Resolution Foundation

The Living Standards Outlook 2022

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Executive Summary

The UK's post-Covid economic recovery is well underway, but a deep living standards downturn is just getting going. Two years after the Covid-19 pandemic began, our economy has bounced back from the immediate hit, with GDP returning to 2019 levels and unemployment historically low. But the defining economic feature of 2022 will be a major living standards hit for households, driven by high and rising inflation. The exact path that prices and earnings growth will take is highly uncertain, but it is clear that the war in Ukraine and the further increase in prices that it is already driving will deepen the major living standards squeeze households face. Looking further ahead, it is weak productivity growth rather than high inflation that poses a lasting threat to household living standards. Productivity and pay growth will have to perform considerably better than all forecasts currently expect if the years ahead are to deliver meaningful growth in living standards.

This report assesses the prospects for household incomes and living standards up to 2026-27. Our approach is to take the latest detailed data on household incomes (covering 2019-20) and cast this forward using a selection of timelier data (for 2020-21 and 2021-22) as well as forecasts from the Bank of England and Office for Budget Responsibility (OBR), and known tax and benefit policies. Those forecasts pre-date the conflict in Ukraine, so we also look at what effect even higher inflation than previously expected might have on household incomes in 2022-23.

High inflation will squeeze incomes in 2022

Higher prices will squeeze household incomes hard over the next year. The main drivers of high and rising inflation are the wholesale prices of gas and oil, which increased rapidly following the re-opening of the global economy, and have increased sharply again since Russia invaded Ukraine. Having stood at 0.7 per cent in January 2021, inflation is currently at its highest rate in 30 years (5.5 per cent), and was projected (before Russia invaded Ukraine) to hit 7.3 per cent in April 2022. The crisis in Ukraine has increased both the scale of price rises, but also the degree of uncertainty about their levels and duration. So far, the conflict has substantially increased the price of oil and natural gas: Brent crude has hit highs of over $110 a barrel, the price of oil futures has also risen commensurately, and the price of gas has exceeded £3.75 per therm (this is the National Balancing Point front-month prices). Considering the impact on petrol and energy costs alone leads us to estimate the monthly peak of inflation will now exceed 8 per cent this spring, and could rival the 8.4 per cent reached in 1991 (in turn the highest inflation since 1982). We now assume that prices in 2022-23 will on average be 7.6 per cent higher than in 2021-22, up from the Bank of England's forecast of 6.2 per cent in February. This ignores any possible impact on food prices which, if it did occur, would be particularly skewed towards low-income households.

High inflation will make falling real household incomes the defining economic feature of 2022. Although rising inflation has so far hit the budgets of richer and poorer households in broadly the same way, that is not necessarily the case as household energy bills surge in April – given that the poorest households spend over three times the proportion of their total expenditure on energy bills as richer households. Higher inflation is also harder for poorer households to deal with, as they have less flexibility in their budgets to cope with higher prices on essentials, and fewer savings to fall back on when prices are high.

Increases in the energy price cap mean a typical energy bill will go up by £693, or 54 per cent, in April 2022, after a £139 rise in October 2021. The Government has responded with a £150

Council Tax rebate for those in Bands A to D (with Scotland and Wales introducing similar policies) and a £200 temporary rebate on all electricity bills this autumn. This policy package means a £350 boost to most households' incomes in 2022-23, but this turns into a £40 drag from 2023-24 as the Energy Bills Rebate is clawed back over the following five years. And the pressure from rising energy prices on household incomes is far from over: the energy price cap was expected to rise again in October even before the conflict in Ukraine began. Based on the latest figures, October 2022 could see a further rise of around 47 per cent – equivalent to around £900 a year for a typical household.

Real earnings are now falling, as pay growth fails to keep pace with rising inflation

The labour market recovery has been stronger than expected over the past year. One of the great success stories of the Government's economic policy response to the pandemic was the fact that unemployment remained so low. It peaked at 5.2 per cent in Q4 of 2020, and the latest data (for Q4 of 2021) shows unemployment at 4.1 per cent, only fractionally higher than the pre-pandemic level. This tight labour market means that nominal wage growth is better than would be typical at this stage in an economic recovery, standing at 4.3 per cent in Q4 of 2021. But this remains well below inflation: real wages fell by 0.6 per cent in Q4 of 2021. Despite a healthy forecast for nominal earnings growth in 2022-23, further increases in inflation mean real earnings are set to fall even further in the coming year: by almost 4 per cent using our most recent inflation assumptions. Even on the basis of the Bank of England's pre-Ukraine inflation forecast, real earnings are not expected to see any year-on-year growth until Summer 2024.

We can be confident that real earnings will be falling in 2022-23, but the scale of the hit is highly uncertain. Projecting the near-term outlook for nominal pay is much more difficult than normal: the latest Pay As You Earn earnings growth data (from January 2022) was very strong, at 6.3 per cent, and Bank of England agents were reporting high pressure on pay, but there has been no big take off in advertised wages or settlements, and

the latest figures for Average Weekly Earnings show only robust, but far from run-away, pay growth (at 4.3 per cent).

Although high inflation will drive the short-term living standards hit, in the medium term it is weak productivity growth that is behind the Bank and OBR's expectation that 'normal' earnings growth by the middle of this decade will still be below the levels we were used to before the financial crisis. The path to reaching those 'normal' nominal growth rates of 3.6 per cent in 2026-27 is rocky, with nominal earnings growth projected to fall to just 2.3 per cent in 2024-25. This sharp slowdown is partly due to an expected fall in the labour share (which had risen in the pandemic), and also the rise in employer National Insurance pushing up non-wage labour costs. Fundamentally, wages will not grow strongly unless matched by productivity growth, and here the UK is in a poor position, with the decade to 2019 delivering the weakest growth in productivity in 120 years.

An additional headwind to living standards at the moment is that employment has fallen despite an almost total recovery in the unemployment rate, because of falls in labour force participation. Having briefly reached a peak of 64.4 per cent immediately pre-pandemic, the participation rate has fallen during the pandemic, to reach 63.1 per cent in March 2021: a larger fall than previous recessions. The fall in participation among 18-24-year-olds and 50-64-year-olds has been almost twice the average fall. This is particularly worrying for older workers, many of whom say this change is due to ill-health: evidence suggests that such individuals are unlikely to return to the labour market. But there have also been falls among younger men and in the number of migrants working in the UK.

Benefit uprating in April will not keep up with price rises

The UK's procedures for uprating benefits mean a rollercoaster ride for benefit rates over the next 14 months, and this will lead to a real, damaging but avoidable living standards rollercoaster for poorer households.

Most income-related benefits are uprated in April by the

previous September's CPI. This means that most benefits, including the State Pension, are set to be uprated by 3.1 per cent in April 2022 at a time when the cost of living could be rising by more than 8 per cent. Over 2022-23 as a whole, the value of most benefits may fall by 4.2 per cent in real terms. This is equivalent to a one-off £10 billion cut to benefit spending in 2022-23 – more than the amount the Government spent on pandemic-related temporary benefit increases in 2020-21 – and will take the core level of support in the benefit system to its lowest level in real-terms since 1983-84.

The real cut in the value of benefits in 2022-23 is set to be largely undone in April 2023, when benefits could rise by 7 per cent or more. This would be the largest permanent nominal increase for most benefits since 1991-92, when benefits were uprated by 10.8 per cent.

This benefits rollercoaster should end up with the real value of most benefits in April 2023 being broadly where they were in April 2021. But that is of little comfort in the meantime to low and middle income households facing a prolonged period where benefits fail to keep up with sharp rises in the costs of essentials. For those on Tax Credits, and most on UC, this comes after the £20 a week cut to their benefits that happened last October, when the temporary pandemic support ended. And some parts of the benefits system are not increased at all in cash terms, most notably Local Housing Allowance. As a result, those who rent privately and receive support for housing costs through UC or the legacy benefits will see no additional support for rents in 2022-23 or beyond, regardless of how quickly these rise. The benefit cap also remains frozen, meaning that families deemed by the benefit system to have the greatest needs will see no additional help in 2022-23 at a time when the cost of living is soaring.

Scheduled tax rises and increasing housing costs will further squeeze disposable incomes

April is due to see significant increases in taxes, as the Government combines a fiscal consolidation with longer-

term plans to increase spending on health and care. National Insurance rates will rise, while higher inflation means the freeze in Income Tax thresholds will represent a bigger tax rise than originally planned. Although the overall squeeze on living standards in 2022-23 will be felt across the income distribution, and rising energy bills will particularly affect those on lower incomes, the effect of these tax changes will be progressive. For example, households in the second-highest income vingtile will lose 1.8 per cent of their disposable incomes, compared to 0.4 per cent for households in the second-poorest vingtile.

Housing costs are also set to rise materially, but on different timescales for different tenures. High inflation will feed through into higher rents in the social sector swiftly. Social rents can currently be uprated in England by a maximum of the previous September's CPI inflation plus 1 per cent every year, meaning rent rises of up to 4.1 per cent in April 2022, and perhaps over 8 per cent in April 2023. And although some of the poorest households are protected from these large rises through Housing Benefit or Universal Credit, 44 per cent of social renters do not receive housing support.

Fluctuating interest rates have fed into sharp changes in mortgage interest payments. A low Bank Rate of 0.1 per cent at the start of the Covid-19 crisis resulted in a fall in average mortgage interest payments of 7 per cent in 2020-21. However, higher inflation than expected has led the Bank of England, and markets, to reassess the future path of interest rates. Two rises in recent months have taken the Bank Rate to 0.5 per cent in February 2022. Although expectations of further rises are falling back somewhat following the Ukraine crisis, we use the market expectation from February, which anticipated rate rises that peaked at 1.3 per cent in Q1 of 2023.

Real incomes will take a huge hit in 2022-23, and potentially fall again in 2023-24

Putting all of these factors together, we can model and project changes in household disposable incomes. Focusing on median living standards – and excluding pensioners – our modelling

suggests that household incomes were relatively protected in 2020-21 (with growth of perhaps 1 per cent, despite a large fall in GDP) and grew again in 2021-22 (by another 1 per cent). In contrast, despite forecasts for robust GDP growth in 2022 (with the IMF forecasting 4.7 per cent growth), there is an incomes recession ahead of us. Inflation of 7.6 per cent in 2022-23 would leave the typical real household income for non-pensioners 4 per cent – or £1,000 – lower than in 2021-22. This is a scale of fall only previously seen around the recessions of the financial crisis, early 1980s and mid-1970s.

