



The 2025 Forecast

A STRONG ECONOMY MOVING TO UNCERTAINTY



**BALL STATE
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Miller College of Business
Center for Business and
Economic Research

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2025 – A Strong Economy Moving to Uncertainty

The United States is in the midst of an unusually robust expansion. Since the introduction of the COVID vaccines in First Quarter 2021, real GDP growth has averaged 3.16 percent, the strongest sustained period of growth since late 2006, and one of only three periods of equally strong growth in the past half century. This is remarkably robust given the recent decline in population growth which limits the two key growth inputs; labor and human capital.

Labor markets continue to perform at the strongest levels since the late 1960s, accompanied by sustained real wage growth, particularly among occupations that have traditionally been lower paid. This wage compression (*Figure 1*) is due to a combination of two forces. First, there was much higher competition for workers in

the wake of a high labor demand period (Autor, Dube and McGrew, 2023), which lessened employer market power. Second, there was a marked ‘compensating differential’ of remote work. With a much higher share of high-wage workers enjoying remote work opportunities, and a much higher share of lower-wage workers facing required ‘in-person work,’ there was natural compression of average wages across the two groups (Barrero, et. al, 2022).

It will take another business cycle before we can fully estimate the relative importance of remote work expansion versus tight labor markets. However, the presence of wage compression in industries that are primarily in person (e.g. health care) suggests that strong economic conditions are a major contributor. That does not rule out the amenity benefits of remote work on wages.

There is other good labor market news for Hoosiers. The long collapse in relative wages seems to have moderated in recent years, at least for the average worker. Manufacturing wages continue to decline relative to the nation (*Figure 2*). At the same time, wage volatility over the year seems to have moderated for the typical Hoosier worker. Taken together, these are signs of tighter labor markets. There is little to support an expectation that this wage gap will improve in the coming years.

The recent period of relatively high inflation continues stemming largely from the public policy response to the COVID pandemic. We examine the annual rates of change in prices and wages through mid-2024 (*Figure 3*). These are the median Consumer Price Index and the Q2 median wages.

Figure 1, College Wage Premium and Unemployment, USA (1998-2023)

Sources: Quarterly Workforce Indicators (BLS) and Current Population Survey (BLS)

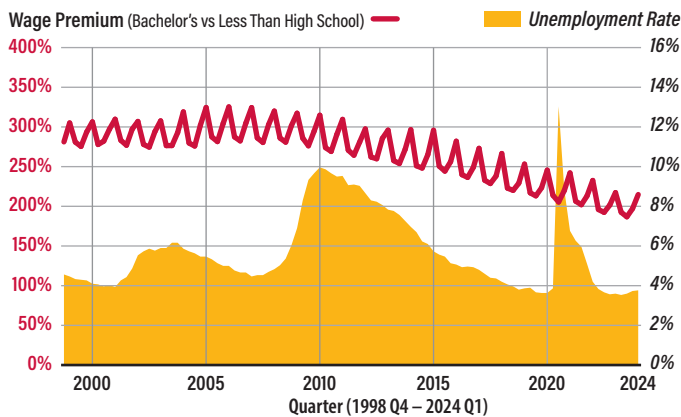


Figure 2, Indiana Average Monthly Wages, Relative to USA, for Manufacturing and All Industries (Quarterly, 1998-2023)

Source: Quarterly Workforce Indicators (BLS)

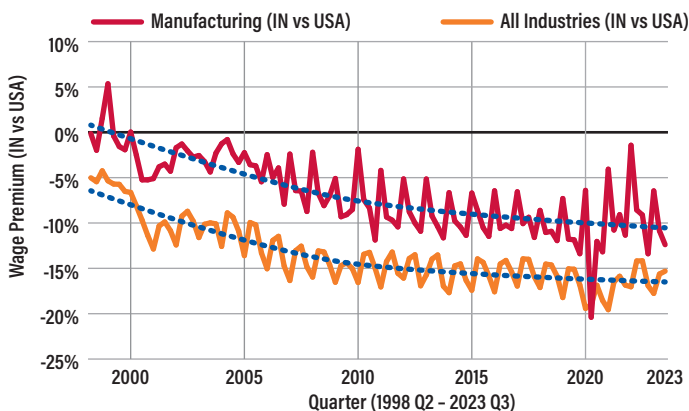
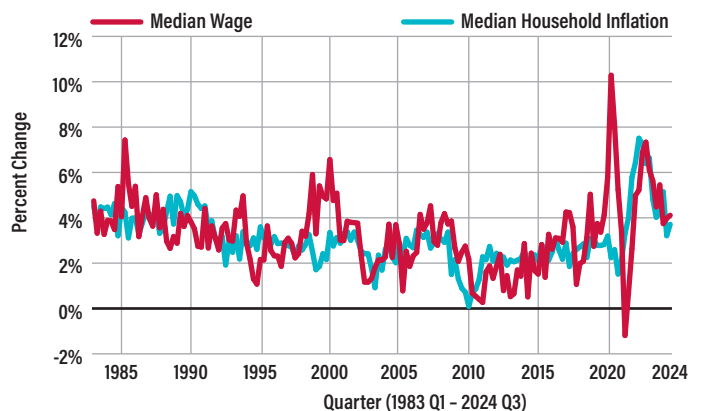


