

The big squeeze

Assessing the changes to family incomes over the next six months

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This winter will see a major income squeeze – and it will be focused on low-to-middle income households. High inflation, especially higher energy bills, will strain many families' finances. But these pressures will be compounded for over 4 million families when £20 a week is cut from Universal Credit in October 2021. Looking forward, April 2022 will also see a rise in employee National Insurance contributions, placing further downward pressure on the income of most working families (in exchange for better funded healthcare).

Increased earnings may offset some of these additional pressures for some families over the coming months, although the forthcoming rise to employer National Insurance contributions could damp down wage rises from 2022. Furthermore, come April 2022 the lowest-paid workers will benefit from a rise in the National Living Wage. Benefits will be uprated at the same point, but it is likely their value will not keep up with rising prices this winter (benefits are pegged to the value of inflation in the preceding September).

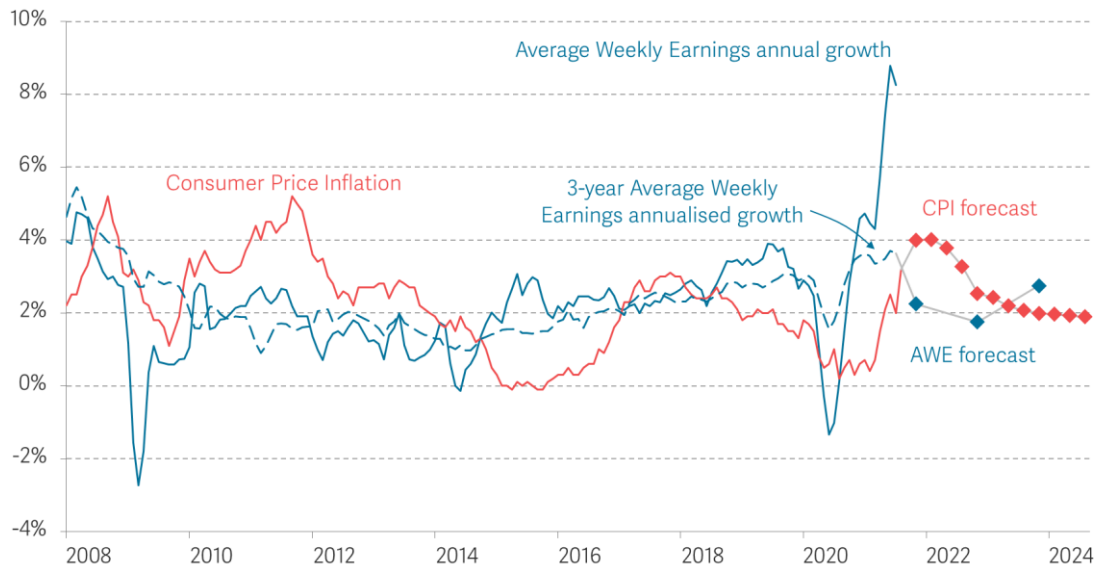
We are a long way from the 20 per cent inflation rate experienced in the 1970s, and price rises are expected to fall in the second half of next year, but it's the combination of higher costs and the cut to Universal Credit that will make the next few months especially tough for low-income families. Overall, this winter will feel nothing like the post-pandemic economic recovery – and improving living standards – the Government (and indeed the country) was hoping for.

Inflation and benefit cuts look set to erode incomes this winter and beyond

The cost of living is on the rise. The [Bank of England](#) has forecast that inflation will rise above 4 per cent in the coming months, the highest rate observed in the UK since 2011. At the same time, average weekly earnings are forecast to grow by just 2.25 per cent by the end of this year once [compositional and base effects](#) as a result of temporary Covid-19 labour market factors are stripped out. While measured AWE growth is currently running at over 8 per cent, the annual rate of earnings growth since 2019 which strips out these effects suggests an

underlying earnings growth rate of just 3.6 per cent. Rising inflation will therefore lead to workers experiencing a return to the falling real earnings experienced between 2010 to 2014 and immediately after the Brexit referendum (see Figure 1).

Figure 1 **Inflation is set to erode the real value of earnings this winter and beyond**
 Average weekly earnings growth and CPI inflation, actual and Bank of England forecasts: UK



Notes: The spike in pay growth in recent months reflects significant compositional and base effects rather than underlying pay growth. The Bank of England forecast for earnings growth also ignores these temporary effects. Source: Bank of England, Monetary Policy Report, August 2021; ONS, Average Weekly Earnings growth (KAC3), Consumer Price Inflation (D7G7).