Even if we assume no significant lasting fallout from the situation in Ukraine, real incomes are also projected to fall in 2023-24 – with typical incomes dropping by 2 per cent due to falling real wages (in the Bank's forecast), rising mortgage costs and the abrupt change from a £350 energy support package in 2022-23 to a £40 levy in 2023-24. Falls in typical real income for two successive years have never been experienced outside of recessions. Sadly, the forecast beyond 2023-24 is not encouraging either, with no rapid rebound from the period of high inflation. Projections based on the Bank's forecasts of weak nominal earnings growth and rising unemployment imply negligible growth (0 per cent) in 2024-25 and 2025-26 and only weak (but welcome) growth of 1 per cent in 2026-27.

Given the uncertainty of all income forecasts, but perhaps particularly of the path of inflation and wages over the next few years, we also explore what difference would be made by alternative assumptions. A scenario where nominal earnings growth remained at 4 per cent a year after 2022-23 (rather than dropping as in the Bank and OBR's last forecasts) and where unemployment remained near its current rate (rather than rising) would improve prospects, but growth in typical incomes in 2023-24 would still be negative. Even with these less pessimistic labour market outcomes – and assuming (unrealistically) that there is no long-run impact of the war in Ukraine on UK living standards –the typical real income would still be lower in 2025-26 than in 2021-22.

These trends are far from uniform across the income distribution, however. The incomes of the poorest were boosted in 2020-21 by the temporary boost to UC and Tax Credits – but the removal of these boosts, alongside rising inflation, led to falling incomes for lower-income households in 2021-22. Incomes in 2022-23 are projected to fall right across the income distribution, but the impact of the benefit rollercoaster means that the poorest may see a smaller income fall than better-off households in 2023-24.

While we should always bear in mind the very big picture – that real household incomes are generally at or near record highs – it is clear that the current outlook would be an awful result in terms of growth if it were realised. While 2020-21 and 2021-22 were terrible years in many respects, in terms of real household incomes, they are as good as it gets over our projection period up to 2026-27.

Comparing four or five-year periods corresponding to Westminster parliaments, we find that 2019-20 to 2024-25 is currently on track to be the worst on record for income growth – even assuming there is no long-run impact of the war in Ukraine on living standards – with the typical non-pensioner income falling 2 per cent, compared with a 1 per cent drop between 2005-06 and 2010-11. Coming on the back of the financial crisis and post-referendum inflation spike, such poor growth in this parliament would leave the twenty-year period from 2005-06 to 2025-26 with an enormous growth shortfall: if incomes had grown in line with the previous long-term trend, the typical income in 2025-26 would be 43 per cent (£11,000) higher than currently projected.

A drop in poverty in 2020-21 has probably already been undone

As has been shown before, the significant package of increased benefit support in 2020-21 did not just contribute towards protecting household incomes while GDP plummeted, it also drove welcome reductions in income inequality, relative poverty and absolute poverty (assessing the whole population, including

pensioners). However, our nowcasting suggests that these changes were essentially all reversed in 2021-22 (despite the permanent UC boost for working families from December 2021). Most strikingly, we project absolute poverty to have fallen from 18 per cent in 2019-20 to 16 per cent in 2020-21 (official figures are due out later in March), but we then project a rise to 17 per cent in 2021-22 and to 18 per cent in 2022-23. Remarkably – but in keeping with the general income outlook – the prevalence of absolute child poverty is projected to be higher in 2026-27 than in 2019-20, with a very large rise of 5 percentage points expected between 2020-21 and 2022-23, in part due to the impact of the war in Ukraine on the cost of living in 2022-23.

Beyond the dip and rebound of 2020-21 and 2021-22, the outlook for relative poverty and relative inequality is comparatively flat – as income growth is projected to be weak for everyone. High benefit uprating in 2023-24 may provide a temporary narrowing of inequalities, though relative poverty after that point is set to continue its pre-pandemic upwards trend, as the two-child limit and abolition of the family element continue to affect more families, and as earnings grow more swiftly relative to social security benefits. Relative poverty is projected to particularly rise for households with more than two children. In 2012-13, around one-in-three children in large families (households with three or more children) were in relative poverty. By 2021-22 that may have reached a record high of almost 50 per cent – and by the end of our projection period (2026-27) the majority of children in large families may be living in relative poverty.

These forecasts are not set in stone, and the Government could cushion this year's living standards hit for poorer households

Economic forecasts can and will change. It is possible that nominal pay growth will outperform the current weak forecast, or that volatile fossil fuel prices will deliver very low inflation at some point. On the other hand, the economic forecasts we have built upon pre-date the conflict in Ukraine, which, as well as putting pressure on energy prices, may well slow growth. In the long-run, the sustainable route to rising living standards

is through a strong economy with faster underlying growth in productivity. How the country's economic strategy might increase the chances of that happening amidst a decade of significant economic change is the focus of the Resolution Foundation and the Centre for Economic Performance's Economy 2030 Inquiry. But there are also steps that the UK Government should take to help cushion the significant living standards blow facing households over the next couple of years.

Most importantly, the Chancellor should revisit this year's benefit uprating in or before the Spring Statement. Because each financial year's benefit uprating is based on inflation from the previous September, even the October 2021 energy price cap rise will not be reflected in benefit rates until April 2023. Although uprating policy does mean that core benefits maintain their real value in the long-run, the benefits rollercoaster that we described above is set to cut £10 billion in real terms from benefit income in 2022-23. This will pose real financial challenges for low- and middle-income households. The Government should therefore increase benefits by more this year, and less next year. For as many benefits as administratively possible, but at least UC and Tax Credits, uprating this April should not be 3.1 per cent but 8.1 per cent. Those benefits that are harder to change at short notice should be increased as soon as possible, and at the very latest in October when the energy price cap is now almost certain to rise again. Benefit increases in April 2023 would then be reduced accordingly. This would not be a permanent change to benefit rates (or public spending), but would significantly protect real incomes for poorer households in the difficult year ahead. In the medium-term, the Government should move permanently to a timelier basis (e.g. December inflation figures) for uprating benefits, or even consider uprating benefits twice a year when price rises are particularly large, to reduce the impact that volatile inflation has on benefit recipients.

Second, although the Government has acted to partially cushion households from rising energy bills, there is more that could be done. As well as being more ambitious on insulating the country's homes, some levies could be moved off electricity bills and instead be funded by general taxation. One specific

option would be for the Government to shoulder Renewables Obligation costs (which are legacy contractual obligations), taking around £70 a year off household bills, and transferring the cost of around £2 billion a year from bills and into public spending.

Third, the Government must revisit its default policy that Local Housing Allowances are now permanently frozen – regardless of increasing rents; and adjust the benefit cap, which is also frozen. There are many policies that could be suggested to improve the UK's inadequate benefit provision – and 2020-21 shows again that policy can make a big difference to poverty rates – but a good place to start would be to stop making further real-terms cuts.

The UK's economy may have recovered from the pandemic more quickly than expected – in part because policy makers protected household incomes from its worst affects. But those same household incomes are now entering a deep recession of their own – made worse by the terrible developments unfolding in Ukraine. The rising cost of living will be the defining economic feature of the year ahead. The government's task against that difficult backdrop is to combine a long-term focus on raising productivity and pay, with immediate action to ease the pain for low and middle income households.

Section 1

Introduction

This is our fourth dedicated Living Standards Outlook:[1] the UK's foremost projection of what the latest economic forecasts mean for disposable incomes across the income distribution, and therefore also poverty and inequality.

It comes at a time of particular concern about household budgets, with the dust only just (hopefully) settling from the Covid-19 pandemic,[2] prices already increasing at their fastest pace in 30 years, and the conflict in Ukraine creating further impacts on gas, oil and food prices.[3] As we will show, concern is justified, with the UK entering a very significant living standards squeeze, though it is also a time of particularly high uncertainty about the future path of prices and wages.

Our approach, in line with previous years, is to take the most recent detailed survey data about household incomes – in this case 2019-20, which we treat as being pre-Covid – and then project that up to the current year using a combination of timelier economic indicators (a process known as nowcasting), and then up to 2026-27, using economic forecasts produced by the Bank of England and Office for Budget Responsibility (OBR), along with pre-announced or default changes to tax and benefit rates. Doing this allows us to say what the disposable incomes of poorer or typical households might be in future years, and whether the UK is on track to become more or less equal, given the forecasts for aggregate figures such as employment, average earnings and inflation.

Of course, both economic forecasts and public policy are likely to change. We therefore also highlight some of the key uncertainties in both the Bank and OBR's economic outlooks (which were made before the conflict in Ukraine), including what that war and alternative scenarios might mean for household incomes, and we discuss how policy could best intervene to improve the living standards outlook.

1 Previous reports have been: A Corlett, G Bangham & D Finch, The Living Standards Outlook 2018, Resolution Foundation, February 2018; A Corlett, The Living Standards Outlook 2019, Resolution Foundation, February 2019; and M Brewer et al., The Living Standards Outlook 2021, Resolution Foundation, January 2021.

2 For example, legal restrictions across the UK should have ended before the start of the 2022-23 financial year. BBC News, Covid: All rules in Wales could be axed on 28 March, March 2022.

3 As we say in Section 2, the cost of that conflict will fall by far the hardest on the Ukrainian people, and our focus on the cost of living in the UK should not be seen as downplaying their suffering in any way.

The rest of this report is set out as follows:

- In Section 2, we explore the various key trends that will determine household incomes, including inflation, earnings, benefits, taxes, housing costs and employment.
- Section 3 sets out what the combination of these trends would mean for household incomes across the distribution.
- Section 4 then looks at the projected path of specific metrics such as absolute and relative poverty, as well as overall inequality.
- Section 5 concludes, and suggests some ways in which policymakers could alleviate the current cost of living crisis.
- Annex 1 sets out the methodology and assumptions underlying our projections.
- Annex 2 presents our main findings in a table for ease of reference.

Section 2

Determinants of household incomes

The post-Covid-19 economic recovery is well underway, but the living standards downturn is just getting going. GDP and real earnings are broadly back to pre-pandemic levels, but a meteoric rise in inflation, driven first by a surge in energy prices, and now by the war in Ukraine, mean that 2022-23 will see a major hit to living standards. Our assessment of prices and market conditions since war began in Ukraine leads us to assume that inflation will peak in April 2022 at 8.3 per cent, and the average rate over 2022-23 at 7.6 per cent, 1.4 percentage points higher than the Bank of England thought last month.

