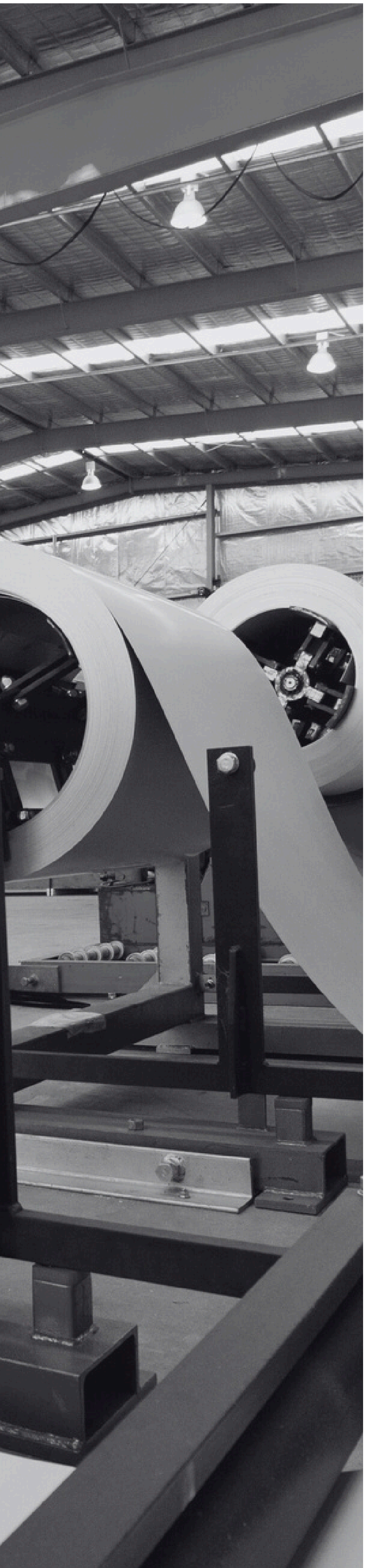
ECONOMIC INSIGHTS
FOR MANUFACTURERS

Q1 & Q2 2025



EMERGING **CHALLENGES**

The first quarter of 2025 has come to an end, bringing new challenges for the remainder of the year. In our previous edition of *Economic Insights for Manufacturers*, we highlighted key topics expected to shape discussions in Q1, including trade policies and tariff implementations. Additionally, issues such as persistent inflation, recession fears, and skilled labor shortages have emerged as critical developments to watch.

As expected, Q1 saw a tougher and increasingly uncertain U.S. trade policy. The current administration believes there is a significant imbalance in international trade, leading to a chronic trade deficit that must be financed through debt, monetary expansion, and other mechanisms.

At the same time, the administration has emphasized the need to protect domestic jobs and industries by reducing U.S. reliance on supply chains from countries that do not align with the broader U.S. strategy — framing these concerns as matters of national security.

In the first quarter of 2025, the U.S. administration’s tool of choice for combating these issues was a series of aggressive tariff measures aimed at both allies and adversaries. Among them: a 25% tariff on steel and aluminum imports, additional tariffs on automobiles and auto parts, and a broad "reciprocal tariff" policy that briefly imposed a 10% baseline tariff on imports from all countries, with higher rates for nations with significant trade deficits with the U.S.

