

THE REAL ECONOMY

VOLUME 61



CONSUMER
OUTLOOK
CRITICAL TO
2020 GROWTH

**2020 OUTLOOK HINGES ON LIFTING
UNCERTAINTY TAX**

INDUSTRY SPOTLIGHT: EQUIPMENT-AS-A-SERVICE—A
POTENTIAL CAPEX ALTERNATIVE IN A SLOWDOWN?

MIDDLE MARKET TREND WATCH:
BUSINESS SENTIMENT REFLECTS SOME
ROOM FOR GROWTH

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CONSUMER OUTLOOK CRITICAL TO 2020 GROWTH

Household spending is the straw
that stirs the drink

BY JOSEPH BRUSUELAS

KEY THEMES

1. Business investment, net exports drag on growth.
2. Top two quintiles of income earners account for 60% of spending.
3. Household earnings growth critical for continued spending.

U.S. CONSUMER SPENDING—OFFICIALLY KNOWN AS PERSONAL CONSUMPTION—HAS BEEN THE MOST CONSISTENT CONTRIBUTOR TO U.S. ECONOMIC GROWTH IN THE RECENT QUARTERS.

IT IS NEARLY impossible to overstate just how important the consumer has become to the health of the economy in 2020. Because fixed investment and net exports have become a drag on growth, household consumption remains the most important driver of overall economic activity, and the difference between modest growth near 2% and an end to the current business cycle.

Consumption has been king since the second quarter of 2014—when the recovery from the Great Recession had finally taken hold, and the unemployment rate was approaching what was then thought to be its equilibrium level. The role of the American consumer grew even more important in late 2018, becoming the only consistently positive contributor to gross domestic product growth.

U.S. consumer spending—officially known as personal consumption—has been the most consistent contributor to U.S. economic growth in the recent quarters, accounting for roughly 70% of overall economic activity. But that strength has not been the result of rising wages among low-wage households; instead, it's the result of the high-income households' spending fueled by deficit-financed gains in equity-market investments.

Contribution to total GDP growth

Quarter	Personal consumption	Investment	Government consumption	Net exports	Total GDP growth
Dec. 2017	3.12	0.80	0.42	-0.08	3.54
March 2018	1.15	1.07	0.33	0.00	2.55
June 2018	2.70	-0.30	0.44	0.67	3.51
Sept. 2018	2.34	2.27	0.36	-2.05	2.92
Dec. 2018	0.97	0.53	-0.07	-0.35	1.08
March 2019	0.78	1.09	0.50	0.73	3.10
June 2019	3.03	-1.16	0.82	-0.68	2.01
Sept. 2019	1.97	-0.01	0.28	-0.11	2.13

Source: BEA; Bloomberg; RSM US LLP

This point is critical to understanding what is driving consumption and the risks to the economic outlook: Outlays are driven by the two upper quintiles of income earners. In short, 40% of households are responsible for

roughly 60% of spending. In turn, this suggests that those households that are heavily invested in asset markets are sensitive to volatility in those markets.

That's why the stock market's decline in late 2018, when the S&P 500 fell by 13.6%, resulted in the halt of household spending in December. That was followed by outright declines in retail sales during the first 60 days of 2019, before growth in spending resumed on the back of a recovery in asset prices and bonus payments to higher-income households.

The current business cycle

The world economy is slowing, which should not be unexpected near the end of a business cycle. In past business cycles, American trading partners could rely on investment and consumption to jump-start a moribund world economy. That would spur a virtuous circle of domestic spending and investment spilling over into increases in foreign demand and economic activity. But that is not likely to be the case this time around, given the attempted repatriation of supply chains and disruption of the rules-based framework for global trade.

MIDDLE MARKET INSIGHT

With U.S. trade policy and tariffs still showing signs of volatility heading into 2020, it is essential that middle market companies build resilience into their value chains, particularly around managing input costs.

So with global consumption and investment thwarted by tariffs, as well as policy polarization in Washington, the U.S. consumer sector is left as the last one standing.

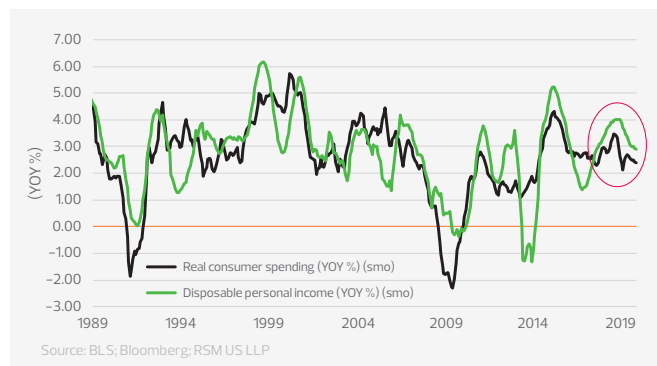
But can we rely on the consumer sector to continue to fuel growth in 2020?

CONSUMER OUTLOOK (CONT.)

In our estimation, the Tax Cuts and Jobs Act of 2017 stimulated spending. While the tax cut peaked in the third quarter of 2018, the reduction in the corporate tax rate has spurred a wave of stock buybacks that has lifted equity prices. That, in turn, has benefited the upper-income consumer and supported spending throughout 2018–19. As our analysis suggests, the increase in wealth and after-tax income for the upper quintiles might, in fact, have been essential to preventing the economy from drifting into what could have been an outright contraction.

It may not last, though. Not only could the lack of investment become harmful to potential long-term growth, but the benefits of the tax cuts also appear to be unwinding, with the diminished growth of disposable personal income having the potential to hurt consumer spending.

Real consumer spending and disposable personal income (YEAR-OVER-YEAR GROWTH RATES)



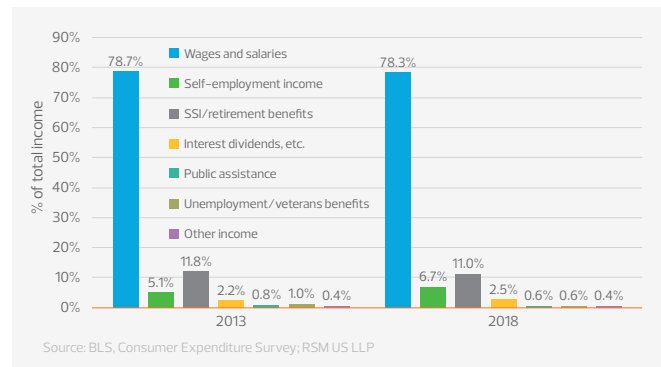
Welcome to the gig economy

In general, more than two-thirds of Americans still earn a paycheck. But according to yearly surveys by the Bureau of Labor Statistics, the share of income derived from wages and salaries declined a bit over the past five years, while self-employment earnings rose from 5.1% of total sources of income in 2013 to 6.7% in 2018.

