THE REAL ECONOMY

VOLUME 85

THE INFRASTRUCTURE PACKAGE WILL BOLSTER PRODUCTIVITY AND MODERNIZE THE ECONOMY

RSM US ANALYSTS EXAMINE THE IMPACT ON THE MIDDLE MARKET IN A SECTOR-BY-SECTOR ANALYSIS: CONSUMER PRODUCTS, GOVERNMENT CONTRACTING, MANUFACTURING, REAL ESTATE, CONSTRUCTION AND ENVIRONMENTAL SERVICES

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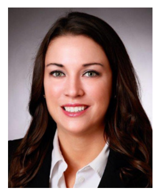

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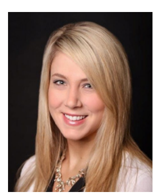

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THE INFRASTRUCTURE PACKAGE WILL BOLSTER PRODUCTIVITY AND MODERNIZE THE ECONOMY

BY JOSEPH BRUSUELAS

THE $1.2 TRILLION Infrastructure Investment and Jobs Act signed into law by President Biden will increase productivity, reduce business costs, cut carbon emissions, improve living standards and have the potential to lift economic growth above the current long-run rate of 1.8%.

Once one accounts for spending at the state and local level, infrastructure spending will reach nearly $3 trillion over the next eight years. This represents the most significant modernization of the nation's infrastructure since the middle of the 20th century.

There are near-term macroeconomic benefits to infrastructure investment—the multiplier effect with real interest rates being negative is likely larger than the 1.25 per dollar spent on traditional hard infrastructure. But the most encouraging benefit of the initiatives will take place over the long run as they bring a payoff to both productivity and growth that will be greater than our estimate suggests.

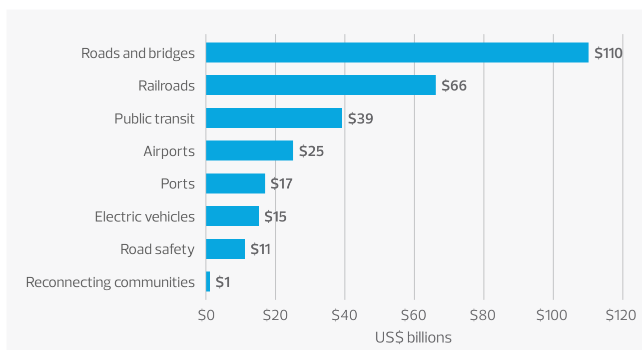
While most ignore productivity in the near term, in the long run, it is everything. The dynamism and vitality of the domestic economy depend upon it.

MIDDLE MARKET INSIGHT

This legislation represents the most significant modernization of the nation's infrastructure since the middle of the 20th century.

The long-run benefits make this infrastructure package distinct from almost all other fiscal policies in recent years. Spending on broadband, roads, bridges, power and water systems, and public transit will receive the largest boost.

Infrastructure spending on transportation



Source: Washington Post; RSM US LLP

THE MOST ENCOURAGING BENEFIT OF THE INITIATIVES WILL TAKE PLACE OVER THE LONG RUN AS THEY BRING A PAYOFF TO BOTH PRODUCTIVITY AND GROWTH.

MIDDLE MARKET INSIGHT
Research shows that for each 10% increase in infrastructure investment, national output grew by 0.8% in the near term and 1.2% in the long run.

For example, the infrastructure law in its first year of implementation will only add $16 billion in net fiscal firepower to the economy. This bill will spur an increase in growth through the productivity channel that will dampen inflationary pressures over the medium to long run and not create undue fiscal constraints.

It is important to remember that the American economy generates roughly $23 trillion per year in overall activity. The $550 billion in new spending on top of the expected $2.4 trillion in investment around the remainder of the economy is not only necessary, but we can also afford it.

Academic research over the past three decades shows that for each 10% increase in infrastructure investment, national output grew by 0.8% in the near term and 1.2% in the long run.

Similar scholarly work implies that a 1% increase in public capital investment in hard infrastructure results in a 0.24% increase in productivity. This law should create roughly 675,000 temporary construction jobs over the next 10 years and reduce the unemployment rate by roughly 0.3%.

Given that almost all construction jobs are temporary—it has and will always be this way—only a fraction of those jobs will result in permanent employment. Should labor growth in the United States continue at a restrained pace below 0.5% a year, demand for labor in the construction industry will reach a point where wages will be bid up and firms will begin looking at guest workers and immigrants to fill basic needs.

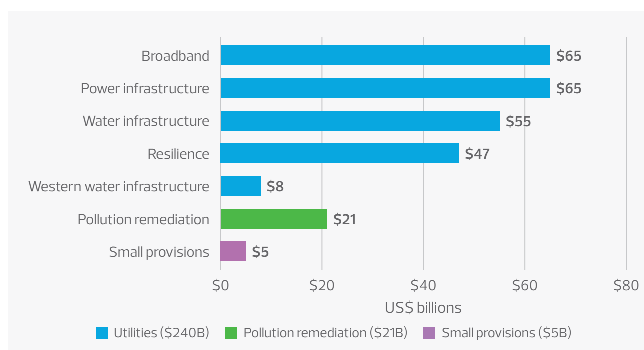
In our analysis, the greatest challenge to the modernization of American infrastructure will be a tight labor market, and not financial constraints, interest rates or medium- to long-term inflation risks.

While this law will add modestly to the federal deficit, investments that will boost productivity and growth over that period are in the interest of the economy and are strongly supported by the firms that populate the real economy.

In a recent RSM US survey of middle market executives that asked their views on infrastructure, roughly 63% of senior executives said that the state of the nation's infrastructure is holding back the national economy, 60% said that it was hurting their local economy and 54% noted that it was restricting the growth of their organization.

