ECONOMIC INSIGHTS
FOR MANUFACTURERS

Q1 2025

THE BIG **PICTURE**

With 2024 now behind us, it's the perfect time to reflect on the key factors that shaped the manufacturing sector last year and consider what might lie ahead in 2025. In our last edition of *Economic Insights for Manufacturers*, we highlighted several elements poised to influence trade, monetary policy, and pricing within the manufacturing industry. Now, Q4 has delivered the political clarity necessary to recalibrate economic expectations and adapt to the emerging realities.

Throughout 2024, a striking contrast emerged between the financial markets and the manufacturing sector. On one hand, financial markets reached all-time highs, while on the other, the manufacturing sector endured a prolonged downturn, marked by contractions in 24 of the last 25 months, according to the Institute for Supply Management. This trend persists despite steady GDP growth, highlighting the manufacturing sector's shrinking share of the overall economy.

Reasons for Hope

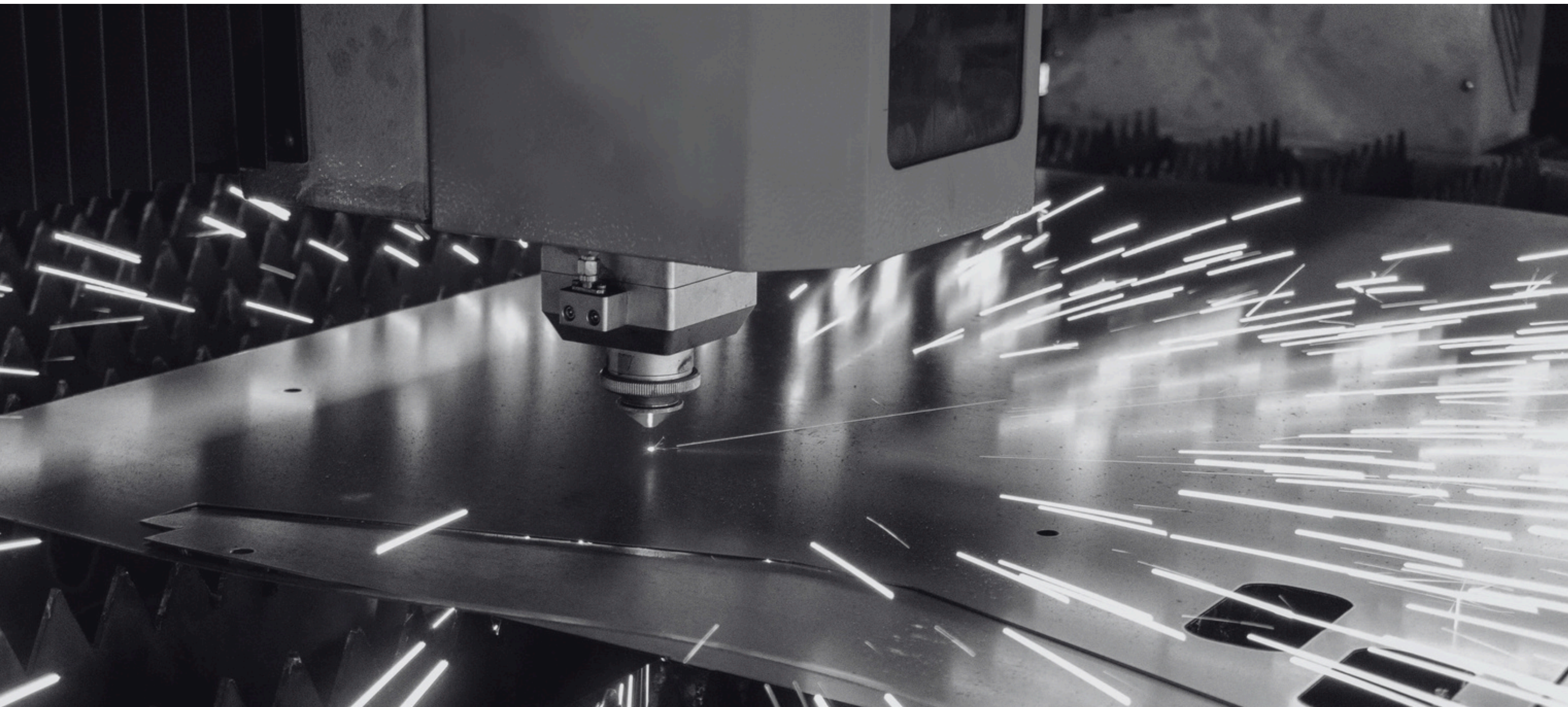
The good news is that this situation could begin to reverse starting in 2025. One positive indication: The interest rate reduction cycle is already underway, with the market expecting rates to end Q1 of next year at 4%. Looking ahead, the average interest rate for 2025 is projected to be 3.75%, according to bond market data.

