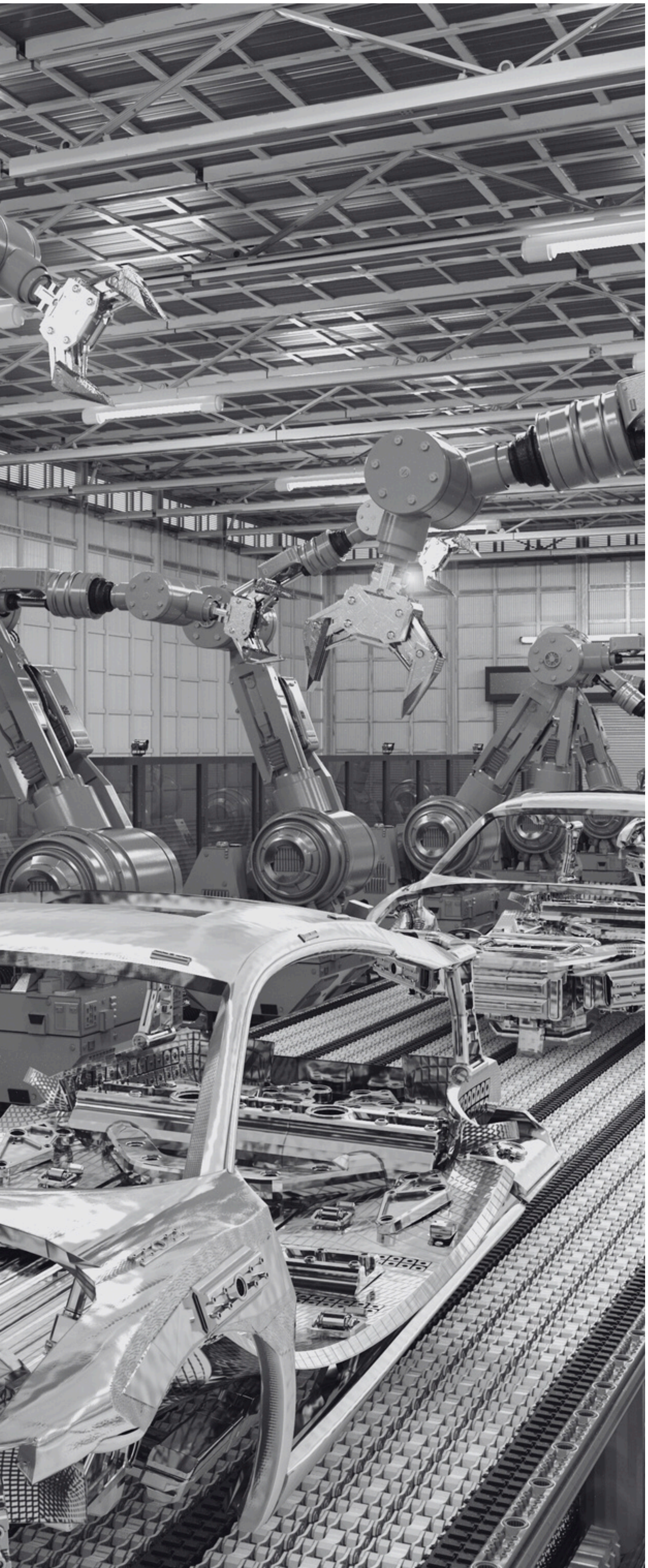
ECONOMIC INSIGHTS FOR MANUFACTURERS

Q3/Q4 2024



THE BIG PICTURE

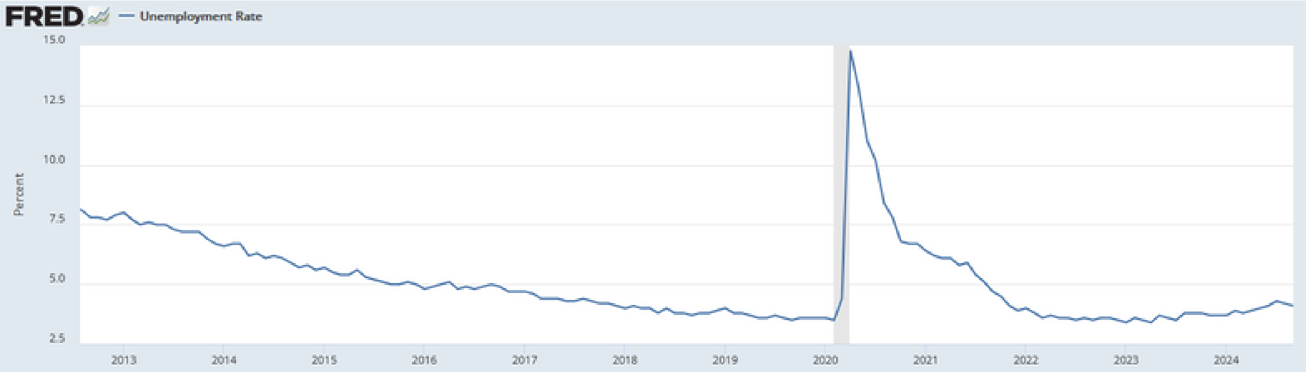
With most of the year behind us, it’s time to review the main factors that have impacted the manufacturing sector so far and what is on the horizon as we near 2025. After a Q3 in which the contrasts we anticipated in our previous edition of *Economic Insights for Manufacturers* became more pronounced, Q4 is poised to bring significant changes in monetary policy, energy costs, and trade policies.

During Q1 and Q2, we noted the growing contrast between the financial markets and the manufacturing sector. On one hand, financial markets are at all-time highs, while on the other, the manufacturing sector has experienced several consecutive contractions.

This phenomenon intensified even more during Q3, with the Institute for Supply Management's Manufacturing PMI indicating contractions in the manufacturing market for 21 of the last 22 months. This is particularly notable given the steady growth of the GDP. In other words, the manufacturing sector's share of the economy continues to decline. One reason for this reduction is the Federal Reserve's interest rate policy. High base rates, about 5.35% in 2024, have impacted the economy, especially manufacturing, which depends on credit for expansion.

