# Being 'Vigilant to the Risks Ahead'

— By Sue Doerfler —

Supply management organizations can expect higher economic growth in 2026, but myriad dynamics — including manufacturing sluggishness, tariffs, geopolitics and AI uncertainty — are longer-term X-factors.

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During an Institute for Supply Management® (ISM®) LinkedIn Live broadcast in January, Steve Miller, CPSM, CSCP, Chair of the ISM Services Business Survey Committee, discussed how the December Services PMI® of 54.4 percent not only exceeded expectations, but also was the highest reading of 2025.

On average, however, the Services PMI® registered 51.7 percent in 2025, the third lowest for a calendar year since the index debuted in 2008. Still, in December, all four key subindexes — Business Activity, New Orders, Employment and Supplier Deliveries — were in expansion for the first time in 10 months.

"The New Orders Index number (57.9 percent, up 5 percentage points compared to November's reading and the highest December reading in four years) was quite a boost," Miller said on LinkedIn, adding that near-term trends are "very positive." He added, "I don't want to minimize the possibility … but a broader geopolitical event that could create a significant disruption seems unlikely. I'm confident we're on a positive path for the summertime and the next few months."

The Services PMI® reading joined other positives like favorable holiday retail spending as economic indicators that rang in the new year on a high note.

But underlying this optimism are factors that aren't so positive — the shifting tariffs landscape, continuing uncertainty, growing geopolitical disruption and less-than-ideal manufacturing sector performance.

## The Forecast

The Economic Outlook Group forecasts a better 2026, with 2.4 percent growth in U.S. gross domestic product (GDP), compared to the 2 percent anticipated last year. However, the economy will slow down in 2027 and '28, says Bernard Baumohl, chief global economist at Princeton, New Jersey-based The Economic Outlook Group.

"Because the economy is going to grow next year, we're expecting hiring to pick up. Therefore, the unemployment rate, which has been rising a little bit, will stabilize and start to come down," he says. "The big question that could affect the U.S. economy, and it is really serious, is not what short-term rates are going to do, but what longer-term rates — the 10-year Treasury rates — will do because that's an important benchmark to the cost of capital."

If inflation pressures continue to rise this year and there's still a lot of liquidity coming into the economy through tax cuts and stimulus checks, Baumohl says, inflation pressures could pick up even more. If U.S. bond investors then decide they no longer want to hold bonds at current yields — of if foreign investors and central banks choose to scale back future purchases of U.S. government Treasurys — then, he says, "all of a sudden we'd see a spike in those longer-term 10-year Treasurys to about 5 percent or higher. And that would trigger a recession.

A recession?

"It isn't going to be possible for the U.S. to continue to borrow and fund its massive fiscal deficit and overall national debt at low interest rates at a time when inflation is rising and Fed independence is under attack," Baumohl says. "So that's a looming threat for the economy."

Recessions occur when there is a widespread collapse in confidence in the ability of the U.S. economy to move forward and be productive," Baumohl says. "That's not what's happened right now. But people are becoming more disoriented and confused. It's hard to catch up with the dizzying pace of domestic and foreign policies changes coming from the White House."

He continues: "2026 started off with a geopolitical bang, followed by the White House seeking to cap bank credit card interest rates at 10 percent, prohibiting large financial firms from buying single-family homes, and the U.S. Justice Department launching a criminal investigation against Fed chair Jerome Powell. (That's) not to mention what's happened in Venezuela, along with U.S. threats against Greenland and Iran."

## The Supply Chain

The ISM® *Supply Chain Planning Forecast*, formerly the *Semiannual Economic Forecast*, reflected business optimism for 2026. In both manufacturing and services, survey respondents — ISM Manufacturing and Services Business Survey panelists who help compile the monthly ISM® PMI® Reports — anticipate increases in revenue and growth in capital expenditures, although at a slower pace than in 2025.

They expect price increases to be less than previously thought, and employment growth is projected to be modest in services while flat in manufacturing.

"(T)he level of optimism, albeit extremely cautious, was somewhat surprising," stated an *Inside Supply Management*® Weekly e-newsletter report on the *Forecast*. "Survey respondents in both sectors expect revenue increases next year, and capital expenditures are projected to grow, although at slower rates than in 2025. Employment gains are expected to be flat in manufacturing and modest in services, and projected price increases could be less than feared."

Miller notes that expected 2025 revenue growth — 4.2 percent for the services sector — "is a complete change from what we were thinking back in May," when the spring Forecast was released. "The full year's performance wasn't bad for 2025: Growth wasn't as fast as we'd like, but it was growth." Services respondents project a 4.6-percent increase in revenue this year.