Figure 3, Year-Over-Year Change in Q2 Median Wages and Median CPI, USA (1983 Q2-2024 Q2)

Sources: Quarterly Workforce Indicators (BLS) and Consumer Price Index (BLS)



Wage changes are affected by inflation, just as prices for other goods and services are affected. However, price changes are not uniform, as this graphic depicts. Wages are also affected by the productivity of the labor force, when combined with physical capital (machinery and equipment). And, wages measured monthly are affected by cyclical variation in employment. During the pandemic for example, the spike in median wages was likely due to very rapid job losses in lower paid occupations. This caused the average wage

to rise artificially. Likewise, as employment recovered, the median wage declined.

The median CPI peaked in Second Quarter 2022, outpacing wage increases. Since 2022, median wage growth has outpaced inflation. Measures of inflation that focus on household consumption rather than a hypothetical basket of goods provide a somewhat more moderate rate of inflation.

This sets the stage for a discussion of our forecast.

The 2025 Forecast

Our 2024 forecast (delivered last January) was reasonably accurate. We projected continued monetary tightening through the summer, followed by modest easing. Our core state GDP forecast was somewhat optimistic, overestimating real growth by 0.18% in the most recent four quarters of state data (Figure 4).

The Indiana Econometric Model projects real GDP growth for the United States to range from 3.1% to 2.6% from Fourth Quarter 2024 through the end of 2025 (Figure 5). Indiana will do well, averaging

growth in Gross State Product between 2.2% and 2.5% for the same five quarters. (Note: This the strongest forecast I have provided since arriving at Ball State.)

Our model also predicts employment growth of roughly 37,000 new jobs over the coming year (Figure 6). This is a modest slowing from recent years, attributable to high rates of capital investment boosting automation, and tight labor markets.

Figure 4, Previous Forecast vs Actual Gross State Product for Indiana (2023 Q3-2024 Q2)

Sources: Indiana Econometric Model and Bureau of Labor Statistics

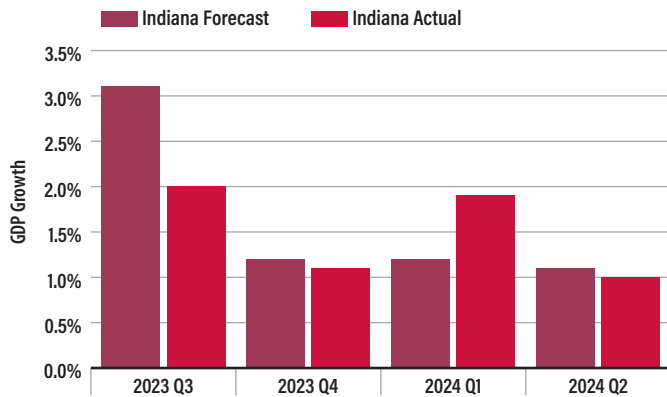


Figure 5, Projected GDP Growth Comparison for Indiana and USA (2024 Q4-2025 Q4)

Source: Indiana Econometric Model (Ball State CBER)