This kind of consensus in the commercial community is uncommon, and the bipartisan legislative agreement represents an encouraging next step to repair the nation's critical infrastructure.

Infrastructure spending on utilities, pollution remediation and small provisions



Source: Washington Post; RSM US LLP

The takeaway

Each year, American states and territories spend roughly $170 billion a year on infrastructure. Over the next 10 years, the new spending, in addition to the congressional baseline established under law, will result in roughly $2.9 trillion in infrastructure investment. That represents the single largest modernization of U.S. infrastructure since the Eisenhower-Kennedy-Johnson era of the 1950s and 1960s. Since that time, public investment in domestic infrastructure has declined by roughly 40%. The new investments are long overdue. The American people, and the businesses that power the real economy, will benefit.

INFRASTRUCTURE SPECIAL FEATURE

CONSUMER PRODUCTS BUSINESSES WILL BENEFIT FROM AN IMPROVED SUPPLY CHAIN

BY KAREN GALIVAN

THIS INFRASTRUCTURE Investment and Jobs Act will provide critical improvements to the supply chain. The pandemic highlighted deficiencies in our roads, bridges, railways, ports and airports. Consumers quickly moved to digital shopping, ordering and delivery, placing additional strain on broadband, logistics, transportation, supply chain management and more. This bill will provide the backbone that America will need to stay competitive in the global marketplace.

In the short term

The large amount of funding is significant and goes to existing programs to fill shortfalls and creates new programs, particularly in broadband distribution and cybersecurity, to address gaps in technology, privacy and accessibility. As consumers continue to embrace omnichannel shopping, middle market consumer products companies pivoted quickly to meet consumer demand. The speed of digital transformation has left many companies susceptible to cyberattacks or with limited ability to reach their customers. Funding these areas will be a welcomed improvement.

Sustainability and transparency are also top of mind for consumers, becoming more of a requirement than a luxury. The increased focus on environmental monitoring with funding for natural resources-related infrastructure, wildfire management, clean water and ecosystem restoration will support consumer products companies' initiatives to produce and deliver environmentally friendly products.

MIDDLE MARKET INSIGHT

The biggest benefit from the legislation is the funding for roads and ports to reduce the strained supply chain that has plagued many industries, including consumer products.

Finally, the biggest benefit from the legislation is the funding for roads and ports to reduce the strained supply chain that has plagued many industries, including consumer products.

The big picture

This package should not be viewed as just a capital injection, but rather a long-term improvement plan to ensure consumers have efficient, affordable and safe access to all types of consumer goods. As for consumer products businesses, including those in the middle market, the hope is for them to strengthen operations, supply chains and more for a profitable future.

INFRASTRUCTURE SPECIAL FEATURE

GOVERNMENT CONTRACTORS WILL PLAY A KEY ROLE IN INFRASTRUCTURE IMPROVEMENTS

BY STEPHANIE JOHNSON

NUMEROUS INFRASTRUCTURE repairs and upgrades funded by the Infrastructure Investment and Jobs Act will be performed by private companies that win contracts with federal agencies or state or local governments. In that sense, government contracting is at the heart of this bill.

It equates to an abundance of opportunities for contractors, even those that have worked only business-to-business jobs. When a contractor wins even a single government contract, they become a government contractor. With new opportunities, though, come new disciplines that contractors need to adopt to be successful, such as government-compliant cost accounting, budgeting, pricing and documentation.

Successful adoption and a track record of quality performance should make it easier for them to bid on future contracts, and winning those bids may result in a stable, predictable and collectible cash flow.

