From merry Christmas to a messy new year

What 2024 has in store

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2024 is going to be messy, for our living standards not just politics. The past two years have been dominated by rising energy and food bills, with everyone affected. It will be very different in 2024. Inflation falling back faster than expected means many will benefit from rising real wages. But politicians tempted to claim happy days have arrived should be cautious – it won't feel like that for everyone.

Higher interest rates actually made households better off in 2023 – higher returns on savings outweighed higher mortgage bills, raising household incomes by £16 billion. But the reverse will be true in 2024, as 1.5 million mortgagors see their annual bills rise by an average of £1,800. Millions of renters will also face big hits when it comes to housing costs – only outright owners will see strong living standards growth.

A New Year resolution to cut taxes (National Insurance cuts arrive on 6 January) won't last, with April's tax threshold rises cancelled – the net effect will be a tax cut for the top half of earners, and tax rises (or no change) for the bottom half. Overall, the richest half of Britain is likely to see incomes rise in the next financial year, but poorer households will see income falls, as targeted cost of living support comes to an end.

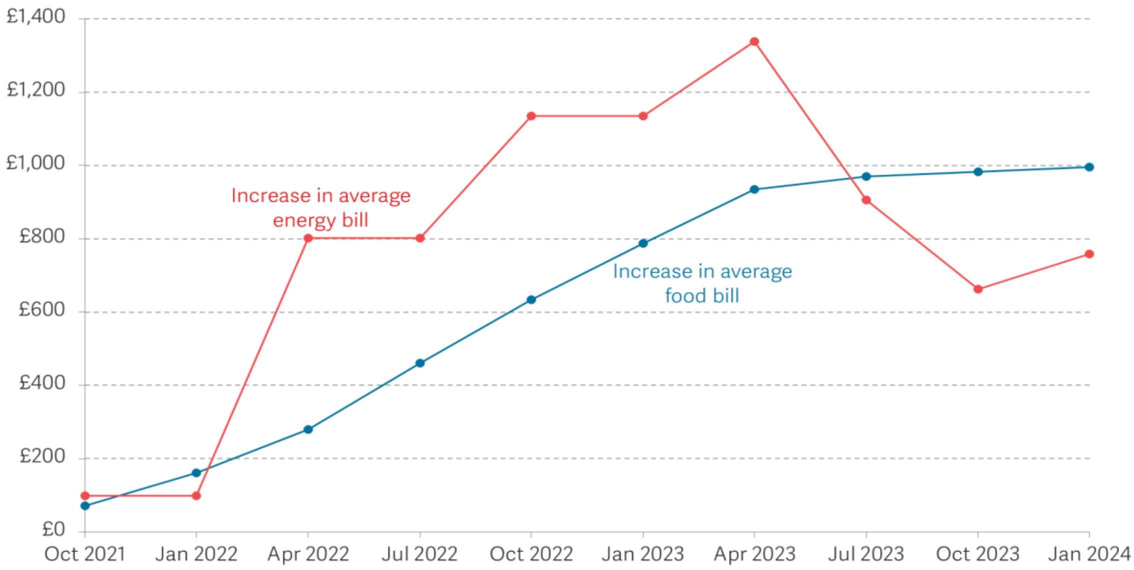
This mixed picture will present challenges for politicians trying to paint in primary colours in a critical election year. But the living standards story for the parliament as a whole is far simpler: British households will, for the first time on record, be poorer at the end of a parliament than at its start.

A messy 2024 lies ahead of us – not just politically, but for our living standards

The big macro story of 2023 was inflation rising far higher than forecast (the Bank of England has a review into that) before falling faster than expected (no new review has been announced yet…). The economic data year ended on a high note, with CPI inflation falling to 3.9 per cent in November, 0.7 percentage points lower than the Bank expected just last month. After a terrible two years for price rises, the journey from double digit to sub-four per cent inflation in just eight months was a Christmas present well worth having.