The increasing rate of inflation means that real earnings are set to fall even more in the coming year. Despite a healthy forecast for nominal earnings growth in 2022-23, further increases in inflation mean real earnings are set to fall even further in the coming year: by almost 4 per cent using our most recent inflation assumptions. Even on the basis of the Bank of England's pre-Ukraine inflation forecast, real earnings are not expected to see any year-on-year growth until Summer 2024. Even before Ukraine, though, these forecasts were considered uncertain, with strong PAYE pay growth and reported high pressure on pay, but without evidence of a big take off in advertised wages or settlements. Both the Bank and the OBR's pre-Ukraine forecasts were for nominal earnings growth to decline sharply, falling to just 2.3 per cent in 2024-25 (but recovering to 3.6 per cent in 2026-27); this is similar to nominal earnings growth in the 2010s, but still much lower than growth typically was in the 2000s. The short-run weakness is due to the labour share falling from its temporary pandemic high, and the employer National Insurance rise; in the long-run, wages will not grow strongly unless matched by productivity growth. The other labour market concern is the fall in labour market participation: the latest data shows the participation rate in November 2021 at 63.2 per cent, over a percentage point lower than the pre-crisis peak of 64.4 per cent, and there are worrying rises in the number of those aged 50 and over outside the labour force for health reasons.

The UK's procedures for uprating benefits mean a rollercoaster ride for benefit rates over the next 14 months. Uprating benefits in April by the previous September's CPI means that benefits are set to be uprated by 3.1 per cent in April 2022, at a time when the cost of living could be rising by more than 8 per cent. Over 2022-23 as a whole, the value of most benefits will fall by 4.2 per cent in real terms: this will take the core level of support in the benefit system to its lowest levels in real-terms since 1983-84. This is equivalent to a one-off £10 billion cut to benefit spending in 2022-23, more than the amount the Government spent in 2020-21 on its additional pandemic-related benefits package.

The real cut in the value of benefits in 2022-23 is set to be largely undone in April 2023, when benefits could rise by 7.2 per cent, whereas inflation was projected by the Bank to be 2.9 per cent in 2023-24. This would be the largest nominal increase for most benefits since 1991-92. But some benefits are not increased at all in cash terms, most notably Local Housing Allowance, but also the benefit cap, meaning that 180,000 families deemed by the benefit system to have the greatest needs will see no additional help in 2022-23. Worryingly for low-income households, social rents are also pegged to inflation, and on current forecasts could rise by 8.2 per cent in April 2023.

The Government's policy response to April's energy price cap rise means a £350 boost to most households' incomes in 2022-23, but this turns into a £40 reduction to incomes in 2023-24 as the electricity bill rebate is clawed back through higher bills over the following five years. On top of these, April will see increases in the rates of National Insurance. Together with freezes to income tax thresholds, these will act to reduce household incomes across the income distribution in 2022-23, but in a progressive way, with households in the 19th vingtile losing 1.8 per cent of their disposable incomes, compared to 0.4 per cent for households in the 2nd vingtile.

This section sets out the determinants of household incomes in the coming years, looking at inflation, energy prices (as well as Government policy to help with the cost of energy), unemployment and labour force participation, wage growth, benefit rates, taxes, and housing costs.

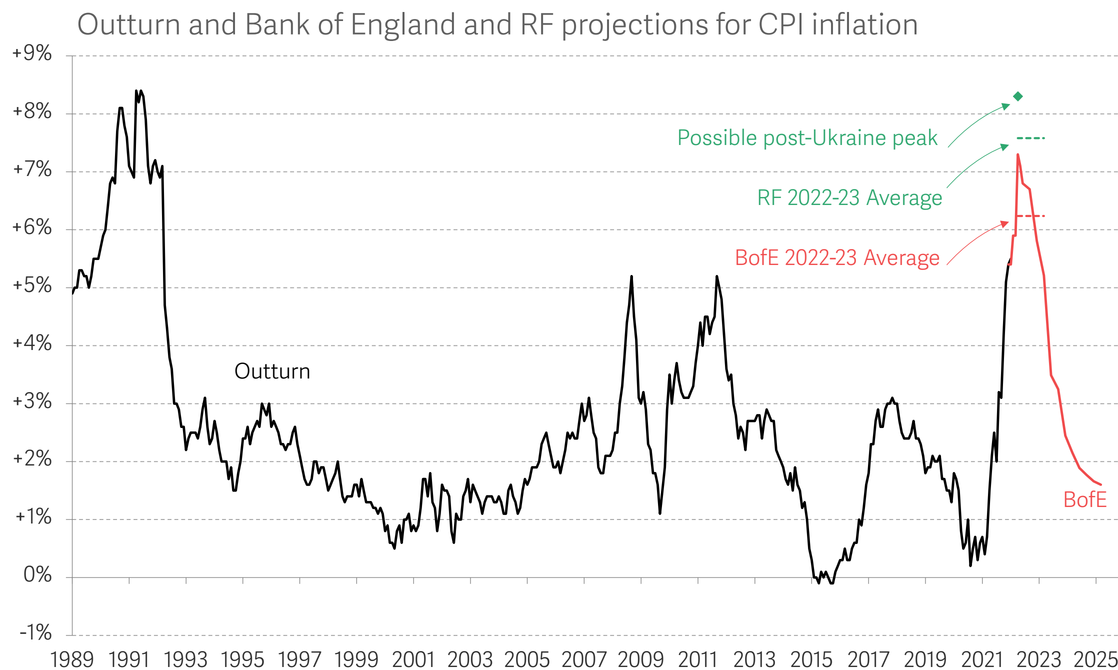
Even before the conflict in Ukraine began, high inflation was going to squeeze incomes in 2022-23 and beyond

The most important determinant of household living standards in the short run is the rapid rise in the cost of living. The re-opening of the global economy following the Covid-19 pandemic, and the consequential rise in demand for goods and services, has triggered a meteoric rise in the price of energy. Wholesale gas prices were, as of January

2022, almost 400 per cent higher than they were in Q4 of 2020, and wholesale electricity rose by over 300 per cent during the same period.[4] Higher energy prices directly push up consumer inflation through energy bills and petrol prices, but higher energy costs also spill over to other consumer prices as producer costs rise. This has caused CPI inflation to reach 5.5 per cent in January 2022, its highest rate in 30 years (see Figure 1).[5]

FIGURE 1: **Inflation is already at its highest rate in 30 years – and projected to rise further**

Outturn and Bank of England and RF projections for CPI inflation



SOURCE: ONS, CPI Annual Rate; Bank of England, Monetary Policy Report February 2022; RF projections.

Since the Bank of England published their forecasts in February, Russia has invaded Ukraine. The cost of that conflict will fall by far the hardest on the Ukrainian people, and nothing written in this report – which by its nature, focuses on living standards for households in the UK – should be seen as trying to diminish their suffering or imply that the most important consequence of war is the cost of living in the UK. The war in Ukraine means that predicting where inflation goes is harder than ever. In February, the Bank of England predicted that CPI inflation would peak at 7.3 per cent in April 2022,[6] but it is almost inevitable that the peak will be higher, with some forecasters currently predicting that inflation could reach 8 per cent.[7] Box 1 describes how the Ukraine crisis will affect inflation, and explains how we reached our projections: we now assume that inflation

4 Bank of England, Monetary Policy Report – February 2022, February 2022.
5 CPIH inflation in January 2022 was 4.9 per cent. We focus on CPI inflation in this report as neither the Bank of England nor OBR forecast CPIH.
6 In this report, we have used the median Bank of England forecasts for CPI inflation and unemployment, meaning numbers may be slightly different to the modal figures used elsewhere.
7 O Smith & M Race, Fears of UK food and fuel prices rising due to war, BBC News, February 2022.

will peak at 8.3 per cent in April 2022, and average 7.6 per cent over 2022-23, up from the Bank of England's average of 6.2 per cent. This is driven in part by an assumption that the energy price cap would reach around £2,900 in October 2022, and we consider in Section 5 how the Government might respond to further energy bill hikes.

BOX 1: **Prospects for inflation given the Russian invasion of Ukraine**[8]

The rise in inflation, driven in large part by rapidly rising energy prices, is now set to continue due to the economic fallout from the Russian invasion of Ukraine.

At the time of writing, the economic impact of the war is highly uncertain, and will depend on how the geopolitical crisis develops. To understand the potential ramifications of the movements in commodity markets so far, we have drawn on the latest market data available on 2 March 2022 to create an alternative inflation scenario. So far, the conflict has substantially increased the price of oil, natural gas, agricultural and other commodities. For example, Brent crude, the most relevant crude oil price for the UK, has hit highs of over $110 a barrel, and the price of oil futures has also risen commensurately, and movements in wholesale gas markets have been similarly dramatic with NBP (National Balancing Point) front-month prices exceeding the eye-watering price of £3.75 per therm. These price rises have been driven by a combination of fears over supply disruption as the war continues, as well as the implications of the economic sanctions on Russia.

The direct effect of higher energy prices on inflation comes through fastest in petrol prices, and we estimate that petrol prices could peak at around 160p per litre, a substantial rise on even the current record levels (around 150p per litre). That could push up inflation relative to the Bank of England peak by around 1 percentage point (to 8.3 per cent), but these estimates are highly uncertain as oil prices are currently volatile. The second, and larger, direct effect of higher energy prices is on consumers' gas and electricity bills. Were gas and electricity prices to stay at their current elevated levels, we would expect the winter 2022-23 energy price cap to rise from the level set to be introduced this April (£1,971) by almost £1,000 (up to around £2,900). Again, this estimate is highly dependent on commodity prices, but should gas prices remain at elevated levels, then they would push inflation up in the second half of 2022-23 by around 2 percentage points.

8 Clearly, the cost of the invasion will fall by far the hardest on the Ukrainian people, and nothing written here should be seen as trying to diminish their suffering or imply that the most important consequence of war is the cost of living in the UK.

There could well be other impacts on inflation too. For example, agricultural prices – such as wheat – have also risen rapidly in recent days, due to the large share of the global export market for wheat originating in Ukraine and Russia; this will eventually pass through to higher food prices. And higher energy and commodity prices will lead to higher producer costs and a longer-term increase in goods (and, to a lesser extent, services) prices. We have not taken that into account in these estimates, as the high volatility in market prices means that the path for future consumer prices is extremely uncertain. However, the risk of higher inflation from broader price increases is somewhat offset by the potential for a more rapid reduction in energy and commodity prices were the war to end soon.

All-told, our alternative inflation forecast for the year 2022-23 has inflation at 7.6 per cent (around 1.4 percentage points higher than the equivalent Bank of England forecast), and peak at 8.3 per cent in April 2022. We use the Bank of England's pre-Ukraine forecasts beyond 2022-23.