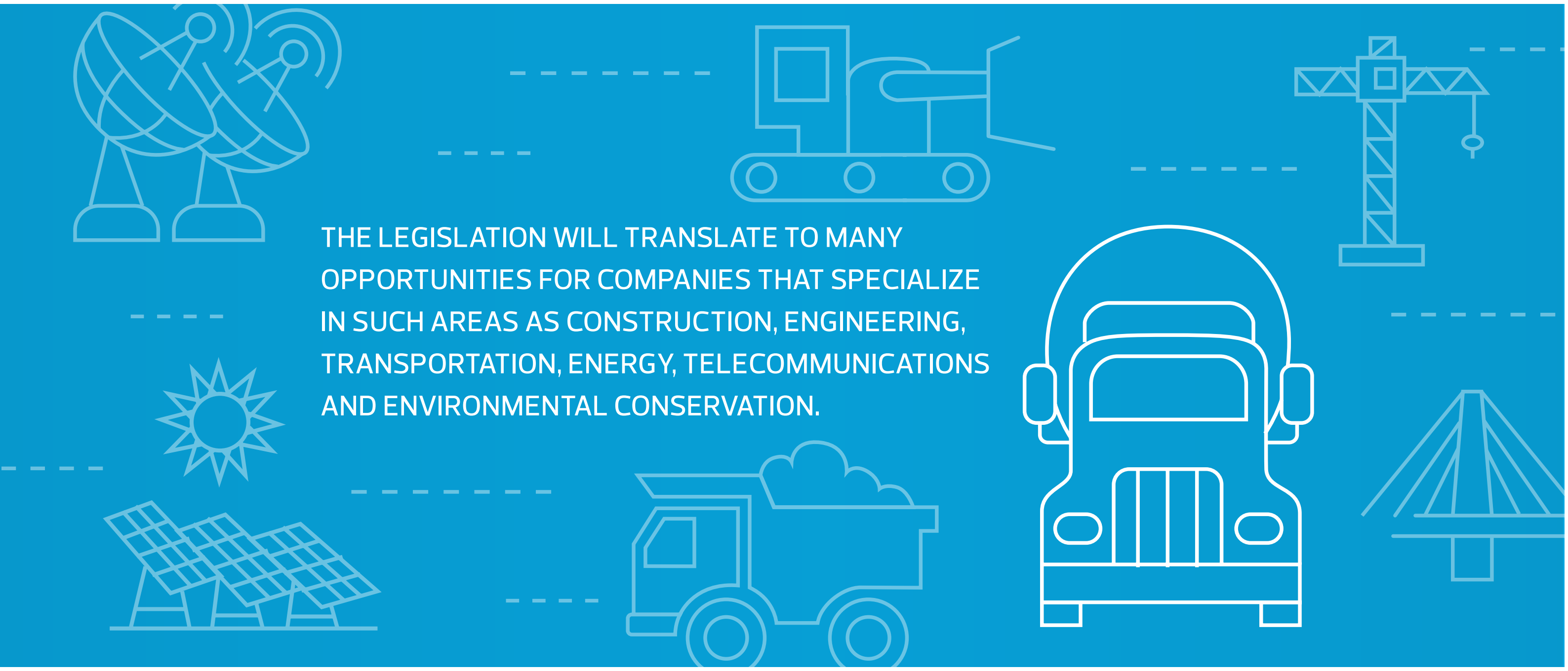
MIDDLE MARKET INSIGHT

The act equates to an abundance of opportunities for contractors, even those that have worked only business-to-business jobs.

Specific allotments for government contracting

The bill provides $550 billion of new federal investments over five years, which will translate to many opportunities for companies that specialize in such areas as construction, engineering, transportation, energy, telecommunications and environmental conservation.

Generally, federal agencies will allocate the funding to states in the form of grants, with state-by-state amounts determined by a formula that accounts for population and other factors. It's important to note that federal regulations could govern projects, even if they are negotiated at the state or local level.



The big picture

While the bill is designed to modernize America's infrastructure, the Biden administration also touts that it will add an average of 2 million jobs per year over the next decade. In fact, while large contractors will benefit, the bill will earmark contract awards for small and disadvantaged businesses, such as those owned by minorities, women, veterans and other similar classifications of people.

In all, the historic funding levels will widen and deepen the pool of government contractors, which will foster competition, growth and innovation in the sector—not to mention resilience.

When a company adds as its customer the No. 1 consumer of goods and services in the world, it diversifies its revenue stream and makes itself more predictable and transparent, which appeals to investors. After all, the government doesn't stop building, contracting or paying when the economy turns downward. On the contrary, it is likely to continue all of that during a recession to spark the economy. Doing business with the government is effectively recession-proof.

In the short term

Companies eager to bid on infrastructure projects need to understand what they're signing up for. That entails complying with various regulations, ones that might be unfamiliar to companies that are new to government contracting. The vaccine mandate for federal contractors is one of the compliance issues that immediately stands out. Whether a company is a prime contractor or a subcontractor, hiring attorneys and consultants who are familiar with government contracts can help it navigate the regulatory environment so that it can win and perform these contracts.

MIDDLE MARKET INSIGHT
The act will earmark contract awards for small and disadvantaged businesses such as those owned by minorities, women, veterans and other similar classifications of people.

Contractors also should ask themselves if they have the personnel necessary for this kind of project—professionals with the proper skills, credentials and the ability to work collaboratively with contract officers. Alternatively, some contractors may be better suited for a subcontractor role that allows them to participate just on the parts they are best suited to perform. Those will also be plentiful in the wake of this bill.

Diligence in record-keeping is absolutely critical for government contractors. This often poses a steep learning curve for those new to serving the government. Well-positioned contractors not only have detailed documentation procedures but also the technology, tools and controls needed to monitor compliance efficiently and effectively. Those that are able to use detailed historic pricing and contract data to plan for the future in a data-driven manner will prove to be superior. ■

INFRASTRUCTURE SPECIAL FEATURE

AN IMPROVED SUPPLY CHAIN AND ENERGY INFRASTRUCTURE WILL BENEFIT MANUFACTURERS

BY MATT DOLLARD, SHRUTI GUPTA, KATIE LANDY, ANNE SLATTERY AND JAMES WARD

THE INFRASTRUCTURE Investment and Jobs Act will have a significant positive impact on a range of industrial companies. While construction sector businesses are perhaps the clearest category that will benefit, so will companies throughout the industrial supply chain, including steel and material suppliers, engineering services firms and more.

The expansion of broadband infrastructure will accelerate the ongoing technology revolution in manufacturing by opening up a wider variety of options for factory locations and allowing for more talent development in rural areas. More robust broadband will allow for the expansion of 5G, which decreases latency and allows companies to use data in real time. The improved reliability of 5G networks will also mean organizations can use more connected devices in their operations—a crucial aspect of manufacturers' increasing efforts to use data in new ways to drive business operations.

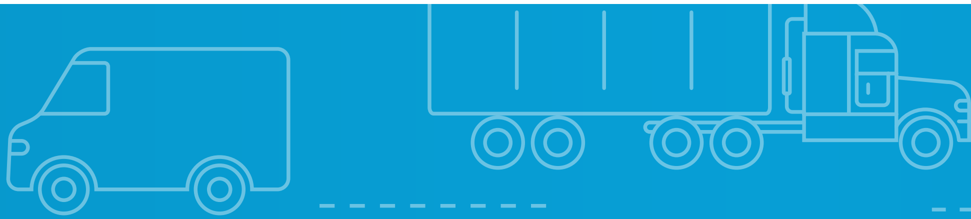
Investments in road transit and rail systems will also help move goods more efficiently, increase talent mobility overall and improve the competitiveness of the U.S. supply chain, which is especially crucial in the manufacturing sector. Supply chain bottlenecks, especially over the last year and a half, have underscored just how important it is to streamline these networks.