Manufacturing sector panelists reported a 2.5-percent increase in overall revenues in 2025, with a projected increase to 4.4 percent this year.

Given that manufacturing economic activity contracted in December for the 10th consecutive month, the optimism for 2026 seems a bit implausible, said Susan Spence, MBA, Chair of the Institute for Supply Management® Manufacturing Business Survey Committee. "Maybe people have gotten used to the chaos," she says. "But if they have, then you'd see new orders coming and backlog and production increasing. But we're not."

This year, manufacturing panelists expect overall prices to rise by 4.4 percent and capital expenditures to increase by 3 percent. They report that their companies are operating at 82.4 percent capacity.

In the services sector, capacity could become an issue. "What could be a future challenge in the services sector is that we're expecting over 90 percent capacity utilization," Miller says. "When you're above 90 percent, you don't have a lot of flex if additional demand comes in."

Services employment for the last six months has generally been in contraction, with Business Survey panelists citing that their companies have hiring freezes and aren't backfilling for workers who retire or are leaving. But job cuts haven't been prevalent, Miller says.

Other projections for the services sector:

- Prices for materials are expected to increase by 4.2 percent
- Overall labor and benefits costs to go up by 3.2 percent
- Increased profit margins.

"So, it seems like they're learning how to better manage in the new world," Miller says.

## Key Factors

That new world is made up of dynamics that push and pull on the economy and supply chains.

In assessing the direction of the economy in 2026, Baumohl says, several key issues stand out, including:

- **Disruption.** Will there be disruption or cracks in business and consumer spending?
- **Tariffs.** Will there be additional disruptive levies, and how will they impact supply chains?
- **Interest rates.** Will the U.S. Federal Reserve (Fed) bow to White House pressures or will make interest-rate decisions based on economic fundamentals?
- **AI.** Many companies have jumped on the bandwagon in investing in this technology.

The trajectory for this year differs from that of 2025. "By and large, 2025 was a bizarre year for the economy," Baumohl says. "That's because over the past 12 months, we have swerved so far away from the norm of economics and politics that it became very difficult to predetermine the path of the economy.

"Occasionally, clients would ask what our crystal ball says about the year, and I told them, 'It's just very cloudy. We don't even bother with the crystal ball this year. We use a Magic 8 Ball, the one that you shake and look at what it says. It was just as effective.'"

## The 'New Reality' of Tariffs

Tariffs have been enacted in a rapid-fire manner, which doesn't align with supply chain timing, says Willy Shih, Ph.D., the Robert and Jane Cizik Baker Foundation professor of management practice in business administration at Harvard Business School. "The timing fails to recognize that supply chains take weeks, months or years to respond" to changes in sourcing, supply and production, he says.

Still, organizations anticipated the tariffs, knowing that they were coming with a second Trump administration. "This resulted in large amount of front-running of materials and goods,"

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— **BERNARD BAUMOHL**
The Economic Outlook Group

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he says. "For example, look at the import statistics for March 2025, in which there were record imports from Germany, Mexico and so many countries, as well as Ireland with pharmaceuticals," he says.

"There was an enormous inventory buildup, and then you saw the trade lanes more or less fall off a cliff after Liberation Day," when reciprocal tariffs were announced in April by the Trump administration.

But after several months during which people tried to circumvent them, people gave up, he says: "The tone shifted to tariffs being here to stay, so let's just deal with it."

Organizations understand that tariffs push prices higher and that they need to find a way to pass the costs through, Shih says. They won't stand for their profits taking a hit over the long term — and neither will Wall Street.

As a result, companies need new sourcing strategies to mitigate tariff impact. "I think there's an acceptance of this new reality," Shih says.

Miller notes that tariffs weren't as prominent in panelist responses in the December *Supply Chain Planning Forecast* as they were in May. They are still a factor, he says, but based on the commentary, organizations seem to be prepared.

"They know the levers they can and can't pull because they are not rushing to reshore," he says. "They're not saying that they're going to change partners mid-year. So, that says to me they've got what they need, that they feel confident in what they'll do going forward, unless something dramatic occurs."

## Interest Rates and Consumer Spending

During the last four months of 2025, the Fed approved three quarter-point interest rate cuts, bringing the central bank's key interest rate to 3.5 percent to 3.75 percent.

Baumohl expects more cuts. "I expect short-term rates to come down later this year because the White House is putting enormous pressure on the Federal Reserve to lower rates," he says.