It is important to note that, even before the war in Ukraine, the size of the peak of inflation, and the duration of high inflation, were both uncertain. Certainly, previous projections of the rate of inflation have been revised substantially: the Monetary Policy Report (MPR) in November 2021 predicted that inflation would peak in Q2 of 2022 at 4.8 per cent, and August 2021's MPR predicted that a peak of 4.0 per cent in Q4 of 2021 and Q1 of 2022.[9] A major cause of the uncertainty is the unpredictability of energy price rises: the Bank of England's February forecast, for example, assumed that energy prices remained constant from September 2022 onwards; as we discuss in Box 1, where energy prices go from is very hard to judge.

Recently, the high rate of inflation has focused attention on whether the average rate of inflation – which is what is captured by the headline CPI measure – is a good measure of how prices are changing for low-income households. Work by the IFS earlier this year estimated that price rises in 2022-23 would bear down more on low-income households than richer households because so much of the increase in the cost of the average basket of goods was due to come through energy, and energy makes up a larger proportion of low-income households' baskets than it does high-income households'.[10] However, that work underestimated the rise in the energy price cap in April and, as we discussed in Box 1, inflationary pressures are likely to go further with the war in Ukraine.

9 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.
10 The IFS's analysis assumed an increase in prices of gas and electricity of 35 and 20 per cent respectively. R Joyce et al., The cost of living crunch, Institute for Fiscal Studies, January 2022.

To the extent that the war pushes up petrol prices, then this will skew the inflationary pressures to richer households (who tend to drive more than low-income households), but it if causes the energy price cap to rise further in October 2022, or for food prices to rise, then this would skew the inflationary pressures towards low-income households. We discuss this further, and other issues to do with measuring inflation, in Box 2.

The approach taken in this paper is to deflate nominal incomes using a single inflation rate covering all households. This is not to downplay the complex issues discussed in Box 2, but is in part a pragmatic choice reflecting that there are no reliable forecasts of the components of the CPI all the way out to 2026-27. However, regardless of the exact definition of inflation or the choices made by analysts, low-income families' experience of inflation is more significant than that of richer families, especially when it is driven by increases in the price of essentials. This is because there is less slack in the budgets of low-income households: they spend a greater proportion of their overall spending on essentials, and less on what might be considered luxury or discretionary spending. Low-income households also have lower levels of savings to fall back on to cushion the impact of high prices. In 2017, 65 per cent of households in the bottom fifth of the income distribution in Great Britain had less than one month's income in savings, compared to 22 per cent in the top fifth.[11]

BOX 2: **The distributional effect of rising inflation on household incomes**

CPI, which is the measure of inflation currently used in most circumstances, measures how a basket of goods and services changes price from one year to the next. The basket is set to be representative of an average household; by definition, it cannot represent the wide range of consumption patterns we see across different households.

One important way in which consumption patterns vary is across the income distribution, and recent work by the ONS tries to measure how households across the income distribution experience inflation.[12] The data shows that both low- and high-income households (as well as retired and non-retired households) have been experiencing about the same level of inflation since 2014. This is because of largely offsetting effects: although the lowest-income tenth of households spend over three-times more as a proportion of their household expenditure on energy bills (an area already experiencing rapid price rises), richer household spend a higher proportion on petrol (another area with high inflation).[13] As we discuss in the

11 M Gustafsson et al., After Shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.
12 Office for National Statistics, CPI-consistent inflation rate estimates for UK household groups: 2005 to 2021, January 2022.
13 Office for National Statistics, Energy prices and their effect on households, February 2022.

main text, IFS analysis from January 2022 updated this to argue that this would change in 2022, with inflation in April 2022 expected to be regressive across the income distribution.[14]

In any case, these estimates of differential inflation rates are only part of the story because the types of products – within the categories defined by the ONS – vary across households. The clearest example is in food prices: as author and poverty campaigner Jack Monroe has argued, low-income and middle-income households do not buy the same make or brand of many foodstuffs. It is also been argued that the prices of some of the cheapest versions of goods at many supermarkets have risen at higher rates than headline CPI, and that the availability of budget options have fallen.[15] If so, then low-income families who rely on budget versions of products are likely to be experiencing a faster rise in costs than is currently suggested by the headline CPI data.

The most visible sign of the energy price-driven cost pressure is in the energy price cap. Even after the 54 per cent rise in the energy price cap scheduled for April 2022, war in Ukraine means the price cap is expected to rise again significantly in October (to around £2,900 according to Resolution Foundation calculations – around a 47 per cent rise on April's cap – or potentially up to £3,000 according to other predictions[16]), and the price cap's position in April 2023 is even more uncertain. The Chancellor announced a package of measures in response to the April 2022 price cap rise, and we discuss these in Box 3. In Section 5, we consider how the Government might respond to further energy bill hikes.

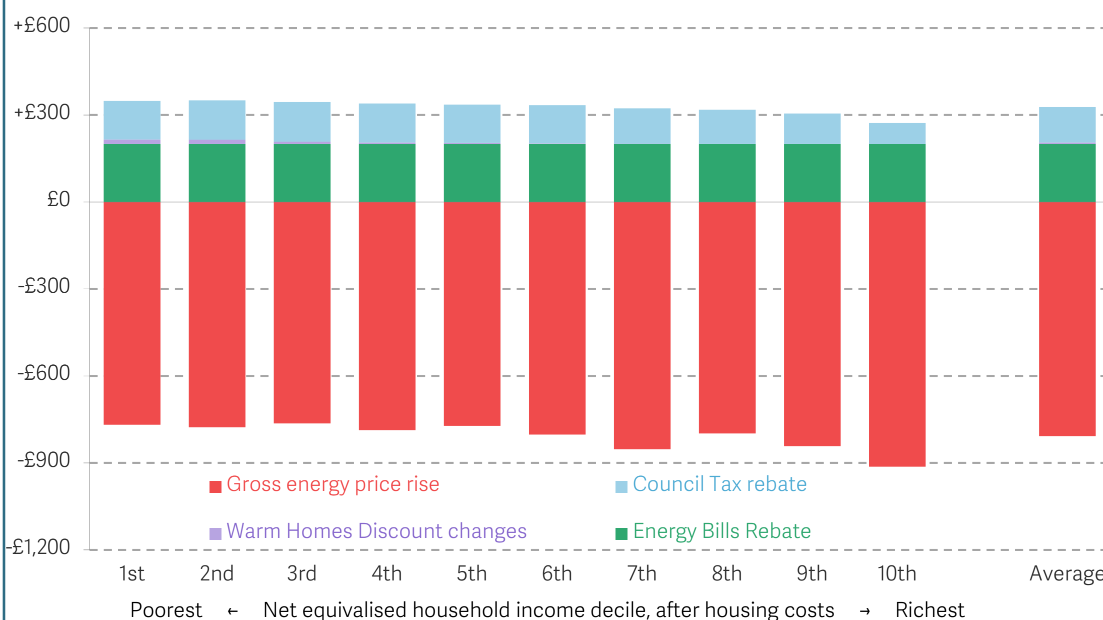
14 The IFS' analysis assumes an increase in prices of gas and electricity of 35 and 20 per cent respectively. R Joyce et al., The cost of living crunch, Institute for Fiscal Studies, January 2022.
15 https://twitter.com/bootstrapcook/status/1483778776697909252, accessed 18 February 2022. ONS inflation figures potentially fail to capture these effects in two ways. First, the categories of product are defined to be representative of a broad range of households – for example including 'coffee pods' (an expensive way to make coffee) and instant coffee (which tends to be a cheaper version). Poorer households will, in general, choose to buy different products than richer households so including more 'premium' product types (and if they change price at a different rate) in the average will skew inflation rates away from the true experience of low-income families. And second, the ONS only collect the price of a single version of each type of a product from each shop. Therefore, the price of budget versions of products will only be collected sometimes and may fail to be reflected fully in the price index.
16 M Brignall & J Selby, Average UK energy bills could hit £3,000 a year, consumers warned, The Guardian, February 2022.

BOX 3: The Government's response to the energy price cap rise of April 2022

The Government recently announced economic support to households to help with the 54 per cent rise in the energy price cap scheduled for April 2022 (a £693 rise in the annual bill for a typical household, following an £139 rise in October 2021).[17] This came in the form of a £200 discount on electricity bills in October 2022 (which would then be paid back in the form of higher energy bills for five years after that), and a £150 rebate on Council Tax for properties in bands A-D in England, due to be received by around four-in-five households[18] (with the equivalent money going to the devolved administrations for them to design their own schemes).[19]

FIGURE 2: **Rebates to help with energy costs may help now, but will be an extra cost in the future**

Policy and price cap impact in 2022-23, by household income decile after housing costs: England



NOTES: Energy price rises may not match typical bill figures from Ofgem. We assume all households in Council Tax bands A to D will benefit, which is an overestimate.
SOURCE: RF analysis of DWP, Family Resources Survey (including using the IPPR Tax Benefit Model); DLUHC, English Housing Survey.

17 It is worth noting that this is the rise for a typical energy user, and some households will pay more, while others will pay less.
18 A Corlett et al., The price is right? The April 2022 energy price rise and the Government's response, Resolution Foundation, February 2022.
19 In Scotland and Wales, households in Bands A to D or receiving Council Tax Reduction will receive the £150. https://www.gov.scot/news/scottish-budget-bill-passed/, accessed 24 February 2022; https://gov.wales/written-statement-cost-living-support-package, accessed 24 February 2022.

The effect of this is shown in Figure 2: for the average household, the combined effect of the energy bills and Council Tax rebates and the expansion of the Warm Homes Discount only compensates for 41 per cent of the rise in the average energy bill. And the fact that the £200 discount this autumn is recouped from future bills means that households will face energy bills that are £40 a year higher for five years from October 2023 onwards than they would otherwise have been.

We have previously argued that this support doesn't target low-income households, for whom energy bills make up a higher proportion of their spending. [20] Even after the £200 discount, the lowest-income households will still see their spending on energy bills rise more sharply as a share of their total consumption: households in the lowest income decile will see their spending on energy bills as a share of total consumption increase by 10 percentage points, compared to 4 percentage points for households in the highest income decile. In addition, the Council Tax rebate helps most, but not all households: more than 10 per cent of households in the bottom half of the income distribution won't benefit from the rebate[21], and people who don't pay council tax (such as students and tenants whose landlords pay their Council Tax) won't receive anything.

We discuss in Box 5 in Section 3 how we account for these interventions in our forecast of household incomes.

A further degree of uncertainty comes from it not being clear how firms and workers in a tight labour market will react to higher inflation and weak productivity growth: there could be second-round effects if perceptions take hold that inflation is high and these lead to workers to demand higher wages, which (if not accompanied by productivity gains) would cause prices to increase further. We discuss this further below when considering prospects for earnings growth.

