BRIEFING

In at the deep end

The living standards crisis facing the new Prime Minister

The Living Standards Outlook 2022 – Summer Update

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An error in the relative child poverty projection and associated text was corrected on 28 September 2022.

Summary

Households are set to face a sharp shock this winter: as the energy price outlook has continued to worsen, forecasts made less than a month ago that inflation would peak at 13 per cent now look optimistic. This winter's cost of living crisis and the Government's response to it will, therefore, determine how successful are the early months of the new Prime Minister's tenure. But so great is the challenge posed by sky-rocketing energy prices that the Government's response will not only determine how successful the first few months of the new PM's tenure is, but will also shape living standards throughout their premiership. To set out the scale of this challenge, this paper presents projections for how household incomes may change across the income distribution, both in the short-term and up to 2026-27. The grim outlook provides the key context for new Prime Minister, whose legacy risks being a disastrous end to a dismal two decades for household incomes.

The rocketing energy price cap will mean a grim winter and continued high inflation

The outlook for household energy prices is now central to the outlook for living standards, over this winter, but also over the next year. The typical gas and electricity bill in 2021-22 was around £1,500, but is projected to be £3,750 in 2022-23. Even without considering price rises for other goods and services, this would be a large shock to households' spending power. While for most households, direct debit payments will be smoothed across the year, for the 4 million households with prepayment meters, a typical household would need to find over £700 a month in the coldest months of January and February.

In August, the Bank of England thought that the rising price cap would push overall inflation to over 13 per cent in October (though falls in oil prices may help lower that peak), and that inflation would still be 10 per cent in Q3 2023, after which the energy price rises begin to fall out of the inflation calculation. Remarkably, however, the energy outlook has worsened still further since the Bank's forecasts. At the start of August, the annualised price cap was predicted to peak at £3,700 in April-June 2023, but the latest forecast is an astonishing £6,600; with inflation forecast by Citi to peak at over 18 per cent, although these forecasts are driven by what are extremely volatile global markets for gas.

As energy spending makes up a larger proportion of lower-income households' spending – and with food price inflation running at 13 per cent, the highest since 2008 – inflation is even higher for poorer households. By October this year, we project that households in the lowest-income decile will face inflation rates of 15 per cent, compared to 11 per cent for the highest-income households.

Energy prices have become both very hard to predict and extremely volatile, but futures curves still imply that gas prices are likely to eventually fall back. In early August, the Bank expected that inflation would decline to 5 per cent by the end of 2023, and to 1 per cent by the end of 2024. However, the projected short and long-term implications of rapidly-rising prices for households' real living standards are dire. Based on the Bank's projections, average real pay could be 9 per cent lower in Q2 2023 than it was two years earlier, wiping out all real-terms pay growth since 2003. This recent bout of weak earnings growth follows on from at least 15 years of economic stagnation driven primarily by weak productivity growth, and this is why, even by Q1 2027, real pay will likely be lower than it was twenty years earlier. Meanwhile, interest rate increases mean that mortgagors' interest payments are currently rising (with payments up 14 per cent in the year to July), and social landlords in England are likely to raise rents in 2023 by considerably more than was the pre-pandemic norm. On the other hand, assuming that the Government follows precedent and existing commitments, the high rate of inflation does mean that the level of state benefits (including the State Pension) will rise by around 10 per cent in both April 2023 and April 2024, but it is only by April 2024 that their real-terms value will be restored to where they were in October 2021.

Real household incomes will fall and poverty will rise both this year and next

These factors – along with the short-term rise in unemployment expected by the Bank –produce a shocking outlook for living standards. The crisis will hit households hard not only this winter (even after considering the value of the temporary cost of living support for households announced earlier this year), but in 2023-24 as well. Using our headline measure of real-terms equivalised household disposable incomes of non-pensioners, after housing costs, the typical income is projected to be 5 per cent lower in 2022-23 than in 2021-22, and then fall again by 6 per cent in 2023-24 – if the Government does not intervene. The combined fall in typical income of 10 per cent between 2021-22 and 2023-24 is twice as severe as that seen between 2009-10 and 2011-12 (a 5 per cent fall), and worse than in the mid-1970s, when there was an 8 per cent fall. The two-year drop in mean disposable income (for which data go back further) is likely to be the worst for at least a century. In absolute terms, the typical real (equivalised) income is projected to be £2,800 lower in 2023-24 than in 2021-22.

Between 2021-22 and 2023-24, all parts of the income distribution see similar losses on average – though there will still be enormous variation in outcomes, with some households having much larger energy bills than others, and some workers receiving much smaller pay rises than others, for example. In 2022-23, targeted (and universal) cost of living payments cushion income falls at the bottom of the income distribution, and higher-income households face larger losses, including from the National Insurance rise. Given current Government policy– which would mean repeating none of the one-off interventions from 2022-23 –the reverse would be true in 2023-24, with those on the lowest incomes facing the largest falls, with a 10 per cent fall in income for the second-poorest income vigintile. This is despite an assumption that the Government will follow usual practice and uprate benefits in April 2023 by around 10 per cent: these large real-terms falls, then, would be driven by the ending of all support packages coming alongside continued high inflation.

Some recovery is projected for 2024-25, with median non-pensioner income growing by 2 per cent, and faster growth for poorer households due to another (delayed) boost from inflation-tracking benefit uprating. Growth continues beyond there, but is relatively weak – at 1 per cent a year – driven by projections of weak real earnings growth (despite below-target inflation) and rising unemployment. Overall, these projections would leave incomes across the distribution significantly lower in 2024-25 than they were in 2019-20 – for example, 7 per cent lower at the median – which would easily make this the worst parliament on record for income growth. The typical inflation-adjusted income for non-pensioners would be no higher in 2026-27 than a decade earlier, and only marginally above where it was in 2006-07. Although the sharp rise in the cost of living can take much of the blame for the fall in household incomes over the Parliament, the continued weakness predicted for the middle of this decade is driven instead by low productivity in the UK economy, and weak earnings growth, of the sort that the UK has been stuck with since the mid-2000s.

In the absence of policy or economic forecast changes, absolute poverty is projected to rise from 17 per cent in 2021-22 to 22 per cent in 2023-24 – again the worst two-year change on record, and a rise of over 3 million from 11 million to 14 million people. Furthermore, absolute child poverty is expected to rocket from 23 per cent in 2021-22 to 31 per cent in 2023-24, an increase of 1 million children. In both cases, rates will fall back in 2024-25, but will remain considerably above where they were in 2020-21, when policy helped to reduce absolute poverty rates during the pandemic. By 2026-27, relative child poverty is set to reach its highest rate since the 1990s, at 32 per cent.

Large changes to the economic forecast or policy will be required to significantly improve this outlook. Boosting wages by 5 percentage points by 2026-27 (equivalent to a 1 percentage point rise in wage growth each year) would increase typical household income by 3 per cent and poorer households' income by 1 per cent, while reversing the personal National Insurance rise boosts them by only 1 and 0 per cent respectively. In both scenarios, though, incomes would still be lower in 2026-27 than they were in 2019-20.

A big policy intervention is expected

These projections are not set in stone. The outlook for energy prices has only worsened since the Bank's last forecast (upon which our projections are built), but the path they will take through 2023 and beyond remains highly uncertain. It is also unclear exactly how policy is going to change, but we can be sure that there will be substantial changes beyond the existing government policies that we have modelled. It should be clear from these forecasts that new interventions will need to be significant in scale. As we have set out in other work, there is now a very strong case for directly holding down unit energy costs, but with this support targeted either via a social tariff or by recouping some of the cost through the tax system.

But the challenge for policy makers is not just about getting through the winter without widespread destitution. Higher energy bills may last, and higher prices of essentials requires a higher level of basic benefits. This means that it is crucial that the default inflation-linked uprating for benefits (including the Basic State Pension) goes ahead in full in April 2023 and April 2024. In addition, the artificial lag between measuring inflation (in September) and uprating benefits (in April) should be reduced: with a permanent shift to at least October-based uprating, which would mean a temporary additional income boost in 2023-24. In periods of high inflation, benefits (particularly Universal Credit) should also be increased more than once per year. Both of these policies would simply speed up the normal process of benefit uprating catching up with increases in the cost of living. Parts of the benefit system that do not automatically rise in line with prices must also be revisited: Local Housing Allowances and the benefit cap should be uprated in April 2023 rather than remaining permanently frozen.

Although global supply shocks and war in Ukraine are the causes of the short-run disaster of crippling energy bills, the weak performance of household living standards across the Parliament as a whole is grounded in the combination of low productivity and weak earnings growth that has been behind the relative decline of the UK economy since the mid-2000s. The current crisis makes it all the more important that the UK grapples with its twin long-term challenges of low growth and high inequality. The Economy 2030 Inquiry will be setting out a policy agenda to help achieve this, but it is clear that failures on both of these fronts left too many households badly exposed to shocks such as this one – increasing the need for frequent ad hoc interventions. Without progress on both fronts, the new Prime Minister risks overseeing the culmination of not just the worst two years in this century or the last, but of two lost decades for British households' living standards.

Rising energy bills and inflation will squeeze household incomes this winter and beyond

Before the invasion of Ukraine in February, the country was facing a cost of living crisis driven by rising energy prices. Since then, the outlook for living standards has become even more horrifying – despite previous rounds of policy intervention to support household incomes during the crisis. This winter's cost of living crisis and the Government's response to it will determine the success of the early months of the new Prime Minister. Indeed, so great is the challenge posed by sky-rocketing energy prices that the evolution of living standards in the years, not just months, ahead is likely to dominate their premiership.

This update to our Living Standards Outlook from March this year shows the outlook for household incomes and poverty rates. [1] As in previous reports, we take as our starting point official survey data (in this case from 2019-20) and combine this with economic forecasts and modelling of tax and benefit policies to produce projections for incomes across the distribution (in this case up to 2026-27).[2] We use the Bank of England's economic projections from August, and base our projections on stated Government policy; our work shows, therefore, what would happen if no further action is taken.[3] Crucially, we cover not just the prospects for this winter and 2023-24 but also look out to 2026-27; our results show that the challenge facing the new Prime Minister is not just an acute short-term one, but is far longer lasting than talk of a 'winter crisis' implies.

The energy price cap will hit a record high this winter

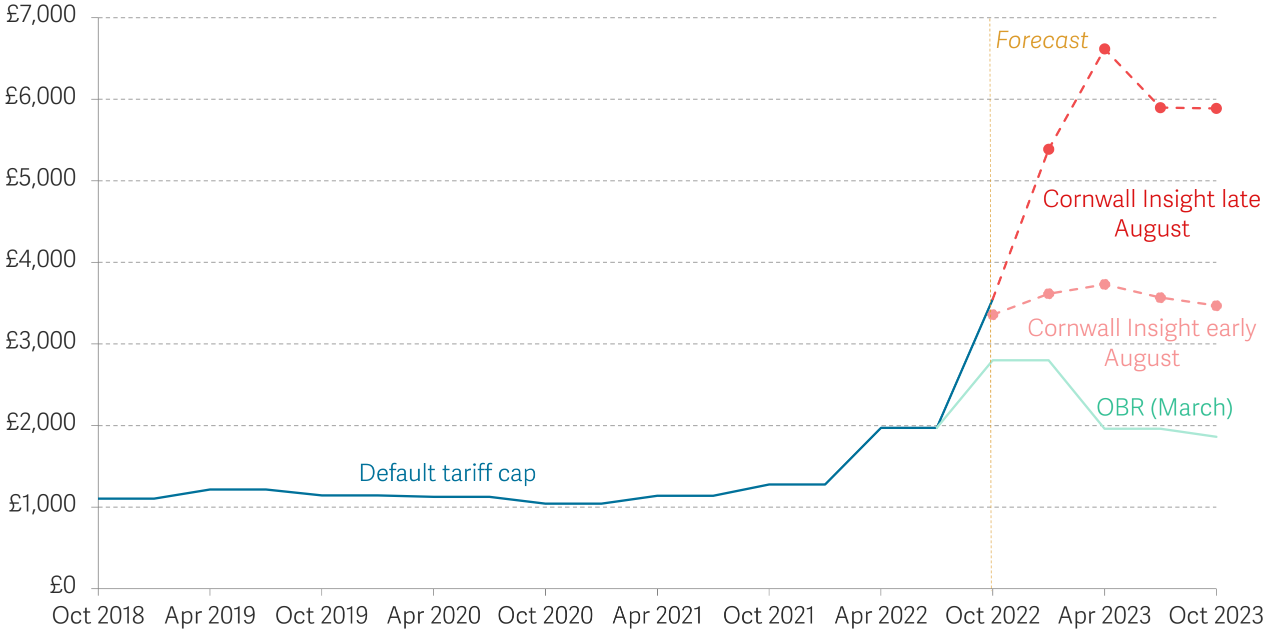
The main factor squeezing household incomes and driving inflation this year and beyond is rising energy prices, and therefore rising energy bills for households. Figure 1 shows the historical and forecast level of the energy price cap, the measure designed to smooth changes in energy prices for consumers. From winter 2018 to winter 2021, the price cap averaged £1,150 a year. Since then, the price cap increased to £1,971 in April of this year, is set to increase to £3,549 (or by 80 per cent) in October, and is projected to increase to £5,400 in January.[4] The typical bill gas and electricity bill for 2021-22 as a whole was around £1,500, but is projected to be £3,750 in 2022-23 and potentially closer to £6,600 over 2023-24.