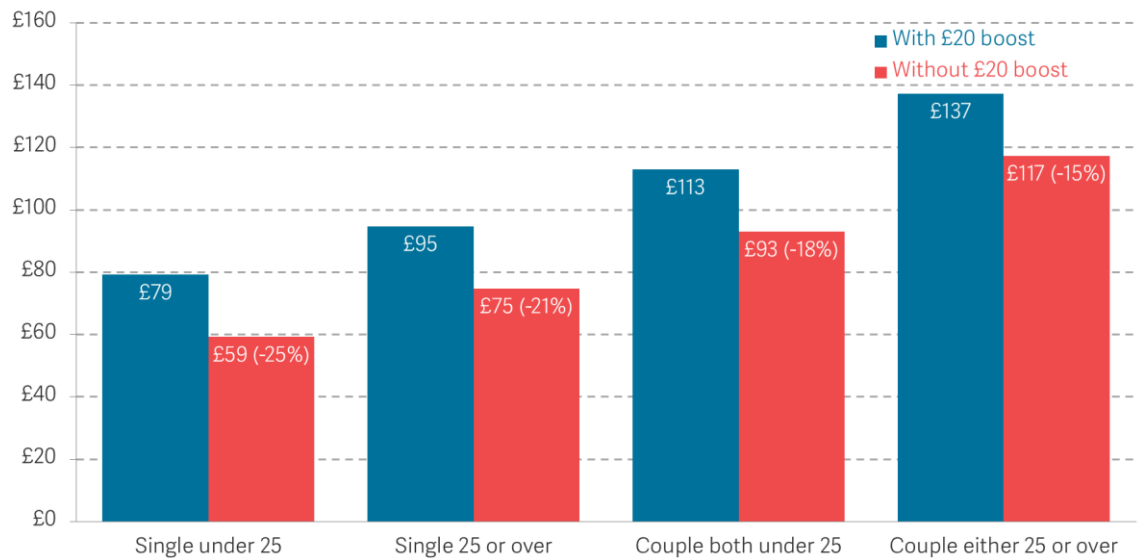
Moreover, there are two reasons to think that Figure 1 understates the extent of the squeeze. First, the earnings forecast we plot pre-dates the Government's announcement of a 1.25 per cent increase to *employer* National Insurance contributions from April 2022, a change which will likely weigh down on pay rises into next year. Second, the Bank's August inflation forecast pre-dates the latest rise in energy prices – and the considerable knock-on effect the energy crisis is having on [household bills](#). (The Bank has [since revised up their inflation expectations](#), but not set out a complete inflation forecast.)

But rising inflation is not the only living standards headwind that many households face over the winter months. The 4 million families on Universal Credit will see their standard allowance fall by £20 per week from October as the uplift that was introduced at the beginning of the pandemic is removed. As Figure 2 makes clear, this constitutes a significant hit to incomes – accounting for an average [income reduction of 5 per cent](#) but as much as a 25 per cent fall in the value of the standard allowance for a young single claimant, and a non-negligible drop of 15 per cent for a couple where either partner is aged 25 or over. And as we look further forward, benefit levels will be uprated in April 2022 by September 2021's rate of inflation, as convention dictates, even though inflation is set to rise further over the winter months.

Figure 2

The cut to Universal Credit will be sharply felt

Universal Credit standard allowances (per week): UK, 2021-22



Notes: The £20 per week boost is set to be withdrawn from UC payments made from 6 October onwards.
Source: DWP, Universal Credit.

Most workers are unlikely to see incomes rise faster than the cost of living this winter

So how will all these trends play out for different types of households over the winter, and resolve by spring next year? We examine what these changes (as well as rising Council Tax bills in April 2022) mean for the incomes of five specimen families.¹

First, we consider two example families *without* children: a single adult working full-time on the National Living Wage (Figure 3), and a couple where both are working full-time with one earning the median wage and the other earning a low wage (Figure 4). Neither of these families is entitled to any support through Universal Credit, so they are unaffected by the £20 a week cut from October this year and by the benefit uprating in April 2022.