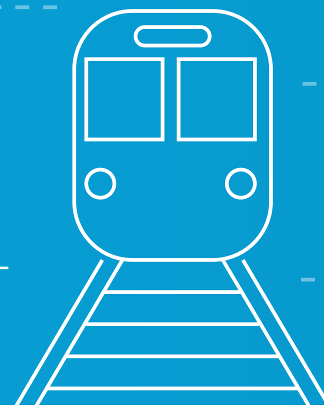
The legislation's considerable investments for rebuilding the electric grid, environmental remediation financing, and outlays for electric vehicle infrastructure expansion will undoubtedly change the energy industry on a fundamental level, as we wrote in November. The deal will further incentivize clean energy and support the overall energy transition.

MIDDLE MARKET INSIGHT
The expansion of broadband infrastructure will accelerate the ongoing technology revolution in manufacturing.

Specific allotments that will directly affect manufacturing and energy:

- Roads and bridges—$110 billion
- Public transit—$39 billion
- U.S. passenger rail system—$66 billion
- Broadband internet infrastructure—$65 billion
- Electric grid—$65 billion
- Electric vehicles, buses, ferries—$7.5 billion
- Clean drinking water—$55 billion
- Airports—$25 billion
- Road safety—$11 billion
- Climate change mitigation—$28.5 billion





INVESTMENTS IN ROAD TRANSIT AND RAIL SYSTEMS WILL ALSO HELP MOVE GOODS MORE EFFICIENTLY, INCREASE TALENT MOBILITY OVERALL AND IMPROVE THE COMPETITIVENESS OF THE U.S. SUPPLY CHAIN.

In the short term

Manufacturers and producers of metal, lumber and aggregate materials will see benefits from the act's large allocation to modernize and expand passenger and freight transportation (which affects roads, bridges, airports, rail and public transit). Manufacturers and suppliers of heavy transport parts for buses, trains and related equipment will get a boost, along with industrial companies in the broadband 5G infrastructure space and manufacturers of water delivery system parts. As EV charging stations become more commonplace along highway corridors, we anticipate an accelerated lift in sales for EV manufacturers and their supplier networks.

There will also be hurdles for businesses as the impacts of the legislation come to fruition. Organizations should prepare to scale operations and capacity as needed and plan for the labor implications of doing so; companies will need to pay a premium for talent. Some hurdles will be sector specific; chemical manufacturers, for instance, will need to navigate the reinstatement of the Comprehensive Environmental Response, Compensation, and Liability Act, which imposes excises taxes on such companies.

In the energy sector, we expect many companies will not experience the true impact of the bill until the second half of 2022, and it may be even longer—perhaps until 2024—until we can truly understand the impact on commodity prices. This is because of the many variables in play, including the timeline for lifting pandemic-related restrictions, the return of U.S. shale production and OPEC increasing output. By the time the infrastructure bill's provisions start to affect the energy sector, these other variables will likely have changed significantly.

The big picture

It's unlikely we will see another bill like this in our lifetimes. The positive impact on Americans' quality of life will be significant for those who haven't had reliable access to clean drinking water and access to the internet—things many of us take for granted.

The increase in jobs via public works projects will be a boon over the next five to seven years when the funds in the bill will likely be spent. Some of the longer-term benefits to Americans' daily lives, such as improved health outcomes and better economic opportunities for disadvantaged citizens, may be measured in generations—much like the federal highway act of 1956, which is still paying dividends.

MIDDLE MARKET INSIGHT
The deal will further incentivize clean energy and support the overall energy transition.

New federal regulations around safety, fuel efficiency and emissions will likely require some industrial companies such as automotive manufacturers and suppliers to pivot. Companies will need to stay close to these regulatory factors of the bill as they could have dramatic impacts on their businesses and customers.

The single greatest hurdle or challenge presented by the infrastructure bill is determining how its programs will be funded. The Congressional Budget Office estimates that the budget deficit will be nearly $260 billion over the next 10 years. Funding is currently expected to be paid by way of unused COVID-19 relief funds, more aggressive IRS tax reviews and new tax revenues.

Recently, there has been an uptick in domestic investment in the EV and semiconductor space. The massive infrastructure investments will help to further develop the supplier base for companies in these sectors. We hope this will encourage more domestic manufacturing investments—eventually beyond the EV and semiconductor space as well—so the United States can increase its global competitiveness.

At a high level across the entire industrial segment, the new legislation could make the transportation of goods cheaper and more efficient in the long term, which would be a win not just for manufacturing companies but also for the U.S. economy as a whole.

RSM national manufacturing sector leader Jason Alexander contributed to this article.

INFRASTRUCTURE SPECIAL FEATURE

REAL ESTATE IMPROVEMENTS WILL HELP MAKE COMMUNITIES MORE LIVABLE

BY SCOTT HELBERG

THE LARGEST BENEFIT of the Infrastructure Investment and Jobs Act for real estate will be in the second-order impacts.

Improvements in transportation, telecommunications and utilities will increase property values across asset types and make communities more desirable. Hundreds of billions of dollars are being allocated to the improvement of roads, bridges and ports. This will make the supply chain quicker and more effective, driving up e-commerce traffic and the need for industrial real estate.

Sixty-five billion dollars are dedicated to improving and expanding broadband internet access, which will substantially increase the number of internet users and provide even greater demand for data centers. Once the power grid improves, data center developers will have more flexibility on where new projects can be situated.

In the short term

The short-term impact of the legislation on real estate will likely be muted. It will take a long time for the funds to be allocated, and for projects to be selected and planned. Then it will take time for these transformational projects to be completed. Once improvements are made, immediate benefits should be seen by both commercial and residential real estate tenants through improved water quality, better access to broadband internet and transportation, and improved roads. Housing will be upgraded, particularly in rural, underserved and low-income areas. When new public transportation stations are identified, developers will likely be quick to start planning projects in those areas. Transit-oriented developments often bring high-value returns.

MIDDLE MARKET INSIGHT

Real estate companies will have more opportunities for value-add and redevelopment of properties to coincide with the areas that get funding from the bill.