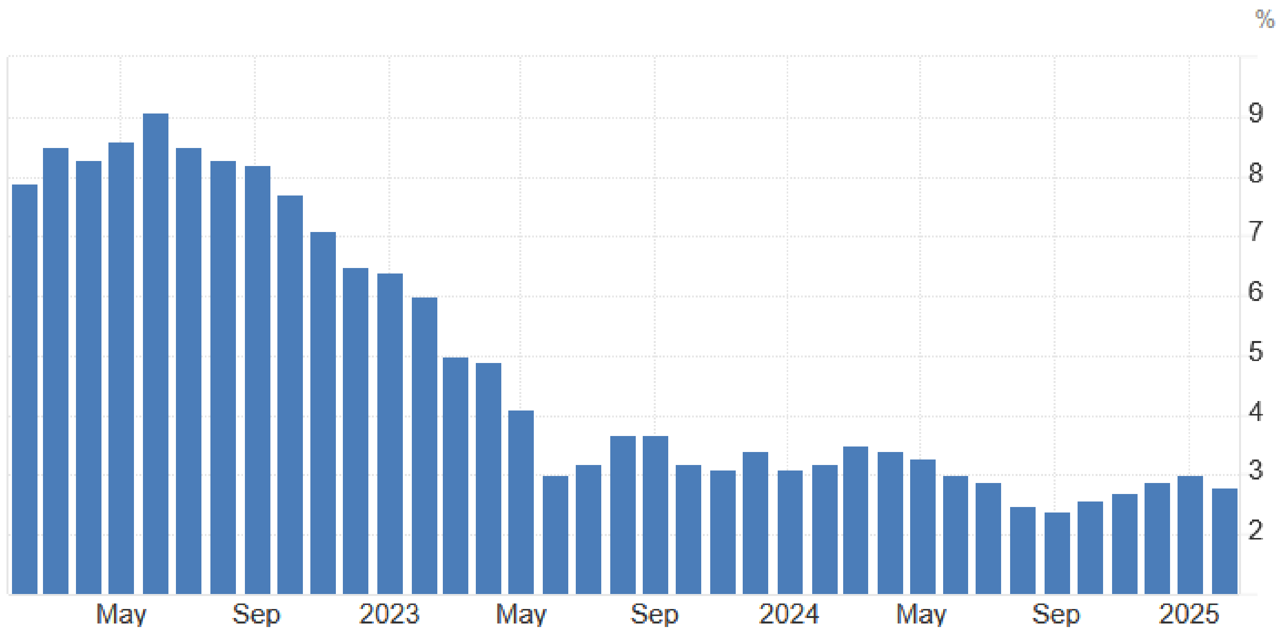
However, the administration’s sudden about-face in early April — which, one day after the baseline tariffs went into effect, put a 90-day pause on reciprocal tariffs for the 75+ trading partners who did not retaliate — suggests the U.S. will consider negotiating trade-barrier solutions with the majority of its trading partners through Q2.

Whether China will be in that camp remains to be seen. Following a series of escalating and retaliatory tariffs between the U.S. and China throughout Q1 and early Q2, both countries had (at the time of this publication) raised tariffs on imports from the other to 125%.

Looking ahead, the administration is expected to continue its focus on reducing dependency on foreign imports, particularly in critical sectors like defense and technology, while addressing supply chain vulnerabilities. But the rollercoaster of recent tariff events suggests that the only certainty about the future of the nation's trade situation is that it will remain largely uncertain — at least for the next 90 days — increasing pressure on prices and the potential for a recession.

Steady Inflation

Inflation reduction has stalled in recent months, hovering around 3% annually. In particular, during Q1, raw material prices increased for the fifth consecutive month, reaching their sharpest rise in the past 15 months in February, with a 7.5-point increase in the Institute for Supply Management Price index. At the same time, the Federal Reserve appears determined to maintain interest rates — at least for now — while uncertainty surrounding the final impact of trade measures persists. The relatively high interest rates have contributed to weaker consumer spending and a reduced potential for consumption.



U.S. Inflation rate. Source: BLS.

