Resolution Foundation

The price is right?

The April 2022 energy price rise and the Government's response

4 February 2022

Mike Brewer, Adam Corlett, Karl Handscomb, Lindsay Judge & James Smith

The Government has opted for universalism and minimising the hit to the public purse in its response to the energy price rise yesterday. The announced measures take the sting out of Ofgem's £693 rise in the energy price cap in April with a broad-based package of support. All households will get a £200 discount on bills, and four-in-five will also receive a £150 Council Tax (CT) rebate. But although this is a more progressive package than a simple cut in the price of energy, it still leaves all facing a sizable rise in bills, with the number of households in England experiencing 'fuel stress' set to double to around 5 million come the spring.

The innovative part of the package is in repurposing the CT system to deliver rebates to households living in properties in Bands A-to-D. This near-universalist approach has come at the expense of measures to protect low-income households such as a radical expansion to the Warm Home Discount, or using the benefit system to deliver targeted support. Moreover, one-in-eight of the poorest families – who live in relatively expensive properties – will not qualify for the CT rebate; nor will it help those who are exempt from CT (such as students) or those tenants whose landlord pays that bill. Meanwhile, the £200 electricity bill discount is effectively a loan, repaid by households through higher bills over the next five years. If energy prices fall, this may be viable; if not, then households are likely to notice a £200 discount on bills this autumn turning into a £40 surcharge in April 2023.

Ofgem's announcement was accompanied by a gloomy outlook from the Bank of England, which expects a higher and longer-lasting spike in inflation. Its forecast makes the extent of income squeeze clear – implying a 2 per cent fall in real incomes household disposable incomes, the largest on record and a hit to average household income of around £1,000 a year. While the economy is recovering from the shock of the Covid-19 pandemic, the outlook for living standards is bleak.

February 3 was a big day for cost of living news, with Ofgem's announcement of the new energy price cap, a policy response from the Chancellor, and a rate rise – accompanied by a gloomy set of forecasts – from the Bank of England.

The price cap rise was predictable, but its scale is still striking. The typical dual-fuel annual bill will rise by 54 per cent (£693) in April, from £1,277 to £1,971.[1] Given the scale of the real income hit facing households from this and other pressures, it is welcome that the Government has responded, with two main measures:

- A universal £200 rebate on electricity bills in the second half of 2022-23; and
- A £150 rebate to Council Tax bills for properties in England in Bands A-to-D. (It will be up to the Scottish and Welsh Governments to choose how to spend equivalent budget increases.)

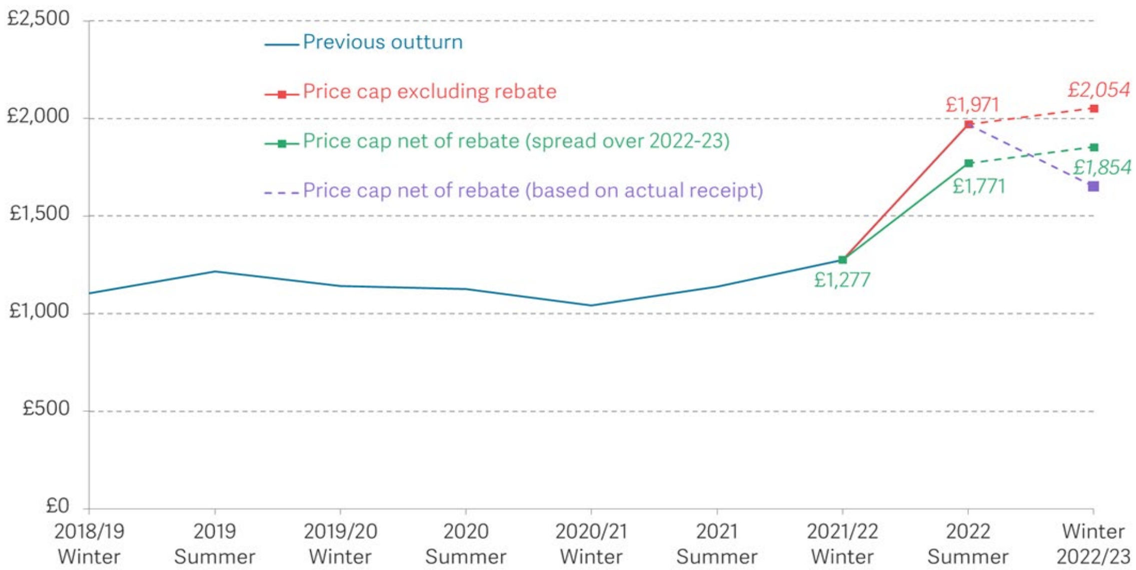
Additionally, as previously announced, the Warm Homes Discount (WHD) is also to be expanded in 2022-23 – to cover around 3 million households – and will be increased from £140 to £150, but remains funded by bill payers.

