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The Living Standards Outlook

Summer 2023 Update

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Acknowledgements

Thank you to Simon Pittaway at the Resolution Foundation for mortgage and savings interest projections. All errors remain the author's own.

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Summary

Household incomes are always a crucial perspective on how living standards are changing, particularly during economic crises. And in democracies, changing living standards also matter for politics, particularly ahead of elections. As Ronald Reagan famously put it in 1980, the answer to "are you better off today than you were four years ago?" is often an important bit of context for voters. In the UK, it mattered that David Cameron had the backdrop of a low energy cost living standards mini-boom in 2015, while Theresa May triggered an election during a period of falling real pay in 2017.

The past year has seen the biggest inflation shock in four decades, continued emergency policy interventions, and a rapid tightening of monetary policy. This briefing note takes stock of where all of this leaves household incomes, and considers what the year ahead – as well as the first year of the next parliament – may have in store. As such, it presents the likely living standards backdrop to a 2024 election.

Some key economic indicators are set to improve…

After a long period of grim economic news, some headline numbers at least are improving. CPI inflation has already fallen from its 11.1 per cent peak to 6.8 per cent, and the Prime Minister may meet his target of halving inflation by the end of 2023. Indeed, the Bank of England forecasts that there is roughly an even chance that inflation will be back below 3 per cent by Q4 2024. At the same time, workers have been securing larger wage rises than economic forecasters have expected, meaning that average real pay is already growing (although in June it was still 3 per cent below its 2021 peak). And mortgagors can hopefully be reassured that the streak of Bank Rate rises is likely nearing an end – with an expected peak of between 5.5 and 6 per cent.

…but significant headwinds remain

Despite these trends, some key headwinds to living standards growth remain. Some of these represent, in some form, delayed impacts of the 2022 and 2023 inflation surge. For example, although Bank Rate may peak shortly, the full impact on mortgagors is yet to be felt. The average interest rate paid by mortgagors is expected to rise from 2 per cent in Q1 2022 to a peak of 4.8 per cent in Q4 2027, and only around half of that increase has now happened, with around 90 per cent due to have been passed through by the time of a potential Q4 2024 general election. The average household remortgaging next year will see their annual payments rise by around £3,000. On top of this, private rents are rising (partly reflecting strong nominal wage growth), with new rents up around a quarter between January 2021 and May 2023, which will filter through to average rents over time. Additionally, unemployment has risen from a low point of 3.5 per cent in 2022 to 4.2 per cent (albeit alongside reduced inactivity rates) and is projected to rise to 4.6 per cent by Q1 2025, partly due to the effect of interest rates in slowing economic growth.

Tax and benefit policy will also weigh on income growth. First, tax thresholds are currently frozen, pushing up average tax rates as salaries rise in nominal terms, meaning that real changes in ***post-tax*** pay will be much slower than the growth in pre-tax pay. For the median employee, real-terms gross pay is projected to have risen by 2.9 per cent between 2019-20 and 2024-25, but growth in post-tax pay will be just 0.6 per cent. Second, the Cost of Living Payments and other schemes that have operated in 2022-23 and 2023-24 are not scheduled to continue into 2024-25. One could see the temporary payments as being a form of compensation for the fact that benefit entitlement increases lag rises in the cost of living, and the end of such schemes is due to be partly offset by a benefit uprating of around 6.9 per cent in April (if the Government follows the usual rule of uprating them in line with past inflation rates), but the combined impact is still set to be a net loss. This is partly because the real values of benefits will not return to their 2019-20 levels until April 2025, and partly because the Cost of Living Payments were not a perfect substitute for timely uprating of benefits, with smaller households having gained proportionally more than larger ones. As a result, the combined real-terms value of basic out-of-work benefits and support payments will fall by 13 per cent (or £700) in 2024-25 for a single person, and by 2 per cent (£300) for a couple with two children.

Living standards are projected to decline in 2024-25 for lower-income households

Household living standards are affected by all of the factors above, and more. We model how overall disposable incomes have changed since 2021-22 (the latest household income survey data) and present projections for the presumed general election year of 2024-25, as well as 2025-26, based on existing government policy and the latest economic forecasts.

These projections imply that real incomes took a big hit in 2022-23 and look likely to have roughly stagnated in 2023-24, with a combined two-year income fall of 4 per cent. But – perhaps more surprisingly – our results suggest there will be zero real growth in the median non-pensioner household income in the 2024-25 election year, despite the very welcome return of real pay growth. And, although there may be growth for higher-income households, the outlook is worse for the lower-income half of the non-pensioner population, whose average income is projected to fall by 1 per cent in 2024-25. As a result, an extra 300,000 people are projected to fall into absolute poverty next year. And there is little sign of a rapid recovery on the horizon: at present, the outlook for 2025-26 is also one of stagnant household incomes, driven by the Bank's relatively weak growth forecast, with real pay rising by just 0.9 per cent in the year to Q4 2025.

For the current Government, this is not an ideal backdrop for a general election. Overall, the median non-pensioner's income is projected to be 4 per cent lower in 2024-25 than in 2019-20, making this the worst parliament on record for income growth. And there is no example of a government retaining power with such weak median income growth in the general election year since comparable data began in the 1960s, given changes of government in 1964, 1974 and 2010, although single-year changes in survey values should be considered with a pinch of salt.

Some groups, however, will benefit from a savings interest windfall

Not all groups face the same outlook. In part this is due to the impact of changing housing costs. In particular, the typical disposable income of mortgagors is projected to be 7 per cent (£2,700) lower in 2024-25 than in 2021-22 after housing costs are considered, while the typical outright owner is projected to become better-off than ever.

But the positive income effect of a higher Bank Rate – via an increase in the interest paid on savings – is even more significant. Given that households now have a combined £1.7 trillion of interest-bearing savings, we project that total interest income will reach £90 billion in 2024-25, up hugely from just £5 billion in 2021-22. This equates to over £3,000 per household next year and (minus some tax) is a significant contributor to the household income outlook, but clearly will only benefit households in (rough) proportion to their savings. Overall, the tenth of households with the most savings wealth will account for two thirds (65 per cent, or around £60 billion) of savings interest in 2024-25, receiving an average of £20,000 each, before tax. In contrast, the half of households with the lowest savings will receive only 2 per cent of total interest income, or around £100 each, on average.

Higher-income households will typically gain proportionally more than lower-income ones, with the rise in savings interest increasing income inequality overall. But our modelling suggests the average boost to households will be significant across the income distribution, with a 4 per cent impact on the median non-pensioner income in 2024-25 compared to a continuation of 2021-22's interest levels. Yet higher savings income will clearly benefit some age groups more than others. Households aged under 35 are projected to receive a net £700 savings income rise on average by 2024-25, while 65-74-year-olds will benefit from a £3,600 rise on average – six times more – although the typical (median) gains will be far lower given the large savings inequalities within all age groups.

Conclusion

We are moving into a big year politically. But it is also set to be another notable year for living standards, as the cost of living crisis evolves. For some, household incomes may now grow. But there is little sign of relief for those most at risk of harm from the higher cost of living, and policy makers should not be entirely distracted from this challenge by the upcoming election.

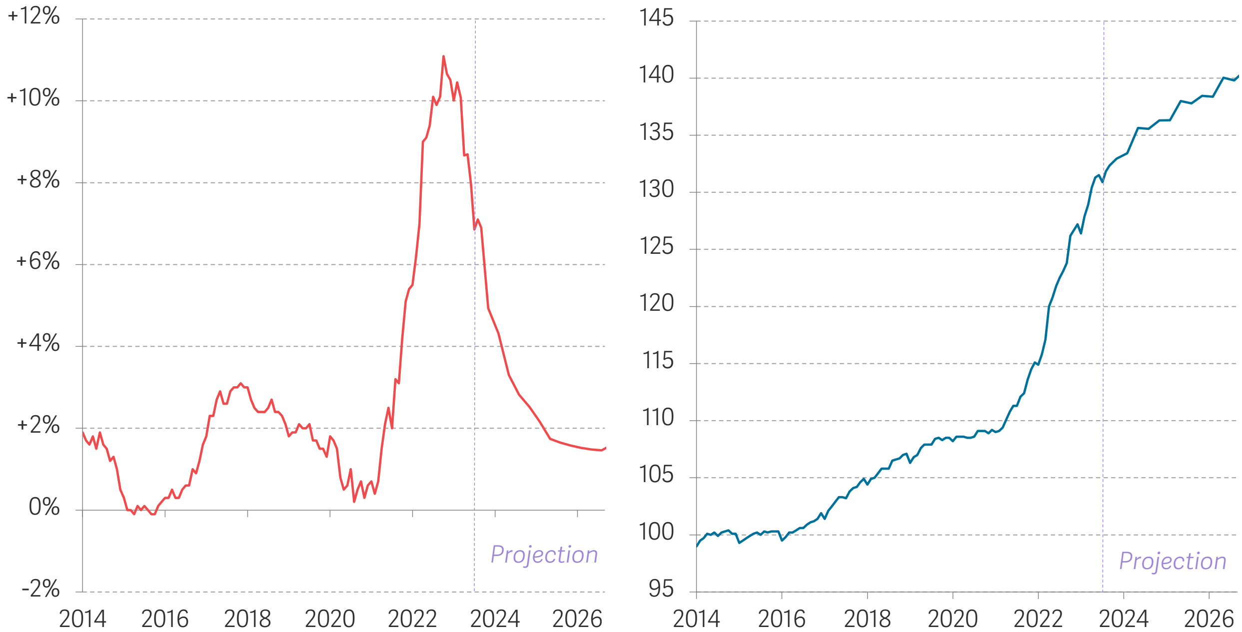
The 12 months leading up to a likely autumn 2024 election should see some key economic indicators improve

With Covid-19 being followed by an energy crisis, the UK has experienced a lot of gloomy economic news in the past three and half years. Some headwinds to living standards growth are now starting to disappear, however.

Most obviously, inflation is coming down. CPI inflation hit a decades-long high of 11.1 per cent peak in October 2022, but fell to 6.8 per cent in July, and the Bank's latest forecast is for inflation to reach 4.9 per cent in Q4 2023 and 2.8 per cent by Q3 2024. The inflation rate has particular political importance given that the Prime Minister has made it his number one 'priority' and 'pledge' to halve inflation in 2023.[1] Depending on the baseline (October, November or December 2022), inflation would need to be below 5.25-5.55 per cent by the end of 2023 to meet this goal.[2] The annual inflation rate should inevitably fall further once October 2022's large energy price rises fall out of the calculation, and the Bank's forecast suggests that the Prime Minister's target will be met, but it remains possible that it will be missed.[3]

FIGURE 1: **Annual inflation is now falling fairly rapidly**

CPI annual inflation rate (left) and level (right, 2015=100): UK



SOURCE: Bank of England, Monetary Policy Report, August 2023; ONS, Consumer Price Inflation.

