Resolution Foundation

The Living Standards Outlook

2021

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Executive Summary

The new year has begun with worse news than expected. But the prospect of a rapid roll out of Covid-19 vaccines this year should mean that, given the depth of the downturn last year, there is a significant recovery in GDP during 2021. Most discussions of recovery begin and end with the path of GDP, but whether this feels like a recovery for UK families will depend on what happens to household incomes and living standards.

In this, our third dedicated Living Standards Outlook, we therefore assess how the hoped-for post-pandemic economic recovery might translate into a recovery for living standards. Focusing on working-age households, we provide what are currently the UK's only projections for household disposable incomes across the income distribution – rather than looking just at how the average may change. We take as our basis the most recent projections from the Office for Budget Responsibility (OBR) and the Government's stated policy choices, and combine that with official survey data to assess the impact on households' living standards in 2021-22, and then through to 2024-25.

Income and employment support schemes kept a lid on unemployment increases and income falls during 2020

Since the crisis hit, the support schemes introduced by the Government have prevented an unprecedented collapse in GDP from turning into a living standards disaster. There have been a series of policies that have aimed to keep firms in business

when they could not actively trade, prevent unemployment (chiefly through the Job Retention Scheme), and support family finances directly through grants to some self-employed workers and more generous welfare benefits. The latter includes an extra £20 a week on Universal Credit (UC) and Working Tax Credits (WTC), plus additional support through benefits for low-income renters. As a result, even though GDP in November 2020 was still 8.5 per cent below pre-pandemic levels, official working-age unemployment in Aug-Oct 2020 stood at just 5.1 per cent, only 1.2 percentage points higher than a year earlier.

There has, though, still been a significant labour market hit, with younger workers, those on insecure contracts, those in leisure and hospitality, and the self-employed particularly affected. But the support policies have also cushioned the impact of that labour market hit on household incomes. Despite huge falls in GDP, our nowcast implies that typical non-pensioner real household incomes grew very slightly, by 0.1 per cent, in 2020-21. While welcome, this success in protecting incomes on average hides large losses for many families, such as those falling onto benefits or those who have fallen through the gaps in government support.

Despite a GDP recovery in 2021-22, typical incomes are set to fall, most significantly at the lower end of the income distribution, leading to increasing poverty

Just as the new support schemes have protected household incomes so far, so their removal in 2021-22 means that the significant recovery in economic activity will not be accompanied by growing household incomes. In fact, the combination of the withdrawal of the extra £20 on UC and WTC, which is still due to expire in April 2021, combined with the expected increase in unemployment of 900,000 in 2021-22 as the JRS comes to an end, means that typical non-pensioner household incomes are projected to fall by 0.4 per cent in 2021-22.

Although the income fall projected for median income next year is significantly smaller than the inflation-driven fall that occurred after the financial crisis, the fall at lower incomes is

set to be significantly larger than seen a decade ago. We project that incomes at the 10th and 20th percentile of the distribution will decline by around 10 per cent and 5 per cent respectively next year. These falls would leave income at the 10th percentile – typical income for someone in the lowest income quintile – no higher than it was in the early 2000s. Overall, across the two years – of the benefit boosts and the planned benefit cut – incomes are forecast to be lower across the whole of the bottom half of the income distribution in 2021-22 than in 2019-20, with falls in excess of 5 per cent in the bottom ten per cent. This is a result of the impact of higher unemployment as well as the continued roll-out of the pre-pandemic benefit cuts.

Rising unemployment and the removal of the £20 uplift in 2021-22 will also lead to a further 1.2 million people falling into relative poverty (defined as those in a household with less than 60 per cent of median income), 400,000 of whom are children. This would be the biggest year-on-year rise in poverty rates since the 1980s. Unlike then, though, when rising relative poverty was caused by typical incomes growing much faster than those at the bottom, the forecast rise in poverty in 2021-22 reflects a predicted sharp fall in the incomes of low-income households. As a result, and unlike in the 1980s, absolute poverty (defined as those in a household with less than 60 per cent of the 2010-11 median income) will also rise.

Earnings are forecast to recover slowly over this parliament, meaning that the fifteen years since the financial crisis will have been truly dreadful for households' living standards

After a rebound during the immediate recovery from the pandemic lockdowns, the OBR expects earnings growth to fall back a little in 2022, before accelerating slightly towards the middle of this decade. The result is a level of earnings that is permanently 6 per cent lower than was projected in March 2020, although the lowest-paid employees will continue to benefit from large increases in the National Living Wage (NLW).

This weak post-pandemic growth in earnings incorporates the OBR's assumption of a permanent 4 per cent hit to productivity from leaving the EU. When combined with the expected fall in incomes in 2021-22, stalled income growth after the vote to leave the EU, and a much larger fall in household incomes after the financial crisis we are two thirds of the way through a dreadful decade and a half for living standards. Taken together, real income growth of 8 per cent is projected over the 15 years between 2009-10 and 2024-25 – five times less than the 38 per cent recorded during the 15 preceding years (1994-95 to 2009-10).

The slow recovery of unemployment and continuing benefit cuts mean child poverty will rise to its highest levels for nearly three decades

Weak and regressive income growth means this parliament is set to be difficult for low-to-middle income households. By 2024-25, we estimate that 23.0 per cent of individuals will be living in relative poverty – up from our estimate of 22.2 per cent in 2019-20, and up from 21.1 per cent in 2020-21. The next few years risk relative poverty reaching its highest level since 2000-01.

We also expect relative child poverty (defined as those children in a household with less than 60 per cent of median income) to rise, pushed up by the continuing roll-out of the two child limit and removal of the family element for families on benefits. These projections imply over one-in-three (33.7 per cent) children being in poverty by the end of the parliament, some 730,000 more than in 2020-21.

An overall measure of inequality – the Gini coefficient – shows a similar picture, with income inequality set to rise further from 2019 to 2024.

A stronger living standards recovery requires success in keeping unemployment low and the UK to outperform the OBR's productivity forecasts

Central to improving on this grim outlook for the living standards recovery is minimising the hit to the labour market in 2021-22. The Government's objective must be that their efforts

to effectively roll out a vaccine programme can be combined with an appropriately-timed wind-down of furlough scheme to deliver a faster bounce back in economic growth and (crucially) a much smaller rise in unemployment. Beyond this year, the key to a stronger living standards recovery rests in a post-Brexit and post-Covid UK achieving significantly faster productivity growth than the OBR currently forecasts.

Across the Parliament as a whole, existing policy and the OBR's central scenario, which underpins the modelling in this paper, implies typical real income growth of around 4 per cent. However, it could be the case the OBR's upside scenario is closer to the economic outcomes that transpire in 2021 and beyond. This scenario involves productivity growth of 6.9 per cent over the five years from 2020 to 2025 compared to 4.1 per cent in the central scenario, and an unemployment rate in 2021 of 4.7 per cent as opposed to 8.4 per cent in the central scenario. Our modelling of household incomes under this forecast projects a typical growth of 6 per cent, 50 per cent higher than in the central scenario.

But policy choices will determine whether this is a fairly-shared living standards recovery

The strength of the economic recovery is central to the pace of the living standards recovery – including whether we can move a post-Brexit and post-Covid UK onto a path of faster productivity growth – but its shape, including, crucially, how it is experienced by low-to-middle income households, will be dominated by the immediate decision facing the Government on whether to extend the £20 a week rise in UC and WTC.

Proceeding with current plans to remove this increase would reduce the incomes of 6 million households by around £1,000, and mean the incomes of the poorest fifth of working-age households fall by over 4 per cent. It would also put the basic level of unemployment benefit at its lowest in real terms since the 1990-91. Were the Government to decide to maintain the current higher level of benefits it would transform the living standards outlook for low-to-middle income households, more

than halving the size of their projected income fall. This single policy change alone would mean that incomes at the 25th percentile of the distribution would grow by a projected 4 per cent over this Parliament, compared to a less-than-1 per cent rise if the boost is not maintained. If the uplift is made permanent throughout the Parliament (and indexed appropriately with inflation), then relative poverty overall and inequality would both fall over this parliament, and child poverty would remain virtually flat.

So, while the living standards outlook is weak, especially for those on low-to-middle incomes, the role for policy in improving it is clear. Successfully navigating the hit to the labour market next year and maintaining a higher (but far from high) basic level of benefits can provide the route to ensuring that household living standards – especially for those on low and middle incomes – share in the wider economic recovery.

Section 1

Introduction

The new national lockdown to tackle the more transmissible variant of Covid-19 means that the first months of 2021 will closely resemble the hard lockdown of Spring 2020. This is a worse start to the year than was typically expected even just a few weeks ago.[1] But there are reasons to be hopeful about a strong recovery in GDP in 2021, with the vaccine roll out proceeding at speed, and the Government holding out the prospect of it covering all adults by autumn 2021. At the same time, the Brexit deal that came into effect a few weeks ago has removed some of the uncertainty that has dogged the country for some time, even if its full implications have yet to be experienced.

In this, our third dedicated Living Standards Outlook, we assess how that hoped-for economic recovery translates into living standards for working-age households. We provide what is currently the UK's only projections for household disposable incomes across the income distribution – rather than looking just at how the average may change.[2] We use official survey data that goes up to 2018-19, plus what we know about how the economy has evolved since then, to create timelier 'nowcasts' of households' living standards in 2019 and 2020. We then project those forward using the OBR's forecasts and current policy choices.

This work brings together our understanding of where Britain stood prior to the Covid-19 crisis; how the crisis and policy responses affected the household finances of different groups; and what the years up to 2024-25 may hold in a range of scenarios. These nowcasts and projections are important to help us understand the state of UK living standards far in advance of full survey data becoming available, but they also make clear the potential impacts of policy choices. Indeed, our work shows that the decision the Government must make soon on whether to continue the currently-temporary boost to Universal Credit (UC) will have a large impact on the outlook for UK living standards over this parliament.

1 J Smith et al, Macroeconomic Policy Outlook Q4 2020, Resolution Foundation, December 2020.
2 The first two reports were in 2018 and 2019. The lack of an OBR Economic and Fiscal Outlook in autumn 2019 (following the delay of the expected autumn 2019 Budget) meant that we did not produce a Living Standards Outlook in 2020.

This year's Outlook must be considered even more uncertain than usual

Our approach in this report is not to make new forecasts for the economy as a whole, nor for the progress of the pandemic. Instead, we take as our basis the most recent projections from the Office for Budget Responsibility (OBR), and the Government's stated policy choices.[3]

There is, of course, considerable uncertainty over future years. Indeed, since the OBR made its forecasts in November 2020, the UK has been hit by a more transmissible variant of the virus, and all parts of the UK are currently in some form of lockdown. This has in turn led the Government to extend the Job Retention Scheme (JRS)at least to the end of April, as well as announce a new support package for businesses directly affected by the 2021 lockdown.[4] The new lockdowns mean that GDP growth rates in early 2021 will be a lower than that forecast by the OBR[5], but it is likely that the impact on earnings and incomes will be largely (but not wholly) offset by the continuation of the JRS and the Self-employed Income Support Scheme (SEISS) through to the end of April 2021. And the other significant development since the OBR's forecast has been the approval of vaccines, and the comparatively successful start to the roll out of a sensible vaccination plan.[6] Accordingly, we feel it is still a sensible central scenario to use.[7] However, to acknowledge the uncertainty for future years, we show a number of different scenarios for the period from 2021-22 to 2024-25.

But we would also stress that there is also much more uncertainty than usual about our estimate (which we refer to as a 'nowcast'[8]) of household incomes in the current financial year, 2020-21. The pandemic saw the introduction of new government programmes to support the economy, including those to directly help household incomes, altogether costing an estimated £280 billion in 2020-21.[9] In addition, a large fraction of the workforce will have had their earnings affected by the pandemic at some point in 2020-21. Although some of these changes are captured well in administrative data or official labour market statistics, there are no definitive official statistics covering the distribution of household incomes or household finances in 2020, which is one of the main reasons why this

3 OBR, Economic and fiscal outlook, OBR, November 2020. The Bank of England's assessment made at the same time was similar, see: Bank of England, Monetary Policy Report – November 2020.
4 HM Treasury, £4.6 billion in new lockdown grants to support businesses and protect jobs, January 2021.
5 Previous RF estimates were that even the less-restrictive Tier 4 restrictions (which at one point had been intended for England in early 2021) would have lowered GDP by 6 per cent by Easter compared to the OBR's forecast, or 1.2 per cent over the whole of 2021. The current set of restrictions are consistent with a bigger fall than that. See J Smith et al, Macroeconomic Policy Outlook Q4 2020, Resolution Foundation, December 2020.
6 Our World in Data, Coronavirus (COVID-19) Vaccinations.
7 The OBR described the central scenario as one "in which restrictive public health measures need to be kept in place until the spring and vaccines are rolled out more slowly, leading to a slower return to pre-virus levels of activity at the end of 2022". OBR, Economic and fiscal outlook, OBR, November 2020
8 J Navicke, O Rastrigina & H Sutherland, Nowcasting Indicators of Poverty Risk in the European Union: A Microsimulation Approach, Social Indicators Research, 2014.
9 OBR, Economic and fiscal outlook, OBR, November 2020.

report is needed (of course, a number of other organisations, including the Resolution Foundation, have commissioned their own studies since the pandemic began, and we summarise what we know from those later).

In this year's Outlook, then, more than ever, our results should not be taken as definitive forecasts, but as projections that are broadly consistent at the aggregate level with what the OBR are assuming for the state of the economy (as well as stated Government policy) and that feature a limited number of assumptions made by us (that are detailed in the Appendix).

This report is about household incomes, as a proxy for living standards, but the crisis has also had profound impacts on household balance sheets, as well as on the cost of living for certain types of households

The focus of this report is on the distribution of household incomes for the non-pensioner population as measured by disposable income after housing costs have been deducted: this is the after housing costs (AHC) measure of income used in the DWP's 'Household Below Average Income' (HBAI) publication.[10] We do not assess prospects for living standards among the population of those above the state pension age, partly because it is very difficult to project how the pandemic will affect future levels of unearned income.[11] We also do not provide any new assessments of how the pandemic has affected household balance sheets (i.e. savings and debt), nor do we project those beyond 2020-21. But previous work by Resolution Foundation and others have already shown not just that the pandemic has had very large impacts on household balance sheets – in aggregate, an increase in the net saving rate driven by a fall in spending[12] – but that that there has been a very strong distributional pattern to these changes. In general, it has been much more likely to have been lower-income families who have seen household balance sheets deteriorate. The increase in savings has been more likely among higher-income families, where it has been driven by falls in discretionary spending on social activities that have been curtailed by the pandemic.[13]

Our results should also be read in the context of recent work showing that the pandemic has made life more expensive for those on a low income, something that is not picked up in the conventional measures of price deflators that are used to produce real-term

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10 Department for Work and Pensions, Households below average income: 1994/95 to 2018/19, March 2020.

11 See, though, R Crawford and H Karjalainen, Financial consequences of the coronavirus pandemic for older people, Institute for Fiscal Studies, September 2020.

12 ONS, Consumer Trends, ONS, December 2020; ONS, Households' saving ratio.

13 See, e.g., See, e.g., Chart C in Box 3 in Bank of England, Monetary Policy Report and Financial Stability Report - August 2020; K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020; A Davenport, R Joyce, I Rasul & T Waters, Spending and saving during the COVID-19 crisis: evidence from bank account data, Institute for Fiscal Studies, October 2020.

income estimates in this report.[14] It is also the case that the surveys used for our analysis, and much of the online survey work undertaken during the crisis, may not reflect fully the circumstances of the most disadvantaged in society.[15]

This report is set out as follows:

- **Section 2** looks at what has happened to **employment and earnings** in this crisis, and what we could expect over the next few years;
- **Section 3** explores some of the other major factors that could help shape disposable incomes for large numbers of people – **benefit policy, taxes, and housing costs;**
- **Section 4** brings together these components and presents our nowcasts and projections for **household incomes across the income distribution** from 2019-20 to 2024-25, in a range of scenarios;
- **Section 5** shows what these patterns would mean for measures of **poverty and inequality**;
- **Section 6 concludes**; and,
- For technically-minded readers, the **Annex** gives additional information about our nowcasting and forecasting methodology.

14 M Brewer and R Patrick, Pandemic Pressures: Why families on a low income are spending more during Covid-19, The Resolution Foundation, January 2021.
15 But see: S Fitzpatrick et al, Destitution in the UK 2020, Joseph Rowntree Foundation, July 2020.

Section 2

Prospects for market incomes

One success story of 2020 has been how the support schemes introduced by the Government have prevented an unprecedented collapse in GDP from turning into a living standards disaster. As a result, even though GDP in November 2020 was still 8.5 per cent lower than before the pandemic, official working-age unemployment in Aug-Oct 2020 stood at just 5.1 per cent, only by 1.2 percentage points higher than a year earlier. But there has still been a labour market hit, and it has been skewed towards the bottom, with younger workers, those on insecure contracts, and those in leisure, retail and hospitality the most affected.

In 2021-22, GDP is set to significantly recover from its precipitous fall in 2020-21, but the OBR expects unemployment to continue to rise from its 2020 level, peaking at 7.5 per cent in Q2 2021, shortly after the end of the JRS. From this high point, unemployment is likely to fall slowly, mirroring the pattern of past recessions. Once the UK moves into the post-crisis recovery period, the OBR are expecting relatively weak growth in earnings, in part because of the permanent hit to productivity caused by leaving the EU. This means that average employee earnings will not return to their (real-terms) pre-financial crisis levels until 2026, approaching two-decades of lost pay growth. One bright light is that the continued growth in the Living Wage should push down on earnings inequality.