Energy costs will be reduced directly with an 'Energy Bills Rebate' and expanded WHD

The £200 Energy Bills Rebate will effectively reduce the size of the annualised rise in the price cap to £493 for a typical dual-fuel bill. This is still a 39 per cent rise (see Figure 1, which also includes a forecast of the energy cap in Winter 2022/23). This is a major, universalist piece of support, worth £5.5 billion to households in 2022. However, the rebate is only payable from October 2022, meaning that absent of any other measures, households would still be on course to see the full impact of the price cap change their April 2022 bill.

Figure 1 **The annualised price cap is set to rise by £693 in April, though the Energy Bills Rebate will reduce this by £200**

Typical annualised price cap: Great Britain



Notes: The £200 Energy Bills Rebate will be paid from October 2022. Winter 2022/23 figure based on a forecast by Cornwall Insight.

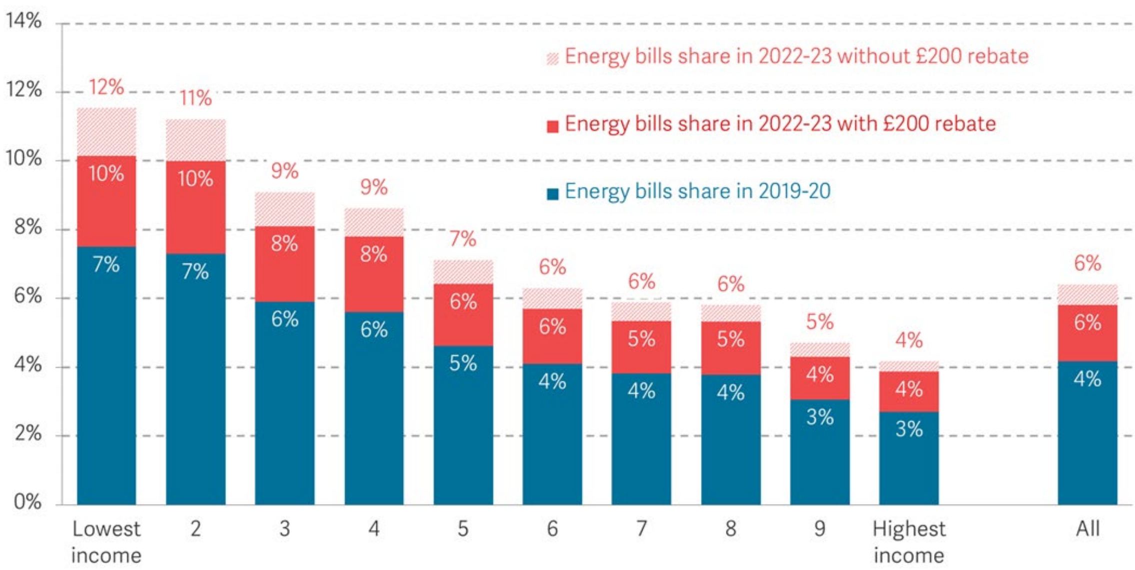
Source: RF analysis of Ofgem, and Cornwall Insight.

The Energy Bills Rebate will not ultimately be paid for by Government, but instead will be paid back by a £40 charge on bills in each of the five years from 2023-24 to 2027-28. The Treasury's hope is that energy prices will fall enough so that this can be added to bills without causing too much pain, but it does mean that households bills are going to switch from benefitting from a £200 rebate this autumn to carrying a £40 surcharge in April 2023 (and the four years after).

Moreover, as Figure 2 shows, the £200 rebate still only partially offsets the increase in spending on energy bills. The net result is that the lowest-income households will see the energy bills as a share of their total spending rise from 7 per cent in 2019-20 to 10 per cent in 2022-23 (although it would have been 12 per cent without the £200 rebate). Middle- and higher- income households will also see their share of their spending on energy rise (from 3 per cent to 5 per cent), but by far less than low-income households.