Britain's inflation journey, and the cost of living crisis to date, in part reflects fast-rising energy, and then food, prices. As we enter 2024, the average annual food bill will remain £1,000, and the average energy bill £760, higher than they were pre-pandemic, as Figure 1 shows. Everyone has to heat their home and put food on the table, so the core of the cost of living crisis has affected us all – though poorer households, who spend a greater share of their budgets on essentials, have been hit hardest.

Figure 1 **Food and energy bills are significantly higher today than in 2019-20**
Average increase in annual household spending on food and energy since 2019-20: UK



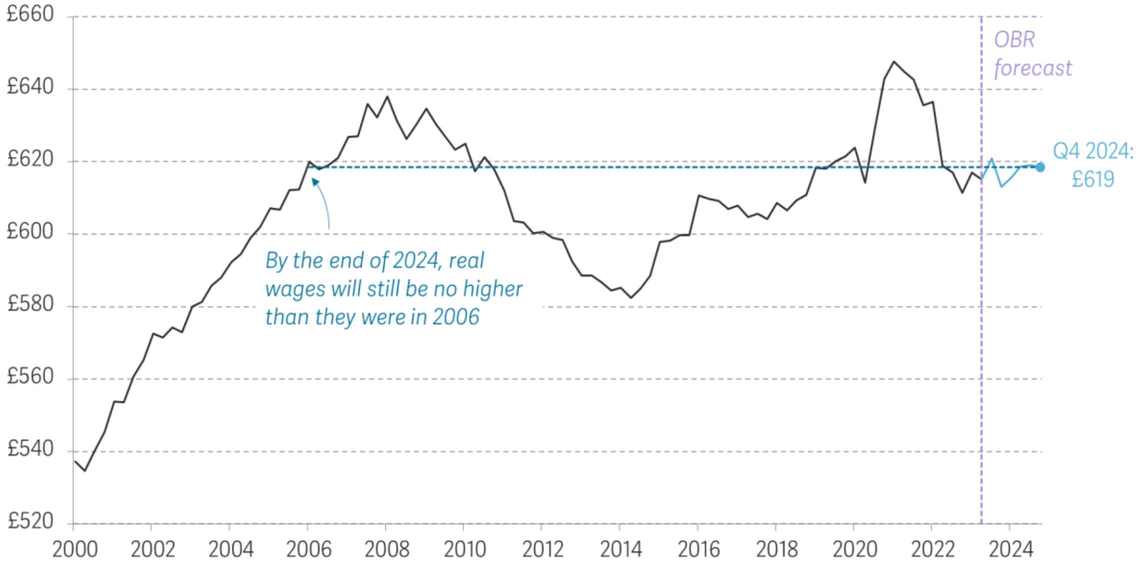
Notes: Q4 2022 and Q1 2023 data include £400 energy bill discount. Data is for annual household consumption, using the prices in each quarter. Consumption baskets are held fixed from 2019-20. Q4 2023 food bill data uses the average of October and November's food inflation rates, and Q1 2024 uses the Bank of England's forecast.
Source: RF analysis of ONS, Living Costs and Food Survey; Bank of England, Monetary Policy Report, November 2023; ONS, Consumer Price Inflation; Cornwall Insight, Energy Price Cap forecast.

Supporting recent inflation falls are the fact that food prices are no longer rising – and energy bills have fallen (and could fall another 14 per cent in April). Different forces instead are moving centre-stage in driving living standard developments. The shared nature of the crisis will evolve into a far more variable one in 2024, with a complex mix of winners and losers for politicians to communicate with in an election year.

Pay packets are growing again

Let's start with the biggest chunk of income. Nominal pay growth is now slowing, but inflation has been falling faster. So real pay growth has returned: the Office for Budget Responsibility (OBR) expects real earnings to grow by just shy of 1 per cent over 2024. This is welcome progress, even if it would still mean workers going into a late 2024 election with real wages lower than they were in 2006 (see Figure 2). Low earners will see bigger pay rises again. The National Living Wage will rise by 9.8 per cent in April – with increases up to 21 per cent in the minimum wage youth rates.