The reduction in interest rates could provide relief to the manufacturing sector, offering opportunities to access cheaper credit and renegotiate existing debt. On the labor market front, the Federal Reserve appears comfortable with the current unemployment rate, which stood at 4.2% at the end of 2024. While historically low, it is the highest level since March 2022.

U. S. unemployment rate. Source: BLS.

With rising unemployment and lower inflationary pressures anticipated in 2025, wage growth is expected to decelerate, along with reduced bargaining power for workers. While neither interest rate cuts nor easing wage pressures directly benefit the sector, they create a more favorable environment that could support improved profit margins.

In our last edition, we questioned how long inflation and stagnation in manufacturing would persist. By Q3 2024, a resolution seemed distant. Now, we can say the situation has improved — albeit without clarity or signs of sustainable growth. Leaders in the manufacturing sector should assume that conditions won't shift significantly in the short term, but early signs of recovery are beginning to emerge.



MARKET
FORCES

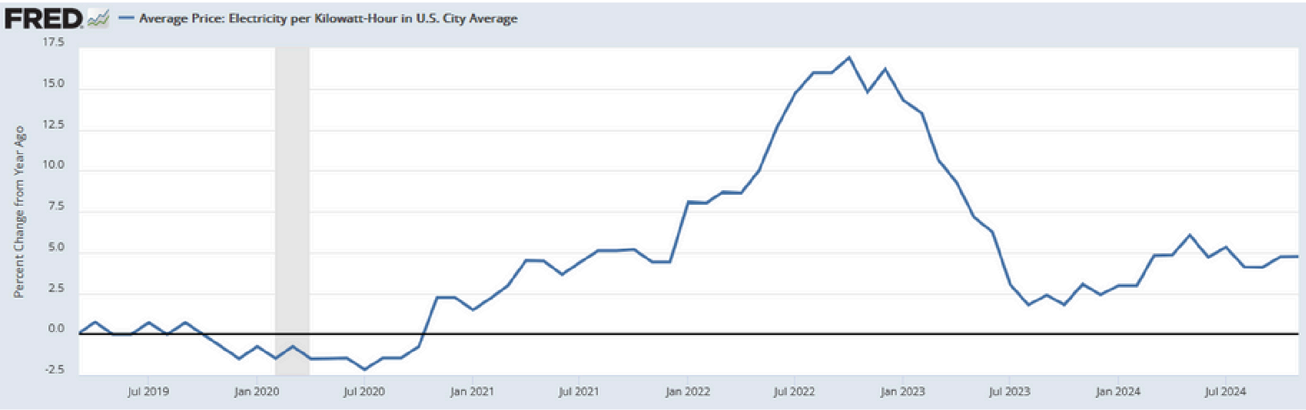
Throughout 2024, overall activity and sales in the manufacturing sector declined. However, price adjustments helped support the sector's gross margins. The rise in domestic prices for manufactured goods — though slower than in previous months — still outpaced the increase in input costs. This helped mitigate some of the pressures on manufacturers.

A Newly Positive PPI

The Producer Price Index (PPI) for materials and components used in manufacturing, which reflects input and commodity prices sector companies face, turned positive for the first time since 2022. While demand might remain constrained until the end of Q1 2025, margins could continue to improve.

