CHEMICAL INDUSTRIES ASSOCIATION

Economic Report

June 2026

Executive summary

Steve Elliott, Chief Executive, Chemical Industries Association

I am pleased to present our latest economic report, written by Léa Charbonnier, Economist at the Chemical Industries Association (CIA). Our economic report has two sections. The first part is a CIA analysis of official statistics; this section assesses the UK chemical industry's performance against that of the wider economy. The second section presents the results of our quarterly industry survey. Our Q1 2026 Business Survey took place between 23 March to 2 April 2026, and we received entries from 40 chemical companies.

Economic Overview

As the economy approached mid-2026, official data for Q1 2026 showed GDP growth of 0.6%, following growth of 0.2% in Q4 2025. Production output increased by 0.2% after expanding by 1.3% in the previous quarter, while manufacturing maintained relatively stronger growth at 0.8%. Within manufacturing, the chemical industry recorded marginal growth of 0.1%, while pharmaceutical output increased by 0.3%.

The sectoral data highlighted an increasingly uneven performance across UK manufacturing industries between 2024 and early 2026. More defensive and high value-added sectors such as Food, Drink and Tobacco, pharmaceuticals, and aerospace remained relatively resilient, supported by stable demand, strong export performance, and rising defence and life sciences investment. By contrast, chemicals and automotive experienced greater difficulties linked to high energy costs, geopolitical uncertainty, trade disruptions, and weaker industrial demand.

Inflationary pressures re-emerged as a major challenge for the UK economy in 2025 and early 2026. After easing to 2.5% in 2024, headline inflation (CPI) accelerated again to an average of 3.4% in 2025, remaining above both the Bank of England's 2% target and inflation levels observed across most major advanced economies. Inflation declined temporarily to 3.0% in January 2026 and remained unchanged in February before rising again to 3.3% in March, highlighting the persistence of underlying price pressures.

Labour market activity has slowed, with the number of payrolled employees in the UK falling by 0.3% between March 2025 and March 2026. Although the unemployment rate declined compared with the previous quarter, it still reached 5.0% in January to March 2026, representing a decrease of 0.2 percentage points on the latest quarter but an increase of 0.5 percentage points compared with a year earlier.

Wage growth for the UK average stood at 3.4% in March 2026, matching the CPIH inflation rate for the same period, while manufacturing wage growth reached 3.2%, reflecting the challenges faced at the end of the first quarter. In contrast, wage growth in the chemical sector remained above CPIH inflation. However, this partly reflects the sector's higher concentration of skilled roles and premium pay arrangements, which can influence official average earnings data.

Insights from our industry

The Q1 2026 survey suggests that conditions across the chemical sector improved modestly compared with the weakness recorded throughout much of 2025, but the environment remains challenging. New orders returned to expansionary territory, with 31% of respondents reporting higher orders, while EU exports, production levels and capacity utilisation also improved compared with Q4 2025. However, the recovery remained uneven, with 33% of firms continuing to report lower total sales and 48% reporting decreasing profit margins. At the same time, cost pressures intensified sharply across the sector. Around 88% of respondents experienced higher raw material prices, 85% reported increased import costs and 80% faced higher export costs, highlighting the continued pressure of rising operating and input costs despite the modest improvement in activity.

Expectations for Q2 2026 suggest that firms anticipate further improvement in activity over the near term. Around 35% of respondents expect stronger new orders during the quarter, while 30% anticipate higher total sales and around one-quarter foresee improvements in exports and EU exports. However, firms remain cautious regarding longer-term expansion. Employment expectations remain contractionary, with only 3% of respondents expecting staffing levels to increase, while investment intentions also remain subdued. Cost pressures are also expected to remain exceptionally elevated, with 78% of firms anticipating higher raw material and import costs and 81% expecting further increases in energy costs during Q2.

The 12-month outlook remains moderately positive overall, particularly for sales, exports and production-related indicators. Around 38% of respondents expect higher sales and exports over the coming year, while 35% foresee stronger new orders. Nevertheless, hiring and investment intentions remain weak, suggesting that firms remain cautious regarding longer-term expansion. Cost pressures are also expected to persist, with more than 80% of respondents anticipating further increases in raw material, import and energy costs and 70% expecting higher finished goods prices over the next 12 months.

The survey also highlights an important shift in the nature of the challenges facing the sector. Energy costs remained the most significant concern during Q1 2026, with 48% of respondents identifying them as their primary challenge. Raw material costs also increased sharply in prominence, while weakening demand became relatively less dominant compared with Q4 2025. Expectations over challenges suggest that firms expect cost pressures to deteriorate further over the coming months, particularly in relation to raw material, energy and freight costs.

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This first part of the economic report focuses on official releases from the Office of National Statistics (ONS), the Bank of England (BoE), and Oxford Economics.

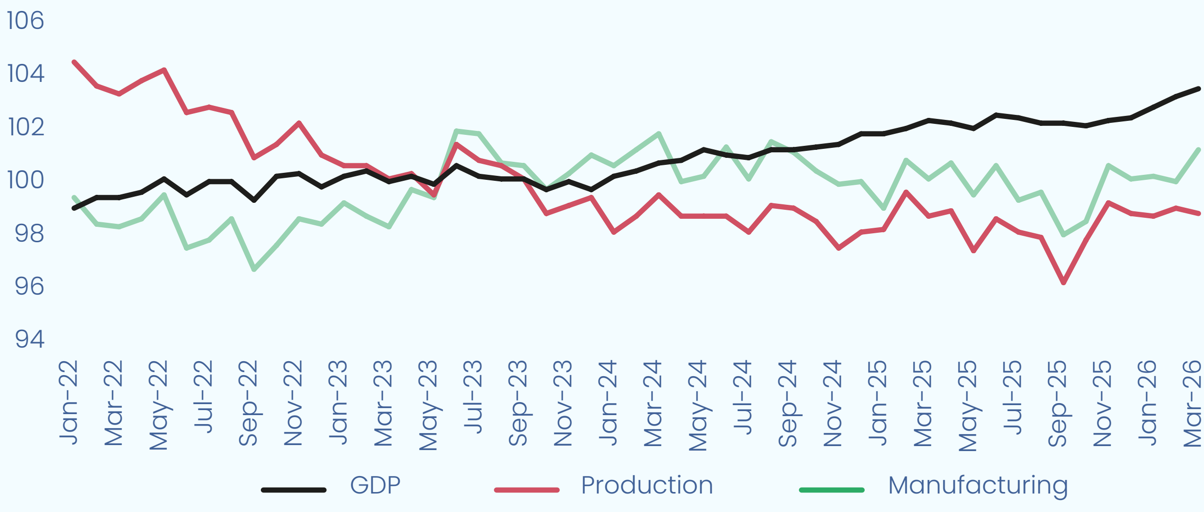
GDP and chemical production

After growth of 1.1% in 2024 and 1.3% in 2025, GDP growth reached 0.6% in Q1 2026, compared with 0.2% in Q4 2025, 0.1% in Q3 2025, and 0.3% in Q2 2025. Following zero growth in January, GDP increased by 0.4% in February and 0.3% in March.

The Monetary Policy Committee (MPC) expects headline GDP growth in Q2 2026 to slow to 0.1%, lower than the 0.3% projected in its previous report, reflecting increased uncertainty.

The MPC outlined three economic scenarios. In Scenario A, GDP growth slows to 0.5% in Q1 2027 before recovering to 1.8%, while the output gap widens to -1.6% by end-2026. In Scenario B, GDP growth falls to 0.6% in Q1 2027 before a moderate recovery, with the output gap reaching -1.5% and ending at -0.8%. In Scenario C, high energy and export prices, stronger second-round effects, and a higher yield curve cause a sharper slowdown. GDP growth falls to 0.3% in Q1 2027, while the output gap widens to -1.7% and remains significantly negative.

Graph 1: Index of GDP, Production and Manufacturing output from January 2022 to December 2025 (2023=100)



Source: CIA analysis of ONS data

Looking at the **above graph**, all three indicators experience monthly volatility; however, GDP follows a relatively stable upward trend, while production and manufacturing output remain weaker and more unstable. Production output declines overall across the period, whereas manufacturing output fluctuates sharply without establishing a sustained recovery trend.

The stronger performance of GDP largely reflects the service-oriented structure of the UK economy.

Services account for most UK economic activity and remained relatively resilient, allowing GDP to continue growing despite weaker industrial performance.

Production output is broader than manufacturing, as it also includes mining and quarrying, electricity and gas supply, and water and waste management. It therefore captures a wider range of industrial pressures, particularly those linked to energy prices and external demand. Recent geopolitical tensions in the Middle East have also contributed to higher energy prices, increasing costs for energy-intensive industries and placing additional pressure on industrial output.