Figure 2 **Real wages are expected to be no higher in 2024 than they were in 2006**
Real average weekly earnings, outturn and OBR forecast: UK



Notes: Deflated to 2023-24 prices using CPI. Forecasts are calculated from successive OBR forecasts of average earnings and CPI, and indexed to the latest Average Weekly Earnings (regular pay) outturn available at the time of the relevant Economic and Fiscal Outlook. OBR's CPI forecasts have been seasonally adjusted.
Source: RF analysis of ONS, Labour market statistics; ONS, Consumer price inflation; OBR, Economic and Fiscal Outlook, various.

So, does the return of real wage growth mean a universal return to rising incomes as inflation falls back? Not so fast. The outlook for living standards – like life – is more complicated.

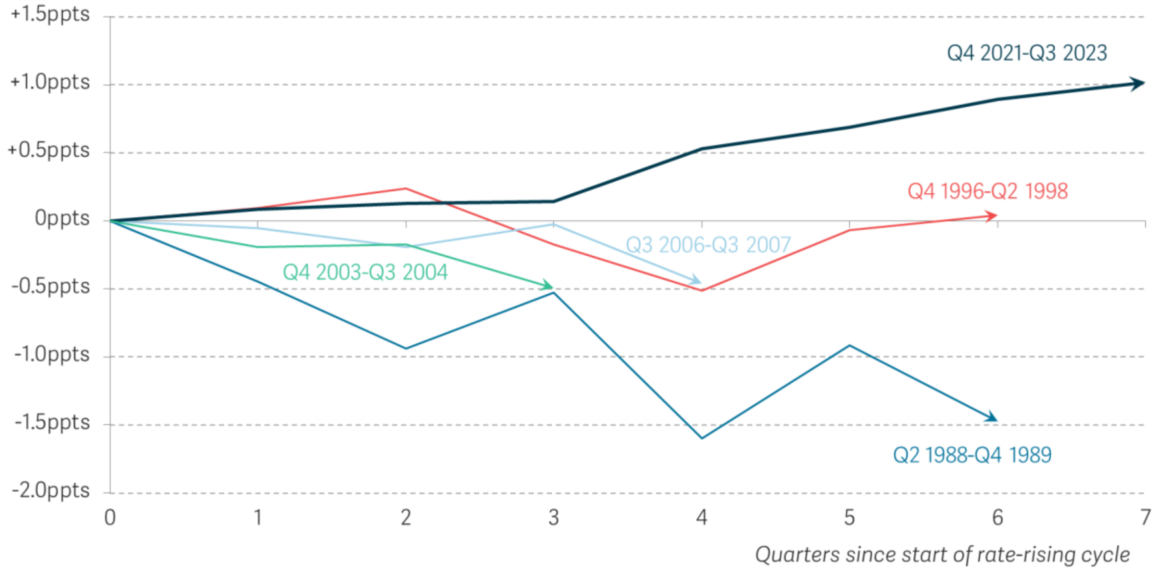
The impact of interest rates is interesting

Here comes the techy bit, concentrate. Interest rates are up a lot, with August's rise to 5.25 per cent looking to have capped the biggest rate-rising cycle in more than three decades. But financial markets have rate cuts of 1.34 percentage points pencilled in by the end of 2024. If rate rises are behind us and cuts are ahead, you'd be forgiven for thinking this means a boost to income growth next year. Forgiven, but probably wrong.

What has largely been missed is that rising interest rates have actually boosted household disposable incomes in 2023. Why? Because British households don't have as much debt as they used to, and higher incomes for savers have arrived quicker than higher costs for borrowers (thanks to fixed-rate mortgages). For British households as a whole, annualised real income from savings interest is actually up £34 billion since the Bank of England started raising rates, almost twice the £18 billion increase in debt interest costs. This £16 billion net interest income boost amounts to 1 per cent of households' disposable income. This is not normal (or remotely equally shared); in fact, it's unprecedented in the recent history of UK rate-rising cycles, as shown in Figure 3.

