

# THE REAL ECONOMY

VOLUME 94

## THE MIDDLE MARKET GRAPPLES WITH AN ECONOMY IN UPHEAVAL

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- WHY THE DOLLAR'S REIGN WILL CONTINUE AMID A GLOBAL FLIGHT TO SAFETY
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**TREND WATCH: THE MIDDLE MARKET HAS BEEN RESILIENT, RSM SURVEY SHOWS**

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ECONOMIC HEADWINDS

# HOW HIGH MUST UNEMPLOYMENT RISE TO TAME INFLATION?

BY JOSEPH BRUSUELAS AND TUAN NGUYEN

**RESTORING PRICE STABILITY** is now the paramount policy goal at the Federal Reserve. That objective will shape economic conditions over the next few years in a manner that will most likely result in slower growth and higher unemployment.

But how high must unemployment rise to push inflation back toward [the Fed's 2% target](#)?

For an answer, we revisit the Phillips curve—which shows the relationship between inflation and the unemployment rate—to estimate the job losses that would be required to meet such a difficult goal.

We then introduce a new variable—the RSM US Supply Chain Index—that accounts for the supply chain distortions during the pandemic and improves the performance of the Phillips curve model.

To reduce inflation to acceptable levels—using the personal consumption expenditures price index as our preferred metric—it will be necessary to sacrifice between 1.7 million and 6 million jobs, in our estimation. That decline would translate to an unemployment rate that rises to a minimum of 4.6%, or possibly as high as 7.2%.

The policy implications are stark.



First, it will be difficult to get back to a 2% inflation target in the near term without triggering a recession that results in somewhere between 5 million and 6 million job losses.

Second, the Fed could engage in “opportunistic reflation” and lift its inflation target to 3%, which would require an increase in unemployment to 4.6% and result in a loss of roughly 1.7 million jobs.

That is as close as we may get to a soft landing. While that outcome would be optimal, resetting the inflation target from the flexible target of 2% announced two years ago would hurt the Fed's credibility.

But the Fed may have little choice. Given the size of the policy challenge, the economy's move from insufficient aggregate demand to insufficient aggregate supply, and the proliferation of risks to the economy, we would not be surprised if the Fed pushed inflation back down to 3% and then revised its target rate to match.

### The Phillips curve trade-off

Named after the economist A.W. Phillips, the Phillips curve has become a cornerstone of modern macroeconomics. In his seminal paper published in 1958, Phillips pointed out the inverse relationship between unemployment and wage growth.

Since then, the curve has been extended and augmented to show the short-term relationship between unemployment and inflation, with major contributions from two Nobel laureates in economics, Edmund Phelps and Milton Friedman, in the 1960s.

### MIDDLE MARKET INSIGHT

To better estimate job losses in reducing inflation using the Phillips curve, we introduce the RSM US Supply Chain Index to account for supply chain distortions during the pandemic.

The theory behind the trade-off between unemployment and inflation is that when unemployment is low, wage income is higher, which fuels more spending demand in the short run.

Given the stickiness of supply in the short run, an increase in demand will push prices higher, causing inflation to rise. The opposite is also true: High unemployment leads to lower inflation.

But in recent years, and especially during the pandemic, the Phillips curve relationship has become less clear, adding to the reasons why both market participants and the Fed's inflation forecasts were so wrong.

In hindsight, the primary explanation for the Fed's failure to stay in front of the curve regarding inflation is the unique pandemic-related supply chain disruptions, which have been anything but transitory.

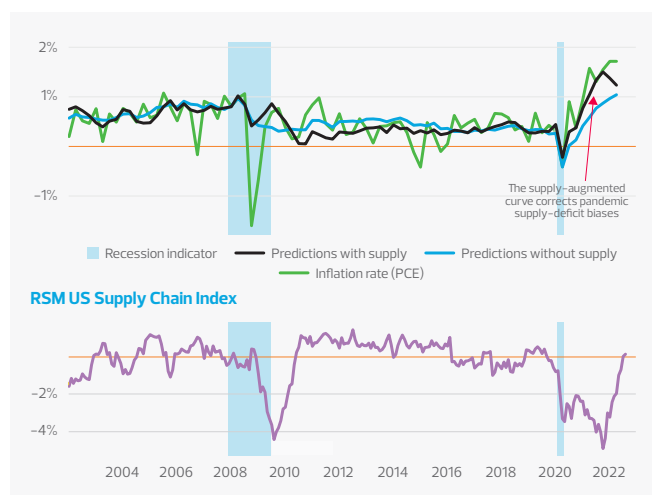
Given that explanation, we revisit the Phillips curve to identify the level of unemployment that would be needed to bring inflation back down to the long-term target, but with an important twist: adding a proxy variable for supply chain deficiencies using data from our proprietary [RSM US Supply Chain Index](#).

To reduce inflation to acceptable levels, it will be necessary to sacrifice between 1.7 million and 6 million jobs, in our estimation.