Figure 2 **The lowest income households will still see the sharpest rise in energy spending despite the £200 rebate**

Household spending on energy bills as a share of total consumption, by income decile: UK



Notes: We assume the £200 discount is also applied in Northern Ireland. Energy bills assumed to rise in line with the change in the price cap from 2019-20 to April 2022. Total consumption uprated in line with the consumption deflator as forecasted by the OBR. Income deciles calculated before housing costs.
Source: RF analysis of ONS, Family Spending.

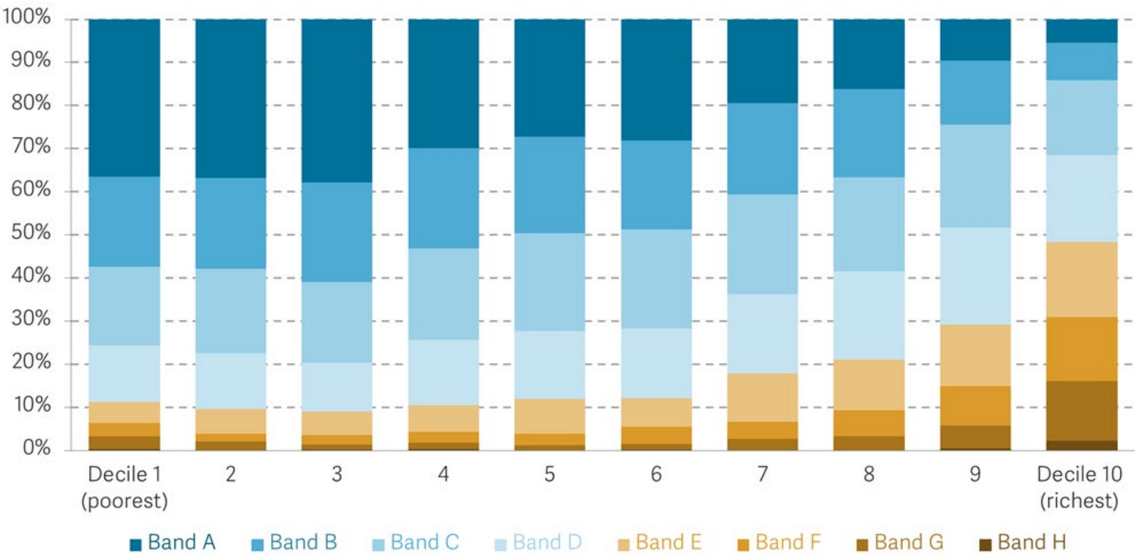
The Government had been expected to target additional support through the WHD. But in the end, this was only increased from £140 to £150 a year with an 800,000 rise in the number of households eligible (to 3 million). The cost of the WHD will continue to be met by other bill-payers, with these changes expected to put £5 on a typical bill.

The Government is using Council Tax (CT) rebates to provide additional help with the cost of living crisis

Alongside the £200 electricity bill rebate, the Chancellor took the relatively unexpected step of cutting 2022-23 CT bills by £150 for those in Bands A-to-D (in England). As 80 per cent of households live in properties in these bands, this is a broad-based policy response. In effect, the Chancellor is repurposing the CT system into a mechanism for handing out lump-sum grants to households, while avoiding giving any to the richest. This makes the policy more progressive in its impacts than a cut in VAT, or other interventions that would have lowered the unit price of energy. But it does have some shortcomings. As Figure 3 shows, there are some low-income households who live in high-band properties who will not be eligible for the rebate: around 640,000 households in England in the lowest three income deciles live in homes in Band E and above.[2] In addition, there is a strong regional skew to this policy: more than one-quarter of households in the South East, London and the South West live in home in CT Bands E and above, compared to less than one-in-ten in the North East, North West and Yorkshire and The Humber.[3]

Figure 3 **More than one-in-ten households in the bottom half of the income distribution will not be eligible for the CT rebate to help with their bills**

Proportion of households in income deciles, by CT band: England 2019-20



Notes: Income deciles calculated after housing costs.
Source: RF analysis of DWP, Households Below Average income.