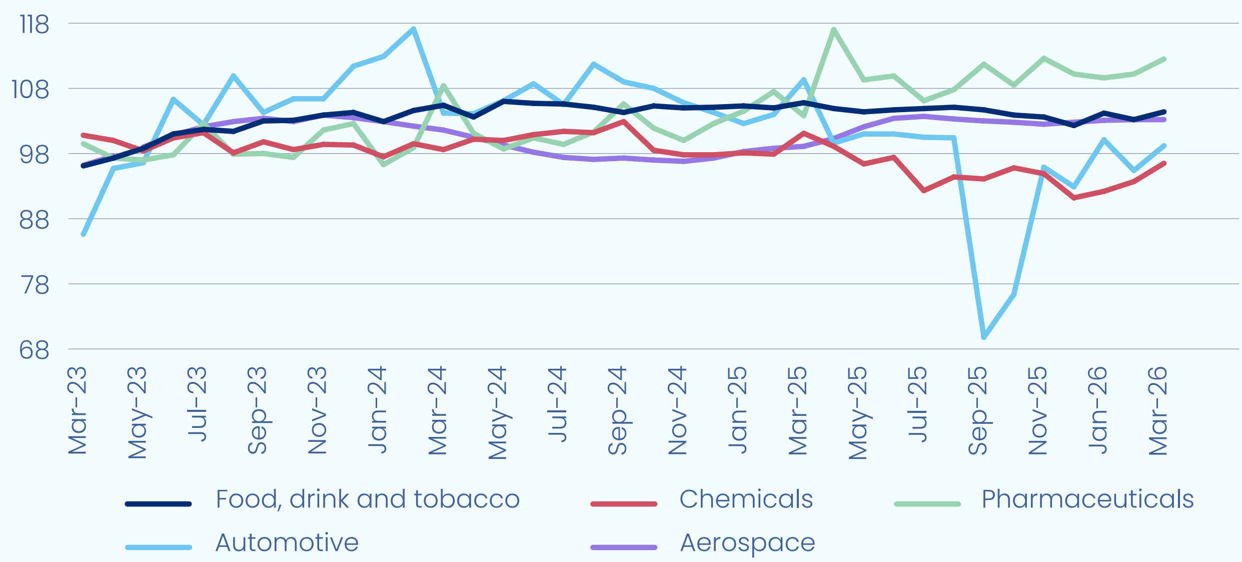
Production output has remained below its 2023 base level for most of the period, indicating persistent weakness across the broader industrial sector. By contrast, manufacturing output, although more volatile, has fluctuated around the 100-index level and recently showed signs of recovery, rising above 100 by early 2026. This suggests that weakness in other components of production, particularly energy supply and mining-related activities, continued to weigh on overall industrial output.

Despite their weaker performance, production and manufacturing remain important due to their spillover effects through supply chains, exports, and productivity gains. Prolonged weakness in these sectors may therefore reduce the competitiveness and productive capacity of the economy.

Turning to the data on the five biggest manufacturing sub-sectors, **Graph 2** shows monthly output for the Food and Drink, Pharmaceutical, Chemical, Automotive, and Aerospace industries, which are referred to as the 'Manufacturing 5' or 'M5'.

The dark blue line represents Food, Drink and Tobacco output. After declining by 0.3% in 2025 and by 1.4% in Q4, the sector returned to growth in Q1 2026, increasing by 0.6%. However, despite these declines, the sector has continued to perform relatively strongly, remaining consistently above its 2023 base level throughout the period. Compared with more cyclical manufacturing sub-sectors, Food, Drink and Tobacco output has also shown limited month-to-month volatility. This relative stability reflects the essential and income-inelastic nature of food and drink consumption, which tends to support demand even during broader industrial slowdowns. The sector nevertheless faces rising external pressures linked to geopolitical tensions in the Middle East. Higher energy, transport, and logistics costs are increasing production expenses and placing additional pressure on pricing and competitiveness, while continued global trade uncertainty may further disrupt supply chains over the coming months. Overall, the recent declines appear more consistent with a moderation from

Graph 2: Index of monthly output of M5 sectors over the past 3 years (2023=100)



Source: CIA analysis of ONS data

previously strong levels rather than a significant deterioration in sectoral performance.

Chemical output, represented by the red line, remains the weakest-performing sector within the M5 group. While some other subsectors experienced temporary declines such as Aerospace between May 2024 and March 2025, or Automotive between September and December 2025, the deterioration in chemicals appears more persistent and structural. After recording an annual decline of 3.6% in 2025, the sector grew marginally by 0.1% in Q1 2026. However, chemical output has remained below its 2023 base level since April 2025, following an earlier period of weakness between October 2024 and February 2025. Overall, the graph suggests a gradual downward trend in sectoral output over time. This persistent weakness highlights deeper structural challenges facing the UK chemical industry. The sector operates in a difficult competitive environment, facing relatively high energy costs and raw material prices compared with producers in the United States and parts of Asia, where cheaper energy inputs and larger-scale industrial capacity provide a competitive advantage. As a result, UK manufacturers face narrowing margins and weaker pricing power. Subdued demand from domestic manufacturing and construction sectors may also be reinforcing these pressures. Although the sector shows signs of recovery at the beginning of 2026, it remains unclear whether this reflects a temporary seasonal improvement or the beginning of a more sustained recovery trend. The deterioration in chemical output may also signal deeper deindustrialisation pressures within the UK and European industrial base. As chemical production operates through highly integrated value chains supplying sectors such as automotive, construction, pharmaceuticals, and advanced manufacturing, sustained plant closures and underinvestment risk weakening industrial resilience, supply security, and long-term productive capacity.

The green line represents pharmaceutical output. The sector grew strongly by 7.8% in 2025 and continued to expand in Q1 2026, recording growth of 0.3%. The industry is characterised by significant month-to-month volatility; however, these fluctuations occur within a broader upward trend. Since July 2024, pharmaceutical output has remained consistently above its 2023 base level and appears to have stabilised at a relatively elevated level despite continued volatility. This volatility is relatively common within the pharmaceutical industry, reflecting its research-intensive and export-oriented nature, where production levels are influenced by product cycles, global demand, inventory adjustments, and regulatory approvals. Despite these fluctuations, the sector remains an important high value-added component of UK manufacturing. The sector has also benefited from supportive policy developments. In April 2026, the UK government announced a pharmaceutical partnership with the United States securing zero tariffs on UK pharmaceutical exports for at least three years. The agreement aims to encourage greater investment in UK life sciences and strengthen the competitiveness of the sector internationally.

The light blue line represents automotive output. The sector recorded a decline of 11.1% in 2025, reflecting a difficult operating environment for UK vehicle manufacturers. Part of this contraction was linked to the cyberattack affecting Jaguar Land Rover (JLR), the UK's largest automaker, which caused operational disruption and temporarily constrained production. More broadly, UK vehicle production fell by 15.5% in 2025, with car output declining by 8.0% and commercial vehicle production falling sharply. External pressures also remained significant. The United States, China, and the European Union are the three largest export markets for UK automotive manufacturers, leaving the sector highly exposed to global trade conditions. In 2025, the introduction of 25% US auto import tariffs increased uncertainty and disrupted transatlantic trade flows. Although a later UK-US trade agreement reduced tariffs on British-manufactured vehicles to 10% under a quota system, the episode highlighted the sector's sensitivity to geopolitical developments and trade policy changes. Despite these pressures, the sector appears to be recovering gradually, with output increasing by 4% in March 2026 and moving closer to its 2023 base level.

The purple line represents aerospace manufacturing output. After declining by 1.2% in 2024, the sector grew by 2.7% in 2025 and continued to expand in Q1 2026, recording growth of 0.8%. Since April 2025, aerospace output has remained above its 2023 base level, reaching and stabilising at a relatively elevated level. The sector has also benefited from rising defence expenditure and stronger military demand linked to heightened geopolitical tensions. Rolls-Royce recently secured several defence-related contracts involving military aircraft engines, armoured vehicle power systems, and support services for European armed forces. Continued progress on major US defence programmes, including the B-52 re-engining project, further highlights the growing role of defence activity in supporting output and investment across the aerospace industry. Following the 2025 NATO Summit, member states also committed to increasing defence and security-related spending to 5% of GDP by 2035, implying sustained long-term demand for military aircraft, engines, defence systems, and advanced aerospace technologies. This is likely to continue supporting UK aerospace and defence manufacturers.

