Resolution Foundation

# The only way is down?

## Assessing the impact of falls in wholesale energy prices on household and public finances

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Huge rises in energy prices through much of 2022 sparked a cost of living crisis with recession-level hits to family (as inflation soared) and public finances (as the state partially protected us from bill rises). But there has finally been some good news with wholesale gas prices for 2023-24 down more than 70 per cent from their peak in August. So, while the extreme volatility in energy markets over the past year means that the outlook is still very uncertain, in this Spotlight we look at what the big fall in energy prices might mean for household and government finances.

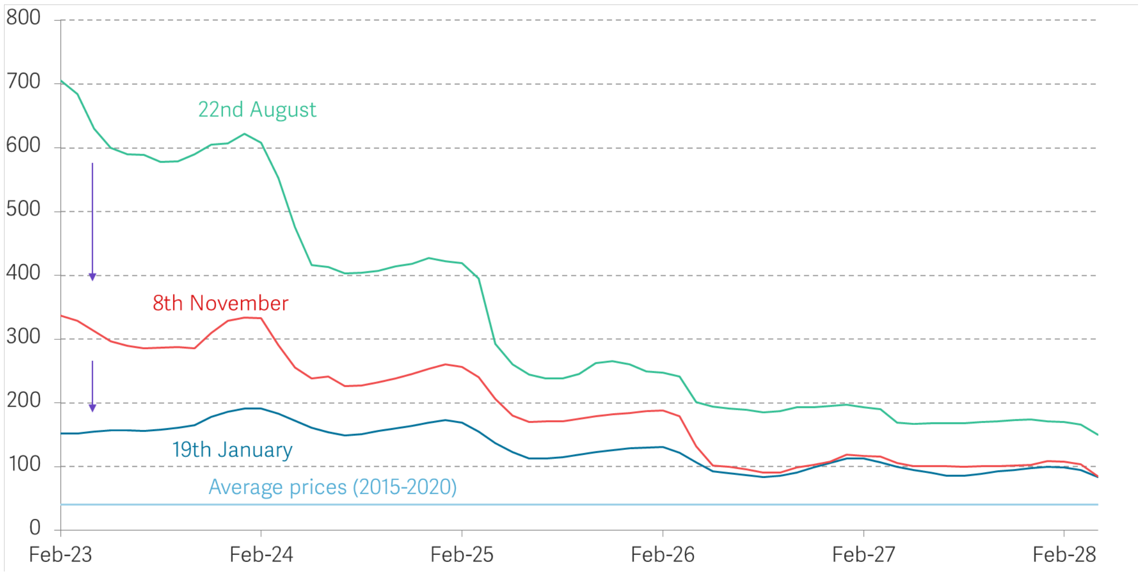
There is good news for households who benefit from smaller-than-feared rises in energy costs if prices remain at current levels. Typical annual energy bills are now forecast to be £2,400 next year (2023-24), down from the forecast of £3,000 at the time of the Autumn Budget (the level of the 2023-24 EPG). But 2023-24 will still feel difficult. The first thing families will notice is a *rise* in energy bills in April, as Government support is reduced and the Energy Price Guarantee (EPG) is raised to £3,000 (from £2,500), and overall, energy bills are set to be 20 per cent (or £400) higher in 2023-24 than in 2022-23. Falling gas prices are not a panacea for families already struggling with the high cost of living.

The public finances will benefit from lower wholesale energy prices more swiftly. Based on current futures prices, the cost of the EPG in 2023-24 is estimated to be around 90 per cent below the Office for Budget Responsibility's costing made in November (£1.5 billion compared with £12.8 billion). Lower energy prices, however, also mean lower receipts from windfall taxes. These are highly uncertain, but a back-of-the-envelope calculation suggests revenues could be as much as £7 billion lower. Nonetheless, the fall in energy prices is likely to materially reduce borrowing once the lower cost of support for firms and the smaller hit to household incomes than feared are considered. Overall, lower energy prices – if sustained – should provide a much-needed economic boost. And while the outlook is still a very difficult one for living standards, some of the pressure on household and government finances have been reduced.

