ECONOMIC INSIGHTS
FOR MANUFACTURERS

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TRADE & **ENERGY**

With the first half of the year behind us and a potentially high-impact second half ahead, this is a good opportunity to take stock of recent developments and consider what may lie ahead. In our previous edition of *Economic Insights for Manufacturers*, we noted that the primary concerns for industry leaders during the second quarter were rising energy costs and trade disruptions caused by the United States-Iran conflict and resulting frequent closures in the Strait of Hormuz.

According to GasBuddy, a fuel-price tracking platform that aggregates real-time station-level price data, the average U.S. gasoline price fluctuated significantly throughout Q2, reaching a peak of $4.55 per gallon in May. However, following the U.S.-Iran ceasefire framework announced in mid-June, gasoline prices retreated and ended the quarter roughly 20 cents below their March 31 closing level.

Renewed U.S.–Iran tensions in July have made the outlook for oil prices less certain, even after gasoline prices retreated from their Q2 peak. Political incentives during the pre-election period may still favor keeping energy prices contained, but crude markets are likely to remain sensitive to regional security risks. At the same time, unresolved trade and tariff negotiations are adding another layer of uncertainty for manufacturers, making Q3 a period defined less by clear cost normalization than by continued volatility.

Foremost among these negotiations is the United States–Mexico–Canada Agreement (USMCA), which held its first mandatory joint review on July 1. The U.S. declined to confirm the 16-year extension, stating it would not renew the agreement "in its current form." That decision triggered the agreement's annual-review mechanism, under which the three countries must now review the pact every year until they agree on an extension, or the USMCA will expire in July 2036.

The agreement allows the parties to confirm a 16-year renewal at any time, which makes the annual reviews a rolling negotiation rather than a countdown. What was originally intended to be a routine check-in has evolved into a broad renegotiation process conducted largely through bilateral discussions rather than at a single trilateral negotiating table, and the U.S. administration has since signaled it may pursue separate 10-year deals with Mexico and Canada, a structure both partners have publicly rejected.

The current negotiating positions highlight how far apart the three countries remain, even as each seeks to shape the next phase of North American trade policy:

- **The U.S**. has kept tariffs as its main pressure tool, holding 50% Section 232 duties on steel, aluminum, and copper and 25% on non-USMCA autos while refusing to extend the deal without concessions. It has raised about 60 issues with Mexico (roughly double the number raised with Canada), centered on stricter rules of origin, higher regional content, and blocking Chinese goods routed through North America. From Canada, the U.S. wants broader rules of origin, dairy market access, and tighter limits on Chinese inputs. It has warned it might add border controls if Canada does not move on rules of origin. A third U.S.-Mexico round remains set for the week of July 20.

- **Mexico** is the most active negotiator, having completed a second bilateral round in mid-June and working through 52 U.S. demands. From the U.S., Mexico is pressing for relief from the Section 232 metal tariffs, which it calls unsustainable, and for predictable rules that protect its steel and auto output. From Canada, it wants closer trilateral coordination on supply chains and critical minerals. Mexico itself backs tighter rules of origin and higher regional content to cut dependence on suppliers outside the region, including duties of up to 50% on imports from non-FTA partners such as China.

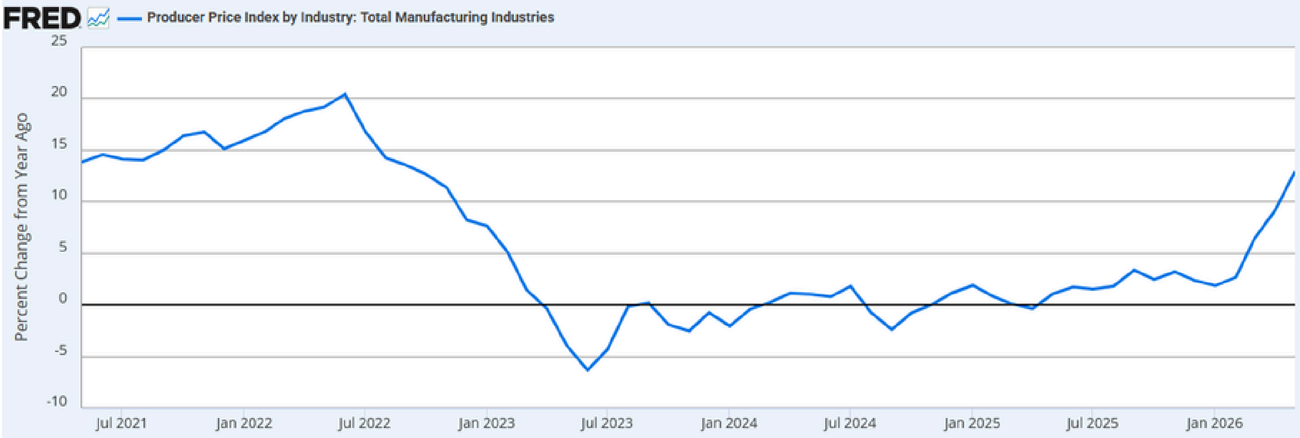
- **Canada** returned to the table after a freeze that began in October and now seeks a clean 16-year renewal rather than the 10-year annual-review track. Its central demand is the removal of the sectoral tariffs on steel, aluminum, autos, and lumber, which it has made essential to the talks. Beyond that it wants only targeted modernization that preserves the existing trilateral framework, not a broad renegotiation, and it is handling the sectoral tariffs on a parallel bilateral track.