Our supply-augmented Phillips curve includes five variables:

- Inflation expectations measured by the Fed's [index of common inflation expectations](#)
- The unemployment rate
- The Congressional Budget Office's natural rate of unemployment estimates
- The RSM US Supply Chain Index
- The inflation rate based on the personal consumption expenditures price index

#### Phillips curve inflation predictions vs. actual inflation\*



Source: Various government and private organizations; Bloomberg; RSM US LLP  
 Note: An index value of zero is defined as a normal level of supply chain efficiency. Positive values of the index suggest adequate levels; negative levels suggest deficiencies.

The inflation prediction results from both Phillips curve versions—those with and without the supply chain index—are shown in the graph above.

Without controlling for supply chain deficits during the pandemic, the Phillips curve shows significant downside biases, failing to predict how elevated inflation would be. In contrast, by including a proxy for the supply chain, the Phillips curve predictions track actual inflation levels significantly better.

Similarly, from 2012 to 2016, when there was a supply surplus, the supply-augmented Phillips curve shows a much better fit to the actual data, correcting the upside biases.

With the supply chain index added, the predicting performance of the Phillips curve in the studied period improves by 73% in terms of mean-squared error benchmarks.

#### Different scenarios for unemployment rates

We can use the supply-augmented Phillips curve to identify different levels of unemployment rates that would be required for the Fed to reestablish price stability. To do this, we make three key assumptions.

First, we assume the natural rate of unemployment will stay at 4.4%, in line with the CBO's estimate for the next two years.

Second, we assume that the supply chain index will go back to its pre-pandemic average level of 0.5. This is a reasonable assumption because the July reading for the index was 0.29—above neutral for the first time since the pandemic hit.

Finally, we assume that inflation expectations will be at 2.15%, slightly lower than the 2.19% for the second quarter of this year, amid signs that inflation expectations are falling.



The Fed's inflation expectation index is based not only on professional forecasts but also on consumer surveys, which are heavily correlated with energy and gasoline prices.

Even though the Fed's long-term target rate remains at 2%, we believe inflation will remain a lot stickier because of demographic and globalization disruptions that have transformed the macroeconomic environment from one of insufficient aggregate demand to insufficient aggregate supply. Our base case points to a 3% inflation target toward the end of next year.

	PCE target	Projected unemployment rate	Job losses
High	4%	2.4%	-1.9M
Base case	3%	4.6%	1.7M
Low	2%	6.7%	5.3M

	CPI target	Projected unemployment rate	Job losses
High	4%	4.1%	0.9M
Base case	3%	5.6%	3.5M
Low	2%	7.1%	6.0M

Source: RSM US LLP

To reach the 3% base case in terms of PCE, the economy would have to shed 1.7 million jobs to get to a 4.6% unemployment rate.

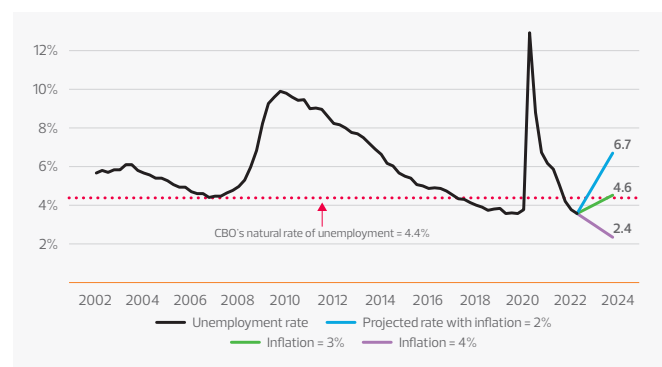
### MIDDLE MARKET INSIGHT

The primary explanation for the Fed's failure to stay in front of the curve regarding inflation is the unique pandemic-related supply chain disruptions.

This unemployment rate would be close to the natural rate of unemployment forecast by the CBO at 4.4%, another reason we think this base case is much more manageable for the Fed without pushing the economy into a severe recession.


To reach the Fed's long-term inflation target of 2%, the cost would be much higher: 5.3 million jobs and a 6.7% unemployment rate.

### Unemployment rate projections based on PCE price index\*



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

\*Quarterly figures



We would not be surprised if the Fed pushed inflation back down to 3% and then revised its target rate to match.

We do the same exercise but with the consumer price index as a proxy for inflation. The levels of unemployment needed to reach the same levels of inflation are much higher because CPI inflation often runs higher than PCE inflation.

Keeping inflation expectations anchored is a top priority of the Fed. An incremental increase in inflation expectations could have a major impact on the number of jobs that must be sacrificed to get inflation back down to the target level.

Inflation expectations	PCE target	Projected unemployment rate	Job losses
2.15%	3%	4.6%	1.7M
2.25%	3%	7.2%	6.0M

Source: RSM US LLP

Using the supply-augmented Phillips curve, we estimate the marginal impact of inflation expectations on the unemployment rate shown above.