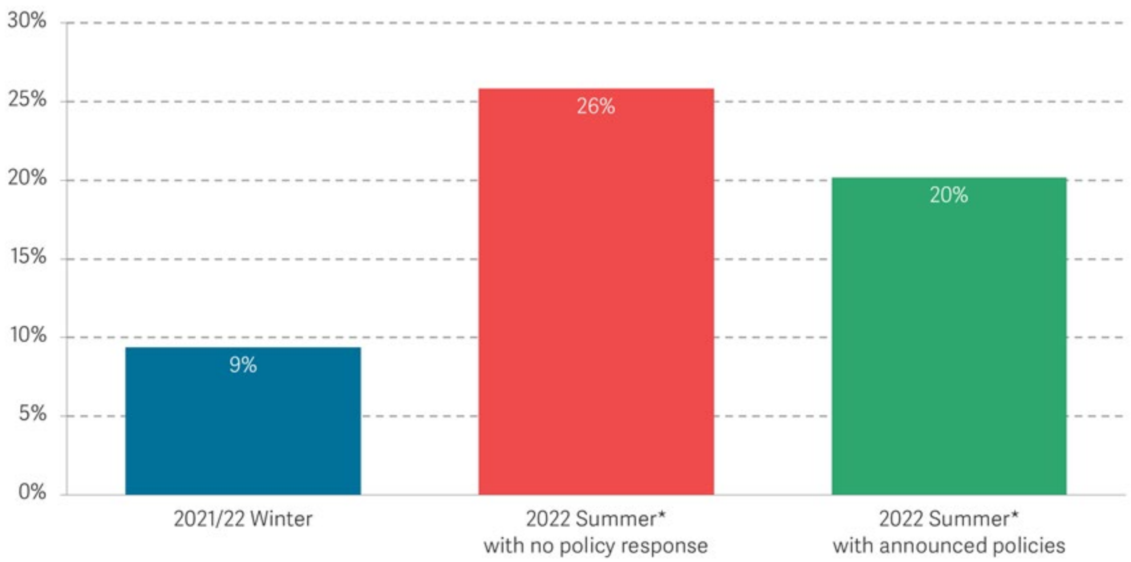
Furthermore, there are other groups who could fall through the cracks and not benefit (or at least not in full) from the Government's decision to tackle the energy bills crisis using CT, including those living in properties that are exempt, and those who have no liability because they are students, and those have CT wrapped into their rent. And there are practical impediments: the rebate will be relatively easy to provide to households who have CT on direct debit (where the Government is asking LAs to pay the full rebate direct to households in April), but will be much more challenging to deliver to the estimated one-quarter who do not pay by this route. The announcement of a £144 million discretionary fund to help families who are eligible for the CT rebate is therefore welcome, although this once again relies on local authorities to publicise and administer effectively.

The announced measures will stop 1 million families experiencing 'fuel stress'

Even with this package of measures, many households will still feel the pinch. Figure 4 shows our forecast for the proportion of households in 'fuel stress' – i.e. spending over 10 per cent of their income on energy bills (this analysis treats the CT rebate as an increase in income, and not a reduction in energy spending). At present, an estimated 9 per cent of English households (over 2 million) fall into this category. The price cap rise by itself would have tripled the number to 26 per cent (6 million). But the measures announced on February 3 will reduce this to 20 per cent (5 million) – keeping over 1 million households out of 'fuel stress', but still representing a more-than-doubling.

Figure 4 **The number of households in 'fuel stress' is set to double, though without the policy package it would have tripled**