In 2020, income and employment support schemes kept a lid on unemployment increases

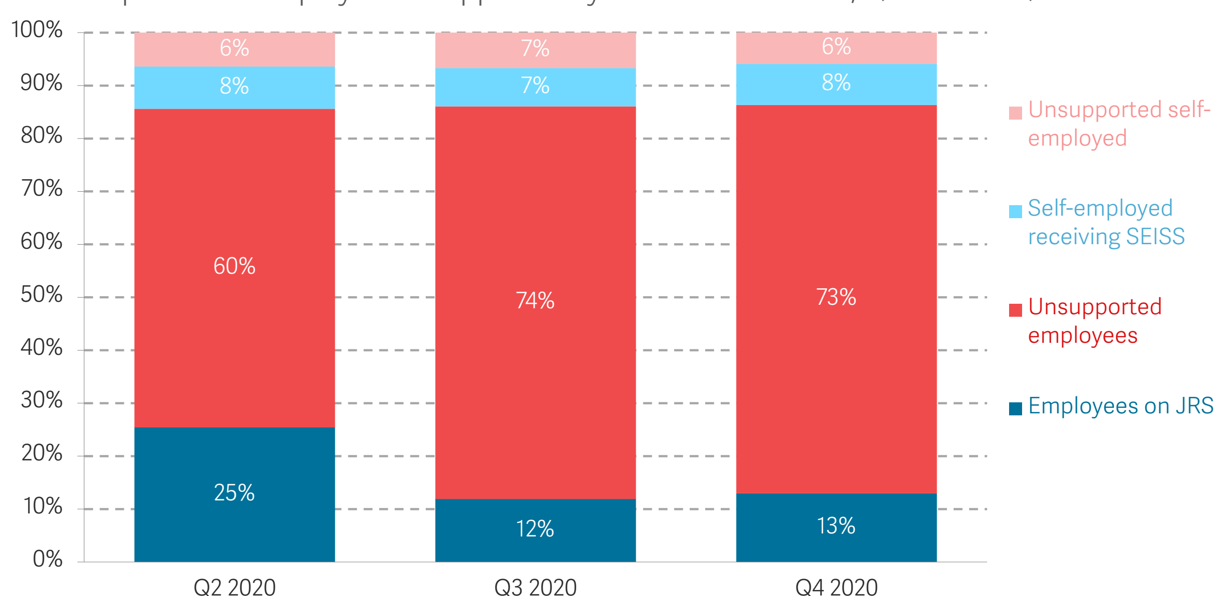
Output fell significantly in 2020 as lockdowns and changes in consumer behaviour caused businesses to close or operate with reduced supply. But despite a very large fall in GDP (with the OBR expecting in November 2020 that GDP in 2020-21 would be 13 per cent lower than in 2019-20) shown later in this section in Figure 5, the impact on employment has been relatively muted. So far, official working-age unemployment has risen only by 1.2 percentage points to 5.1 per cent (in Aug-Oct 2020, compared to a year

earlier), although Real Time Information (RTI) payroll measures suggest that it may really be closer to 6 per cent.[16 17]

Although not every job has been protected, and there have been gaps in the coverage, the success story at preventing catastrophic rises in unemployment is due to the various support schemes brought in by the Government when the pandemic hit. Over 10 million workers have had their wages paid at one point in 2020 by the JRS, and 2.7 million people claimed the first SEISS grant, and 2.4 million the second.[18] Figure 1 puts these schemes into perspective, showing that around one-third of the workforce were initially supported by the JRS or SEISS in the hard lockdown in Spring 2020, but that this fell to one-fifth in the second half of 2020.

FIGURE 1: **In the first months of the pandemic, one-third of the workforce had their earnings directly supported by government**

Proportion of employment supported by JRS and SEISS: UK, Q2 2020 to Q4 2020



NOTES: Q4 2020 bars are projections.
SOURCE: OBR analysis of HMRC and ONS.

Low-earners have been more likely to experience job losses and furloughing in 2020-21

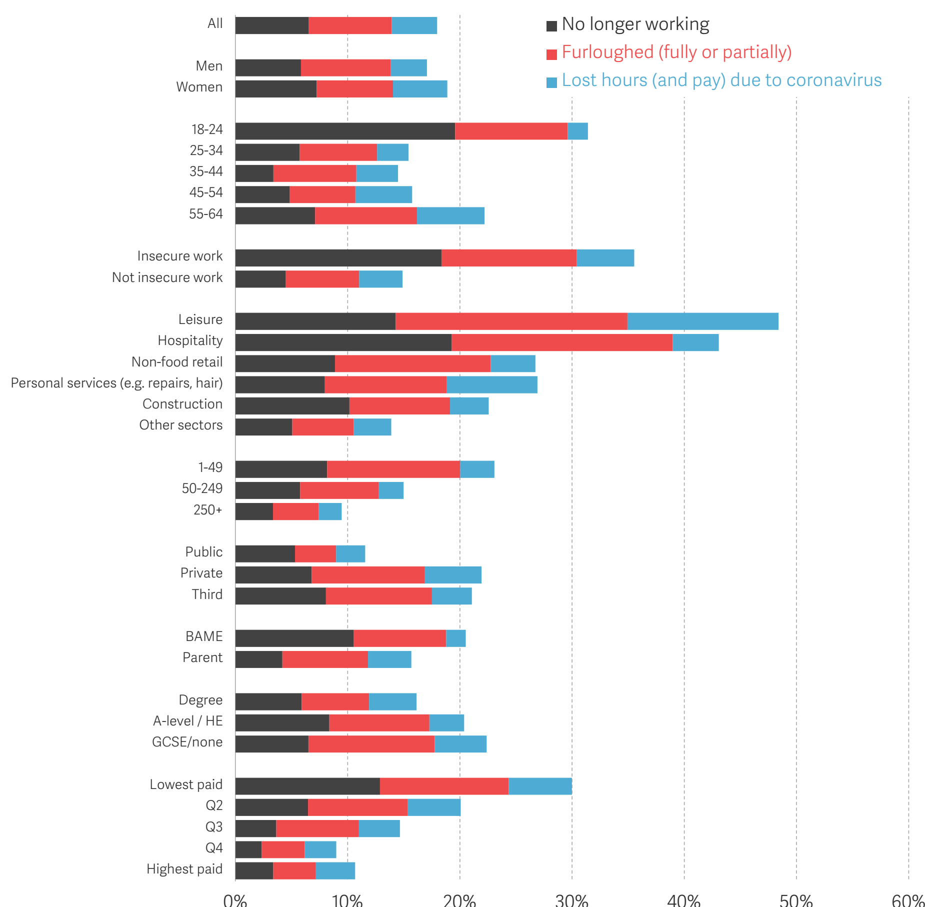
It is well known that the labour market hit of this crisis has been very sectorally-differentiated, and in turn this means that some types of workers have been

16 OBR, Economic and Fiscal Outlook, November 2020.
17 There are also concerns at how well the Labour Force Survey is measuring the labour market during the pandemic. See, most recently, M O'Connor and J Portes, Estimating the UK population during the pandemic, Economic Statistics Centre of Excellence, January 2021.
18 From HMRC, Coronavirus Job Retention Scheme statistics: November 2020 and HMRC, Self-Employment Income Support Scheme statistics: November 2020.

disproportionately likely to have experienced job losses. Figure 2, for example, shows data from September 2020 to show that younger workers, those on insecure contracts, and those in leisure and hospitality were much more likely to have lost earnings in some way than other workers.[19]

FIGURE 2: **Employment effects vary widely across groups, with those working in hard-hit sectors, the young, and the low paid, worst affected**

Change in employment status in September compared to February among those who were employed pre-coronavirus (in February): UK, data collected 17-22 September 2020



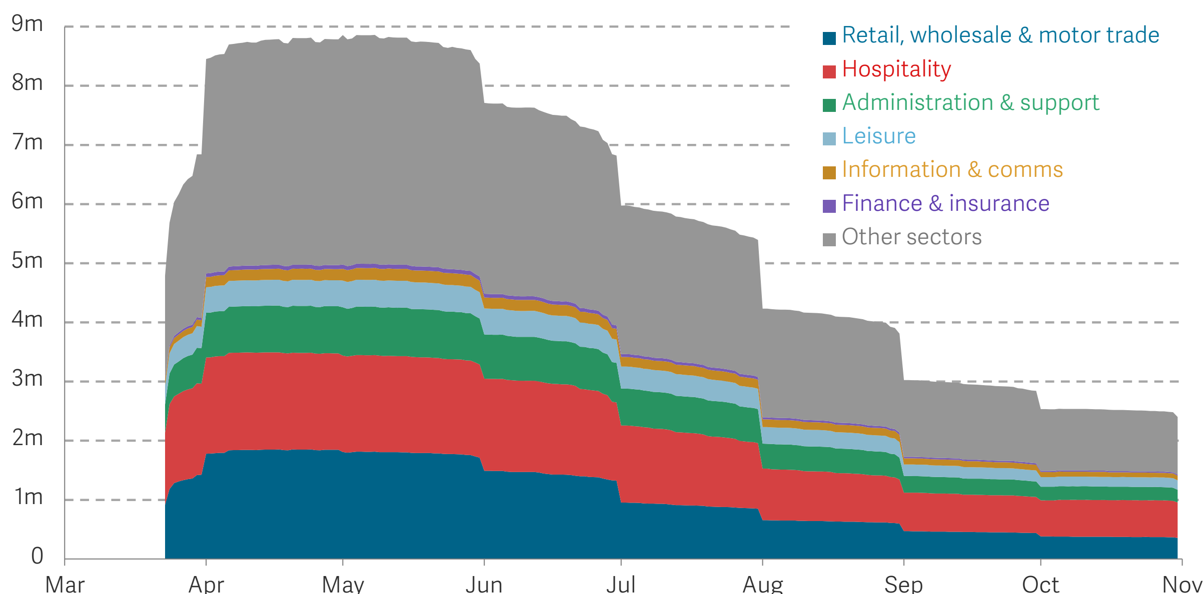
NOTES: Base = all those in employment in February (N=4,479). Sample size for the subgroups are as follows. Men: 2,175, Women: 2,261; age 18-24: 382, age 25-34: 1,133; age 35 to 44: 1,093, age 45-54: 1,128, age 55-64: 647; Insecure work: 648, Not insecure work: 3,788; Leisure: 196, Hospitality: 168, Non-food retail: 194, Personal services: 205, Construction: 120; Other sectors: 3,460; Employer size 1-49: 1,143, 50-249: 954, 250+ 1,404; Public sector: 1,711, private sector: 2,247, third sector: 332; BAME: 274, Parent: 1,494; Highest qualification is degree: 2,874, A-level or equivalent: 851, GCSE or equivalent or lower: 625; Pay quintile 1: 729, quintile 2: 773; quintile 3: 724, quintile 4: 713, quintile 5: 740. Insecure work defined as including zero-hour contract, agency worker, temp worker, or variable hours contract. Pay quintiles are based on weekly net (take-home) usual pay prior to the coronavirus outbreak. These figures have been analysed independently by the Resolution Foundation.
SOURCE: RF analysis of YouGov, Adults Age 18 to 65 and The Coronavirus (COVID-19) – September wave.

19 Taken from: M Brewer et al., Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the UK labour market, Resolution Foundation, October 2020.

Figure 3 uses administrative data on which employees have had the wages covered by the JRS since March, showing that being between 42 and 46 per cent came from just three sectors: retail, hospitality and leisure.

FIGURE 3: **The number of employees supported by the JRS has varied considerably with the evolving restrictions on economic activity**

Number of employees furloughed, by sector: UK, 23 March 2020 - 31 October 2020



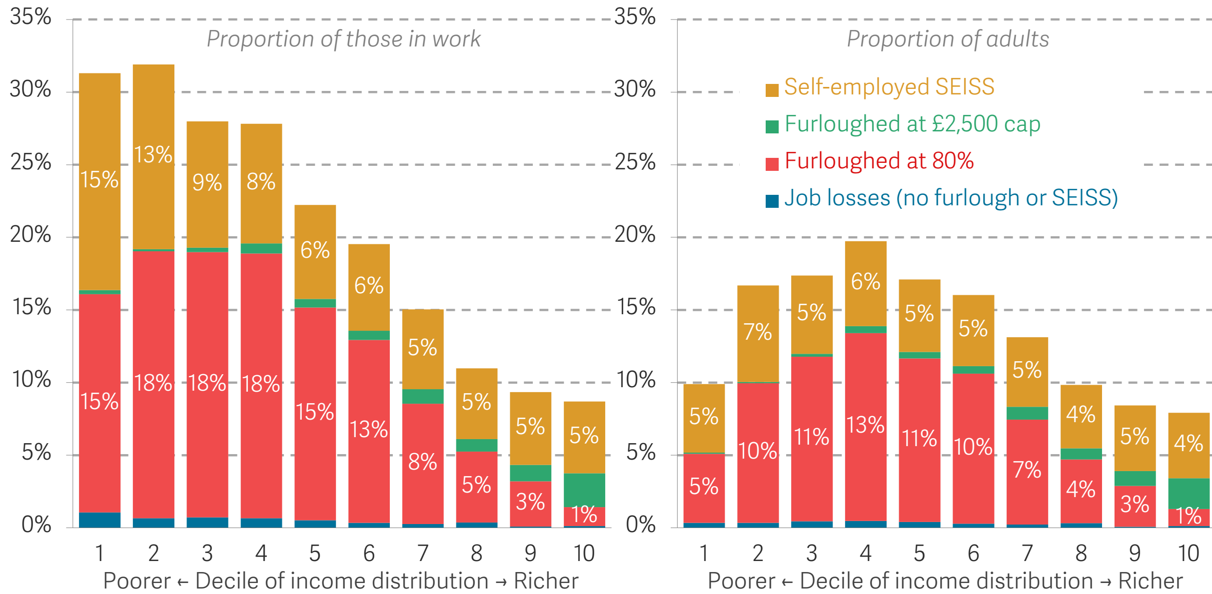
NOTES: JRS data by sector only became available from 23 March.
SOURCE: RF analysis of HMRC, Coronavirus Job Retention Scheme statistics: December 2020.

Figure 2 also shows that those on lower (pre-pandemic) earnings were much more likely to have been affected than those on higher earnings, but what matters for the assessment of living standards is how these impacts vary across households with different levels of disposable income. We have shown in previous work that, although, before the pandemic, low-income households were more likely to have been affected by a negative labour market shock than high-income households, the gradient was less steep with respect to household income than it is with respect to earnings.[20] This is partly because not all low earners live in low-income households, but is also because the lowest-income households are especially likely to contain no-one in work. This can also be seen clearly in the two panels of Figure 4, which show our assumptions of how the employment shock in 2020-21 is distributed across households of different (pre-pandemic) income levels (full details can be found in the Annex).

20 See, for example: M Brewer & L Gardiner, Return to spender: Findings on family incomes and spending from the Resolution Foundation's coronavirus survey, Resolution Foundation, June 2020; K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020; P Bourquin et al, The effects of coronavirus on household finances and financial distress, Institute for Fiscal Studies, June 2020.

FIGURE 4: **Furloughing and job loss is concentrated among working adults in low-income households**

Proportion of working-age adults affected by Covid-19 labour market shock, by 2019-20 non-pensioner household income decile, among those in work (left-hand panel) and all working-age adults (right-hand panel): UK, 2020-21



NOTES: Incidence of labour market effects of coronavirus by decile drawn from RF modelling results, for details see Annex.
SOURCE: RF analysis of DWP, Households Below Average Income; and RF nowcast.

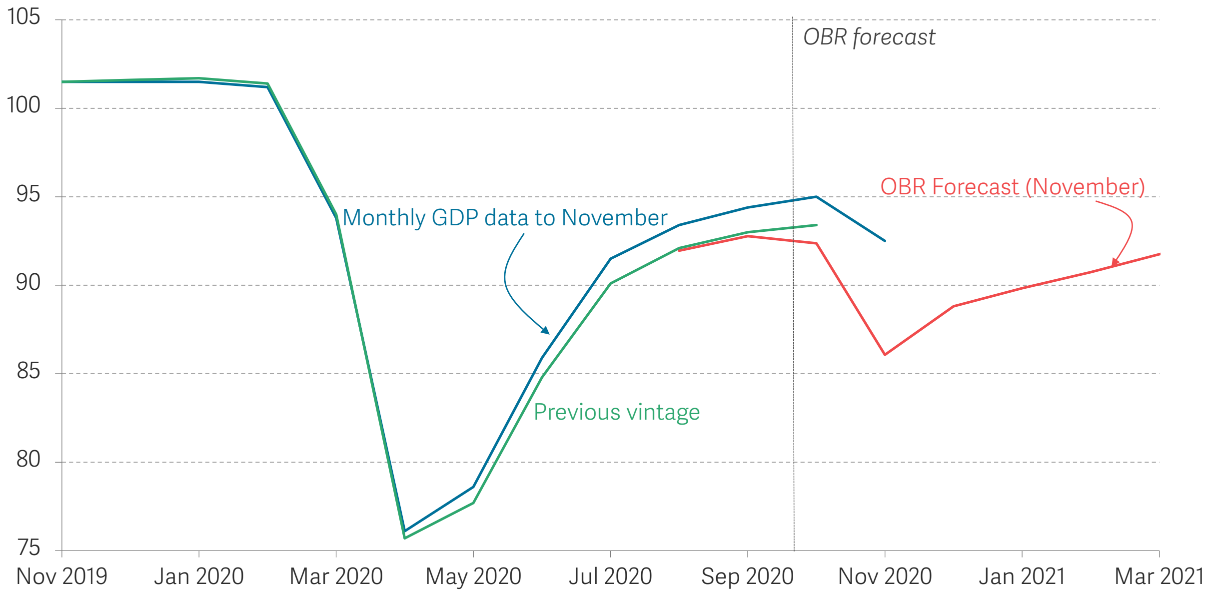
Despite an expected economic recovery in 2021-22, unemployment has further to rise, and is expected to peak after the Job Retention Scheme is wound down

We move now to the labour market outlook for 2021-22 and beyond. The starting point for our projections is the OBR's forecast of the state of the economy and the labour market. Figure 5 shows the forecast for GDP, and Figure 6 shows forecasts for unemployment.