More surprising is that the share of Social Security and other retirement benefits—the other most significant source of income—has been decreasing since 2013, most likely because of the poor performance of fixed-income investments in an era of low interest rates. As baby boomers continue to retire—and if their spots in the labor force are not replaced by immigrants or because of low birthrates—we might expect the share of income derived from retirement benefits to eventually increase.

Sources of household income as a percent of total income

2013 VS. 2018



The trends in household spending also reflect the times. While a third of household expenses still go toward housing, transportation expenses have dropped from 17.6% of total income in 2013 to 15.9% in 2018. That might be symptomatic of changing tastes in lifestyles and commuting, the low cost of fuel and the decrease in new automobile sales.

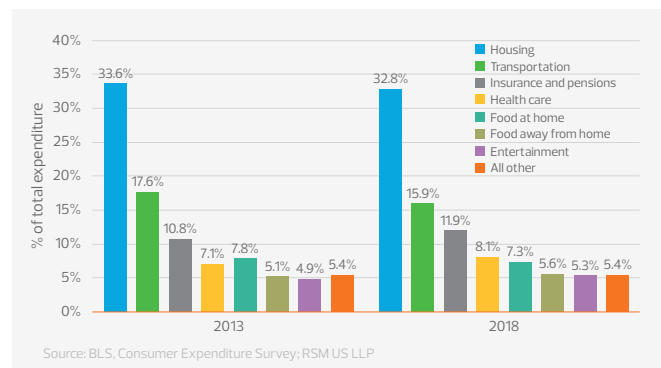
Another significant change is the increased share of health care in the economy—from 7.1% of total spending in 2013 to 8.1% in 2018—which might play a part in the 2020 political discourse.

And finally, although spending on food at home decreased from a 7.8% share of total spending to 7.3% in 2018, spending on food away from home increased from 5.1% to 5.6%.

In summary, about 50% of household spending goes to housing costs and transportation. Spending on retirement funds and health care comprises about 20%, 17% goes to entertainment and miscellaneous spending (like education). So that leaves 13% to be eaten up by food costs.

Categories of household spending as a percent of total expenditure

2013 VS. 2018



The inequality equation

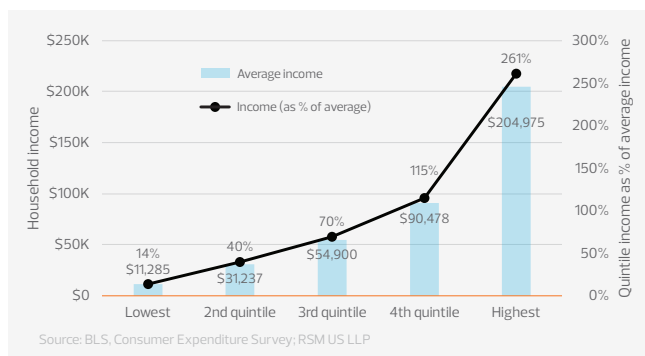
There are inarguable inequalities in income and spending. Those inequalities are part and parcel of what is driving overall spending and is ironically some of the risks going forward because of the imbalanced nature of overall household consumption.

While the move to a \$15 an hour minimum wage around the 20 large metro areas has modestly stimulated spending among lower-income groups, the ability of the lowest quintile of households to spend is limited by what is earned—an average of \$11,000 per year. That amounts to 14% of the national average annual household income of \$61,000. So while an increase in wages can obviously put more food on the table, it cannot lift an entire economy.

Even incomes in the second quintile (\$31,000 a year) and third (\$55,000 a year) amount to only 40% and 70% of the national average income. It's not until the fourth quintile (\$90,000) that household incomes are greater than the national average, giving some leeway for discretionary spending.

Household income in the highest quintile is \$205,000 a year, which amounts to 261% of the national average, and is more than twice the income for households in the fourth quintile.

2018 Household income before taxes by quintile AND QUINTILE INCOME AS A % OF AVERAGE INCOME

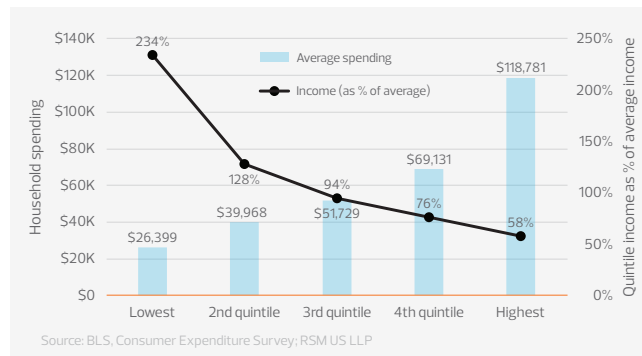


Spending patterns are just the opposite. The lowest quintile spends 234% of its annual income, with the gap financed or filled in by government programs or credit that is often accompanied by high interest rates. The level of spending increases from \$26,000 a year in the lowest quintile to \$119,000 a year in the highest quintile, with spending as a percent of household income decreasing the higher the quintile.

You would have to assume that only the top two quintiles have enough discretionary income to provide the impetus for consumer spending to have an impact on overall GDP growth. But even then, you can spend only so much.

In terms of the efficiency of tax policy, middle-class households in the third quintile have expenses of \$51,000 per year, which is 94% of household income. Although that's dwarfed by the \$119,000 spending by the highest quintile, the highest quintile is spending only 58% of available income. Which begs the question: Would the fiscal costs of the 2017 changes to tax policy have been better spent on the middle class, which shows a higher propensity to spend? Given the return to trend growth as the effect of the tax cut fades and with the emergence of trillion-dollar fiscal deficits, it is clear that the economy is not responding to tax cuts the way that it did in the 1980s and has not for some time.

2018 Total household spending by quintile AND QUINTILE SPENDING AS A % OF BEFORE-TAX INCOME



The specifics of spending

In general, households spend more on housing than anything else. For the lowest quintile, housing expenses amount to 40% of total expenses, while in the highest quintile 30% of total expenses goes to housing.