1 Our previous forecasts are in: A Corlett & L Try, The Living Standards Outlook 2022, Resolution Foundation, March 2022; and T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.
2 For more information on how we produce these projections, see the Annex of this report.
3 The Bank of England's projections are in Bank of England, Monetary Policy report – August 2022, Bank of England, August 2022. The distributional impact of the policies suggested by the two contenders to be the next Prime Minister are discussed in M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.
4 See Ofgem, Ofgem updates price cap level and tightens up rules on suppliers, August 2022, and Craig Lowrey, Cornwall Insight comments on the announcement of the October price cap, Cornwall Insight, August 2022.

High gas prices are driving this significant projected increase in energy bills. Gas prices have soared since the Russian invasion of Ukraine, with further rises since Russia started restricting supplies. Current UK natural gas prices are around three times the level they were prior to the invasion, with futures markets suggesting prices will rise even more dramatically in the face of supply constraints across Europe this winter. Not only does this mean that gas prices for consumers will be higher as suppliers pass on the higher cost of buying gas, but there will also be a knock-on effect on electricity prices. Businesses will also be affected, with households likely to see higher prices for goods and services as these costs are passed through.

FIGURE 1: **The energy price cap is currently projected to reach over £6,000 in 2023**

Historical and forecast levels of the default annualised tariff cap: GB



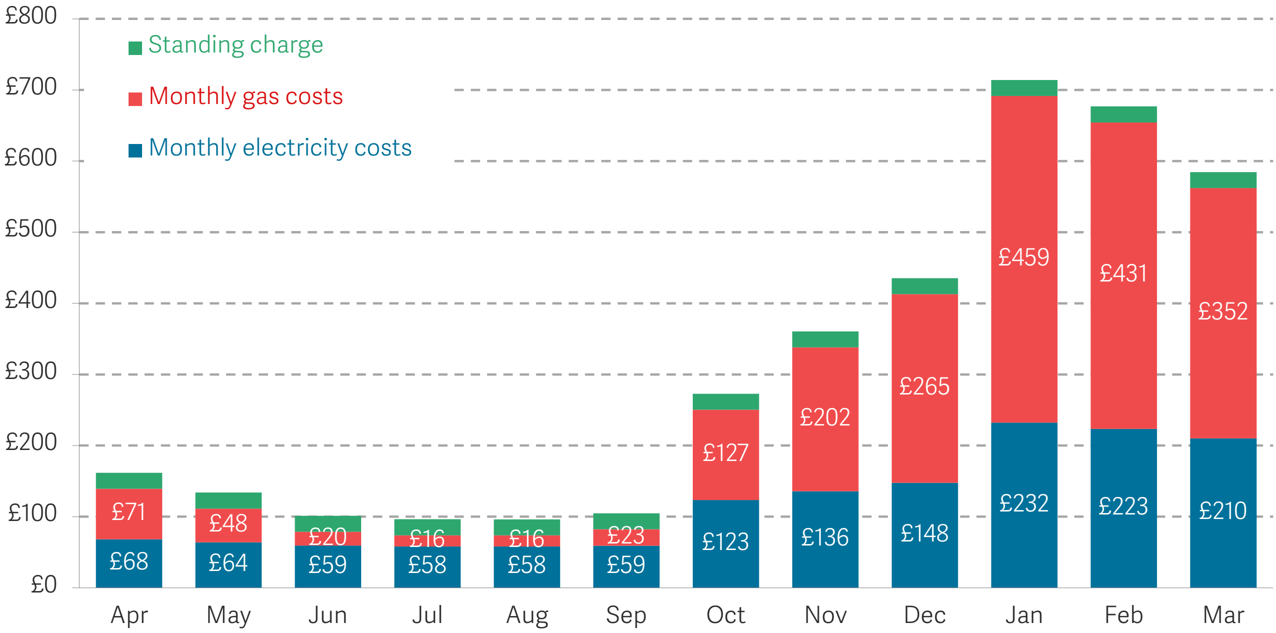
NOTES: Values are for a household paying by direct debit with typical annual electricity consumption of 2,900 kWh and gas consumption of 12,000 kWh. The figure shows six-monthly price cap periods until Q4 2022 onwards, when they are for three-monthly price cap periods instead.
SOURCE: RF analysis of Ofgem, Cornwall Insight, OBR data.

It should also be noted that the significant increase in the energy price cap in October, and likely further increase in January, will coincide with a period of higher energy consumption over winter. For direct debit customers, energy price rises are smoothed out to some extent, as the amount customers pay is spread out over the year (meaning that they pay more in summer than the cost of the energy they consume, building up a credit that is then run down in the winter). However, the 4 million households in Great Britain with pre-payment meters are unable to smooth out their payments in this way, with the typical household needing to find £700 to pay for energy in the month of January, as shown in Figure 2. Poorer households are also more likely than richer households to be on pre-payment meters: 30 per cent of the poorest fifth of households pay for energy using a pre-payment meter, compared to just 2 per cent of the richest fifth.[5]

Even before this winter, bill arrears were concerningly high, with 1.5 million customer accounts in arrears as of Q1 2022.[6] More will inevitably fall into arrears this winter, which could also result in widespread damage to peoples' credit ratings. People with prepayment meters are already struggling to pay for energy: as of July 2022, Citizens Advice had already seen over 13,000 people contact them who had been unable to top up their prepayment meter.[7] This is much higher than the nearly 9,000 who had contacted them the whole of last year, and they have projected nearly 22,000 people will have contacted them after being unable to top up their prepayment meters by the end of 2022. It is clear that rising energy prices, which have already begun to squeeze household incomes, will put an unprecedented level of pressure on incomes over the winter.

FIGURE 2: **For the 4 million households with pre-payment meters, higher prices will coincide with higher energy consumption over the winter – meaning a typical household will spend as much as £700 in January**

Monthly cost of domestic gas and electricity used by a typical household: April 2022-March 2023



NOTES: Monthly consumption levels determined from Ofgem typical consumption (TDCV) levels of 2,900 kWh of electricity per annum and 12,000 kWh of gas, and historical smart meter data. As such they do not account for likely changes in behaviour associated with high prices this winter. Monthly standing charge costs assumed to be unchanged on current levels, and shared equally over months. Figures do not account for £400 Energy Bill Rebate, or payments through other government support schemes.
SOURCE: RF analysis of Ofgem, Cornwall Insight, UCL Smart Energy Research Lab data.

5 M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.
6 M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.
7 Citizens Advice, Citizens Advice cost of living data dashboard, August 2022.

Rising energy prices feed into the highest rate of inflation in 40 years

These unprecedently large increases in the level of the energy price cap will also go on to bring inflation to a level that many people in the UK will not have experienced in their lifetimes. It is stark how much inflation forecasts have changed over the past several months. The Bank of England's inflation forecast from February this year projected that inflation would peak in Q2 of 2022 at 7.0 per cent, hit 5.8 per cent in Q4 of 2022, and then fall back to around 2 per cent at the start of 2024. As shown in Figure 3, just six months later, the Bank projected inflation to peak later, at 13.1 per cent in Q4 of 2022, and for it to stay high through 2023, reaching the Bank's 2 per cent target only in Q3 of 2024.

There is considerable uncertainty in these forecasts. In the short-term, it is possible that recent falls in petrol and diesel costs may persist, leading to lower inflation in Q4. Indeed, Resolution Foundation modelling shows inflation hitting 12.5 per cent in October, which is lower than the Bank's 13.1 per cent figure.[8] However, as gas prices have continued rising since the release of the Bank's August forecasts, higher inflation rates have been projected by other forecasters, with Citi forecasting an inflation peak of 18.6 per cent in January 2023, when the energy price cap is reset.[9] Rapidly rising gas prices over August have meant that, despite the Bank's projections being released in early August, they are now likely to be out of date. As shown in Figure 1, projections for the level of the energy price cap made in early August were much lower than they currently are. Therefore, it is probable that the Bank's inflation projections for 2023 would have been higher if the energy price cap forecasts available today had been used in their calculations.

As well as energy costs, an important component of overall inflation is that coming from food and non-alcoholic beverages: this currently stands at 12.6 per cent, a level not seen since the food price shock of 2008, due to higher costs for producers now being passed onto consumers. And food price inflation currently looks set to continue to rise this winter: Resolution Foundation modelling suggests a peak of around 20 per cent in April 2023 is possible.[10]

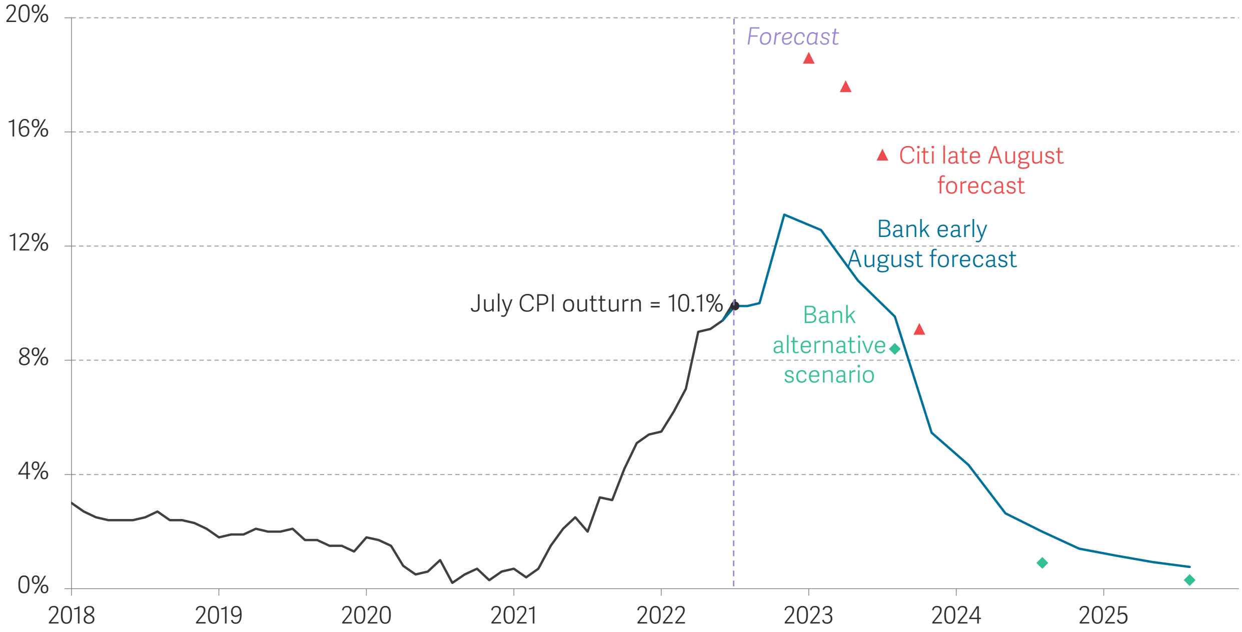
8 Huge economic uncertainty presents a considerable challenge in making accurate inflation forecasts – 12.5 per cent (and indeed 13.1 per cent) could well under estimate the inflation level.

9 C Giles, D Sheppard & J Pickard, UK inflation to hit 18.6% next year according to Citi, Financial Times, August 2022.

10 The modelling does not take into account recent falls in wholesale market prices which may feed through into consumer prices in time. For more on changes in commodity markets, see: J Leslie, In the dread of winter: Prospects for inflation in the coming months ahead of the Bank of England's Monetary Policy Report, Resolution Foundation, August 2022. And for more information on how our inflation forecasts are produced, see the Annex of this report.

FIGURE 3: **Inflation is set to remain high for the next year**

Annual CPI inflation: UK



NOTES: The Bank's alternative scenario assumed that energy prices follow their futures curves throughout the forecast period rather than remaining constant.
SOURCE: Bank of England, Monetary Policy Report, August 2022; OBR, Economic and Fiscal Outlook March 2022; ONS, Consumer Price Inflation; Citi Inflation forecast.

To better understand the nature of the rapidly rising inflation households in the UK are facing, it is worth considering what factors are driving inflation. The main contributor by far to rising inflation in October this year is housing bills (which includes rents, maintenance, energy, water, and other fuels) at 5.6 percentage points – unsurprisingly, given the large rise in the energy price cap for that month. Indeed, electricity, gas and other fuels contribute 5.3 percentage points to our forecast for inflation in the year to October.[11] Food will also be a significant contributor to rising prices, responsible for 1.8 percentage points of inflation.

