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Purchasing Manager's Dilemma

How Inventories Could Swing GDP in 2025

Economist(s)

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Summary

Inventory management is a trying job at the best of times, but rising tariffs make it even harder. Stocking up on whatever you need sounds easy, but at a time when inventory financing remains dear, that's an expensive fix. The choice of the purchasing manager has big implications for GDP.

Pity the Purchasing Manager

Across a diverse mix of businesses from retailers to manufacturers and even many parts of the service sector, someone is stuck with the job of figuring out what goods, raw materials or supplies will be needed in the short-, medium- and long-term. That is tricky work at the best of times, but in the past decade it has been made even more difficult by a trend move away from globalization, a pandemic that snarled global supply chains and a rate environment that has made inventory financing a consequential line item for corporate profits.

The outcome of the 2024 U.S. elections adds another consideration to that list: Will Trump really put in place 60% tariffs on goods coming in from China and 10% across-the-board tariffs on other trading partners? Or will a watered-down version be the more likely outcome?

Even in the case of milder tariffs, history teaches us to expect immediate, tit-for-tat retaliatory tariffs. On that basis, the sooner a business can procure the needed inputs the less costly they will be, at least on a very basic level. But commodity prices and currency valuations could both move against you, so the longer you hold inventory, the greater the risk these unpredictable factors could nullify the savings or worse, end up costing you *more*. Also, win or lose in the commodity and FX markets, inventory financing still costs more that it did a few years ago, even after accounting for recent rate cuts.

Procurement is not unlike being a placekicker in the NFL: doing your job well is essentially the baseline expectation, while any sort of miss is often met with exasperation. Considering that in the context of all the variable costs that come with carrying inventory, there is not much incentive to make a major move to take on new inventory until there is greater distinction between campaign talk and actual policy. We have also identified how there are fairly-substantial lags associated with the implementation of tariffs. At the same time, it would be difficult to explain why you did not take measures to stock up on needed inputs amid oft-repeated tariff threats. The incoming administration is also making personnel announcements that include known protectionists who would be placed in positions to make tariff threats a reality.

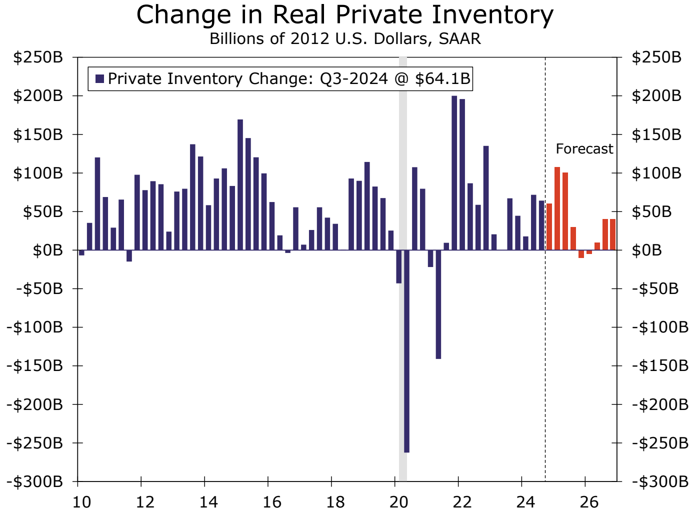
Just Wake Me Up When It's Over

It is appropriate to pay attention to tariffs, but it is not as though recent years have been without trade drama. While the Biden administration has been less vocal, most of the protectionist policies directed against China have remained intact. There was also a lot of hand-wringing over the potential of an East Coast port shutdown to disrupt trade and by extension the scope for firms to source inventory. Our baseline expectation therefore looks for a substantial but measured inventory build in the first half of next year as firms seek to stock up in anticipation of expanded trade tariffs. By the end of Trump's first year back in office, some of those tariffs could already be in effect. That is what is behind the drawdown in inventories that we have penciled in to occur in the fourth quarter of 2025 and into Q1-2026. We see a more gradual pace of inventory accumulation taking hold in the out-quarters of 2026.

You are unlikely to find a standard operating procedure or basic econometric model for forecasting the impact of tariff policy on inventories in an economic textbook. We would be the first to say that this timetable will have a lot to do with political lags and implementation lags. We will readjust our expectations as the actual policy framework comes into focus.

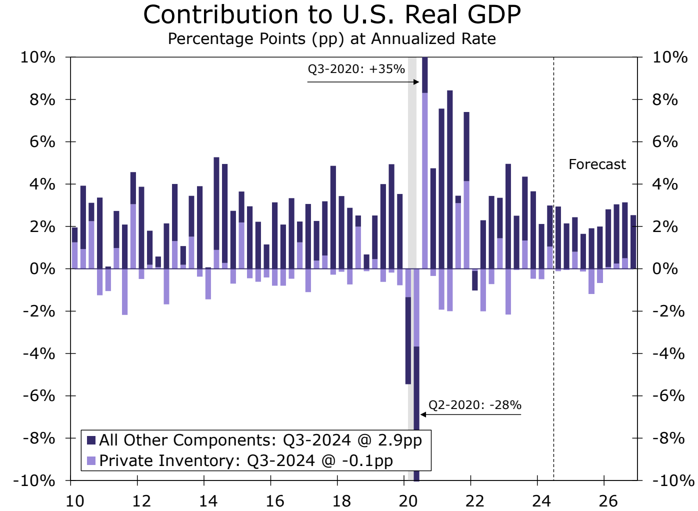
Rather than getting too wrapped around the axle on the question of the precise timing of inventory investment, it is more useful to look at the impact of how our baseline expectations about inventories impact topline growth. As seen in the charts below, we have inventory builds of more than $100 billion in each of the first two quarters of 2025, and while the boost from inventories in the first quarter is almost a full percentage point, the second quarter's build is no boost at all. In fact, by virtue of a slightly *slower* pace of inventory accumulation ($100 billion in Q2 versus $108 billion in Q1) inventories are actually a slight *drag* on GDP in Q2. The third quarter shows yet another gain in inventories, but the comparatively modest build of $30 billion exerts a substantial 1.2 percentage point drag on the headline growth rate for the quarter.

Change in Real Private Inventory



Source: U.S. Department of Commerce and Wells Fargo Economics

Contribution to U.S. Real GDP



Source: U.S. Department of Commerce and Wells Fargo Economics

In ordinary times, the tally of inventories in the GDP accounting tends to serve as a built-in counterweight. A strong quarter for spending by consumer and businesses would come with a drawdown in inventories which drags on headline growth. Conversely, a weak quarter for spending or an outright decline in it is apt to come with some inventory accumulation and therefore a boost to growth. In a world where supply chain disruptions have become the norm and in which trade wars loom on the horizon, there is scope for even more disruption than usual from inventories.

In our routine indicator coverage this next year, we will make a point to identify the clues as they appear in order to get a better sense of the precise timing of the expected inventory swings. We will place greater emphasis than usual on measures such as inventory sentiment, supplier deliveries and new orders to better frame that thinking. In the meantime, thank the person in charge of purchasing at your business and at your client's. They have gone from just-in-time, to just-in-case to just-wake-me-up when it's over.

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