Transportation is the next largest expense for households, accounting for 14% of lowest quintile expenses and up to 15% to 17% for all other quintiles.

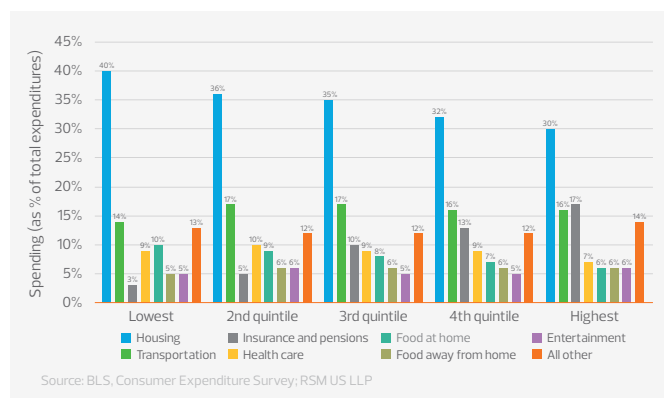
The lowest quintiles apply less than 3% of total expenditures on insurance and pensions. It's hard to plan and save for the future when you don't have enough income to pay the rent. The amount of spending on insurance and pensions rises from 3% at the lowest quintile to nearly 17% in the highest quintile.

CONSUMER OUTLOOK (CONT.)

Health care spending drops from roughly 10% of total spending in the lower quintiles to less than 7% at the highest.

The common denominator is entertainment; everyone applies about 5% of their expenses to having a good time.

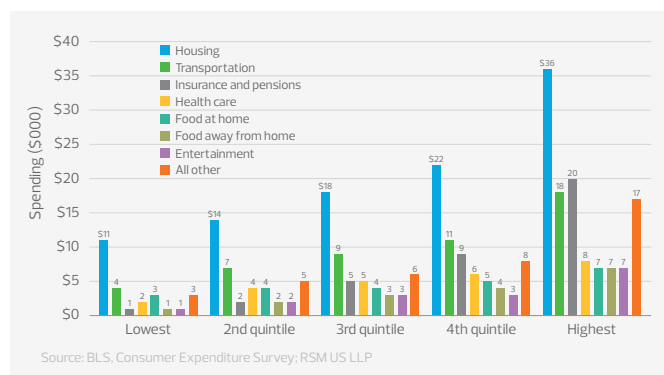
2018 Household spending as a % of total expenditures



The magnitude of differences in spending illustrates why the December 2017 tax cuts were successful in temporarily stimulating the economy late in the business cycle. The increase in wealth derived from equity buybacks and the cuts in marginal tax rates for high earners were enough to maintain moderate GDP growth even as investment and exports became negative. But those cuts and the reallocation of wealth up the income ladder did not result in a permanent return to 3% growth.

2018 Household spending by quintile

QUINTILE EXPENDITURES IN THOUSANDS OF DOLLARS



Jobs, wealth and consumption

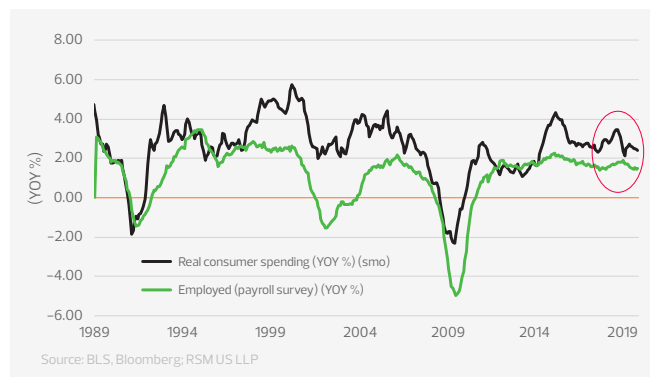
The conventional wisdom has been that a tightening labor market and rising wages were responsible for spurts in consumer spending. That would certainly have been intuitive in the postwar industrial age, when liberal democracies were rebuilding and transforming manufacturing into consumer-driven, choice-driven enterprises. More important was the relative lack of inequality with a smaller gap between the earnings of a production worker and management.

Recent data suggests that other factors might now be at work; specifically, the diminished demand for basic manufacturing labor in the liberal economies, the growth of the low-wage service sector and growing income inequality. Now that the developed economies have established a basic social safety net for labor-derived employment, what are the factors driving personal consumption?

First, the availability of employment is a necessary condition for consumer spending. The correlation between real consumer spending and the yearly rate of employment growth is 70% for 1989–2019 and 85% for the 2001–19 period. Both suggest a significant relationship that demands the attention of the monetary and fiscal authorities.

Real consumer spending and employment

YEAR-OVER-YEAR GROWTH RATES



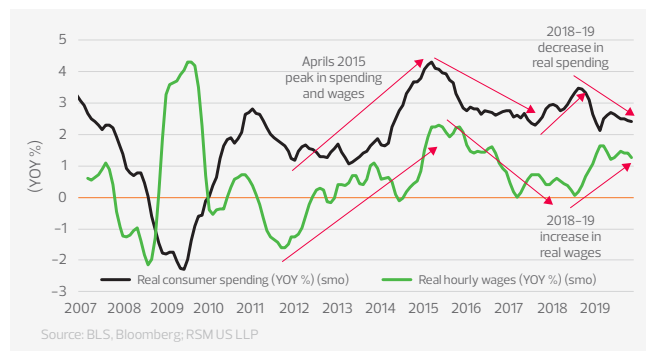
Yet it's not sufficient for policymakers to simply rely on wage growth to keep an expansion going. The direction of consumer spending and wage growth can at times be coincident, and can at times move in opposite directions. In just the 11-year recovery and expansion following the financial crisis, there are several examples of this divergence.

During the financial crisis, real (inflation-adjusted) spending dropped like a rock even as wages continued to grow. (This was most likely because of contractual requirements of workers lucky enough to be employed.) After the 2009 crisis, it took six years for the growth rate of consumer spending to peak at more than 4% a year in April 2015. Meanwhile, real hourly wage growth, which had been flat or negative from 2010 to 2013 in the immediate post-crisis period, began to increase before reaching a peak rate of 2.25% a year, also in 2015.