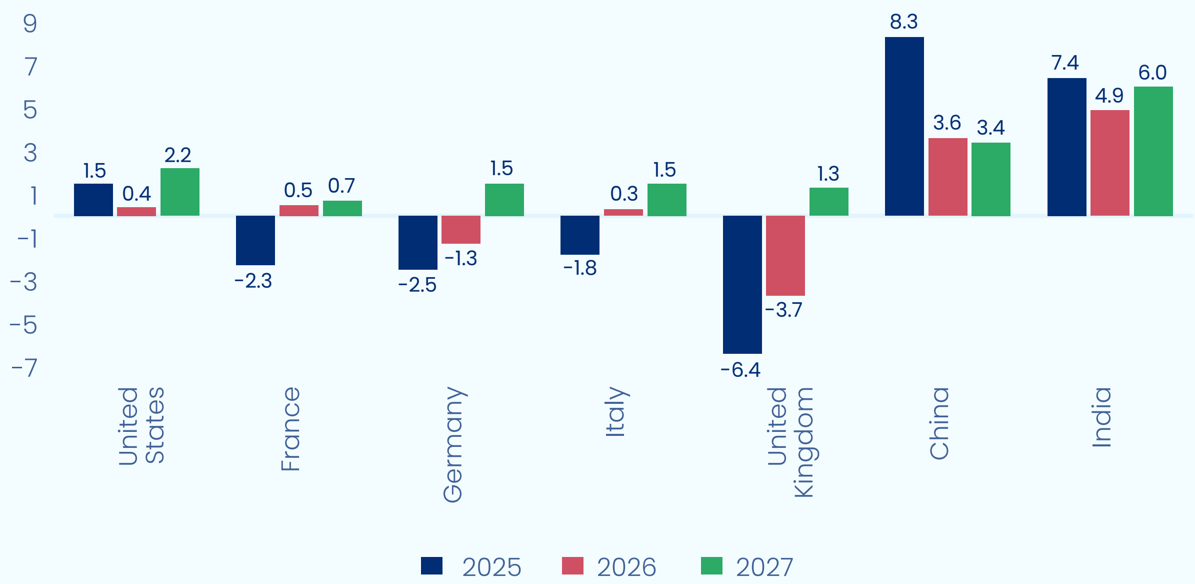
Graph 3 The latest revised data for 2025 highlight the widening divergence between European and Asian chemical producers. Output declined sharply in the UK (-6.4%) and Germany (-2.5%), while growth remained modest in France (2.3%) and Italy (1.8%). By contrast, production expanded more strongly in the United States (1.5%), China (8.3%) and India (6.4%), underlining the growing competitiveness gap between Europe and major international producers.

The 2026 outlook suggests that weak conditions will persist across much of Europe, particularly in the United Kingdom (-3.7%) and Germany (-1.3%), while Asia is expected to continue outperforming, led by China (3.6%) and India (4.9%). Conditions are expected to improve more broadly in 2027, with output returning to growth across most advanced economies. However, Asian producers, particularly India (6.0%), are still expected to expand at a significantly faster pace.

The European chemical sector continues to face a difficult environment characterised by weak industrial demand, elevated energy prices and growing international competition. European producers remain at a disadvantage relative to regions with lower energy and feedstock costs, while continued Chinese capacity expansion is deepening global oversupply and maintaining pressure on prices and margins. These conditions are already contributing to industrial restructuring across Europe, including several cracker closures over the past 18 months. However, the European Commission's Action Plan for the Chemical Industry may provide some support by reducing regulatory burdens and encouraging investment and innovation.

The United Kingdom faces additional pressures beyond the broader European challenges. Weak demand, high energy prices, stringent climate policies and rising Chinese imports continue to weigh on competitiveness. The expected weakness also partly reflects the exceptionally poor performance recorded during late 2024 and throughout 2025, meaning that the modest recovery expected is insufficient to offset the previous downturn. Producers must also absorb the costs associated with UK REACH re-registration requirements estimated by Defra at up to £3 billion, alongside the gradual withdrawal of free carbon allowances, further increasing operating costs.

Graph 3: Annual Percentage Change in Chemical Production



Source: CIA analysis of Oxford Economics Data

By contrast, China and India continue to benefit from stronger industrial momentum and expanding domestic demand. In China, however, growth continues to be accompanied by significant overcapacity pressures, particularly as substantial additions to ethylene capacity are planned through 2028. Weakness in the housing sector is also expected to weigh on demand from an important downstream market for chemicals.

The United States continues to benefit from its structural shale gas advantage, providing producers with relatively competitive feedstock and energy costs compared with Europe. However, recent policy changes may increase uncertainty surrounding future investment and decarbonisation efforts. The Trump administration has reportedly withdrawn around $3.7 billion in clean energy awards, while the Department of Energy plans to revise or cancel substantial funding linked to renewables, emissions reduction and electric vehicle projects, including projects connected to the chemical sector.

Chemical trade

UK chemical exports accounted for 17% of total UK exports in 2025, with a total value of £66.5 billion. Of this, 52% was exported to non-EU markets and 48% to the EU. The United States was the largest export destination (£13.9 billion), followed by Belgium (£6.5 billion) and Germany (£4.6 billion).

More broadly, the United States remains the UK's largest trading partner for total exports. Within the chemical sector specifically, the US continued in 2025 to be the main export market for medicinal and pharmaceutical products, organic chemicals, and plastics in both primary and non-primary forms, while also remaining among the top five destinations for most other chemical subsectors.

This is particularly important given the composition of non-EU chemical exports. Medicinal and pharmaceutical products accounted for around 67% of non-EU chemical exports in 2025, with the majority destined for the United States. Organic chemicals represented around 4%, plastics in non-primary forms 4%, and plastics in primary forms 3%. Combined, these product groups accounted for almost 80% of non-EU chemical exports, highlighting the strategic importance of the US market for the UK chemical industry.

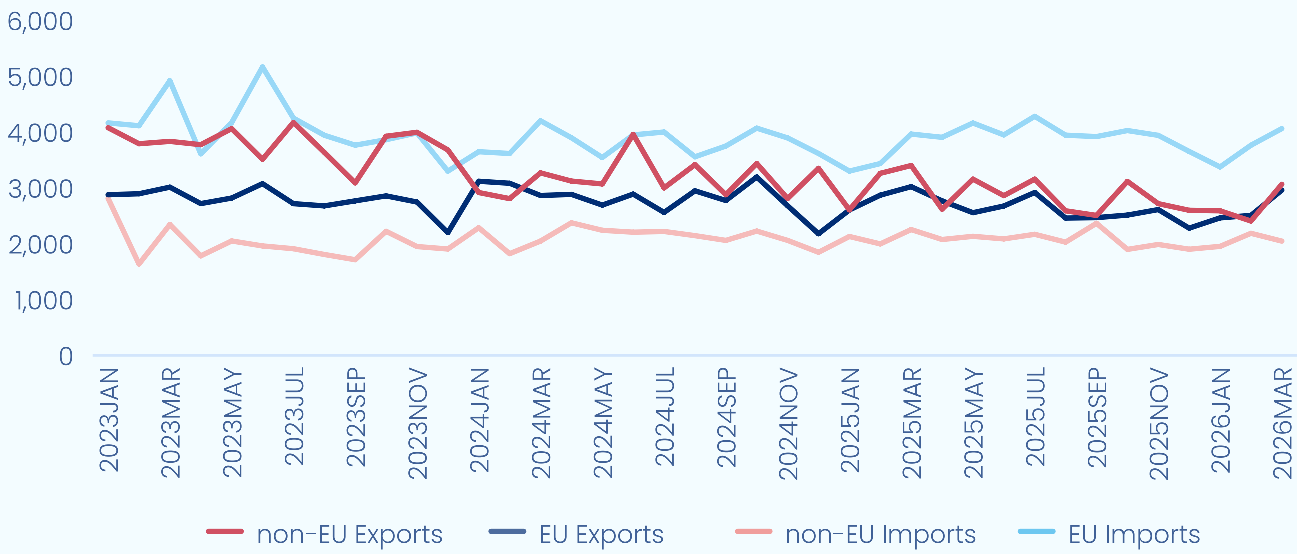
However, export values to the United States fell to their lowest level since 2018. Following the introduction of tariffs in April 2025, export performance weakened, with average monthly exports between April 2025 and March 2026 approximately 17% lower than during the previous twelve-month period. Nevertheless, the data do not suggest a sharp collapse in trade flows. Monthly export values remain highly volatile, and no clear structural break is visible, indicating that weaker exports may also reflect softer global demand, inventory adjustments, and broader cyclical factors rather than tariffs alone.

It is also important to note that the UK is currently the only country to have secured a bilateral agreement with the United States guaranteeing zero tariffs on pharmaceutical exports for at least three years. This provides the UK with a preferential position within the US pharmaceutical market and may help support future export performance in high value-added chemical products.

On the import side, chemicals that were imported represented 71,468 million and chemicals accounted for 11% of total UK imports in 2025. Of these, 65% originated from the EU and 35% from non-EU markets.

In 2025, the Netherlands was the UK's main import partner for several chemical product categories, including organic chemicals, toilet and cleansing preparations, processed fertilisers, and other chemical products. Germany was the leading supplier of inorganic chemicals, medicinal and pharmaceutical products, plastics in both primary and non-primary forms, and dyeing, tanning, and colouring materials. Within EU chemical imports,

Graph 4: Monthly chemical trade in current prices from January 2023 to March 2026 (£m)



Source: CIA analysis of ONS

medicinal and pharmaceutical products accounted for 43% of total imports, followed by plastics in primary forms (8%), plastics in non-primary forms (6%), inorganic chemicals (5%), and dyeing and colouring materials (3%). Together, these categories represented approximately 65% of EU chemical imports,

Overall, Germany and the Netherlands each accounted for approximately 12% of total UK chemical imports in 2025, while the United States represented around 10%.

EU imports (light blue line) remained consistently higher than all other trade flows, fluctuating around £3.5-4.5 billion per month, underlining the importance of European suppliers for UK chemical demand. By contrast, non-EU imports (light red line) remained comparatively lower and more stable, generally fluctuating around £1.8-2.3 billion per month.