The good news is that interest rate cuts have already begun. In September, the Federal Reserve lowered benchmark rates by 50 basis points. Now the question is how far — and how quickly — will they continue down this path. According to bond market data, interest rates are expected to be around 4.35% at the end of Q4.

Additionally, an interesting pivot by the Federal Reserve during Q3 was its increased focus on the labor market. The unemployment rate rose to 4.2%, up 0.4% from Q4 2023, sparking concerns about a potential recession and accelerating expectations for further rate cuts. However, there is little evidence supporting a recessionary scenario at this time.



U.S. unemployment rate. Source: BLS

In our last edition, we questioned how long inflation and stagnation in the manufacturing sector would last. By Q2, resolution seemed distant. Now, we can say the situation has improved, though not clearly or with prospects for sustainable growth. Leaders in the manufacturing sector should assume that conditions won't change significantly, at least until after the presidential elections.

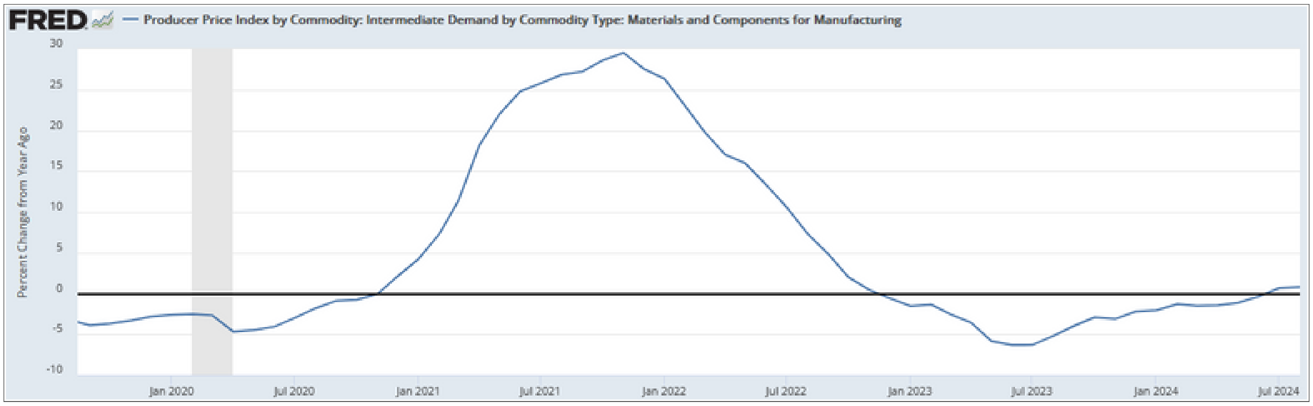
Finally, another relevant factor to consider is the completion of the price correction process between the input costs faced by manufacturers and the prices they charge customers. While input costs were falling through Q1 and Q2, they started rising again during Q3.