Inflation-adjusted spending then began declining until late 2017. Spending had a growth spurt in early 2018 before resuming its downward trend later in the year as the trade war and uncertainty over policy took their toll. At nearly that same point late in 2018, however, wages began increasing again as the unemployment rate reached well below equilibrium levels and a shrinking pool of available workers required higher compensation.

Real consumer spending and real average hourly earnings of private nonfarm employees

YEAR-OVER-YEAR GROWTH RATES

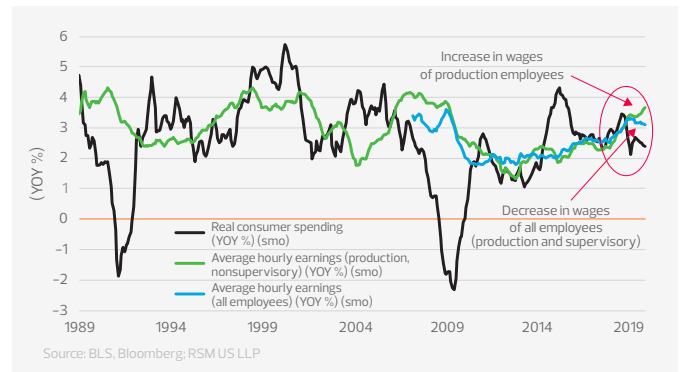


So what accounts for the divergence in spending and wages in 2018 and 2019? There are some clues within the trend in nominal wage growth, which can be broken down by employee type. Although nominal hourly earnings are rising for production (nonsupervisory) employees, when higher-wage supervisory employees are factored in, the trend in hourly earnings has declined since April 2019. A look at the three-month average annualized pace of retail sales strongly suggests that spending peaked in May 2019.

The impact of the decline in earnings for higher-wage supervisory employees becomes apparent in the delineation between household income and spending in the lower and upper quintiles. Put simply, high-income households spend more than low-wage households.

Real consumer spending and average hourly earnings

YEAR-OVER-YEAR GROWTH RATES



So in this latest cycle, it is not wages driving consumer spending as much as it is the amount of disposable income in the system. With the upper quintiles accounting for income and spending that is magnitudes higher than the lower quintiles, the data suggests that lower growth of earnings would push disposable personal income lower, and push consumer spending lower overall.

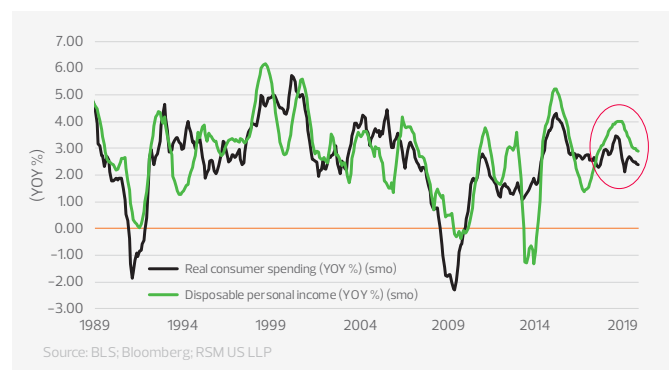
After the tax cuts were passed in December 2017, the excess cash spurred an increase in disposable income and an increase in spending that continued until January 2019.

While spending remains robust, you can only spend so much. It would be hard to argue that the tax cuts were not effective, if the goal was simply to induce spending. But investment has not responded to the flood of cash, and the U.S. export sector is still contracting.

Nevertheless, we anticipate the global economy bottoming out in coming months. That doesn't necessarily mean a resumption of spending increases, or a snap revival of investment. Instead, we anticipate the period of slow-to-moderate growth to continue. ■

Real consumer spending and disposable personal income

(YEAR-OVER-YEAR GROWTH RATES)



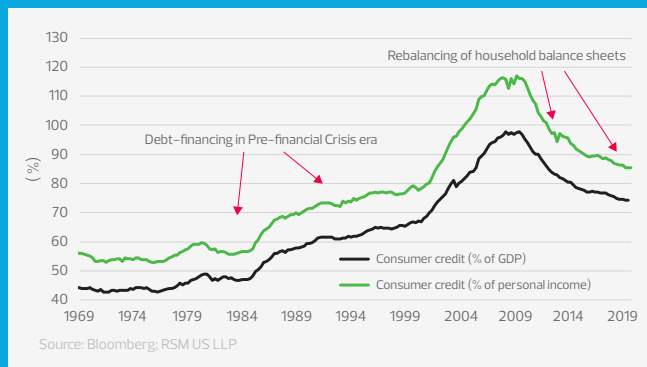
HOUSEHOLD BALANCE SHEETS

The supposition that consumer spending will be enough to sustain GDP growth at 2% has several requirements: the willingness of consumers to continue spending, consumer access to funds and the willingness of lenders to extend credit.

American households got in way over their heads during the run up to the 2007-09 housing-induced financial crisis. Credit balances grew to nearly 100% of nominal GDP and to 115% of personal income. Those ratios have since returned to early 2000s levels of 74% and 85%, both of which are still high relative to pre-credit card levels of the 1960s, but more symptomatic of the evolution toward a cashless society as well as the deficit of household savings.

Consumer credit

AS PERCENT OF GDP AND PERSONAL INCOME

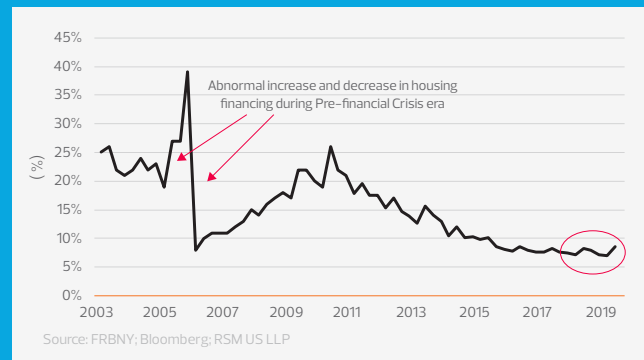


The other half of credit transactions is the willingness of banks to provide funds. While credit providers integrate a risk premium into their fees, the availability of credit is still dependent on expectations for employment, income and consumers' ability to repay those funds.

Although new bankruptcies have declined dramatically since the financial crisis, that trend has flattened and is showing signs of turning higher again. And recognition of the increase in bankruptcies might have caused banks to tighten their standards for issuing consumer loans.