1 UK Government, Prime Minister outlines his five key priorities for 2023, January 2023.
2 At the time of the Prime Minister's pledge, the latest data was from November 2022.
3 H Karjalainen & P Levell, Stubborn inflation puts PM's target in jeopardy, IFS, August 2023.

Whether this specific goal is hit on schedule or not, however, a return to normal levels of inflation is good news for households and the Prime Minister alike. According to the Bank's forecast, there is roughly an even chance that by the time of a Q4 2024 general election inflation would be back below 3 per cent, and the Bank's Governor would no longer be writing monthly letters to the Chancellor explaining why inflation is too high.[4]

The inflation outlook is aided by cheaper energy. The headline price cap for typical use will fall in October by 7 per cent, from £2,074 to £1,923 – down from October 2022's Energy Price Guarantee level of £2,500.[5] For now, though, 2024 is not expected to bring substantial further falls in energy prices, despite the hope that bills will in time move back towards pre-2022 norms.[6]

With inflation falling, it is expected that real pay growth will return. This is already seen in the latest statistics: adjusting for CPIH inflation, the low point for average pay was in Q4 2022, and regular pay in Q2 2023 was 0.1 per cent higher than a year earlier, while total pay (including bonuses) was up by 0.5 per cent.[7] Growth is also expected to continue in 2024. Although the Bank expects nominal pay growth to weaken – falling from annual growth of 6 per cent in Q4 2023 to 3.5 per cent in Q4 2024 – it should continue to rise more quickly than inflation, with expected real-terms pay growth of around 1 per cent in the year to Q4 2024. As Figure 2 shows, even with such growth it could be several years until CPI-adjusted average pay gets back to where it was in 2021.[8] But real growth is still a very welcome change.

4 At the time of writing, prediction markets suggest a nine in ten chance that the general election will be in financial year 2024-25, with Q4 being the most likely quarter.

5 However, the reduction in the price cap hides variation, with some households actually facing higher bills this winter due to higher standing charges and the removal of the £400 Energy Bill Support Scheme that applied last winter – see: J Marshall & E Fry, Gotta get through this: Energy bills this winter, Resolution Foundation, August 2023. Also note that Ofgem's typical consumption values will change in October 2023.

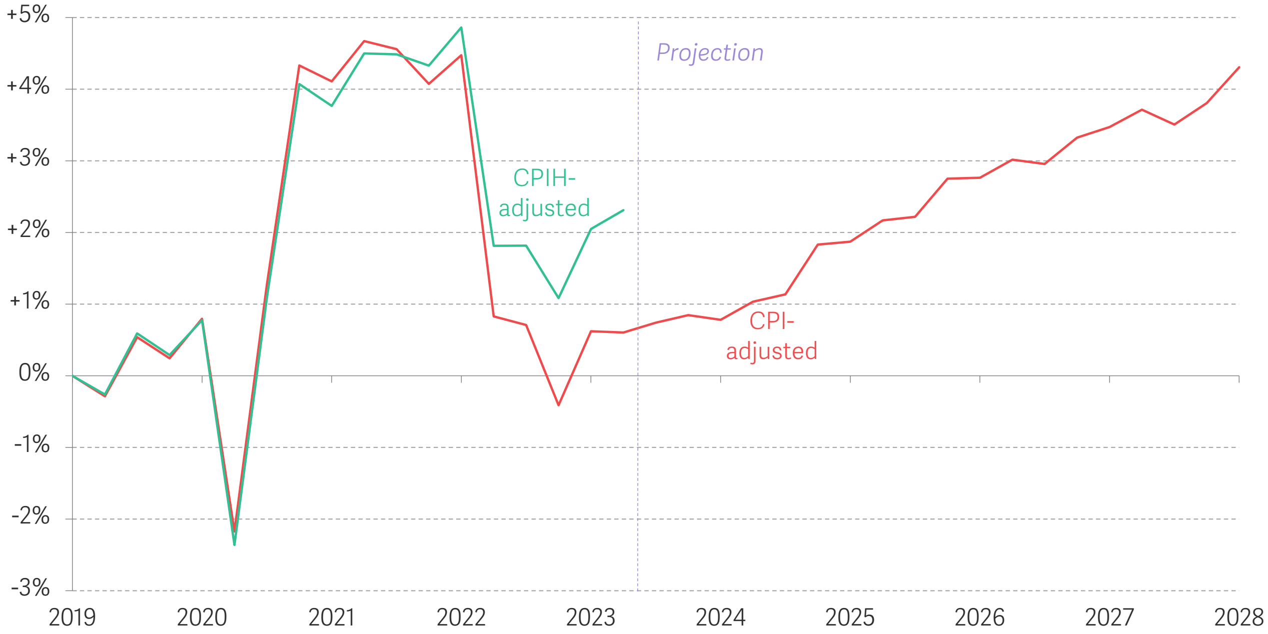
6 Cornwall Insight, Predictions and Insights into the Default Tariff Cap, August 2023 and Drop in power price predictions up to 2030 but prices to remain above pre-pandemic levels for next decade, January 2023.

7 ONS, Labour market overview, UK: August 2023.

8 While the ONS favours the use of CPIH inflation when assessing real-terms pay, neither the OBR nor Bank of England produce CPIH forecasts and so our projections are based on CPI.

FIGURE 2: **Real average earnings are now forecast to rise**

Cumulative change in average real total pay since Q1 2019: GB



NOTES: CPIH projections are not available. Pay figures for 2026-27 and 2027-28 are based on a spliced Bank/OBR series and are therefore illustrative.
SOURCE: RF analysis of ONS, Consumer Price Inflation; Bank of England, Monetary Policy Report – August 2023; OBR, Economic and Fiscal Outlook, March 2023.

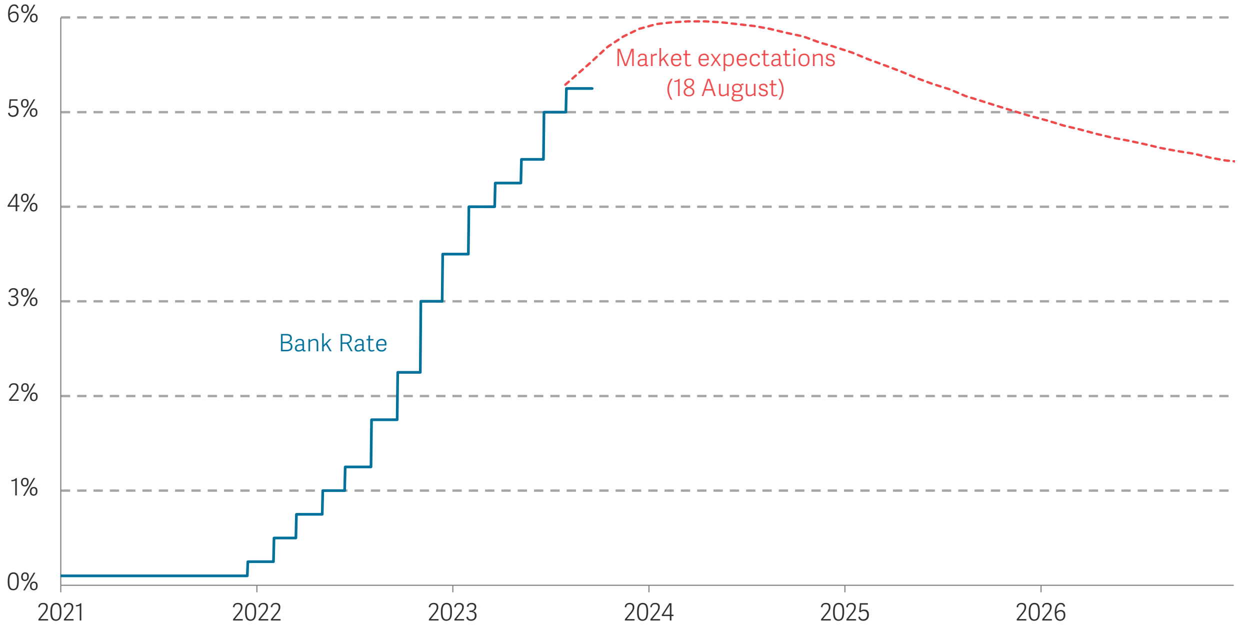
The discussion above has been about average pay. In fact, recent pay growth has not varied dramatically between lower- and higher-paid employees. Median monthly pay has grown very slightly faster than mean pay between 2019-20 and Q2 2023 (except within London).[9] Over the same time period, the very top (the 99th percentile point) and the bottom (the 10th percentile point) of the monthly pay distribution have done slightly worse than the median – despite the hourly National Living Wage having continued to rise faster than average pay.[10]

Finally, another change related to falling inflation is that the long series of Bank Rate hikes – where we have seen the largest tightening cycle since 1989 – may come to an end relatively soon. As Figure 3 shows, markets expect a peak of between 5.5 and 6 per cent, up from the current level of 5.25 per cent. As we will explore in more detail later, a rising Bank Rate is not necessarily bad for household incomes overall, but the end of rate rises may contribute to a public sense that inflation is under control. Indeed, market expectations (already priced into mortgage costs) suggest that there could even be rate reductions this side of a general election.

9 X Xu, Pay growth for London's top earners has driven up geographical inequality in mean earnings, IFS, July 2023.
10 ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information, UK: August 2023.

FIGURE 3: **Markets believe we are nearing the end of Bank Rate hikes**

Bank of England official policy rate, actual and market expectations



SOURCE: RF analysis of Bank of England, yield curves.

But there are significant brakes on income growth

However, despite falling inflation and recovering real pay, there remain several key causes for gloominess about households' finances over the year ahead. Some of these can be seen as the delayed impacts of the energy crisis, and some relate directly to policy choices (although these too stem from economic pressures).