MARKET **FORCES**

During Q3, commodity markets showed an interesting ambivalence: on one hand, the input costs faced by manufacturers began to accelerate, while on the other, crude oil prices hit their lowest levels since 2021 and gasoline prices also dropped during Q3.

Simultaneously, the rise in domestic prices of manufactured goods, though at a slower rate than in previous months, continued to be higher than the rate of change in inputs. This indicates that despite the volume contraction in sales, there has been an improvement in the gross margins of the manufacturing sector.

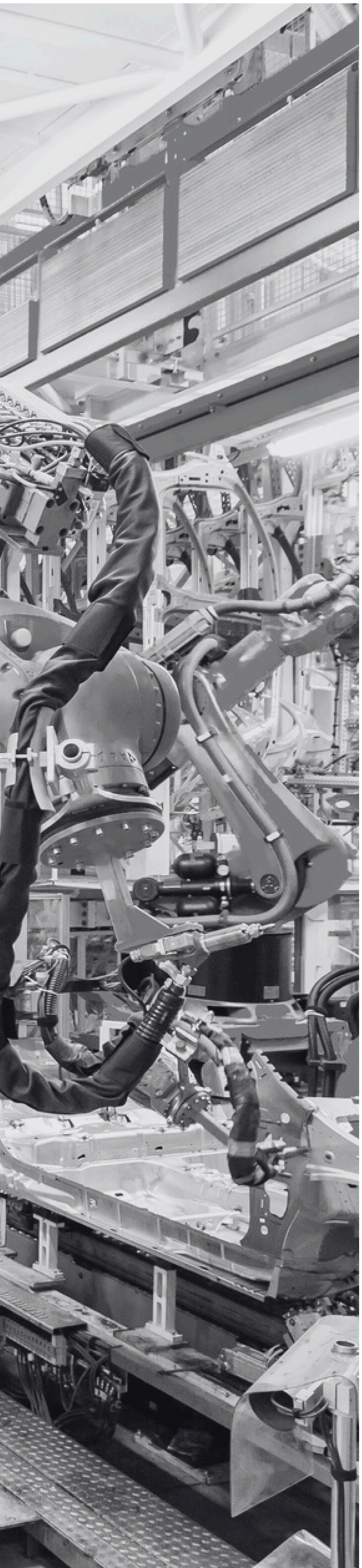
The Producer Price Index for materials and components used in manufacturing, which reflects the prices of inputs and commodities faced by sector companies, turned positive for the first time since 2022. While demand may remain constrained until Q1 2025, margins could continue to improve gradually, and by the end of the year, we might anticipate an uptick in sales volumes.



Producer Price Index YoY Change in Commodity Prices Components for Manufacturing. Source: BLS

Energy prices also showed mixed results during Q3, with electricity costs reaching new all-time highs, while gasoline dropped to a national average of $3.25 per gallon, the lowest price of the year. According to data from the Bureau of Labor Statistics, the cost of electricity has been rising above inflation. Therefore, careful management of indirect costs could still make a difference in Q4.