If inflation expectations increase by 0.1 percentage point from 2.15% in the base case above, to reach the same 3% PCE inflation target rate, the economy would have to sacrifice 6 million jobs at a 7.2% unemployment rate.

This underscores why we believe the Fed should continue to increase its policy rate to 4% at the end of this year—to reduce inflation at a much faster rate than what the market is pricing in.

## Policy choices and economic pain

We are in the midst of a serious cost-of-living crisis that cannot be ignored. The Fed needs to do all it can to stabilize prices that most affect working families: food, fuel and housing. This requires policies that cool overall aggregate demand and cause unemployment to increase.

The Phillips curve finds a short-term inverse relationship between the level of inflation and the level of unemployment.

Using the Phillips curve framework, we find that all things being equal, it will be necessary to generate higher unemployment, which means that millions of people will be out of work before inflation is brought under control.

Tighter monetary policy sacrifices short-term employment opportunities in order to stabilize prices. Price stability is needed for maximum sustainable employment, growth at or above the long-run trend of 1.8% and a stable set of financial conditions.

## The takeaway

Despite the economic pain that will be required to restore price stability, it is ultimately in the interest of the real economy that it be done and done quickly.

In 1980 and 1981, Fed Chairman Paul Volcker arguably did the right thing by hiking the overnight rate to 18% to 20% to create the conditions to restore price stability over the long term. While the current bout of inflation in the United States will not require that type of root-canal economics, it will be necessary over the coming year or two to drive the unemployment rate higher. ■

# THE REIGN OF KING DOLLAR WILL CONTINUE AMID A GLOBAL FLIGHT TO SAFETY

BY JOSEPH BRUSUELAS

**THE U.S. DOLLAR** is on a tear, increasing in value against its traditional trading partners as well as against the Chinese renminbi.

A combination of factors is fueling the surge, including rising interest rate differentials, a global move to the safe haven of the dollar and an escalation of geopolitical tensions, especially in Ukraine.

The economic implications are straightforward. A stronger dollar tends to dampen inflationary pressure as Americans gain greater purchasing power. In a time of rising inflation, this is not insignificant. As the dollar rises, the price of imports falls, which in turn lowers costs for consumers

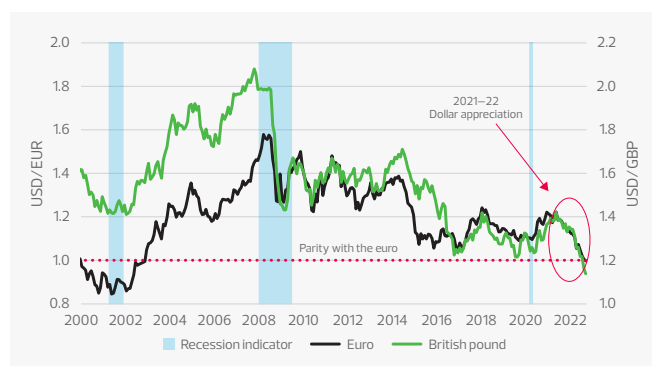
and businesses. At the same time, though, the cost of exports increases, which hurts companies that ship their goods abroad.

The result has been a stunning rise in the dollar's value. From Jan. 1 through the middle of September, the dollar has appreciated by roughly 12% versus the euro, 14% against the British pound, and 24% against the Japanese yen.

Overall, the U.S. dollar index surged by 14% against its traditional trading partners, gaining momentum as the impact of the war in Ukraine and the European energy crisis has set in.

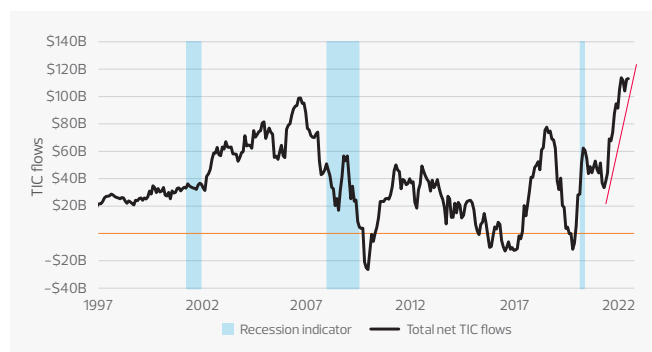
A combination of factors is fueling the dollar's surge, including rising interest rate differentials, a global move to the safe haven of the dollar and an escalation of geopolitical tensions.

## The euro and British pound versus the dollar



Source: U.S. Bureau of Labor Statistics; National Bureau of Economic Research; Bloomberg; RSM US LLP

## Total long-term and short-term net foreign portfolio investment in the U.S.



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

\*12-month average

## MIDDLE MARKET INSIGHT

The dollar's rise against the yuan this year has not prompted the strong reaction from the United States that it would have in the past.