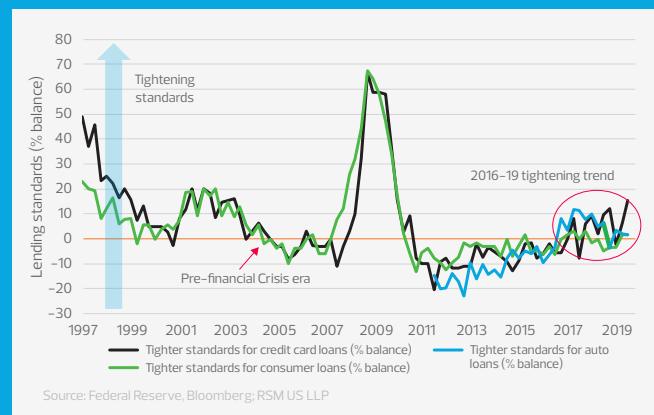
New consumer bankruptcies

AS PERCENT OF BANK CUSTOMERS



Lending standards for consumer loans

FEDERAL RESERVE SENIOR LOAN OFFICER OPINION SURVEY



PROMOTING FROM WITHIN

As an alternative to tax cuts for the wealthy, which clearly provide short-term boosts to spending, we should consider investment in low-income earners that would have a longer-term impact on potential growth. It is critical that as the economy evolves in a digital age, pathways to prosperity should be built for those who have been left out because of the lack of education and infrastructure.

The military and corporations like McDonald's are known for developing their workforce from within, providing employees the means to develop their skills and rise up through the ranks. General Colin Powell is a prime example, as were the Merrill Lynch chief executives who began their careers in the mailroom. A similar approach could be constructed to ensure that a large percentage of the population not be left behind as the digital economy rapidly accelerates.

MIDDLE MARKET INSIGHT

Faced with a tight labor market, middle market companies should consider retraining existing employees with the skills needed to thrive in the digital economy.

According to a [recent Brookings analysis](#), "Low-wage workers comprise a substantial share of the workforce. More than 53 million people, or 44% of all workers ages 18 to 64 in the United States, earn low hourly wages."

This is due, in large part, to competition from a global supply of cheap labor and the off-shoring of basic manufacturing to low-wage centers. While this shift in labor supply is a fact of life, it does not mean we should simply walk away from society's responsibility to provide the means for development.

From the Brookings report: "The well-educated and technically savvy find ample employment opportunities, while those with lower levels of education face a labor market that is decidedly less welcoming, with lower wages and less potential for career growth. Meanwhile, some regions dramatically

outpace others in job growth, incomes and productivity, raising disquieting questions about how best to promote broad-based economic growth."

Policy alternatives include expanding the earned income tax credit, wage subsidies and increasing the minimum wage to \$15 an hour in an orderly fashion. This increase would partially shift the source of income for low-wage workers from government subsidies to corporations. A century ago, Henry Ford provided wages that were sufficient for his employees to purchase a Model-T; modern-day corporations are expected to simply outsource or automate their low-wage jobs in the name of maximizing shareholder earnings.

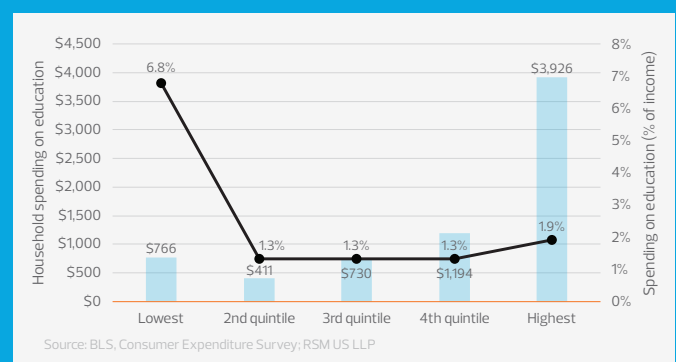
Household spending data appears to support the need for assistance. As the figure below indicates, the lowest quintile spends 6.8% of its before-tax income on education; all other quintiles spend 1.3% to 1.9% on education.

Government programs in liberal democracies include an element of income redistribution, mostly in the form of progressive taxation programs that fund means-tested assistance programs. We can choose to promote long-term potential growth by providing the means for everyone—regardless of income level—to develop their individual capital through education.

Think of the role that public schools play in providing the first step, with public universities providing the ticket to the top. (In addition, public universities are subsidized research and development resources for business and technology development.)

2018 Education spending by quintile

AND QUINTILE SPENDING ON EDUCATION AS A % OF BEFORE-TAX INCOME





2020 OUTLOOK HINGES ON LIFTING UNCERTAINTY TAX

Deceleration leaves little room for policy mistakes

BY JOSEPH BRUSUELAS

KEY THEMES

1. Easing of trade tensions may bolster global growth.
2. Monetary and fiscal policy to moderately support growth.
3. "Japanification" linked to demographic challenges.
4. Manufacturing conditions stabilizing.

THE GLOBAL ECONOMY has decelerated over the past two years as an uncertainty tax in the form of disruptions to the free movement of goods along the global supply chain and a broad move away from a rules-based economic framework continue to damp overall economic activity. Even so, the global economy is likely to continue expanding around 3% in 2020, the minimum threshold before recessionary risks begin to build. In short, a number of things will have to go right with respect to trade policy and political risk to avoid growth slowing below our realistic forecast.

Outlook for business growth

In 2020, we expect the ebbing of financial risk around Brexit, the possibility of a cease-fire in the trade war, or even the roll back of existing tariffs, to help bolster global growth. Moreover, monetary and fiscal policy stimulus should boost overall global activity in the second half of the year, though firepower is limited given political constraints across the developed economies.

To avoid a greater slowdown, the trade conflict between the United States and China will need to ease. A cease-fire is simply not enough. Rather, tariffs will need to be rolled back on both sides to create the conditions for a global reacceleration in growth. This means that both economies need the uncertainty tax lifted, which would then signal private sector firms to boost fixed investment. It is important to note that for much of 2019, an elusive trade deal did not materialize; trade policy was instead characterized by tariff increases, declining trade and lower fixed business investment. Even the recent phase one trade deal with China, which avoided a new round of tariffs from going into effect, was not substantial enough to significantly ease the uncertainty around trade. It would not take much in terms of a breakdown of the current talks between Washington and Beijing and the strains around the U.S. presidential election for a repeat in 2020.

