SPRING 2026 FORECAST: WEAKENED REGIONAL LABOUR MARKETS AS ENERGY COSTS BITE

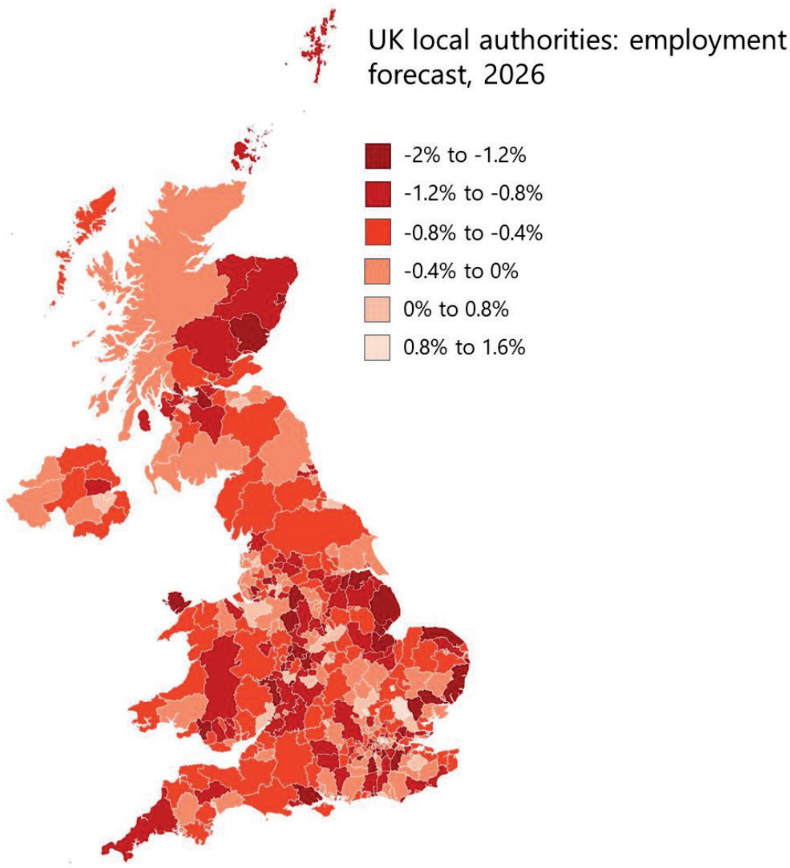
KEY MESSAGES

- The energy shock is feeding through to a broad-based labour market slowdown. Employment is expected to decline across all regions and most major cities in 2026 as firms respond to weaker demand and higher costs.
- Job losses are set to be concentrated in energy-intensive and demand-sensitive sectors, particularly manufacturing, retail, construction, and hospitality, reflecting both rising input costs and the squeeze on household spending.
- Labour market impacts will vary across places, with industrial regions such as Wales and Yorkshire and the Humber more exposed to cost pressures. Meanwhile, cities reliant on consumer spending face demand-driven job losses, while publicly funded sectors (public administration, education, and healthcare) are the only ones set to remain resilient this year. Cambridge is the only significant urban area expected to see employment growth in 2026.
- If the Middle East conflict is prolonged, lower-income areas are particularly exposed, as higher spending on essentials and transport will reduce discretionary consumption, weakening local demand and placing additional pressure on local economies.

JOB LOSSES WILL SPREAD ACROSS MOST CITIES

The conflict in the Middle East is expected to weigh on the UK economy, primarily through higher energy prices, tighter fiscal conditions, and sustained supply chain disruption, which in turn will feed through to the labour market. As cost pressures rise and demand softens, firms are likely to scale back hiring and, in some cases, reduce headcount. Overall, employment is forecast to decline by 0.4% in 2026, representing a net loss of 163,000 jobs across the country.

Chart 1: Employment forecast by local authority, 2026



Sources: ITEM Club, ONS

Given its size, London is expected to account for the largest decline in employment, with a loss of 25,000 jobs. Similar pressures are likely to be felt across other major urban areas, with Birmingham (-12,500), Leeds (-9,800), and Glasgow (-6,200) all forecast to experience notable contractions. In Wales, Cardiff (-2,100) is also expected to see a significant decline, reflecting similar pressures on both demand and industrial activity.