On the export side, non-EU exports (red line) were consistently stronger than EU exports (blue line) and displayed greater volatility over the period and showed a noticeable downward trend between 2023 and 2026. This likely reflects the dominant role of high value-added products such as pharmaceuticals in non-EU trade flows, particularly exports to the United States. EU exports remained comparatively stable but at a lower level, generally fluctuating around £2.5-3.0 billion per month.

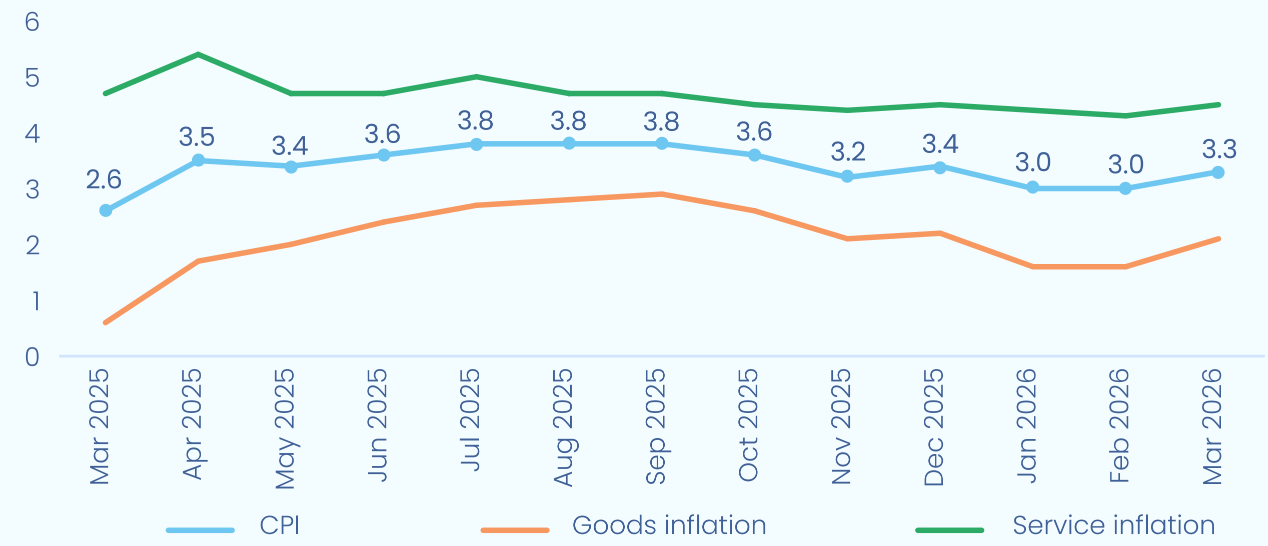
Consumer Side Inflation

Inflation has remained one of the UK's major economic challenges in recent years. After peaking in 2022, headline inflation (CPI) averaged 7.3% in 2023 before easing significantly to 2.5% in 2024. However, inflationary pressures re-emerged in 2025, with CPI rising again to 3.4%. By comparison, average headline inflation across the EU27 stood at 2.5% in 2025, including 2.3% in Germany and 0.9% in France, while the United States recorded an average rate of 2.6%. After finally declining to 3.0% in January 2026 and remaining unchanged in February, CPI inflation rose again to 3.3% in March 2026.

The Office for Budget Responsibility had previously forecast inflation at 2.3% for 2026. However, more recent estimates from Oxford Economics suggest inflation could exceed 4% in the second half of 2026, partly reflecting the impact of the Gulf conflict. Looking ahead, global fertiliser prices are expected to rise by around 15-20% in the first half of 2026 if the crisis continues. The Bank of England also expects food price inflation to peak at around 6-7% by the end of 2026.

At its April meeting, the Monetary Policy Committee (MPC) voted by a majority of 8-1 to maintain Bank Rate at 3.75%. The MPC expects weaker economic growth and a softer labour market to gradually reduce inflationary pressures. Slower consumer spending, weaker business activity and lower labour demand are likely to limit both price and wage growth, helping inflation return towards the 2% target over the medium term.

Graph 5: Headline (CPI), Goods and Services prices inflation over the past 13 months.



Source: CIA analysis of ONS data

In **graph 5** the orange line represents goods inflation over the past 13 months. In March 2025, goods inflation reached its lowest level of the selected period at 0.6%, before remaining mostly above 2% throughout the rest of the year. Although goods inflation declined in January and February 2026 following a relatively high 2025, it increased again to 2.1% in March 2026. Overall, average goods inflation over the past 13 months stood at 2.1%, slightly above the 2025 average of 2.0%.

This increase was largely driven by specific CPI components. Within food inflation, several products recorded sharp monthly increases between February and March, including fresh or chilled fish (4.5%), frozen seafood (10.1%), and edible ices and ice cream (6.3%). Non-alcoholic beverages rose by 1.1% over the month, reaching an annual inflation rate of 5.5%, mainly driven by increases in coffee, tea, cocoa, and mineral or spring water prices. Electricity, gas and other fuels also recorded strong price increases, reaching 5.0%, including a particularly sharp rise of 95.3% for liquid fuels.

Turning to services inflation – green line – it averaged 4.7% over the past 13 months, slightly down from the 2025 average by 0.1 percentage points. Throughout the period, services inflation remained consistently higher than goods inflation. It stood at 4.7% in March 2025 before reaching a peak of 5.0% in July 2025. Although it eased at the beginning of 2026, it increased again to 4.5% in March 2026, returning close to its 2025 levels.

These inflationary pressures were mainly driven by increases in the operation of personal transport equipment (7.1%) and transport services (5.1%), with passenger air transport prices rising particularly sharply by 14.5%. Insurance prices also increased, reaching their highest level of the past 13 months at 2.4%.

Goods and services each account for roughly half of the CPI basket, with services carrying a slightly larger weight. As a result, developments in both components play an important role in shaping overall inflation. In 2025, the moderation in goods inflation contributed to easing headline CPI.

Chemical prices

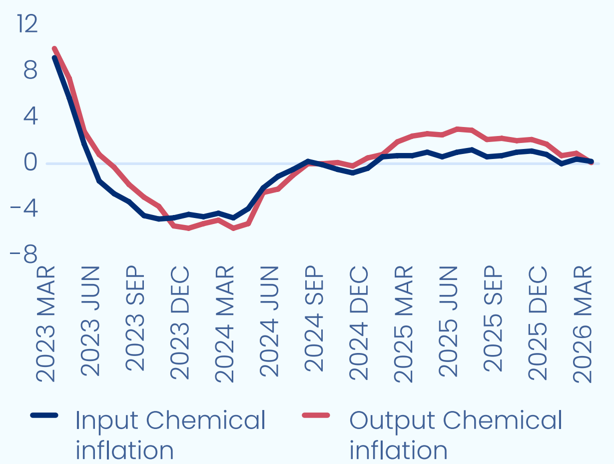
Turning to the **Graph 6.1** at the chemical input inflation (blue line), year-on-year price pressures were still high in March 2023 before reaching a period of relative stability one year after. After reaching almost 9% in March 2023, it fell rapidly throughout 2023 and entered negative territory by mid-2023, reaching around -5% by late 2023 and early 2024. This decline likely reflected lower energy prices, easing supply chain pressures after the crisis but also weaker industrial demand. From mid-2024 onwards, input inflation gradually recovered and returned to positive territory, fluctuating around 1% during 2025 before easing back towards 0.2% by March 2026.

By contrast, output chemical – red line – inflation followed a similar trend but remained above input inflation during most of 2025. After peaking near 10% in March 2023, output inflation also declined sharply and turned negative during late 2023 and early 2024. During the first half of 2024, output inflation remained below input inflation, highlighting the difficulties faced by the chemical industry in passing rising costs onto customers. However, output inflation recovered more strongly from mid-2024 onwards, peaking at around 3% in mid-2025 and remaining above input inflation for much of the year, suggesting some improvement in producers' ability to pass costs through. By March 2026, however, output inflation had fallen below input inflation once again, indicating renewed pressure on producers' margins.

This likely reflected the impact of the ongoing Gulf conflict, which contributed to higher feedstock, gas and electricity costs, all of which are critical inputs for the chemical sector. The fact that input inflation exceeded output inflation suggests that producers were unable to fully pass rising production costs onto customers, likely reflecting weaker demand conditions and competitive pressures within the market.

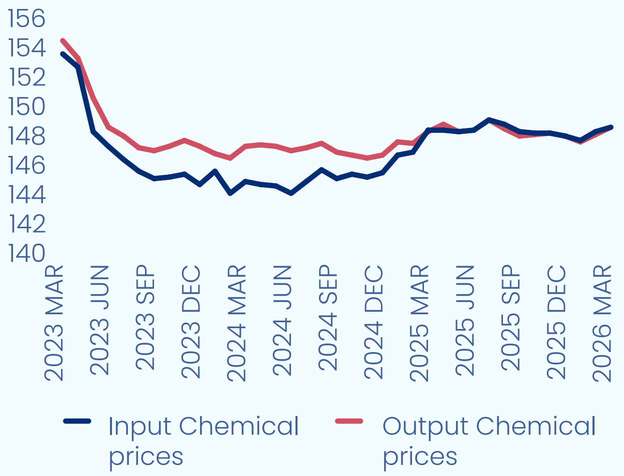
Looking at **Graph 6.2**, input chemical prices remained consistently above output chemical prices throughout almost the entire period. Although output inflation exceeded input inflation during much of 2025, indicating some short-term improvement in producers' ability to pass cost through, the overall level of input prices remained higher. It highlights that the chemical industry continued to face elevated production costs despite some recovery in selling prices. Between May and August 2025, however, both input and output price indices remained almost identical, suggesting a temporary balance between production costs and selling prices. It is also noticeable that output prices recovered from mid-2025 onwards and occasionally exceeded input prices, particularly in September 2025. By March 2026, the two indices had converged once again, after output prices had remained slightly above input prices in January and February 2026.