As Q3 progresses, political and electoral dynamics will likely take center stage, especially with the midterm elections approaching. The current U.S. administration will likely seek to ensure that trade agreements can be presented as evidence of effective governance, alongside visible progress on national security.

MARKET **FORCES**

The manufacturing sector has turned a corner. After nearly three years of contraction, the ISM Manufacturing PMI reached 54.0 in May, its highest reading since 2022. It also held expansion territory in June at 53.3, marking a sixth consecutive month of growth, the longest streak since 2022. After the prolonged divergence between a growing broader economy and a shrinking industrial base, the data now point to a genuine recovery in demand. The binding challenge this year is prices.

Inflation has accelerated for three straight months and is now the defining macro force for the sector. Headline CPI reached 4.2% year over year in May, the fastest pace in three years, while core inflation rose to 2.9%. The gap between the two reflects the energy shock rather than a broad price spiral. The ISM prices index showed that 15 of 18 industries reported paying more for inputs, with most manufacturers citing pricing volatility as a planning problem.



Source: Federal Reserve Economic Data

Input costs, led by energy, freight, and petrochemical materials, have risen faster than the prices most producers can charge: the Producer Price Index for early-stage inputs climbed 12.3% over the year ended in May, nearly double the 6.5% increase in prices received for finished goods and services. The second half will test how much of that cost can be passed through to customers, a harder exercise in a demand environment that is recovering but not yet strong enough to tolerate aggressive repricing.

Manufacturers are not without options. Building inventory in the most exposed inputs, or signing fixed-price supply agreements where stockpiling is impractical, locks in current prices while demand is still firming. On the revenue side, contracts that adjust prices when input costs rise keep the increase off the producer's margin. The base case for Q3 and Q4 is a gradual descent of headline inflation as energy normalizes, but a slow one, with prices likely to remain above the Federal Reserve’s target through year-end.

Regarding interest rates, the Federal Reserve in June held its benchmark rate for the fourth consecutive meeting at 3.50%–3.75% and dropped its prior easing bias. Its projections now point to a year-end rate of 3.8%, implying the next move is more likely a hike than a cut.

Manufacturers that are carrying floating-rate debt or planning capital investment should budget for higher financing costs through 2026 rather than expect the relief that was projected at the start of the year. A year ago the question was when demand would return; now demand is back, and the question is what it costs to serve it. Margins will define performance in Q3 and Q4.

KEY TAKEAWAYS

In Q3, manufacturing leaders should keep a close eye on several developments that could shape the second half of the year.

- **USMCA:** The agreement has entered a new “steady” state — annual reviews are expected through 2036, with a 16-year extension available whenever the three countries agree. Rules of origin will be at the center of every round. Firms relying on duty-free treatment should verify qualification status now and map how much of their input base could be exposed.
  - **Your Move: Evaluate Audit Exposure.** Run a certification review of your top imported inputs by spend. Confirm each qualifies for duty-free treatment under current rules of origin and flag those that would fail if regional content thresholds rise.

- **Inflation:** The monthly CPI readings over the summer will indicate whether the energy-driven surge has peaked. The path depends heavily on oil markets. Renewed disruption in mid-July is likely to reverse the recent relief in input prices.
  - **Your Move: Insert Pricing Clause.** Break down cost increases from the first half of 2026 before passing them through. Energy-linked increases may not justify permanent repricing (although that remains to be seen, based upon U.S.-Iran relations in the coming months), while materials and labor likely will. For contracts renewing in the second half, add clauses that adjust prices when documented input costs cross an agreed threshold, rather than renegotiating case by case.

- **Interest Rates:** The environment has inverted from a year ago. With the Fed's easing bias gone and its projections pointing to a possible hike, companies facing refinancing needs should act on the assumption that today's rates are the floor, not the ceiling, for the remainder of 2026.
  - **Your Move: Plan for Financing & Liquidity Needs.** As interest-rate expectations shift higher, companies should evaluate upcoming refinancing needs and consider locking in financing where appropriate. Reviewing debt structures and prioritizing working capital efficiency can help reduce exposure to future borrowing cost increases.

While uncertainty remains across trade, inflation, and monetary policy, the common theme is the need for proactive planning. Organizations that stress-test supply chains, protect margins, and maintain financial flexibility will be better positioned in Q3 and Q4.

For questions or to continue the conversation, contact your Rehmann advisor, visit rehmann.com, or call 866.799.9580. Our manufacturing specialists are ready to help you navigate change and identify opportunities for long-term success.