The income of these two family types is comprised solely of their earnings. We use the Bank of England's earnings forecast and estimate that in cash terms, *average* wages will rise by 1.3 per cent from September 2021 to April next year (obviously workers will in reality receive wage rises both above and below this amount). However, the rising cost of living will act as a significant drag on living standards over the next six months. We model this by calculating the effect of the Bank of England's August inflation forecast on the income purchasing power of each family type, adding in an additional £3 per week for rising energy costs. (Here, we assume that the expected [increase in the energy price cap](#) rate next April by a further 19 per cent is passed on in full to our specimen families; and to avoid double counting, we exclude the rise in the cap this October that was announced around the time of the Bank of England's August inflation forecast.) This combined cost of living increase (the Bank's August inflation forecast and the April energy price cap rise) is consistent with the Bank's

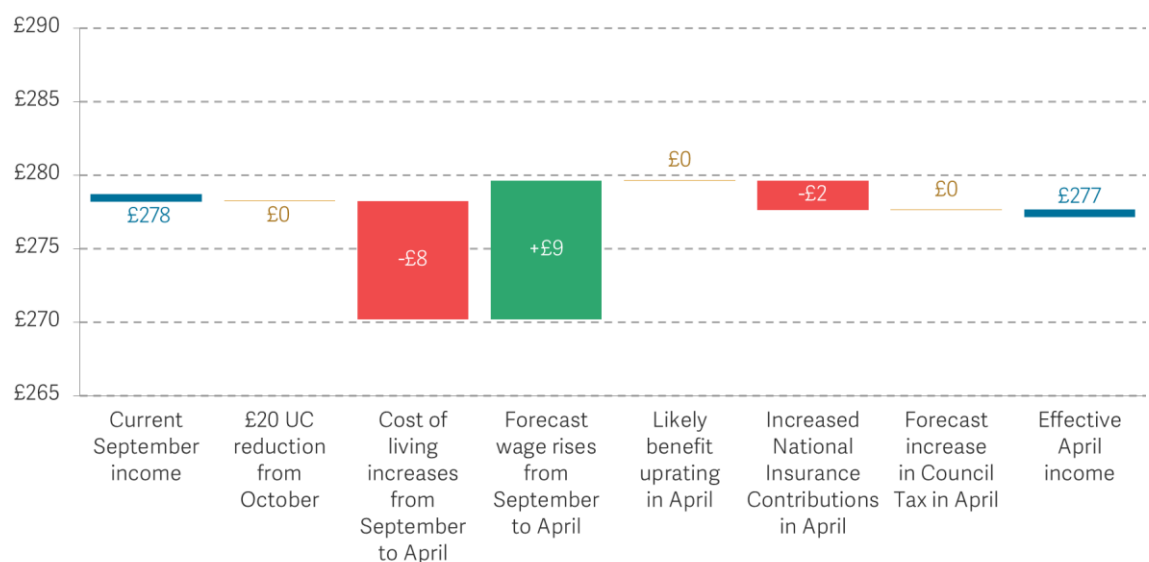
higher inflation expectations as set out in the [minutes of the September Monetary Policy Committee meeting](#).

Come April 2022, while not set in stone, the OBR forecasts an uplift in the National Living Wage of 4.2 per cent from £8.91 an hour to £9.28 (the Government will confirm the rate later this autumn). At the same time, however, working families will also have to pay increased *employee* [National Insurance contributions](#) – costing a low-paid worker around £2 per week in our case studies, undoing some of possible wage gains over the winter. Increases in Council Tax are set to be lower in 2021 than in previous years: the OBR forecasts a rise of 1.9 per cent in 2022-23 compared to 4.4 per cent in 2021-22. Based on this, we estimate a small increase for families of up to £1 per week. However, with many councils [dealing with increased costs from Covid-19](#), there remains a risk of higher increases in Council Tax bills.

So how will all these changes shake out for our two family types without children? Figure 3 shows that overall, a working single person on the National Living Wage is likely to experience an £8 per week higher cost of living through the winter months, but by April 2022, will find themselves only marginally worse off than currently, as a result of the anticipated uplift to the wage floor.