### The new year has brought good news in the form of falling energy prices

The new year has started with good news on energy prices. After European wholesale oil and gas prices rocketed in 2022 following the Russian invasion of Ukraine, they have fallen significantly over the past six months. UK wholesale gas prices are now at their lowest level since December 2021. Gas futures prices for 2023-24 are down 71 per cent, and down 44 per cent since the Government set out its plans to support households with energy bills in November's Autumn Statement, as shown in Figure 1.

Figure 1 **Steep falls in wholesale gas prices are good news for energy costs**
Wholesale gas futures prices, pence per therm: UK/GB




Notes: Average prices show gas price forward delivery contracts, weekly average, GB.
Source: RF analysis of ICE Futures Europe; Ofgem.

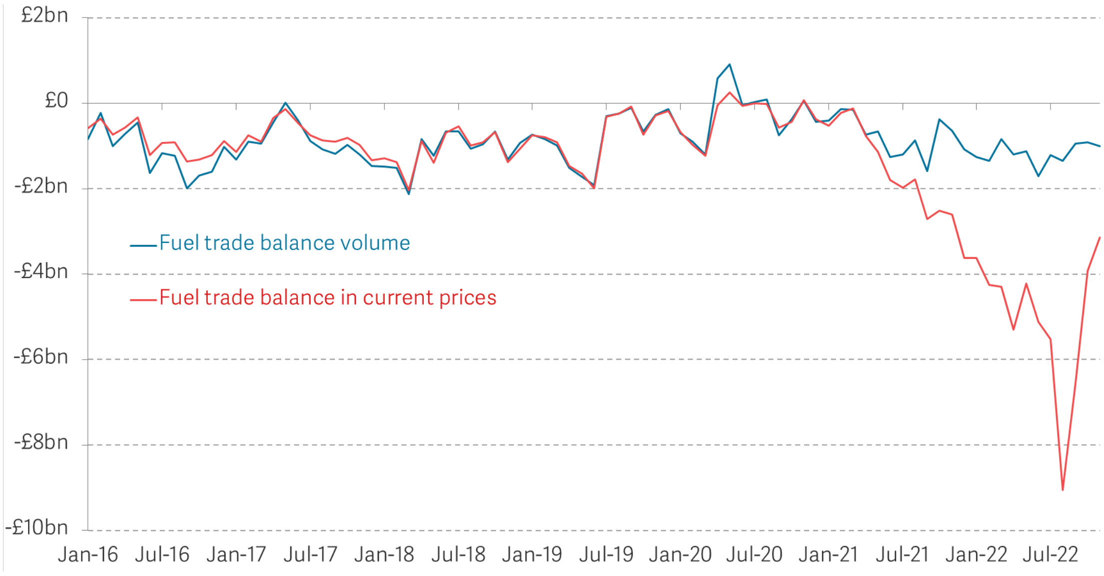
The good news on prices reflects a combination of the response from European policy makers and energy users, and also a large slice of good luck. Record winter temperatures across Europe mean demand has been lower, while weak demand in China has facilitated the diversion of LNG supplies to a Europe rapidly expanding its LNG infrastructure. Policy has helped too: campaigns to reduce energy consumption have reinforced the impact of high prices such that EU gas consumption has fallen 20 per cent. The result is gas storage is 81 per cent full, around 20 percentage points above the five-year average.

The outlook for energy prices still remains highly uncertain, however. The huge volatility in gas prices over the past year means we can't assume energy prices will continue to fall, and they could well rise from their current levels with the outlook still dependent on temperatures in Europe and the unpredictable situation in Ukraine. But the huge falls we've seen in recent weeks beg the question: what might this mean for household and Government finances? Below we discuss the implications.

**Lower energy prices are very good news for households, but with bills set to rise in the short term, it might not feel like it**

As a net importer of fuel (Figure 2), falling oil and gas prices – if maintained – should provide a material economic boost for the UK by reducing the extent to which the higher cost of our imports is making the UK poorer. Indeed, lower energy prices, are a big deal for household and public finances simply because the volume of pain to be shared between them, as higher energy prices make us poorer as either energy billpayers or taxpayers, is smaller.

