



Navigating the Economy with Subrahmaniam Krishnan-Harihara

An honest commentary on the economy, the region and the future outlook.

The UK economy made a subdued entry into 2026 with GDP growth hovering in positive territory but certainly not taking flight. The last 12 months have seen a decline in a host of economic indicators: consumer confidence weakened, the construction sector showed signs of an acute contraction and growth in services stalled. Only the manufacturing sector bucked the trend towards the end of the year. Q4 GDP growth was 0.1% (1.3% overall in the year) - enough to keep the economy out of recession but short of the strong growth the government so desperately needs.

The weakening labour market offers another challenge. UK unemployment rose to 5.2%, the highest levels since early 2021. Even more worrying is the youth unemployment rate of 16.1%, the highest in a decade. At the Greater Manchester level, the Chamber's Quarterly Economic Survey results show a similar weakening. In Q4 2025, only 45.8% of businesses had attempted to recruit, nearly 3 percentage points lower than the same time in 2024. Many businesses have reported that the increased NICs are starting to impact their recruitment plans, which could be further thwarted by the expected increases of 4.1% and 8.5% respectively to National Living Wage and National Minimum Wage due in April 2026. With firms not replacing leavers and reportedly trying to counteract wage pressures through technology investment and automation, the number of payrolled employees has decreased for every month since October 2024.

The fiscal drag caused by frozen income tax thresholds has increased the tax burden for more workers and, in turn, affected consumer spending. The GfK consumer confidence index dipped in February negating the gains in recent months. Although there is optimism that the Bank of England might reduce interest rates further on the back of easing inflation, price pressures caused by service sector inflation and wage pressures remain. If geopolitical conflicts were to push oil prices higher, there is the risk of an increase in inflation and consequent cost burden.

January's public sector finances figures contained genuine good news: the public sector recorded a surplus of £30.4 billion in January - more than double the January 2025 surplus and £6.3 billion better than the OBR's forecast. The windfall was driven primarily by self-assessed income and capital gains tax receipts of £46.4 billion as companies and individuals brought forward asset sales ahead of the capital gains tax changes announced in the Autumn Budget.

There are other distinct signs that some parts of the economy may be turning a corner. The Greater Manchester QES results of Q4 2025 showed improvements in both domestic and overseas demand. Nationally, S&P Global's composite UK index for January was at a 17-month high of 53.7. Sector indices for all sector groups have shown recent improvements, setting the scene for better growth figures in Q1 2026.



Growth

Growth in the UK economy in 2025 was in line with expectations at 1.3%, a marginal improvement from the 1.1% in 2024. The varying sectoral performance at the end of 2025 presents an interesting picture and offers some indications of a recovery. Manufacturing and production posted a 1.2% gain while construction slumped by 2.1%. The services sector, which accounts for over 80% of the UK economy, flatlined. Together, these resulted in real GDP per head falling for a second consecutive quarter meaning most households are not seeing any improvement in their living standards.

The S&P Global UK Services PMI rebounded sharply to 54.0 in January with many firms reporting a post-budget improvement in sentiment and greater willingness among customers to commit to spending. Led by increased sales into Europe, service exports have also edged upwards. The manufacturing and production sector also had a hopeful beginning to this year. The S&P Global UK Manufacturing PMI rose to 51.8 in January, the highest level in nearly a year and half. Activity levels in the B2C sub-sector remain weaker than in B2B. In particular, restaurants and hotels appear to be struggling more than their retail counterparts. These trends are consistent with consumer confidence data, which show that households are pulling back on discretionary spending. Manufacturing exports also went up in January. This recovery, however, is concentrated amongst larger manufacturers. The NatWest/S&P Business Growth Tracker showed that SME manufacturers recorded a further fall in output. Amongst SMEs, new orders have declined and recruitment weakened for over one year.

Whilst there are encouraging signs in some parts of the economy, they need to be weighed against weaknesses in the construction sector, which has been particularly under stress in 2025. The S&P Global Construction PMI was at 46.4 in January, firmly below the growth threshold of 50. The ONS also confirmed that construction output fell 2.1% in Q4 2025. Moreover, new orders have now declined for 13 consecutive months, with residential work the weakest segment. In contrast, the GM QES showed more optimism amongst construction sector businesses, with both demand and business confidence related measures registering improvements. Anecdotal evidence indicates that the pipeline of work, both in residential and public infrastructure, is expected to increase in Q1 2026.

Inflation

The new year brought a welcome easing in price pressures with headline CPI falling to 3.0% in January from 3.4% in December, while the broader CPIH measure eased from 3.6% to 3.2%. Transport and food prices provided the largest downward contribution. Although inflation remains above the Bank of England's 2% target, it is clearly moving in the right direction. The January PMI data tells a more nuanced story on prices: input cost inflation remains sharp. This is largely attributable to higher payroll costs. However, firms appear to have hit a stumbling block in passing these costs on with many feeling that their customers will not accept any further increases in prices. As a result, many firms are attempting to absorb some of these higher costs rather than passing them on. This is evident in the QES profitability confidence measure, which is 11 percentage points lower than the turnover confidence measure.

The Bank of England expects inflation to remain above target through 2026, and recent geopolitical tensions are pushing oil prices up. Any substantial increase in energy prices could see a resurgence in headline inflation.

Confidence and Spending

The mood music on consumer spending is mixed. Retail sales volumes rose by 1.8% in January, the largest monthly increase since May 2024. Compared to the same period in 2025, retail sales are 4.5% higher now. This indicates that household spending is getting squeezed but it certainly has not collapsed. E-commerce sales also surged nearly 15% year-on-year. In sharp contrast to these optimistic figures, the GfK Consumer Confidence Index rose one point to -16 in January but slipped back three points to -19 in February. This decline was driven by worsening perceptions of personal finances. The S&P Global Consumer Sentiment Index was similarly subdued at 44.6 in January. The combination of positive retail sales data in January yet deteriorating consumer sentiment in February suggests consumer spending may remain volatile in the months ahead.

Future Outlook

The months ahead will test whether January's PMI optimism was prescient or premature. Recent data suggests the economy is capable of modest acceleration in 2026, but the risks are asymmetric and, with tensions brewing up in the Middle East, there is the distinct possibility of some recent gains being negated. For employers, last year's increase to employer NIC and oncoming increases to NMW/ NLW pose a distinct barrier to hiring. And yet, real wages are not increasing although the ONS data shows that average earnings excluding bonuses have increased by over 4%. If wage pressures result in employers slashing headcount, consumer spending will struggle to sustain momentum regardless of what recent retail sales data suggests. A March rate cut in interest rates is possible but further cuts will be contingent on input prices and wage pressures.

The Spring Spending Review is another critical variable. The Chancellor faces the familiar dilemma of consolidating the public finances while avoiding a fiscal drag. The January surplus provides a modest buffer, but capital gains receipts are a one-off windfall and will not offer sustained structural headroom. And thus, it comes down to the perennial problem of how public spending decisions and tax adjustments can be crafted to give businesses and consumers the confidence to continue to invest. The economic outlook may not be inspiring, and the Chancellor's best bet will be to give some reassurance that there will be no further tax rises.