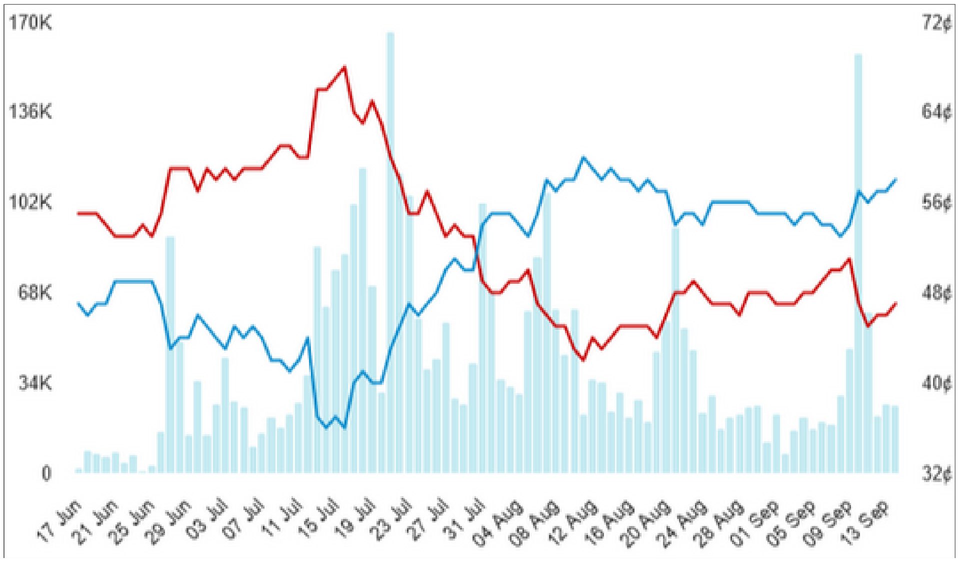
During 2023 and most of 2024, commodity prices showed moderation. However, this may soon change. Based on the Fed's actions and market trends, we can expect an "inflationary baseline" of around 2.5% annually for 2025. Leaders in the manufacturing sector should continue to anticipate rising costs throughout the supply chain, driven by the inertia of previous years.



CURRENT EVENTS **& OPINIONS**

In just a few weeks, the United States will elect its next president, potentially triggering changes in external regulations and trade policies. Ongoing issues such as the trade war with and "decoupling" from China, which began in 2017, could see further developments or intensifications regardless of the election outcome.

Our previous *Economic Insights for Manufacturers* highlighted that Donald Trump might have an edge over Kamala Harris, largely due to uncertainty within the Democratic Party regarding its leadership. Following the September debate between the two candidates, a growing sense of parity has emerged, making the presidential race a close contest once again.



PredictIt betting odds. Red line: Republican Party. Blue line: Democratic Party.

On trade, a Harris presidency would focus on modernizing trade agreements, with particular attention to updating the United States-Mexico-Canada Agreement (USMCA) to address emerging economic challenges. As a U.S. Senator, Harris was one of only 10 members to vote against the USMCA, citing concerns over insufficient environmental provisions and the lack of focus on climate change. If elected, she is expected to advocate for stronger environmental standards during the 2026 USMCA review and pursue new trade agreements that prioritize labor rights, environmental protection, and fair-trade practices.

A second Donald Trump presidency could bring more significant changes in international trade, with a particular focus on imports from China. In an interview with Time magazine in April, Donald Trump stated his intention to substantially increase import costs. He made it very clear that he would push for an additional tariff of over 10% on all imports, and possibly over 60% for imports from China.

Tariffs could have dual effects: On one hand, they might escalate input and output costs, while on the other hand, they could create opportunities if viable manufacturing substitutes emerge. In other words, leaders in the manufacturing sector might want to consider the possibility of replacing goods or services currently produced in China or Europe with domestic alternatives.

To wrap up, Q4 presents a complex landscape for the manufacturing sector, with decisions required on multiple fronts. Companies should prepare for potential shifts in international trade and environmental regulations, while also keeping a close eye on rising energy and input costs.

If you have any questions or would like to continue the conversation, please reach out to your dedicated Rehmann advisor. You can also visit our website at rehmann.com for additional resources and insights. Alternatively, feel free to give us a call at 866.799.9580. We're here to assist you!