Figure 2 **As a net fuel importer, falling prices will boost the economy**
Monthly fuel trade balances (exports minus imports), chained volume measure and current prices: UK



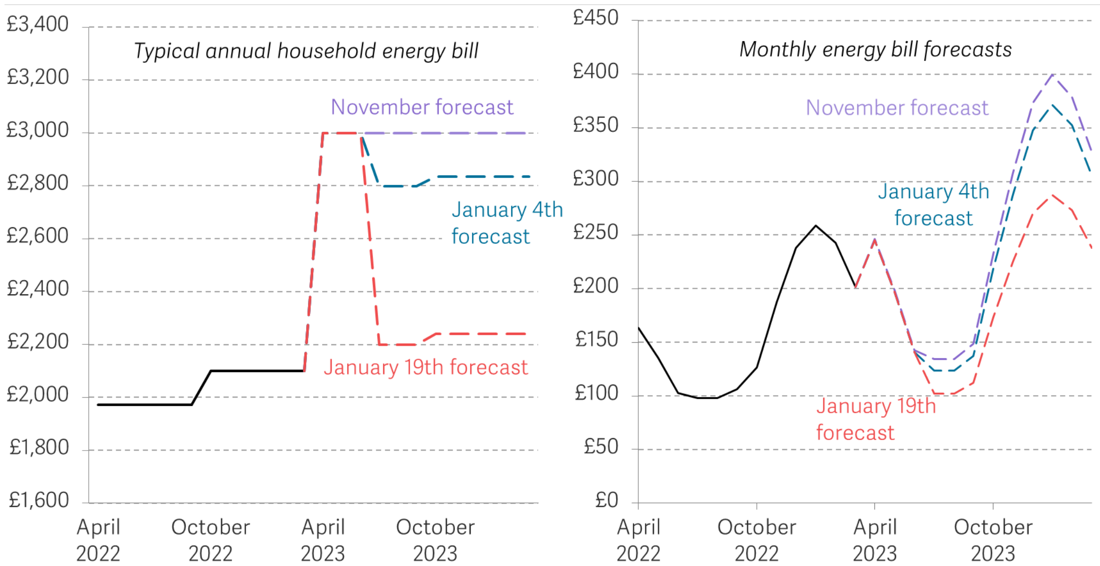

Source: RF analysis of ONS trade statistics.

Households will benefit from smaller-than-feared rises in energy costs if prices remain at current levels. Typical annual energy bills are now forecast to be around £2,400 next year (2023-24), down from the forecast of £3,000 at the time of the Autumn Budget (the level of the 2023-24 EPG binding for the whole year), as shown in Figure 3. These price forecasts for winter 2023 are also good news for inflation, as the direct contribution of energy to UK inflation would become negative, contributing an estimated -0.4 percentage points in October 2023 compared to propping up inflation by 3.2 percentage points in February 2023.[2]

But policies put in place to protect households from rising energy costs will mean that the benefit will not be felt right away despite prices falling. The increase in the Government's Energy Price Guarantee (EPG) from £2,500 to £3,000 in April for a typical household means that energy costs will initially *rise* before falling back to just above £2,200 from October. Indeed, as shown in Figure 3, across 2023-24 overall energy prices are forecast to be 20 per cent (or £400) higher than in 2022-23, due to the scaling back of government support. Furthermore, prices in 2023-24 are forecast to cost twice as much as a typical bill in the year running up to the pandemic (2019-20), when typical bills were just £1,200 a year.

Figure 3 **Further falls might benefit consumers, but prices are set to rise in April**

Historical and forecast energy bills for a typical household annual price cap (left chart) and monthly household gas and electricity bills (right chart): Great Britain, 2022-24




Notes: Figures net of £400 Energy Bills Support Scheme rebates during October 2022 to March 2023, but no other Cost of Living Payments such as those delivered through the benefits or council tax system.
Source: RF analysis of Ofgem price cap methodology, Government Energy Price Guarantee, Cornwall Insight, UCL SERL data.