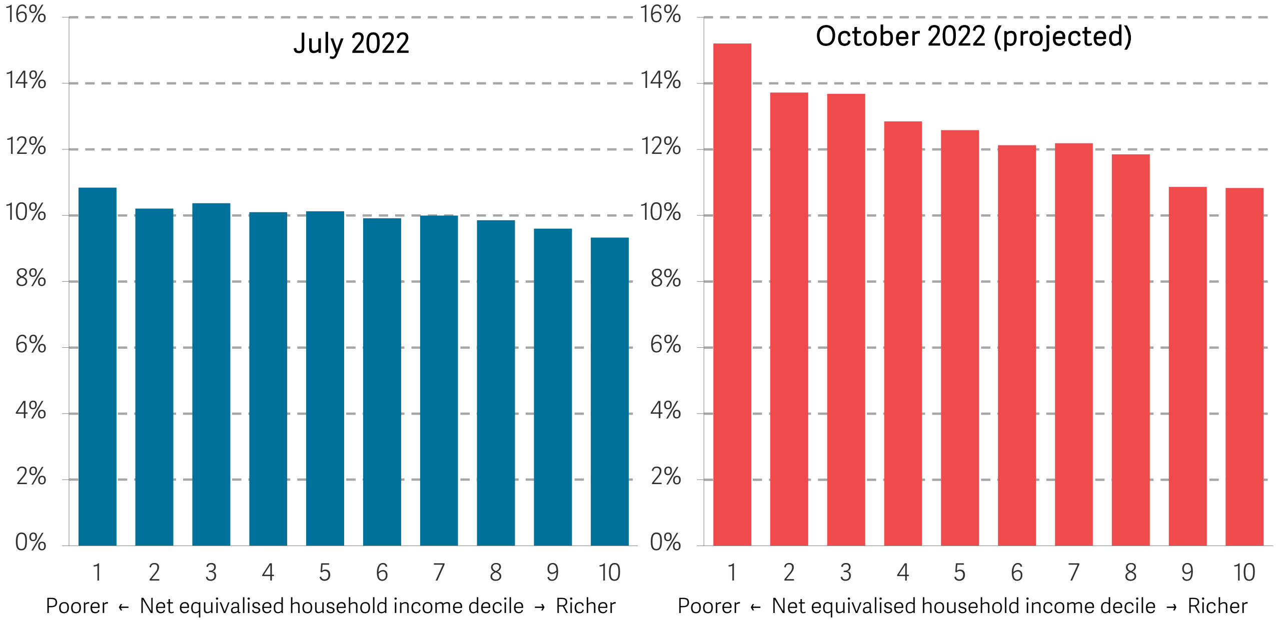
It is especially worrying that soaring inflation is primarily driven by rising energy costs and food costs, as a higher proportion of lower-income households' consumption is allocated to spending on these essentials. In 2019, 59 per cent of households in the lowest income quintile's total non-housing household consumption was spent on essentials (referring to food, fuel, clothing and transport), much higher than the highest income quintile, which spent 43 per cent on essentials.[12] This results in low-income households facing higher rates of inflation than the headline rate of inflation, as Figure 4 shows.[13] In July, as shown

11 The centrality of the energy price cap for CPI inflation means that, if the Government acts to alter the way that the energy price cap works, then this could have a significant impact on headline inflation.
12 M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.
13 Both the ONS and IFS have also published similar projections for differential rates of inflation. See: Office for National Statistics, Inflation and the cost of living for UK households, overview: June 2022; P Johnson et al., The long squeeze: rising inflation and the current government support package, Institute for Fiscal Studies, August 2022.

in the left panel, households in the lowest income decile experienced an inflation rate of 11 per cent, compared to 9 per cent for households in the highest income decile – at a time when inflation was 10 per cent overall. However, when the energy price cap rises in October, this disparity is set to worsen. Our projections for October, shown in the right panel, show that households in the lowest income decile are set to face an eye-watering rate of inflation of 15 per cent, much higher than the rate the highest-income households will face, of 11 per cent. Although we do not use differential rates of inflation in our income and poverty forecasts – in part due to a lack of detailed price forecasts and because inflation tends to be equally shared in the long-term –policy makers should bear in mind these differential rates over the coming months.

FIGURE 4: **Lower-income households are experiencing the highest rates of inflation, with this disparity with higher-income households set to get worse this winter**

Outturn and forecast CPI-consistent inflation rates by equivalised income decile (before housing costs): UK, July and October 2022



NOTES: This forecast is based on RF's inflation forecast model. This model breaks down the CPI index into 30 constituent parts which have internally consistent historic dynamics and economic drivers. For 28 of these indexes, we estimate an individual forecast of monthly inflation rates based on historic statistical dynamics including seasonal factors, persistence and cyclical factors. The final two components, gas and electricity bills and transport fuel costs, are forecast using the announced energy price cap changes and weekly fuel pump prices held constant, respectively.
SOURCE: RF analysis of ONS, Consumer Prices; BEIS, Weekly Road Fuel Prices.

As well as being subject to larger price rises than high-income households, low-income households will be less prepared to deal with these price rises, due to them being less likely to have enough, or even any, savings to fall back on. Indeed, just before the Covid-19 pandemic, 8 per cent of households in the lowest-income decile had no savings, compared to 2 per cent in the highest-income decile.[14] By June 2022, four-in-ten people with personal incomes under £40,000 reported spending less on food and other essentials.[15] The energy bill surge will put pressure on households across the income distribution, but low-income households will have fewer coping strategies available, and are more likely to struggle to change their spending patterns in the face of rapidly rising prices.

Rapidly-rising inflation means the real value of benefits and earnings are falling

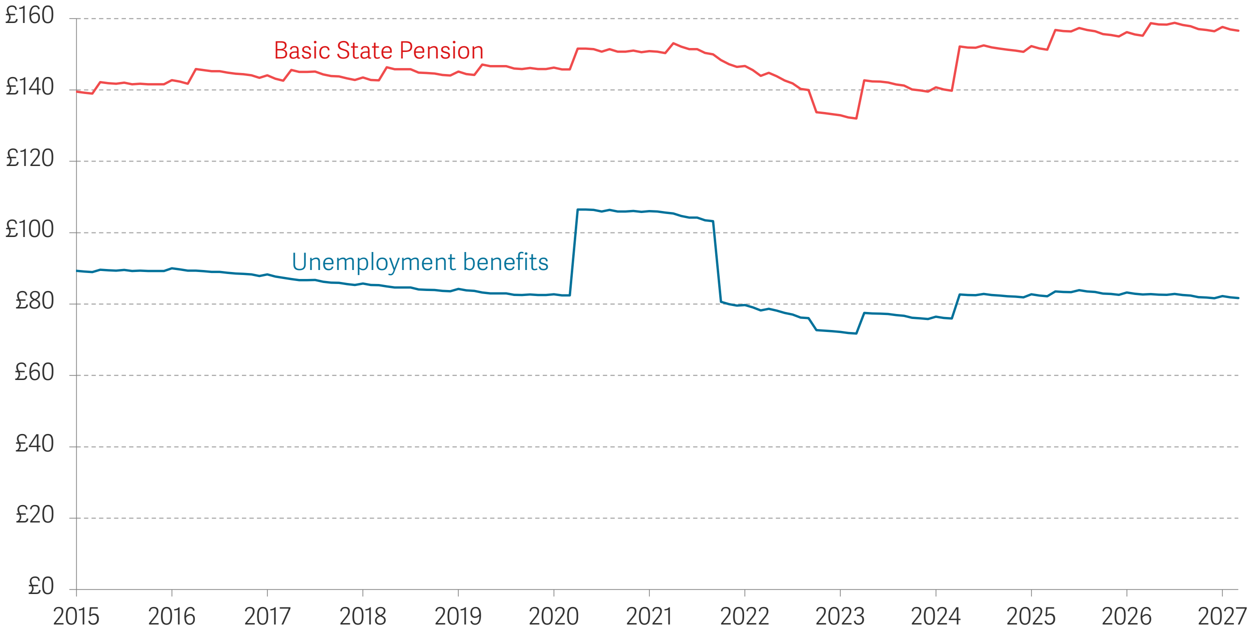
Most benefits are uprated in April using the previous September's rate of CPI inflation. In normal times, this means that the real value of benefits stays broadly constant, but the combination of rapidly rising inflation and the fact that there is a six month lag between the measure of inflation and the increase to benefits means that the real value of benefits is set to continue its rollercoaster ride, as shown in Figure 5. In particular, in March 2023, unemployment benefits are expected to be 11 per cent lower in real-terms than they were in October 2021 (just after the removal of the £20 uplift to Universal Credit), or 31 per cent lower than they were in September 2021, when the £20 uplift was still in place.

Assuming that the Government follows established precedent, benefits (including the State Pension) will rise by around 10 per cent in April 2023 in cash terms, providing a long-awaited and much-needed boost for benefit claimants. But it is only in April 2024 that they will get back to the same real value as October 2021, following a projected further rise of 9.5 per cent.[16] (However, many elements of the benefit system are not uprated and are therefore experiencing large real-terms cuts. For example, the benefit cap has stayed at the same rate in nominal terms since 2016, and Local Housing Allowance rates have not been uprated since April 2020 (although they were increased substantially then). We discuss these more in our concluding section.)

14 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.
15 RF analysis of ONS, Impact of increased cost of living in adults across Great Britain, August 2022.
16 Working recipients of UC will have seen small increases to their entitlements in early 2022, following changes to the taper rate and work allowances; this will also have brought more households into the UC system. See: M Brewer, K Handscomb & L Try, Taper cut: Analysis of the Autumn Budget changes to Universal Credit, Resolution Foundation, November 2021.

FIGURE 5: **Higher inflation and policy changes mean that the real value of basic unemployment support will be 11 per cent lower March 2023 than it was in October 2021**

Unemployment benefits and the Basic State Pension in real-terms (July 2022 prices): UK



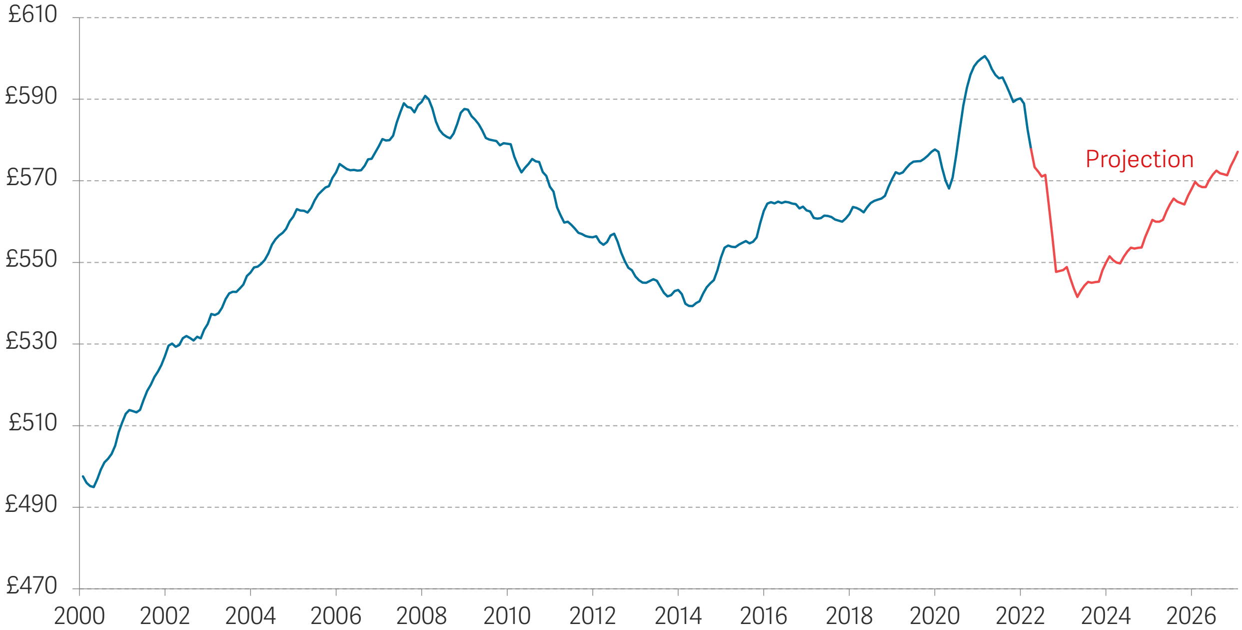
NOTES: Projections based on the Bank of England's August 2022 inflation forecast.
SOURCE: RF analysis of ONS, Average Weekly Earnings; DWP, Abstract of Benefit Statistics; ONS, CPI; Bank of England, Monetary Policy Report, August 2022.