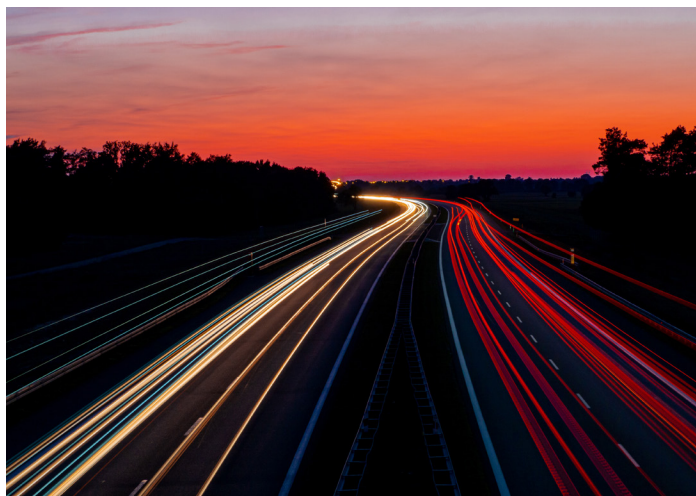
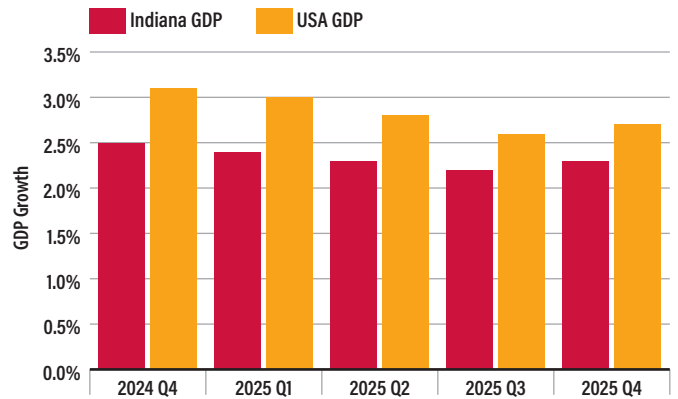
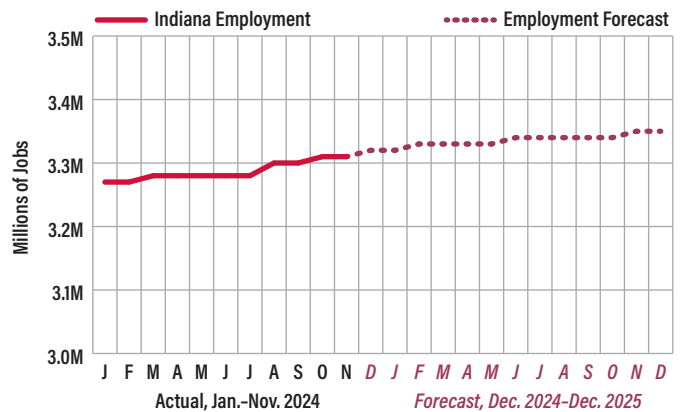
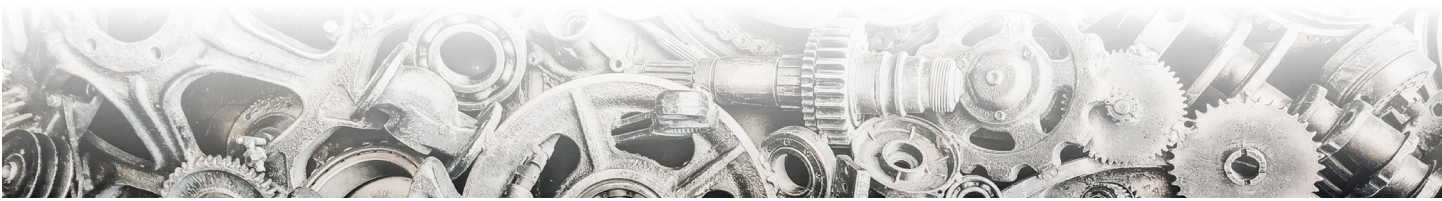


Figure 6, Indiana Employment History and Forecast (2024-2025)

Sources: Bureau of Labor Statistics and Indiana Econometric Model





Manufacturing Employment & Productivity

The post-pandemic period has seen substantial new manufacturing investment. Part of this is due to direct federal and state policies that subsidize several sectors, including electric vehicles, wind and solar power generating equipment and semiconductor plants. But, a portion of this is due to consumer demand, which shifted modestly from services to goods at the outset of the pandemic, and has remained high. However, a substantial reason for the increased investment is a likely higher rate of return on that investment through the realization of labor saving productivity increases (higher levels of output by the average manufacturing worker). That is visibly apparent in these data on the average product per worker (labor productivity) and manufacturing employment in Indiana (*Figure 7*).

Manufacturing production in Indiana hit a new record in Second Quarter 2024, the most recent period for which we had data. Manufacturing employment in Indiana peaked in 1973. Productivity gains lessened the demand for labor in manufacturing. During periods of slow productivity growth, such as the recovery from the Great Recession, the demand for workers rose.

Indiana manufacturing production and employment both contracted after Third Quarter 2018, as tariffs took an initial toll on consumer demand and production costs. And, the pandemic saw the deepest post-war recession, which also affected the production of goods.

The recovery saw factory employment return to 542,000 workers, near the 2018 peak. Despite heavy demand for goods since 2022, manufacturing employment has declined by 3.7 percent, as productivity rose by roughly 10 percent per worker.