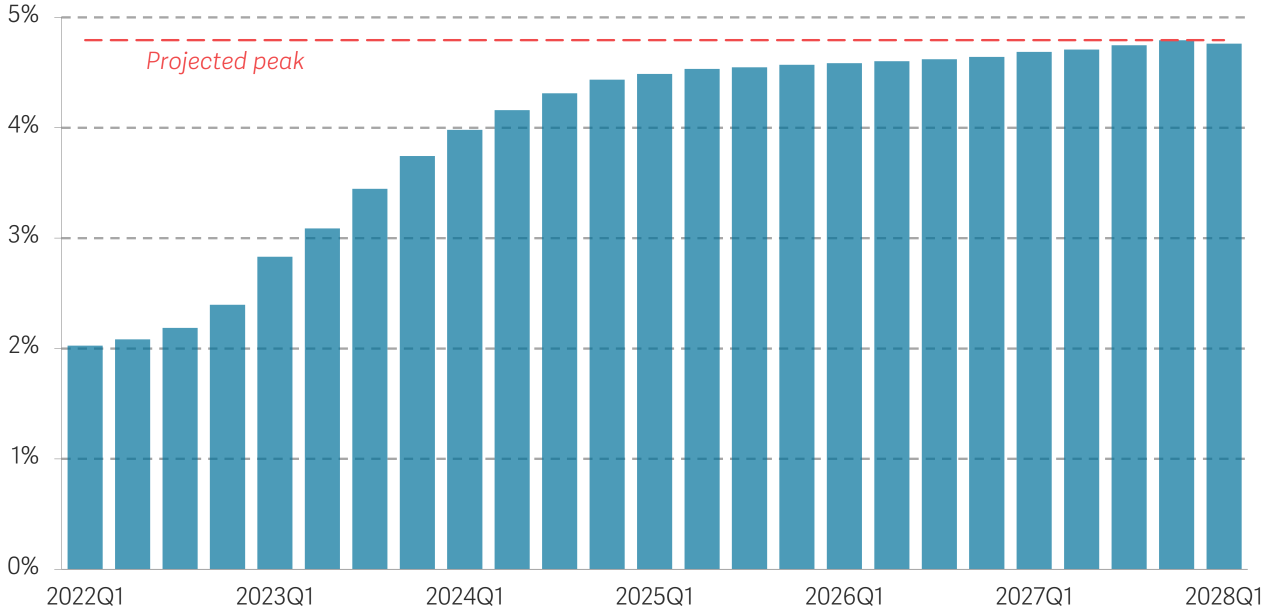
Housing costs are rising

First, as has been much discussed, the rising Bank Rate means that a housing costs are rising for mortgagors, but the widespread use of fixed-rate mortgages means that this is happening gradually, as existing fixed-rate deals come to an end.[11] The average interest rate for all mortgagors was 2 per cent in Q1 2022, and is projected to peak at 4.8 per cent in Q4 2027, and this means that around half (51 per cent) of that shock has now (in Q3 2023) fed through. As Figure 4 shows, however, the impact is rapidly growing and, by the time of a Q4 2024 general election, we estimate around 90 per cent of the rise will have fed through. In aggregate, once we factor in expected reductions in repayments of the principal, annual costs for mortgagors are due to rise by £17 billion relative to Q4 2021 by the end of 2026 (and around £15 billion of this rise will have happened by Q4 2024), while those remortgaging now or in 2024 are projected to see their annual payments rise by around £3,000 on average.[12]

11 More than £9 out of every £10 lent in 2022 was at a fixed rate (96 per cent), compared to around £4 in every £10 (41 per cent) from 2004 to 2006. S Pittaway, The Macroeconomic Policy Outlook Q2 2023, Resolution Foundation, May 2023.
12 S Pittaway, The Mortgage Crunch, Resolution Foundation, June 2023.

FIGURE 4: **The shock to mortgagors continues to roll out**

Average interest rate on the stock of mortgages: UK

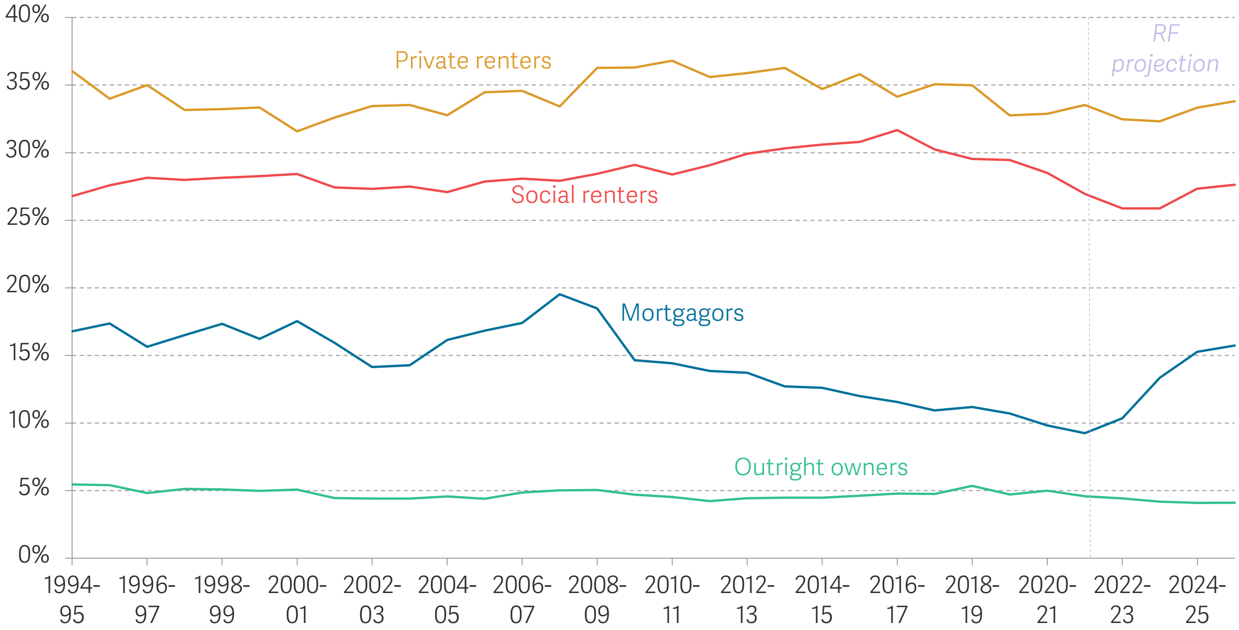


NOTES: Based on market rate expectations on 18 August 2023.
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2023; Bank of England, yield curves.

As a result of this change, the average share of income that mortgagors spend on their mortgage interest (excluding capital repayments) is set to return to levels not seen since before the financial crisis, with an average ratio of 16 per cent in 2025-26 (see Figure 5). These are not high figures in comparison to renters or previous cohorts of mortgagors but it is a rapid change and, as we demonstrate later in this note, a significant headwind for mortgagors’ disposable incomes.

FIGURE 5: **Housing costs are rising for both mortgagors and renters**

Average ratio of housing costs as a share of disposable income, by tenure group: GB/UK



NOTES: GB from 1994-95 to 2001-02. Outright owner housing costs include water, ground rents, service charges and structural insurance.
SOURCE: RF analysis of DWP, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS data; Bank of England, Monetary Policy Report – August 2023; OBR, Economic and Fiscal Outlook, March 2023.

Rising rents are also set to take a toll on disposable income growth. Social rent rises in England are by default capped at CPI plus 1 per cent, which could mean increases of up to 7.9 per cent in April 2024, although the Government did cap the rise in 2023 at 7 per cent. Meanwhile, rapid growth in average pay is helping to push up private rents, with a rise in new rents of around a quarter between January 2021 and May 2023.[13] This will take time to filter through to the average rent paid across all renters, but rental inflation has already risen to 5.3 per cent overall. And it should be stressed that high growth in both average pay and average rents will hide a wide range of experiences, with those renters facing rising rents but not commensurate pay rises put under significant pressure.[14] For lower-income private renters, such pressures are also compounded by the fact that Local Housing Allowances are now frozen, meaning that Housing Benefit and its equivalent in Universal Credit will not rise despite rising rents.

Unemployment is expected to rise

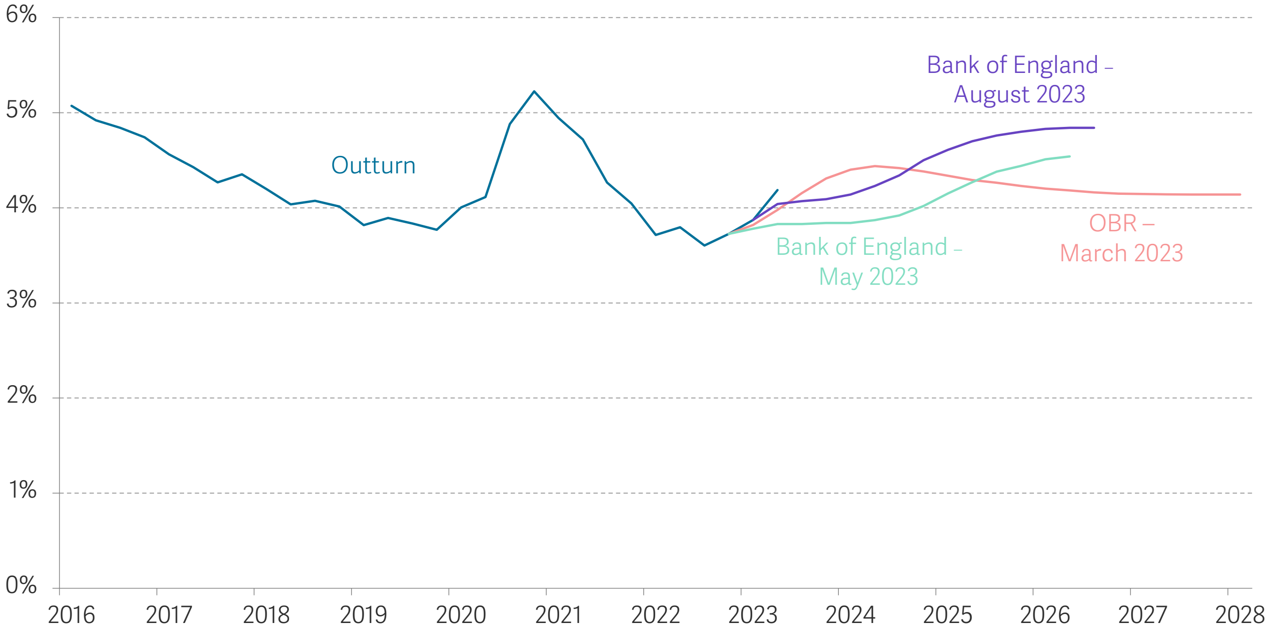
A further headwind to growth may be rising unemployment. This is one facet of a weak outlook for GDP, and so can be seen as a delayed impact from the energy price shock and subsequent Bank Rate hikes. The unemployment rate has risen from a low point

13 ONS, Index of Private Housing Rental Prices, UK: June 2023, July 2023.
14 J Evans & S Collard, Focus on Housing: Exploring the financial wellbeing of different tenure groups in the UK, University of Bristol, June 2023.

of 3.5 per cent in 2022 to 4.2 per cent in Q2 2023 – albeit alongside reduced inactivity rates – and is projected by the Bank to rise to 4.6 per cent by Q1 2025, as shown in Figure 6. While an unemployment rate of 4.6 per cent would still be lower than was ever reached between 1976 and 2016, this still means that around 200,000 more people were unemployed in Q2 2023 than in 2022 on average. Forecasts have often been too pessimistic on unemployment, but the Q2 2023 unemployment rate came out higher than the Bank forecast in August, and the unemployment rate in June has been estimated to be 4.6 per cent – although single month estimates are less reliable.