The big picture

In the long term, the infrastructure bill will drive gross domestic product growth and job creation, with both boosting demand for real estate. Additionally, existing communities will improve and new communities will be created with the investment in roads, bridges and public transportation.

Real estate companies will have more opportunities for value-add and redevelopment of properties to coincide with the areas that get funding from the bill. Spending toward resiliency against climate change will also preserve properties that may otherwise be destroyed in areas susceptible to hurricanes, wildfires and floods.

INFRASTRUCTURE SPECIAL FEATURE

CONSTRUCTION INDUSTRY STANDS TO REAP THE BENEFITS, BUT IT NEEDS THE WORKERS

BY NICK GRANDY

A RISING TIDE lifts all boats. And so goes the thinking around infrastructure investment headed for construction projects, which have recently seen an imbalance favoring residential work as commercial jobs slowed during the pandemic.

The Infrastructure Investment and Jobs Act will result in a five-year net new investment of $550 billion, which alone won't create equilibrium, but we expect it will lead to less hesitancy about jobs in the nonresidential space. This includes the harder-hit hospitality and office sectors, as these public infrastructure projects with secured funding help reduce competition in other nonresidential works. We expect backlogs to fill and contractors to expand their service offerings.

The big picture

The new legislation offers construction a sustained capital infusion over the next five to seven years that will provide longer-term opportunities for growth while helping to shore up America's aging infrastructure.

But to capitalize on the windfall, the industry must find ways to offset a shrinking labor pool. Contractors must find innovative ways to attract talent—whether through vocational partnerships, in-house training, higher wages or other incentives. And amid increasing pressure to offset climate change, the industry will need to moderate its own practices and move toward lessening its impact on the environment.

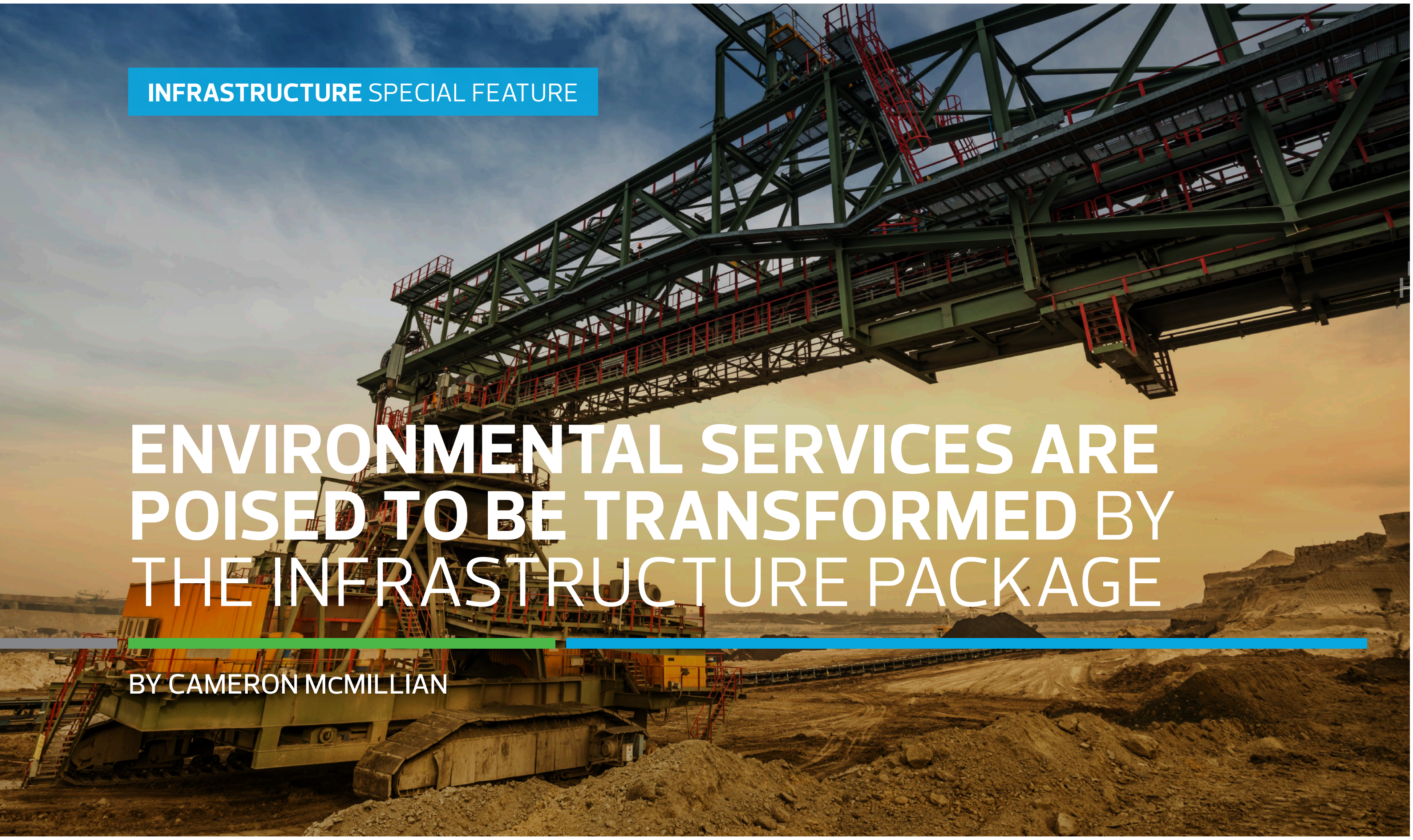
MIDDLE MARKET INSIGHT

Every $1 billion of infrastructure investment requires 3,000 construction workers—a tall order for an industry facing a labor shortage.