Unemployment is less of a long-term problem in the labour market than is labour force participation

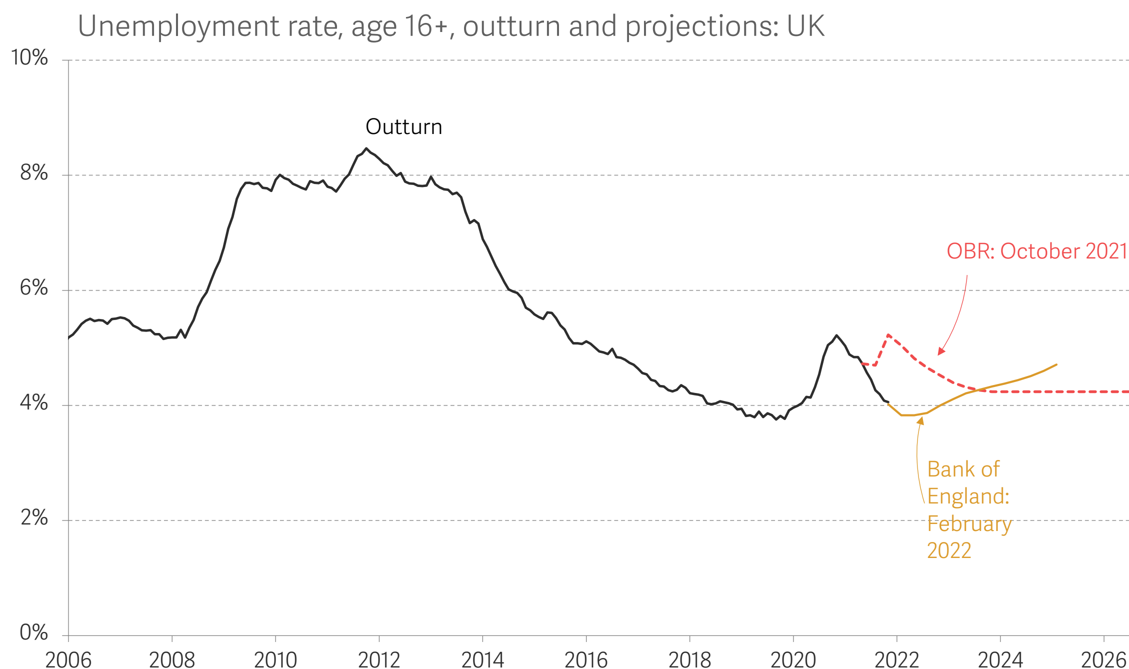
One of the great success stories of the Government's economic policy response to the pandemic was the fact that unemployment remained so low. In March 2020, unemployment was at 4.0 per cent, and it peaked during the crisis at 5.2 per cent in Q4

20 A Corlett et al., The price is right? The April 2022 energy price rise and the Government's response, Resolution Foundation, February 2022.
21 A Corlett et al., The price is right? The April 2022 energy price rise and the Government's response, Resolution Foundation, February 2022.

of 2020 (see Figure 3). The latest data (for Q4 of 2021) shows unemployment at 4.1 per cent. In its projections from October 2021, the OBR forecast that unemployment would rise slightly following the end of furlough, then fall and plateau at 4.2 per cent from Q4 of 2023 onwards. This points towards a tight labour market, where the unemployed have little difficulty in finding jobs and vacancies are high. However, the most recent Bank of England projections paint a different picture: the Bank expects unemployment to fall slightly, to 3.8 per cent in Q1 and Q2 of 2022, then rise steadily, up to 4.7 per cent in Q1 of 2025. This more pessimistic take comes directly from the worsening outlook for inflation, with the cost of living pressures already evident late last year reducing demand for some firms' goods and services, and thereby making for a looser labour market.[22] Just as with the inflation forecasts discussed above, the situation in Ukraine means these forecasts should now be seen as being even more uncertain.

FIGURE 3: **Following the success of the furlough scheme through the pandemic, pre-Ukraine expectations were for unemployment to return to its low pre-pandemic level**

Unemployment rate, age 16+, outturn and projections: UK



SOURCE: ONS, Labour Force Survey; OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report February 2022.

While prospects for unemployment are relatively benign, the much more worrying aspect of the post-pandemic labour market is the drop off in labour force participation (the fraction of the population who are active in the labour market, i.e. they are either in work or unemployed). In particular, since the beginning of the Covid-19 crisis, the number of

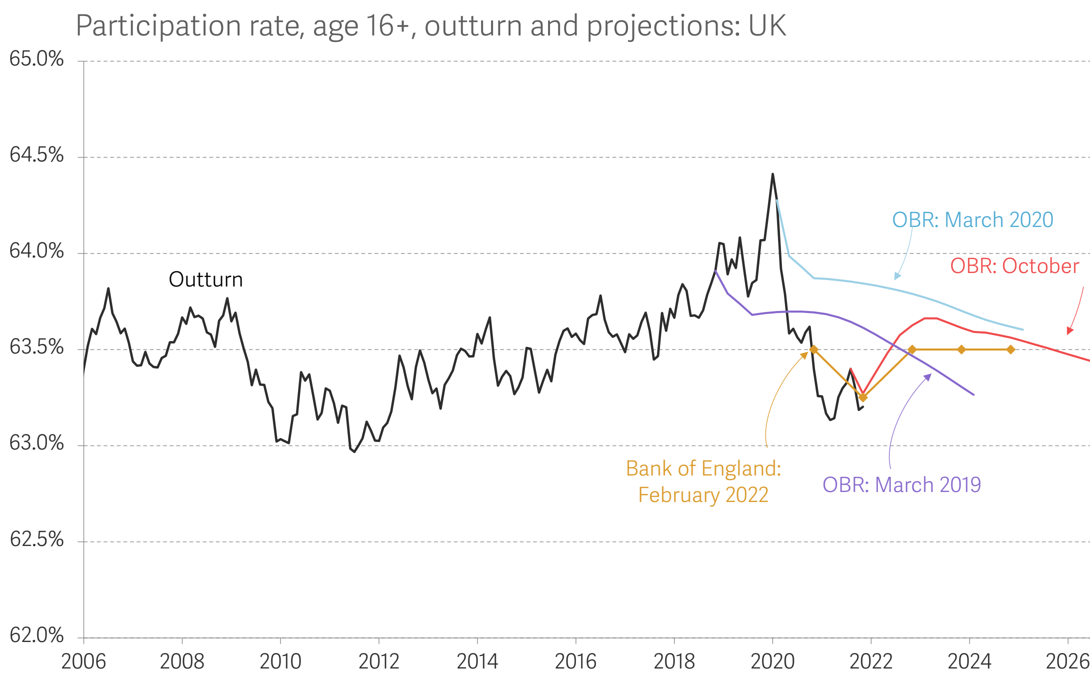
22 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.

working-age people (aged 16-64) in employment has fallen by 511,000.[23] Unemployment has barely changed during this period, but participation has fallen by a much higher number of 394,000. Figure 4 shows the participation rate since 2006, along with the recent OBR and Bank of England forecasts. The participation rate has been rising consistently for most of the 2010s, peaking at 64.4 per cent pre-pandemic in January 2020. Unsurprisingly, the participation rate fell during the Covid-19 crisis, but it fell faster than it had in previous recessions, with participation reaching a low of 63.1 per cent in March 2021. [24]

The fall in participation has been concentrated among young and old workers: the falls since the start of the crisis among 18-24-year-olds and 50-64-year-olds have been almost twice the average fall.[25] This fall in participation among older people, often for reasons of ill-health, is particularly worrying: evidence suggests that such individuals are highly unlikely to return to the labour market.

FIGURE 4: **Labour market participation is forecast to fall more than it was forecast just before Covid-19**

Participation rate, age 16+, outturn and projections: UK



NOTES: Bank of England figures are rounded to the nearest quarter percentage point.
SOURCE: ONS, Labour Force Survey; OBR, Economic and Fiscal Outlook, various.

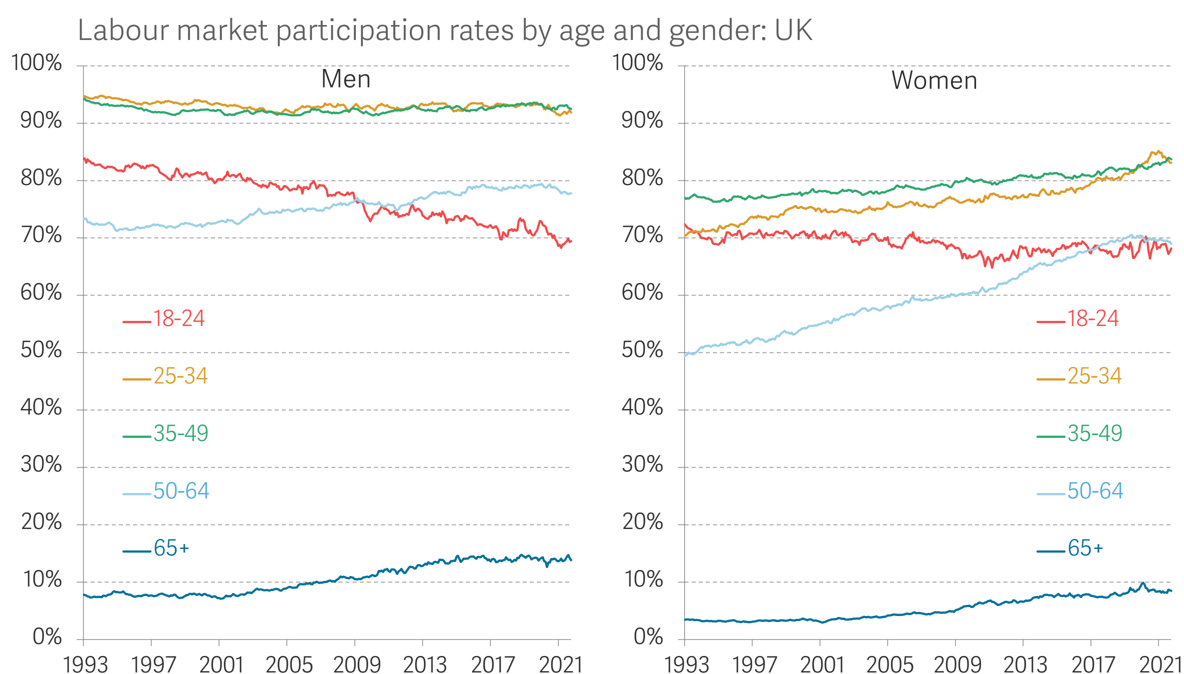
23 Office for National Statistics, A01: Summary of Labour Market Statistics, February 2022. Changes in employment, unemployment and participation are measured from December-February 2020 to October-December 2021.
24 M Brewer et al., Begin Again? Assessing the permanent implications of Covid-19 for the UK's labour market, Resolution Foundation, November 2021.
25 Office for National Statistics, A01: Summary of labour market statistics, February 2022.