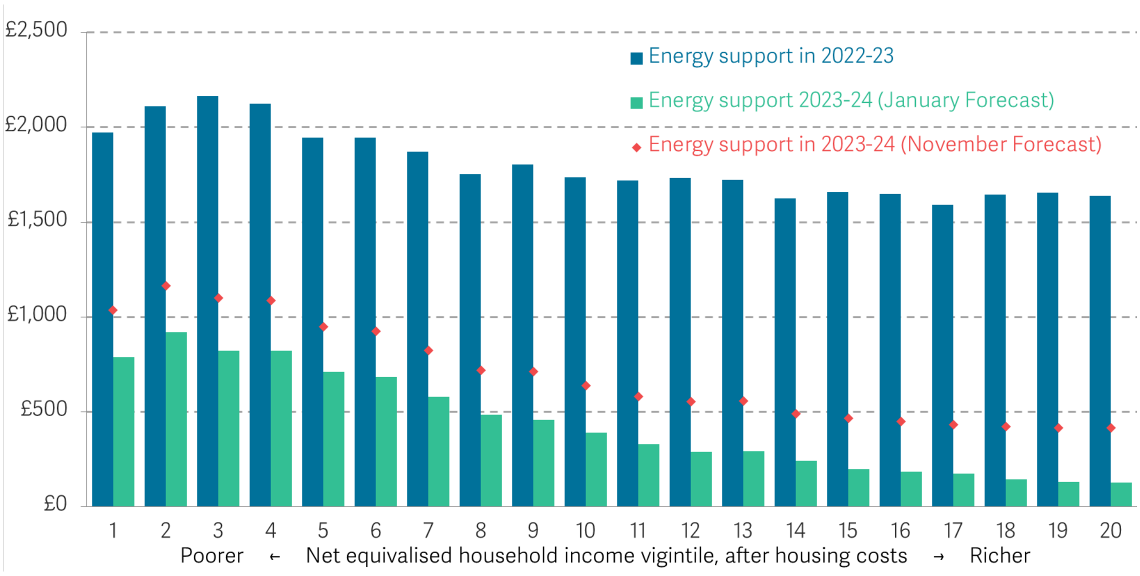
Last winter's bills were enough to create significant hardship for families already struggling with the high cost of living. Our recent Living Standards Outlook found that 11 per cent or 6 million adults (up from 5 per cent pre-pandemic) reported being hungry in November because they lacked enough money to buy food. People are also falling behind on bills: 10 per cent of people – and a quarter of workers in poorer households – have missed at least one payment of a priority bill over the three months to November 2022.

## Lower prices means a boost to the public finances even in the short term

Lower wholesale prices should also bring immediate relief to the Exchequer. In November, the OBR estimated the total cost of the £2,500 EPG for October 2022 to March 2023 would be £24.8 billion which is unlikely to have changed significantly. But the forecasted £12.8bn price of the £3,000 EPG for 2023-24 now looks set to have been slashed by almost 90 per cent, and will be closer to £1.5 billion thanks to these lower wholesale prices. Indeed, with lower wholesale futures prices for much of 2023-24, the EPG will likely only be active between April-June 2023 under current projections.[3]

As shown in Figure 4, the combination of reduced support from the EPG and higher Cost of Living Payments to those receiving benefits means that in 2023-24 spending should be more targeted towards lower income households, as well as lower overall. The poorest households will receive six times the level of support as the top in 2023-24, but that support will still be less than half (40 per cent) of the support received by this group in 2022-23 and worth threequarters (76 per cent) of the support as announced in November had wholesale energy prices not fallen.[4]

Figure 4 **Support in 2023-24 is far more targeted and far less generous than 2022-23**
Total value of energy support in 2022-23 and 2023-24 by income vigintile, in nominal prices: UK




Notes: Energy support in 2022-23 includes the £2,500 Energy Price Guarantee, £400 energy bills payment, £150 Council Tax payment, £650 means-tested benefit payment, £300 pensioner payment, and £150 disability payment. Energy support in 2023-24 includes the £3,000 Energy Price Guarantee, £900 means tested benefit payment, £300 pensioner payment, and £150 disability payment. Chart assumes Cornwall Insight energy bill forecasts as of January 2023.
Source: RF analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; DWP, Households Below Average Income; ONS, Living Costs and Food Survey; Ofgem; Cornwall Insight.