In the short term

Every $1 billion of infrastructure investment requires 3,000 construction workers. That's a tall order for an industry already facing a prolonged labor shortage worsened by the pandemic. There were 344,000 open U.S. construction jobs in August—the most recent month of available government data—38% more than the five-year average of 249,000 monthly openings.

The labor shortage could be further exacerbated by federal government vaccine mandates as construction worker vaccine rates continue to remain low; only slightly more than half of the construction workers have their shots, compared to about 80% in occupations overall, data from the Construction Center for Research and Training shows. Meanwhile, supply chains and material prices remain volatile, with steel, copper and fabricated metals all currently inflated. Pricing volatility makes it difficult to bid on jobs.



ENVIRONMENTAL SERVICES ARE POISED TO BE TRANSFORMED BY THE INFRASTRUCTURE PACKAGE

BY CAMERON MCMILLIAN

THE BILLIONS of dollars earmarked for environmental services are meant to strengthen the health, equity and resilience of American communities by remediating legacy pollution and other environmental harms. Environmental services firms will be tasked with those objectives on a wide variety of projects from start to finish. This indicates an increase in demand for services such as environmental studies, remediation and waste removal. To put that increased demand in context, the administration touts the Infrastructure Investment and Jobs Act as "the largest investment in tackling legacy pollution in American history" and "the single largest investment in water that the federal government has ever made."

Specific allotments for environmental services

The law apportions tens of billions of dollars to different types of infrastructure and programs that would help to enhance environmental protection, public health and environmental justice for small and disadvantaged communities. Of those numerous allotments, the administration classifies $21 billion as environmental remediation spending:

MIDDLE MARKET INSIGHT
The additional tens of billions of dollars earmarked for roads, bridges, airports, waterways and utilities will generate demand for environmental services firms as well.

$11.3 billion—reclamation of abandoned mine land: Funding for the Abandoned Mine Reclamation Fund, which distributes annual grants for reclaiming abandoned coal mines and production facilities.

$4.7 billion—methane reduction infrastructure: Money for a new federal program that grants funding to plug, remediate and restore orphaned oil and gas wells.

$3.5 billion—cleanup of Superfund sites: A Superfund site is an area of land that has been polluted by hazardous materials and requires a long-term cleanup plan. The Environmental Protection Agency reported in July that 73 million people (22% of the U.S. population) live within three miles of one of the country's 1,866 Superfund sites. That includes 26% of all Black Americans, 29% of all Hispanic Americans and 15% of all Americans living below the poverty line—percentages that are greater than their respective shares of the total population.

$1.5 billion—brownfield revitalization: Funding for grants and loans to scale up so-called brownfields—properties whose expansion, redevelopment or reuse might be complicated by the presence of hazardous substances or pollutants.

Other apportionments for environmental projects and programs include:

$3 billion—reclamation of abandoned hardrock mine land: Money for reclaiming and responding to abandoned hardrock mine land contaminated by hazardous substances. Federal agencies have identified 140,000 such areas and believe hundreds of thousands more exist.

$1.96 billion—environmental programs and management: Funding for EPA programs through which partnerships with various organizations work to protect national water treasures and ensure they continue to serve as vital economic and recreational assets.

$350 million—waste management and recycling: Grants to states to upgrade local waste management systems and to improve recycling programs through education and outreach.

MIDDLE MARKET INSIGHT

The law apportions tens of billions of dollars to programs that would help to enhance environmental protections, public health and environmental justice.

$100 million—pollution prevention programs and a new program to promote environmental justice: Funding to help businesses reduce toxic pollutants, cut water usage, improve efficiency and lower costs.

The additional tens of billions earmarked for roads, bridges, airports, waterways and utilities will generate demand for environmental services firms as well. Waste management companies will see big demand here, but those projects may also require environmental studies and remediation, depending on the location and the quality of the structure that is being built or rehabilitated.

In the short term

Cleaning up a Superfund site is a complex undertaking that historically can take decades to complete. The apportionment of funding for this purpose stands out as an opportunity for environmental services firms because they are typically engaged from the assessment phase at the start of the project all the way through to the waste hauling stage at the conclusion.

Firms eager to bid on Superfund cleanup projects should understand the capabilities that historically have enabled successful site cleanups. Typically, firms are well-versed in at least one of the following treatment practices:

- **Biological treatment:** Adding or stimulating the growth of microorganisms. These microorganisms metabolize contaminants or create conditions in which contaminants will convert to nonhazardous or less toxic forms.
- **Chemical treatment:** Chemically converting hazardous contaminants to nonhazardous or less toxic forms. Chemical precipitation (formation of a separable solid substance from a solution) is often included in this form of treatment.
- **Physical treatment:** Using the contaminant's physical traits to separate or debilitate the contaminant.
- **Thermal treatment:** Using heat to separate contaminants from contaminated media (rocks, soil, sediment, etc.). The contaminants or the contaminated media can then be immobilized or destroyed in several ways, including melting and detonating.
- **Pump and treat:** In this common method of cleaning contaminated groundwater, water is extracted from the ground into a treatment system that removes contaminants.

MIDDLE MARKET INSIGHT

Firms eager to bid on Superfund cleanup projects should understand the capabilities that historically have enabled successful site cleanups.

The big picture

Many proponents of environmental causes applaud the infrastructure package as a positive step while lamenting spending levels they deemed inadequate to address the country's scope of environmental issues. Still, billions of dollars in new funding for environmental projects and programs should equate to numerous opportunities for environmental services firms. That increase in demand figures to result in growth for firms that are equipped to successfully carry out projects, whether they be environmental assessments, waste management, remediation or others.

As environmental services firms know well, however, it can take years or even decades for a project to result in substantial, visible or quantifiable environmental improvements. In that sense, the sector would benefit from sustained positive momentum sparked by these investments. How long the momentum lasts, though, depends on a few factors, including national and local political dynamics and the early returns on initiatives catalyzed by this new law.