Importantly for household incomes, high inflation is cutting pay in real terms. Workers are currently facing a record-low rate of real pay growth, despite furlough effects still being present in the data, but this is likely to get even worse.[17] Indeed, the Bank of England's most recent forecasts imply that workers will have been subject to a 9 per cent fall in average real pay over the two years up to Q2 2023, as shown in Figure 6. It is important to note that weak pay growth in the 15 years preceding the cost of living crisis already put household incomes in a precarious position, and the current crisis exacerbates the existing effects of low economic growth and high inequality on household incomes.[18] The level of real pay (at least using CPI) may fall back in 2023 to where it was twenty years earlier, and by Q1 2027 may still be below where it was in Q1 2007.

17 N Cominetti & H Slaughter, The labour market is making history for all the wrong reasons, Resolution Foundation, August 2022.
18 T Bell et al., Stagnation nation: navigating a route to a fairer and more prosperous Britain, Resolution Foundation, July 2022.

FIGURE 6: **The Bank of England's latest forecasts for prices and earnings suggest a 9 per cent two-year drop in real average pay, leading to two lost decades**

Average weekly earnings in real terms (CPI-adjusted, July 2022 prices), three-month average: GB



SOURCE: ONS with RF projection based on Bank of England (August 2022) and OBR (March 2022).

In our modelling, we assume that hourly and weekly pay growth is highest for low earners, due to the likely future increases in the National Living Wage. However, this may be too positive an assumption. Nominal monthly pay growth over the past three years (2019 Q2 to 2022 Q2) has actually been weakest for the lowest monthly earners (13 per cent) and strongest at the very top (16 per cent).[19] In addition to falling real pay, the Bank of England's forecasts include a rise in unemployment from its current 3.8 per cent up to 6.3 per cent by Q3 of 2025, and we allow for this in our modelling. The UK's labour market has tended to outperform expectations in terms of unemployment, but increases in the Bank Rate, wages and firms' energy costs are good reasons for this pessimism.

Finally, the rate of inflation also feeds into social rent uprating in England. The current social rent uprating settlement states that social housing providers are able to increase their rents in April using the previous September's CPI figure, plus one percentage point. If this were to go ahead in April 2023, social renters could see their rents rise by 11 per cent. The Government has announced, however, that there will be a rent cap on social housing rents in 2023-24, and that they are consulting on caps at 3, 5 and 7 per cent.[20] Our modelling assumes a (still high) 7 per cent social rent uprating in 2023-24 and 2024-25.

19 ONS, Earnings and employment from Pay As You Earn Real Time Information, UK: August 2022.
20 Department for Levelling Up, Housing and Communities & Greg Clark, Rent cap on social housing to protect millions of tenants from rising cost of living, DLUHC, August 2022.

Current economic conditions and policy will lead to large falls in household incomes and increases in poverty rates over the next couple of years

Payments to support the cost of living will help mitigate some of the price rises

Since early 2022, when the energy price cap began its rapid rise, the Government has announced multiple rounds of support for households, which we outline in Box 1.

BOX 1: **What are the current Government's responses to the rise in the price cap?**

The Government has intervened on three occasions this year to support households with higher energy costs, with spending on these measures amounting to £30 billion.

In February it was announced that all households were to receive a £200 energy bill discount in October (to be repaid over 4 years), and that all households (except students) living in properties with a council tax band of A-D would receive a £150 council tax rebate.

In March's Spring Statement an additional £500 million for the Household Support Fund was announced, on top of the £500 million unveiled in 2021. Also announced was a 5 pence per litre discount on fuel duty.

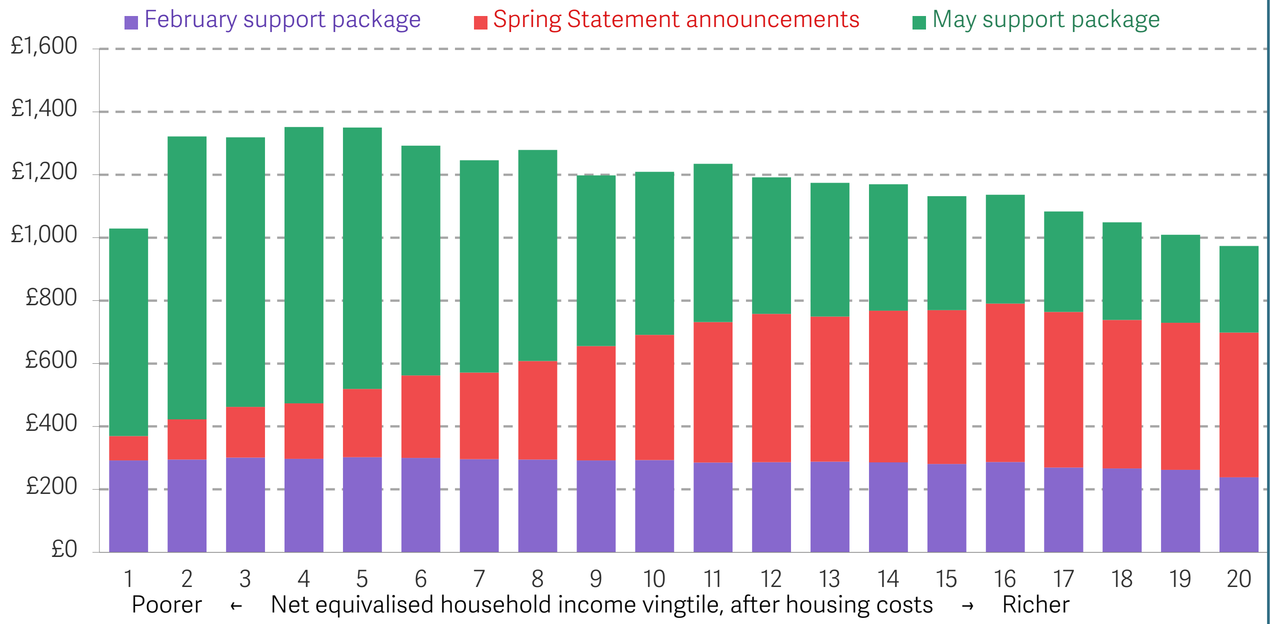
A third intervention in May 2022 was more comprehensive, doubling the £200 loan to £400 (due to be provided as equal payments over the six winter months) and converting it to a grant by cancelling the need to pay it back, introducing £650 payments (to be made over two lump sum grants) to households on means-tested benefits, an additional £300 for all pensioner households, and an extra £150 to individuals in receipt of a disability benefit.

As shown in Figure 7, the gains from these measures are fairly evenly spread across the distribution. Combined, these measures did offset the majority of the increase in energy costs for low-income households on average, but this was calibrated against the expectation that the typical energy bill would be £2,800 this winter.[21]

21 For a detailed assessment of the Government's interventions, see: T Bell et al., Back on Target, Resolution Foundation, May 2022.

FIGURE 7: **The gains from the existing cost of living support are spread fairly evenly across the income distribution**

Annual gains from all cost of living support measures announced in 2022, by equivalised after housing cost household income vigintile: 2022-23



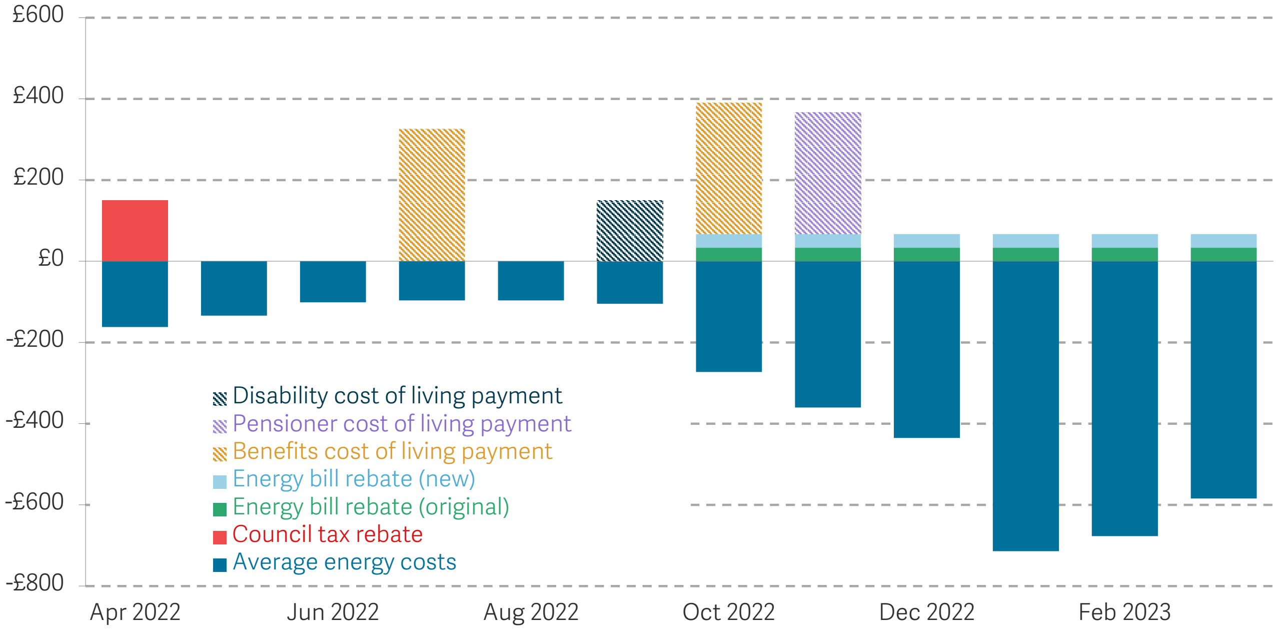
NOTES: Includes the £150 Council Tax Rebate and original £200 Energy Bills Support announced in February; the 5p Fuel Duty cut and raising of the National Insurance Primary Threshold announced during the Spring Statement; and the £650 cost-of-living payment for families on means-tested benefits (except Housing Benefit), the £150 disability cost-of-living payment, the additional £300 for the pensioner Winter Fuel Payment, and the additional £200 for the Energy Bills Support scheme.
SOURCE: RF analysis of IPPR Tax-Benefit Model; DWP, Households Below Average Income 2019-20; ONS, Living Costs and Food Survey 2019-20.

When support was announced in May, the energy price cap was expected to reach £2,800 in October, and this support was expected to offset the vast majority of the energy bill increase for low-income households expected in October.[22] However, as we discussed above, the price cap is now expected to be much higher this winter, particularly from January, than was expected in May. Furthermore, the timing of the payments isn't well targeted at helping households when bills and inflation will be at their highest; as Figure 8 shows, the cost of living payments reach households this Summer and Autumn, leaving them exposed to the very high energy costs this winter.

22 T Bell et al., Back on target: Analysis of the Government's additional cost of living support, Resolution Foundation, May 2022.

FIGURE 8: **Planned rebates and cost of living payments will help with rising energy bills, but more support is needed**

Average energy bill cost and cost of living-related payments by month: UK



NOTES: Exact month of lump sum payments may vary for some. Cost forecasts as of 26 August 2022.
SOURCE: RF Calculations and analysis of UCL, Smart Energy Research Lab.

If no more support is announced by Government, median incomes are set to fall significantly in both 2022-23 and 2023-24

Having set out the prospects for the factors influencing household incomes, we now turn to the outlook for incomes themselves. For the purposes of this report, our preferred measure of income is equivalised household disposable income after housing costs, for non-pensioners, adjusted for inflation.

Our projections (in Figure 9) show remarkable falls in median non-pensioner household incomes both in this year and next. Median household incomes are set to fall by 5 per cent in 2022-23, and 6 per cent in 2023-24.[23] The 6 per cent income fall for 2023-24 would be the single largest median income fall in a single year on record, and the 5 per cent fall would be one of the largest falls on record, with the only comparable annual median income fall being the 5 per cent fall in 1975.