Graph 6.1: Year-on-year inflation in chemical input and output prices (PPI) over the past 3 years



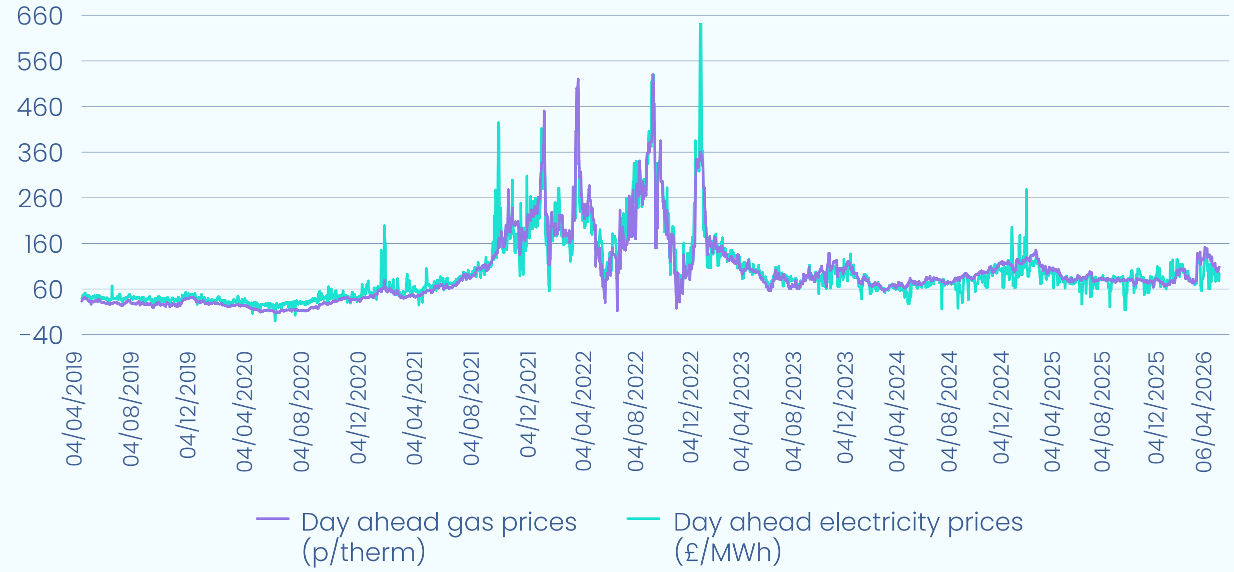
Source: CIA analysis of ONS

Graph 6.2: Price level of chemical output and input over the past 3 years



Source: CIA analysis of ONS

Graph 7: Day ahead gas (p/therm) and electricity (£/MWh) prices



Source: CIA analysis of Inspired PLC data

Graph 7 displays the day-ahead wholesale gas and electricity prices in the UK from January 2019. In 2019 and early 2020, prices remained relatively stable and low, with gas prices generally fluctuating between 30 and 45 p/therm and electricity prices between £40 and £50/MWh. However, the period from 2021 to 2023 was characterised by exceptional volatility and sharp price increases, particularly during the 2022 energy crisis following the Russia-Ukraine conflict and disruptions to European energy supplies.

More recently, prices stabilised at a higher level than in 2019/2020, showing that wholesale energy markets have settled into a new, higher price regime compared with the pre-crisis baseline.

During early 2026, moderate upward pressure re-emerged in both gas and electricity markets, partly reflecting renewed geopolitical uncertainty linked to the Gulf conflict and continued concerns surrounding global energy supply conditions. UK wholesale natural gas prices also rose by roughly 75% between late February and 23 March 2026. Prices of other petroleum-based commodities, including jet fuel and heating oil, increased sharply as well. The initial economic consequences of the conflict have already been felt across the UK economy. Petrol prices increased by around 14 pence per litre (approximately 10%) between 28 February and 23 March, while diesel prices rose by 29 pence per litre (around 20%). Farmers also reported substantial increases in the cost of fuel and fertiliser.

Labour market

The UK labour market presented mixed signals at the start of 2026. Between March 2025 and March 2026, the number of payrolled employees declined by 104,000, representing a fall of 0.3%, while a further decrease of 0.1% was recorded between February and March 2026. Over the January to March 2026 period, the UK unemployment rate stood at 5.0%, representing an increase of 0.5 percentage points on the year, despite a decline of 0.2 percentage points compared with the latest quarter. At the same time, the economic inactivity rate was estimated at 20.9% in January to March 2026. This was down by 0.4 percentage points compared with a year earlier, but up by 0.1 percentage points on the previous quarter.

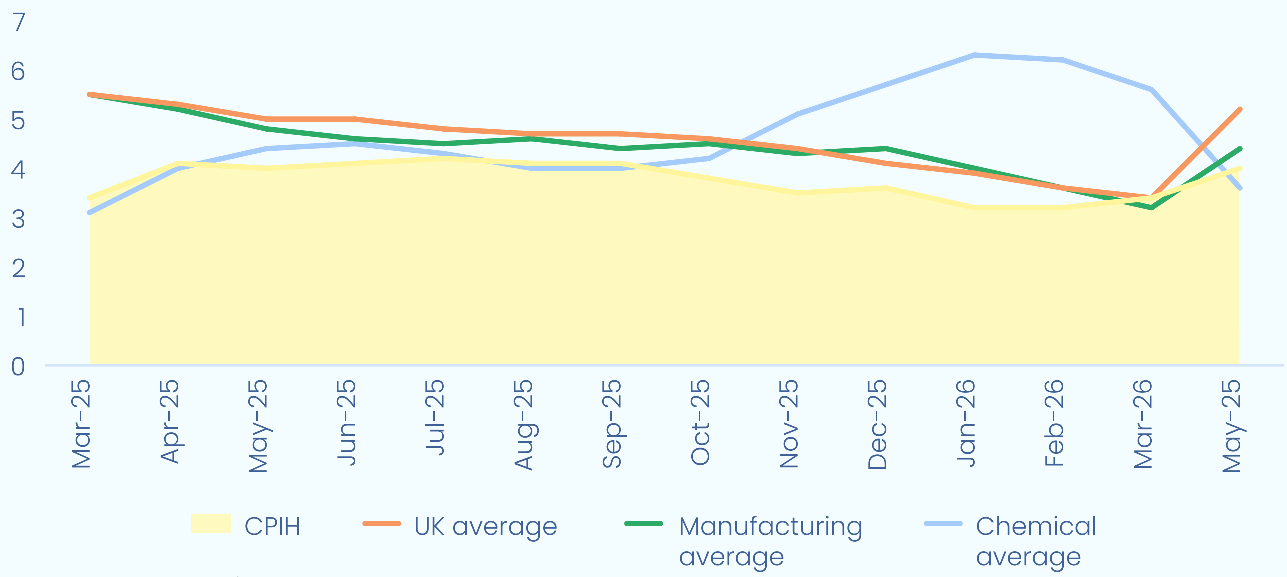
The yellow shaded area indicates the level of CPIH inflation over the period. Pay growth rates that fall within this area are below inflation and therefore imply real term pay reductions. By contrast, pay growth rates that lie above the shaded area exceed inflation and translate into positive real wage growth. CPIH inflation stood at 4.1% in September before falling to 3.6% in December. It then eased further to 3.2% in January and February, before rising again to 3.4% in March 2026, remaining relatively elevated throughout the period.

The UK average pay growth (orange line) remained consistently above CPIH inflation throughout 2025, finishing the year at 4.1% compared with 3.6% for CPIH inflation. At the beginning of 2026, wage growth gradually moderated, declining to 3.9% in January and 3.6% in February, while CPIH inflation stood at 3.2% and 3.4% respectively. By March 2026, average pay growth had eased further to 3.4%, aligning with the CPIH inflation rate for the first time during the period observed.

Manufacturing pay growth (green line) generally followed the UK average throughout the period, although it exceeded it in December 2025, reaching 4.4% compared with 3.6% for CPIH inflation. However, the first quarter of 2026 was characterised by a more pronounced slowdown in manufacturing wage growth, which fell to 4.0% in January, 3.6% in February, and 3.2% in March. By March 2026, manufacturing pay growth had dropped below the CPIH inflation rate, entering the yellow shaded area and indicating real-term reductions in pay.