FIGURE 6: **Unemployment is projected to rise, and has begun to do so**

16+ Unemployment rate: UK



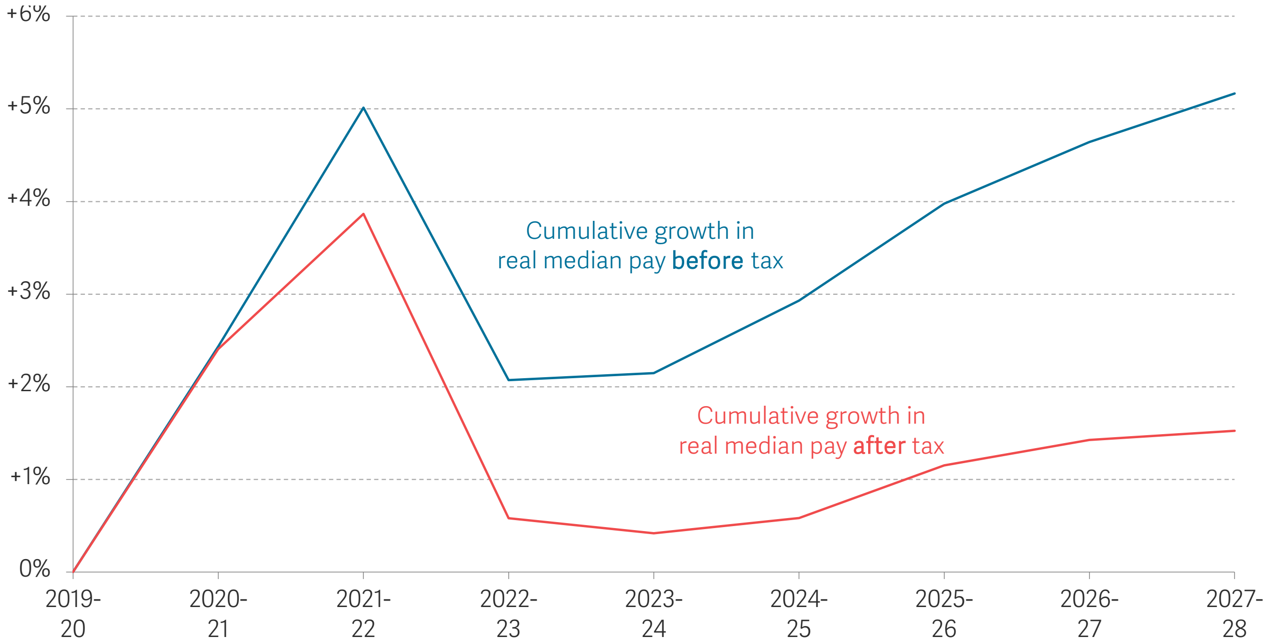
SOURCE: ONS, Labour Market Statistics; Bank of England, Monetary Policy Report, various; OBR, Economic and Fiscal Outlook, March 2023.

Specific tax and benefit policies will have significant impacts

Tax and benefit policy will also weigh on income growth. Tax thresholds are currently frozen until 2028, rather than keeping pace with rapid nominal pay growth. This means that effective tax rates are rising, and so changes in post-tax pay will be much slower than the growth in gross pay. For example, real-terms (CPI-adjusted) gross pay for the median employee is projected to rise by a total of 2.9 per cent between 2019-20 and 2024-25, but real-terms growth in post-tax pay will be just 0.6 per cent, as Figure 7 shows.

FIGURE 7: **Frozen tax thresholds will dampen the already weak outlook for real-terms pay growth**

Cumulative change in median real earnings for employees since 2019-20: UK



NOTES: CPI-adjusted. Median pay in July 2023 was equivalent to around £27,000 a year. Pay figures for 2026-27 and 2027-28 are based on a spliced Bank/OBR series.
SOURCE: RF analysis; ONS; Bank of England, Monetary Policy Report, August 2023; OBR, Economic and Fiscal Outlook, March 2023.

For workers who are auto-enrolled into pension schemes, real growth in take-home pay accounting for pension contributions may be essentially zero over this same period of 2019-20 to 2024-25, as a frozen contribution threshold (Lower Earnings Limit) increases the scale of their contributions. The Government also has an ambition to abolish the auto-enrolment Lower Earnings Limit entirely in the "mid-2020s".[15] This would boost pension saving, which is necessary, but further worsen the outlook for real take-home pay.[16]

Changes in benefits and other cash supports will also shape the living standards outlook. The Cost of Living Payments and other schemes that have operated in 2022-23 and 2023-24 have had a major positive impact on incomes and provided invaluable support for households. In 2023-24, for example, lower-income working-age households can receive up to £900 to help with the cost of living. But no extra support is scheduled to continue into 2024-25.

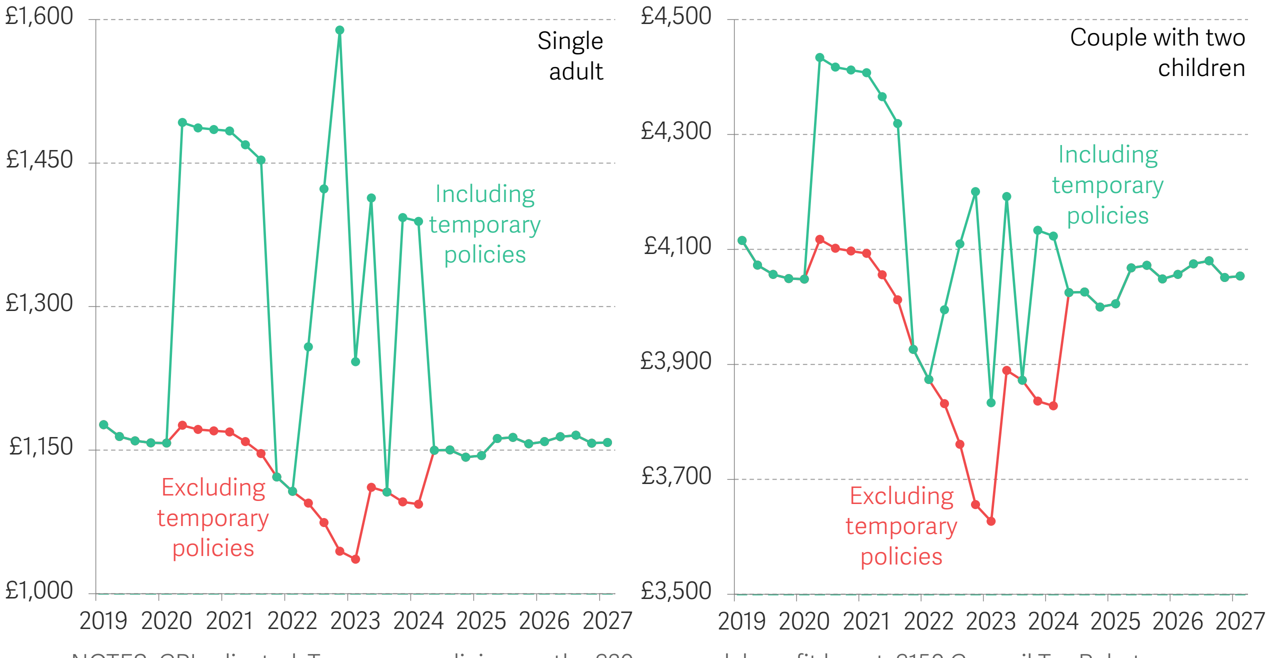
In a sense, one role of the Cost of Living Payments and other schemes has been to tide households over until benefit uprating finally 'catches up' with the higher cost of

15 For example, see DWP, Automatic enrolment review 2017: Maintaining the momentum, December 2017, and DWP, Government backs bill to expand pension saving to young and low earners, March 2023.
16 Auto-enrolment policy is discussed further in: P Brandily et al., Beyond boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023. We do not include any new auto-enrolment policy effects in our household income projections.

living, as Figure 8 illustrates. (There is a strong argument that benefit uprating should be permanently reformed to make this less necessary.[17]) And entitlements to working-age benefits are due to rise by around 6.9 per cent in April, if the Government follows the usual practice of using the rate of inflation in September 2023. But what will be the combined impact of changes in 2024-25? Overall, basic out-of-work support from the benefit system for a single person will fall by 13 per cent (£700) in 2024-25 in real terms, and by 2 per cent (£300) for a couple with two children. The differences between family types reflect the fact that the temporary payments were all flat per-household amounts, and therefore much more important in supporting the income of smaller households. And it is important to note that even if benefit entitlements rise in April 2024 in line with this September's rate of inflation, they will still not return to their 2019-20 real value until April 2025.

FIGURE 8: **Benefits may rise by around 7 per cent in April 2024, but the end of one-off supports means a drop in support from the benefit system overall**

Real basic support per quarter from the benefit system and one-off payments: GB



NOTES: CPI-adjusted. Temporary policies are the £20 per week benefit boost; £150 Council Tax Rebate; £400 Energy Bill Support Scheme; and Cost of Living Payments. Benefits are Universal Credit (prior to any tapering) and Child Benefit.
SOURCE: RF analysis; ONS, Consumer Price Inflation; and Bank of England, Monetary Policy Report, August 2023.

It has been reported that the Government might be considering cuts to benefits, perhaps by not following the usual indexation rules.[18] For example, it might argue that benefits should not rise faster than earnings over the past two years and so, because uprating

17 A Corlett & L Try, The Living Standards Outlook 2022, Resolution Foundation, March 2022.
18 H Yorke, Welfare cuts loom after forecast for inflation to climb again, The Times, August 2023.

was faster than earnings growth in 2023, uprating in 2024 should be below the level of inflation. This logic could mean that, rather than uprating benefits by a projected 6.9 per cent, in line with September's rate of inflation, there could be an increase of just 3.6 per cent, leaving the two-year growth in benefits the same as that in average total pay.

There are very good arguments for permanently uprating working-age benefits in line with earnings,[19] but this argument applies in good economic times (when earnings are growing in real terms), and not just when it reduces spending. Any attempt to reduce working-age benefit uprating in April 2024 should be seen simply as a permanent real cut to working-age benefits, and would only worsen the real cut to support already due to happen in 2024-25 (shown in Figure 8). In the rest of this note, we assume that normal uprating does take place (i.e. the use of the triple lock for the State Pension and a CPI link for most other benefits).