This lower participation rate is bad news for both the economy and individuals. At the aggregate level, the OBR determined in its most recent forecast that falls in labour force participation are responsible for 0.3 percentage points of the 2 per cent scarring that it expects the economy to suffer as a result of the Covid-19 pandemic.[26] A decrease in labour force participation is also hard to reverse: it's much harder for people to get back into work after being inactive than after being unemployed. And lower participation rates have a negative effect on household incomes, with the UK's benefit system providing extremely low basic levels of support, and weak replacement rates in the event of falling out of work.[27]

It is useful to compare recent changes to past trends, as we do in Figure 5. Over the past 30 years, participation gains have come from groups with historically low rates of participation catching up with others: women's participation has increased among those aged 25-to-64, and most significantly for 50-to-64-year-olds, going from 49 per cent in 1992, to 71 per cent in 2019, in part due to increases in the female State Pension age (and something which therefore is unlikely to be repeated).[28] For men, by contrast, the defining trend is a fall in participation for 18-to-24-year-olds, in part due to an increase in young men entering higher education.

FIGURE 5: **Young men's participation has been falling, while 25-to-64-year-old women's participation has been rising**

Labour market participation rates by age and gender: UK



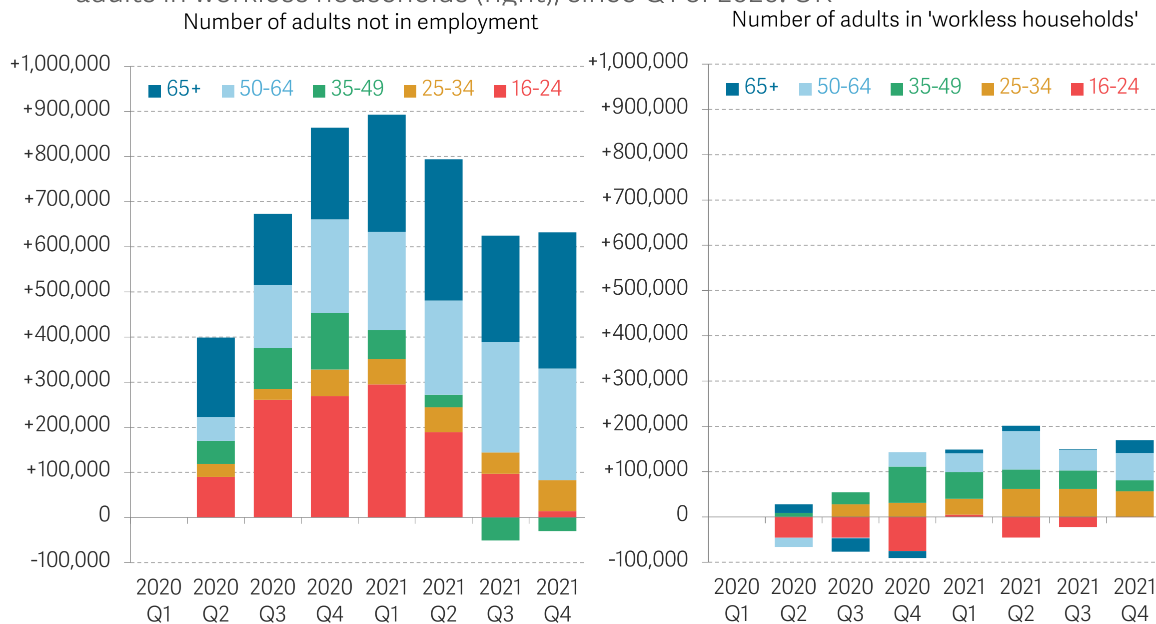
SOURCE: ONS, A05 Labour market by age group.

26 Paragraph 2.33 of Office for Budget Responsibility, Economic and Fiscal Outlook, October 2021.
27 M Brewer et al., Social Insecurity: Assessing trends in social security to prepare for the decade of change ahead, Resolution Foundation, January 2022.
28 J Cribb, C Emmerson & L O'Brien, The effect of increasing the state pension age to 66 on labour market activity, Institute for Fiscal Studies, January 2022.

The fall in the number of people in the labour market has not, however, translated into a commensurate rise in household-level worklessness. As we show in Figure 6, the number of adults not in work (i.e. unemployed or not participating) rose by around 800,000 between Q1 or 2020 and Q2 of 2021, but the rise in adults living in a workless household over the same period was only 160,000. This implies that falling employment has come from households with more than one earner, or – for example – that young adults not in work have moved back in with their parents – which may act to reduce the living standards hit from the fall in participation.

FIGURE 6: **Although there has been a rise in household-level worklessness since the start of the pandemic, this is small in comparison to the drop in employment**

Rise in number of adults not employed since Q1 of 2020 (left), and rise in number of adults in workless households (right), since Q1 of 2020: UK



NOTES: 'Workless households' only include those in which at least one person is aged 16 to 64.
SOURCE: ONS, Labour market overview, UK: February 2022; ONS, Working and workless households in the UK: October to December 2021, March 2022.

Weak nominal earnings growth will result in incomes being squeezed

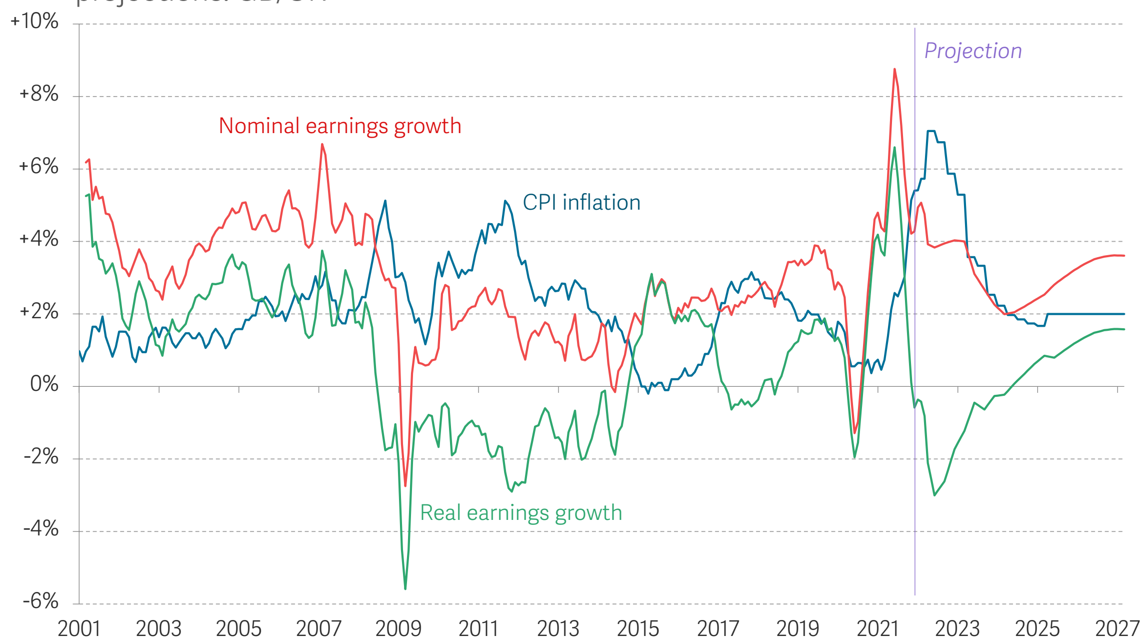
The fact that the labour market has been relatively tight through the second half of 2021 has led to nominal wage growth being stronger than might be typical at this stage in an economic recovery, standing at 4.3 per cent in the year to Q4 of 2021. However, this was still below the rate of inflation, meaning that real wages fell by 0.6 per cent over the same period.

The current combination of high inflation and low(er) nominal earnings growth will continue. Despite a healthy forecast for nominal earnings growth in 2022-23, further increase in inflation mean real earnings are set to fall even further in the coming year: by almost 4 per cent using our most recent inflation assumptions. As shown in Figure 7, this is the fourth period of negative wage growth the UK has experienced in the last decade: the first following the financial crisis, the second following the Brexit vote, and the third taking place at the beginning of the Covid-19 pandemic.

However, the outturn for real earnings could easily turn out to be worse if our post-Ukraine-conflict assumptions about inflation set out in Box 1 are proved correct and nominal earnings growth does not increase to compensate.

FIGURE 7: **Pre-Ukraine forecasts were for high inflation and lacklustre nominal earnings growth to cause falling real wages**

Annual growth in average weekly earnings (total pay) and CPI inflation, outturn and projections: GB/UK



NOTES: Nominal and real earnings growth is 3-month on 3-month annual AWE growth, with data being for the three months ending in the month shown. AWE data is GB. Inflation data used is ONS for outturn, Bank of England for projections up to 2025, and OBR after 2025. PAYE RTI earnings data is used for January 2022.
SOURCE: ONS, CPI; ONS, PAYE RTI; Bank of England, Monetary Policy Report February 2022; OBR, Economic and Fiscal Outlook October 2021.

Figure 7 shows that the outlook for real wages is weak not just because of high inflation but also because of lacklustre nominal earnings growth: both the Bank of England and OBR's pre-Ukraine forecasts show that nominal earnings are projected to grow at an average of 2.3 per cent in 2024-25 (although this will rise to an average of 3.6 per cent in 2026-27), a similar rate to that seen in the decade following the financial crisis, but still

much lower than growth typically was in the 2000s.[29] Within this, the Bank are expecting private sector growth to be stronger than public sector growth, as private sector firms struggle to recruit and offer higher pay settlements and bonuses.[30] Some good news for low-income households is that nominal earnings growth is likely to be higher at the bottom of the earnings distribution if the Government continues to let the National Living Wage (NLW) rise to hit its target of reaching two-thirds of median earnings for workers by 2024 (the NLW is also due to be extended to workers aged between 21 and 23 in 2024).[31]

There are a range of factors driving the weak nominal earnings growth seen in Figure 7. In the short-run, the labour share (the share of national income that goes to workers) is expected to fall from its temporary pandemic high (it peaked in 2020-21 at 67.1 per cent) as firms rebuild their profit margins following the pandemic, reaching 62.6 per cent in 2026-27.[32] And the rise in employer National Insurance contributions in April of 1.25 percentage points will put costs up for employers, making them less willing or able to increase pay. In the long-run, though, the poor forecast for wage growth is driven by a poor forecast for productivity growth, and here the UK is in a poor position, with the decade to 2019 leading to the weakest growth in productivity in 120 years.[33]

On the other hand, there are reasons to think that the latest forecast from the Bank could be too pessimistic. Even before Ukraine, the future of wage growth was considered relatively uncertain. For example, although there has been no big take off in advertised wages or settlements and the latest figures (up to Q4 of 2021) for AWE show modest pay growth, at 4.3 per cent (for total pay), PAYE pay growth is stronger, at 6.3 per cent, as of January 2022,[34] and Bank of England agents are already reporting high pressure on pay.[35] The combination of a tight labour market (characterised by low unemployment and high vacancies) and high inflation could lead to nominal wage growth being higher if workers seek pay rises to compensate for the high cost of living. In Section 4, we therefore explore how incomes would grow if nominal earnings growth was maintained at 4 per cent from 2022-23 to 2026-27, a more optimistic scenario.