Proportion of households in 'fuel stress': England



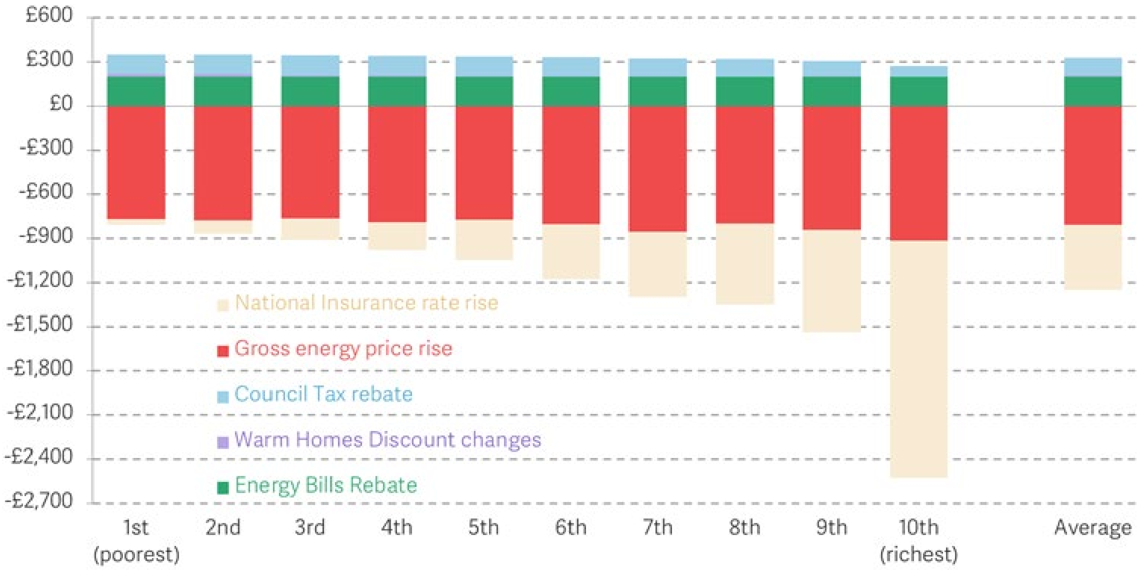
Notes: Fuel stress is defined as spending more than 10 per cent of after housing costs household income on energy. * These figures are based on the price cap that will apply from April 2022, but factoring in the £200 rebate that will be applied from October 2022 (as well as other policies).
Source: RF analysis of English Housing Survey; Ofgem; OBR.

The Government is offsetting a near-universal cost of living hit with near-universal spending measures

The Energy Bills Rebate and CT cut will together offer most households £350 of respite over the course of 2022-23. As the Chancellor said, that offsets the majority of the £693 price rise for the typical bill, albeit a very narrow one (51 per cent). As Figure 5 shows, both the gross average impact of the price rise and the effect of the policy package are similar in cash terms across the income distribution. Those in the top income decile spend the most on energy and, as shown above, are the least likely to live in CT Bands A-to-D. However, what is not shown in Figure 5 is the full distribution of how much people spend on energy: around 10 per cent of households spend under two-thirds of the typical amount on energy, while another 10 per cent spend over 50 per cent more. For some households, the £350 will therefore represent a large majority of their specific price rise, while for others it will be a small part.

Figure 5 **The Government is offsetting a near-universal cost of living hit with near-universal spending measures**