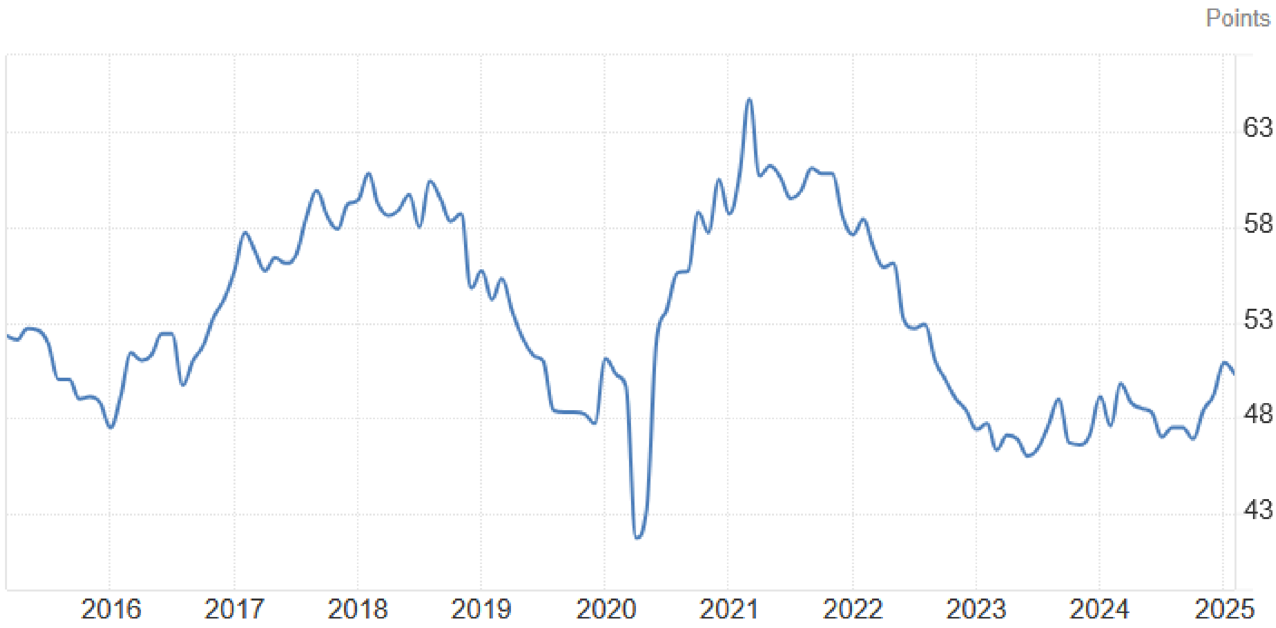
In recent weeks, nowcasts from various Federal Reserve branches have shown contradictory signals about economic performance in Q1 and Q2 of 2025. The Atlanta Fed projects an economic contraction of approximately 1.8% for the quarter that just ended, while the New York Fed anticipates 2.7% annualized growth. This wide disparity signals strong volatility in future expectations.

For now, current hard data — coupled with Federal Reserve Chair Jerome Powell's remarks following the latest Fed press conference — suggests that while many economists outside the Fed have raised the probability of a recession, a severe downturn is still considered unlikely in Q2. However, persistent inflation remains a key concern for leaders in the manufacturing sector, as both tariffs and skilled labor shortages continue to exert upward pressure on costs.

MARKET **FORCES**

Throughout 2024, a significant disconnect emerged between the broader economy, financial markets, and the manufacturing sector. While the economy and major Wall Street indices posted substantial growth, manufacturing endured 26 consecutive months of contraction before showing signs of recovery in December.

However, recent data from the Institute for Supply Management (ISM) suggests that this prolonged downturn may be easing. The sector recorded two consecutive months of growth in January and February, indicating a potential turning point for industrial production and demand.



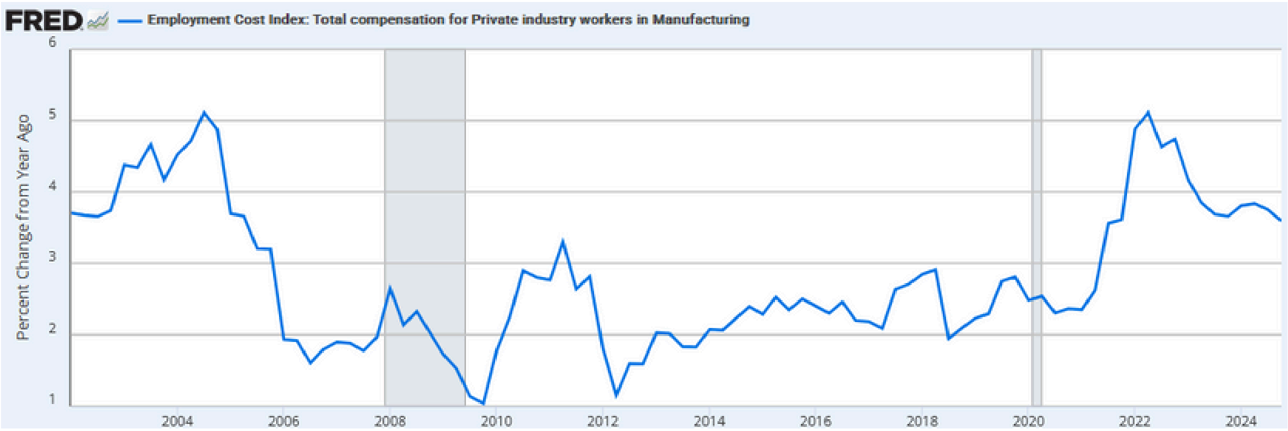
ISM Manufacturing PMI - Values above 50 indicate growth.