29 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022, and Office for Budget Responsibility, Economic and Fiscal Outlook – October 2021, Office for Budget Responsibility, October 2021. The OBR's forecast predates the recent surge in inflation, but the Bank's forecast from February is almost identical to the one made by the OBR in October.
30 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.
31 https://www.gov.uk/government/news/large-minimum-wage-increase-to-boost-low-paid-workers-incomes, accessed 18 February 2022.
32 Office for Budget Responsibility, Economic and Fiscal Outlook – October 2021, Office for Budget Responsibility, October 2021; Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.
33 T Bell et al., The UK's decisive decade: The launch report of The Economy 2030 Inquiry, Resolution Foundation, May 2021.
34 Yearly pay growth calculated using median pay. RF Analysis of Office for National Statistics, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted, February 2022.
35 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.

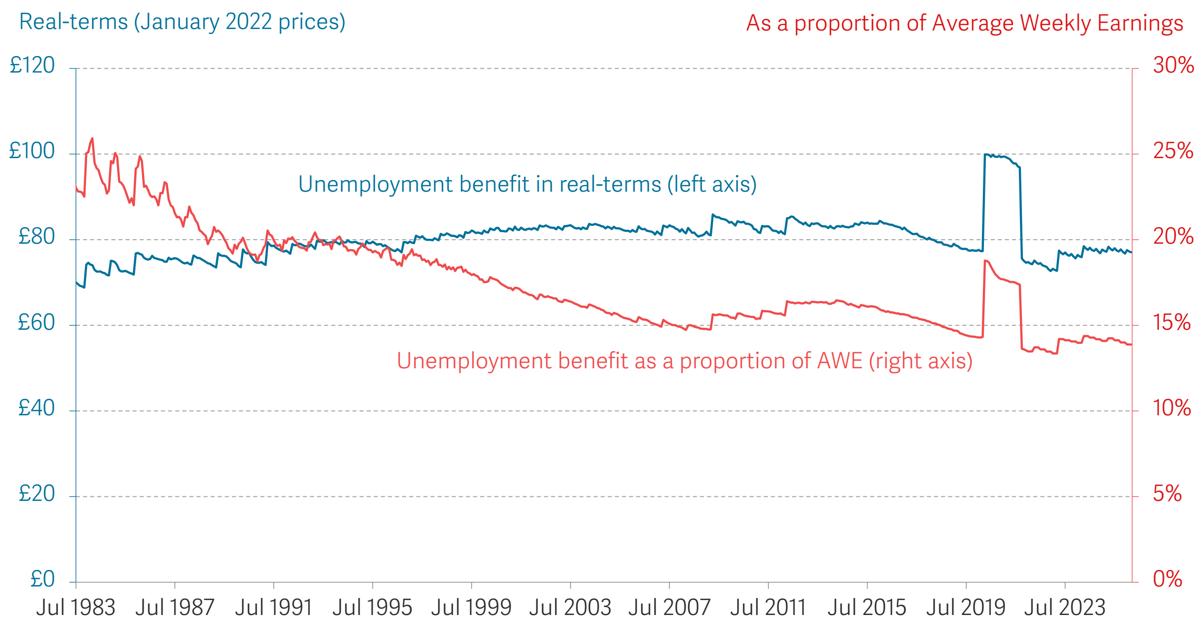
The real value of benefits is set to fall in 2022-23, despite recent improvements to UC for some

Over the next 14 months, the real values of most benefits are about to go on a rollercoaster ride, driven by the rules that mean that most benefits are uprated every April by the value of inflation recorded in the previous September.

At times when inflation is rising, this rule mechanically causes a temporary fall in the real value of benefits, but rarely is this as fall as stark as the one due next month: most benefits are due to rise by just 3.1 per cent (this includes the State Pension, which will be uprated by the September 2021 CPI, as the triple lock has been suspended for one year[36]), but the rate of inflation in April 2022 could easily exceed 8 per cent (see Box 1; it was forecast (pre-Ukraine) by the Bank of England to be 7.3 per cent). On the Bank's pre-Ukraine forecasts, the real value of benefits was due to be 3.0 per cent lower in 2022-23 than 2021-22; under our Ukraine scenario, the fall will be greater, reaching 4.2 per cent lower. This is equivalent to a one-off £10 billion cut to benefit spending in 2022-23, more than the amount the Government spent in 2020-21 on its additional pandemic-related benefits package.

FIGURE 8: **High inflation means the real value of benefits is set to fall**

Unemployment benefits in real-terms and as a share of Average Weekly Earnings



NOTES: Data is monthly. Unemployment benefit data is for Unemployment Benefit up to April 1995, JSA up to March 2020, and UC standard allowance from April 2020 onwards.
SOURCE: RF analysis of ONS, Average Weekly Earnings; DWP, Abstract of Benefit Statistics; OBR, Economic and Fiscal Outlook October 2021.

36 E Kirk-Wade & R Harker, Benefits Uprating 2022/23, House of Commons Library, February 2022.

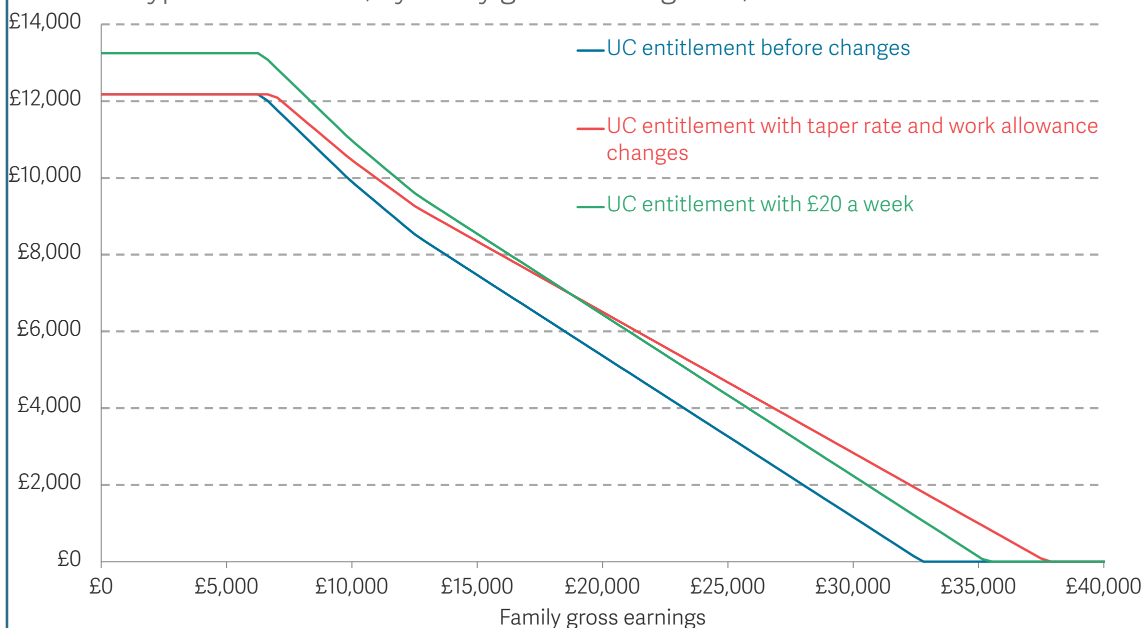
This fall means that the basic level of benefit in 2022-23 will be the lowest in real-terms since 1984-85, as shown in Figure 8 (negative real earnings growth means that the value of unemployment benefit as a proportion of AWE actually increases from 13.5 per cent in 2022-23 to 14.2 per cent in 2024-25, but it will fall again to 13.6 per cent of AWE in 2026-27). And the changes in April 2022 are happening not long after a £1,040 a year cut to UC rates that took effect in October 2021. We should note that the cut in the UC taper and increase in the allowance that took effect in December 2021 are not reflected in Figure 8, because they affect the entitlement of working families in UC, rather than the maximum amount that is received by unemployed claimants; we discuss these in Box 4.

BOX 4: **Changes made to Universal Credit in 2021**

Universal Credit has been subject to many changes over the last year: firstly, the £20 a week uplift to UC (and equivalent to Tax Credits) introduced at the start of the Covid-19 crisis was removed at the beginning of October 2021; then a reduction in the UC taper rate from 63 per cent to 55 per cent, and work allowances were increased by £500 a year, meaning people receiving UC and earning more than the old work allowance were able to receive more in benefit income.

FIGURE 9: **Recent changes to UC are better for some families with higher earnings than the £20 boost was**

Universal Credit entitlement for a single-earner couple with two children under actual and hypothetical rules, by family gross earnings: UK, 2022-23



NOTES: Other parts of tax and benefit system are set to April 2022 values. Family assumed to be home-owners.
SOURCE: RF Case Study Model.

Although these changes made some households on UC better off (mainly households in work on higher pay), but 73 per cent of households on UC were worse off as a result of these changes combined.[37] As shown in Figure 9, a single-earner couple with two children earning over £18,700 would have a higher income with the changes to the taper rate and work allowances than they would have done had the £20 a week boost to UC was maintained into 2022-23.

However, the real cut in the value of benefits in 2022-23 is set to be largely undone in April 2023: on our post-Ukraine assumptions, benefits could be uprated by 7.2 per cent in April 2023 (or 6.7 per cent in April 2023, using the Bank's projections), while inflation in 2023-24 is projected to average 2.9 per cent. [38] Uprating of 7.2 per cent (or 6.7 per cent) would be the largest nominal increase for most benefits since 1991-92, when they rose by 10.8 per cent. Although this benefits rollercoaster shown in Figure 10 would end up with the real value of most benefits in April 2023 being broadly where they were in April 2021, this would still represent a prolonged period in which lower-income households will have seen incomes fail to keep up with sharp rises in the costs of essentials.