The OBR had expected strong growth in GDP in 2021, with the level in 2021-22 forecast to be 10 per cent higher than in 2020-21. But despite this, it also forecast unemployment to continue to rise from its 2020 level, peaking in its central scenario at 7.5 per cent in Q2 2021, shortly after the end of the JRS (at the time, the JRS had been confirmed to last until March 2021).

FIGURE 5: **Despite the dip in November 2020, when England was in lockdown, GDP is expected to grow rapidly in 2021**

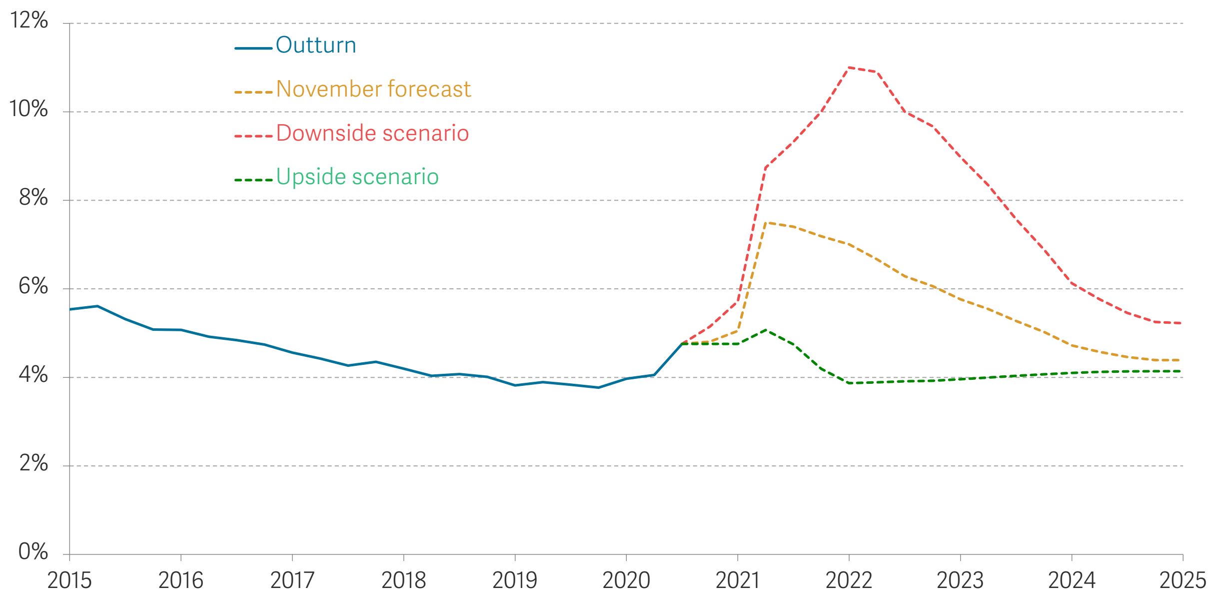
Monthly index of real GDP: UK, November 2019 to March 2021



NOTES: The OBR forecast was made prior to the release of monthly GDP data for October and before a set of revisions affecting the data since April; OBR monthly profiles beyond March 2021 are consistent with quarterly GDP growth.
SOURCE: RF analysis of ONS; OBR.

FIGURE 6: **The path of unemployment in 2021-22 and beyond could vary widely, depending on progress in vaccinating the population and phasing out support at the right time**

Unemployment rate, outturn and various scenarios: UK, Q1 2015 to Q1 2025



SOURCE: OBR and ONS.

The OBR also produced a downside scenario, reflecting a possible state of 2021 in which vaccines proved ineffective, and stringent limits on economic activity persisted. [21] We show this in Figure 6, but we do not use it in our main forecasts of household incomes through to 2024-25 because the evidence to-date is both that the available vaccines are effective and their roll out is happening effectively. The scenario does illustrate, though, what the impact on the economy could be if any further mutations of the virus reduce the effectiveness of the current vaccination programme.

The current lockdown in early 2021 will hamper GDP growth in the short-term, relative to the OBR's central scenario. However, much of the economic pain is concentrated in the 2020-21 financial year with the JRS still minimising the employment hit from the current lockdown. In reality, the path for unemployment in 2021-22 depends both on the success in rolling out the vaccine programme, as that should allow restrictions on economic activity to be eased, and also on getting right the timing of the phasing-out of the support schemes, which have kept a lid on business failures and unemployment so far.[22]

Of particular note is the decision that the Government has said will be taken in the March 2021 Budget about whether to extend support via the JRS and SEISS beyond the current end date of 30 April. The end of April may be sufficient if it follows a rapid mass vaccination programme and the current restrictions reduce caseloads enough to allow for larger easing of restrictions in the late-Spring (and there are no nasty surprises from any new variants of Covid-19). Indeed, in this circumstance the outcome for unemployment may well be closer to the OBR's upside scenario, in which a low level of restrictions on economic activity in 2021-22 were assumed alongside a fall in unemployment as the economy recovers rapidly, and the vast majority of previously furloughed workers return to work paid by their employer.[23] But there are risks to this benign scenario. For example, vaccine roll-out could take longer than expected, or virus prevalence could be higher than would allow significant easing of restrictions in April. If policy isn't adjusted in some way, then this would mean that support is phased out prematurely, leading to a sharp increase in unemployment when schemes end.

Beyond 2021-22, in both the central and pessimistic OBR scenarios, it takes a number of years before we are back to pre-pandemic levels.[24] This is entirely in line with the

21 It described it as: "a downside [scenario], in which lockdown has to be extended, vaccines prove ineffective in keeping the virus in check, and a more substantial and lasting economic adjustment is required with economic activity only recovering to its pre-virus level at the end of 2024". OBR, Economic and fiscal outlook, OBR, November 2020.

22 At time of writing, the Chancellor had announced the continuation of the JRS up to the end of April. Any continuation or drawdown of the scheme is expected to be announced at the Budget on 3 March 2021.

23 This scenario involves productivity growth of 6.9 per cent over the five years from 2020 to 2025 compared to 4.1 per cent in the central scenario, and an unemployment rate in 2021 of 4.7 per cent, as opposed to 8.4 per cent in the central scenario.

24 The OBR's overall forecast for employment includes very different projections for employees and the self-employed. The various government schemes have been effective at protecting the number of employees during 2020-21 (if we count someone on furlough as being employed) to the point where the OBR expect there to be more people in work in 2020-21 than the year before. In contrast, the OBR expect a 9 per cent fall in the number of self-employed workers in 2020-21, and that there would be fewer self-employed workers in 2025-26 than there were before the pandemic hit. We reflect this in our projections.

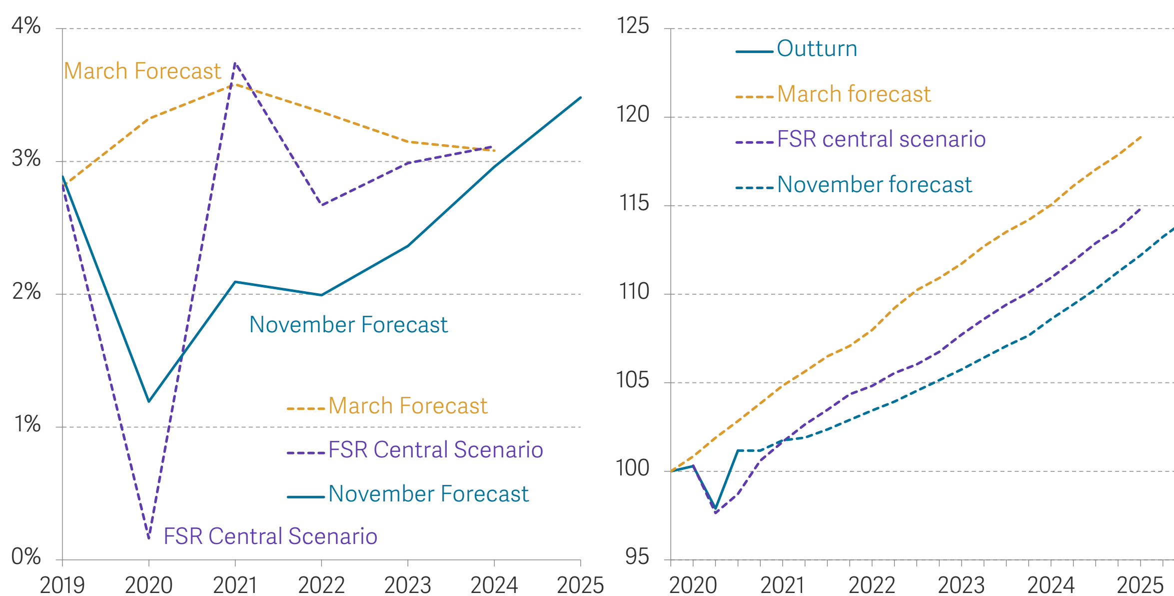
experience of past crises: history tells us that unemployment falls much slower than it rises. After the financial crisis, for example, unemployment reached 7.9 per cent in early 2009 but did not return to pre-crisis levels until 2015.[25] But this is not an inevitable outcome: wider economic policy success (e.g. the continuation of an adequate broader fiscal stimulus) could also lead to a faster bounce back in economic growth and a smaller rise in unemployment, in line with the OBR's upside scenario.

The OBR expects earnings to recover slowly, although the National Living Wage is still set to rise substantially in the years to come

The OBR expects earnings to have grown in 2020, if at a slower rate than the year before, and expects 2021 to feature rapid earnings growth from the stalled base of the pandemic year. [26]

FIGURE 7: **Average earnings will be permanently lower as a result of the pandemic**

Average nominal earnings growth (left-hand panel), year-on-year percentage change; average earnings level (right-hand panel), indexed to Q4 2019: UK, 2019-2025



SOURCE: Economic and Fiscal Outlook, November 2020, OBR.

25 N Cominetti et al., The Full Monty: Facing up to the challenge of the coronavirus labour market crisis, Resolution Foundation, June 2020.

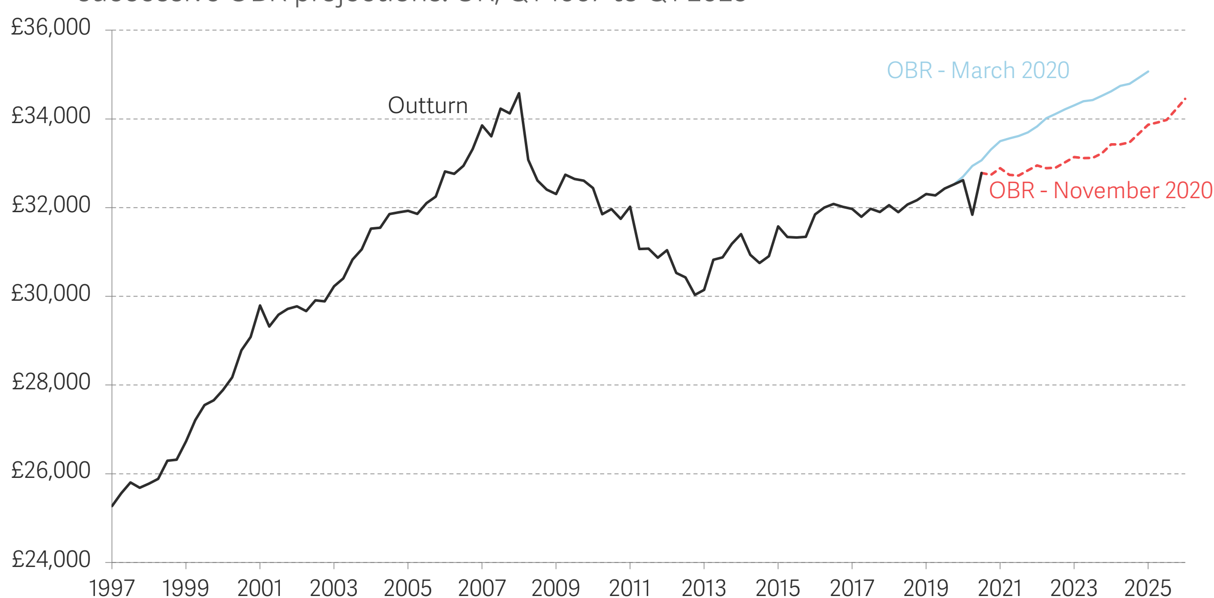
26 The result for 2020 is partly because the OBR's definition of earnings used in their forecasts differs slightly from the usual AWE metric, and is based on dividing the National Accounts measure of earnings, including the pay received by those who are furloughed (a significant minority of whom have had their pay topped-up by their employers) by the number of workers.

The forecast trajectory is shown in Figure 7. After a rebound during the immediate recovery from the pandemic lockdowns, earnings growth is expected to fall back a little in 2022, before accelerating slightly towards the end of the forecast period as unemployment falls and the economy returns to a more normal path. But despite earnings quickly regaining their previous rate of growth, the outlook is for a permanently lower level of earnings compared to the to the (pre-pandemic) March 2020 projection. The OBR's latest forecast – which incorporates the OBR's assumption of a permanent 4 per cent hit to productivity from leaving the EU – projects that earnings will be 6 per cent lower in Q1 2025 than was forecast in March 2020.

This new trajectory for average earnings combined with the OBR's expectations for inflation, discussed in Box 1, means that, as Figure 8 shows, they (on the OBR's metric, at least) will not return to their (real-terms) pre-financial crisis levels until 2026, approaching two decades of lost pay growth.[27]

FIGURE 8: **Real average earnings will remain below their pre-financial crisis level through to 2026-27**

Real average annual employee earnings (CPI-adjusted to 2019-20 prices), outturn and successive OBR projections: UK, Q1 1997 to Q1 2025



SOURCE: OBR, Economic and Fiscal Outlook, various.

27 The figure is taken from T Bell et al., Here today, gone tomorrow: Putting Spending Review 2020 into context, Resolution Foundation, November 2020. However, on the Average Weekly Earnings measure (based on regular pay, rather than total pay), real earnings returned to their pre-financial crisis peak in February 2020, dipped below that level during the spring lockdown, and then returned to the previous peak in August 2020.

BOX 1: Prospects for inflation

The OBR expect that CPI inflation will steadily climb from a low of 0.8 per cent in in 2020 back to the Bank of England's 2 per cent target by the middle of the decade. This provides a crucial difference from the last economic downturn, when inflation spiked after the financial crisis.

One aspect of how inflation affects living standards that is not picked up in the official statistics is the fact that the inflation rate is an average of the price changes of different types of goods and services, and that some goods and services make up a greater share of the spending basket of low-income households than high-income households. Although this has long been recognised by researchers[28], the ONS has only recently attempted to recognise this. In a November 2020 article, the ONS assessed what impact measuring the specific inflation rate faced by different sorts of households has on our impression of real income growth since 2005 for low- and high-income households, as well as how this changes how we should think of trends in income inequality. It is likely that this approach would also have a large impact on our impression of how real living standards changed in 2020, given that spending patterns changed considerably, particularly for higher-income households. However, the ONS say that data is not yet available to allow them to make that assessment.[29]

Given the heterogenous features of this crisis, inflation across different households may well vary even more in 2020-21 than previously. In addition to this, the new trading arrangements the UK now has with the EU are likely to lead to different price changes to different goods and services, further complicating the distributional picture in future years.

The distribution of pay growth in the early 2020s will be heavily affected by government policy decisions. In the short term, pay for public sector workers outside the NHS earning less than £24,000 is due to be frozen in 2021-22 (those earning less than £24,000 will receive a pay rise of at least £250). Workers in the public sector affected by the freeze earn 8 per cent less than their counterparts in the private sector when controlling for observed characteristics, so this freeze will act to widen the public/private pay differential

28 I Crawford and Z Smith, Distributional Impacts of Inflation, Institute for Fiscal Studies, 2002 or S Clarke, The going rate: moving from CPI to CPIH and the inflation experiences of UK households, Resolution Foundation, March 2017.
29 For more on this, see Figure 1 and Figure 2 of M Brewer and R Patrick, Pandemic Pressures: Why families on a low income are spending more during Covid-19, Resolution Foundation, January 2021.

for higher-paid public sector workers.[30] It is possible that the Government may continue with a pay freeze in future years; if they do, prospects for overall pay growth will be lower than that modelled in this paper (we follow the OBR, which assumes that the pay freeze lasts only one year).

One piece of good news is that the lowest-paid employees will benefit in the coming years from relatively large increases in the National Living Wage (NLW) as it moves to reach two-thirds of median pay (which implies a NLW of £10.10) in three years' time.[31] As well as increasing as a share of median pay, the NLW will also be extended to younger age groups in the coming years, first to those aged 23 and above from March 2021, and then to those aged 21 and above from March 2024.[32]

Overall, continued increases in the NLW and, to a lesser extent, the impact of limiting the impact of public sector pay freezes on lower earners in 2021-22, should act to reduce wage inequality in the coming years. This is not to say, however, that overall inequality in household labour market incomes will fall. The impact of higher unemployment is likely to increase inequality in the amount of labour income going to households. And the impact of that labour income inequality on household disposable income depends also on prospects for the tax and benefit system, and for housing costs, which we turn to in the next section.

30 H Slaughter, Earnings Outlook Q4 2020: Public sector pay, December 2020, Resolution Foundation.
31 See Figure 7 of T Bell et al., Here today, gone tomorrow: Putting Spending Review 2020 into context, Resolution Foundation, November 2020.
32 Low Pay Commission, National Minimum Wage: Low Pay Commission Report 2019, January 2020.

Section 3

Prospects for benefits, taxes and housing costs

After the labour market, the key determinants of household living standards, especially for low-to-middle income households, are what happens to personal taxes and benefits, and to housing costs. At the time of writing, the Government's plan was still to remove the £20 a week increase to Universal Credit and Working Tax Credit (WTC) that were introduced when the pandemic hit. If this decision is not reversed, then the poorest fifth of households will experience an average 4 per cent fall in their income, and this after a decade of benefit cuts that have already weighed down on low-income households' living standards.