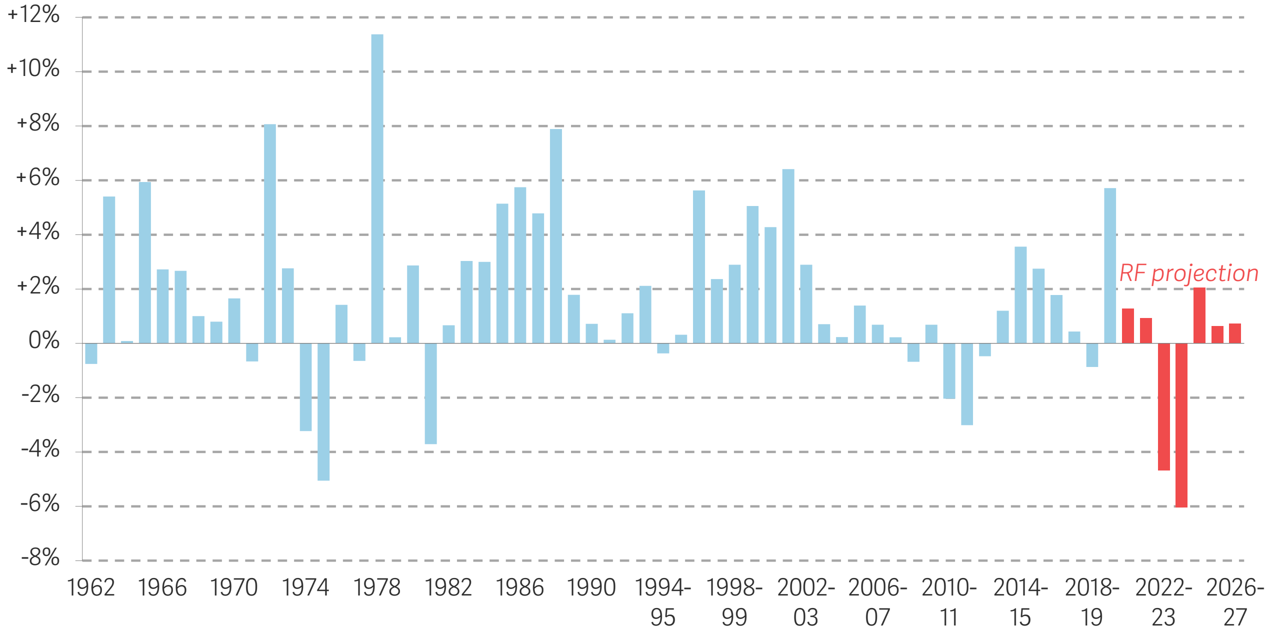
With inflation averaging 11 per cent over 2022-23 and 7 per cent over 2023-24 (with nominal wage growth at 5 and 6 per cent respectively), it is not particularly surprising that households are facing an income hit this large. But another important factor in these

23 The Bank of England's Monetary Policy Report provides forecasts for average post-tax household income. These give smaller income falls (-1.5 and -2.25 per cent in 2022 and 2023 respectively) for various reasons, including but not limited to the use of calendar rather than financial years; aggregate rather than per capita figures; and the Consumer Expenditure Deflator rather than CPI – with the latter currently recording faster inflation.

results is the one-off payments to protect household incomes during 2022-23 (as shown in Box 1): these provide a considerable cushion to household incomes in 2022-23. But the fact that these payments are currently not due to be repeated means that the fall in median income in 2023-24 is larger than it would have been otherwise.

FIGURE 9: **Despite fiscal support this year, median incomes are set to fall in 2022-23 and 2023-24 by the highest or near-highest rates on record**

Annual real growth in median equivalised household disposable income for non-pensioners, after housing costs: GB/UK

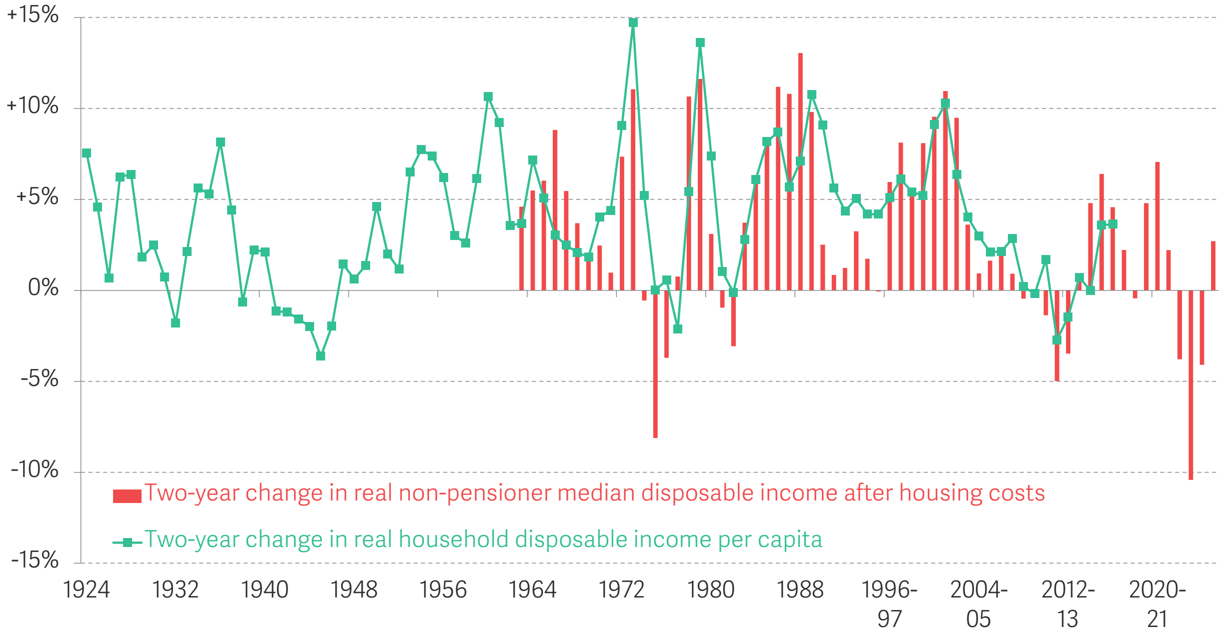


NOTES: Projections after 2019-20. Data source change in 1994-95. GB from 1994-95 to 2001-02.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

The scale of the effect of the cost of living crisis on household incomes cannot be overstated. We project median incomes to fall by 10 per cent between 2021-22 and 2023-24, or £2,800 in absolute terms. As Figure 10 shows, this combined fall in income across 2022-23 and 2023-24 is, at a minimum, the worst two-year income fall since 1961, and, although we do not have an entirely consistent series, it looks likely to be the worst fall in 100 years. The only comparable income fall happened between 1973 and 1975, where the typical median income of non-pensioners fell by 8 per cent (though Bank of England income data does not show such a pronounced fall). This fall is twice as large as the fall during the financial crisis between 2009-10 and 2011-12, of 5 per cent. And even in the depths of the Second World War, the average real disposable income fell by at most 4 per cent.

FIGURE 10: **The projected fall in incomes between 2021-22 and 2023-24 would likely be the largest in at least a century**

Two-year change in real household disposable income measures: GB/UK



NOTES: Projections after 2019-20. RHDI figures are means, and calendar years throughout. Non-pensioner median figures are GB from 1994-95 to 2001-02.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts; and RF analysis of Bank of England, A millennium of macroeconomic data.

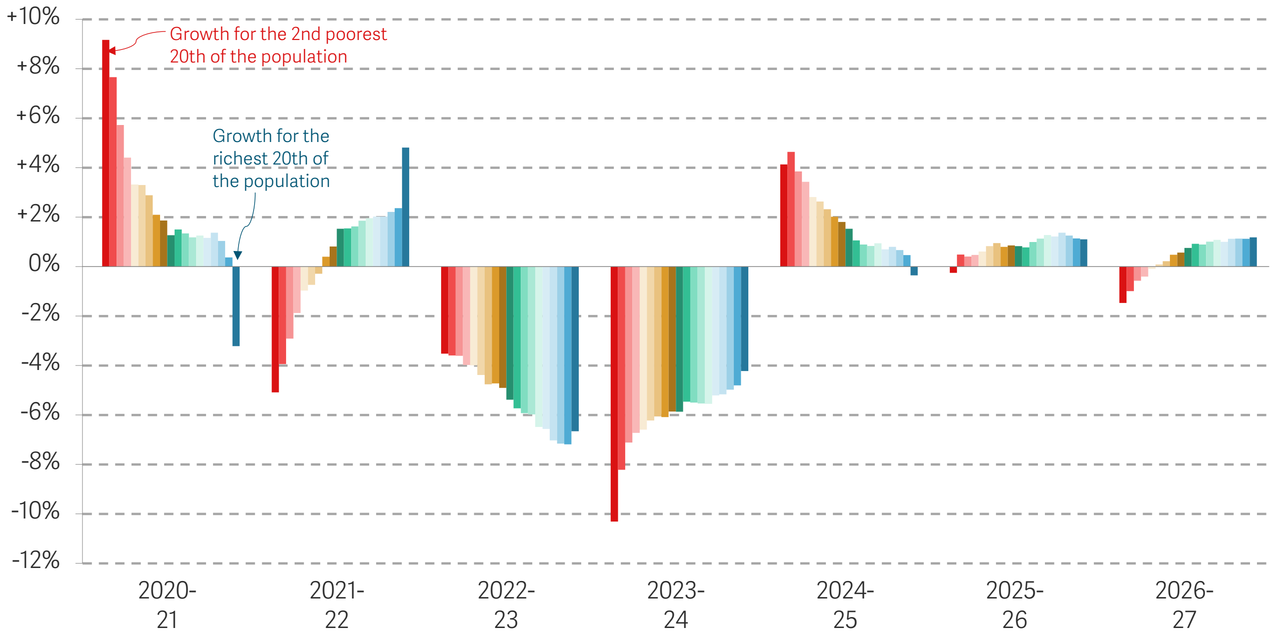
Incomes will fall across the distribution

Evidently the hit to median household incomes for both 2022-23 and 2023-24 – with no extra government support measures – is a very large one, but household incomes across the income distribution are affected in different ways, as shown in Figure 11.

In 2022-23, incomes are set to fall by between 4 and 7 per cent, with smaller falls at the bottom and larger falls at the top of the income distribution. This pattern is driven by the impact of the various payments to support household incomes, as set out in Box 1, and all of which have different impacts across the income distribution. Overall, though, they will have more impact at the bottom of the distribution, where the £650 cost of living payments do a lot to prevent incomes from falling by too much. However, this support doesn't mitigate the full hit to incomes anywhere across the distribution (on average). The 1.25 percentage point increase in National Insurance rates also affects income growth this year, particularly hitting incomes at the top of the distribution.

FIGURE 11: **Cost of living payments contribute to lower income falls for lower-income households in 2022-23, but removing them hits lower-income households in 2023-24**

Annual real growth in average equivalised household disposable income for non-pensioners, after housing costs, by income vigintile: UK



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

Looking ahead to 2023-24, incomes across the distribution are set to fall again, at rates between 4 and 10 per cent. However, in contrast to 2022-23, lower-income households are set to face the largest falls. This large projected fall is despite an assumption that benefits will be uprated in April 2023 in line with this September's inflation (10.0 per cent, according to Bank of England forecasts). Most of that rise is offset by further inflation of 7 per cent across 2023-24 but, as mentioned above, a key driver of these large falls in real income will be the removal of the various cost of living payments paid to households in 2022-23. We show a case study in Box 2.

BOX 2: **Changes in income for an example household**

The actual hit to living standards faced by households will vary enormously – such as based on their pay growth and current energy needs. But, to show how real income falls of around 10 per cent may come about in practice, Table 1 gives the illustrative example of a single renter on the median employee salary. If their pay tracks forecasts for average earnings, they may benefit from 11 per cent pay growth between 2021-22 and 2023-24. Tax policy would be a slight headwind (due to freezes in the Income Tax threshold, which offset the slight fall in National Insurance contributions), meaning net pay would only grow by 10 per cent. Rents have been growing slower than earnings, providing a small boost to incomes after housing costs, which overall grow by 10 per cent. But (non-housing) inflation is set to total 21 per cent over this period, leading to a real income hit of 9 per cent.

TABLE 1: **A simple illustrative example shows how real household incomes may fall so rapidly**

Case study for an illustrative single private renter

	Gross pay	Income Tax	NI/ HSCL	Net pay	Lump sums	BHC income	Rents	AHC income	Prices	Real AHC income
2021-22 level	£ 26,000	£ 2,700	£ 2,000	£ 21,300	£ -	£ 21,300	£ 7,000	£ 14,300	1.00	£ 14,300
2022-23 level	£ 27,300	£ 2,900	£ 2,000	£ 22,300	£ 600	£ 22,900	£ 7,300	£ 15,600	1.12	£ 13,900
2023-24 level	£ 28,900	£ 3,300	£ 2,200	£ 23,500	£ -	£ 23,500	£ 7,600	£ 15,800	1.21	£ 13,100
2022-23 change	5%	10%	4%	5%	-	7%	4%	9%	12%	-3%
2023-24 change	6%	11%	6%	5%	-	3%	5%	1%	8%	-6%
Two-year change	11%	22%	10%	10%	-	10%	9%	10%	21%	-9%

Mortgagors generally face even weaker growth in disposable household income than other tenure groups, with the average mortgage interest payment rising in our projections by 19 per cent in 2022-23 and 20 per cent in 2023-24, pushed up by rising interest rates.