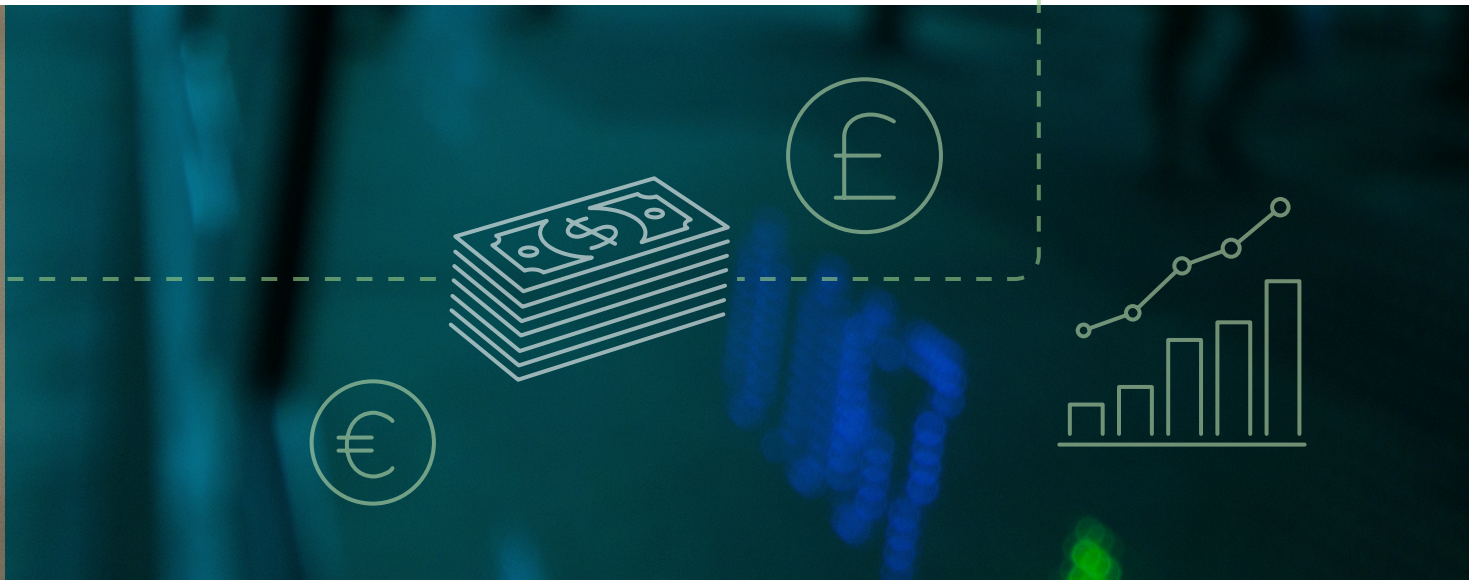
## The reign of the dollar

Even with the recent runup, all signs point to continued dollar strength. The Federal Reserve raised its policy rate by another 75 basis points at its September meeting, which will further increase demand for Treasury securities. And the looming price cap on Russian oil, to be imposed on Dec. 5, will help push foreign exchange markets toward one of the bigger moves to the dollar in recent memory.

To better understand what is behind the dollar's rise, consider three additional factors:

**Transaction demand:** Global trade is transacted in dollars, for many good reasons, including access to credit and the reliability of billing.

In 2020, the [Bank for International Settlements reported](#) that although the United States accounts for a quarter of global economic activity, half of all cross-border bank loans and international debt securities are denominated in U.S. dollars.



## MIDDLE MARKET INSIGHT

The looming price cap on Russian oil, to be imposed on Dec. 5, will add to the upward pressure on the dollar.

Now, limited supplies of food and energy are leading to higher costs, and these transactions are priced in dollars, which only increases the demand for dollars.

**The search for higher returns:** Within the global search for yield, particularly in a world dominated by real negative interest rates, international investors will look for securities that offer both a nominal return on investment and a currency return.

The demand for dollar-based investments will be determined by the positive divergence in expectations for U.S. economic growth versus its trading partners and by the divergence in interest rates as monetary policy responds to that growth.

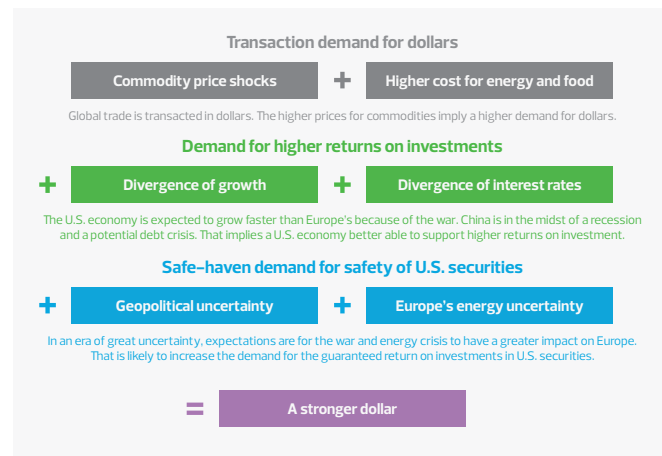
While the consensus expects U.S. real gross domestic product growth to slow to 0.9% next year, the odds suggest that Germany's growth will slow to negative 0.1% next year.