After two parliaments of large cuts to personal taxes, the Government has no firm plans to reduce personal taxes. Indeed, tax increases seem more likely, particularly towards the middle of the decade, given the need to repair the structural damage to the public finances caused by Covid-19.

Housing costs have fallen for mortgagors in line in recent years with lower interest rates. In contrast, social landlords are now able to increase rents up to CPI + 1 per cent, and many are likely to take advantage of this – leading to higher housing costs for social tenants to the extent that housing benefit doesn't fully take the strain.

A number of benefit boosts will expire in 2021

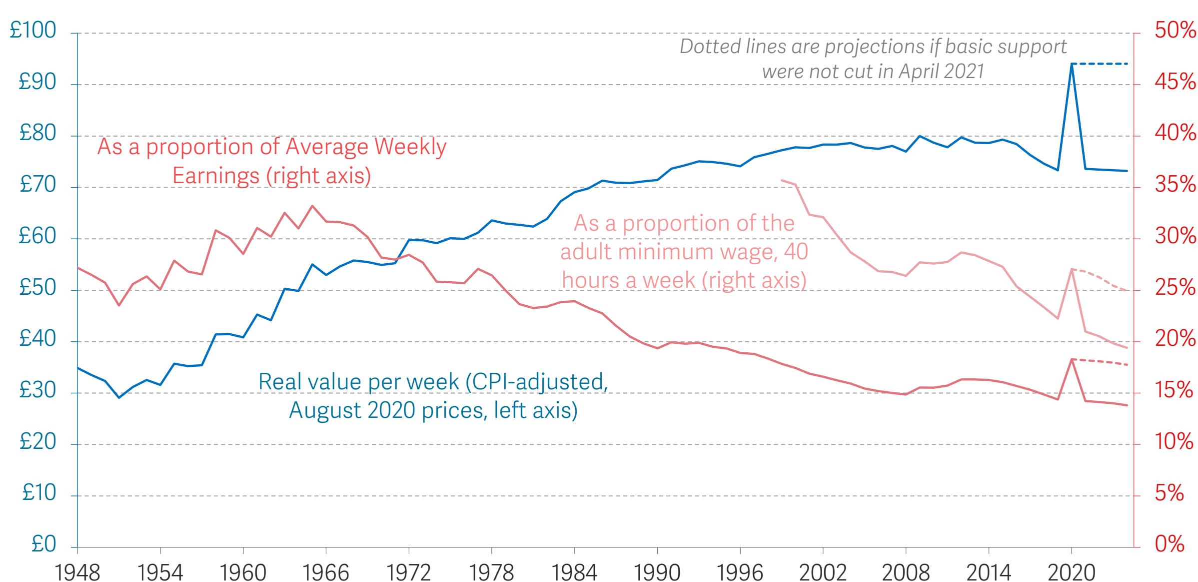
Benefit policy has done a great deal to support incomes in 2020-21, through policies like suspending the Minimum Income Floor, a £20 a week increase to Universal Credit (UC) and Working Tax Credit, and additional help for renters through the increase in Local Housing Allowance (LHA) rates to the 30th percentile of local rents. Together, the OBR estimates these boosted household incomes by £8.3 billion in 2-2020-21.[33]

33 OBR, Economic and fiscal outlook, November 2020, although note that this does not count additional money given to English local authorities for them to spend on more generous council tax support (see https://www.gov.uk/government/publications/council-tax-covid-19-hardship-fund-2020-to-2021-guidance). For more on benefit policy in the past year, see M Brewer et al., The Living Standards Audit 2020, Resolution Foundation, July 2020, or K Handscomb, Safe Harbour? Six key welfare policy decisions to navigate this winter, Resolution Foundation, September 2020.

The most significant of these was the £20 a week boost, costing an estimated £6.1bn in 2020-21. But, having been increased from £73 per week to £94 per week, the basic level of support for a single out-of-work adult (aged over 24) is now set to fall back to around £75 in April 2021, an estimated 22 per cent cut in real terms. Such a reversion to pre-coronavirus levels would mean a return to the lowest price-adjusted generosity since 1990-91, as Figure 9 shows.

FIGURE 9: **The basic level of unemployment benefit and Universal Credit is set to fall back to its lowest real-terms level since 1990-91**

Value of the main rate of unemployment-related benefit over time for a single adult, with projections: UK, 1948 to 2024



NOTES: National Living Wage forecast is based on OBR, Economic and Fiscal Outlook, November 2020.
SOURCE: RF analysis of IFS, Fiscal Facts; ONS; Bank of England; and OBR.

We estimate that 6 million households (22 per cent) – containing 18 million people (27 per cent) – will lose over £1,000 in 2021-22. That is a big cash loss for millions of families: as Figure 10 shows, the bottom quintile of the distribution (excluding the poorest twentieth of the population) is set to experience a 4 per cent fall in incomes.[34]

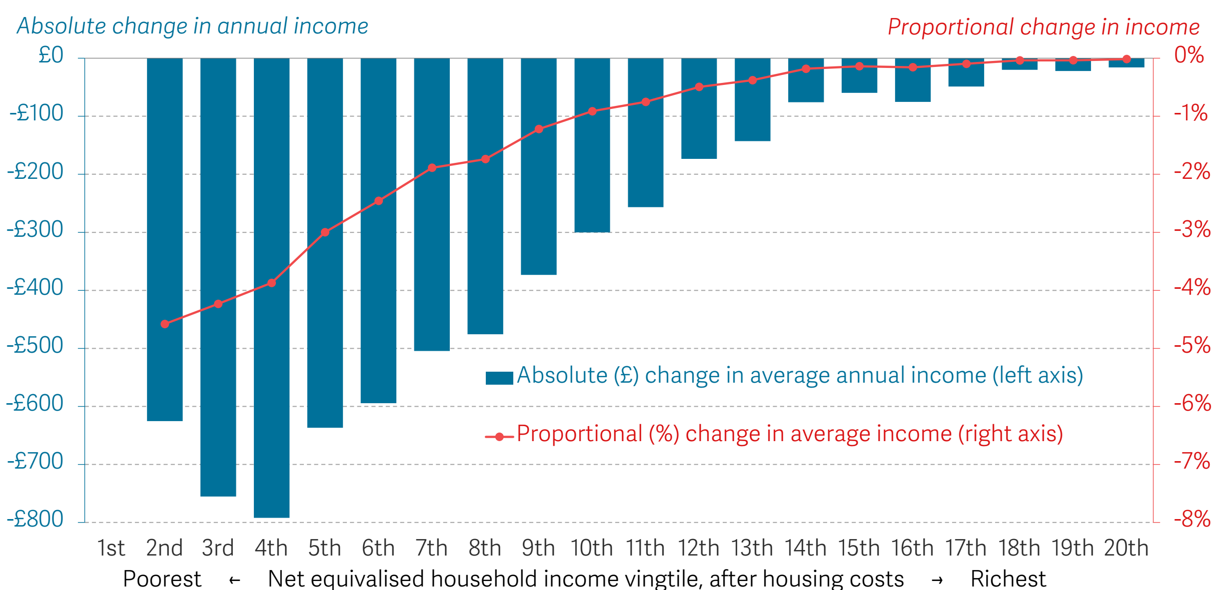
Together with the reintroduction of the minimum income floor (due to return in April 2021), and the ending of the additional support provided to local authorities in England to help boost council tax support schemes, this represents a very large reduction in incomes for UC and tax credit recipients in 2021-22 (as we show in Section 4). And it should be seen in the context of other cuts that are ongoing and will put further pressure on working-age incomes over the coming years: chiefly the continued roll-out of the

34 We have updated our estimated impact using our nowcast modelling of incomes, which reflect new OBR assumptions for unemployment and earnings growth. We exclude the bottom vingtile, as the data on incomes is unreliable (but the estimated fall in income is much greater).

'two child limit' and the abolition of the family element in UC and other means-tested support.[35] This is why we have previously called for the £20 a week boost to be made permanent, as well as extended to recipients of the so-called legacy benefits, and with an associated change made to the benefit cap so that families affected by it feel the £20 a week uplift in full.

FIGURE 10: **Ending the £20 a week boost to benefits would mean the poorest households losing 4 per cent of their income**

Estimated impact on household income of not continuing £20 a week UC and WTC boost in 2021-22, by income vingtile: UK



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.
SOURCE: RF analysis of DWP, Households Below Average Income; and RF forecast.

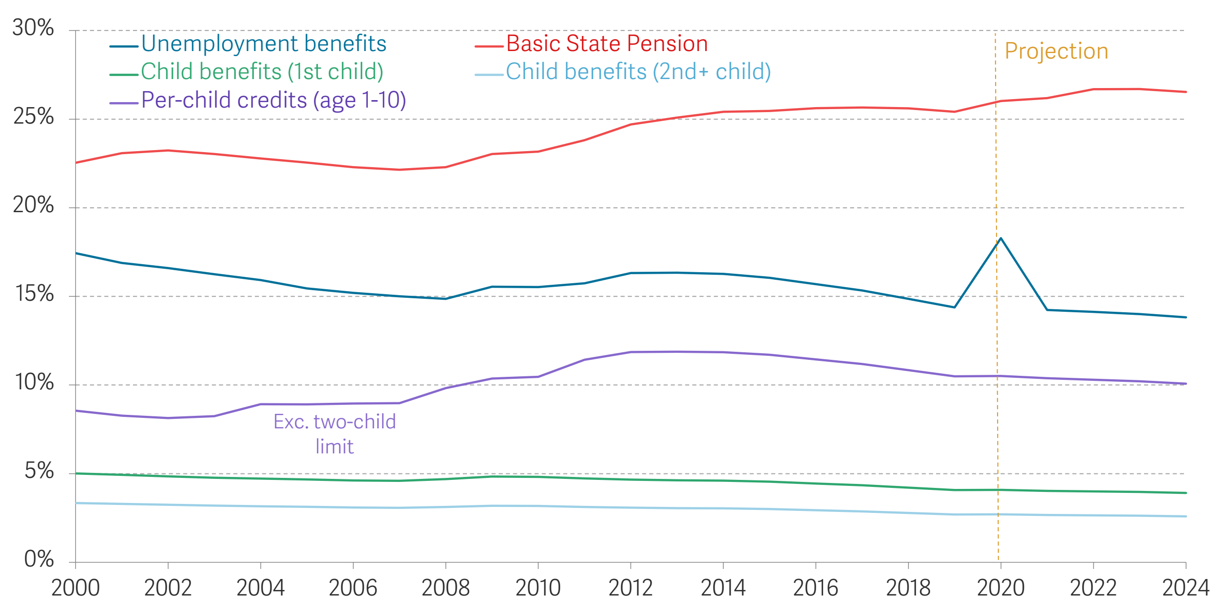
The state pension is set to increase by almost 5 per cent above inflation between 2020 and 2022

The planned expiration of the temporary boost to UC and WTC, coming after nearly a decade of cuts to working-age benefits, stands in contrast to policy on benefits for those over the retirement age. In particular, the state pension is set to continue increasing in line with the 'triple-lock', pushing up its value as a fraction of earnings (see Figure 11). This will continue to widen the gap between welfare support for pensioners and that for working-age adults and children.

35 See, for example, Figure 32 in Resolution Foundation, Spring Budget 2020 response, March 2020, and L Gardiner, The shifting shape of social security: Charting the changing size and shape of the British welfare system, Resolution Foundation, November 2019.

FIGURE 11: **The state pension is due to continue growing as a fraction of average earnings, as benefits for working-age adults and children fall back**

Value of selected benefits as a proportion of Average Weekly Earnings: UK, 2000 to 2024



NOTES: 'Unemployment benefits' captures the main rate of Universal Credit from 2013 onwards.
SOURCE: RF analysis of IFS, Fiscal Facts; ONS; Bank of England; OBR; HM Treasury.

Specifically, the state pension increased by 3.9 per cent in April 2020 (while earnings fell and inflation was at just 0.6 per cent), will increase by 2.5 per cent in April 2021, and on current forecasts is set to rise by 4.1 per cent in April 2022 in line with earnings growth. The interaction of the triple-lock and the sharp movements in earnings during this crisis means that the state pension is on track to have increased by 6.7 per cent in cash terms in just two years, or 4.5 per cent in real (CPI-adjusted) terms. On current forecasts and policy, by 2024-25 the state pension will reach 27 per cent of average earnings, up from 22 per cent in 2008.[36]

Although tax rises may follow in future years, the Government's current tax plans are modest

Personal tax changes provided a tailwind for household living standards throughout the 2010s, largely as a result of the large increases in the Personal Tax Allowance. It now stands at £12,500, up from just £6,475 in 2010-11. Although the Conservative 2019 General Election manifesto set out an "ultimate ambition" of increasing the NICs threshold to the

36 The implications of the Covid-19 crisis on the basic state pension were discussed in T Bell & L Gardiner, Locked in? The triple lock on the State Pension in light of the coronavirus crisis, Resolution Foundation, June 2020, although the outturns and forecasts for average earnings will have changed since then.

same level, no details have yet been provided on when this will take place.[37] Spending Review 2020 simply confirmed inflation increases in NICs thresholds for 2021-22.[38]

Instead of tax cuts, the Spending Review provided for a tax increase that directly affects disposable incomes, as it increased the social care precept from 2 per cent to 3 per cent for 2021-22. Effectively this means councils can increase Council Tax by 5 per cent next year without needing to call a local referendum. The OBR assumes that "most councils" make use of this higher limit on increases, raising Council Tax by "around £1 billion".[39]

This is, however, unlikely to be the full extent of the tax rises announced in the rest of this Parliament. The long-term impact of this crisis on the UK economy and public finances implies that fiscal consolidation will be needed in the future, not to pay down the debt, but to reflect that the crisis has permanently lowered the size of the economy, and also to build fiscal headroom so that the public finances are ready for the next major crisis. The Resolution Foundation has previously estimated that in the region of £40 billion of consolidation a year will be required from 2023-24 onwards.[40] Given the significant spending cuts over the past decade, this should primarily come through tax rises rather than further cuts to expenditure.

Housing costs for mortgagors look set to remain low

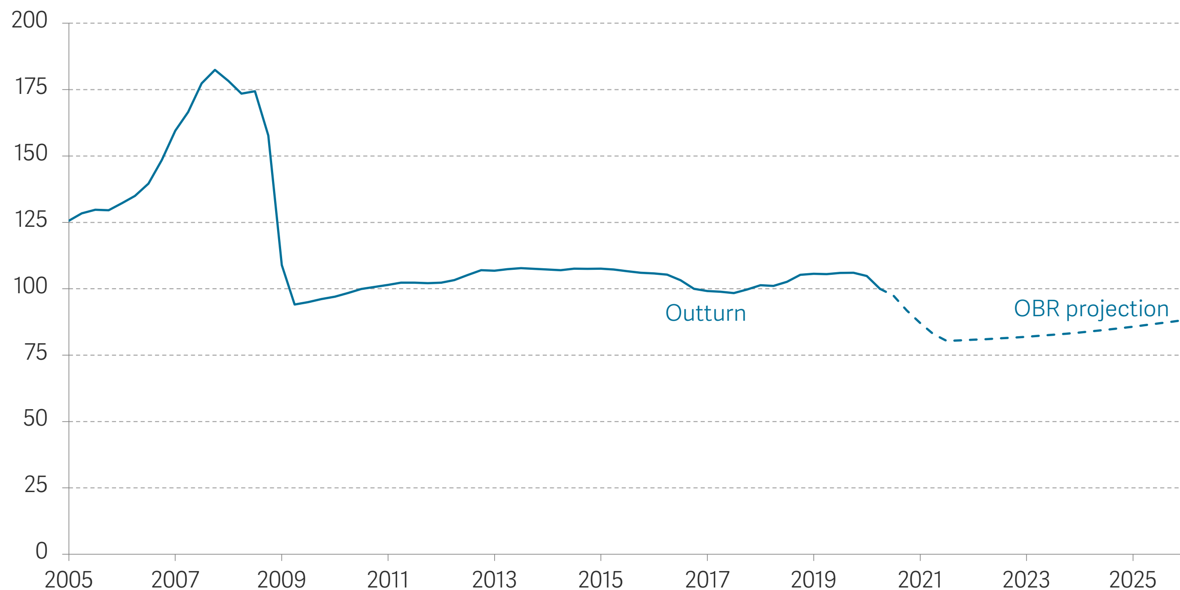
The day-to-day cost of housing also has a large effect on disposable incomes measured after housing costs. The pandemic has led to falls in housing costs for mortgagors as a result of the decline in interest rates. The Bank of England's base rate was cut from 0.75 per cent to 0.1 per cent in March 2020, and this has passed through into mortgage costs, such that the average mortgage interest rate has fallen from 2.37 per cent at the start of 2020 to 2.12 per cent in November 2020.[41] The OBR forecasts that aggregate mortgage interest payments will remain lower than they were pre-pandemic out to the middle of the decade, as shown in Figure 12.

The broader outlook for the housing market is also tied to the health of the labour market and economy. The OBR's forecast is that the pandemic will have reduced house prices by 17 per cent by 2025-26.

37 Conservative Party, Manifesto Costings Document, December 2019.
38 HM Treasury, Spending Review 2020, November 2020.
39 OBR, Economic and Fiscal Outlook, November 2020.
40 G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.
41 Bank of England, CFMHSDE.

FIGURE 12: **Mortgage interest costs are falling and set to remain low in the years ahead**

Mortgage interest payments (Q2 2020=100), actual and forecast: UK, Q1 2005 to Q1 2026



SOURCE: ONS, DOBQ; OBR, Economic and Fiscal Outlook, November 2020.

There is more certainty around the outlook for social renters, whose housing costs are set to increase at a faster pace than previously in the early 2020s. Social rents can now increase by a maximum of CPI + 1 per cent, and many registered social landlords are expected to make full use of this, after four years of 1 per cent rent reductions. The overall picture in terms of housing costs looks likely to be a continuation of the trend of widening housing costs inequality since the financial crisis.[42]

Having briefly previewed the prospects for the main determinants of household disposable income, the next section presents our nowcasts and forecasts for what these mean for living standards in this year and the years ahead.