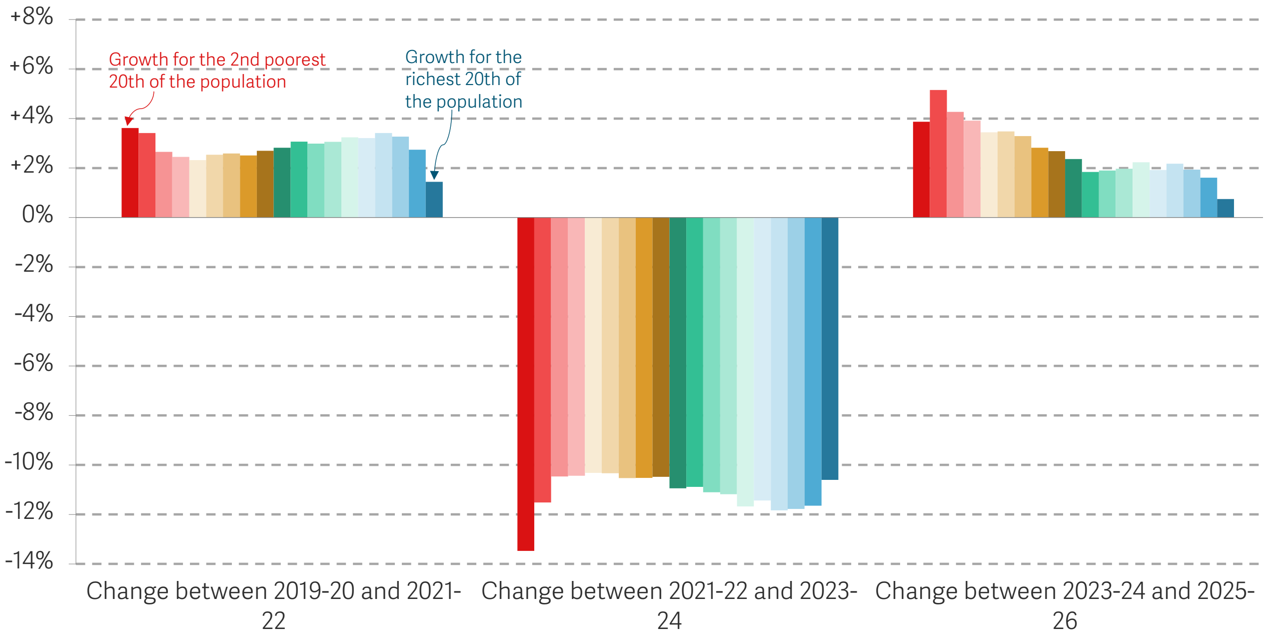
By 2024-25, the high inflation projected for the year to September 2023 would result in an above-inflation benefit uprating in April 2024: normal practice would mean benefits rising by 9.5 per cent in April 2024, while inflation is projected to be only 1.8 per cent over the whole financial year. This explains the pattern of income growth forecast for that year, where we project low-income households seeing incomes rise by more than by higher-income households. As we showed earlier, though, this rise in the levels of benefits is necessary to return the real value of benefits to their pre-cost-of-living-crisis levels. In addition, by 2024-25, real earnings growth is forecast to return, further boosting incomes across the distribution.

In 2025-26 and 2026-27, income growth continues for most of the distribution, but not lower-income households, due to elements of the benefit system being frozen, such as Local Housing Allowance and the benefit cap. This results in housing payments falling further behind rents, and the value of the benefit cap falling in real-terms, meaning more households are capped as a result. The roll-out of the two-child limit, which caps benefit income for families with three or more children, will also affect more households.

The pattern of income changes across the distribution in 2022-23 and 2023-24 is heavily influenced by the (currently) one-off cost-of-living support payments that were announced by the Government earlier this year. Figure 12 abstracts from those by showing the change in household incomes across the income distribution over a two-year period, revealing the underlying impact of the cost of living crisis on household incomes. Across the distribution, incomes are set to fall significantly across the whole distribution, but more so for the lowest-income and higher-income households. Households in the 2nd income vigintile are set to lose, on average, £1,300 in two years, or 14 per cent of their incomes. In contrast, households in the 19th income vigintile are set to lose on average £6,800, or 12 per cent of their household income in real-terms.

FIGURE 12: **Overall, household incomes are set to fall by 10 per cent at both ends of the income distribution over the next two years**

Two-year real growth in average equivalised household disposable income for non-pensioners, after housing costs, by income vigintile: UK

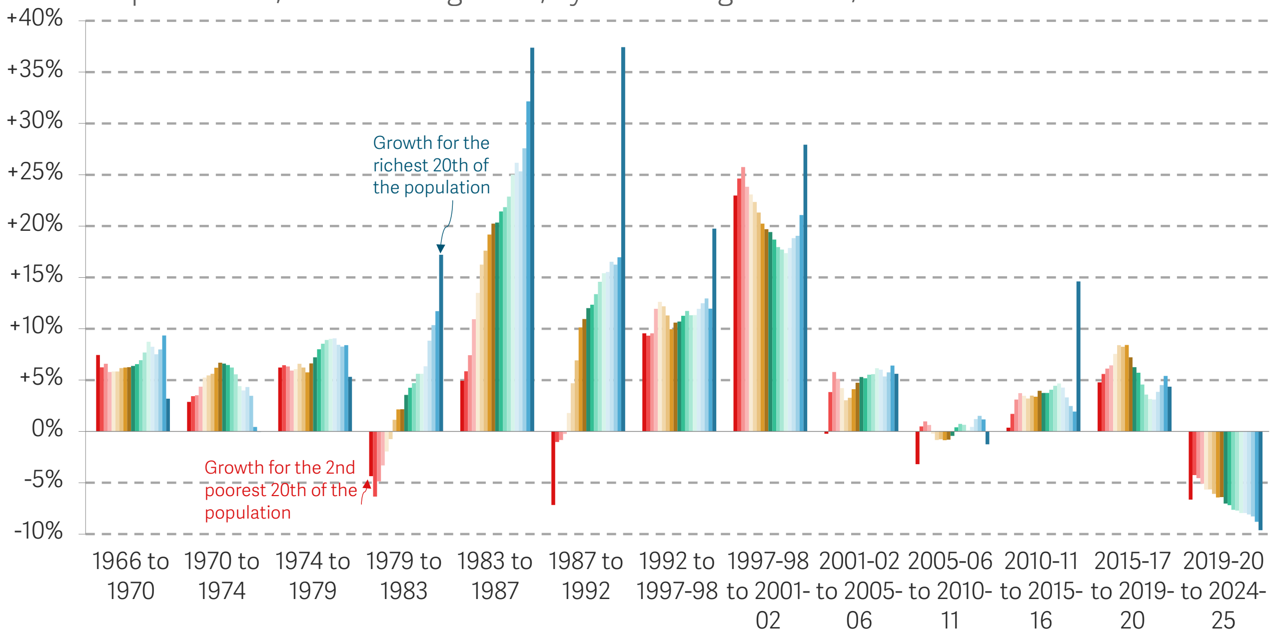


NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

If realised, these projections would mean that this Parliament stands out as by far the worst for income growth, as shown in Figure 13. During this period, the median household income is set to fall by 7 per cent. The only other Parliament where the median household income fell is the one where the financial crisis first hit, from 2005-06 to 2010-11, but the median income fell by just 1 per cent during this period. Indeed, our forecasts suggest that the current Parliament will see household incomes fall at every point across the income distribution, the only time that has happened in the near-70 year span of consistent data. Interestingly, incomes at the top of the distribution are set to fall the most, with incomes in the top half of the distribution falling by 8 per cent, compared to 6 per cent for the bottom half of the distribution – likely reflecting the bigger medium-term hit to earnings than to benefits, as well as tax changes.

FIGURE 13: **Real incomes are projected to be lower in 2024-25 than in 2019-20 across the distribution, making this the worst Parliament in history for income growth**

Total real growth in median equivalised household disposable income per period for non-pensioners, after housing costs, by income vigintile: GB/UK



NOTES: Projections after 2019-20. Data source change in 1994-95. GB from 1994-95 to 2001-02. Some periods are four years long and others five years. The chosen time periods correspond to the years of past general elections (plus 2024-25), but we do not include a division for the 2017 election and nor do we try to estimate growth over the February to October parliament of 1974. We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

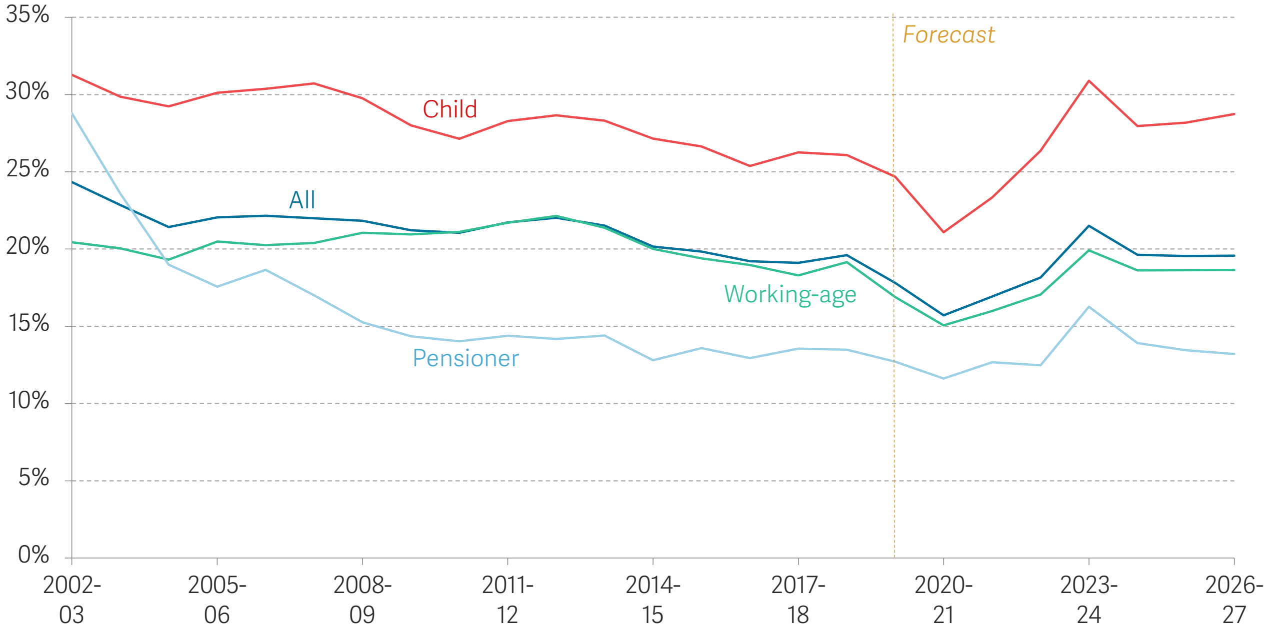
High inflation and the removal of state support for incomes in both 2021-22 and 2023-24 will cause poverty rates to rise

Figure 14 shows our forecasts for the overall absolute poverty rate, as well as the rates for absolute child, working-age, and pensioner poverty, under current government policies.

The absolute poverty measure uses a fixed poverty line (60 per cent of the median household income after housing costs in 2010-11), which allows us to see how incomes have changed in relation to a fixed point.[24] In normal times, we would expect absolute poverty rates to fall, as economic growth usually leads to increases in household incomes over time. However, as Figure 14 shows, absolute poverty is actually set to rise for all groups between 2021-22 and 2023-24. In 2020-21, despite the pandemic, support for household incomes – specifically the £20 a week boost to Universal Credit and Working Tax Credits, but also the furlough scheme – meant that poverty rates for all of the groups shown fell to record lows. However, the removal of this support in 2021-22, and the cost of living crisis that followed it, will likely result in a large rise in absolute poverty in 2022-23. We project the overall absolute poverty rate to increase from 17 per cent in 2021-22 to 22 per cent in 2023-24, which is an increase of 3.1 million people, or 28 per cent – meaning over 14 million people would be in poverty.