Lower energy prices will, however, also reduce tax revenues. The Government has put in place a number of 'windfall' taxes, directly related to high energy prices, designed to help fund support for households and business: the existing higher corporation tax regime for North Sea hydrocarbon production; the Energy Profits Levy (the EPL - a windfall tax on oil and gas producers); and the Electricity Generators Levy (EGL). The extent to which lower energy prices would reduce revenues from these taxes is itself uncertain, and will depend on a range of factors, not least how prices evolve from here. But below we provide back-of-the-envelope estimates based on prices on 20 January:

- For North-Sea Oil and Gas producers, the short run breakeven oil price is around $30 for most operators, and with oil prices ranging from $80 to $120 over the past year, total government revenues from corporation tax, the EPL and the petroleum revenue tax were forecast to be their highest in 2023-24 in almost 40 years (since 1985-86). Based on oil and gas futures prices on 20 January, the OBR's 'ready reckoners' would suggest that the total North Sea receipts could fall by a quarter;
- Electricity generators will pay a 45 per cent levy from January 2023 when electricity prices are above £75/MWh (prices previously seen in July 2021). Again, the EGL is likely

to fall proportionally with the fall in gas prices over 2023-24, as gas is the marginal source of electricity in the UK.

Based on this, total Government receipts from these sources *could* fall by as much as £7 billion in 2023-24 (from £25 billion to £18 billion).[5] Although the impact here is very uncertain, it is important to keep in mind that lower energy prices could have a chunky impact on revenues as well as spending.

But given wider fiscal benefits from lower energy prices, the net effect on the public finances should still be substantially positive. As well as reducing the cost of supporting households, lower energy prices should mean that the costs of the £5.5 billion support for businesses announced in January could be even lower.[6] Moreover, lower energy costs than were previously feared means generally stronger consumer finances and firm profits, further boosting the public finances.

**The fall in energy prices provides much needed good news**

Overall, both households and the Government should benefit from lower energy prices. While the reduced generosity of Government support means households still face higher costs in 2023-24, it is much lower than expected even a couple of months ago. And that reduced support means the Treasury should benefit even in the short term from a lower cost EPG. So, although huge uncertainty remains and the outlook for this year and next remains a difficult one for living standards, these lower wholesale prices should reduce pressure on both household and public finances.

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[1] Thank you to Torsten Bell and Mike Brewer for comments and feedback, and to Jack Leslie for analytical contributions.

[2] In addition to these direct inflationary effects, energy prices also have indirect inflationary effects by raising businesses' costs which might take time to feed through.

[3] The April-June Ofgem price cap is based on wholesale prices between November and February.

[4] Poorest are the lowest quintile, and richest are the top quintile. The lowest decile will receive support worth seven times the top decile using January forecasts, compared with 2.5 times the level of support using November forecasts.

[5] Behavioural changes for businesses or for households have not been factored in in the face of falling energy costs. Higher energy costs should mean that households cut back on their energy spending – our recent research found that 80 per cent of adults had tried to cut back on energy spending in November 2022. However, the aggregate effect of these changes on energy consumption in the UK is uncertain. On the government revenues side, the EPL includes a new investment allowance, which might incentivise some companies to bring forward or increase planned investment. Alongside the higher tax rate this is likely to leave investment unchanged, but again this is highly uncertain.

[6] The Government also announced new support worth up to £5.5 billion for businesses in 2023-24 in January. This is well below the support of £18.4 billion for October 2022 to March 2023.