Policy and price cap impacts in 2022-23, by household income decile: England

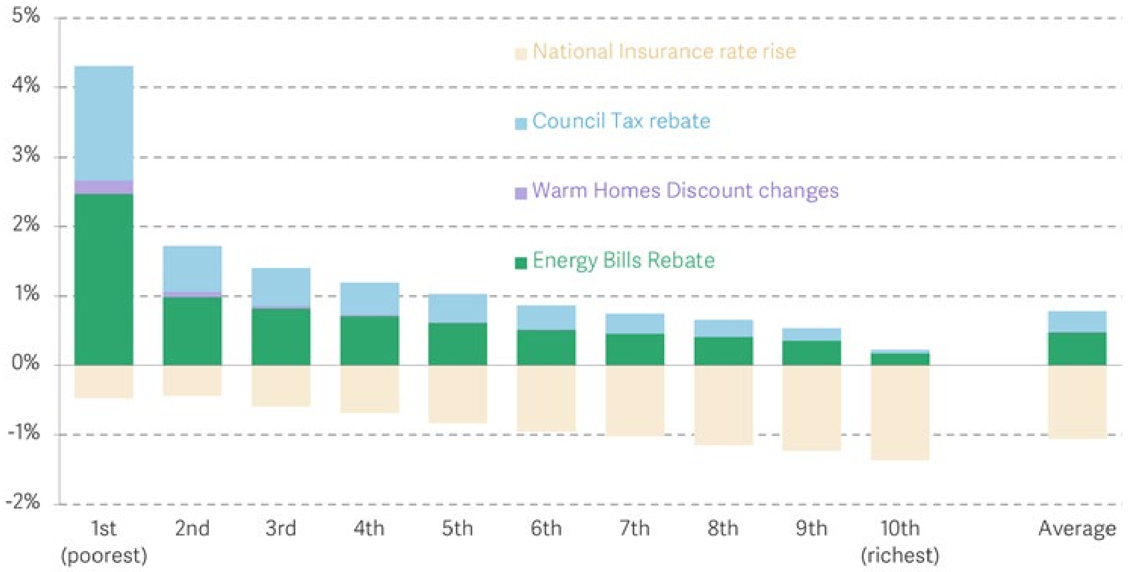


Notes: Energy price rises may not match typical bill figures from Ofgem. We assume all households in CT bands A-to-D will benefit, which is an overestimate. Income deciles calculated after housing costs.
Source: RF analysis of DWP, Family Resources Survey (including using the IPPR Tax and Benefit Model); and English Housing Survey.

We can also compare the energy policy package with April's planned employee and self-employed National Insurance rate rise (an additional 1.25 percentage points). As Figure 5 shows, the cash impact of that rise will be smaller than the energy price rise for the vast majority of households, but it is one more factor set to weigh on incomes in 2022-23. Figure 6 shows that in proportional terms, both the universalist package and the National Insurance rise are progressive – with the former more than offsetting the latter for the bottom half of the income distribution.

Figure 6 **Although not the purpose, the energy policy response does offset the NI rise for low- to middle-income households**

Impacts of selected policies in 2022-23 relative to disposable incomes, by household income decile: England



Notes: We assume all households in CT bands A-to-D will benefit, which is an overestimate. Income deciles calculated after housing costs.
Source: RF analysis of DWP, Family Resources Survey (including using the IPPR Tax and Benefit Model); and English Housing Survey.

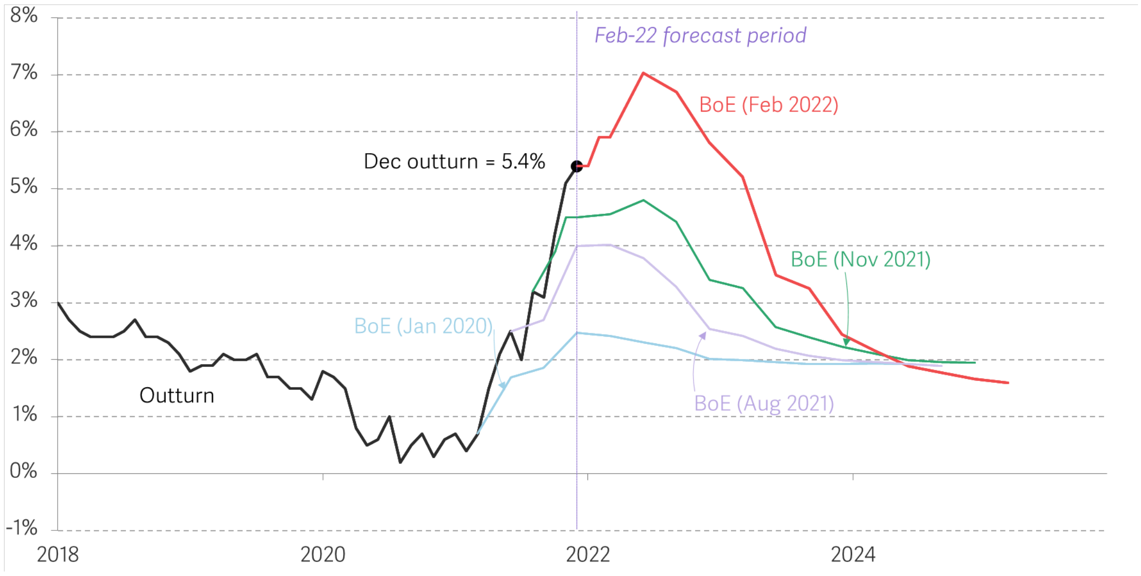
2022 is still set to be a year of record falls in real incomes

Alongside the price cap announcement, yesterday's Bank of England projections paint a picture of a higher and longer-lasting spike in inflation. Forecasts for CPI inflation peak at around 7¼ per cent in April this year as the impact of the rise in the energy price cap feeds into the calculation (Figure 7). This is the highest inflation rate ever forecast by the Bank. Although that forecast does not include the impact of the new policy announcements – suggesting inflation might be slightly lower than suggested in the coming months – the picture is one of higher inflation persisting for longer than previously thought – with CPI now projected to be above 5 per cent into Q1 2023.