FIGURE 14: **14 million people could be in absolute poverty by 2023-24**

Proportion of people living in absolute poverty, after housing costs: UK



NOTES: Outturn data is available for 2020-21 but the values shown here are our nowcasts, as we use 2019-20 rather than 2020-21 data as the starting point for our projections.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

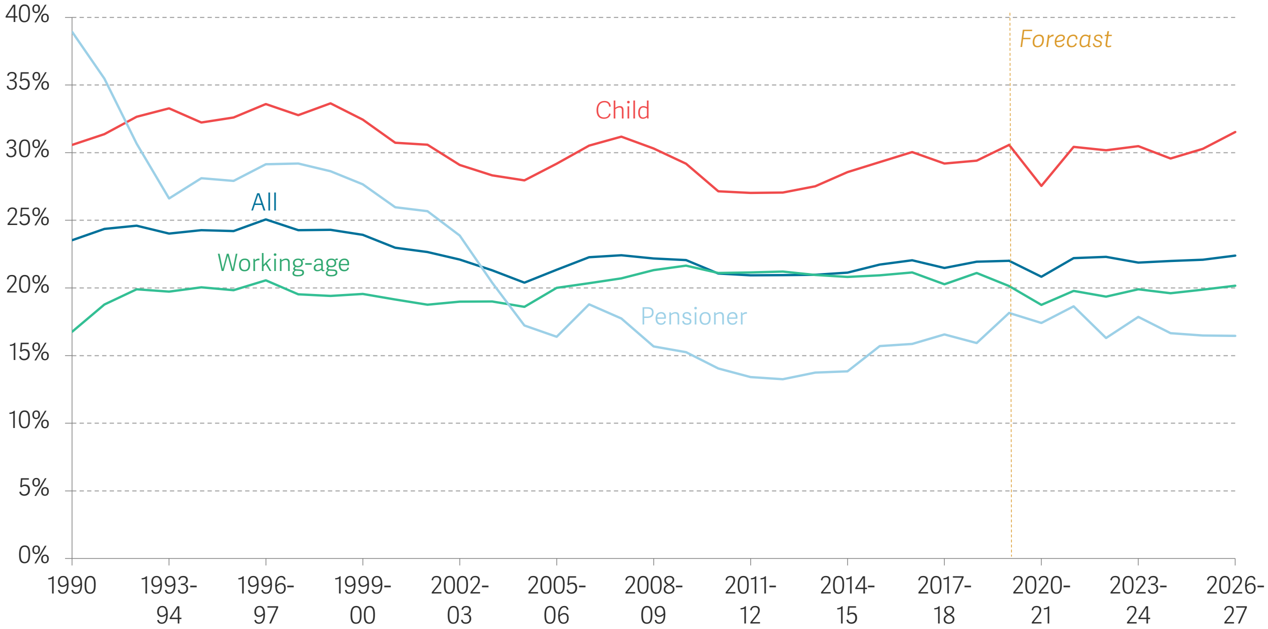
24 In 2022-23, the real-terms equivalised absolute poverty line for a couple after housing costs is £15,781.

Absolute child poverty is projected to rise even more sharply: from 23 per cent in 2021-22 to 31 per cent in 2023-24, a 45 per cent increase, meaning 1.3 million more children will be in absolute poverty. These increases are not temporary, either: absolute poverty rates for all groups shown in Figure 14 are set to be higher in 2026-27, at the end of our forecast period, than they were in 2019-20, before the pandemic.

We have also forecasted the outlook for relative poverty, a measure which defines poverty relative to current household incomes, using 60 per cent of the contemporary median income after housing costs as its threshold. As shown in Figure 15, overall relative poverty is set to increase in 2021-22 following a fall in 2020-21: this is due to the pandemic-era support, specifically the £20 a week increase to Universal Credit, being removed in 2021-22. Overall relative poverty is then forecast to remain stable at 22 per cent for the rest of the forecast period, despite the cost of living crisis; this reflects that, as shown in Figure 11, the hit to incomes in 2022-23 and 2023-24 is relatively even across the distribution, meaning that overall relative poverty remains stable.

FIGURE 15: **Relative poverty is projected to remain broadly stable overall**

Proportion of people living in relative poverty, after housing costs: GB/UK



NOTES: Data source changes in 1994-95. GB from 1994-95 to 2001-02. Our modelling produces lower relative poverty figures than the published data suggests – in part due to under-reporting of benefits in the published data. We adjust our projection levels to match the outturn data. Outturn data is available for 2020-21 but the values shown here are our nowcasts, as we use 2019-20 rather than 2020-21 data as the starting point for our projections.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

However, relative poverty rates by age group do vary. Pensioner relative poverty is set to fall by 3 percentage points in 2022-23, as the cost of living payments and higher winter fuel allowance boost incomes for lower-income pensioners. In contrast, relative child poverty is forecast to hit 32 per cent, the highest rate it has been since the late 1990s, as the two-child limit, and the absence of uprating of the benefit cap and Local Housing Allowance, together result in incomes falling for families with children on benefits.

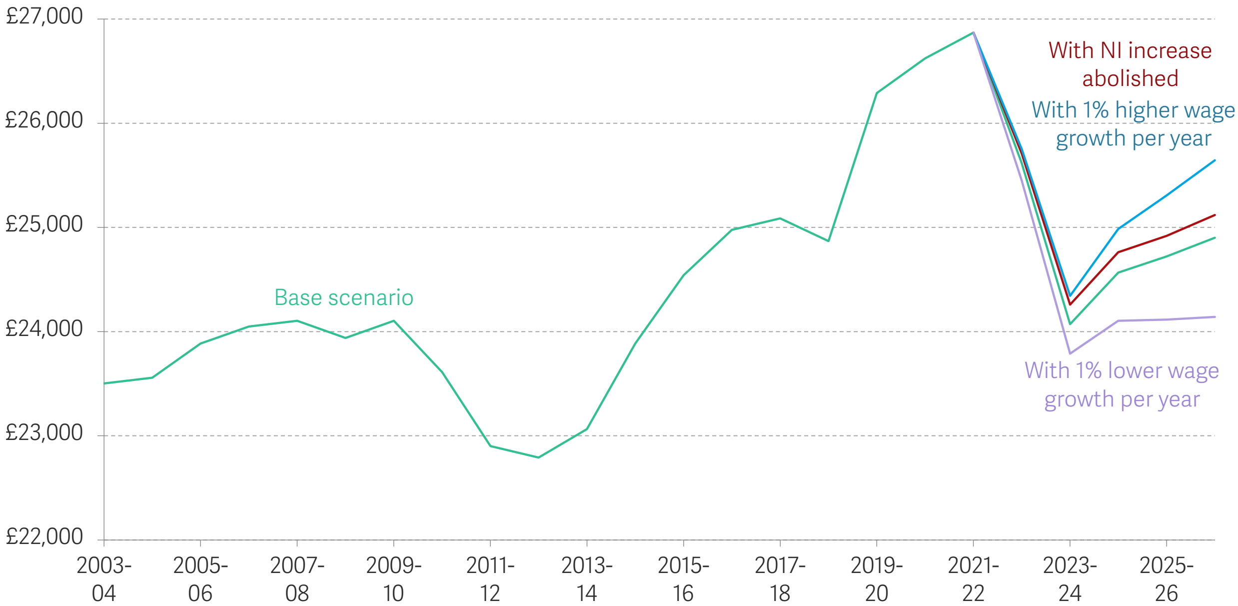
It will take large changes in the economic or policy outlook to dramatically improve the outlook

Given the uncertain economic and political outlook, we have also modelled the impact of some alternative or hypothetical scenarios. These include scenarios with higher and lower wage growth scenarios, and also the impact of undoing the recent 1.25 percentage point National Insurance tax increase, a policy proposed by Liz Truss, currently favourite to be the next Prime Minister. Figure 16 shows the impact of these different scenarios on median income.

FIGURE 16: **Abolishing the National Insurance increase would marginally improve average household incomes, but consistently higher wage growth would improve them even more**

Real median non-pensioner equivalised household disposable income, after housing costs, 2021-22 terms: UK

NOTES: All figures beyond 2019-20 are projected. Cancelling the NI rise scenario assumes the NI rise will be cancelled from October 2022 onwards (meaning the income level for 2022-23 includes half of the



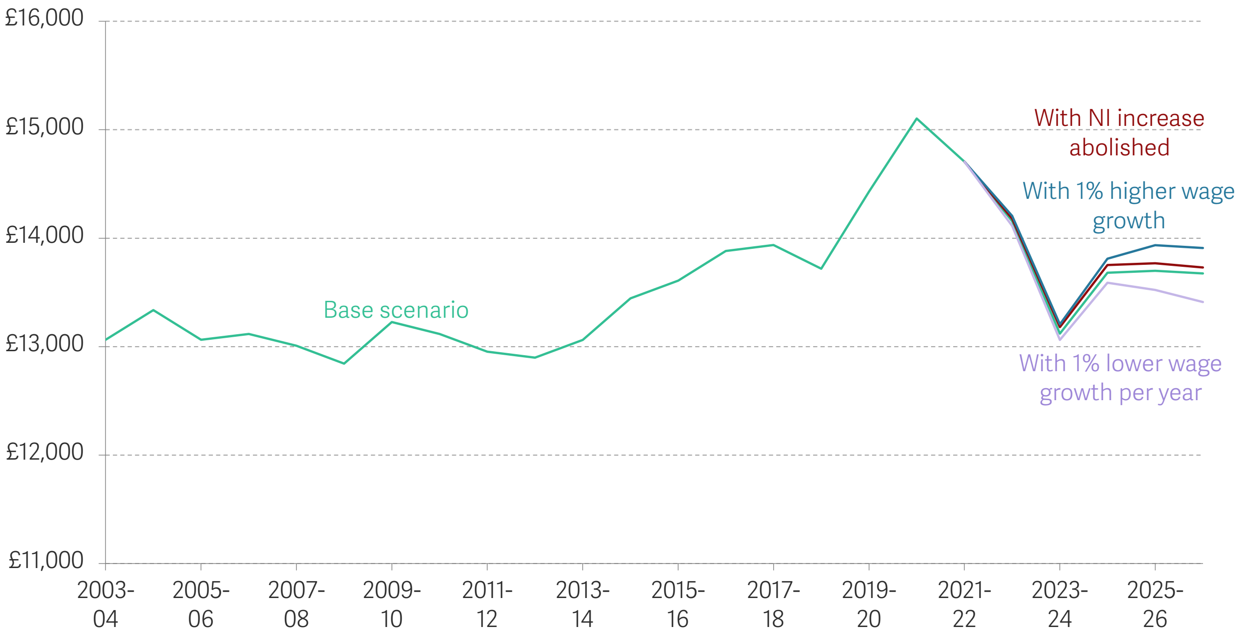
1.25-percentage point NI rise introduced in April 2022). Cancelling NI rise includes employee, but not employer NICs. Final data point covers 2026-27.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

As shown above, median household income is set to fall dramatically between 2021-22 and 2023-24, by £2,800 in real-terms. Undoing the recent National Insurance tax rise marginally improves the outlook for median household incomes (by 1 per cent by 2026-27) – but improves incomes at the 10th percentile by only a negligible amount.[25] Consistently higher wage growth would boost median incomes by even more. By 2026-27, higher productivity-driven wage growth of 1 per cent a year would result in median incomes increasing by 3 per cent, and incomes at the 10th percentile increasing by 1 per cent.

However, these scenarios don't provide as much of a boost in cash terms for lower-income households, as shown in Figure 17. This is partly because lower-income households are less likely to be in work, and so less likely to benefit from higher earnings growth or a cut to National Insurance that helps working-age adults who are in work. Furthermore, the gains from cutting NI are higher among those with high earnings, with previous Resolution Foundation work finding that twice as much of the benefit goes to the top twentieth (28 per cent) as the entire bottom half (15 per cent).[26]

FIGURE 17: **It will take large changes in the forecast for the incomes of the poorest to get back to where they were in 2020-21**

Real p20 non-pensioner equivalised household disposable income, after housing costs, 2021-22 terms: UK



NOTES: All figures beyond 2019-20 are projected. Cancelling the NI rise scenario assumes the NI rise will be cancelled from October 2022 onwards (meaning the income level for 2022-23 includes half of the 1.25ppt NI rise introduced in April 2022). Assumes employer NI unchanged.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

25 As a working assumption, we simulate this happening from October 2022. See: D Keane, Liz Truss vows to reverse National Insurance rise 'immediately', Evening Standard, August 2022.
26 T Bell & A Corlett, Talking tax: What's been said and what's gone unsaid in the Conservative leadership election? Resolution Foundation, July 2022.

Further large-scale policy support will be needed

To call this a 'cost of living crisis' is clearly appropriate: the worst shock to household incomes in at least a century, with potentially a slower recovery than the financial crisis, and (beyond the scope of this note) underpinned by deadly serious geopolitical considerations. What's more, despite our grim projections, forecasts for the energy price cap and inflation have – as set out earlier – only worsened since the Bank of England's projections used in this report.[27]

There is huge uncertainty about what heights the energy price cap will reach in 2023, when prices will begin to fall back, and how far they will eventually fall. We cannot know yet whether prices in the winter of 2023-24 will be as high as in winter 2022-23 (or even higher); nor how cold those winters will be. But there is no doubt that policy changes will be needed beyond the already-confirmed Government support for this autumn that has been factored into our projections.

In the relatively short term, it is essential that additional support is provided through this winter, to help with what would otherwise be catastrophically high energy bills. In another paper, we have analysed the proposals made so far by the two contenders to be the next Prime Minister, along with the idea of a universal price freeze suggested by the Labour party. We also set out the case for a large intervention delivered via unit energy costs (so that the level of support matches energy needs), with support targeted either directly via means-testing or indirectly through accompanying Income Tax rate rises.[28] At the same time, the Government should also be doing all it can to rapidly increase the supply of cheap renewable energy, reform energy markets, inform households about how they might reduce energy demand, and increase funding for insulating and decarbonising homes. In the rest of this note, we focus on what other measures should be taken to ease the cost of living crisis.