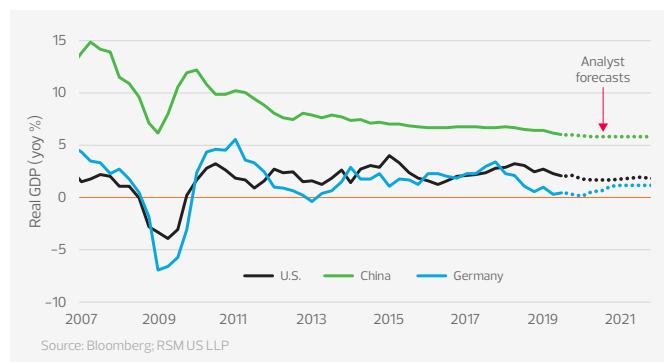
Second, American households will need to continue to see wage gains to support consumption near the level of 2% to 2.5% to absorb the global surplus in production of goods necessary to boost overall global activity via the trade channel.

Third, while the European Union teeters on the brink of recession, global manufacturing will likely bottom out in early 2020. Even so, the German economy has plenty of spare fiscal capacity to boost growth if its economy continues to experience below-trend growth near 0.5% on a seasonally adjusted annualized basis. We expect the European Central Bank to increase monetary accommodations early in 2020, and we think an important conversation about the use of the fiscal channel to boost growth will start in European policymaking circles, which will be one of the major global narratives in 2020.

[Estimates by the International Monetary Fund](#) indicate that the world economy—which includes both developed and emerging economies—slowed to 3.0% from a growth of 3.75% in 2017. But more disturbing for the U.S. business community are [estimates by the Organization for Economic Cooperation and Development](#) that economic growth in the 45 developed economies declined to 1.8% in 2019 from 2.6% in 2018.

The modest expectations for 2020 are what one would call realistic, and the consensus forecast of economists is for modest growth in the following two years. That could have an enduring impact on U.S. exporters and for those U.S. businesses looking to expand their market. Given the pullback of the United States from the global economy over the past two years, internationally active firms are legitimately questioning why they should trade with the United States and risk disruption to supplies of goods or loss of sales.

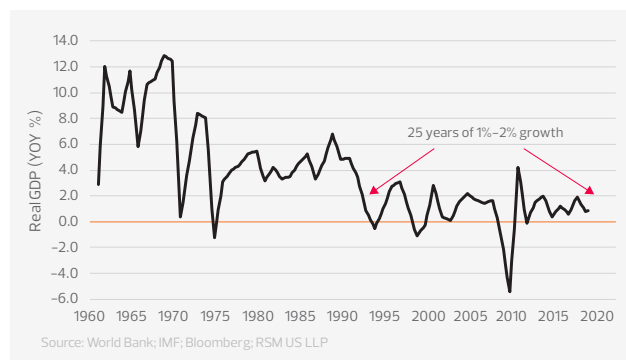
Expectations for U.S., China, and Germany real GDP growth



Long-term global economic challenge: Demographic change

Many analysts refer to the so-called Japanification of the developed economies, as an extended period of slow growth and low inflation linked to aging societies. Japan—once the driver of innovation and investment—grew old and stopped innovating. Its population became stagnant because of passive societal decisions that reduced the country's birth rate and limited immigration. Without a young, growing population to replenish the labor force, economic growth became impossible, and for the past 25 years, Japan's economic growth has become range-bound at less than 2% annually.

Japan real GDP growth



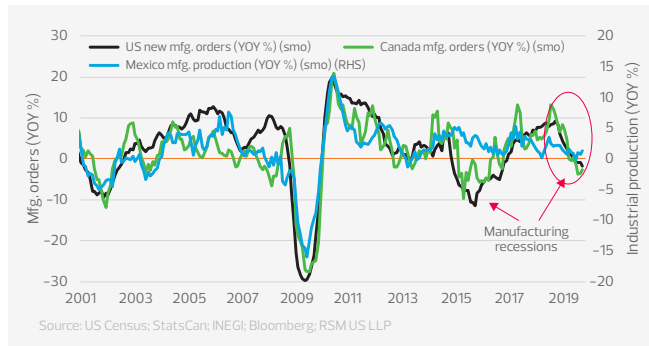
Indeed, in the advanced economies, the aging societies present long-term challenges to growth, given the move to limit immigration into those economies.

Global manufacturing activity

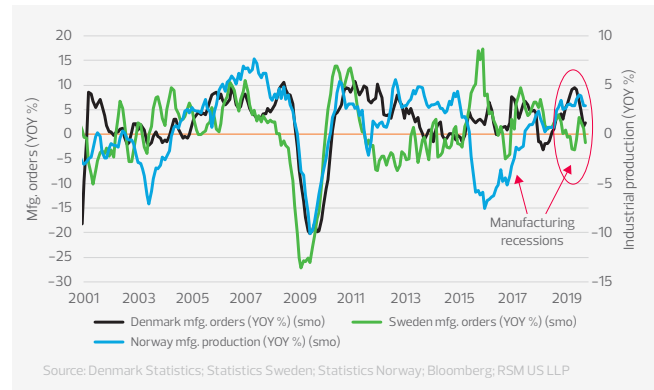
As the following figures suggest, most of the developed world, including the United States, is already in a manufacturing recession. And as the table on page 15 indicates and is perhaps most threatening, real gross domestic product growth is decelerating, and inflation trends have reversed direction, a symptom of insufficient demand and a lack of confidence. Because of the threats to economic growth from trade wars and the lack of investment related to political and policy uncertainty, short-term interest rates around the world remain low, with more than \$12 trillion in negative yield government securities and more than \$1 trillion in private-label government securities yielding negative rates. Given the difficult economic and financial landscape, it is clear that growth via the fiscal channel is going to be key to resuscitating global manufacturing growth opportunities. The following is a look at global manufacturing conditions. ■

MANUFACTURING OUTLOOK AMONG THE DEVELOPED ECONOMIES

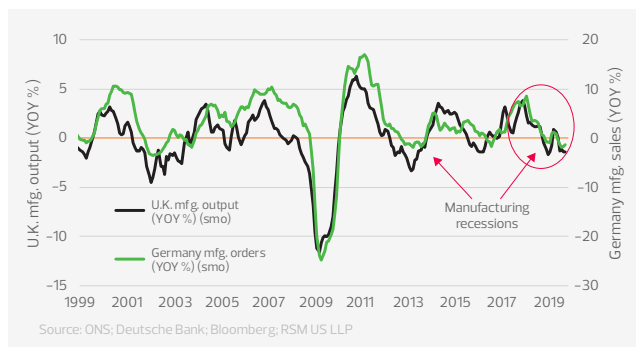
North American manufacturing activity 3-MONTH MOVING AVERAGES