Figure 3 **For the first time, higher rates have boosted households' net interest income**

Change in household sector net interest income as a proportion of gross household disposable income, during rate-rising cycles of at least one percentage point and at least six months in duration: UK



Notes: For each cycle, its line ends in the final quarter in which there was a Bank Rate rise. Net interest income is calculated as interest resources minus interest uses for the household sector. For both resources and uses, the measure used are before financial intermediation services indirectly measured (FISIM) which captures the actual levels of interest paid and received by households.
Source: RF analysis of ONS, Economic accounts.

Housing cost are moving centre-stage

So, households have had the good news from higher rates (lucky savers), but much of the bad news is to come – interest rates will move from boosting income growth to undermining it in 2024, as another 1.5 million households re-mortgage. They will face an average annual housing costs rise of around £1,800, even accounting for markets now expecting earlier rate cuts. Bear this in mind when you read news stories saying 'homeowners will benefit from a fall in mortgage rates' – what they mean is that the increases in people's mortgage bills won't be as painful as they would otherwise have been. I'd gently suggest they won't feel like they're 'benefiting' as their mortgage bill rises by hundreds of pounds a month.

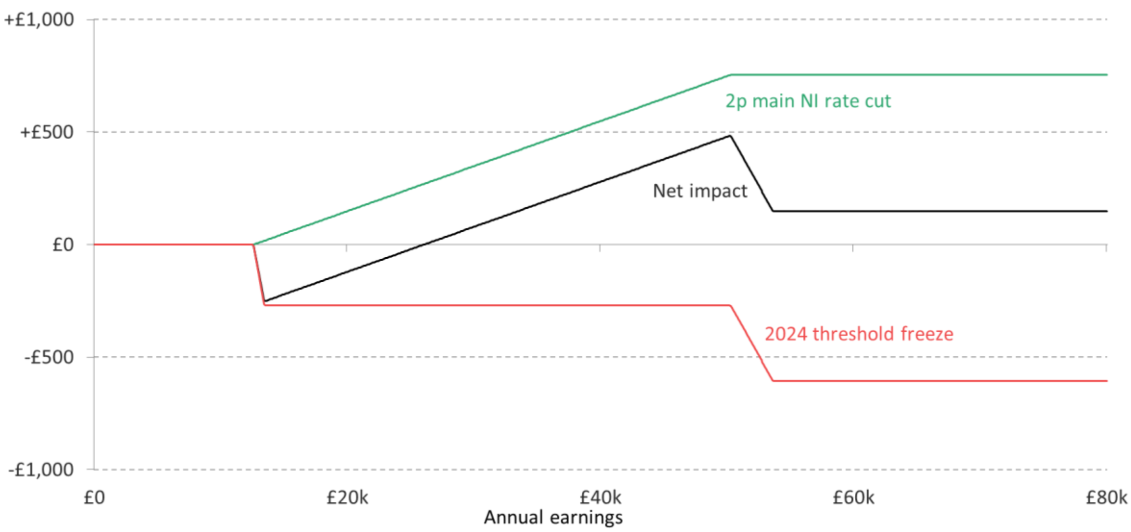
This is part of a wider story of housing costs moving centre-stage. Those mortgagors affected face the biggest hits – but renters are much more likely to see some housing cost rise as rents respond to the recent high nominal earnings growth (for private renters) or inflation (for social renters), continuing the late 2023 pattern. Outright owners, meanwhile – now the single largest tenure – are completely protected. This will make a real difference to who wins and loses in 2024. Living standards growth is likely to be strongest for outright owners (2 per cent), while mortgagors face the largest income falls (1 per cent). Renters sit between the two.