42 D Tomlinson, Inequality street: Housing and the 2019 general election, Resolution Foundation, November 2019.

Section 4

Prospects for household incomes

GDP is set to grow significantly by over 10 per cent in 2021-22, but household incomes are set to fall. This large divergence in economic and household fortunes is a result of both the planned £1,000 a year cut to Universal Credit that will take place from April and the forecast increase in unemployment set to follow from the ending of the Job Retention Scheme at the end of the same month.

As a result, next year is set to be the peak of the living standards downturn, rather than the start of a living standards recovery. We forecast that typical incomes will fall by 0.4 per cent in 2021-22, with sharp falls at the lower end of the distribution. Our forecast implies that incomes at the 10th and 20th percentile of the distribution will decline by around 10 per cent and 5 per cent respectively. The living standards downturn of 2021-22 will be much worse for low-income households than the financial crisis, even though the fall in typical incomes is lower than the falls in the financial crisis.

However, this outcome is by no means set in stone. If the Government decides not to press ahead with the reversal of the £1,000 a year boost to welfare, the fall in income at the lower end of the distribution would be cut down by more than half.

Furthermore, a smaller increase in unemployment and faster earnings growth in subsequent years resulting from an economic recovery in line with the OBR's upside scenario would also improve income prospects across the distribution. If the OBR's upside scenario is combined with the maintenance of the welfare boost, we project income growth would be broadly flat across the whole distribution in 2021-22, a much-improved outcome for millions of households.

Typical household incomes are projected to fall in 2021-22 – even as GDP surges

In 2020-21 the economy was subject to an unprecedented shock, and the state stepped in to protect household incomes from that shock to an unprecedented degree. Although GDP is forecast to have fallen by 12.9 per cent over the year, our nowcast projects a very slight real-terms increase, of 0.1 per cent, in typical non-pensioner after housing costs (AHC) household incomes over the year.[43] Box 2 discusses how this estimate compares to previous assessments of how household incomes have changed during 2020.

BOX 2: **Difference between our projections here and those from the 2020 Living Standards Audit**

We have previously estimated that in the first lockdown typical incomes fell by 4.2 per cent relative to 2019-20, a significantly larger fall than that presented here.[44] The primary reason for this difference is that our previous forecast was of the level of income at the depth of the lockdown, whereas here we are presenting an estimate of the average position over the whole financial year. This includes the months in which income falls were lower due to a reduction in furloughing and lighter restrictions. Looking over the year as a whole, for example, the OBR forecasts average earnings growth of 0.9 per cent whereas Real Time Information (RTI) pay data in summer 2020 pointed to a change in median pay of -2.2 per cent between 2019-20 and May 2020.

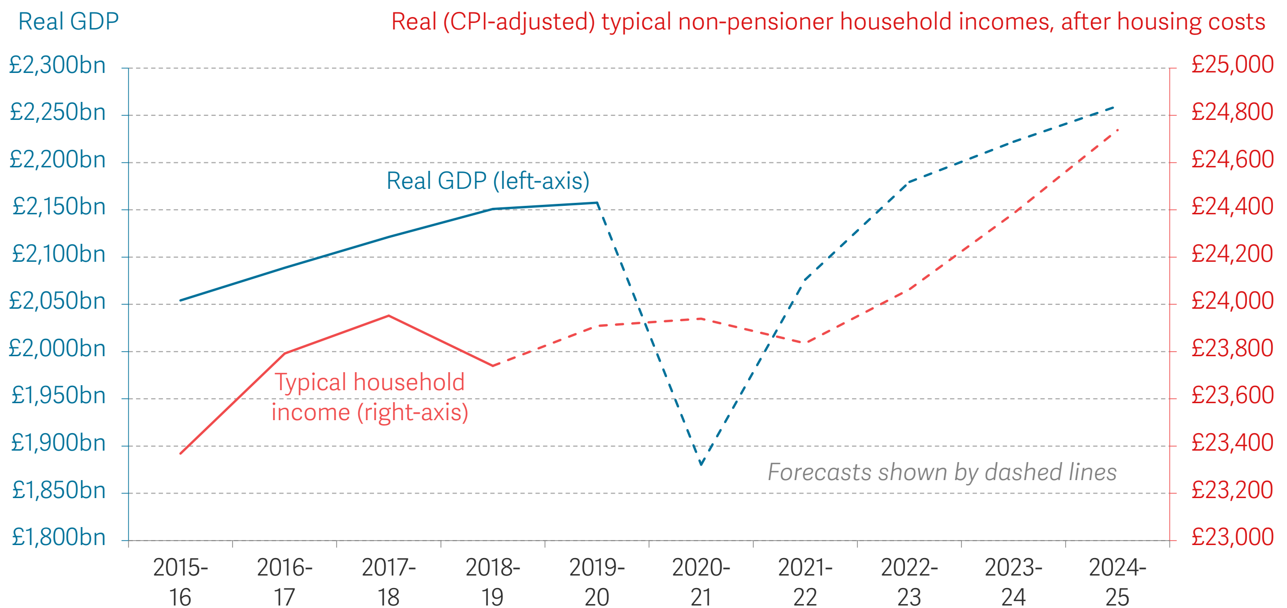
In basing our nowcast presented here on the OBR's forecast for 2020-21, we are also modelling a significantly more positive employment picture than implied by the timely RTI employment data on which our first lockdown nowcast was based. The OBR forecasts the number of employees to have increased by 100,000 between 2019-20 and 2020-21 (an assumption in line with the change in employees recorded in the Labour Force Survey). By contrast, the RTI employment data shows a decline in the number of payrolled employees of over 800,000 since February 2020.[45] The true scale of the employment change this year is as-yet unresolved, but our approach here is to stick to official forecasts where possible.

43 Detail on our household income modelling choices and process is provided in the Annex.
44 M Brewer et al., The Living Standards Audit 2020, Resolution Foundation, July 2020.
45 ONS, Earnings and employment from Pay As You Earn Real Time Information, UK, December 2020.

In 2021-22, we find that even as GDP is forecast to surge by over 10 per cent, the planned unwinding of employment and welfare support means that typical incomes are actually set to fall slightly next year. The £20 a week cut in benefits in the new financial year and the planned ending of the Coronavirus Job Retention Scheme (JRS) at the end of April, after which unemployment is expected to increase, mean that typical incomes are projected to fall by an estimated 0.4 per cent in 2021-22. As Figure 13 shows, incomes are on course to have in fact moved slightly in the opposite direction to large swings in GDP in 2020-21 and 2021-22.

FIGURE 13: **As GDP fell in 2020-21, household incomes rose slightly; GDP is set to surge in 2021-22, whereas household incomes are set to fall**

Real GDP and real (CPI-adjusted) typical non-pensioner household incomes after housing costs, outturn and forecast: UK, 2015-16 to 2024-25

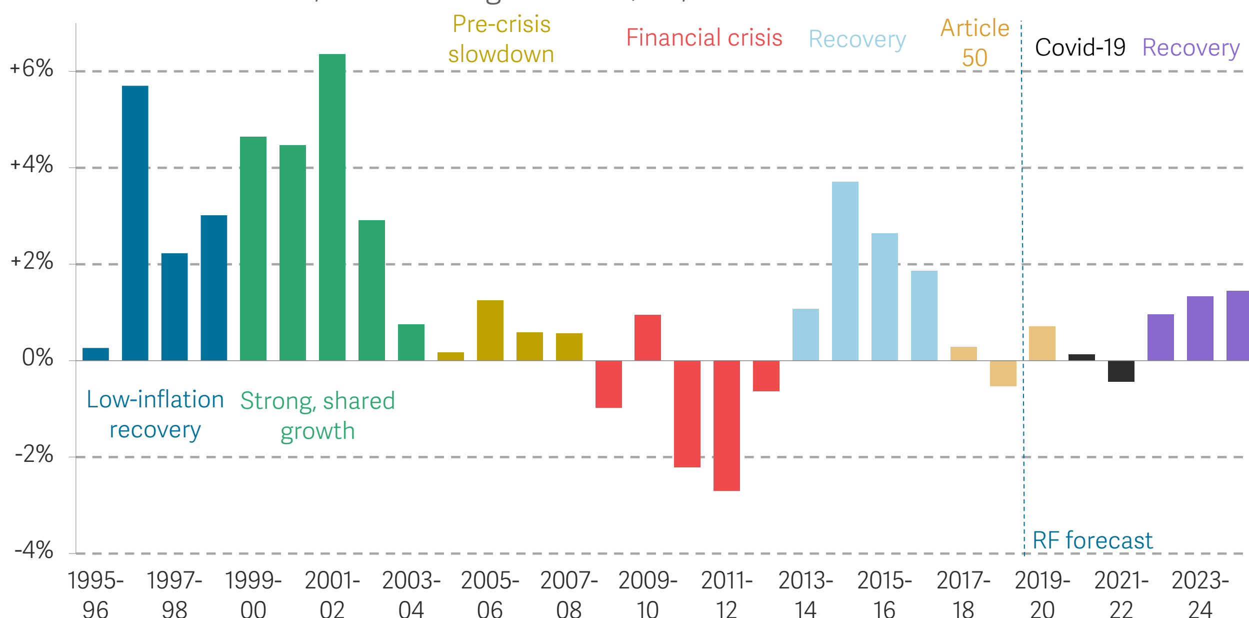


SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast; OBR, Economic and Fiscal Outlook, November 2020.

The growth in incomes in each year of our forecast out to 2024-25 and the past 25 years of changes in incomes are presented in Figure 14. The prognosis is for a weak recovery from the pandemic, and it is not until 2022-23 that we forecast typical working-age after housing cost incomes will surpass their 2017-18 peak of £24,000 a year.

FIGURE 14: **Typical household income may have grown slightly this year, but is set to fall in 2021-22**

Annual real (CPI-adjusted) growth in median non-pensioner equivalised disposable household income, after housing costs: UK/GB, 1995-96 to 2024-25



NOTES: Northern Ireland is not included in the household income series in the years between 1994-95 and 2001-02.
SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast.

Overall, with the exception of a 'mini-boom' for household incomes around 2015, the years since the financial crisis in the late 2000s have been historically poor for household income growth. In fact, our new forecast implies that typical real non-pensioner household incomes will grow by just 8 per cent over the 15 years between 2009-10 and 2024-25 – five times less than the 38 per cent recorded between the 15 preceding years (1994-95 to 2009-10). The triple hit of the financial crisis, Brexit and Covid-19 has not been good for typical household incomes.

The planned cut to benefits and forecast rise in unemployment implies large income falls at the lower end of the income distribution

The living standards downturn of 2021 is very different from the squeeze on household incomes that took place during the financial crisis. Inflation-driven falls in real typical income in 2010-11 and 2011-12 were much larger than that predicted for next year. However, next year's hit to living standards is considerably worse for low-income households than was the financial crisis, as it is driven by the bottom-heavy impact of the reversal of the benefits boost and the forecast increase in unemployment in 2021-22.[46]

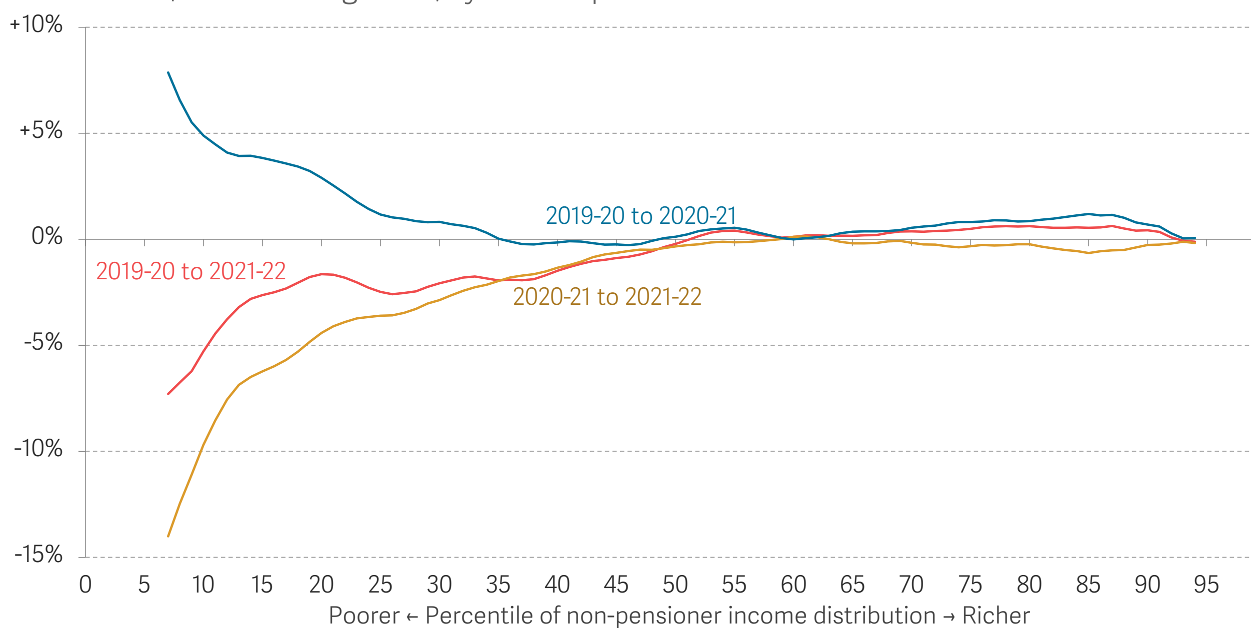
46 Our modelling for 2021-22 is based on the OBR's central forecast showing employment falling from 32.5 million in 2020-21 to 31.8 million in 2021-22.

Our modelling suggests that although real non-pensioner household income at the 10th percentile of the distribution increased by 5 per cent last year, the reversal of the benefit boost and increasing unemployment will lead to falls of over 10 per cent in 2021-22 (see Figure 15). Income changes are smaller further up the distribution: for example, we project a decline in incomes of 5 per cent at the 20th percentile.

Figure 15 also shows our revised assessment of how the income distribution changed in 2020-21, updating that estimated by the Resolution Foundation in July 2020 (although that estimate applied only to the position in May 2020, not the whole of 2020-21). It is important to note that this chart does not show how incomes have changed for people with different levels of pre-crisis income. It shows instead the difference between our estimates of the shape of the income distribution in different years. This means that it is perfectly possible, for example, for a lot of people to see income falls that bring them towards the bottom of the distribution and for incomes to appear to be higher at the bottom of the distribution in 2020-21 than in 2019-20: this is because of the temporary boost to UC and other benefits, which would have increased the incomes of many households on low incomes. Box 3 reviews the estimates made by several organisations of how incomes changed during 2020.

FIGURE 15: **Ending the welfare boost means big falls in household income at the bottom of the distribution next year**

Change in real (CPI-adjusted) average equivalised non-pensioner disposable household income, after housing costs, by income percentile: UK



SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast.

BOX 3: Is there a consensus on how household incomes changed during 2020?

Several studies have estimated the distributional impact of the pandemic, or estimated how incomes have changed through 2020, and it is worth reviewing their findings and comparing them to the results presented here.

It is widely agreed that the labour market shock from the pandemic has been more likely to affect low earners than high earners, although there is some evidence that high-earning self-employed people who have been affected may have seen particularly large falls in income. [47] However, there isn't a clear link from this to an assessment of how household disposable incomes – the focus of this report – have changed for households of different income levels. There are several factors to consider. First, adults who were not working before the pandemic cannot have seen earnings falls, and these adults are more likely to be found at the bottom of the income distribution. Second, the boost to benefits means that some low-income families will have seen incomes rise during the pandemic. Third, the benefits system provides some income protection for people who lose their job or see earnings fall – through benefits such Jobseeker's Allowance, Universal Credit, tax credits and local housing allowance – and so for many people, particularly in low-income households, the impact of the labour market shock on household income is smaller than that on earnings.[48] Finally, not all low earners live in households with a low income, particularly young people. All these factors mean that we would not expect the pattern of income changes when assessed by family or household income to look the same as the pattern of earnings changes or job loss when assessed by the level of earnings.

Four studies looked closely at what happened to household incomes during the first lockdown. Three of them used methods that were similar to each other, and similar to the method used in this Outlook. [49] In these, data collected in April or May 2020 by the Understanding Society Covid-19 study was used to learn about which sort of workers had been furloughed,

47 See, for example: T Crossley et al., The Idiosyncratic Impact of an Aggregate Shock: The Distributional Consequences of COVID-19, Understanding Society Working Paper 2020-09; A Adams-Prassl et al., Inequality in the Impact of the Coronavirus Shock: New Survey Evidence for the UK, Cambridge-INET Working Paper Series No: 2020/10; L Gardiner and H Slaughter, The effects of the coronavirus crisis on workers: Flash findings from the Resolution Foundation's coronavirus survey, Resolution Foundation, May 2020; M Brewer et al., Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the UK labour market, Resolution Foundation, October 2020. All of these use different primary data sources.

48 This is shown in M Brewer & L Gardiner, Return to spender: Findings on family incomes and spending from the Resolution Foundation's coronavirus survey, Resolution Foundation, June 2020, and in P Bourquin et al., The effects of coronavirus on household finances and financial distress, Institute for Fiscal Studies, June 2020.