In contrast, chemical sector pay growth (blue line) displayed greater volatility throughout the period. It stood at 4.0% in September 2025 before increasing sharply to 5.7% in December, peaking at 6.3% in January 2026. Although it remained elevated at 6.2% in February, it eased slightly to 5.6% in March 2026. It is important to note that the chemical industry has a higher concentration of skilled roles and premium pay arrangements, which can influence official average earnings data.

Graph 8: Growth rate of UK average, manufacturing, and chemical pay over the past 13 months compared to CPIH inflation



Source: CIA analysis of ONS

Rounding up the official data

The UK economy continued to expand into early 2026, although growth momentum weakened considerably as the period progressed. The economy expanded by 1.3% in 2025. Quarterly growth slowed from 0.7% in Q1 2025 to 0.3% in Q2 and only 0.1% in both Q3 and Q4, leaving the economy close to stagnation by year-end. However, Q1 2026 recorded stronger-than-expected growth of 0.6%, supported by monthly GDP growth of 0.4% in February and 0.3% in March after no growth in January. Despite this temporary improvement, the MPC expects GDP growth to slow again to 0.1% in Q2 2026 amid rising uncertainty. Across the MPC's scenarios, GDP growth falls to between 0.3% and 0.6% by Q1 2027, while the output gap widens to between -1.5% and -1.7%, highlighting expectations of persistently weak economic momentum.

Within manufacturing, sectoral divergence became increasingly pronounced. Pharmaceuticals remained one of the strongest-performing sectors, growing by 7.8% in 2025 and a further 0.3% in Q1 2026, while aerospace output expanded by 2.7% in 2025 and 0.8% in Q1 2026, supported by rising defence expenditure and stronger military demand. Food, Drink and Tobacco output remained comparatively resilient despite a modest annual decline of 0.3% in 2025 and a 1.4% contraction in Q4, before returning to growth of 0.6% in Q1 2026. By contrast, automotive output contracted sharply by 11.1% in 2025 amid operational disruptions at Jaguar Land Rover, weaker vehicle production, and rising trade uncertainty linked to US auto tariffs. Chemicals remained the weakest-performing sector, with output declining by 3.6% in 2025 and remaining below its 2023 base level for most of the period despite marginal growth of 0.1% in Q1 2026.

The broader outlook for the chemical industry remains particularly challenging. UK chemical production is expected to decline by a further 3.7% in 2026, compared with Germany (-1.3%), while Asia is expected to continue outperforming, led by China (3.6%) and India (4.9%)

Chemical exports accounted for 17% of total UK exports in 2025, reaching £66.5 billion, with 52% exported to non-EU markets. The United States remained the largest export destination at £13.9 billion, particularly for medicinal and pharmaceutical products, which represented around 67% of non-EU chemical exports. However, average monthly exports to the US fell by around 17% following the introduction of tariffs in April 2025, although no clear structural collapse in trade flows is visible.

After averaging 2.5% in 2024, headline CPI inflation accelerated again to 3.4% in 2025, compared with 2.5% across the EU27 and 2.6% in the United States. Inflation temporarily eased to 3.0% in January and February 2026 before rising again to 3.3% in March. Food, transport, and energy-related components contributed significantly to renewed inflationary pressures, including a 95.3% increase in liquid fuel prices and a 14.5% rise in passenger air transport prices. Although the MPC maintained Bank Rate at 3.75% in April 2026, more recent forecasts suggest inflation could exceed 4% later in 2026 if geopolitical tensions and commodity price pressures persist.

During early 2026, UK wholesale gas prices rose by around 75% between late February and March amid renewed geopolitical tensions linked to the Gulf conflict. Petrol prices increased by around 10%, diesel prices by around 20%, and global fertiliser prices are expected to rise by 15-20% if the conflict continues. Producer price data also indicate continued pressure on the chemical industry's margins. Although chemical output inflation exceeded input inflation during much of 2025, input inflation again rose above output inflation by March 2026, suggesting producers remained unable to fully pass rising energy and feedstock costs onto customers.

The labour market showed mixed conditions in Q1 2026, with payrolled employment declining and unemployment remaining higher than a year earlier, despite a slight quarterly improvement. Wage growth moderated across the wider economy and manufacturing sector, gradually converging towards CPIH inflation, with manufacturing pay falling below inflation by March 2026 and implying real term pay reductions. In contrast, wage growth in the chemical sector remained significantly above inflation throughout the period, although this partly reflects the sector's higher concentration of skilled roles and premium pay arrangements.

Survey results

About the survey

At the end of each quarter, we survey member companies of the Association to gather data about current operating conditions and views on what lies ahead. The information from this is incredibly useful in our work, and we are grateful to all who responded.

The CIA's Q1 2026 Business Survey was live between March 23rd and April 02nd 2026. The survey received responses from 40 CIA members. This edition of the survey was split into two sections. The first and second sections contained the standard industry performance and challenges and opportunities questions.

In the industry performance section, three questions asked respondents whether the 19 variables listed below had increased, decreased, or stayed the same in the first quarter of 2026 compared to the fourth quarter of 2025 and their expectations for these variables in the second quarter of 2026 and 12 months' time.

Industry performance variables:

1. Total sales
2. Domestic sales
3. Exports
4. EU exports
5. The rest of the world exports
6. New orders
7. Production levels
8. Capacity utilisation
9. Employee numbers
10. R&D spend
11. Business investment
12. Your level of business optimism
13. Time to deliver
14. Raw material (input) prices
15. Cost of importing
16. Cost of exporting
17. Your energy costs
18. Finished goods (output) prices
19. Your company/site profit margins

When displaying the industry performance data, diffusion indexes are used. These are easy-to-interpret statistical tools that can be read in the same way as S&P Global's Purchasing Managers Indexes (PMIs). Therefore, any figure below 50 indicates a contraction, above 50 an expansion, and 50 means it remained constant. To compute these indexes, we combined the percentage of respondents who reported experiencing an increase with half of those who reported experiencing no change.

Industry performance

Performance in the first quarter of 2026

Table 1 displays the diffusion indexes for the 19 variables mentioned in 'About the Survey' and the percentage of respondents that reported experiencing a decrease in the variables. The first column is the diffusion index for the performance in the first quarter; the second column contains the diffusion index for the performance in the fourth quarter, and the third column contains the diffusion index for what was expected for the first quarter of 2026 when respondents were asked in the CIA's Q4 2025 Business Survey. The fourth and fifth columns contain the percentage of respondents that experienced a decrease of that variable in the current quarter and the previous one. This allows comparisons between the performance in the first quarter of 2026 compared to expectations and the prior quarter. As Q1 2026 was characterised by considerable increases in several variables, a sixth column showing the percentage of respondents reporting increases in Q1 2026 has been added to facilitate comparison.

Table 1: Q1 performance compared to Q4's and expectations made in Q4

	Q1 Actual	Q4 Actual	Q1 Expected	Percentage that experienced a decrease in Q1 2026	Percentage that experienced a decrease in Q4 2025	Percentage that experienced an increase in Q1 2026
Total sales	49	40	44	33%	37%	30%
Domestic sales	49	37	41	15%	35%	13%
Exports	48	42	40	28%	35%	23%
EU exports	51	42	43	18%	35%	20%
Rest of the world exports	45	41	41	28%	31%	18%
New orders	55	38	36	21%	40%	31%
Production levels	46	37	34	30%	34%	23%
Capacity utilisation	45	36	35	28%	33%	18%
Employee numbers	31	35	29	45%	38%	8%
R&D spend	44	46	35	15%	14%	3%
Business investment	45	39	29	25%	32%	15%
Your level of business optimism	26	46	31	55%	48%	8%
Time to deliver	48	49	40	18%	6%	13%
Raw material (input) prices	93	49	55	3%	16%	88%
Cost of importing	93	51	55	0%	0%	85%
Cost of exporting	90	52	58	0%	0%	80%
Your energy costs	84	55	53	0%	18%	68%
Finished goods (output) prices	74	45	45	5%	18%	53%
Your company/site profit margins	31	54	35	48%	60%	10%

Source: CIA Q1 2026 and Q4 2025 Business Survey

Key take away

Q1 was marked by improvements in several indicators, including total sales, production levels and capacity utilisation. European Union exports and new orders returned to expansion, with 31% of respondents reporting an increase in new orders, representing a significant improvement compared to Q4. However, cost pressures increased sharply, with raw material prices and import costs showing very strong expansionary trends (93), while export costs also expanded substantially (90). Energy costs also remained strongly expansionary at 84. In addition, 88% of respondents reported higher raw material prices, while 85% experienced increases in import costs.

Q1 2026 showed mixed but gradually improving conditions across the manufacturing sector following a difficult 2025. Although several indicators remained below the neutral threshold, many strengthened compared to previous quarters, suggesting a continued recovery in activity after the weakness experienced last year. Improvements were particularly visible in new orders, which finally returned to expansion (55 vs 38) and European Union exports, which also moved back into expansion territory. Around 31% of respondents reported an increase in new orders, compared with 21% reporting a decline. Production levels and capacity utilisation also improved respectively, although both remained slightly below the neutral mark.