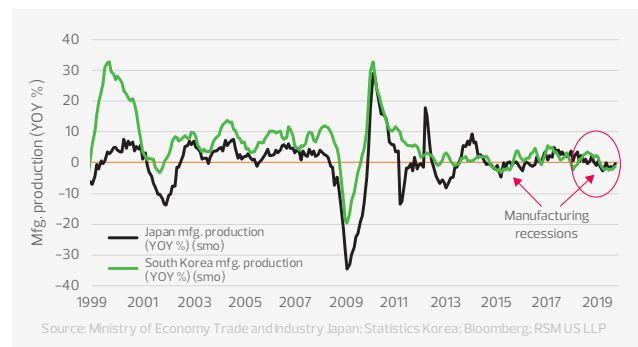
Scandinavia manufacturing activity 3-MONTH MOVING AVERAGES



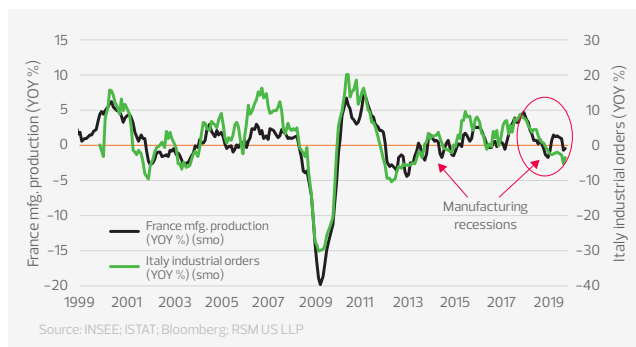
U.K. and Germany manufacturing activity 3-MONTH MOVING AVERAGES



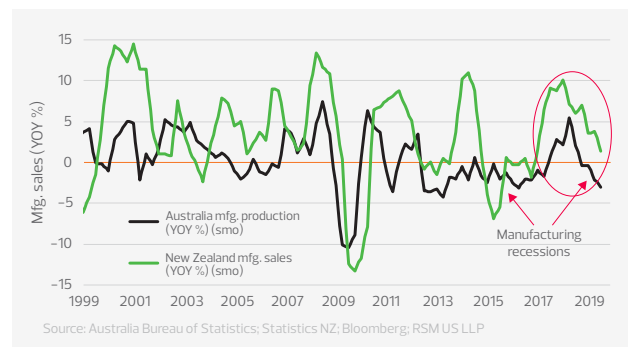
Japan and South Korea manufacturing activity 3-MONTH MOVING AVERAGES



France and Italy manufacturing activity 3-MONTH MOVING AVERAGES

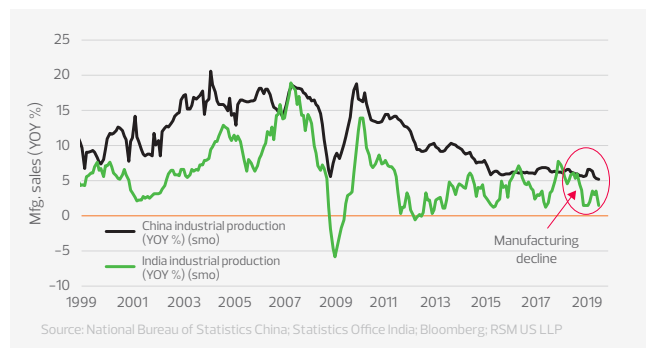


Australia and New Zealand manufacturing activity 3-MONTH MOVING AVERAGES



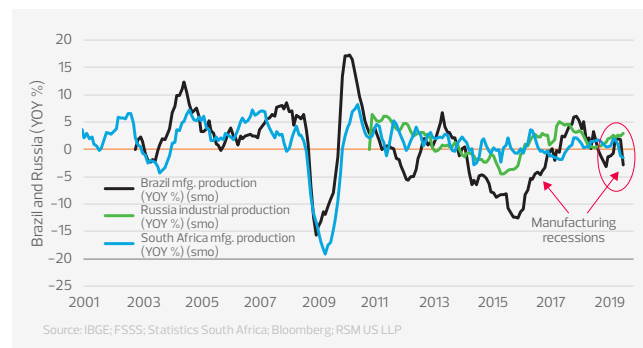
BRICS (China and India) manufacturing activity