Then there is the divergence in policy rate forecasts for the Federal Reserve and European Central Bank. While the Federal Reserve is expected to raise its policy rate to 3.75% by the end of this year (we have forecast 4% or greater), the European Central Bank is expected to raise its policy rate to only 1.5%.

**Safe-haven demand:** Amid the global turmoil, a flight to the safety of U.S. assets is taking place. Just as U.S. investors will forgo investment in higher-risk corporate bonds during periods of economic distress, international investors will seek the safety of the guaranteed return of U.S. government securities.

**Q: What's behind the dollar's strength in the middle of a wartime energy crisis?**

**A: Demand**



Source: RSM US LLP

## Currency intervention

Amid the dollar's rise, there were bound to be calls for currency stabilization.

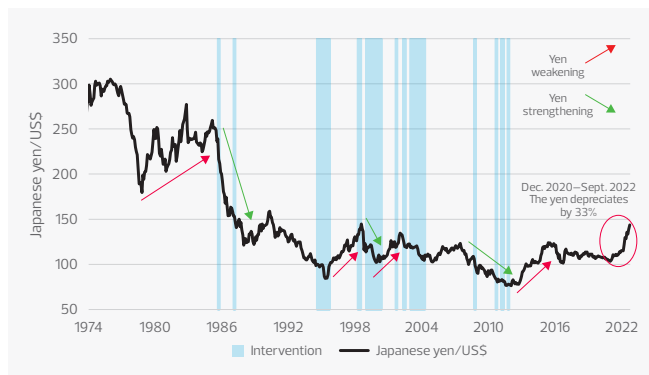
Indeed, on Sept. 22, the Bank of Japan began buying yen on the foreign exchange market for the first time in 24 years. The move came soon after the central bank suggested it would keep interest rates at near-zero levels.

Just as U.S. investors will forgo investment in higher-risk corporate bonds during periods of economic distress, international investors will seek the safety of the guaranteed return of U.S. government securities.

Intervention into currency markets by a major central bank like the Bank of Japan is rare and almost always fails. And even when it partially succeeds, the intervention is supported by the other major central banks, which is also rare.

So why is the Bank of Japan doing this now?

#### Japan's yen and the history of intervention in the era of a "free-floating" U.S. dollar



Source: Reuters; Bloomberg; RSM US LLP

Its intervention is almost certainly linked to elevated oil prices and the highest inflation to grip the global economy in decades.

Given the likelihood of continued dollar strength, we surmise that other central banks may be reconsidering their long-held reluctance to intervene in currency markets.

#### MIDDLE MARKET INSIGHT

While the Federal Reserve is expected to raise its policy rate to 3.75% by the end of this year, the European Central Bank is expected to raise its policy rate to only 1.5%.

For the Bank of England, European Central Bank and Bank of Japan, coordinated intervention makes some sense. But for the Federal Reserve, it's a far more difficult decision.

First, a stronger dollar tends to dampen inflation on the margin, which supports the Fed's policy objective of price stability. Yet the Fed cannot dismiss the concerns of domestic exporters, which struggle as the dollar rises.

In our view, central banks and finance ministries ought to refrain from intervening in foreign exchange markets wherever and whenever possible. Intervening in markets tends to result in a misallocation of resources.

This would not be the first time such a dislocation in currency markets has occurred. In the 1980s, a perfect storm of currency weakness versus the dollar took place when U.S. monetary policy and its fiscal policy moved in the dollar's favor.

The Federal Reserve had jacked up short-term interest rates to 18% to slow inflation, while Reagan-era government spending became expansionary.

Interest rates in the rest of the world failed to keep up, resulting in international investment flocking into U.S. assets and a rising dollar.



The Plaza Accord of 1985 ended the dollar's run but created other asset bubbles and economic distortions. That required the Louvre Accord of 1987, which halted the dollar's free-fall and stabilized the currency markets.

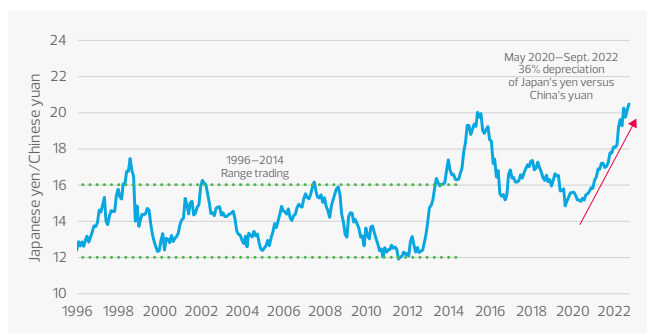
Despite the reluctance to disrupt market forces, the current inflation shock may outweigh policy concerns. We may be entering an era of intervention in foreign exchange markets.

### The plunging yen

Consider how dramatically the economic landscape has changed. The yen has lost 15% against the dollar since the start of the year and 36% since the end of 2020.

