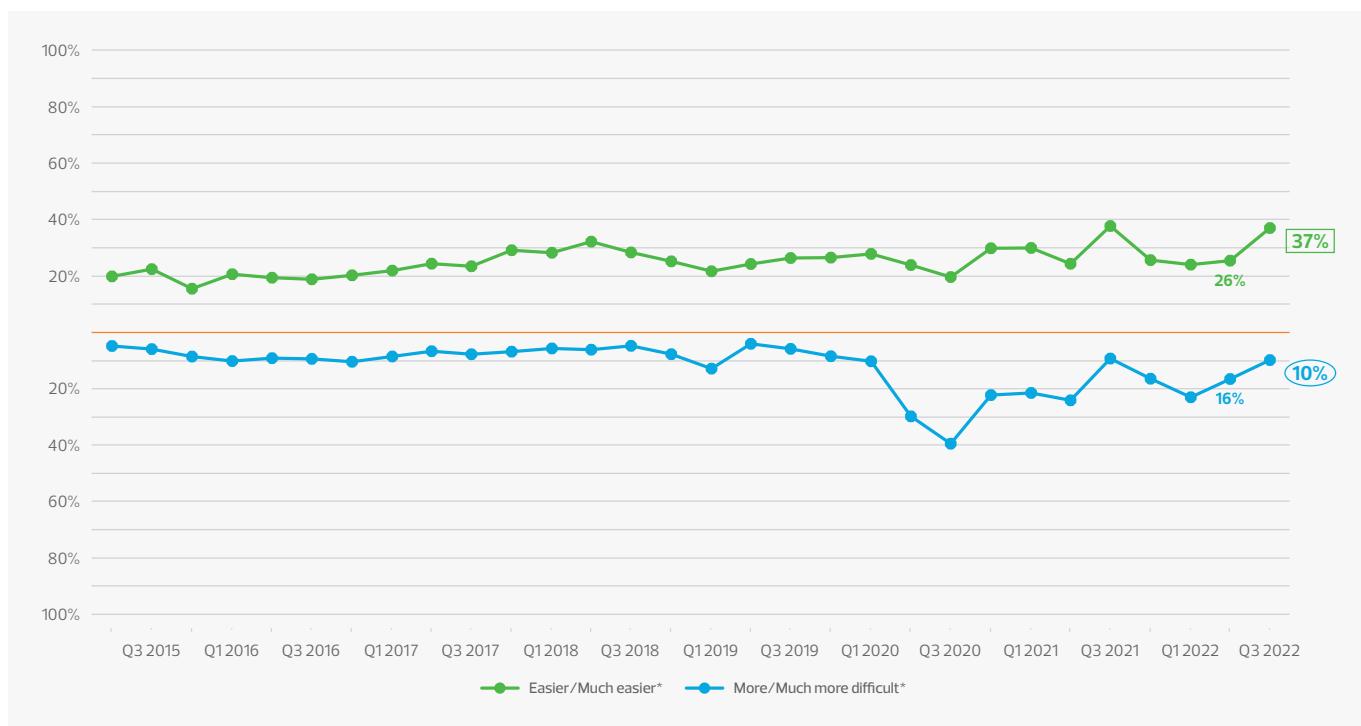
Thinking about employee compensation at your organization this quarter versus last quarter, how would you describe the current employee compensation level on average? Would you say employee compensation, on average, has...?

*seasonally adjusted

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

ACCESS TO CREDIT

Access to credit strengthened in Q3, with 37% of participants saying their companies found it easier to get loans, up sharply from 26% in Q2.