Even with rising demand for Indiana produced goods, this level of worker productivity suggests reduced demand for manufacturing employment. And, in Indiana, the employment growth within manufacturing is highly polarized (*Figure 8*). The only net growth in this sector, in almost two decades, are for workers without a high school diploma, and those with a four-year college degree or higher.

This trend is even more pronounced since COVID (*Figure 9*). Total employment in manufacturing by college graduates has risen by 2,774 since the start of COVID, and those without a high school degree have risen by 2,179. Workers with some college has declined by 5,307 and those holding only a high school degree have declined by 13,756 (through Second Quarter 2024). This polarization of labor demand is not substantially different than the nation as a whole.

Figure 7, Indiana Manufacturing Employment and Labor Productivity (2005-2023)

Sources: Quarterly Workforce Indicators (BLS) and National Income Accounts (BEA)

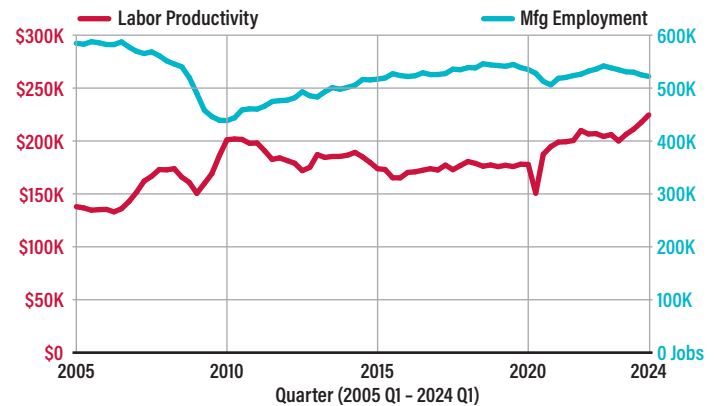


Figure 8, Cumulative Manufacturing Employment in Indiana (2005-2024)

Source: Quarterly Workforce Indicators (BLS)

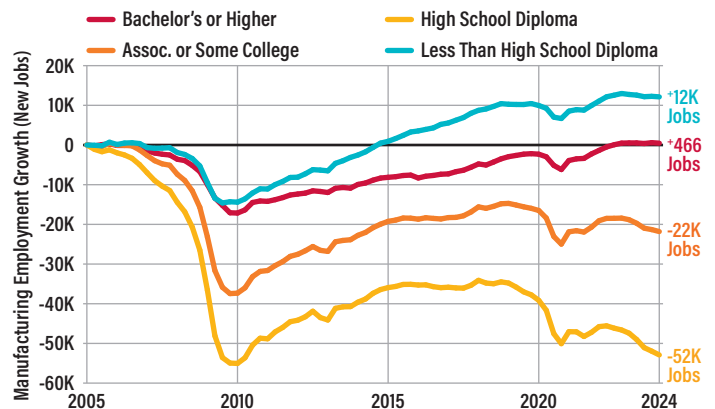
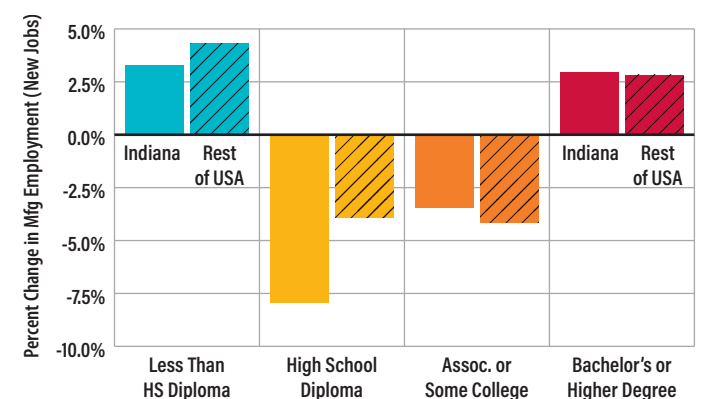


Figure 9, Change in Manufacturing Employment by Educational Attainment, Indiana and Rest of USA (2020 Q1-2024 Q2)

Source: Quarterly Workforce Indicators (BLS)



An Element of Uncertainty

All forecasts are wrong, but hopefully some are useful. This particular forecast reflects a policy-neutral environment by the federal and state government and a path of continued monetary easing by the Federal Reserve. Recent persistence of inflation, coupled with continuing strength in labor markets, suggests the Fed may slow its interest rate cuts. That would affect this forecast, but only slightly. Any period of interest rate adjustments is expected to change as new data becomes available. This one should be no different.