3-MONTH MOVING AVERAGES



BRICS (Brazil/Russia/S. Africa) manufacturing activity

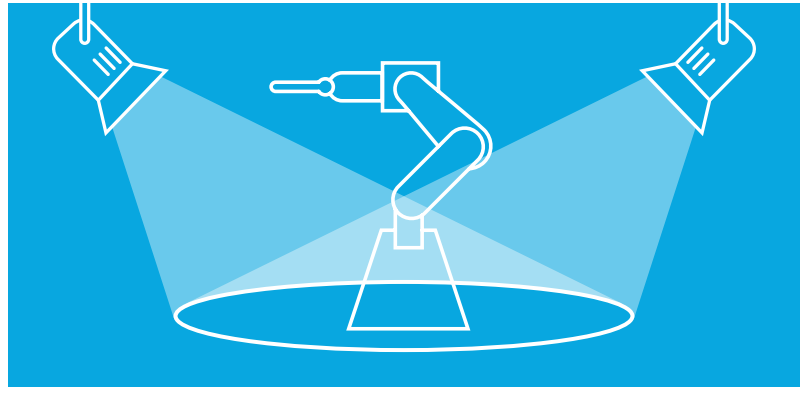
3-MONTH MOVING AVERAGES



EXPECTATIONS OF REAL GDP GROWTH, INFLATION, AND EXTERNAL BALANCE

		Real GDP (YOY %)				Inflation rate (%)				Current account (% of GDP)			
		2018	2019	2020	2021	2018	2019	2020	2021	2018	2019	2020	2021
North America	U.S.	2.9	2.3	1.8	1.9	2.5	1.8	2.1	2.0	-2.4	-2.5	-2.6	-2.5
	Canada	1.9	1.5	1.5	1.7	2.3	1.9	2.0	2.0	-2.6	-2.0	-1.9	-1.8
	Mexico	2.0	0.2	1.2	1.8	4.9	3.6	3.4	3.4	-1.6	-1.0	-1.5	-1.3
Europe Union	U.K.	1.4	1.2	1.1	1.5	2.5	1.9	1.9	2.0	-3.9	-4.3	-4.2	-4.1
	Germany	1.5	1.2	1.1	1.5	1.9	1.4	1.4	1.5	7.2	7.1	6.6	6.5
	France	1.7	1.3	1.2	1.3	2.1	1.3	1.3	1.4	-0.7	-0.6	-0.5	-0.5
	Italy	0.8	0.1	0.4	0.6	1.3	0.7	0.8	1.0	2.5	2.7	2.4	2.5
Scandinavia	Denmark	1.5	1.8	1.5	1.5	0.8	0.9	1.2	1.4	7.0	6.8	6.5	5.9
	Norway	1.3	2.5	1.9	1.6	2.8	2.2	2.0	2.0	4.3	6.9	6.5	6.3
	Sweden	2.4	1.4	1.3	1.6	2.0	1.8	1.7	1.8	2.2	3.7	3.5	3.0
Asia/Pacific	Japan	0.8	0.9	0.3	0.8	1.0	0.6	0.9	0.7	3.5	3.3	3.3	3.1
	S. Korea	2.7	1.9	2.2	2.3	1.5	0.5	1.2	1.6	4.5	3.3	3.6	3.4
	Australia	2.8	1.8	2.4	2.6	1.9	1.6	2.0	2.0	-2.1	0.1	-0.8	-1.2
	New Zealand	2.8	2.3	2.4	2.6	1.6	1.6	1.9	2.0	-3.9	-3.3	-3.2	-3.2
BRICS	Brazil	1.1	1.0	2.0	2.5	3.7	3.6	3.6	3.6	-2.2	-1.7	-2.0	-2.3
	Russia	2.3	1.1	1.6	1.9	2.9	4.5	3.5	4.0	7.0	5.0	3.9	3.7
	India	7.2	6.0	6.0	6.7	4.0	3.4	3.6	3.9	-2.5	-1.9	-1.9	-2.0
	China	6.6	6.1	5.8	5.8	2.1	2.6	2.6	2.2	0.4	1.0	0.8	0.6
	S. Africa	0.8	0.5	1.2	1.6	4.6	4.3	4.8	4.8	-3.6	-3.4	-3.6	-3.5
Weighted average		3.2	2.7	2.6	2.8	2.3	2.0	2.1	2.1	0.1	0.3	0.1	0.0

Source: Bloomberg; RSM US LLP



MANUFACTURING

INDUSTRY SPOTLIGHT

EQUIPMENT-AS-A-SERVICE—A POTENTIAL CAPEX ALTERNATIVE IN A SLOWDOWN?

BY SHRUTI GUPTA

FROM STREAMING videos to music services and food preparation, today's world is rife with on-demand subscription models. And at a time when uncertainty is stalling capital investment by businesses, a similar idea might be just the ticket for manufacturers looking to support ongoing, new or experimental projects, while keeping a lid on costs.

Known as "equipment-as-a-service," this twist on a rental concept isn't new. Rolls-Royce has long offered its expensive aircraft engines on a "power-by-the-hour" basis. The idea is now gaining traction among manufacturers as connectivity facilitated by the internet of things comes to industrial equipment, affording operators the ability to remotely monitor their machinery.

Here's how it works: Instead of making an outright purchase, manufacturers pay a comprehensive periodic fee for machinery uptime based on consumption or outcomes. Unlike traditional lease arrangements, the amount varies, and is based on the extent of use tied to a particular asset. Think of it as taking a taxi as opposed to leasing a car.

Since the user—a manufacturing company—does not own the equipment, the supplier is responsible for service, repairs, spare parts, service-level agreements and related costs for the duration of the contract, which is generally long term.

The growing focus on EaaS has been prompted by digital technologies: internet-enabled smart machines or legacy machines retrofitted with these capabilities. These allow producers to monitor equipment on a real-time basis for performance, usage and billing data. EaaS helps suppliers as well through sustained customer engagement and critical data insights that would enhance the product design and service offerings. The predictive maintenance capabilities allow suppliers to manage repair costs by addressing concerns early on before a machine breaks down, and to schedule service based on use rather than hew to a fixed schedule.

Of course, shifting to an EaaS model requires a cultural shift within the organization, including a commitment to retraining. But if a full-blown capital outlay for new equipment is not on the table, this alternative may be worth considering. ■

MIDDLE MARKET BUSINESS SENTIMENT EASES TO A STILL SOLID 127.2

Middle market business sentiment remained stout in the fourth quarter, according to the RSM US Middle Market Business Index survey, as expectations about the direction of the economy, capital expenditures and hiring softened. Solid domestic demand continues to bolster current conditions and expectations for increasing revenues and net earnings in the real economy.

Learn more in the [full report](#).



MIDDLE MARKET TREND WATCH

BUSINESS SENTIMENT REFLECTS SOME ROOM FOR GROWTH

THE Q4 2019 numbers are out. RSM's Middle Market Business Index indicated a slight decline of 127.2, a decrease from the 131.0 recorded in Q3 2019, and well below the cyclical peak of 136.2 posted in Q1 2019. However, despite this seasonally adjusted dip, strong demand in the United States continues to sustain current business conditions as well as forecast for positive revenues and net earnings. Here's what middle market executives told us in the latest MMBI survey. ■

Nearly half of leaders said their firms plan to increase capital expenditures during the next six months. Similarly, **46%** said they boosted capital expenditures in the current quarter.

The broader economic deceleration did not affect the positive outlook for revenues and net earnings. More than half of business leaders reported improved revenues in the current quarter, and **62%** said they expect improvement to continue over the next six months.

Finding willing and available workers remains a top challenge for executives. Forty-two percent stated their businesses increased hiring in Q4 and **48%** plan to do so in the first half of 2020.

Forty-one percent of executives indicated that the economy improved in Q4, and nearly half (**46%**) expect it to improve over the next six months.

KEY TAKEAWAY

While business sentiment is cautious, middle market leaders are eyeing opportunities to grow. A careful strategic approach is vital, however. Sound intelligence about business processes, functions and forecasting is key. Leverage data and technologies to evaluate internal processes, business models, sales efforts, strategic acquisitions and more to make the best business decisions for 2020 and beyond.



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