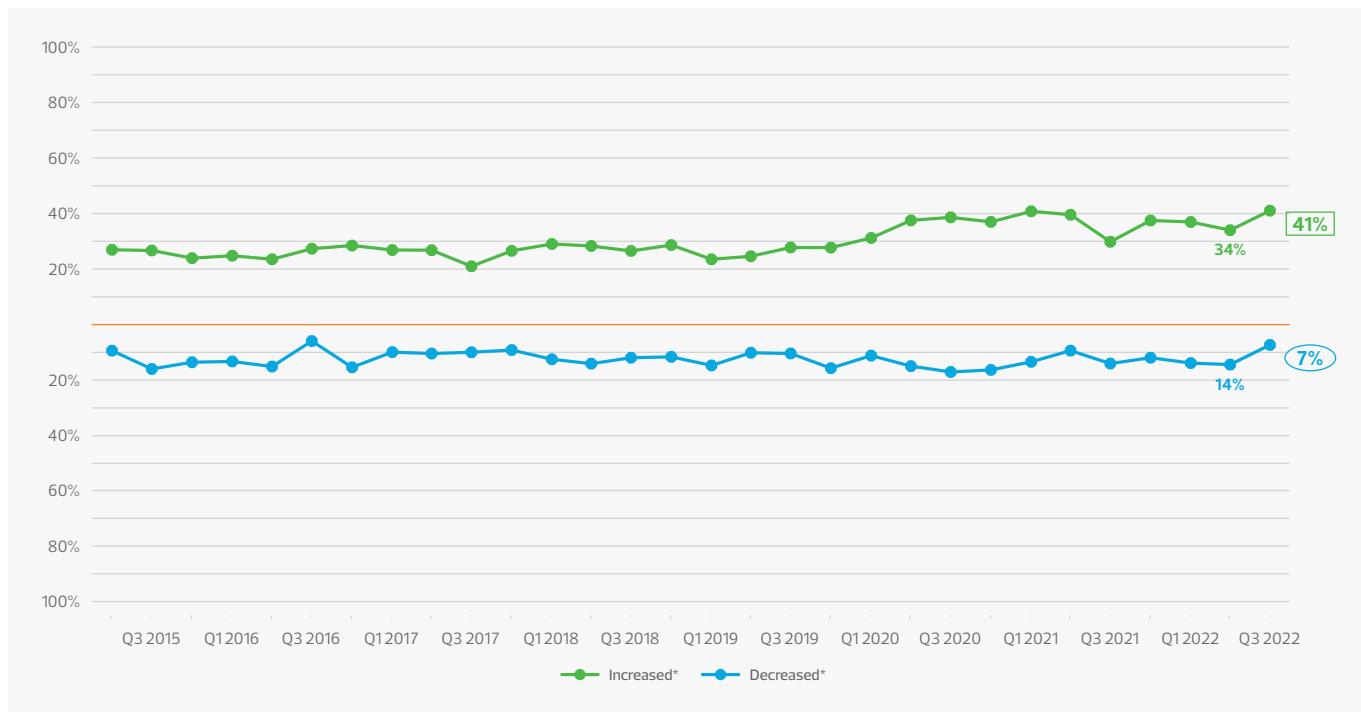
Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit?
Would you say that accessing credit is...?

*seasonally adjusted

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

PLANNED BORROWING

Forty-one percent of respondents say their organizations will borrow more over the next six months, up from 34% in the prior polling period.