A new year's resolution to cut taxes will last until April

It's not just housing costs that will see some win but others lose. Britain will bring in the new year with hefty National Insurance cuts on 6 January – costing £10 billion a year and including a 2 per cent fall in the main rate of employee National Insurance. 29 million workers will benefit by an average of £330 a year. Conservative hopes for further tax cuts lie in the hands of the OBR's final pre-election forecasts – likely in early March. But huge tax rises will also be part of the mix come April, when Income Tax and National Insurance thresholds will be frozen, the third of a six-year freeze, that will ultimately raise over £40 billion a year. The net effect will see all employees who earn below £26,000 (roughly the median salary) worse off or unaffected, while those above will gain. If you earn £50,000 you're in the sweet spot and will benefit most (see Figure 4).

Figure 4 **The biggest cash winners from the NI rate cut are higher-rate payers, and low earners will be net losers given threshold freezes**

Annual gain / loss for employees of a 2p reduction in main rate of National Insurance plus Income Tax / employee National Insurance threshold freezes in 2024-25: UK



Notes: Freeze is relative to the £12,570 and £50,270 Income Tax and National Insurance thresholds rising in line with 6.7 per cent inflation in April 2024. Excludes any impacts from higher employer NI. Does not include the impact of Universal Credit means-testing.
Source: RF analysis.

Incomes for poorer households will likely fall as cost of living support comes to an end

There are other reasons – beyond them not benefiting much from coming tax cuts – that mean 2024 is not looking rosy for poorer Brits. One striking feature of the cost-of-living crisis is that incomes at the bottom of the distribution haven't fallen as much on average as the middle and top over the past two years. This is because the Government rightly prioritised support for those on the lowest incomes. In April 2023, most social security benefits rose in line with inflation (by 10.1 per cent), and extra targeted support was provided via Cost of Living Payments for pensioners and families on means-tested or disability benefits, at a total cost of £11.3 billion. This was the right thing to do in a 'cost of essentials' crisis because even with it, nearly one-in-in-three (30 per cent) of the poorest fifth of households skipped meals in recent months (versus 13 per cent pre-pandemic).[1]

2024-25 will see another inflation-linked uprating (of 6.7 per cent) in April, but also the end of the Cost of Living Payments (the last payment is due in February 2024) – meaning benefit support will generally be falling in real terms. For many households, even in cash terms they will be worse off: the uprating of Universal Credit will mean around £520 more for a single, out-of-work parent with one child in 2024-25 than in 2023-24, but the loss of £900 in Cost of Living Payments will leave their total support in the next financial year around £380 lower. The result? Even as wage growth returns, incomes will be falling for lower-income Britain.[2] For them 2024-25, will be worse than either of the past two years. The typical household in the poorest quarter of the working-age population is on course for an income fall of 2 per cent next year (see Figure 5).

Figure 5 **Incomes for the poorest are expected to fall in 2024-25, driven by rising housing costs and the end of Cost of Living Payments**