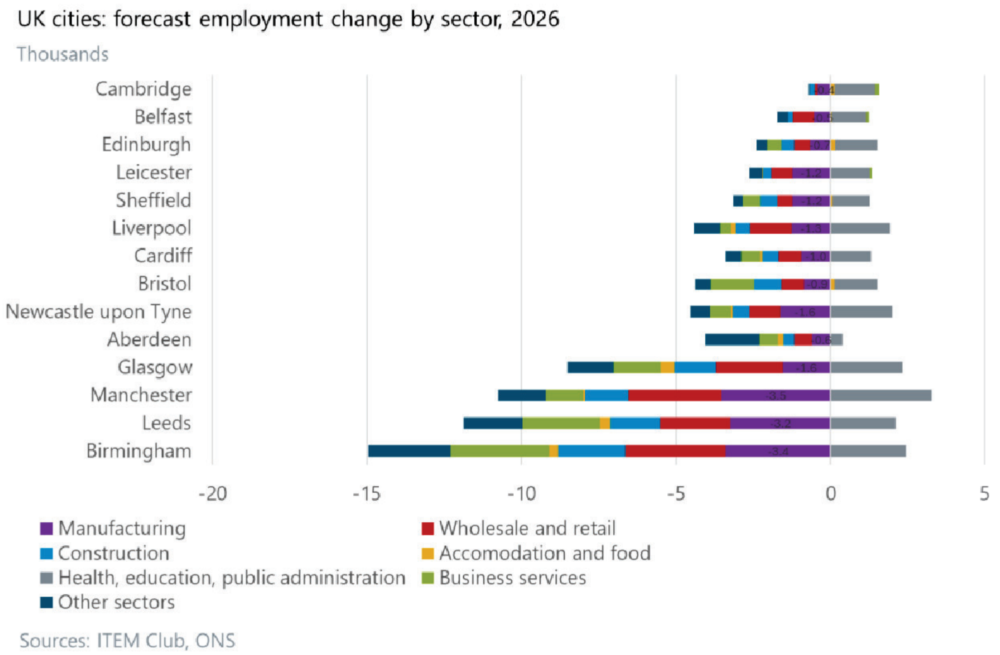
By contrast, a small number of cities are likely to prove more resilient. Belfast and Edinburgh are expected to see relatively limited job losses—less than a thousand in each—thank to their more favourable sectoral mix. Cambridge, however, stands out as the clear exception: it is the only large urban area where employment is forecast to grow, albeit modestly—a testament to its economic strength and relative insulation from the current economic headwinds.

Unemployment is projected to rise across the country as job losses feed through and hiring slows. In Birmingham, for example, unemployment is forecast to increase from 6.7% in 2025 to 7.8% in 2026, while in Glasgow we expect unemployment to rise to 5.1%, from 4.3% in 2025. At the same time, economic inactivity remains elevated following the Covid-19 pandemic, and a further uptick in early 2026 suggests that some individuals may exit the labour market altogether rather than transition into new roles. Together, these trends point to a more subdued and uneven labour market adjustment in the year ahead.

ENERGY-INTENSIVE AND DEMAND-SENSITIVE SECTORS WILL BE MOST AFFECTED

Job losses are expected to be concentrated in a handful of large sectors: manufacturing, construction, wholesale and retail trade, and accommodation and food services. These sectors are especially exposed to the current economic environment: manufacturing and construction face rising input and financial costs, while retail and hospitality are highly sensitive to the squeeze on households' disposable income.

Chart 2: Forecast employment change by sector and largest urban areas (excluding London), 2026



Local economic structures play a key role in shaping the pattern of job losses across cities. In London, wholesale and retail trade is expected to account for the largest decline in employment, reflecting weaker consumer demand in a city with a large and highly exposed retail sector. In Birmingham, job losses are likely to be more broad-based, driven by a combination of declines in manufacturing, wholesale and retail, and construction. Similarly, in Glasgow and Cardiff, the sectoral mix means that losses are expected across both consumer-facing and industrial activities.