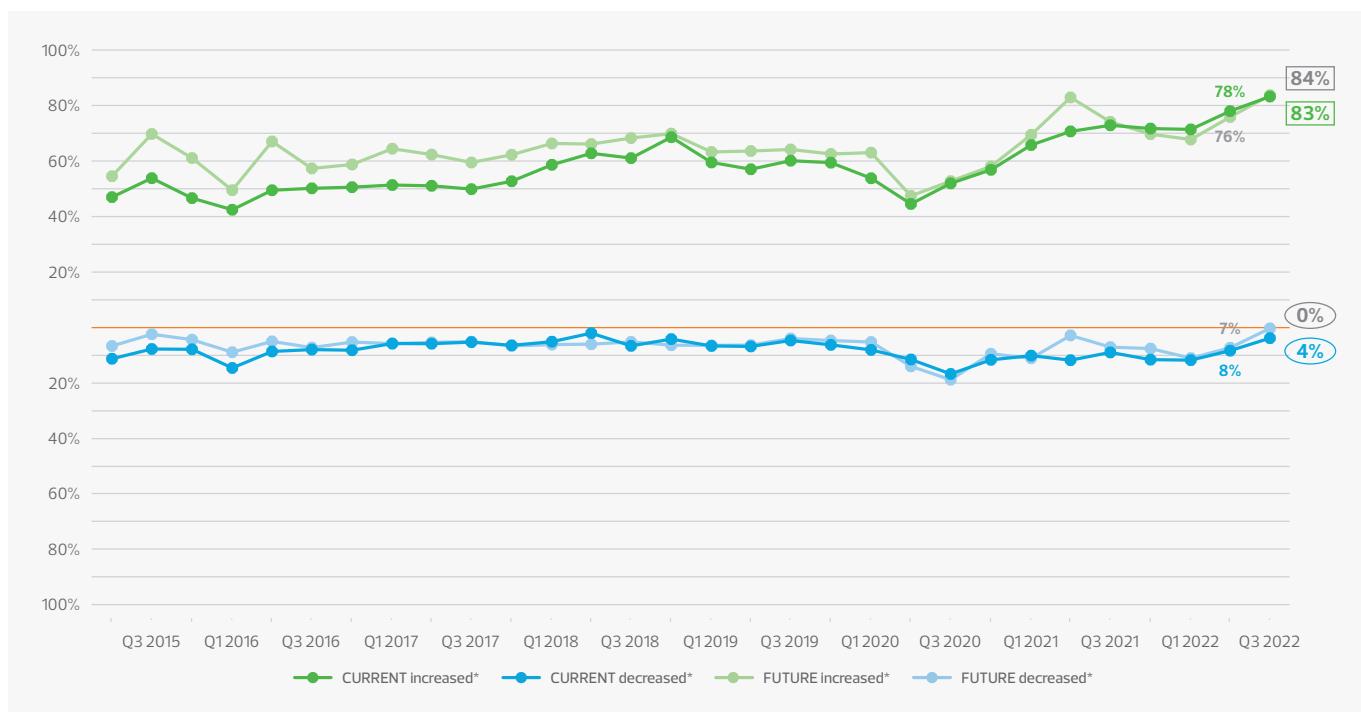


What are your expectations regarding your organization's planned borrowing over the next six months? Would you say your organization's borrowing will...?

*seasonally adjusted

AMOUNT PAID FOR GOODS AND SERVICES

A strong majority (83%) of MMBI respondents said they paid more for goods and services in Q3, up from 78% in Q2. Nearly the same amount expect to pay more over the next six months.



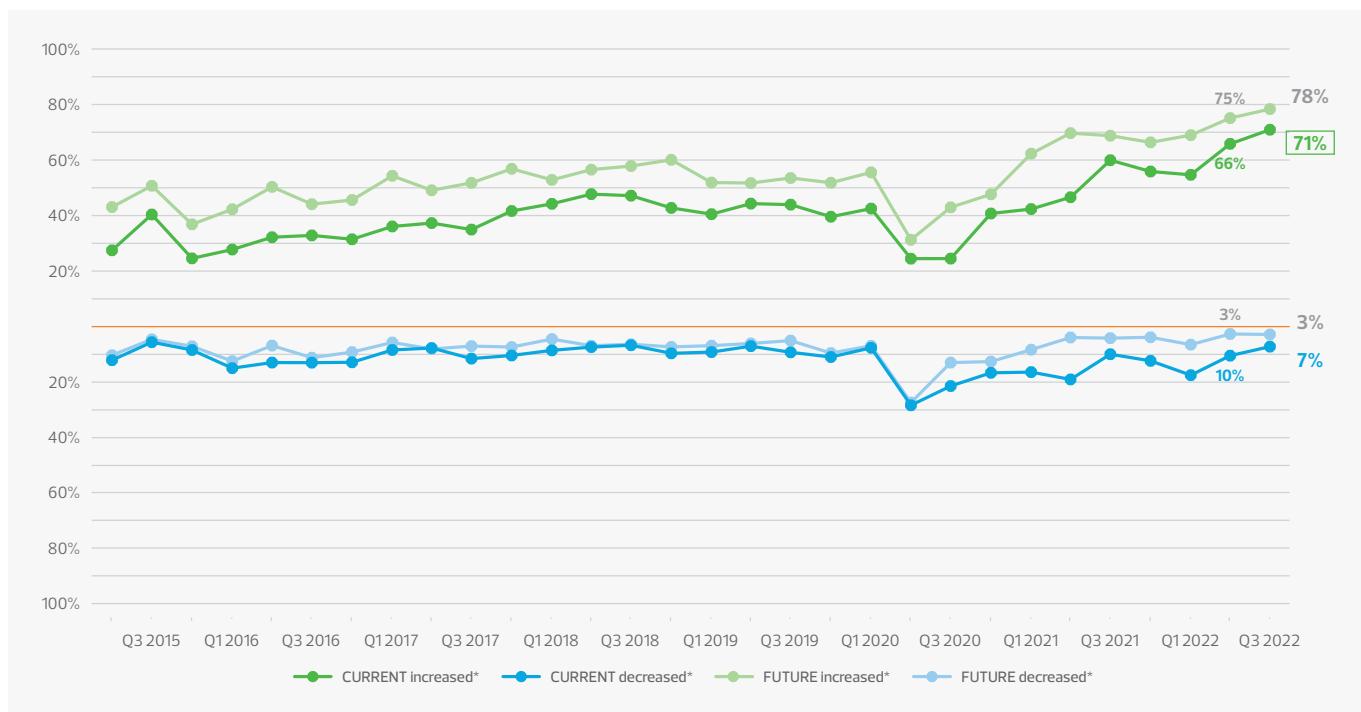
Thinking about the prices that your organization pays for all goods and services, except labor, this quarter versus last quarter, how would you describe the current general level of prices paid? Would you say prices paid, on average, have...?

*seasonally adjusted

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...?

AMOUNT RECEIVED FOR GOODS AND SERVICES

Seventy-one percent of survey participants received more for their goods and services in Q3, up from 66% in Q2; this is an indication of their ability to pass higher input prices downstream.