Figure 3 **The lowest-paid without children face a tough winter, but their income will improve with the National Living Wage rise in April 2022**

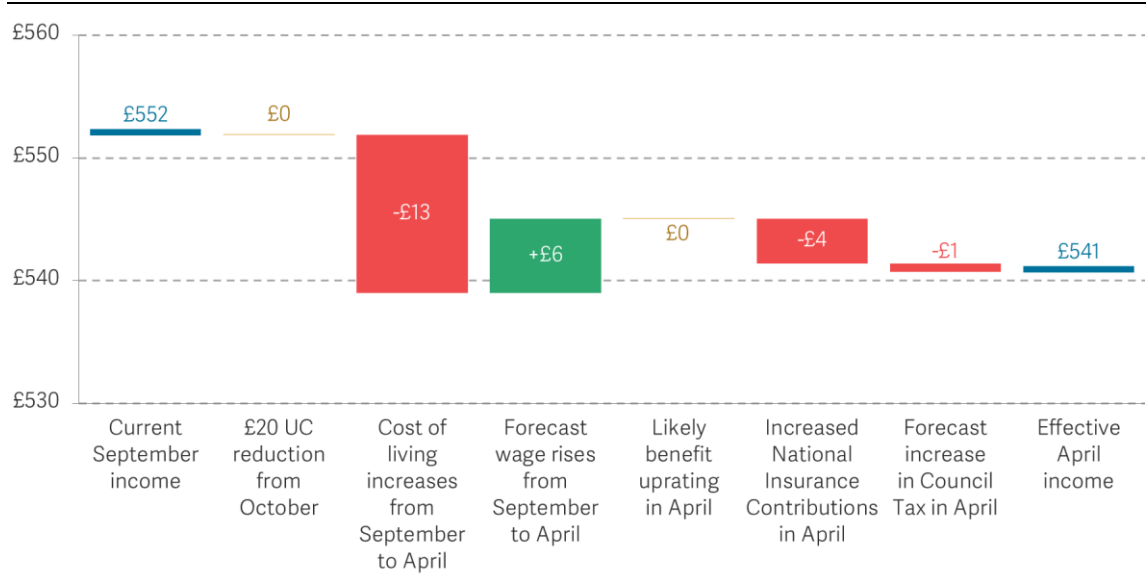
Changes in household income per week for a single adult working full-time and earning the National Living Wage: September 2021 to April 2022



Notes: Cost of living increase calculated as effect of Bank of England August inflation forecast on income purchasing power, as well as an additional £3 per week energy costs. Wage rise includes OBR forecast of National Living Wage rise in April 2022. Renting privately at the 30th percentile of average UK rents.
 Source: RF case study model.

In contrast, a couple earning above the National Living Wage have no such respite. Any earnings increase is unlikely to compensate for increasing costs this winter: our example suggests such a family will be worse off by around £10 per week by April 2022 (a fall in effective income of 2 per cent).

Figure 4 **Workers earning above the minimum wage are unlikely to see sufficient pay rises to offset the rising cost of living this winter**
Changes in household income per week for a couple both working full-time, at median wage and at the 25th wage percentile: September 2021 to April 2022



Notes: Cost of living increase calculated as effect of Bank of England August inflation forecast on income purchasing power, as well as an additional £3 per week energy costs. Wage rise includes OBR forecast of National Living Wage rise.

Source: RF case study model.

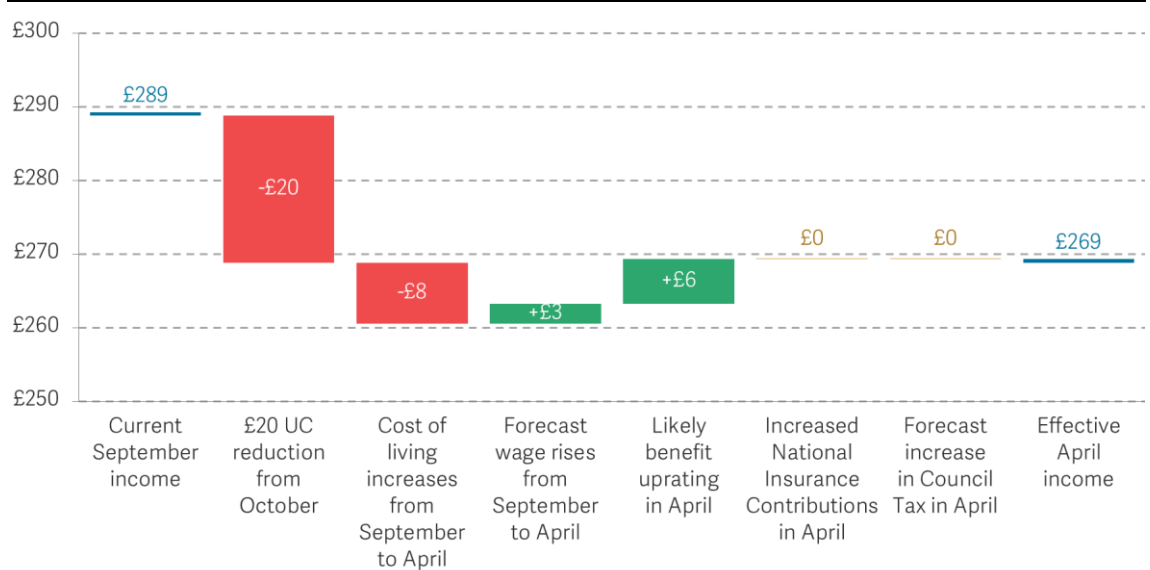
Low-income families with children are set to lose out this winter