49 These are: M Brewer et al., The Living Standards Audit 2020, Resolution Foundation, July 2020; M Brewer & I Tasseva, Did the UK Policy Response to COVID-19 Protect Household Incomes?, revised October 2020; HM Treasury, Impact of COVID 19 on working household incomes: distributional analysis as of May 2020, July 2020.

lost their job, seen hours or pay fall, or seen their self-employment work or income dry up. This data was then combined with detailed information in a different dataset on the pre-crisis household income distribution to estimate how the income distribution in early 2020-21 was different from earlier years. All three studies found that the hit to disposable incomes was bigger at the top than at the bottom of the distribution.[50] (There are some differences in the scope of the analysis which should be borne in mind when making a detailed comparison: the HM Treasury study looked at working-age households who were in work pre-crisis, the Resolution Foundation study looked at non-pensioner households, and the Brewer-Tasseva study looked at the whole population. These differences matter because non-working working-age households are likely to have gained from the crisis through the emergency increases to benefits; pensioner households are likely to have been largely unaffected in income terms, at least in the first few months of the crisis.) A very closely related calculation was done by the Institute for Fiscal Studies (IFS), who simulated disposable incomes directly with the Understanding Society data: they found the biggest loss in the second-poorest quintile, but otherwise found a pattern that the losses were bigger the higher was pre-crisis income.[51] Finally, a study by the IFS used data up to May 2020 collected by Money Dashboard. This has the advantage of using real data from bank accounts, but the disadvantage that it is not a representative sample. It found a pattern of income changes by pre-pandemic income that was similar to those in the studies above: in the lowest income quintile, there was a small rise, and, other than the second-lowest quintile (which recorded the largest fall), the income falls were greater in the higher income quintiles.[52] So, in all cases, these studies suggest that, among the working-age population, the falls in income caused by the pandemic were, on average, greater (as a share of pre-crisis income) the higher was households' pre-crisis income.

Separately, two studies by the Resolution Foundation have used data collected from about 6,000 working-age adults in online surveys in May and September 2020 that asked people directly how their income has changed since February 2020. The results from May show that the incidence of income falls was skewed towards (pre-pandemic) lower-income families: 32 per cent of adults in the second-poorest (pre-pandemic) quintile

50 The HM Treasury study compared estimated incomes in February and May 2020 (Chart 1A); the Brewer-Tasseva study compared estimated incomes in May 2020 to what they would have been without the pandemic (Figures 1 & 2); the Resolution Foundation study compared estimated incomes in May 2020 to those in 2019-20 (Figure 22, but see also Figure 19).

51 See Figure 10 of P Bourquin et al., The effects of coronavirus on household finances and financial distress, Institute for Fiscal Studies, June 2020.

52 P Bourquin et al., The effects of coronavirus on household finances and financial distress, Institute for Fiscal Studies, June 2020.

reported a fall in income of at least 10 per cent, compared to 25 per cent in the richest (pre-pandemic) quintile; and the poorest quintile was less affected for reasons discussed above.[53] On the other hand, adults in (pre-pandemic) lower-income families were also more likely to report rises in income than were adults in (pre-pandemic) higher-income families, presumably reflecting the impact of the additional welfare benefits. By September, though, the pattern of income falls since the pandemic started was a little flatter, with 16-17 per cent reporting falls in income of at least 10 per cent in the richest three (pre-pandemic) quintiles, only slightly lower than the 21 per cent reporting this in the second-poorest quintile; the experience of rises in income was also very similar in all quintiles.[54] (It should be noted that in both studies there were a relatively high number of "Don't knows" in the bottom income quintile: these largely correspond to single adults with low family income who lived in households with other people, and were not able to say how their wider household income had changed.)

The findings of these two studies may appear to be at odds with the four that looked at income changes during lockdown. One important difference is that the two RF studies classify people into deciles based on their family income, whereas the first set of studies classify using household income. As we noted above, this matters a great deal given that the pandemic has particularly hit the jobs and the earnings of young people. Assessed on their family income, a young single adult working in hospitality may appear to have a very low family income, but if they live with other adults or with their parents, then they may have a much higher household income; this means the pattern of income losses will probably look steeper assessed by family income than by household income. It is also possible that when asked to report how their total income has changed, respondents to surveys focus on their earned income and forget to make an allowance for any higher benefit payments (and this will affect the two RF studies above). On the other hand, it is also possible that the studies that used estimated or simulated incomes might have overstated the income of low-income families by being too optimistic about benefit take-up, or by not reflecting the five-week wait in UC or the fact that about four-in-ten UC recipients have some form of deduction made to their payments. Finally, it is also the case that the four studies above focused on the first lockdown in Spring 2020 when furloughing was at its most widespread and most likely to

53 Figure 1 of M Brewer & L Gardiner, Return to spender: Findings on family incomes and spending from the Resolution Foundation's coronavirus survey, Resolution Foundation, June 2020.
54 Figure 3 of K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020.

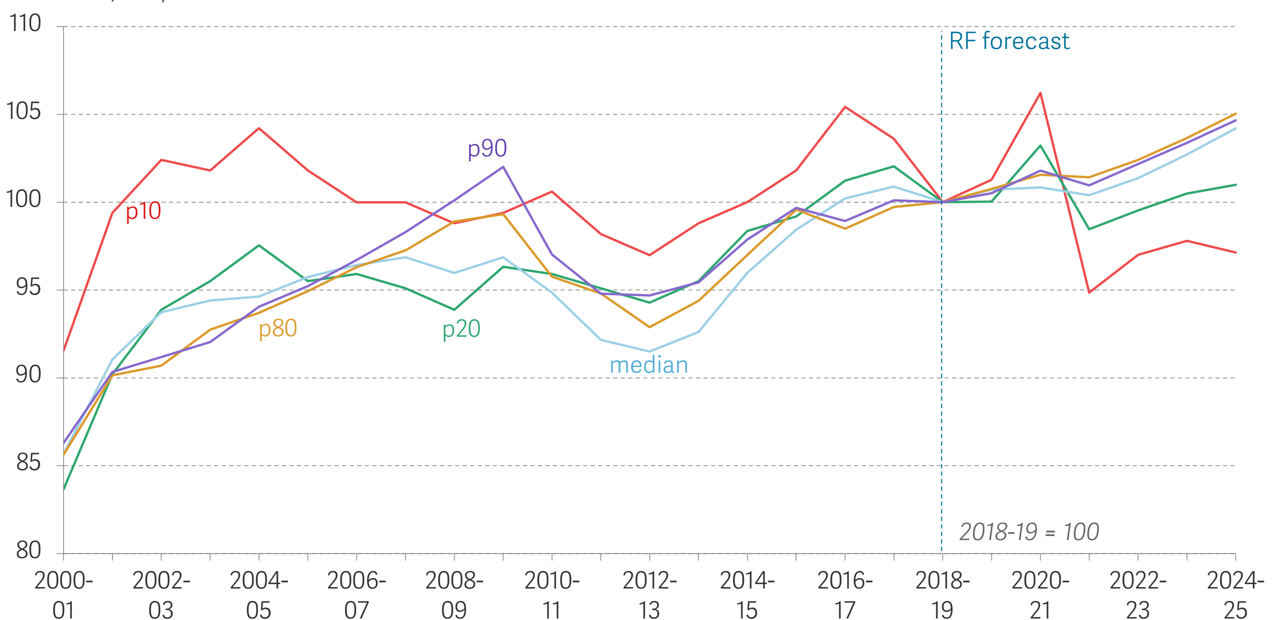
affect high earners. All of these points would help explain the slight difference in results.

What is clear, though, is that the pandemic is causing hardship for lower-income households considered generally. We can see this in studies of how household finances have been affected, in estimates of material deprivation, in the growing use of foodbanks, or in accounts of the lived experience of low-income families.

Overall, across the two years from 2020-21 to 2021-22, incomes are forecast to be lower across the whole of the bottom half of the income distribution, with falls in excess of 5 per cent in the bottom ten per cent. This is a result of the way in which unemployment increases in 2021-22 lead to the lower end of the distribution containing more workless (or single earner) households. Taking a longer-term perspective, as we do in Figure 16, we can see that this predicted fall in income at the 10th percentile will mean that incomes at this point in the distribution in 2021-22 will be no higher than in 2001-02, but that incomes across much of the rest of the distribution will be around 10 per cent higher than in 2001-02 (of course, this is still an historically slow pace of income growth).

FIGURE 16: **Low-income households are forecast to be no better off in 2024-25 than in 2001-02**

Change in real (CPI-adjusted) median equivalised non-pensioner disposable household income, after housing costs, indexed to 2018-19, by selected income percentile points: UK/GB, 2000-01 to 2024-25



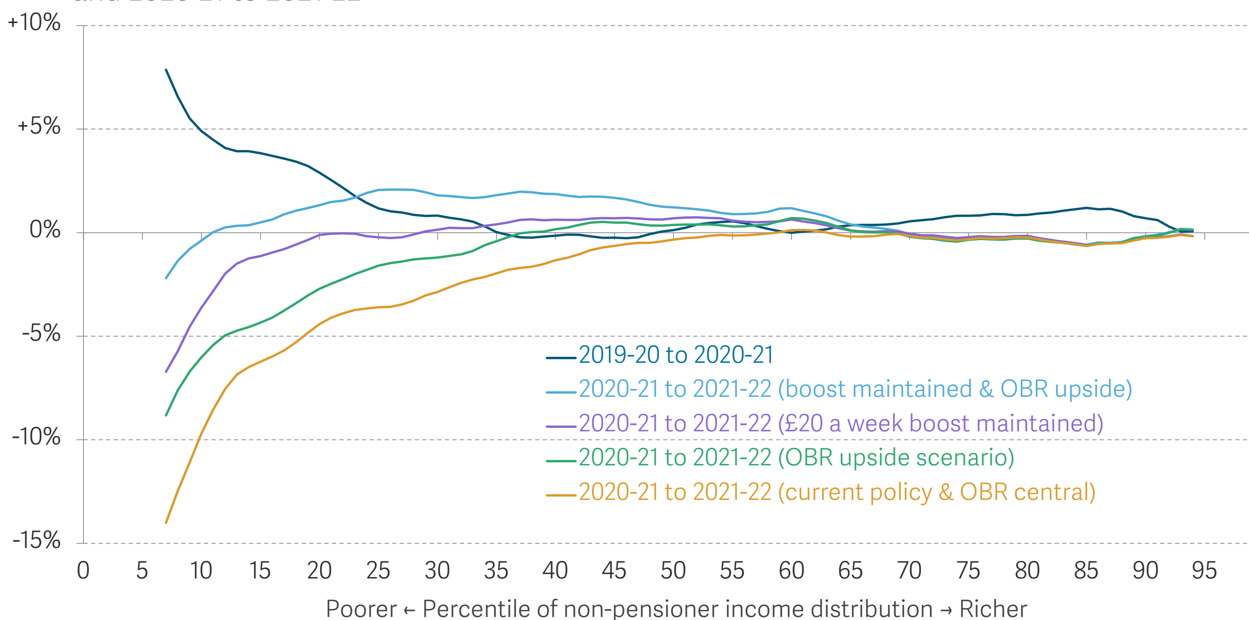
NOTES: Northern Ireland is not included in the household income series in the years between 2000-2001 and 2001-02.
SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast.

But neither the level nor the shape of income growth in 2021-22 are set in stone

The pace of the economic recovery – and the level of employment – in 2021 could well surprise on the upside, leading to an improved (if still weak by historical standards) outlook for living standards. Fast and effective roll-out of vaccinations coupled with an appropriately-timed wind-down of furlough and wider economic policy success (e.g. the continuation of an adequate broader fiscal stimulus) could lead to a faster bounce back in economic growth and a smaller rise in unemployment, in line with the OBR's upside scenario. This scenario involves productivity growth of 6.9 per cent over the five years from 2020 to 2025 compared to 4.1 per cent in the central scenario, and an unemployment rate in 2021 of 4.7 per cent as opposed to 8.4 per cent in the central scenario. If this 'upside' were to materialise, the level of income growth would be higher across the distribution – as shown by the green line in Figure 17.

FIGURE 17: **Living standards outcomes in 2021-22 will be shaped by policy and the economic recovery**

Change in real (CPI-adjusted) average equivalised non-pensioner disposable household income, after housing costs, by income percentile and scenario: UK, 2019-20 to 2020-21 and 2020-21 to 2021-22



SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast.

But the shape of the distribution of non-pensioner income growth next year is heavily determined by whether or not the £20 a week cut in Universal Credit goes ahead. Maintaining the benefit boost would more than halve the size of the income fall

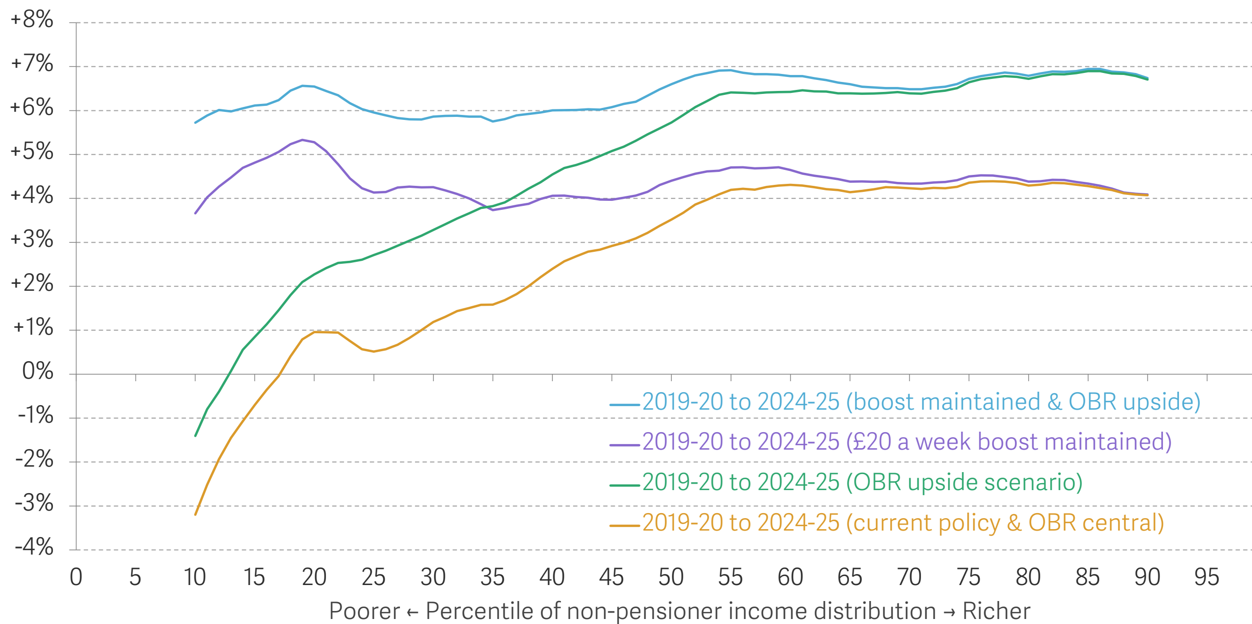
projected for lower income households, protecting many more households from a large income shock. Although in this scenario (purple line in Figure 17) incomes are still set to fall in 2021-22 at the lower end of the distribution (as a result of rising unemployment) the falls are much smaller, and the shape of the change in incomes is considerably less regressive. Finally, if the OBR's upside scenario is combined with the maintenance of the welfare boost, we project that income growth would be broadly flat across the whole distribution in 2021-22, a much-improved outcome for millions of households.

Income growth over this Parliament will be heavily shaped by what happens in 2021-22

Figure 18 shows the prospects for income growth across the Parliament as a whole and how existing policy and the OBR's central economic scenario implies real income growth of around 4 per cent across the top half of the income distribution, with near-flat or falling incomes across the bottom fifth of the distribution. However, if the OBR's upside scenario were to unfold alongside the maintenance of the £20 a week boost to welfare then incomes are forecast to rise by 6 per cent or more across the distribution.

FIGURE 18: **Policy decisions and the economic recovery in 2021 and beyond will shape the level and distribution of income growth over the Parliament**

Change in real (CPI-adjusted) average equivalised non-pensioner disposable household income, after housing costs, by income percentile and scenario: UK, 2019-20 to 2024-25



SOURCE: RF analysis of DWP, Households Below Average Income; RF forecast.

Current policy and the OBR's central scenario will put income growth in this Parliament on course to be of similar average pace to that experienced in the 2010-2015 Parliament,

where typical real non-pensioner household incomes grew at slightly less than 1 per cent a year. Income growth at the bottom, however, is forecast to be worse in the years to 2024-25 than in the first five years of the Cameron Government.

In contrast, if the £20 a week benefits boost is maintained and economic outcomes are in line with the OBR's upside forecast, typical incomes are projected to grow at around 1.5 per cent a year over this Parliament. This pace, along with relatively similar growth forecast across the distribution, means that the alternative is a Parliament of income growth in line with that experienced between 2001 and 2005.

So while the living standards outlook looks both weak and regressive as things stand, the role for policy in improving it is clear. Successfully navigating the hit to the labour market next year and maintaining a higher (but far from high) basic level of benefits are the route to ensuring that the years ahead feel anything like recovery for household living standards – especially for those on low and middle incomes. This matters too for poverty and inequality, subjects to which we now turn.

Section 5

Prospects for poverty and inequality

Although relative poverty fell in 2020-21, by the end of the Parliament in 2024-25, we estimate 23.0 per cent of individuals will be living in relative poverty – up from our estimate of 21.1 per cent in 2020-21. We also expect child poverty to rise, with some 730,000 more children living in poverty by 2024-25 compared to 2020-21, meaning that by the end of the Parliament we expect one-in-three children will be living in poverty in the UK.

We also forecast the effect of the Government keeping the £20 per week boost to Universal Credit and Working Tax Credit and what this would mean for poverty. With the boost continued, overall relative poverty would fall over the course of the Parliament, with child poverty seeing a (much smaller) rise due to the continuing roll-out of the two child limit and removal of the family element for families on benefits.

In this section, we look at what our forecasts for household incomes imply for measures of poverty. All of our poverty projections are based on incomes after housing costs, better reflecting the resources a household has to spend on core living costs.[55] As mentioned in Section 1, all of our modelling assumes that households across the distribution face the same changes in the cost of living, something that we strongly suspect is not the case so far in the pandemic, and so we take special care in interpreting our poverty estimates for 2020-21.[56]

Relative poverty fell sharply during 2020-21, but is set to see its largest rise in 2021-22 since 1987

Figure 19 shows the proportion of the whole population living in relative poverty since 1975. Following on from the scenarios introduced in the previous section, we show four possible future paths: with and without the continued £20 boost to benefits, and with the

55 They are also consistent with the measures published in Department for Work and Pensions, Households below average income: 1994/95 to 2018/19, March 2020.