But perhaps even worse considering its status within Asia, Japan's currency has weakened by 35% since May 2020 versus China's renminbi.

### Depreciation of Japan's yen versus China's renminbi



Source: Bloomberg; RSM US LLP

Do we need another Plaza Accord to stop the dollar from moving higher against the yen? And given past experience, why would the U.S. even consider another round of currency intervention?

Let's start with the second question, which might be more about mutual protection than anything else.

The currency forecaster Michael Rosenberg [argues](#) that recent calls for intervention might be a function of protecting Japan's status in Asia as much as protecting its economy from currency-induced inflation.

If Japan's economy needs a lifeline, there are many reasons for the United States to provide one. Japan is a steadfast ally, a major trading partner and a willing investor in the U.S. economy.

In recent decades, however, Japan was surpassed by other Asian nations in manufacturing and technology.

We have to assume that Japan's diminished role in Asia is in large part because of China's economic ascension and its investment in neighboring economies.

One result has been a breakout of the renminbi versus the yen following the 2008–09 global financial crisis, and then the rapid 36% depreciation of the yen versus the renminbi starting in May 2020.

### MIDDLE MARKET INSIGHT

The Plaza Accord of 1985 ended the dollar's run but created other asset bubbles and economic distortions. That required the Louvre Accord of 1987, which halted the dollar's free-fall.

It would not be any surprise if Chinese authorities tolerate a wider band in the yuan's value and the currency depreciates further in the near term.

### MIDDLE MARKET INSIGHT

Diminishing the value of the dollar to save the yen would contradict efforts by the Federal Reserve to reduce U.S. inflation.

If the rise of the dollar versus the yen might be ancillary to Japan's other issues, that brings us back to the first question: Why would an intervention be needed now?

After all, diminishing the value of the dollar to save the yen would contradict efforts by the Federal Reserve to reduce U.S. inflation.

For Japan, the decrease in the yen's value might be expected given its diminished role in international trade. The weaker yen would in many ways help Japanese industry and increase its comparative advantages.

### China and currency manipulation

Then there is China. The dollar increased by roughly 9% versus China's yuan this year through the middle of September, a rise that in the past would have prompted outcry from the United States. But times have changed, and so far, the reaction to that increase from American officials has been benign.

The Chinese abandoned their overt mercantilist pegging of the yuan in 2005, apparently opting for a loose peg against a basket of their trading partners' currencies in 2010.

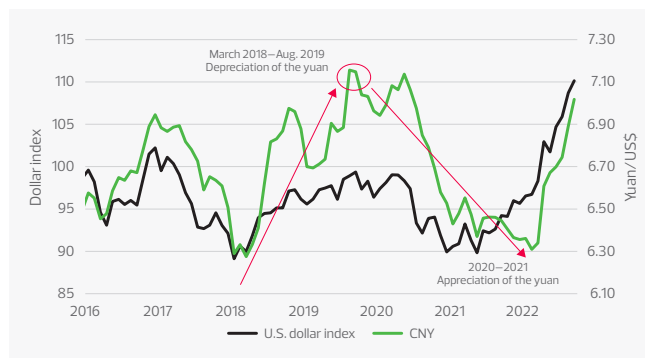
When the developed economies were reeling from the trade war with China and the subsequent global manufacturing recession threatened a full-on recession in 2019, the renminbi weakened along with other currencies.

This current episode is eerily similar. The dollar index has been gaining momentum along with the growth of the U.S. economy and weakness in Europe.

At the same time, COVID-19 shutdowns threaten China's economic growth. It would not be any surprise if Chinese authorities tolerate a wider band in the yuan's value and the currency depreciates further in the near term.

Even so, the 12-month forward market is pricing in less than 1% appreciation of the yuan from its current level, hardly a sign of manipulation. ■

### The Chinese yuan has more or less followed a currency basket of its trading partners since 2016



Source: U.S. Bureau of Labor Statistics; National Bureau of Economic Research; Bloomberg; RSM US LLP

# ECONOMIC HEADWINDS: CONSUMER PRODUCTS

BY MIKE GRAZIANO

## KEY TAKEAWAYS

- Understanding shifts in consumer purchasing behavior will be key for all sectors.
- Businesses must leverage technology to understand consumer habits, anticipate inventory needs and minimize labor shortages.
- Discounting and reevaluating product portfolios can better position businesses.

**RIISING INFLATION** and the shift in spending from goods to services have made it difficult for middle market businesses to forecast financial performance. The result has been bloated inventory levels for many consumer products companies.


While top-line inflation eased to 8.3% in August (down from 9.1% in June), energy and gasoline prices continue to put outside pressure on consumers, especially those with fixed monthly budgets.

Though inflation has affected discretionary spending, consumers have been shifting dollars from goods for

some time. Many consumer goods companies that experienced outsize growth last year are now struggling to forecast spending as consumers pull back.