U.S. HOUSEHOLDS DRAWING DOWN SAVINGS AS ECONOMY BOOMS

BY JOSEPH BRUSUELAS

AFTER BUILDING UP prodigious savings during the pandemic, American households are starting to spend that cash, our analysis of consumer savings and checking deposit data shows.

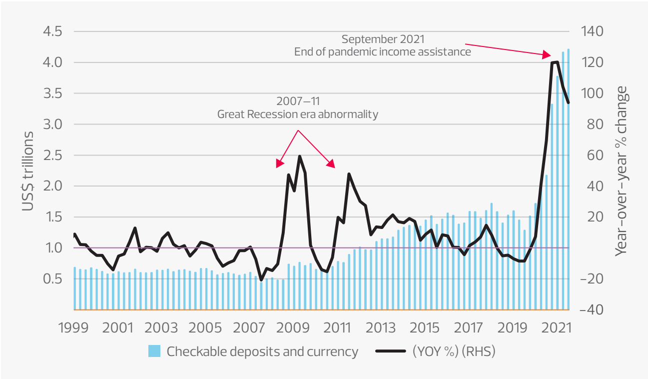
This drawdown is an encouraging sign that households, buoyed by ample employment opportunities and rising incomes, feel confident enough to spend some of those savings.

And it's another sign that consumers are returning to more normalized spending and saving patterns, which should continue to boost overall economic activity even as risks around inflation and the omicron variant loom.

This reduction in savings will no doubt affect families' decisions about work and spending. And when the fading fiscal support is added in, the demand that is playing a role in the current surge in inflation will ease during 2022.

Throughout the ups and downs of the pandemic, household savings have provided a vital cushion to the economy and American households. After peaking in the middle of 2021, the savings stashed away during the pandemic provided a bridge through the slowdown in the third quarter and are now helping fuel a growth rate that will exceed 7% to close out the year.

Consumer holdings of checkable deposits and cash*



Source: Federal Reserve; Bloomberg; RSM US LLP *Level and yearly growth rate

But questions remain regarding the expiration of the pandemic assistance programs. Will their positive impact on overall economic growth continue, and will increases in the cost of food, energy and rent eat into those gains?

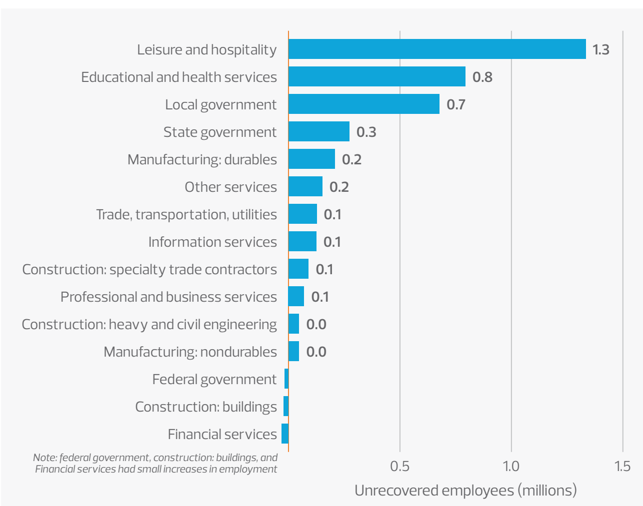
The pandemic, after all, continues to affect workers in certain areas of the economy more than others.

The leisure and hospitality occupations, for example, were still 1.3 million jobs below their pre-pandemic levels as of November 2021. Education and health services were 800,000 jobs short, and state and local governments were still 1 million jobs below pre-pandemic levels.

MIDDLE MARKET INSIGHT
Throughout the ups and downs of the pandemic, household savings have provided a vital cushion to the economy and American households.

For the economy in general, the discussion on getting people back into the workforce centers on low-wage employees, ranging from teachers to hotel staff to senior-care workers. Will those workers of more limited means be more likely to return to work as cash savings dwindle?

Employment deficits of occupational groups relative to pre-pandemic levels*



Source: U.S. Bureau of Labor Statistics; RSM US LLP

*Millions of employees not on nonfarm payrolls as of November 2021

Cash and savings among those out of work

The argument has been that those workers will not return to jobs until the spigot of government largesse is turned off and household balance sheets are depleted.

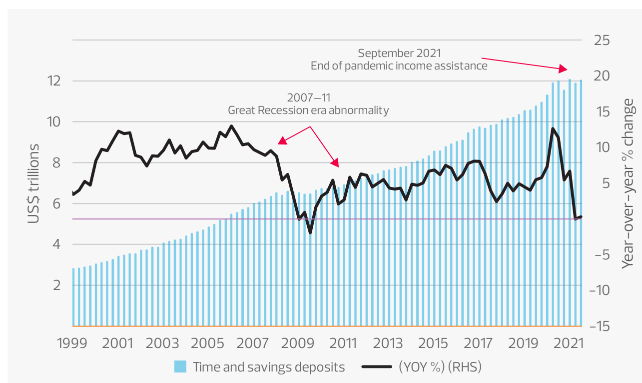
If anything, funds in checking accounts and savings accounts plateaued before the pandemic benefits expired. We attribute this surge in deposits to the need for precautionary savings. Households held onto cash and savings out of fear that the economy would worsen during the pandemic.

This is not the first time this has happened. Checking deposits surged during the shock of the 2008-09 financial crisis and then again in 2011.

The savings rate, though, was another story. During the 2008-09 recession, savings dropped, most likely as households dipped into their reserves to maintain spending.

But in 2020, savings jumped as government support boosted household balance sheets. Savings has remained at that higher level, not only because of the threat of the pandemic but also because of the limitation of spending opportunities during the pandemic.