56 For example, see: M Brewer and R Patrick, Pandemic Pressures: Why families on a low income are spending more during Covid-19, Resolution Foundation, January 2021.

OBR's central and upside economic scenarios.

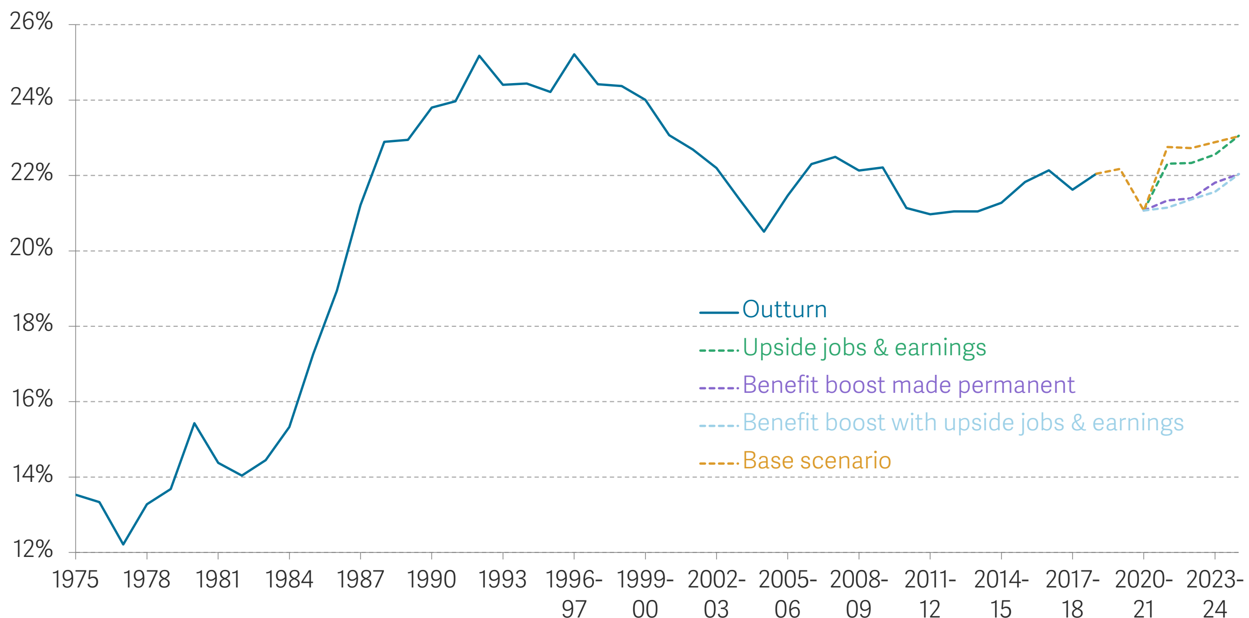
We find that overall relative poverty fell by 1.1 percentage points from 2019-20 to 2020-21, reflecting in part the £20 per week boost, but also other welfare changes discussed in Section 3. In our base scenario where the £20 per week boost is removed and we follow the OBR's central economic assumptions (represented by the dashed orange line in Figure 19), we find that relative poverty rises by 1.7 percentage points next year (corresponding to 1.2 million more people), and remains relatively flat until the end of the Parliament. Over the course of the whole Parliament (from 2019-20 to 2024-25), we anticipate overall relative poverty will have risen 0.9 percentage points in total.

If we compare the path of poverty under the OBR's 'upside' economic scenario (represented by the dashed green line), relative poverty grows at a slower rate before reaching a similar point at the end of the Parliament. This is due to the lower levels of unemployment forecast by the OBR in the intervening years in this scenario, meaning that fewer households see a fall in their income.

However, continuing with the £20 a week benefits boost would mean lower poverty through the whole forecast period (with a rate of 22.0 per cent in 2024-25 compared to 22.2 per cent in 2019-20). But even with this continuation, relative poverty would still rise in 2021-22, driven by the rise in unemployment.

FIGURE 19: **Relative poverty is set for its largest single-year rise since 1987 in 2021-22**

Proportion of people living in relative poverty: UK, 1975 to 2024-25



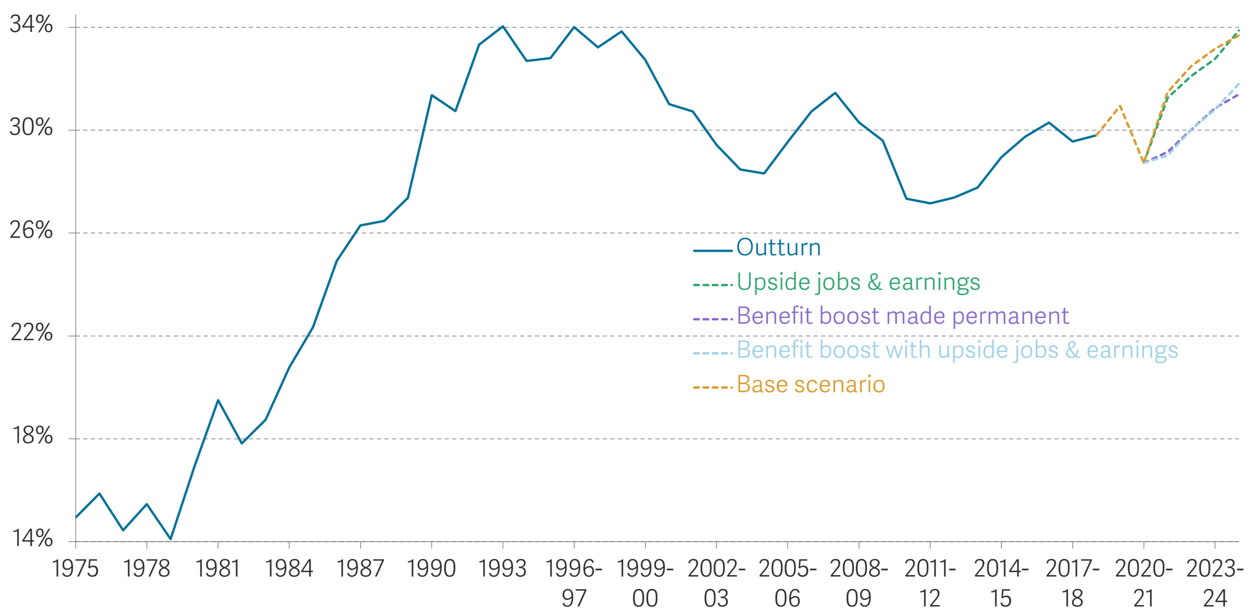
NOTES: Poverty rates are calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

Relative child poverty follows a similar pattern (see Figure 20), although it increases by more than overall poverty in our base scenario, and it increases over the Parliament in all of our scenarios, in part because the continuing roll-out of the two child limit and the removal of the family premium will further reduce the income of some low-income families on benefits. We estimate that child poverty fell by 2.2 percentage points in 2020-21, and we expect it to rise by 2.7 percentage points in the following year, corresponding to 400,000 additional children. Over the course of the Parliament we expect child poverty to have risen from 30.9 per cent to 33.7 per cent. From this year – 2020-21 – to the end of the Parliament, we expect around 730,000 more children to be living in poverty (although this follows a fall by 290,000 from 2019-20 to 2020-21).

If the benefits boost was made permanent, we still expect child poverty to grow, albeit slightly, to 31.4 per cent by 2024-25.

FIGURE 20: **One-in-three children will be in poverty by 2024-25**

Proportion of children living in relative poverty: UK, 1975 to 2024-25



NOTES: Poverty rates are calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

Box 4 discusses what our projections mean for child poverty in Scotland, where the Scottish Government has an explicit target.

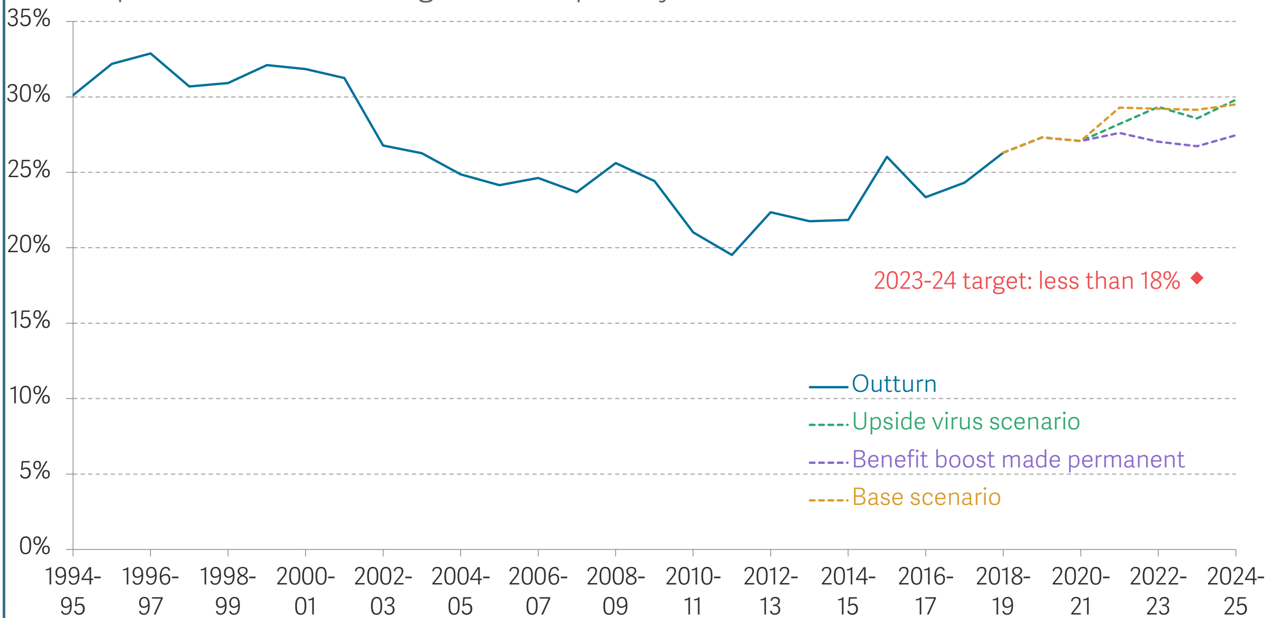
BOX 4: Prospects for child poverty in Scotland

The future level of child poverty is of added importance in Scotland due to the Child Poverty (Scotland) Act 2017. This legislation requires the Government to – among other things – reduce the proportion of children living in relative poverty to under 18 per cent by 2023-24 and under 10 per cent by 2030-31. This compares to a level of 23 per cent in 2018-19.

As with the UK overall, relative child poverty in Scotland has likely fallen in 2020-21. Unfortunately, our modelling (Figure 21) suggests that this fall will only be temporary, and that the rate will – at around 29.1 per cent – be higher in 2023-24 than it was pre-crisis. This is despite the roll-out of the Scottish Child Payment – a new £10 a week payment for children in poorer households – which will make an important difference. If the £20 a week UC boost were maintained, the outlook would be notably improved, but would still not deliver the large falls that are necessary to reach the interim target.

FIGURE 21: **Based on current policies, relative child poverty in Scotland is not projected to fall and the 2023-24 target will be missed**

Proportion of children living in relative poverty: Scotland, 1994-95 to 2024-25



NOTES: Poverty rates are calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

Our modelling does not include some smaller Scottish policies such as the Best Start Grants. And it is possible that earnings, employment or housing costs in Scotland could perform better than the whole-UK forecast suggests (though these also could perform worse). But our four scenarios – together with the fact that neither the pandemic, nor the introduction of Scottish Child Payments, have changed the projected direction of travel[57] – show that it would take some substantial Scottish or UK policy changes to reach the 2023-24 target, let alone the 2030-31 target.[58]

The Act also includes a target for absolute child poverty, which should be reduced below 14 per cent by 2023-24, from 20 per cent in 2018-19. As with relative poverty, we estimate that the proportion of children in absolute poverty temporarily fell in Scotland in 2020-21, but that there will overall be little progress made towards the target by 2023-24. The extension of the £20 a week boost would get Scotland substantially closer to that target, but it would still be missed. We have not modelled the other two goals in the Act, relating to material deprivation and persistent poverty.

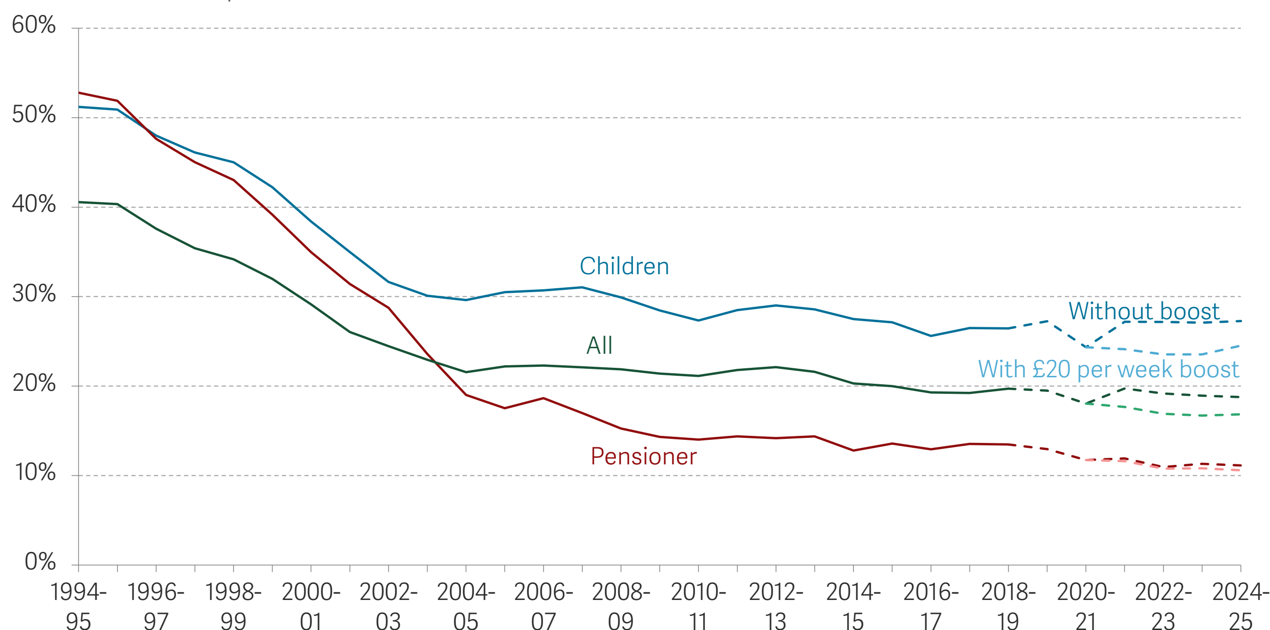
Absolute child poverty will increase further if the £20 a week benefit boost is not continued

We forecast overall absolute poverty rising into 2021-22 – mostly due to the removal of the £20 per week benefit boost from April, but also because of higher unemployment and the expiration of smaller benefit increases – and then falling in future years (see Figure 22). As we move into the post-pandemic recovery, this fall in overall absolute poverty is to be expected, as the absolute poverty indicator compares incomes to a fixed income benchmark, and we would expect income to improve as unemployment falls and earnings grow.

57 A Corlett, Wrong direction: can Scotland hit its child poverty targets?, Resolution Foundation, March 2019.
58 Note that estimated poverty levels may be revised down in years to come, though meeting the targets in that way would clearly not be in the spirit of the law. See: A Corlett, Improving our understanding of UK poverty will require better data, Resolution Foundation, January 2021.

FIGURE 22: **Absolute poverty is set to rise in 2021-22, and then fall slowly afterwards**

Proportion of people in households with income below 60 per cent of the 2010-11 median: UK, 1994-95 to 2024-25



NOTES: Poverty rates are calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

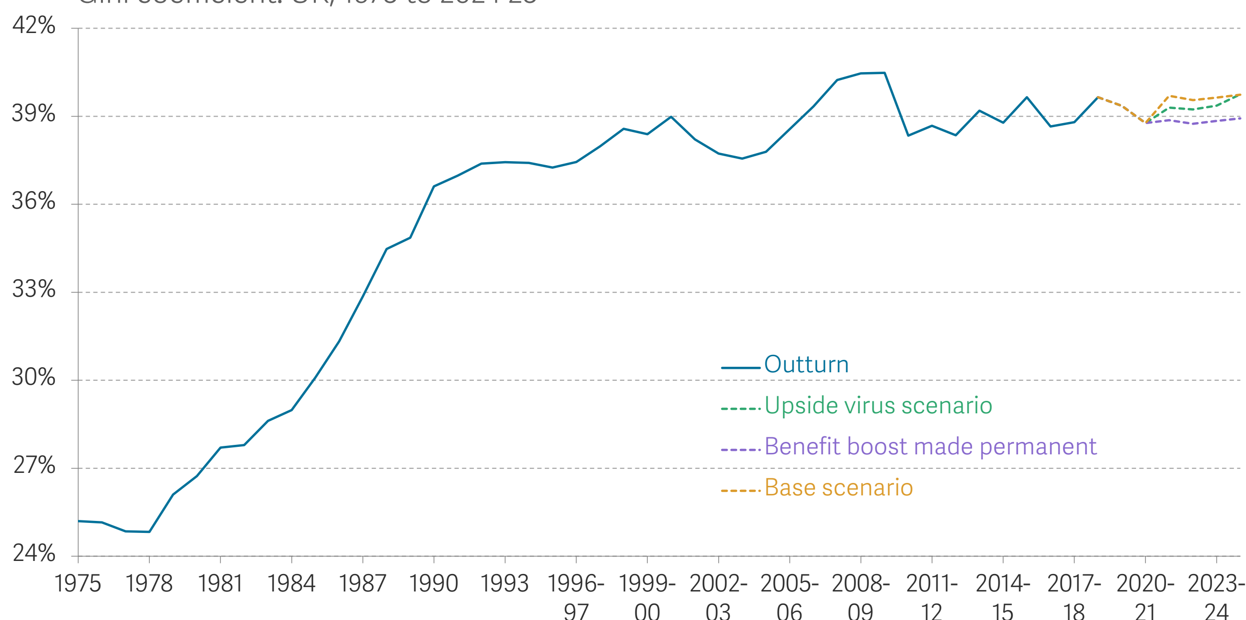
However, as Figure 22 shows, absolute child poverty is set to reach 27.8 per cent by 2024-25, which would put it at its highest level since 2013-14, and is set to be on a rising trend. The different trend with the rest of the population once again reflects the ongoing impact of the two-child limit and associated reforms that are reducing incomes among larger families. The lighter blue dashed line presents an alternative scenario where the £20 per week increase to benefits is made permanent: unsurprisingly, under this absolute child poverty would end the Parliament lower than it was at the start, but would still be on a slight rising trend by 2024-25.