We now consider some example working families that *are* supported by Universal Credit. First, we look at a single working parent (Figure 5) and then at a working couple (Figure 6) – both on low wages.

To begin, both family types will be hard-hit by the £20 cut to Universal Credit from October this year. Likewise, our families with children can expect to see a similar increase in the cost of living as families without children over the coming months, putting further downward pressure on their incomes. Furthermore, because they are in receipt of Universal Credit, they are subject to a taper rate which means that they will only see their income increase by 37p (or less) for every extra £1 their earnings increase over the winter months.

The annual uprating of benefits in April 2022 will increase their Universal Credit award in line with the cost of living. However, it is questionable whether this increase in the spring will fully reflect rising prices this winter. This is because the uprating of benefits each April is based on inflation in the preceding September. At present, it looks like the September 2021 inflation figure will be lower than inflation over the rest of the winter, meaning that families have to wait *another* year for the increased cost of living this winter to be reflected in their Universal Credit award.

Figure 5 **Low-income single parents working part-time will be especially hard-hit in the coming months**
Changes in household income per week for a single parent working 20 hours per week at the National Living Wage: September 2021 to April 2022



Notes: Cost of living increase calculated as effect of Bank of England August inflation forecast on income purchasing power, as well as an additional £3 per week energy costs. Wage rise includes OBR forecast of National Living Wage rise.
Source: RF case study model.

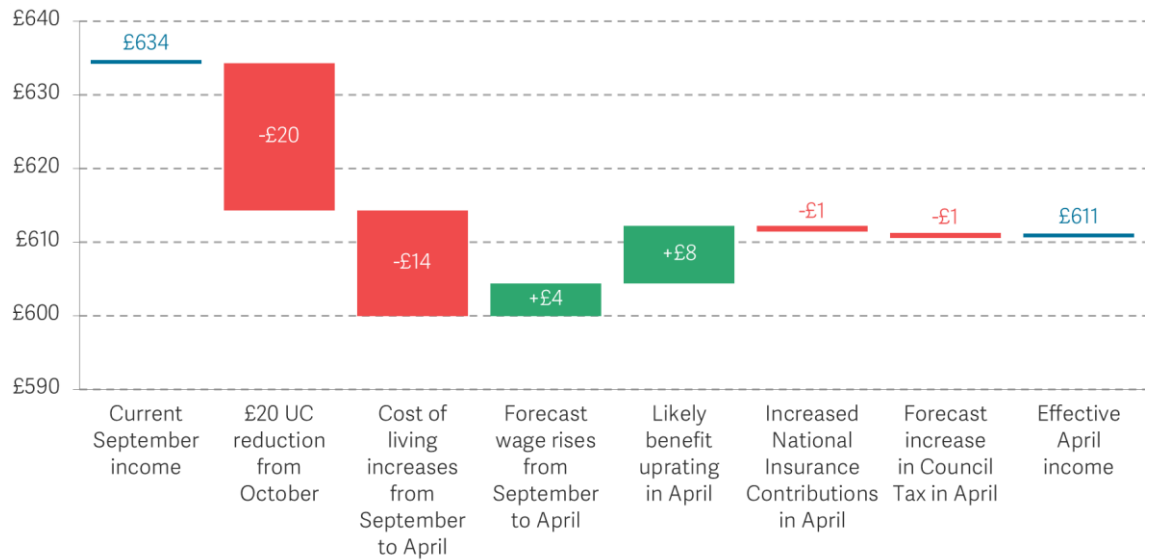
Overall, as Figure 5 shows, we estimate a single parent working 20 hours per week at the National Living Wage will be worse off by around £20 per week by April 2022 – or an effective income fall of 7 per cent. Our low-earning couple with children will be £23 worse off by the spring, equivalent to an income fall of 4 per cent (see Figure 6).