Consumer holdings of time and savings deposits*



Source: Federal Reserve; Bloomberg; RSM US LLP

*Level and yearly growth rate

In a study conducted by the Institute at JPMorgan Chase in September 2021, researchers found that checking account balances in the lowest quartile of households—those earning $12,000 to $30,000—were 70% higher than two years earlier but were still holding an insufficient cash buffer of only $1,000.

When looking at households that did not receive child tax credit payments, checking balances were 50% higher than two years earlier, but still insufficient at $1,600. For high-income groups, $4,000 checking balances in September were 40% higher than two years earlier.

THIS SAVINGS DRAWDOWN IS AN ENCOURAGING SIGN THAT HOUSEHOLDS, BUOYED BY AMPLE EMPLOYMENT OPPORTUNITIES AND RISING INCOMES, FEEL CONFIDENT ENOUGH TO SPEND SOME OF THOSE SAVINGS.

It makes mathematical sense for low-income households to have the largest percentage change in their cash balances because of pandemic assistance, and for their checkable holdings to be depleted more quickly as reported in the JPMorgan report.

Conversely, the percentage increases for higher-income households during the pandemic were not as large, but their rates of depletion were slower.

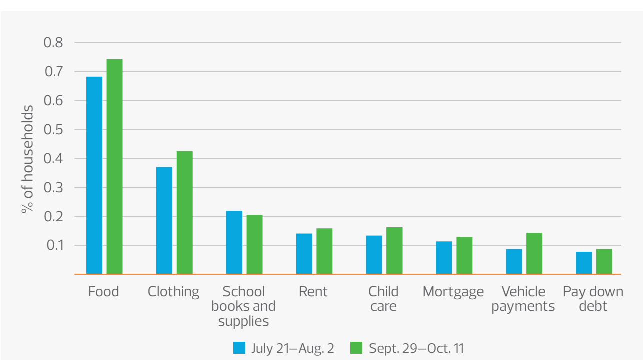
In our estimation, that accounts for the persistence of savings still to be spent by higher-income households. It also implies that there is policy space to address the needs of low-income workers who are still dealing with the economic fallout from the pandemic.

And it also makes sense that lower-income households would apply government benefits for essential expenses. That was borne out of surveys by the Census Bureau in the weeks immediately following the receipt of the first monthly child tax credit payments in the summer of 2021, and then repeated during the fall when the children were back in school.

An overwhelming majority of those who received child tax credits applied those funds to food, clothing and school supplies. Smaller percentages of households allocated a portion of their benefits to rent, child care, vehicle payments and debt repayments.

And as would be expected, 85% of those responding to the survey were 25 to 55 years old, in their prime working age.

How households spent child tax credit payments*



Source: U.S. Census Household Pulse Survey; RSM US LLP

*Percentage of households that spent most of their CTC payment

MIDDLE MARKET INSIGHT

An overwhelming majority of those who received child tax credits applied those funds to food, clothing and school supplies.

Policy considerations

The drop in checking and savings deposits is telling a different story for different income groups.

It's not realistic to think that parents of children not yet in school will risk their children's health and suddenly return to work. For as long as the pandemic persists and until a vaccine is formulated for infants, someone in those families will remain at home. And for as long as schools are threatened by frequent COVID-19 outbreaks and closures, at least one parent will remain out of the labor force.

And it's incorrect to think that the working class is sitting on top of a pile of savings. Yes, their savings rate has increased, but it is now being drawn down. The data shows that whatever money that was given to low-income families was and is being spent on food and clothing and school supplies.

Policymakers are keenly aware that the end of pandemic assistance will become a drag on consumption. This is why one area of the policy debate of the Build Back Better legislation revolves around making the enhanced child tax credit permanent.

Whether that assistance comes in the form of food stamps or rent assistance, or in direct payments through the monthly child tax credit, a strong economic argument can be made. Government transfers that augment the income of low-income households are spent on essential goods and services, with downstream multiplier effects that benefit every strata of incomes.

HOW REMOTE WORK IS AFFECTING COMPANIES AND WORKERS

AS MIDSIZE COMPANIES continue to grapple with the pandemic, most recently the spread of the omicron variant, they have discovered that the usual methods of working and the workplace have not just faded away. Those old standards have been obliterated.

Foremost among these changes is the rise of the remote worker. Employees have proven that they don't need to come into the office to be productive, and the desire to telecommute has moved from an occasional perk to a worker demand.

But how are these changes affecting workers and companies? RSM asked executives at middle market companies to share their views as part of the fourth quarter 2021 RSM US Middle Market Business Index survey. The results of the special questions in the survey will be released in January. Among the findings:

76%

of executives said that remote workers have had few to no issues when it comes to enhancing their skill sets, which puts them in a better position to pursue new career arcs.

70%

of executives said their remote workers do not have significant problems maintaining their mental health.

68%

of executives reported that their remote workers either do not feel isolated or have only minor qualms about feeling isolated.

And with this shift to remote work, executives are in turn devoting more resources to adapting to this new landscape:

59%

of executives said they were focusing on investing in automation or information technology.

73%

of those executives who said they were investing in automation or information technology said that their goal was to increase the productivity of their employees.

Look for the complete findings in the next MMBI special report due to be released in January.

REAL BUSINESS INSIGHTS FOR MIDDLE MARKET COMPANIES

Check out *The Real Economy: Industry Outlook* and get data-driven, sector-specific insights from RSM's senior industry analysts, a select group of professionals dedicated to studying economic and industry data, market trends and the emerging issues faced by middle market businesses like yours.

Each outlook provides unique perspectives and planning opportunities affecting businesses in the following industries:

- Business and professional services
- Consumer products
- Financial services
- Health care
- Life sciences
- Manufacturing and energy
- Real estate and construction
- Technology, media and telecom

Get the Winter 2022 issue now.

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