Despite these encouraging signs, underlying conditions across the sector remained fragile. Total sales and domestic sales continued to contract marginally, although both improved compared to Q4 2025, with 33% of respondents reporting a decline in total sales and 15% reporting lower domestic sales. Exports to the rest of the world also remained weak despite a slight improvement during the quarter, with 28% of firms experiencing a decrease. Business sentiment deteriorated further, however, as more than half of respondents (55%) reported lower levels of business optimism, indicating that firms remained cautious about the economic outlook despite the gradual recovery in activity. Employment conditions also weakened further during the quarter, with 45% of firms reporting lower staffing levels. Profit margins remained under considerable pressure, reflecting the persistent challenges faced by manufacturers, as almost half of respondents (48%) experienced declining margins while only 10% reported an improvement.

The most significant development in Q1 2026 was the sharp intensification of cost pressures. Raw material prices and import costs increased particularly strongly, while export and energy costs also rose substantially during the quarter. These increases were significantly higher than both Q4 outcomes and firms' expectations for Q1, highlighting the scale of inflationary pressures facing manufacturers. Around 88% of respondents reported higher raw material prices, while 85% experienced increased import costs and 80% reported higher export costs. These pressures were also passed through to customers, with finished goods prices rising sharply and more than half of respondents reporting higher selling prices.

Expectations for the second quarter of 2026

Table 2 displays the diffusion indexes for what is expected for each of the 19 variables in the first quarter of 2026 and the percentage of respondents who expects to see an increase.

Table 2: Expectations for Q2 2026

	Q2 Expectation	Percentage that expects an increase in Q2 2026
Total sales	53	30%
Domestic sales	54	22%
Exports	54	24%
EU exports	54	24%
Rest of the world exports	54	28%
New orders	57	35%
Production levels	50	30%
Capacity utilisation	51	32%
Employee numbers	34	3%
R&D spend	46	3%
Business investment	45	11%
Your level of business optimism	30	8%
Time to deliver	49	8%
Raw material (input) prices	88	78%
Cost of importing	89	78%
Cost of exporting	88	76%
Your energy costs	91	81%
Finished goods (output) prices	80	65%
Your company/site profit margins	39	24%

Source: CIA Q1 2026 Business Survey

Key take away

Demand-related indicators are expected to remain in expansionary territory, with new orders continuing to provide the strongest signal of activity. Around 35% of respondents expect higher new orders during the quarter, while total sales, exports and domestic sales are all expected to expand moderately. Production levels and capacity utilisation also point towards a modest improvement in operational activity.

Expectations for Q2 2026 suggest that firms anticipate a continuation of the gradual recovery observed in Q1. Whilst most indicators are expected to move into expansionary territory, the outlook remains cautious. Around 30% of respondents expect total sales to increase during the quarter, while 35% anticipate stronger new orders and 24% expect improvements in both exports and EU exports. This points to a moderate strengthening in demand conditions and manufacturing activity during Q2.

However, the expected recovery remains uneven due to continued economic uncertainty, elevated cost pressures and the broader challenges facing the sector. Employment expectations remain firmly contractionary, with only 3% of respondents expecting staffing levels to increase. R&D spending and business investment also remain weak, with only 3% and 11% of firms respectively expecting increases.

Cost pressures are also expected to remain exceptionally elevated during Q2 2026. Raw material, import, export and energy costs are all expected to increase sharply, with 78% of respondents anticipating higher raw material and import costs, 76% expecting higher export costs, and 81% forecasting further increases in energy costs. Firms also expect continued increases in finished goods prices, with almost two-thirds of respondents (65%) anticipating higher output prices during the quarter, indicating that inflationary pressures are likely to continue feeding through the production chain. Despite expectations of stronger activity, profit margins are still expected to remain under pressure, with only 24% of firms expecting an improvement, suggesting that many manufacturers do not expect higher selling prices to fully offset rising operating and input costs.

Expectations for 12 months ahead

Table 3: Medium-term expectations

	12 months Expectation	Percentage that expects an increase in 12 months time
Total sales	58	38%
Domestic sales	54	23%
Exports	56	38%
EU exports	55	32%
Rest of the world exports	54	31%
New orders	54	35%
Production levels	53	33%
Capacity utilisation	53	33%
Employee numbers	30	8%
R&D spend	44	5%
Business investment	43	10%
Your level of business optimism	35	18%
Time to deliver	48	10%
Raw material (input) prices	90	83%
Cost of importing	90	82%
Cost of exporting	89	80%
Your energy costs	88	79%
Finished goods (output) prices	81	70%
Your company/site profit margins	35	13%

Source: CIA Q1 2026 Business Survey

The Q1 2026 results suggest that firms expect conditions to improve gradually over the next 12 months, despite the difficult operating environment and continued cost pressures affecting the sector. Most forward-looking activity indicators remain in expansionary territory, signalling that more firms anticipate improvement than deterioration over the year ahead. Total sales (58), exports (56) and new orders (54) all point towards a moderate recovery in demand conditions, while production levels and capacity utilisation are also expected to strengthen further. Around 38% of respondents expect higher total sales and exports over the next 12 months, while 35% anticipate stronger new orders.

However, the expected recovery remains uneven and appears to be largely demand-led rather than investment-driven. Employment expectations remain firmly contractionary, with only 8% of respondents expecting staffing levels to increase over the next 12 months. Similarly, business investment (43) and research and development spending (44) remain below the neutral threshold, with only 10% and 5% of firms respectively expecting increases. Although firms expect activity to improve gradually, they remain reluctant to commit to longer-term expansion plans amid continued uncertainty.

Cost expectations continue to weigh heavily on the outlook. Around 83% of respondents anticipate further increases in raw material prices over the next 12 months, while 82% expect higher import costs, 80% higher export costs and 79% rising energy costs. Firms also expect continued increases in finished goods prices, with 70% anticipating higher selling prices over the coming year. Despite expectations of stronger activity, profit margins are expected to remain under pressure, with only 13% of respondents expecting margins to improve, suggesting that many firms remain concerned about their ability to fully offset rising operating and input costs.

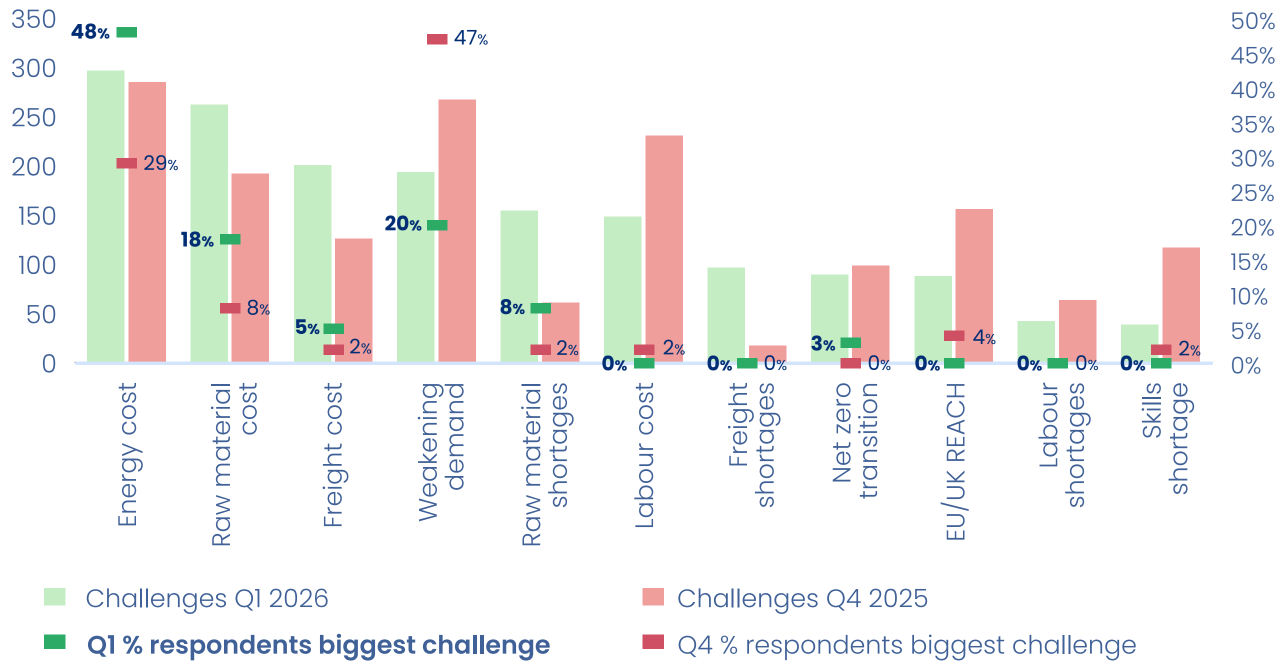
Key take away

The 12-month outlook remains moderately positive for activity indicator. Total sales, exports and new orders are all expected to remain in expansionary territory, with 38% of respondents anticipating higher total sales and exports over the coming year, while 35% expect stronger new orders. Cost pressures are expected to remain exceptionally elevated, with around 80% of firms anticipating further increases in raw material, import, export and energy costs.