Combining all factors, the outlook for household income growth is poor

Below, we consider all these factors and more to model how disposable incomes are projected to change over the next few years. This uses the DWP's 2021-22 'Households Below Average Income' microdata as a starting point; projects forward earnings and housing costs for all of the population using outturn data (where applicable), the Bank of England's August 2023 forecasts and market-based interest projections; and models the subsequent direct taxes and benefit payments that default government policy would suggest for each year.[20]

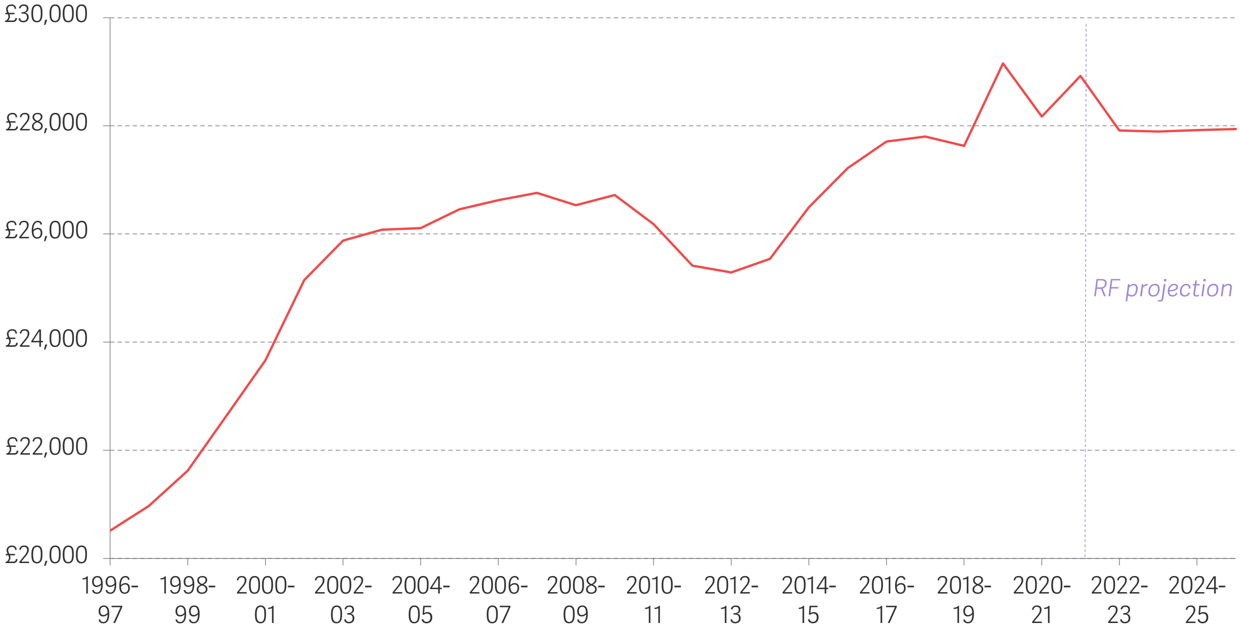
Figure 9 shows past trends in median non-pensioner income and our modelling beyond 2021-22. It should be no surprise that our results show a large real income fall in 2022-23, given the inflation hit set out earlier (official household survey data is not yet available, but average Real Household Disposable Income per capita fell by 1.9 per cent).[21] The typical income then looks likely to have stagnated in 2023-24, leaving a combined two-year income fall of 4 per cent on this measure.

Unfortunately, the outlook currently includes no recovery from that fall: despite falling inflation and the welcome return of real pay growth, our projection is that there will be zero real growth in the median non-pensioner household income in the likely election year of 2024-25. And zero growth is also currently projected for 2025-26, with this three-year stagnation leaving the typical non-pensioner £1,000 a year worse off in 2025-26 than in 2021-22, as Figure 9 shows.

19 M Brewer et al., Sharing the benefits: Can Britain secure broadly shared prosperity?, Resolution Foundation, July 2023.
20 More details can be found in previous Living Standards Outlooks, the latest being: M Brewer, E Fry & L Try, The Living Standards Outlook 2023, Resolution Foundation, January 2023.
21 ONS, Quarterly sector accounts, UK: January to March 2023, June 2023.

FIGURE 9: **No household income growth is projected for 2023-24, 2024-25 or 2025-26**

Real median non-pensioner equivalised household disposable income, after housing costs, in 2022-23 prices: GB/UK



NOTES: GB from 1996-97 to 2001-02. Inflation-adjusted using CPI excluding housing costs.
SOURCE: RF analysis of DWP, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

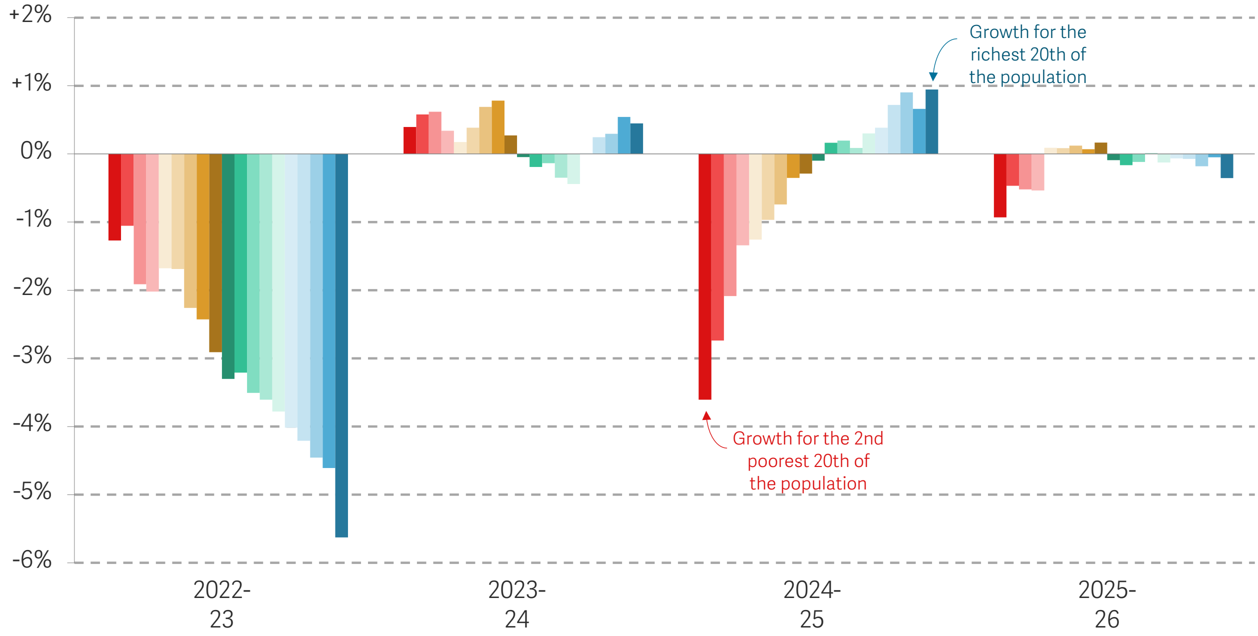
This is not dissimilar from the Bank of England's own forecast for mean 'real post-tax labour income', which – if we adjust for population growth – is -0.5 per cent for calendar year 2023; 0.3 per cent for 2024 and 0.1 per cent for 2025, flatlining over the three years as a whole.[22]

Looking beyond mean and medians, however, the living standards outlook is very different for different income groups. In 2022-23, low-income households were relatively protected, due to the various forms of temporary support (the Council Tax Rebate, the Energy Bill Support Scheme and the Cost of Living Payments). In 2023-24, the combination of recovering real earnings and an extension of the Cost of Living Payments, among other factors, likely meant that real incomes were relatively stable across the income distribution. But in 2024-25, we project a stark income gradient to the changes in living standards, with a fall of 1 per cent for the lower-income half of the non-pensioner population, but a 1 per cent rise on average for the top half. Indeed, for the poorest quarter, a projected income hit of 3 per cent would be bigger than (and additional to) the 2022-23 shock.

22 Bank of England, Monetary Policy Report - August 2023.

FIGURE 10: **Living standards are projected to fall for lower-income households in 2024-25**

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 projection including use of the IPPR Tax Benefit Model; DWP, Households Below Average Income; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

It should be noted that this assessment of real household incomes assumes that different groups face the same rate of (non-housing) price inflation. However, we know that inflation rates have been higher for lower-income households for a while now: the inflation shock has been driven by energy and food, and these form larger shares of the budgets of low-income households than high-income households. We estimate that CPI inflation peaked at 12.5 per cent for the lowest-income decile in October 2022, but only 9.6 per cent for the top-income decile.[23] This inflation gap is now shrinking, but it remains to be seen whether it will at some point reverse and bring long-term inflation rates for different groups back into alignment.

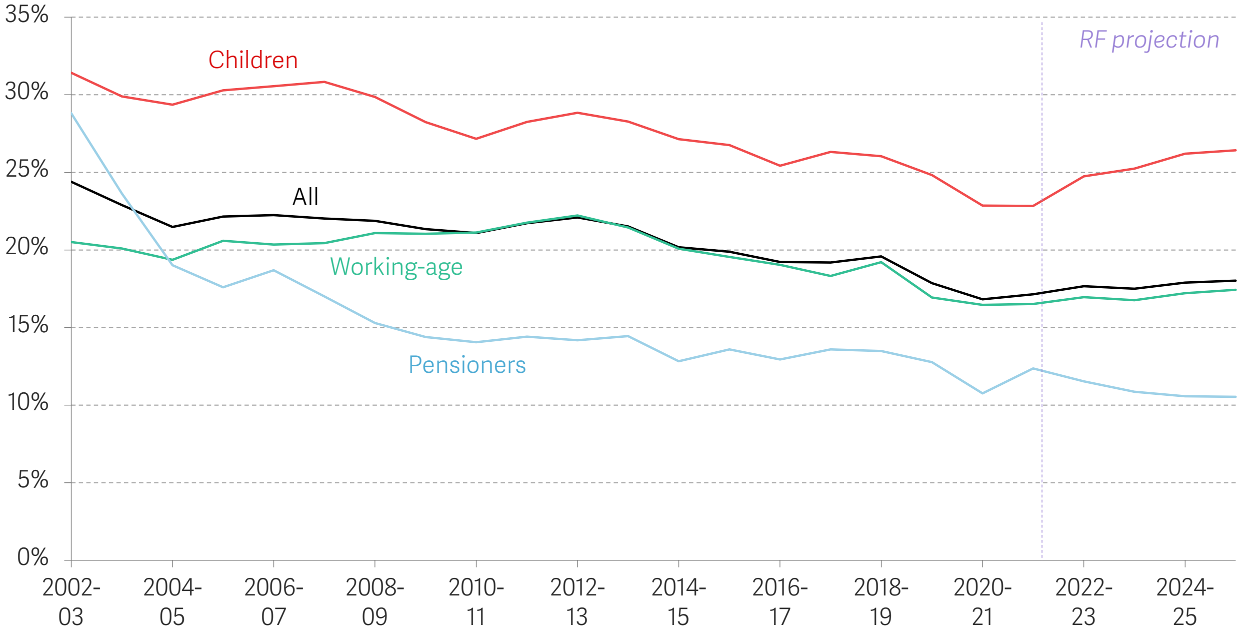
Declines in real income are also reflected in the outlook for absolute poverty. The number of people living in absolute poverty (i.e. below 60 per cent of the 2010-11 median income in real-terms) is projected to rise by 300,000 next year, from 11.7 million in 2023-24 to 12.0 million in 2024-25. The projected rate of 18 per cent overall (Figure 11) would be the same as in 2019-20, reflecting the protection that the benefit system will have delivered. But within this, pensioner poverty is forecast to fall while the proportion of children living in absolute poverty (and relative poverty – not shown) is projected to rise more strikingly,