## By the numbers

Since January, on a three-month annualized basis, real consumer spending on durable goods has declined overall. Over the same time, spending on nondurable goods fell in all but one month but spending on services increased. The pent-up demand for traveling, dining out and spending on services has contributed to the recent decline in goods sales.



Managing inventory levels, driving consumer engagement and managing cost pressures will be the biggest challenges for consumer products companies.

### Understanding shifting behavior

Managing inventory levels, driving consumer engagement and managing cost pressures will be the biggest challenges for consumer products companies.

### Discounting and divesting

How can businesses manage this change in consumer behavior? Discounting to offload excess inventory, evaluating product portfolios and divesting product lines should all be considered. Companies will need to reevaluate forecasts to manage lower consumer spending and should not rely on financial results from last year when making projections.

### Making difficult decisions today will support growth for years to come

Investing in technology, building consumer loyalty programs and mapping supply chains will be expensive today but will set up companies for success. The ability to leverage consumer and manufacturers' data will allow executives to manage their businesses and make smarter decisions.

Other top considerations to offset the impact of headwinds facing consumer products industries include:

**Consumer products:** Consumer goods companies should reevaluate inventory levels across all product categories and consider discounting options in the coming months. Many consumer goods companies are dealing with elevated inventory levels, primarily because of price increases, supply chain disruptions and inaccurate sales projections

### MIDDLE MARKET INSIGHT

Rising inflation and the shift in spending from goods to services have made it difficult for middle market businesses to forecast financial performance.

Part of the strategy to reduce inventory will be discounting, something many companies didn't need to do until recently as consumers largely overlooked price increases. Companies will need to make difficult decisions and absorb months of margin contraction to better manage inventory levels.

**Food and beverage:** Food and beverage companies will need to engage a consumer who has experienced significant increases in food-at-home costs. Not only are customers challenged by broad price increases, but inflationary pressures for food costs have also expanded throughout the grocery store. This could drive consumers to shift spending toward private label products.

**Retail and restaurant:** Retail and restaurant companies should continue to drive consumer engagement in a period of high prices and labor shortages by better understanding the needs of the consumer at the local level. Regional foot traffic varies significantly; understanding this and tailoring offerings will be important. Additionally, the use of customer sales data on a store-level basis can help reallocate labor for peak sales periods.

Retailers need to further lean into technology to drive consumer engagement. While buy online, pick up in store was a game changer for retailers looking to drive consumer engagement during the pandemic, it's now table stakes for retailers today. ■

# ECONOMIC HEADWINDS: LIFE SCIENCES

BY JUSTIN CULBERTSON, STEPHEN KEMLER, ADAM LOHR, DAVID STUART  
AND BRIAN WINNE

## KEY TAKEAWAYS

- IPO slowdown is pressuring life sciences companies that have yet to generate revenue.
- Robust labor demand, coupled with inflation, has led to significant wage pressure.
- Challenges can be mitigated through cash flow management, alternative funding and technology upgrades.

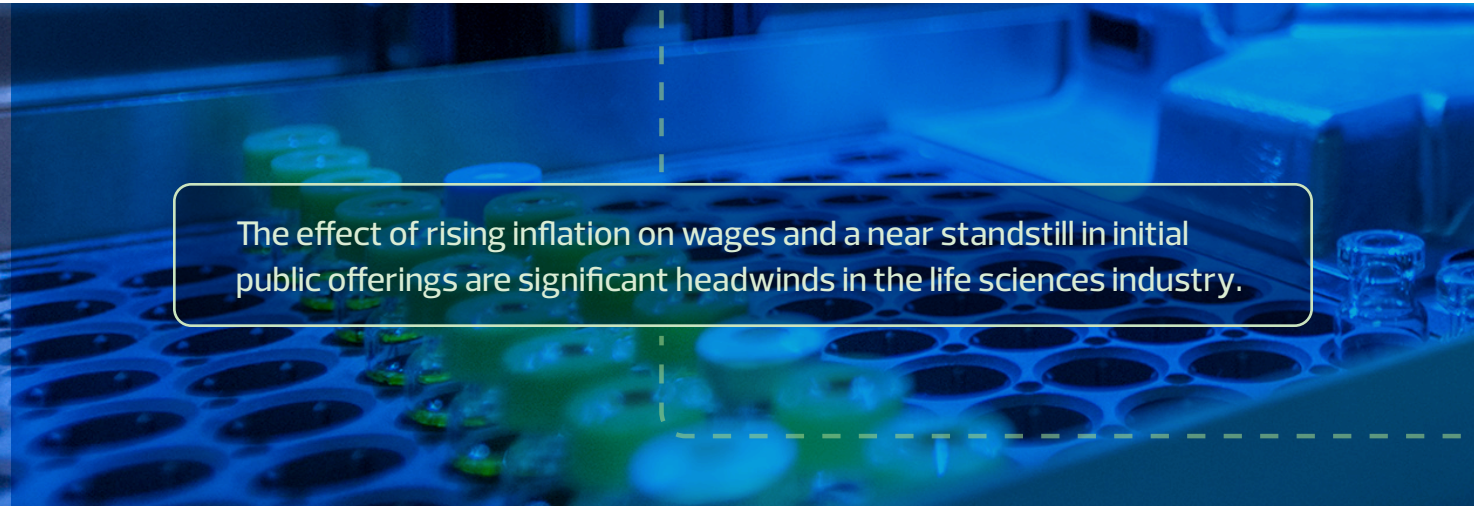
**THE LIFE SCIENCES INDUSTRY** maintains robust employment and job growth compared to the overall U.S. economy; however, the effect of rising inflation on wages and a near standstill in life sciences initial public offerings serve as significant headwinds.