Mr. Trump's election promises included higher tariffs. The president is authorized by Congress to impose tariffs under Section 232 of the Trade Expansion Act. Because Mr. Trump does not need Congressional approval for tariffs, there is substantially more uncertainty surrounding them than other policies.

Mr. Trump and Mr. Vance have both suggested several different tariff regimes—10% or 20% on all imports, 25% on Mexico and Canada, and 60% on China.⁽¹⁾ These comments alone contribute to policy uncertainty that is wildly detrimental to U.S. manufacturing and logistics firms and consumers. Tariffs are taxes on imports, the incidence of which will fall primarily, but not exclusively, on domestic consumers (i.e., both businesses and households).

The Tax Foundation has estimated that the 2018 tariffs added just over \$300 per household in additional taxes last year (York, 2024). They estimate that a 20% tariff on all imports would increase that cost to over \$2,000 per household.⁽²⁾ That estimate does not include targeted retaliation, which would likely be focused on U.S. commodity exports, such as oil, coal, corn, soybeans and pork. The incidence of a commodity tax in one jurisdiction will fall almost exclusively on producers.

1. See <https://thehill.com/opinion/international/5037302-trump-tariffs-north-america-trade/> and <https://www.dw.com/en/trump-tariffs-mexico-and-canada-weigh-potential-fallout-of-new-threats/a-70972316> for examples.

2. See <https://taxfoundation.org/research/all/federal/tariffs/> for more information.

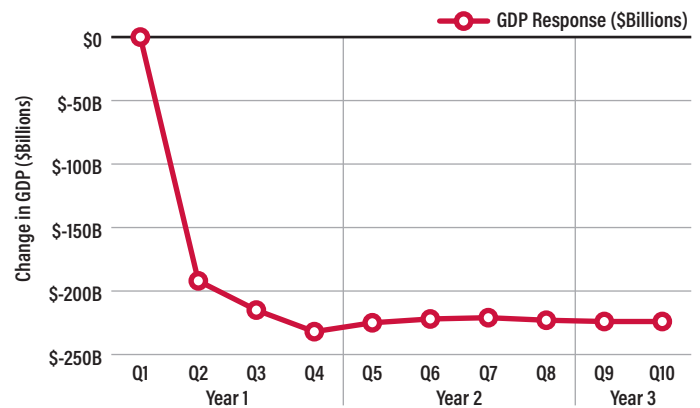
Summary

The U.S. economy enters 2025 in the midst of a robust recovery, marked by (1) the strongest labor markets in a half century, (2) sustained wage growth, (3) moderate and moderating inflation, and (4) an investment and productivity boon in domestic manufacturing. This has led to atypically robust GDP growth for three years.

Many of the nation's persistent economic challenges—particularly public debt—pose long-, not short-, run risks to the economy. Thus, 2025 should be expected to be a reasonably strong period of expansion. The direction of domestic fiscal policy, especially tariffs, adds an unusually high level of uncertainty to this forecast. Tariffs at the levels discussed during and after the presidential campaign are large enough to significantly slow GDP growth, and could cut growth by almost a third over the coming year nationwide.

Figure 10, Effect of a 20% Tariff on U.S. Gross Domestic Product

Source: The Tax Foundation and Ball State CBER



For our purposes, we estimate the effect of tariffs, using the Tax Foundation estimate of incidence. I construct a vector error correction model, with U.S. Personal Consumption Expenditures and Gross Domestic Product to produce an impulse response function of a tariff increase (Figure 10).

That model yields declines in GDP starting at \$192 billion in the first full quarter following introduction of the tariffs and increasing to a loss of \$232 billion by the fourth quarter. That would reduce growth of the U.S. economy in 2025 by a cumulative 0.74 percent from a baseline. The effect on Indiana would be range between 1.5 and 1.9 times worse (on growth), as Indiana is more reliant on the production and movement of goods. This estimate does not include retaliation effects, which will be concentrated on commodity exporters.

Indiana's economy exists within a national framework, and has benefitted from federal subsidies in several goods producing sectors. That benefit has led to record manufacturing GDP, and record labor productivity. Inevitably this reduces demand for labor. With productivity growth exceeding the growing demand for goods, we should anticipate further cuts to manufacturing employment in 2025, despite continued growth in Gross Domestic Product.

Indiana shares the healthy national labor market, but is far more sensitive to tariff risk, both from U.S. tariffs and more especially from retaliatory tariffs, which will substantially damage our export markets, particularly the three commodities that Hoosier farmers export—corn, soybeans and pork.



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