As a result, the Bank of England is now projecting a sharp fall in incomes this year. As shown in Figure 8, the Bank expects real incomes to fall by 2 per cent this year. If realised that would make it the weakest on record (coming after a prolonged period of weak income growth since the financial crisis). Mapping the Bank's forecasts onto ONS data on the level of real household disposable incomes suggests this translates into an average fall of around £1,000 per household in 2022.

Figure 7 **The Bank of England is forecasting that inflation will rise above 7 per cent in 2022**

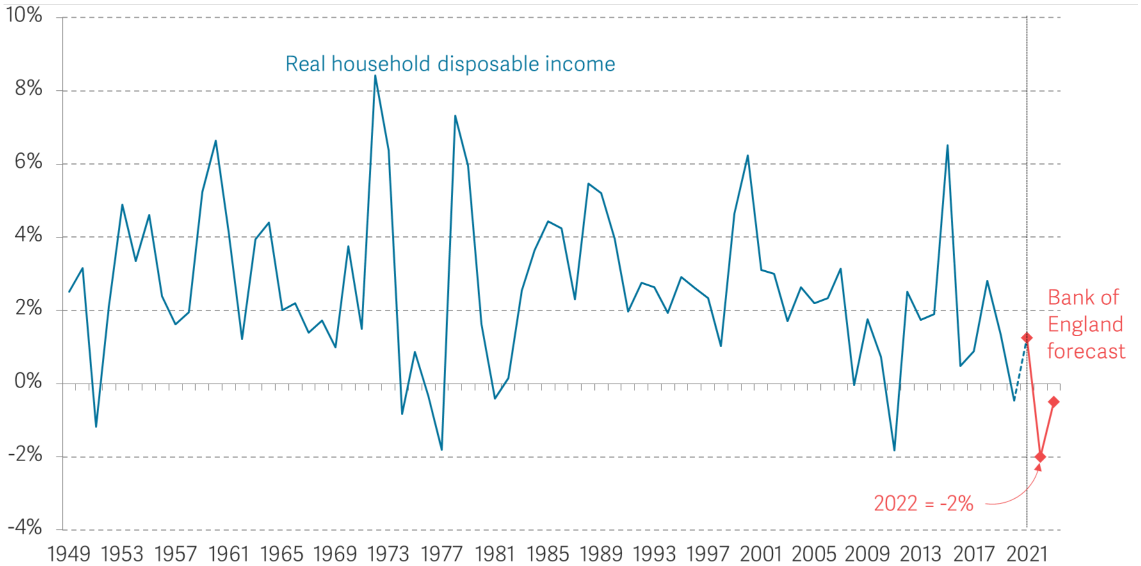
Bank of England projections for CPI inflation



Source: Bank of England, Monetary Policy Report, various; and ONS, Consumer price inflation.

Figure 8 **The Bank of England is projecting the weakest real, household disposable income growth on record**

Real household disposable income growth, outturn and February 2022 Bank of England projection: UK



Source: ONS, UK Economic Accounts time series; Bank of England, Monetary Policy Report, February 2022.

The Chancellor began his statement on energy prices lauding the strong performance of the UK economy. Output has certainly bounced back from the shock of the Covid-19 pandemic, and the UK's policy response meant we avoided mass unemployment. But, even after the Government's attempt to defray some of the pain of higher energy prices, the legacy for living standards in 2022 is bleak.

---

[1] These figures refer to Great Britain. The energy market in Northern Ireland is regulated differently, so the price cap and the £200 electricity bill discount do not affect households in Northern Ireland. All figures based on direct debit payment. Prepayment customers will see an increase of £708 from £1,309 to £2,017.

[2] Source: RF analysis of DWP, Households Below Average Incomes, 2019-20.

[3] The share of households living in Band E and above properties are as follows: South East (31 per cent), London (29 per cent), South West (26 per cent), East of England (21 per cent), West Midlands (15 per cent), East Midlands (10 per cent), Yorkshire and The Humber (10 per cent), North West (8 per cent), North East (7 per cent). Source: RF analysis of DWP, Households Below Average Incomes, 2019-20.