Outside of the main urban centres, manufacturing activity is expected to come under pressure, particularly in energy-intensive industries such as chemicals, metals, and heavy manufacturing. This is particularly pronounced in South Wales, where industrial activity is highly specialised in metal processing and steel production—both of which are very energy-intensive. Similarly, the Humber area—with its large concentration of petrochemicals, refining, and steel manufacturing—is particularly exposed. These areas are expected to see employment declines of 5,700 and 2,800 respectively this year. The latest payroll data show a decline of around 3,700 employees in South Wales in the year to February 2026, whereas the Humber was more resilient, with employee levels broadly level over the period.

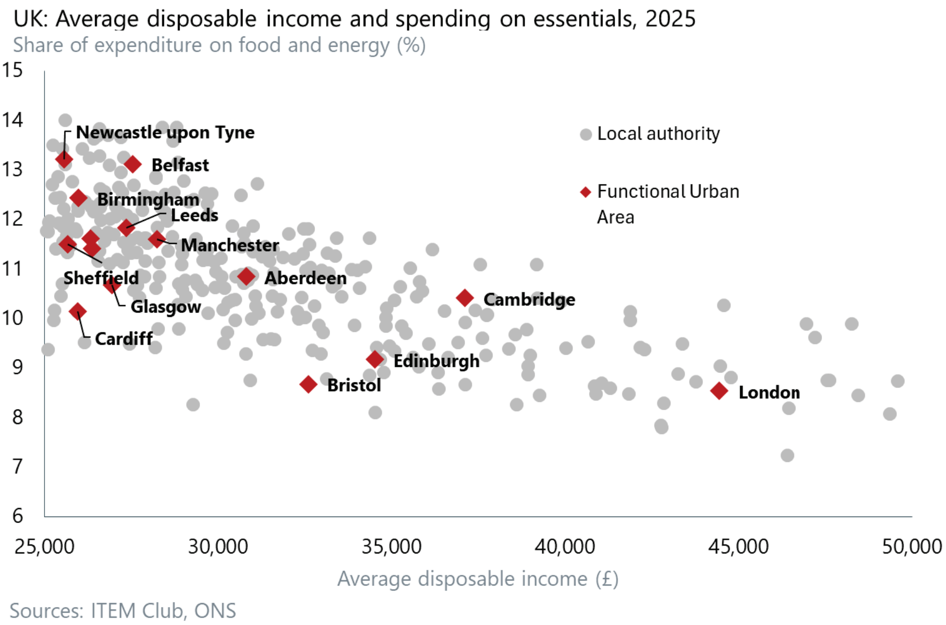
Only a small number of sectors are expected to generate employment growth this year. Gains are likely to be concentrated in public administration, education, and human health and social work—sectors that are largely publicly funded and therefore more insulated from the current economic environment. However, these increases are unlikely to offset losses in larger, more demand-sensitive sectors.

LOWER-INCOME AREAS ARE AT GREATER RISK OF MORE SIGNIFICANT SLOWDOWN

Rising energy costs are expected to place disproportionate pressure on lower-income households, whose budgets are already more constrained. With limited financial headroom, these households are more sensitive to increases in essential spending and more likely to reduce discretionary consumption.

If the Iran war lasts longer than our current expectations, consumers in Newcastle, Belfast, and Birmingham will be more exposed, with implications for regional demand (**Chart 3**). In these areas, a combination of lower average incomes and a higher proportion of spending on essentials such as food and energy means that households will be less able to absorb the shock, potentially leading to sharper cutbacks in spending.

Chart 3: Average disposable income and share of spending on essentials, 2025



Other local factors will also shape how households respond to inflationary pressures, particularly differences in transport usage. Regions that are more heavily dependent on private cars are likely to face additional cost pressures as fuel prices rise, further squeezing disposable incomes. For example, in the West Midlands, car users commute an average of 872 miles per year, compared with 548 miles in the North West England and just 212 miles in London.

Altogether, this suggests that the impact of the inflationary shock will be shaped not only by industrial structure, but also by household vulnerability. In practice, this means that areas with more financially constrained households are likely to experience a sharper and more sustained slowdown in local demand and growth prospects.

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The ITEM Club is the only non-governmental economic forecasting group to use the HM Treasury's model of the UK economy. Its forecasts are independent of any political, economic or business bias.

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