23 Resolution Foundation, Cost-of-living gap between rich and poor hits fresh high, as effective inflation rate for low-income households hits 12.5 per cent, November 2022.

although note that the Government's significant £5 billion a year boost to childcare entitlements, rolling out in 2024 and 2025, does not show up in this standard definition of income.

FIGURE 11: **Absolute poverty rates are projected to worsen rather than improve**

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

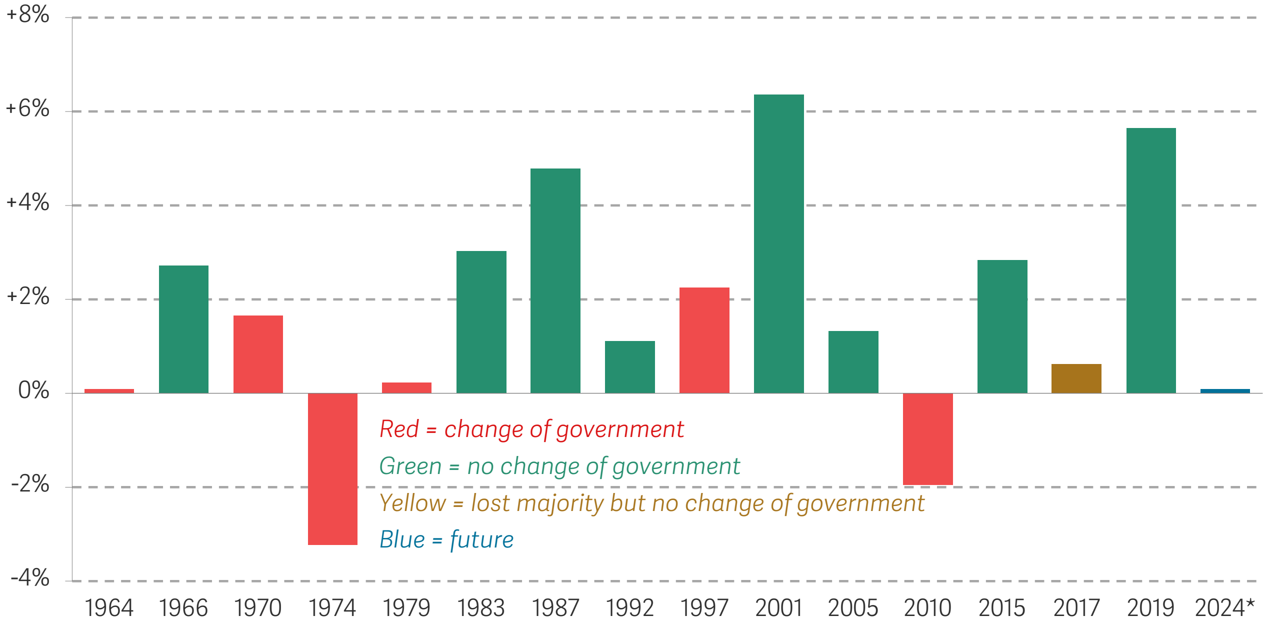


NOTES: Some Department for Work and Pensions poverty numbers are expected to be revised in 2024 / 2025.
SOURCE: RF analysis of DWP, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

For the current Government, this does not make an ideal backdrop for a general election. Since the 1960s, when comparable data on household incomes began, 1974 and 2010 are the only election years that recorded weaker income growth than what is forecast for 2024-25 (using the non-pensioner median), and both years featured changes of government – as did 1964, which recorded zero income growth. The counter-example of 1997, in which there was healthy income growth but still a big swing against the government, should show that such short-term metrics are not electoral destiny, but it is clear that the outlook presented above is hardly likely to aid the incumbent government's fortunes.

FIGURE 12: **Although the number of data points is limited, no government on record has retained power with such weak election year income growth**

Single-year real change in median non-pensioner equivalised disposable income, after housing costs: GB/UK



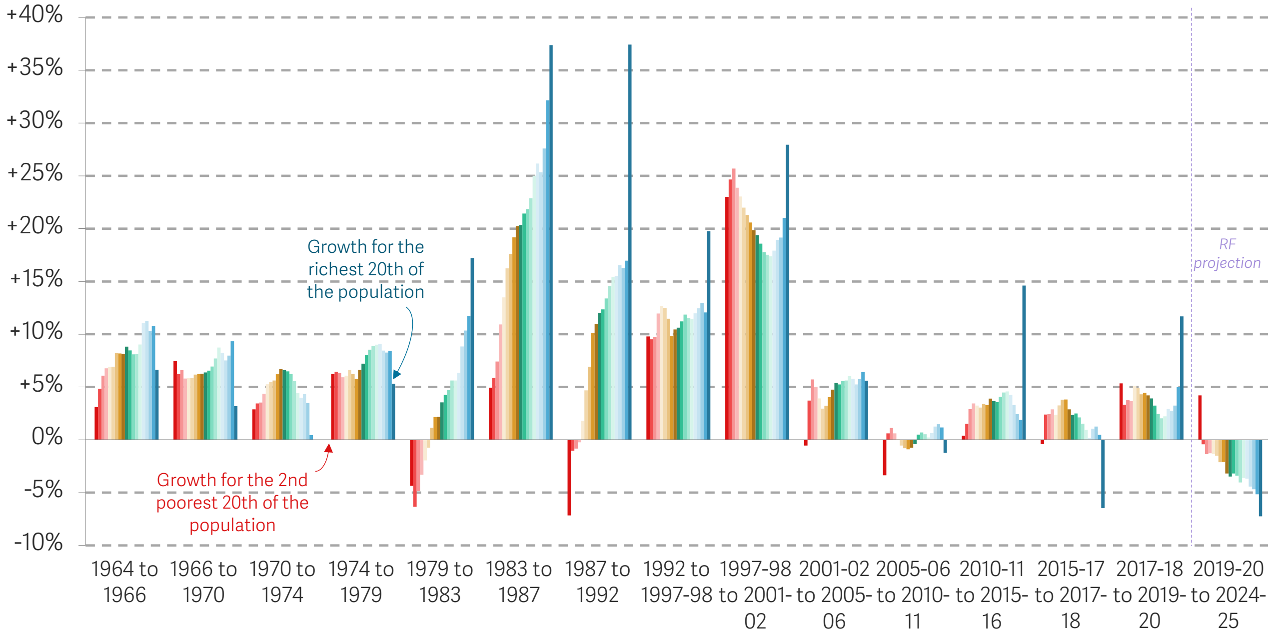
NOTES: GB from 1994-95 to 2001-02. We treat the two elections of 1974 as one.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

Estimates of changes in income in individual years can be volatile, but we can more robustly assess growth over entire parliaments. Overall, as Figure 13 shows, the median non-pensioner is projected to be 4 per cent poorer in 2024-25 than in 2019-20, making this the worst parliament for income growth since at least the 1960s. Additionally, separate data on average Real Household Disposable Incomes suggests strong growth during the parliaments of 1955-1959 and 1959-1964.[24] This conclusion also aligns with the OBR's last round of income forecasts.[25] As we noted as far back as 2021, if the question of "are you better off today that you were five years ago?" is raised in 2024, the answer looks increasingly likely to be "no" on these measures.[26]

24 A Corlett, Are you better off today?: Real income growth under different governments since 1955, Resolution Foundation, November 2021.
25 T Bell et al., We're going on a growth Hunt: Putting the 2023 Spring Budget in context, Resolution Foundation, March 2023.
26 A Corlett, Are you better off today?: Real income growth under different governments since 1955, Resolution Foundation, November 2021.

FIGURE 13: **The projected fall in real incomes between 2019-20 and 2024-25 would make this the worst parliament on record for growth**

Real median non-pensioner equivalised household disposable income, after housing costs, CPI adjusted to 2022-23 prices: GB/UK



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group. We do not try to estimate growth over the February to October parliament of 1974. GB from 1994-95 to 2001-02.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

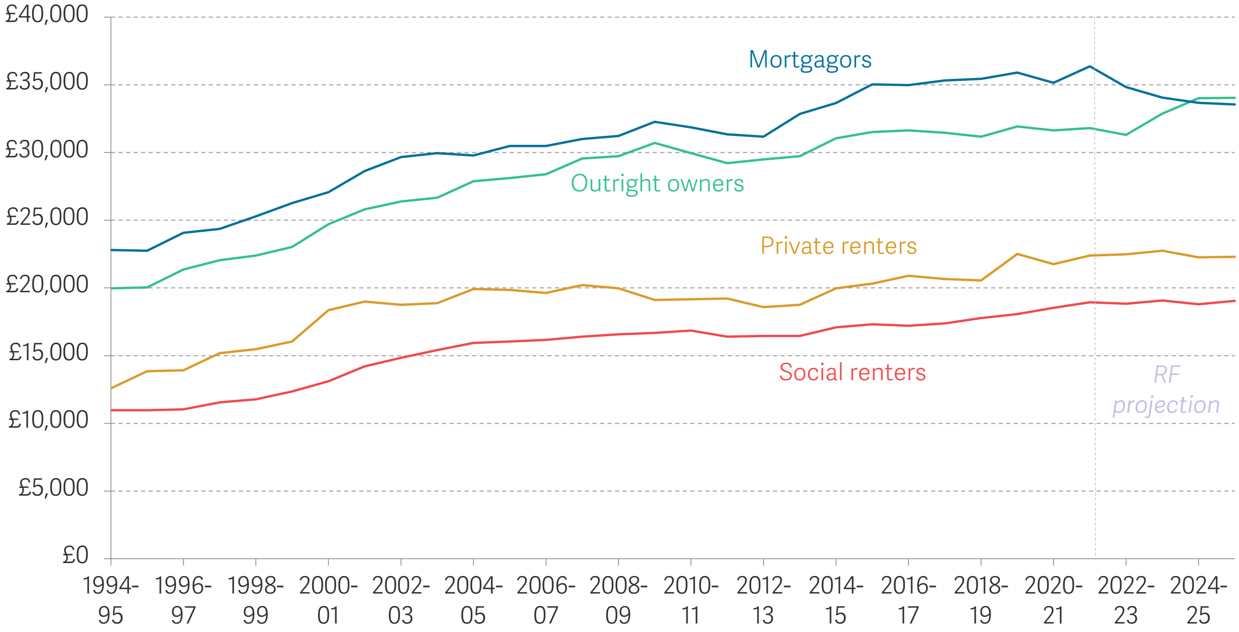
But rate rises and other factors produce a mix of winners and losers

The overall outlook for household income is, then, poor. But, beyond growth differences across the income distribution, some groups are more likely to be winners or losers, particularly given the scale of changes in interest rates.