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

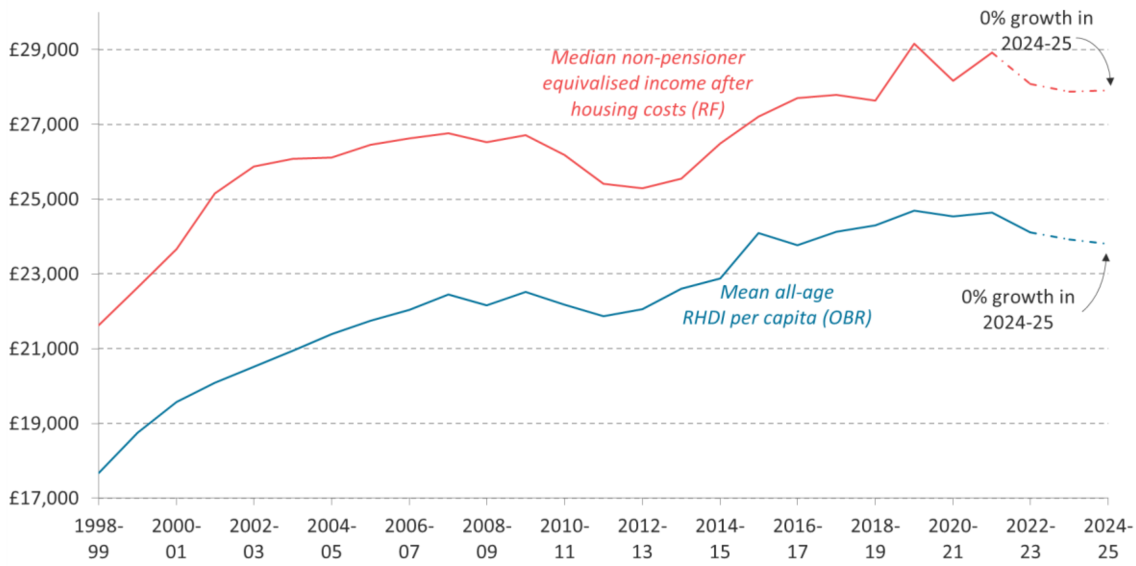
Notes: We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
Source: RF projection including use of the IPPR Tax Benefit Model; DWP, Households Below Average Income; ONS, Wealth and Assets Survey; ONS data; OBR forecasts.

The immediate backdrop to General Election 2024 is highly variable and uncertain – but the big picture of the parliament as a whole is clear: Britain is poorer

The previous chart spelt out that the year ahead is a story of two halves: a welcome return to income growth for the top, but falls for the bottom. The average (mean or median) household income is likely to be little changed in the election year of 2024-25 if the OBR's forecasts prove to be broadly correct (see Figure 6), according to our own analysis. Of course, the recent past has shown us there is very considerable uncertainty about this – if inflation continues to fall fast and wages hold up, things would look much better.

Figure 6 **On two different measures, projected disposable income growth is zero for 2024-25**

Real median/mean household disposable income: GB/UK



Notes: 2022-23 prices. The two series differ in multiple ways, including the use of equivalisation and the treatment of imputed rents. Median income is for GB from 1997-98 to 2001-02.
Source: OBR, Economic and Fiscal Outlook, November 2023; RF projection including use of the IPPR Tax Benefit Model; DWP, Households Below Average Income; ONS, Wealth and Assets Survey; ONS data; OBR forecasts.

Overall, 2024 will see some easing of cost pressures. But with people's experiences of the year ahead likely to be so varied, there are real challenges for politicians trying to tell a single story about whether the country is making progress or not. Outright owners, alongside those who benefit most from tax cuts and wage rises, may think a corner has been turned. Those seeing their mortgages and rents surge, or benefit support cut back, most certainly won't.

This mixed picture however, contrasts with the far simpler story over this Parliament as a whole: British households are on course to be poorer (by 4 per cent, or £1,200 on average) going into the coming election than they were coming out of the last one. That is something never seen before in modern British history. Our New Year's resolution should be to make sure it never happens again.

[1] This research uses data from a recent online survey conducted by YouGov. Fieldwork for the survey took place during 13-17 October 2023, and the total sample size was 8,378 UK adults aged 18 and over, although the facts were calculated for working-age adults only. Base for bottom quintile n= 1,009 and base for the top half of income distribution, n= 2,735. All figures have been weighted and are representative of all UK adults. The figures from the surveys have been analysed independently by the Resolution Foundation. The views expressed here are not the views of YouGov. We are grateful for the Health Foundation for supporting this survey. Pre-pandemic figures are RF analysis of the Family Resources Survey.

[2] Our method for projecting disposable incomes after housing costs is set out in previous work, such as M Brewer, E Fry & L Try, The Living Standards Outlook 2023, Resolution Foundation, January 2023. The projection in this spotlight is based primarily on the OBR's November 2023 Economic and Fiscal Outlook, together with planned tax and benefit policies.