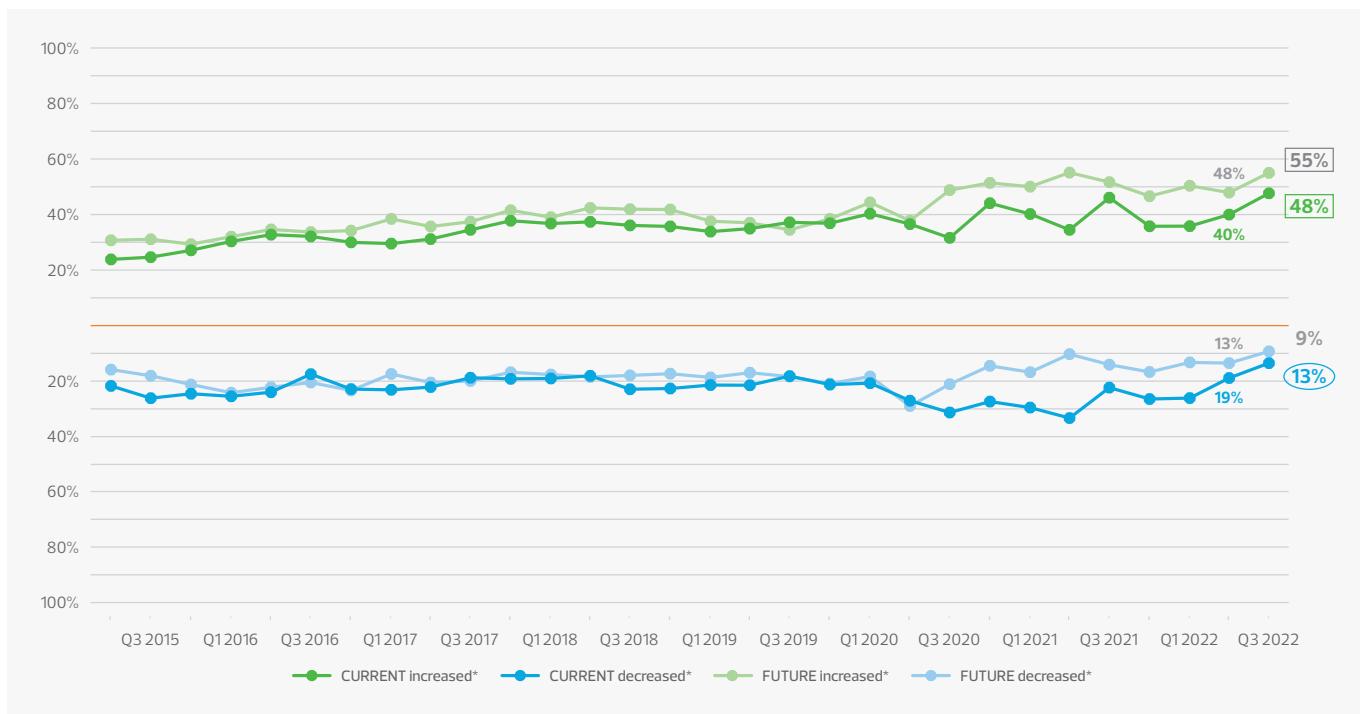
Thinking about the prices that your organization received for all of its goods and services this quarter versus last quarter, how would you describe the current general level of prices received? Would you say prices received by your organization, on average, have (among those not nonprofits)...?

*seasonally adjusted

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)?

INVENTORY LEVELS

Of those companies with inventory, 48% said levels were higher in Q3, up from 39% in Q2. Fifty-five percent of those surveyed see their businesses stockpiling more goods over the next six months.



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...? 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)?

*seasonally adjusted

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 those 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 are some select responses.

“Labor shortages: There’s a huge problem with skilled labor.”

– Construction executive

“Managing the pivot from remote work back to in-office work.”

– Education services executive

“We have issues related to keeping up with upcoming technology trends.”

– Construction executive

“Getting all investors to commit to our ideas.”

– Manufacturing executive

“We are currently involved in a digital transformation that will open our sales to a much larger demographic in the United States. The biggest problem we are facing are supply disruptions.”

– Manufacturing executive

“My main concern has been supply chain management support, finding technical skills and issues, shipping cost, logistics.”

– Agriculture executive

“Information security is a top pain for us right now. Data breaches cost our organization greatly so keeping our data secure with the efforts of our CISO is of the utmost importance.”

– Information technology executive

“Regulation and compliance issues are a top business problem facing our organization today and how to navigate the related complexities.”

– Manufacturing executive

“The top business problem is dealing with remote work and cloud computing in the future and today with the older generation of our company that are resistant to change.”

– Finance and insurance executive

“The organization supply chain and technological deficiencies are a concern for the future of the company.”

– Retail executive

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

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