Plus, Powell's term expires in May, opening the position to a successor who likely will favor easing monetary policy, Baumohl says. The challenge facing the Fed this year, however, is that its key mandates — price stability and low unemployment — are going in opposite directions, he says.

Fed governor Stephen Miran, whose term expires at the end of January, said last week that he would like to see rate cuts 150 basis points (or 1.5 percent) this year to boost the labor market and curb inflation.

Treasury secretary Scott Bessent in early January also called for cuts. CNBC reported that during a speech at the Economic Club of Minnesota, he said, "It is the only ingredient missing for even stronger economic growth, which is why the Fed should not delay."

Lowering interest rates typically leads to an increase in consumer spending. The administration has an eye on the November midterm elections — which will determine whether the Republicans hold or lose control of either or both houses of Congress — also will likely spark an emphasis on pleasing consumers, he says.

The Economic Outlook Group sees no major cracks in consumer or business spending in 2026. "We expect them both to contribute significantly to the economy this year," Baumohl says. "Consumers are resilient. The enormous amount of capital spending still taking place in AI and building out data centers is helping the economy."

He noted that it's important to keep in mind that consumers are not one monolithic group: "Much of the spending has occurred in the top 20 percent to 30 percent of the income spectrum, while the lower 70 percent tends to be a bit more cautious more conservative in their spending," Baumohl says. "But the backdrop is positive, and that's in part because we still have a fairly low unemployment rate."

Unemployment above 6 percent would be considered historically high. "We're still in the mid 4-percent range, and I don't see it really creeping up very much beyond that," he says.

## And What About AI?

Last year could be called the year of investment in AI. Baumohl refers to it as the "AI tsunami," given what he calls a "tidal wave" on spending on it. This year may be different.

A September J.P. Morgan Asset Management article states: "Today, evidence suggests a new bellwether may be emerging: artificial intelligence. In the first half of 2025, AI-related capital expenditures contributed 1.1 percent to GDP growth, outpacing the U.S. consumer as an engine of expansion."

A World Economic Forum article mentions fears of an AI bubble — like the dot.com bubble of the late 1990s — due to all the money and investment on making AI viable. Is AI inflating the value of stocks?

An October Goldman Sachs article discussed the topic, stating, "AI bubble concerns are back amid a rise in AI-exposed companies' valuations, ongoing massive AI spend and the increasing circularity of the AI ecosystem. So, are bubble concerns warranted or overblown?" The conclusion: There are opportunities, but diversification is a solid strategy.

How valuable has AI been for supply management organizations? In response to a question about whether their organizations have experienced work quality changes by using AI, nearly three in four (73 percent) of *Supply Chain Planning Forecast* panelists selected there had been no change or it had gotten worse. Only 27 percent said work quality had improved.

More than half reported that their companies either have or will be investing in AI-specific related roles. Doing so will enable organizations to foster new capabilities among existing talent, Miller says: "You can't just say, 'You should speak German.' You need to have training to do so."

"With AI, there is a lot of interest and piloting going on, but not anything conclusive," he adds. The *Forecast* found that a quarter of respondents aren't using AI applications and about 50 percent are running pilot programs.

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> Harvard Business School

Organizations still need to determine the benefits of AI investment, Miller says. This year, he adds, they may be spending more time figuring out AI's capabilities and company impacts rather than spending more money on it. If such spending pauses, Miller says, that could lead to ramifications to the economy.

## Being Prepared

To grow in 2026, experts say, supply management organizations should determine whether they have:

- The ability to ramp up if demand increases
- Relationships with contract staffing organizations and/or the capacity to add part-time workers
- Close relationships with key suppliers
- Equipment to support higher growth
- The right talent
- Effective strategies to mitigate tariff risk, including new sourcing and production locations
- Tools to manage unexpected disruption and uncertainty.

AI investment, consumer spending, interest rates, tariffs, politics and employment aren't the only factors that will impact the economy — and supply chains — this year.

Geopolitics (including regime change in Venezuela and the Ukraine-Russia war), shipping challenges, supply versus demand, capital expenditures, the real estate market and inventory issues will be top of mind. Among other concerns: inflation, market competitiveness (especially concerning China), and whether to reshore, nearshore or stay put.

Compared to 2025 with all its uncertainty and policy changes, Baumohl says, "we're more optimistic for 2026 in terms of employment and economic growth. We think consumers and businesses will continue to spend. It's the upcoming years that we see that we're more concerned about. But we also need to be vigilant to the risks ahead. Given the incredibly rapid pace of economic, political and geopolitical surprises these days, the need to be agile and adaptive is absolutely crucial." **ISM**

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