If the next Prime Minister follows the usual practice, and the commitment made by the former Chancellor, then the 7.3 million households on means-tested benefits will get an income boost in April 2023 when benefits are uprated by an expected 10 per cent, the rate of CPI inflation currently expected for September 2022.[29] For the forecasts in this note, we have assumed that this will happen, and so it is crucial that the new Prime Minister confirms that this will go ahead (particularly given the distributional variation in effective inflation rates set out in Figure 4).

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27 C Giles, D Sheppard & J Pickard, UK inflation to hit 18.6% next year according to Citi, Financial Times, August 2022.
28 M Brewer et al., A chilling crisis: Policy options to deal with soaring energy prices, Resolution Foundation, August 2022.
29 HM Treasury, Cost of Living Support: Statement by the Chancellor of the Exchequer on Cost of Living Support, May 2022: "And I can reassure the House that next year, subject to the Secretary of State's review, benefits will be uprated by this September's CPI [...] Similarly, the triple lock will apply for the state pension."

As we showed in Figure 5, even this large cash rise will leave the real value of Universal Credit in April 7 per cent below where it was in April 2019 (and the State Pension 3 per cent below): it is only in April 2024 that the real value of benefits will broadly catch up with where it was five years earlier, primarily because of the more-than-six-month lag between the point of measuring inflation (September) and the date when benefits are increased (the following April). But this lag could be reduced, with two rule changes.

- First, the basis for uprating benefits and the state pension should be permanently moved from September to at least October, and ideally as late as is possible ahead of the following April. The short-term impact of moving this to October would be an uprating of around 14 per cent in April 2023, rather than 10 per cent.[30] This would be more in keeping with expected contemporary inflation. Uprating in 2024 would then be commensurately lower (5 per cent rather than 10 per cent), based on current Bank projections.
- Second, in years of high inflation, benefits (or at least those for which the administrative process is easy, such as Universal Credit) should be uprated twice a year. For example, the Government could plan for an additional uprating in October 2023 (with the amount of the uprating depending on the change in the price level over half a year, and then a correspondingly smaller rise in April 2024), and should also consider one for January 2023.

Neither one of these changes would have any long-run impact on the generosity of benefits, but they would both mean that the value of benefits would change more quickly when prices are rising rapidly.

In addition to this change, the high rate of inflation makes it all the more important to address those parts of the benefit system where financial values are not uprated by default, in particular Local Housing Allowances, and the value of the benefit cap, both of which are now frozen in cash terms. When the benefit cap was introduced in 2013, it was intended to reflect 'median earnings after tax and national insurance contributions for working households', but it has instead been frozen, reduced (in November 2016), and then frozen again.[31] Its real value is now 36 per cent less than when it was first introduced in 2013, and 17 per cent lower than in November 2016. As a result of the cap, around 120,000 households will see no rise at all in cash terms in their income in April 2023, and more households will hit the cap each year as benefits rise in cash terms.[32] Both Local Housing Allowances and the benefit cap should be increased in April 2023 (if not before), by rental price growth and CPI inflation respectively.

30 It would be imperative that the increase in April 2022 was based not on the annual rate of inflation in October 2022, but the change in the level of the cost of living index from September 2021 to October 2022, so as not to avoid missing out on a month of rising prices. From April 2024 onwards, the annual rate of inflation in the previous October could be used.
31 R Keen et al., The Benefit Cap, House of Commons Library, November 2016.
32 Department for Work and Pensions, Benefit cap: number of households capped to February 2022, July 2022.

The policies above are primarily focused on alleviating the stress on lower-income households over the next 18 months or so – both from energy prices and other cost pressures. However, the current crisis also makes it all the more important that the UK grapples with its twin long-term challenges of low growth and high inequality.[33] The Economy 2030 Inquiry will be setting out a policy agenda to help achieve this, but it is clear that failures on both of these fronts left too many households badly exposed to shocks such as this one, increasing the need for frequent ad hoc interventions.

Annex: Nowcasting and forecasting methodology and table of projections

Methodology

The methodology used for our income projections in this report largely follows that used in The Living Standards Outlook 2022, as set out in more detail in that report's Annex 1.[34]

The baseline for our projections remains the Department for Work and Pensions' Family Resources Survey (and Households Below Average Income data) for 2019-20. Although survey data for 2020-21 has now been released, the Covid-19 pandemic affected both the quality of the data (particularly the sample size) and its utility as a starting point for modelling incomes in future years.[35] For consistency within our projections, the results we show for 2020-21 are our nowcasts – but information on actual survey-based data for 2020-21 can be found in official publications.[36]

The key economic forecasts used in this report are taken from the Bank of England's August Monetary Policy Report (from 4 August).[37] Specifically, we make use of the Bank's forecasts for CPI inflation, average earnings growth, the unemployment rate and the participation rate. Beyond the Bank's forecast period, we assume the unemployment rate remains constant; that inflation returns to 2 per cent after one additional year (in Q3 2026); and that earnings growth follows the OBR's last forecasts. As noted in this report, since the Bank's Monetary Policy Report was published, other organisations have published forecasts for inflation that peak at higher levels than the Bank expected – but we have not attempted to account for these.

Mortgage interest costs are projected to increase in line with the OBR's March forecast,[38] and private rents are assumed to rise in line with earnings, although in both cases we

33 The Economy 2030 Inquiry, Stagnation nation: navigating a route to a fairer and more prosperous Britain, July 2022.
34 A Corlett & L Try, The Living Standards Outlook 2022, Resolution Foundation, March 2022.
35 Department for Work and Pensions, Technical report: assessment of the impact of COVID-19 on the HBAI statistics for FYE2021, May 2022.
36 See: Department for Work and Pensions, Households below average income: an analysis of the income distribution FYE 1995 to FYE 2021, March 2022; Office for National Statistics, Average household income, UK: financial year ending 2021, March 2022.
37 Bank of England, Monetary Policy report – August 2022, August 2022.
38 Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022.

account for the fact that the actual pace of change so far in 2022 has been below the OBR's expectations. We assume that average social rents do not increase by CPI plus 1 per cent in 2023 and 2024: instead, we use a figure of 7 per cent. And we depart from our usual assumption that the average private pension income rises in line with RPI each year, instead assuming a rise of around 6 per cent in 2023-24, in line with average earnings growth (returning to our normal assumption in 2024-25).

- Our projections include all major government policies as they stand, including the May cost of living support package. To account for non-take-up of the £150 Council Tax Rebate, we have reduced the average payment using the OBR's assessment of the policy's cost.[39]

Scenarios

We also model three alternative scenarios. The methodology behind these alternative scenarios is as follows:

- One per cent more wage growth per year: in this scenario, we take our adjusted annual wage growth figures (based on the Bank of England's August forecast and the OBR's March data), and increase them each by 1 percentage point a year, starting in 2022-23 (this is not intended to be a comprehensive economic forecast).
- One per cent less wage growth per year: as above, but with annual wage growth 1 percentage point lower per year than in our main projection, starting in 2022-23.
- National Insurance increase abolished: this scenario assumes the NI rise will be cancelled from October 2022 onwards (meaning the income level for 2022-23 includes half of the 1.25 percentage point NI rise introduced in April 2022). Cancelling the NI rise includes employee and self-employed NI, but not employer NI or dividend tax.

39 See Annex Table A.3 in Office for Budget Responsibility, Economic and Fiscal Outlook, March 2022.

Key inputs and results

Table 2 shows our headline results and many of the key inputs that we used to form these projections.

TABLE 2: **Key inputs and outputs from our living standards projections**

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	Primary source for projection
Annual changes in economic determinants									
Av. earnings (& private rents from 2022)		2.2%	6.6%	5.2%	5.7%	2.7%	3.0%	3.3%	Bank (Aug) / OBR (Mar)
Higher earnings growth scenario				*6.2%*	*6.7%*	*3.7%*	*4.0%*	*4.3%*	*RF scenario*
Lower earnings growth scenario				*4.2%*	*4.7%*	*1.7%*	*2.0%*	*2.3%*	*RF scenario*
National Living Wage		6.2%	2.2%	6.6%	6.0%	5.8%	3.0%	3.3%	OBR (Mar) / Bank (Aug)
Dividend income		-23.8%	21.8%	8.9%	3.8%	3.5%	3.2%	3.2%	OBR (Mar) NGDP/person
Main benefit uprating		1.7%	0.5%	3.1%	10.0%	9.5%	2.0%	0.8%	Based on Bank (Aug)
Unemployment rate, 16+, ppts		+0.9%	-0.6%	-0.5%	+0.8%	+1.1%	+0.7%	+0.1%	Bank (Aug) then flat
Participation rate, 16+, ppts		-0.6%	-0.2%	-0.0%	-0.5%	-0.2%	-0.1%	-0.1%	Bank (Aug)
CPI		0.6%	4.0%	11.2%	7.4%	1.8%	1.0%	1.9%	Bank (Aug)
CPI excluding all housing costs		0.5%	4.2%	12.0%	7.7%	1.7%	0.9%	1.9%	Derived from BOE, OBR
Mortgage interest payments		-7.2%	0.3%	18.7%	20.5%	2.0%	-0.9%	0.0%	OBR (Mar)
RF Projected changes (after housing cost measures)									
Real non-pensioner median h'h' income		+1.3%	+0.9%	-4.7%	-6.0%	+2.1%	+0.6%	+0.7%	
Relative poverty (all), ppts		-1.2%	+1.4%	+0.1%	-0.4%	+0.1%	+0.1%	+0.3%	
Relative poverty (child), ppts		-3.0%	+2.9%	-0.3%	+0.3%	-0.9%	+0.7%	+1.2%	
Absolute poverty (all), ppts		-2.1%	+1.2%	+1.2%	+3.3%	-1.9%	-0.1%	+0.0%	
Absolute poverty (child), ppts		-3.6%	+2.2%	+3.0%	+4.5%	-2.9%	+0.2%	+0.6%	
Gini coefficient, ppts		-1.4%	+1.0%	+0.2%	+0.0%	+0.0%	+0.1%	+0.1%	
RF Projected levels (based on 2019-20 DWP figures)									
Real non-pensioner median h'h' income	£26.3k	£26.6k	£26.9k	£25.6k	£24.1k	£24.6k	£24.7k	£24.9k	
Relative poverty (all)	22.0%	20.8%	22.2%	22.3%	21.9%	22.0%	22.1%	22.4%	
Relative poverty (child)	30.6%	27.5%	30.4%	30.2%	30.5%	29.6%	30.3%	31.5%	
Absolute poverty (all)	17.8%	15.7%	16.9%	18.2%	21.5%	19.6%	19.5%	19.6%	
Absolute poverty (child)	24.7%	21.1%	23.3%	26.4%	30.9%	28.0%	28.2%	28.7%	
Gini coefficient	39.0%	37.7%	38.7%	38.9%	38.9%	38.9%	39.0%	39.2%	

NOTES: Although outturn household income figures are available for 2020-21, the figures shown here are our nowcasts, for consistency with later years. RF projections include use of the IPPR Tax Benefit Model. Real household income figures are in 2021-22 prices.

Differential inflation forecast methodology

In Figure 4 of this report, we have also forecasted future rates of inflation by income decile – although these projections are not used in our main income and poverty forecasts.

Our inflation forecast is based largely on a statistical projection of inflation indexes using past dynamics of price changes between January 2000 and July 2022. Specifically, our methodology starts by breaking down the CPI index into 30 constituent parts using the standard 'classification of individual consumption by purpose' (COICOP) definitions.

The 30 indexes were chosen to group products and services into categories which share similar historic patterns and economic drivers. For example, one index includes restaurant, fast food establishment and hotel prices, because these have tended to have experienced similar inflation rates in the past and future price rises will be driven by similar factors (i.e. staff, energy and food costs). Equally, dissimilar products and services are separated; for example, airfares and road fuel prices are forecast separately because they do not share similar historic monthly inflation rates (airfares are far more volatile), despite oil prices being a key joint input cost.

Having defined these sub-indexes, for 28 of them we estimate an individual forecast of monthly inflation rates based on historic statistical dynamics including seasonal factors, persistence and cyclical factors. Specifically, we estimate an unobserved component model with an autoregressive term, for each individual component. These do not all have the same level of accuracy: some components (such as airfares) are volatile, and forecast accuracy is relatively low; other series have a high degree of historical accuracy. Although we validated the models using pseudo out-of-sample tests, it is worth recognising that they may not provide particularly accurate forecasts, particularly at a time when inflation dynamics are far from their pre-energy crisis norms and economic uncertainty is extremely elevated.

The final two components, gas and electricity bills and transport fuel costs, are forecast using the announced energy price cap changes and weekly fuel pump prices (which are then assumed to remain constant) respectively. These forecasts are then combined, with the weights of each component varied to reflect different spending patterns across the income distribution.

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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