Thanks to the large mortgage interest rate rises set out earlier, the outlook is, unsurprisingly, particularly bad for mortgagors. The typical disposable income of mortgagors is projected to be 7 per cent (£2,700) lower in 2024-25 than in 2021-22. The real incomes of renters are projected to be slightly down (-1 per cent) over the same period, while – in contrast – the typical outright homeowner is projected to be left 7 per cent (or £2,200) better off.

FIGURE 14: **Mortgagors' disposable incomes are falling as interest rates rise, while the incomes of outright owners are projected to reach new highs**

Real median equivalised household disposable income, after housing costs, by housing tenure, CPI adjusted to 2022-23 prices: GB/UK



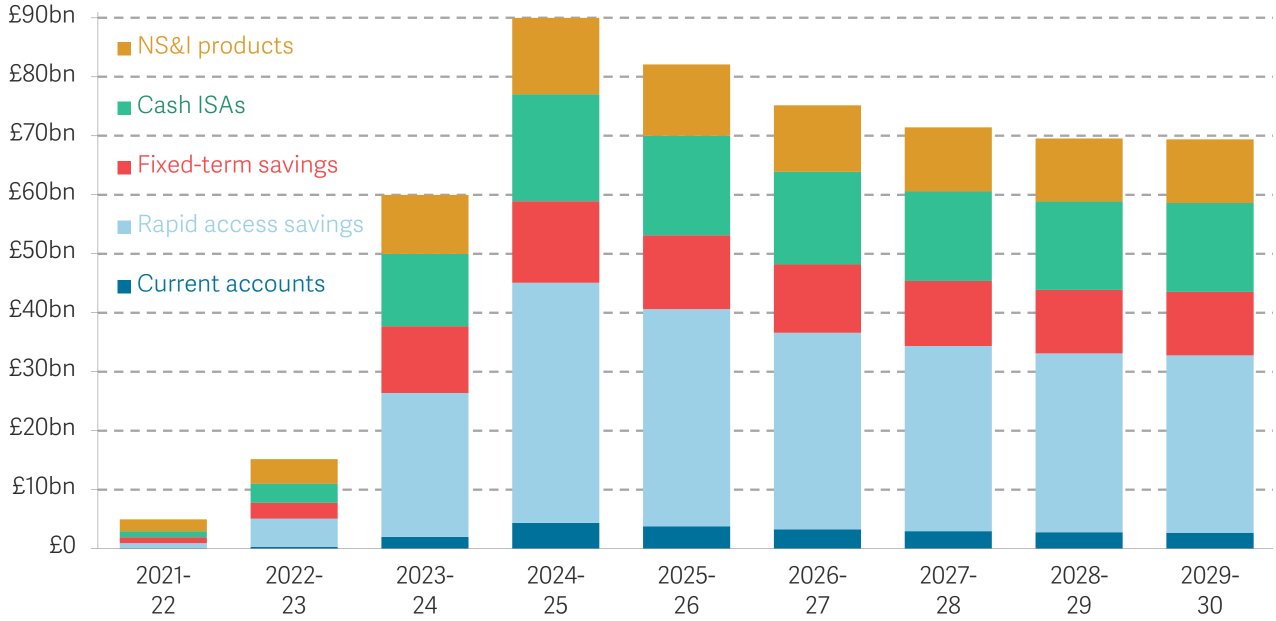
NOTES: GB from 1994-95 to 2001-02.
SOURCE: RF analysis of DWP, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

However, the impact that a higher Bank Rate has directly on incomes, via an increase in interest on savings, is even more significant.[27] Bank of England data shows that households had £1.7 trillion of interest-bearing savings in 2022-23 (including interest-bearing current accounts, savings accounts, cash ISAs, and National Savings and Investments products such as premium bonds). Combining this data with projections for the average interest rates that savers will actually receive, we project that total (pre-tax) interest income will reach £90 billion in 2024-25 – equating to over £3,000 per household on average – up from £5 billion in 2021-22.[28] As shown in Figure 15, this is a rapid rise in interest income in 2023-24 and 2024-25, producing a material impact on our income growth forecasts for those years. Current market forecasts imply that this income will then fall over the rest of the 2020s.

27 Interest paid on loans excluding main homes is not included in our modelling or income definition, except for an assumption about landlords' net incomes, which will be affected by the rate they pay on any buy-to-let mortgages.
28 This includes judgements about how average interest rates will move relative to Bank Rate. For example, we assume that the average rate on rapid-access savings accounts will be 1 percentage point below Bank Rate. We also assume that 40 per cent of current account savings remain non-interest-bearing, as suggested by combining Bank statistics and WAS data.

FIGURE 15: **Higher interest rates will deliver a £90 billion boost to savers in 2024-25**

Projected total pre-tax income from savings interest: UK



NOTES: Based on Bank statistics for the stock of savings up to July 2023, August 2023 market-implied Bank Rate projections, and RF projections for spreads. We assume that interest is re-invested but do not account for other potential future increases in savings.
SOURCE: RF analysis of Bank of England data.

Of course, this windfall will not be distributed equally. We estimate that the tenth of households with the most savings wealth will account for two thirds (65 per cent, or nearly £60 billion) of savings interest in 2024-25, receiving an average of £20,000 each, before tax. In contrast, the half of households with the lowest savings will receive only 2 per cent of the additional income, or around £100 each, on average.

The importance of savings income will also vary across the income distribution, although our modelling suggests that this variation is not nearly as stark as the aforementioned inequality in savings, because (for example) some low-income households have substantial savings. Although there are significant uncertainties in assessing the distribution of future savings income, which we discuss further in Box 1, it is clear that the effect will be large across the distribution. In our modelling, the rise in savings interest since 2021-22 boosts the typical non-pensioner income by 4 per cent in 2024-25: a very large effect relative to our overall outlook. The boost is slightly smaller for lower-income households (3 per cent towards the bottom of the income distribution) and larger for higher-income households (5 per cent near the top). It should be stressed again that for very many households, the scale of the interest boost will be far smaller than these numbers suggest. Still, the large gains for households with substantial savings will impact on a wide range of income statistics.

BOX 1: Difficulties in measuring and modelling UK savings income

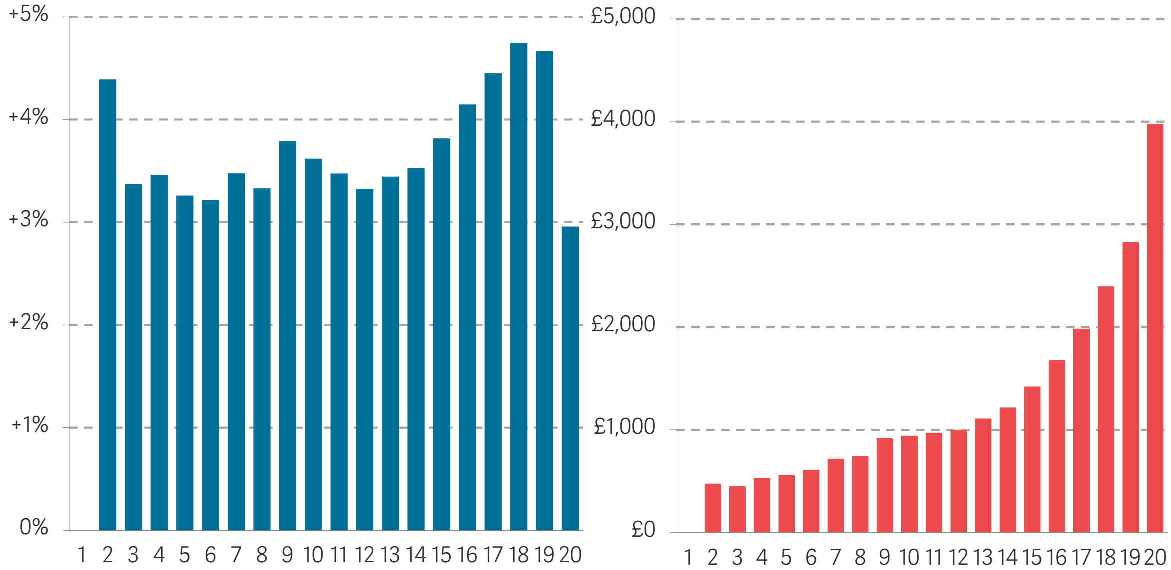
Bank of England data can give a relatively clear answer about the scale of savings and savings interest overall, as presented in Figure 15. However, it is much harder to know with precision how this income will be distributed across the population. This was not a substantial problem when interest rates were very low, but the scale and speed of the recent interest rate rise makes this an important research question.

Our forecasts make use of the Wealth and Assets Survey (WAS) April 2018 to March 2020 (Round 7), which records various forms of households' savings. We scale up the implied totals to account for the known growth in savings per household between 2018-20 and 2022-23. When doing this, we assume that this growth was equal across the income distribution, although rough indicators suggest that higher-income households were more likely to increase their savings over this period.[29] We then impute projected savings interest from WAS into our Family Resources Survey (FRS)-based modelling, using household income, age and other factors.[30] We also account for Income Tax on some savings income (although we do not assume any behavioural changes in the product make-up of taxpayers' savings to minimise tax as interest rises). Figure 16 shows our final estimates of the impact of the savings interest rise (compared to a continuation of 2021-22 interest rate levels) on non-pensioner disposable incomes across the income distribution in 2024-25.