The overall U.S. economy has experienced barely break-even performance on employment compared to pre-pandemic levels; meanwhile, employment in life sciences has increased by approximately 2% since the beginning of the year, and 11% from pre-pandemic levels. While wages rose through the first quarter of the year, those gains

were offset by reductions through the second quarter. The bigger story is the significant falloff in IPO funding through the first half of the year.

## By the numbers

IPO funding has dropped from an average of about \$25 billion per year over the past two years to roughly \$1.5 billion and has come to a near standstill halfway through 2022. A slowdown in IPO funding places significant pressure on life sciences companies that are not yet generating revenue.



The effect of rising inflation on wages and a near standstill in initial public offerings are significant headwinds in the life sciences industry.

### Decreased funding

IPO funding, venture capital and private equity investment remain the primary funding sources for pre-revenue life sciences companies. VC and PE investment averaged approximately \$90 million per year over the last two years and had dropped to about \$36 million halfway through 2022. Even mergers and acquisitions, which may seem like a last resort for the wild west environment characterized by early-stage biotechs, have dropped significantly. There were 134 M&A deals worth approximately \$137 billion in each of the last two years, compared to 24 deals totaling some \$13 billion in value halfway through 2022.

### Other challenges

Robust labor demand, coupled with inflation, has led to significant wage pressure on employers; however, there are signs the pressure may be easing. Life sciences wages rose through the first quarter but saw signs of relief in the second quarter as those gains were offset by reductions. More data is needed to know whether this is the start of recessionary fears shifting the power back into the employers' court.

Sales and pricing could also potentially be affected by recessionary fears; however, there are currently no signs of a slowdown in spending, according to Evaluate Pharma, with worldwide sales for 2022 forecast to grow 7% year over year, to \$1.14 trillion. Additionally, prices for prescription drugs have not seen the same level of inflation as the broader U.S. economy in the first half of 2022, remaining flat year to date.

As we consider the recently passed Inflation Reduction Act's provisions directing the U.S. Department of Health and Human Services to negotiate the prices of the

### MIDDLE MARKET INSIGHT

IPO funding has dropped from an average of about \$25 billion per year over the past two years to a near standstill now.

highest-spend prescription drugs, we expect little impact on middle market life sciences companies that are not the manufacturers and distributors of such drugs.

### Addressing challenges

While there is clearly a funding slowdown exacerbated by wage pressures, there is a silver lining for life sciences companies. Coming off two years of historic fundraising, many have working capital on hand to support operations for the next 24 to 36 months. Companies not lucky enough to secure such funding are looking for alternative measures to support their operations, such as licensing deals. And large pharma companies have also stated that they are remaining acquisitive for the right companies to join their portfolio.

### More considerations

Small to midsize biotechs often have small teams and are overly dependent on inefficient spreadsheets. Working with the right consultant may seem counterintuitive in a recessionary environment; however, identifying and remediating process inefficiencies now can save thousands, if not millions, of dollars over the next couple of years and position companies with strong back-office technology platforms to be ready for eventual commercialization or an IPO when the opportunity presents itself. ■

# RSM US MIDDLE MARKET BUSINESS INDEX SURGES 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 executives of midsize companies improved to a seasonally adjusted index reading of 138.5, up 7.3 points from the second quarter. A reading above 100 for the MMBI indicates that the middle market is generally expanding.

## RSM US MIDDLE MARKET BUSINESS INDEX

Top-line middle market business sentiment eased to 125.1 in the first quarter of the year from 130 in the final quarter of last year.



Source: RSM US LLP

\*Seasonally adjusted



An economy displaying such a robust reading, along with business conditions that have produced an unemployment rate of 3.7% in August, is not consistent with a recession.

The survey was conducted from July 5 to July 26 and is based on the responses of 407 participants. Among the findings:

#### Revenues were up ...

# 48%

of the survey's respondents said that gross revenues were up in the third quarter, an improvement over the 44% in the previous quarter.

# 60%

see gross revenues improving over the next six months.

#### ... as well as earnings ...

# 50%

of executives reported that earnings were higher, up from 42% in the second quarter.

#### ... and hiring remained strong.

# 58%

reported hiring more workers, up sharply over the 47% in the prior period.

For more on the Middle Market Business Index survey, download [the full report](#).



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