Overall income inequality is set to change only slightly, but the true impact of this crisis on inequality should be measured by how it affects household balance sheets

Figure 23 shows a measure of income inequality that captures the whole distribution – the Gini coefficient. It is set to fall back in 2020-21 (reflecting the pattern of income changes shown in Figure 15), and then rise in 2021-22 if the benefit boost stops. Its path after that depends if the benefit boost is maintained – which would lower inequality – and on the speed of the recovery – with a stronger recovery acting to increase inequality.

FIGURE 23: **Inequality prospects depend on the speed of the post-pandemic recovery, and on whether the £20 benefit boost is maintained**

Gini coefficient: UK, 1975 to 2024-25



NOTES: Gini calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

But how the crisis has affected inequality between the rich and the poor is better understood by looking at broader measures of household finances or balance sheets, rather than just income. Resolution Foundation will be doing more research on this later this year, but we already know that the combination of changes to incomes and changes in spending patterns has led to changes to household balance sheets – i.e. the amount of savings and the amount of debt that a household has – which have acted to increase inequality. For example, previous Resolution Foundation work showed that the additional saving that has happened in 2020 has been concentrated among those on higher incomes: households in the top fifth of the population were three times more likely (by September 2020) to have increased their saving than those in the bottom fifth.[59] In contrast, poorer households are more likely to have borrowed to cover day-to-day expenses during this crisis: 50 per cent of adults with the lowest levels of savings (less than £1,000) have had to draw down on them since February this year, compared to 19 per cent of those with financial reserves of over £20,000.[60] And over half (54 per cent) of adults in the lowest income quintile report using at least one form of borrowing (credit cards, catalogue debt and the like) to a greater extent than they did in February to cover

59 J Smith et al, Macroeconomic Policy Outlook Q4 2020, Resolution Foundation, December 2020.
60 See Figure 11 of K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020.

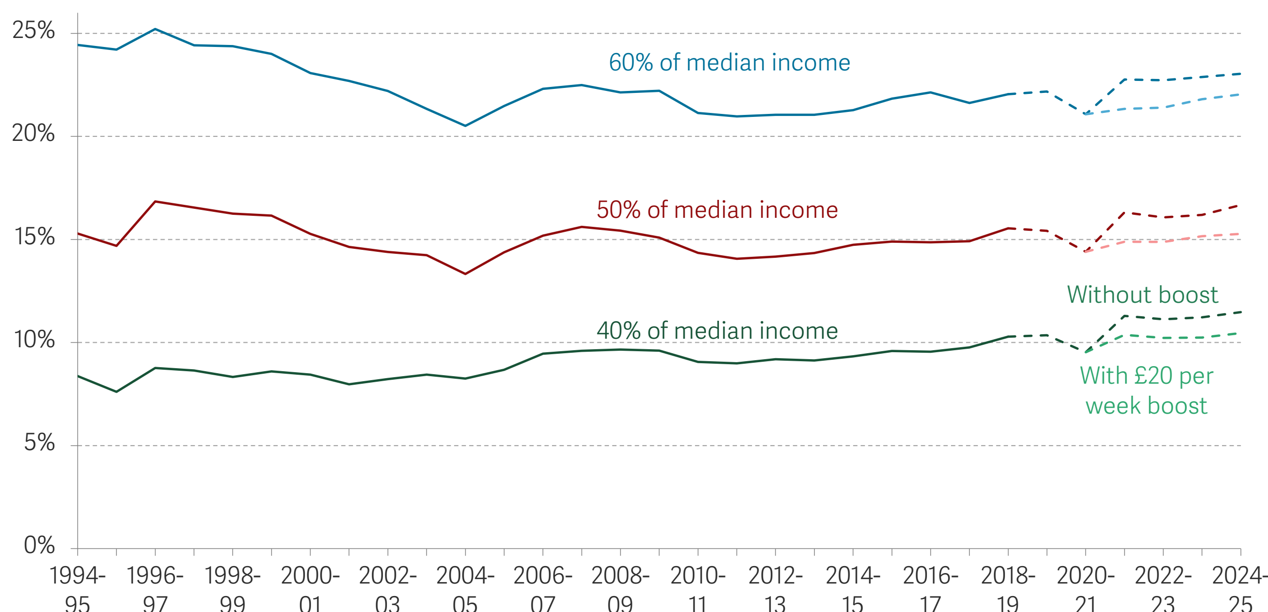
everyday living costs, indicating not only the pressure such households are currently under, but also that a debt problem may be brewing for the future.[61]

The depth of poverty matters, as well as its scale

2020-21 has highlighted some very serious issues for families living in poverty, where it is impossible to ignore the huge growth in reliance on foodbanks, and those in financial difficulties or problem debt.[62] Those facets of disadvantage or deprivation are not captured well by the purely income-based indicators of poverty that we are able to forecast here.[63]

FIGURE 24: **If the £20 a week boost is not maintained, there will be record numbers of people in households with under 40 per cent of median income**

Proportion of people in relative poverty, under various definitions: UK, 1975 to 2024-25



NOTES: Poverty rates are calculated using incomes after housing costs.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income; RF forecast.

But we are able to look at the depth of poverty that different individuals are experiencing. In Figure 24, the blue line shows the main relative poverty measure from Figure 19 (with the effect of the continuation of the £20 per week benefit boost in the lighter blue line). The subsequent lines show our estimates of poverty if we lower the threshold to 50

61 Taken from K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020.
62 For example, see: Lockdown, Lifelines and the long haul ahead: The impact of Covid-19 on food banks in the Trussell Trust network, September 2020, The Trussell Trust.
63 But see S Fitzpatrick et al, Destitution in the UK 2020, Joseph Rowntree Foundation, July 2020.

and 40 per cent of median income in each year, with each of the lighter lines showing the effect of the benefit boost. It tells us that, next year, about a half of individuals living in poverty will be living below two-thirds of the poverty threshold (i.e. they are in households with less than 40 per cent of median income). Worryingly, this fraction has been increasing over time. We estimate that by not maintaining the £20 per week benefit boost, the proportion of individuals living on less than 40 per cent of average incomes will be the highest in 30 years, rising from 1 in 12 in 2004-05 to 1 in 9 by the end of the current Parliament in 2024-25.

The Covid-19 crisis has had a huge impact on the economy, but, largely due to unprecedented support from the Government, this year has seen falling levels of relative poverty. The uncertainty posed by the recovery in the next few years will in part determine the path poverty will take in the UK, but our analysis is clear: welfare policy has an important part to play in whether the UK has rising – or falling – levels of poverty.

Section 6

Conclusion

A year ago, the first reports of a novel coronavirus were emerging in China, and six months ago, at the time of the publication of our lockdown Living Standards Audit, the "end" of the pandemic seemed a long way away. But, now, at the start of a new year, the hope of an effective and rapid vaccination roll-out means a significant economic recovery in 2021 is now a very realistic prospect.

The end of the worst of the pandemic should also mean good news for living standards. But instead, our projections for household incomes suggest that, rather than being a year of recovery, the year ahead could bring a mini-living standards downturn, particularly for low-income households.

Policy has played an unprecedented part in holding up incomes so far in this crisis, from the impact of furlough to the boost to benefits. However, unless the Government changes its plans in the coming weeks, policy will deliver a £1,000 cut to incomes for millions of low-to-middle income families across the country this year.

The triple hit to incomes from the financial crisis, Brexit and now Covid-19 means that the past decade has been historically very poor for income growth. A living standards recovery in the first half of the next decade depends on timing the withdrawal of economic support closely to the easing of the public health restrictions, a strong fiscal stimulus, and moving a post-Brexit and post-Covid UK onto a path of faster productivity growth.

Annex

Nowcasting and forecasting methodology

As set out in this paper, there are many factors that influence household disposable incomes and therefore need to be modelled when 'casting forward' the latest household income data (DWP's Family Resources Survey / Households Below Average Income, 2018-19) to the years from 2019-20 through to 2024-25. Our approach for projections is as follows.

Projecting underlying demographic change

Part of our forecasting relies on simply changing the composition of the population in the data, in line with actual or projected changes.

- We reweight the population to match ONS forecasts for demographic change by age, gender and region.[64]
- We also model changes in the numbers of dependent children of each age, using ONS forecasts.
- The proportion of women aged 70+ who have private pension income is also adjusted each year, rising in line with past Family Resources Survey trends. Note that there has been broadly no change among men.
- For 2019-20, outturn Labour Force Survey data is used to adjust for changes in employment rates by region and age; family type; household employment status; and housing tenure; and OBR totals for private employment, public sector employment, self-employment, unemployment and the non-participating population are also used.
- We do not adjust for a slight rise in the State Pension Age between 2019-20 and 2020-21 (when it hit 66), but changes in 2019-20 are captured in our reweighting.
- We do not account for changes in migration patterns, housing tenure changes

64 J Browne, Reweight2: Stata module to reweight survey data to user-defined control totals, IFS, July 2012.

(beyond 2019-20) or related shifts in the number of students living with parents – even though all of these could potentially have been significant in 2020.[65]

Modelling unemployment, furloughing and the Self-Employment Income Support Scheme

Sadly, our nowcasting and forecasting must now include significant changes in unemployment, as well as other large falls in earnings in 2020-21. Figures for the numbers of people affected are provided by outturn data or OBR forecasts, but we must also model who should be affected.

- To model furloughing we use logistical regression modelling based on waves two (May 2020) and five (September 2020) of the Covid-19 Understanding Society data. We weight the results to reflect the number of months the UK has spent in near lockdown (using the May wave), and otherwise (using the September wave). We use this predictive modelling to directly adjust wages in line with the furlough rules, allowing for a proportion of employees who will have had their wages topped up. We only model furloughing in 2020-21, and the total number of employees furloughed is aligned to the average OBR level for the year.
- For the SEISS we follow a similar approach to furloughing, and specifically we limit SEISS receipt to self-employed workers who have lost earnings in our modelling. We deviate from the OBR assumption here – assuming that a similar number of self-employed will be support by the SEISS in the final quarter of 2020-21, given the announcement of a fourth SEISS payment. To model self-employment losses in 2020-21 we apply a similar approach, using an OLS estimator for change in log hours worked. We then scale gross earnings for the change in hours worked – allowing for increasing as well as falling hours.
- To model the level of unemployment in 2020-21 and beyond, we use the OBR forecast. Earnings are reduced to zero for the necessary number of observations in the data. Unemployment is distributed using logistical regression modelling of characteristics of those who have lost their jobs in the Covid-19 Understanding Society panel data. For 2021-22 and later years, we use furloughing and unemployment data in the Understanding Society panel data to predict unemployment – reflecting that the higher unemployment expected in these years will be due to the furlough scheme ending. We model unemployment separately for employees and self-employment – using the OBR employment figures for each.

65 For example, see M O'Connor & J Portes, Estimating the UK population during the pandemic, Economic Statistics Centre of Excellence, January 2021.

Uprating market incomes

Projecting wages and other forms of market income into the present and future is a key part of our modelling.

- In every year, we model the wage floor: ensuring that no-one in our data falls below their age-appropriate minimum wage. We model a spill over effect on a linear scale from the minimum wage to the appropriate 30th percentile of wages. We also model the extension of the 'National Living Wage' to ages 23 and 24 in 2021-22; and ages 22 and 21 in 2024-25.
- For 2019-20, we ensure that wage growth matches the level and distribution measured in HMRC's Real Time Information data.[66]
- For 2020-21 and beyond, we ensure that overall wage growth – including the compositional impacts of demographic and unemployment changes, and the impact of furloughing – match the OBR's projections. Beyond our wage floor modelling, we assume a flat distribution of wage growth. For the OBR's 'upside' scenario we increase earnings growth in line with the increase in productivity in the OBR forecast.
- For self-employment income growth we use figures implied by the OBR's projections for mixed income and numbers of self-employed workers.
- Private pension incomes are uprated using the previous September's RPI inflation (but see also: Projecting underlying demographic change, above).
- Outturn dividend income is moved in line with the ONS's household sector dividends series. For the future, we assume that dividends recover relative to 2019, in line with the OBR's equity price forecast.
- Other private income sources are uprated in line with the OBR's average earnings forecast.
- The composition of top income in our modelling is based on data that does not have the 'SPI' adjustment. However, this only impacts on the growth rather than levels of top incomes.
- We model increases in private pension contributions due to the further roll-out of auto-enrolment in 2019-20. We do not model growth in student loan repayments.

66 ONS, Earnings and employment from Pay As You Earn Real Time Information, UK, December 2020.

Projecting prices and housing spending

As our focus is on real disposable incomes, after housing costs, we must also account for changes in prices and housing costs.

- We create specific household income deflators for both the 'before' and 'after housing costs' income measures, in line with DWP definitions. To project these we use OBR forecasts for CPI, mortgage interest payments and actual rents.
- Mortgage interest costs are uprated uniformly using OBR projections.
- Private rents are – for the most part – assumed to rise in line with average earnings in future, matching the OBR's assumption. Ground rents and service charges are assumed to do the same. No regional variation in price changes is assumed beyond 2020, with the ONS's Index of Private Housing Rental Prices used in our nowcasting. For 2021-22, however, we use the OBR's actual rents forecast (which includes social housing) as this is likely to be a better assumption than using earnings growth at a time when earnings are rebounding from 2020-21.
- Social rents are uprated using old OBR forecasts for eligible social rents.
- Other housing costs are uprated using the OBR's CPI forecast.

Modelling taxes and benefits

We model the tax and benefit system in future years using stated government policy (e.g. 2021-22 benefit rates) and default policy (e.g. CPI uprating in many cases).[67] But there are a number of choices to note:

- We model a mix of UC and legacy benefit systems, with roll-out estimated using OBR figures. We assume that full roll-out is not complete until 2026-27. We do not account for the 'transitional protection' policy that will apply to some cases who would otherwise lose out when moved to the new scheme, but this is likely to be limited and will depend on the delayed managed migration process.
- We model incomplete take-up of the main means-tested benefits. For example, we assume 60 per cent take-up of Pension Credit, and 85 per cent take-up of UC. We assume for simplicity that these figures do not change between years.
- A number of policies are modelled as being gradually rolled out:
  - The two-child limit is applied to children born from April 2017 onwards, and so

67 See Annex A (Indexation in the public finance forecast baseline) in HM Treasury, Budget 2020: policy costings, March 2020.

affects a growing proportion of the caseload each year.

    - The abolition of the family element of tax credits and UC works in the same way. However, the 'family premium' in housing benefit has been abolished for new claims as well as for births after 1 May 2016. We model this by phasing out the premium over a five year period.
    - The Work-Related Activity Component of Employment and Support Allowance (and its equivalent in UC) has also been ended for new claimants from April 2017. We model this by phasing out the component over a five year period.
    - The introduction of the new State Pension for younger cohorts is modelled.
    - The change in eligibility of mixed-age couples for Pension Credit in 2019 – with newly-claiming mixed-age couples now receiving (less generous) UC instead, but existing claims protected, is not modelled. We instead use the new eligibility rules for everyone, in every year.
    - The replacement of Disability Living Allowance with Personal Independence Payments is not modelled.
- Council Tax is assumed to rise in line with OBR forecasts by nation. Detailed changes to Council Tax Support by nation and local authority are not modelled.
- We model the new means-testing of free TV licenses for those over the age of 75 (as this forms part of the DWP's household income definition), and assume this applies for the whole of 2020-21 onwards.
- To model changes in disposable household incomes using all the inputs and policies above, we use the IPPR tax benefit model.

There are a number of smaller policies that we have not modelled, but which might also affect household incomes. These include:

- The phasing out of above-basic-rate tax relief for landlords' mortgage interest costs.
- Scotland's Best Start Grant and increased Carer's Allowance.
- Income in the form of Help to Buy ISA, Lifetime ISA and Help to Save bonuses, or Green Homes Grants.
- The temporary introduction of free school meals, or equivalent support, during holidays.

Projecting changes rather than levels

Using all of the above, we model incomes in the years 2018-19 through to 2024-25. However, as our modelled estimates can systematically differ from survey data – e.g. due to survey data underestimating benefit incomes – we apply income growth rates from our modelling to the 2018-19 outturn data, rather than directly using the projected levels.

Our scenarios

As set out in Section 4, in addition to our base projection, we model three other scenarios. These differ from the base projection in only limited respects:

- Our 'benefit boost made permanent' scenario increases the UC standard allowances and Tax Credit basic element in line with inflation after 2020-21, rather than ending the £20-a-week boost in April 2021.
- Our 'upside scenario' is taken from the OBR's November EFO. We simply use their more optimistic unemployment projections, and increase average earnings growth (including for the self-employed) in line with the difference in productivity per hour growth between the two scenarios (as upside earnings figures are not published). Given the limited scope of the OBR scenario data, and to make the contrast between scenarios simpler, we make no changes to other parameters such as inflation, housing costs, investment income or the State Pension triple lock.
- Finally, our 'upside and boost' scenario combines the two sets of changes above, with the upside economic outlook together with a permanent benefit boost.

Resolution Foundation

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged.

We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

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