29 See Figure 2 in M Broome, I Mulheirn & S Pittaway, Peaked Interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.
30 Previous Living Standards Outlooks have used an FRS-based approach without this WAS imputation.

FIGURE 16: **Higher savings interest is projected to have a major average impact on disposable incomes across the distribution**

Modelled average impact of increased savings income (net of Income Tax) in 2024-25, by non-pensioner income vigintile, relative to disposable incomes after housing costs (left) and in cash terms (right): UK



NOTES: Impacts relative to a continuation of 2021-22 interest levels. In comparison to Bank statistics, around one third of aggregate savings are missing from WAS 2018-20 and we do not attempt to correct for that: our figures are therefore conservative. 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, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

Our view is that this method, if anything, may understate the true impact of higher interest rates on households' incomes overall. This is because aggregate savings recorded in the WAS 2018-20 are about one-third lower than suggested by comparable Bank statistics. However, in the absence of information about whose savings are underestimated, we do not attempt to correct for that in our disposable income modelling. On the other hand, our projections might be including more savings interest than household income surveys, such as the FRS, will in the future pick up, given that survey respondents may not know how much interest they have received. To the extent that interest is under-recorded, recorded income growth in 2023-24 and 2024-25 may also be under-estimated. In addition, while Survey of Personal Incomes taxpayer data is used to correct household survey data for high-income individuals, this data suffers from the complete exclusion of non-taxable savings income such as within cash ISAs. As we have noted in previous work, attempts should be made to remedy this.[31]

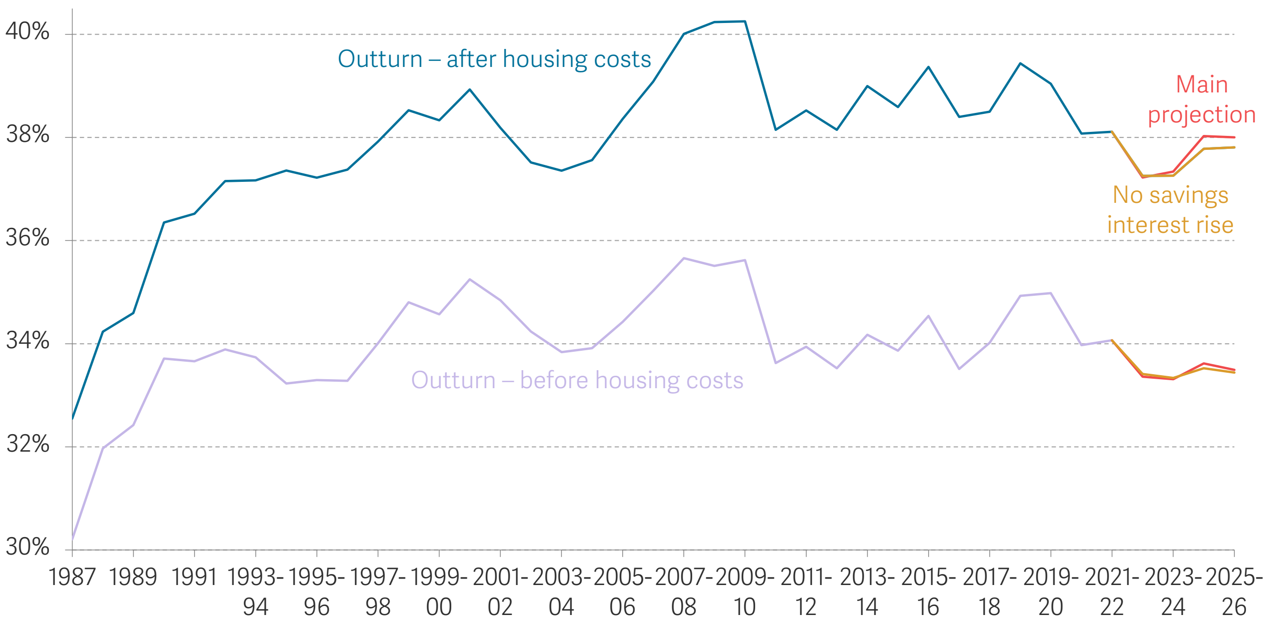
31 A Corlett, A Advani & A Summers, Who gains? The importance of accounting for capital gains, Resolution Foundation, May 2020.

The variation in this average savings income boost relative to incomes can also be seen in projections of the Gini measure of inequality. As Figure 17 shows, the inclusion of savings interest raises income inequality slightly over the projection period, using our preferred measure of incomes after housing costs (but not using incomes before housing costs). Overall, income inequality is projected to rise sharply in 2024-25, but this can be seen as undoing an equally sharp fall in inequality in 2022-23 (as illustrated earlier in Figure 10), leaving little net change since 2021-22.

However, as well as considering how cash incomes are affected, a broader assessment of the effects of rate rises on inequality overall must recognise other impacts, such as how higher rates are affecting the values of many assets: recent Resolution Foundation work suggests that over £2 trillion of household net worth has already been wiped out, and high inflation has also reduced the real value of people's savings.[32]

FIGURE 17: **Inequality is projected to have fallen in 2022-23 and to rise in 2024-25, in part due to savings interest**

Gini coefficient of income inequality: GB/UK



NOTES: GB from 1994-95 to 2001-02. Projected levels depend on the recorded level in 2021-22, noting that separate ONS data shows a rise in income inequality in 2021-22.
SOURCE: RF analysis of DWP and IFS, Households Below Average Income, and RF projection including use of the IPPR Tax Benefit Model; ONS, Wealth and Assets Survey; ONS data; Bank of England forecasts; OBR forecasts.

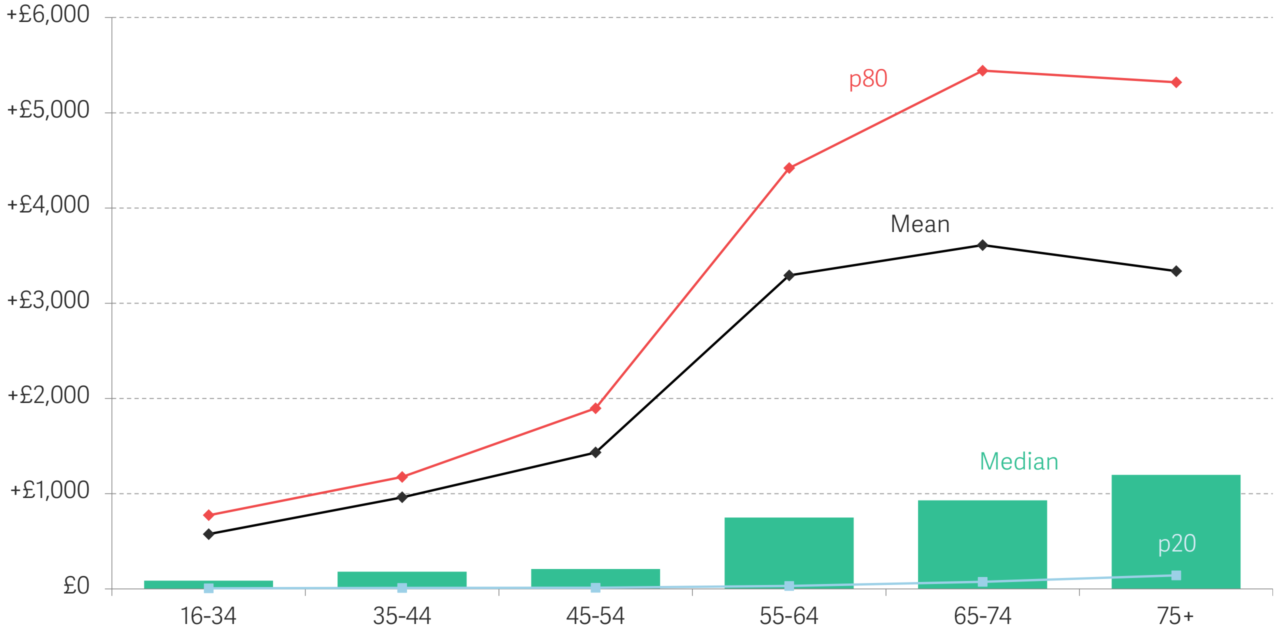
32 M Broome, I Mulheirn & S Pittaway, Peaked Interest?: What higher interest rates mean for the size and distribution of Britain's household wealth, Resolution Foundation, July 2023.

Given the distribution of savings, higher interest income will also benefit some age groups more than others. For example, as shown in Figure 18, households aged under 35 are projected to receive £700 in 2024-25 on average, while 65-74 year olds will receive £3,600 – or six times as much.[33]

Again however, the distribution of savings within every group varies greatly. Over 70 per cent of households within each age group will see less than the mean income boost, with the median gain being far lower: e.g. £1,200 in the case of 65-74 year olds. Nonetheless, although we do not present overall pensioner income forecasts, savings interest is clearly set to be a new important contributor to differences in income growth between pensioners and other age groups.

FIGURE 18: **Higher savings interest will be of far more benefit to older households, although savings also vary greatly within age groups**

Imputed change in post-tax savings interest income between 2021-22 and 2024-25, by age of eldest household member: UK



NOTES: In comparison to Bank statistics, around one third of aggregate savings are missing from WAS 2018-20 and we do not attempt to correct for that: our figures are therefore conservative.
SOURCE: RF analysis using ONS, Wealth and Assets Survey 2018-20; Bank of England data; DWP, Households Below Average Income.

33 In contrast to the £3,000 average implied by Figure 15, these values are post-tax and do not attempt to account for the known under-estimate of savings in WAS relative to Bank data, discussed in Box 1, as we do not know the age distribution of the missing savings.

Conclusion

We are moving into a big year politically. But it is also set to be another notable year for living standards as the cost of living crisis evolves. For some, household incomes may now grow. But there is little sign of relief for those most at risk of harm from the rising cost of living, and policy makers should not be entirely distracted from this challenge by the upcoming election. Tightening monetary policy means that there is no easy fix for the immediate living standards outlook overall, but additional targeted support needs to be considered. Certainly, a forecast of rising and deepening poverty should not be compounded by new benefit cuts – as has been mooted.

For the longer-term, with incomes in 2025-26 currently projected to be lower than in 2019-20 (by 4 per cent), there is clearly as much need as ever to secure strong, shared growth, and our Economy 2030 Inquiry is setting out a policy agenda that would help achieve that.[34] The current living standards outlook is not an ideal one politically for the current Government, but the relationship between incomes and politics is a two-way street, and good policy can help to deliver sustainably rising incomes and falling poverty.

34 See https://economy2030.resolutionfoundation.org/reports/

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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