Electricity Costs Rising

Energy prices presented a mixed picture in 2024. While electricity costs reached new all-time highs, gasoline prices dropped to an average of $3.05 per gallon, the lowest of the year. According to the Bureau of Labor Statistics, electricity prices have been rising faster than inflation, which adds to manufacturers' operating costs. Given these trends, careful management of indirect costs, particularly energy expenses, will be crucial for manufacturers in 2025.



Electricity Price YoY Percentage Change. Source: Federal Reserve Economic Data (FRED) database

Supply Chain Costs Continue Upward

Looking at commodity prices, there was moderation throughout 2024, but this trend may shift. The Federal Reserve's actions and broader market trends suggest an "inflationary baseline" of around 2.5% annually for 2025. According to bond market data, the implied annual inflation rate for the next five years is expected to average 2.4%. For leaders in the manufacturing sector, this means rising costs across the supply chain are likely to persist, influenced by the inertia of previous years. Planning for these challenges will be key to maintaining profitability.

CURRENT EVENTS
& OPINIONS

With Donald Trump's victory in the recent U.S. presidential election, it's increasingly likely that the "trade war" with and "decoupling" from China, which began in 2017, may further evolve or intensify, especially given the Republican Party's trifecta of control within the executive branch and U.S. House and Senate.

On Trade & Tariffs

Donald Trump's presidency could bring significant changes to international trade with other countries, as well, particularly with imports. Recently, Trump announced that he had selected Peter Navarro as his top trade advisor. Navarro, who previously served as a key trade aide during Trump's first term, has been described as a tariff hawk.

During his first administration, Trump imposed tariffs on solar panels, washing machines, and certain metals. President Joe Biden maintained most of those tariffs and introduced new ones on additional Chinese goods, including electric vehicles and semiconductors. Now, Trump is proposing even more aggressive measures, with tariffs ranging from 60% to 100% on Chinese goods and a universal tariff of up to 20% on imports from all other countries.

Tariffs could have dual effects: They might escalate input and output costs but they also might create opportunities if viable manufacturing substitutes emerge. In other words, leaders in the U.S. manufacturing sector could consider the possibility of replacing goods or services currently produced in China or Europe with domestic alternatives.

Additionally, tariffs serve as a protective measure for the manufacturing sector. They lead to higher domestic prices and make it more challenging for foreign goods to compete. Tariffs drive up costs throughout the supply chain, and only time will reveal the extent to which end consumers can absorb these price increases.

The Potential Impact of DOGE

On the topic of deregulation, Donald Trump announced the creation of a Department of Government Efficiency (DOGE), which will be led by Vivek Ramaswamy and Elon Musk. Despite the sound of its name, DOGE would not function as a federal executive department; creating one would require an act of Congress. Instead, it will operate as an advisory body outside of the formal government structure.

Donald Trump has said he intends to use the DOGE to dismantle government bureaucracy, slash excess regulations, cut expenditures, and restructure federal agencies. For the manufacturing sector, DOGE could present an opportunity to highlight or reverse cases of excessive regulation within the industry. One potential approach is to submit these cases collectively through the relevant industry associations, such as the National Association of Manufacturers (NAM), the American Iron and Steel Institute (AISI), and others.

Your Takeaway

The manufacturing sector faces a mix of current challenges and future opportunities. While cost pressures and weak demand remain significant concerns, signs of recovery — such as stabilizing margins and anticipated lower interest rates — offer a more optimistic outlook for 2025. Political developments, including Trump's proposed tariffs and the rise of protectionism, could lead to significant shifts in trade and regulatory policies, reshaping the industry's landscape in the years ahead. Finally, DOGE may present an opportunity for collaborative efforts with the federal government to address internal regulations and facilitate production within the manufacturing sector.

If you have any questions or would like to continue the conversation, please reach out to your dedicated Rehmann advisor. Visit our website at rehmann.com for additional resources and insights, or give us a call at 866.799.9580. We're here to assist you and help navigate these changes together!