Challenges and Opportunities

The second section of the CIA's Q1 Business Survey focused more in detail on the challenges members faced and the opportunities they identified. The first question asked respondents to rank 11 challenges faced by the industry from most significant to smallest, with '1' signalling the greatest issue and '11' the smallest.

Graph 9: Industry ranking of business challenges in Q1 2026 and Q4 2025



Source: CIA Q1 2026 and Q4 2025 Business Survey

Key take away

1. Energy cost

2. Raw material cost

3. Freight cost

This quarter's survey recognised: 'Energy Cost', 'Raw Material Cost' and 'Freight Cost' as the three main challenges. This marks the first significant shift in the top three challenges in almost two years. Previously, the main concerns consistently centred on energy costs, weakening demand and labour costs. Cost pressures linked to supply chains and trade have now become a more immediate concern for firms than labour-related pressures.

The green bars on **Graph 9** show the ranking of the challenges in this quarter's survey, whilst the red bars show ranking in the previous quarter (Q4 2025). The squares represent the percentage of respondents that ranked each challenge as their number one challenge. The green square is the percentage in Q1 2026 and the red one in Q4 2025.

Energy costs remained the most frequently cited challenge facing manufacturers in Q1 2026, with almost half of respondents (48%) identifying it as their single biggest concern, compared with 29% in Q4 2025. This suggests that rising energy prices continue to place significant pressure on firms' competitiveness, profitability and operating costs. Raw material costs also became more prominent during the quarter, with 18% of respondents identifying them as their main challenge, compared with 8% in Q4. Freight costs also moved into the top three challenges for the first time in almost two years, although only 5% of firms ranked them as their primary concern. Together, these shifts suggest that supply chain and trade-related pressures have intensified and are now weighing more heavily on firms than labour-related concerns.

By contrast, weakening demand, whilst still one of the most significant challenges facing the sector overall, became relatively less dominant in Q1. The share of respondents identifying it as their primary concern declined sharply from 47% in Q4 2025 to 20% in Q1 2026, suggesting that the modest recovery in activity indicators observed during the quarter may have slightly eased immediate concerns around demand conditions. However, weakening demand remains one of the most widely cited challenges overall, indicating that firms continue to face a fragile trading environment despite signs of gradual recovery.

Labour costs, freight shortages, UK-EU REACH requirements and labour shortages continued to be recognised as challenges across the sector, although none were identified by respondents as the single biggest challenge during Q1 2026. Whilst these pressures remain part of the broader operating environment for manufacturers, they are currently being overshadowed by the sharp rise in energy, raw material and freight-related costs. By contrast, net zero transition pressures became slightly more prominent during the quarter, with 3% of respondents identifying them as their primary challenge.

Members also highlighted a number of additional challenges affecting their operations. Several respondents expressed growing concern about international competitiveness, particularly in relation to low-cost imports, Chinese overcapacity and increasing price competition from overseas producers. Some firms also referred to the impact of US tariffs and the risk of product dumping into UK and European markets.

Geopolitical uncertainty also emerged as a concern during the quarter, particularly regarding tensions involving the Gulf and the potential implications for energy availability, fuel costs and wider supply chain stability. Shipping restrictions affecting hazardous bulk cargo exports were also identified as an operational challenge for some manufacturers.

Inflation, persistently high energy costs and regulatory pressures were also frequently

Table 4: Expectations over challenges

	Expectations	Percentage that expects this challenge to worsen
Energy cost	5	92%
Raw material cost	1	97%
Freight cost	5	90%
Weakening demand	28	51%
Raw material shortages	18	67%
Labour cost	19	62%
Freight shortages	28	46%
Net zero transition	45	21%
EU/UK REACH	53	13%
Labour shortages	56	10%
Skills shortage	50	18%

Source: CIA Q1 2026 Business Survey

mentioned. Respondents highlighted concerns surrounding the UK Emissions Trading Scheme, compliance requirements and regulatory costs, which were seen as affecting the competitiveness of UK manufacturing. Other firms referred to longer-term structural challenges, including workforce demographics, limited credit availability and weak investment appetite across parts of the sector.

The next question asked respondents if the 11 challenges from the previous question were improving, worsening or remaining unchanged. **Table 4** displays the diffusion indexes of the answers, with figures above 50 indicating an improvement, below 50 a worsening, and 50 indicating no change, along with the percentage of respondents that expect a worsening in the near future.

The most concerning signals in the latest survey relate to cost pressures, which firms expect to deteriorate further over the coming months. Raw material costs appear to be the most severe challenge overall, with 97% of respondents expecting conditions to worsen further. Energy and freight costs also remain major concerns, with 92% and 90% of firms respectively anticipating further deterioration. Labour costs are also expected to continue increasing, with 62% of respondents expecting pressures to worsen. Demand conditions also continue to generate concern across the sector. Just over half of respondents (51%) expect weakening demand to worsen further, indicating that firms remain uncertain about the durability of the recent recovery in activity indicators and continue to view market conditions as fragile.

By contrast, shortage-related challenges appear less acute than cost pressures. Labour shortages and EU-UK REACH requirements both recorded expectations above the neutral threshold, suggesting that firms expect these pressures to stabilise or improve slightly over time. Skills shortages appear broadly stable, while net zero transition pressures remain slightly negative overall, although considerably less severe than the major cost-related challenges affecting the sector. However, raw material and freight shortages continue to concern a sizeable share of firms, indicating that supply-side pressures have only partially eased.

Turning to opportunities, members identified a number of potential opportunities despite the difficult operating environment. Several respondents pointed to geopolitical developments and supply chain disruptions as creating short-term commercial opportunities for UK manufacturers. In particular, some firms reported increased demand linked to disruptions affecting competitors' access to raw materials and imports, especially in relation to tensions in the Middle East.

A number of respondents also highlighted opportunities linked to diversification, innovation and investment in new production capacity. These included new product introductions, expansion into international markets such as the United States, Brazil and India, and investment in new manufacturing facilities and product grades. Some firms also identified opportunities arising from increased demand for responsible manufacturing, defence-related materials, renewable energy and biofuels.

Key takeaways from the survey

The Q1 2026 survey suggests that the sector has continued to recover gradually following the difficult conditions experienced throughout 2025, although the improvement remains uneven and fragile. Several activity indicators strengthened during the quarter, with new orders returning to expansionary territory and 31% of respondents reporting an increase in new orders, compared with 21% reporting a decline. EU exports also moved back into expansion, while production levels and capacity utilisation improved compared with Q4. However, despite these improvements, underlying conditions remained weak overall. Around 33% of firms reported lower total sales during the quarter, 28% experienced declining rest of the world exports and 48% reported a decrease in profit margins, highlighting the continued pressure facing producers. At the same time, cost pressures intensified sharply across the sector, with 88% of respondents reporting higher raw material prices, 85% increased import costs and 80% higher export costs, suggesting that the gradual recovery in activity continues to be heavily constrained by rising operating and input costs.

Looking ahead, firms expect the gradual improvement in activity to continue into Q2 2026, particularly across demand-related indicators. Around 35% of respondents anticipate stronger new orders during the quarter, while 30% expect higher total sales and around one-quarter foresee improvements in exports and EU exports. Production levels and capacity utilisation are also expected to strengthen further, pointing towards a modest recovery in manufacturing activity. However, confidence remains cautious. Employment expectations continue to signal contraction, with only 3% of firms expecting staffing levels to increase, while investment intentions also remain subdued. Cost pressures are also expected to remain exceptionally elevated, with around 78% of firms anticipating higher raw material and import costs, 81% expecting further increases in energy costs and 65% forecasting higher finished goods prices during Q2.

The 12-month outlook remains cautiously positive overall. Around 38% of respondents expect higher total sales and exports over the coming year, while 35% anticipate stronger new orders and around one-third foresee improvements in production levels and capacity utilisation. However, the expected recovery still appears largely demand-led rather than investment-driven. Employment expectations remain weak, with only 8% of firms expecting staffing levels to increase, while business investment and R&D intentions also remain subdued at 10% and 5% respectively. Cost pressures nevertheless remain the dominant concern across the sector as they are expected to persist with more than 80% of firms anticipating further increases in raw material, import and energy costs over the next 12 months. Firms also expect these increases to continue feeding through into selling prices, with 70% anticipating higher finished goods prices over the coming year.

Energy costs, raw material costs and freight costs emerged as the three main challenges facing manufacturers in Q1 2026, marking the first significant shift in the top three challenges in almost two years. Around 48% of respondents identified energy costs as their primary concern, compared with 20% for weakening demand and 18% for raw material costs. Expectations over challenges also point towards further deterioration in cost conditions, with 97% of respondents expecting raw material costs to worsen further, alongside 92% for energy costs and 90% for freight costs. Labour costs also remain a major concern, with 62% anticipating further deterioration. By contrast, labour shortages and EU-UK REACH-related pressures appear more stable, suggesting that supply-side shortages are becoming less acute than rising operating and trade-related costs.

Despite the challenging environment, some firms also identified emerging opportunities. Respondents highlighted potential gains linked to shifting global supply chains, stronger international demand and diversification into new markets and products. Increased interest in renewable energy, biofuels, defence-related materials and responsible manufacturing was also seen as creating potential areas for future growth.

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