Finally, it is worth noting that these trends affect households *out of work* as well as working households. In Figure 7, we document the cumulative effect of benefit cuts and cost of living rises over the winter and into the spring for a single out-of-work adult. As this makes clear, they are set to be worse off by around £24 a week by April 2022, a significant fall of around 14 per cent to an already low income.

Figure 6

Low earning families on UC will be over £20 per week worse off this winter

Changes in household income for a couple with two children, one working 20 hours at the National Living Wage per week and one full-time at the 25th wage percentile: September 2021 to April 2022

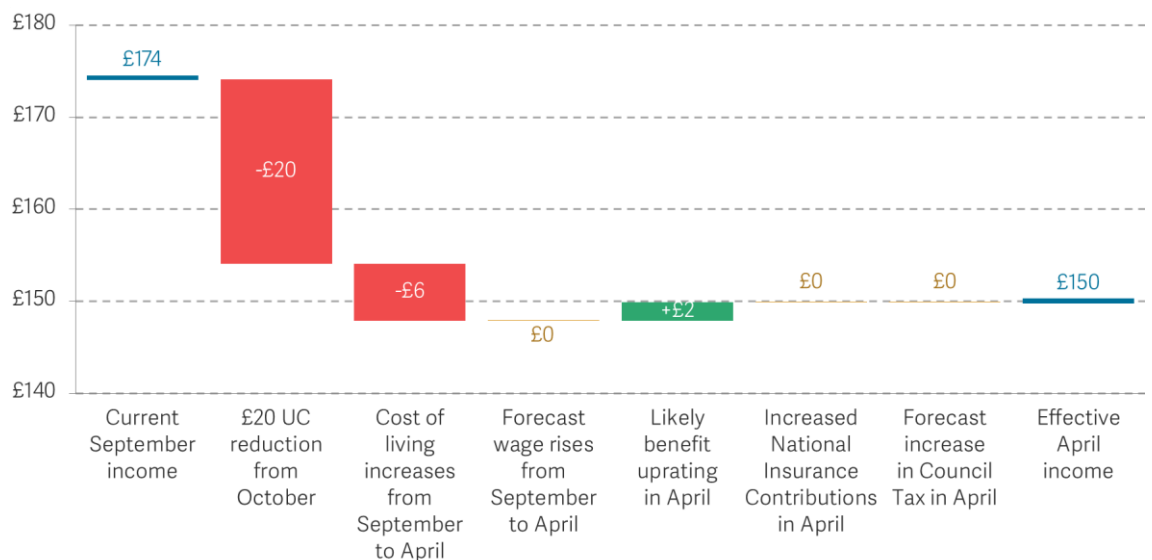


Notes: Cost of living increase calculated as effect of Bank of England August inflation forecast on income purchasing power, as well as an additional £3 per week energy costs. Wage rise includes OBR forecast of National Living Wage rise. Renting privately at the 30th percentile of average UK rents, and assuming all housing costs are covered by UC. Source: RF case study model.

Figure 7

Unemployed UC claimants will see bills rise as their benefits fall

Changes in household income per week for a single unemployed person: September 2021 to April 2022



Notes: Cost of living increase calculated as effect of Bank of England August inflation forecast on income purchasing power, as well as an additional £3 per week energy costs. Wage rise includes OBR forecast of National Living Wage rise. Renting privately at the 30th percentile of average UK rents, and assuming all housing costs are covered by UC. Source: RF case study model.

Conclusion

The high inflation we anticipate this winter is a long way away from the income-eroding rates of the late 1970s – and at present is forecast to be temporary – but its effect on family incomes will be considerable. Costs are rising dramatically at a point when lower-income families in receipt of Universal Credit are facing a significant cut in support. While uprating of benefits and the National Living Wage in April 2022 will unwind some of these effects, even a short-term squeeze on finances is the last thing any family – or indeed a recovering economy – needs.

¹ The author would like to thank Jack Leslie, Adam Corlett, and Lindsay Judge for helpful discussions on the case study modelling.