An emerging concern for manufacturers is the availability and composition of the workforce. One of the ISM's specialized reports found that companies continue to reduce their workforce, though at a more gradual pace. More firms are citing ‘attriting down’ as the preferred approach, with destaffing no longer as urgent as it was in the second half of 2024.

At the same time, the U.S. Chamber of Commerce has raised concerns about ongoing shortages in labor force participation. Data from the Bureau of Labor Statistics (BLS) shows that participation rates have yet to return to pre-pandemic levels. If workforce participation matched its February 2020 level, the U.S. labor market would have an additional 2 million workers.

The labor supply imbalance varies widely across industrial sectors, highlighting a growing skilled labor shortage in manufacturing. While the construction industry currently faces a labor surplus — with more unemployed workers than available job openings — the situation is markedly different in nondurable goods manufacturing. As of January 2024, a significant gap remains, with 622,000 unfilled job openings in manufacturing, underscoring the persistent challenge of recruiting and retaining skilled labor.

One clear outcome of the pressure on the manufacturing labor market is reflected in the evolution of real wages in the sector. According to BLS data, despite workforce reductions, labor costs have outpaced inflation since Q3 2023, with cumulative wage growth exceeding the reference basket by 1.5% over the past two years.



Compensation for Private Industry Workers in Manufacturing YoY change.

To address labor shortages, manufacturing leaders can adopt flexible work arrangements, competitive compensation, and workforce development initiatives. Shift rotations and remote options can enhance retention, while incentives like stock options and profit-sharing strengthen commitment. Other options such as tuition reimbursement and international hiring through H-1B visas may also help bridge skill gaps.

In short, retaining skilled workers will require more than higher wages — investing in training, providing clear career growth opportunities, and integrating automation to improve efficiency can strengthen retention. Performance-based incentives also play a key role in attracting and keeping talent during 2025.

Interested in determining what's motivating your own employees to stay or leave your company — and what you can do about it? There's a tool for that. Click here to learn more.

Finally, with inflationary pressures, labor shortages, and trade policy shifts shaping the manufacturing sector, adaptability will be key this year. Owners of small to mid-sized manufacturing businesses should take proactive steps to tackle these challenges.

Recommended Actions for the Quarter:

Optimize Procurement Strategies:

- Reassess supplier relationships to minimize tariff impacts.
- Diversify suppliers to reduce dependency.
- Click here for a free three-phase plan, developed by international tax and transfer pricing experts at Rehmann and around the world, to help you assess the impact of — and adjust to — the changing customs and tariff footprint.

Invest in Workforce Development:

- Offer competitive compensation and flexible work arrangements.
- Develop training programs and provide clear career growth opportunities.

Integrate Automation:

- Invest in automation technologies to improve efficiency.
- Use AI to streamline administrative and commercial tasks.

Enhance Local Sourcing:

- Develop local alternatives to replace existing suppliers.
- Build relationships with local suppliers.

By adopting these strategies, businesses can enhance their resilience and seize growth opportunities in an ever-evolving economic landscape. If you have any questions or wish to continue the conversation, please contact your dedicated Rehmann advisor. Visit our website at rehmann.com for more resources and insights, or call us at 866.799.9580. Our manufacturing specialists are here to support you and navigate these changes together.