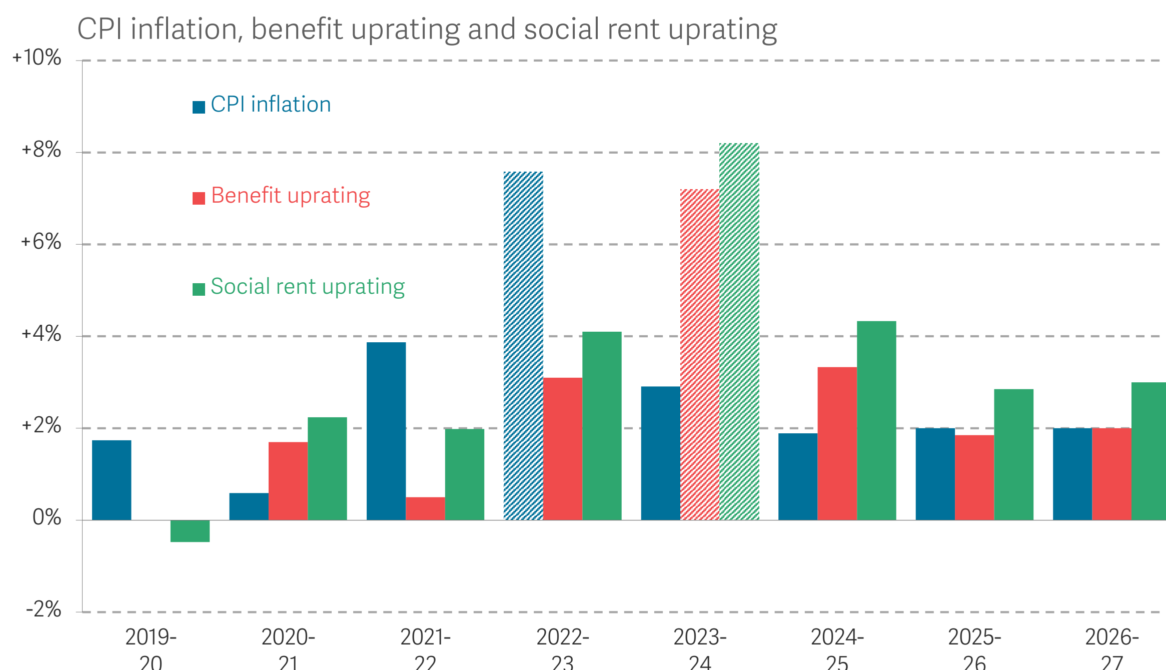
It should be noted, though, that not all benefits go up in line with inflation: having been increased in April 2020 to reach the 30th percentile of local rents, current policy is to freeze Local Housing Allowance rates at this level, but this will be reviewed annually.[39] If this policy continues, then by April 2025 they will have fallen by 14.5 per cent in real terms since April 2020 (under the Bank's pre-Ukraine forecasts). The benefit cap, which puts a ceiling on the total amount of benefit a household receives, is also frozen, meaning 180,000 households will see no rise at all in benefits in 2022-23, and more households will hit the cap.

Another factor in the benefit system that will have an increased impact on household incomes is the continuing rollout of the two-child limit to Universal Credit and Child Tax Credits. Despite it being introduced in 2017, the impact of the policy has affected households gradually, due to the policy only applying to children born on or after 6th April 2017. In 2022-23, the policy will affect just under three quarters of the caseload, and this will grow, becoming more of a drag on incomes as time goes on.

37 M Brewer et al., Taper cut: Analysis of the Autumn Budget changes to Universal Credit, Resolution Foundation, November 2021.
38 Based on the Bank of England's forecast for CPI in Q3 of 2022.
39 HM Treasury, Policy costings: November 2020, HM Treasury, November 2020.

FIGURE 10: **Inflation has a delayed effect on both benefit uprating and social rent uprating**

CPI inflation, benefit uprating and social rent uprating



NOTES: Most benefits were frozen in cash terms in 2019. The current settlement on social rent uprating of CPI + 1 per cent lasts until April 2025; for this analysis, we assume that this settlement continues for a further year. CPI inflation figures are for the financial year. Benefit uprating and social rent uprating numbers are based on the Bank of England's CPI forecasts for Q3 of the previous financial year. RF calculations are used for CPI inflation in 2022-23, and benefit and social rent uprating in 2023-24.
SOURCE: ONS, CPI; ONS, CPI Private rents, registered social landlord rents and local authority rents for the period January 2005 to May 2020; Bank of England, Monetary Policy Report – February 2022; OBR, Economic and Fiscal Outlook – October 2021; RF Calculations.[40]

Direct tax rises in April will result in lower incomes for all, but the effect is more significant at the top of the distribution

From April 2022, households will face incomes being squeezed even more by tax rises, as the Government combines a fiscal consolidation with longer-term plans to increase spending on health and care.

There are two main tax changes. First, the four-year freeze in the Income Tax personal allowance and higher-rate threshold announced in March 2021 will start in April. This equates to a tax rise in real terms, and will result in more people paying income tax, and more people paying the higher rate of income tax. Interestingly, the fact that inflation is higher than expected when this measure was announced means that it is raising more revenue: the OBR's forecast in October 2021 put the total yield from freezing the threshold at £5 billion more by 2025-26 than they did in their March 2021 forecasts; this yield is likely to go higher, as the likely path of inflation will be higher than the OBR's

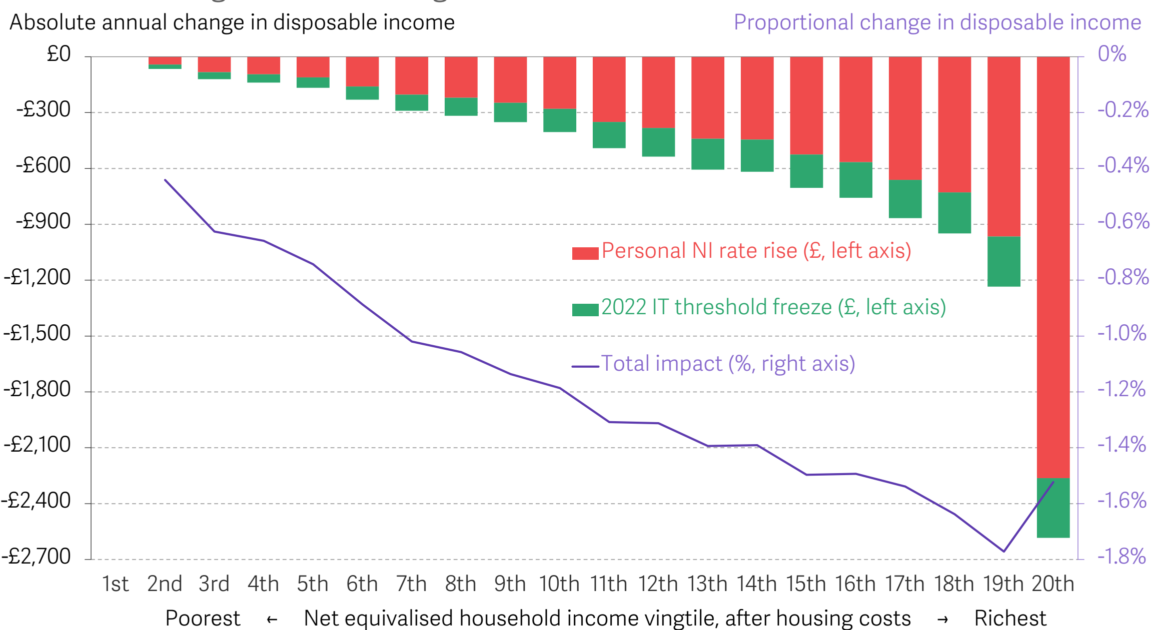
40 A Corlett et al., The Living Standards Outlook 2018, Resolution Foundation, February 2018.

October 2021 projections.[41] Second, as announced in September 2021, the employee, employer and self-employed National Insurance (NI) rates will rise by 1.25 percentage points, to help fund the NHS and social care;[42] dividend taxes will also increase by 1.25 percentage points.[43]

Although the overall squeeze on living standards will be felt across the income distribution, and rising energy bills will particularly affect those on lower incomes, the effect of these tax changes will be progressive. As shown in Figure 11, households in the 19th vingtile will lose 1.8 per cent of their disposable incomes, compared to 0.4 per cent for households in the 2nd vingtile.[44]

FIGURE 11: **April's National Insurance rate rise will hit higher income households the most**

Annual impact on average disposable household incomes in 2022-23, by equivalised income vingtile after housing costs: UK



NOTES: Figures are relative to a scenario without either tax rise. We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model.

41 Office for Budget Responsibility, Supplementary forecast information release: The effect of the personal allowance and higher rate threshold freezes on taxpayer numbers, Office for Budget Responsibility, January 2022.
42 This rise will be re-branded in April 2023 as a new tax, named the Health and Social Care levy. For more analysis, see: T Bell et al., Nationally Insured? New taxes and new spending to address key Department for Health and Social Care priorities, Resolution Foundation, September 2021.
43 HMRC, Increase of the rates of Income Tax applicable to dividend income, HMRC, October 2021.
44 This chart was first featured in T Bell et al., Labour Market Outlook Q4 2021: Wages and the cost of living in 2022, Resolution Foundation, December 2021.

The combination of rising inflation and interest rates will result in higher payments for both social renters and homeowners

Housing costs are also set to rise materially, but on different timescales for different tenures. Both the interest rate set by the Bank of England and the rate of inflation have a direct impact on housing payments for social renters and households with mortgages. We discuss these in turn.

In the social rented sector, high inflation will swiftly feed through into higher rents. Under the current social rent uprating settlement in England, which lasts until April 2025, social rents can be uprated each April by an amount up to the previous September's CPI inflation plus 1 per cent.[45] This means that social renters face a rent rise in April of up to 4.1 per cent, the largest rise in a decade. It is not yet clear how providers will respond, but it seems likely that many will raise rates by the maximum, as they were forced to make rent reductions of 1 per cent each year from 2016 to 2019. Rent rises are likely to be even higher for social renters in April 2023: based on the Bank of England's pre-Ukraine projections, social rents could rise by up to 7.7 per cent, and this could be 8.2 per cent under our post-Ukraine scenario (see Figure 12). These rent rises will considerable pressure on household incomes for social renters; 44 per cent of social renters don't receive any housing support from the benefit system (these are more likely to be living in London, the South East and the South West of England), and the Government's current policy is to freeze rates of Local Housing Allowances in cash terms.

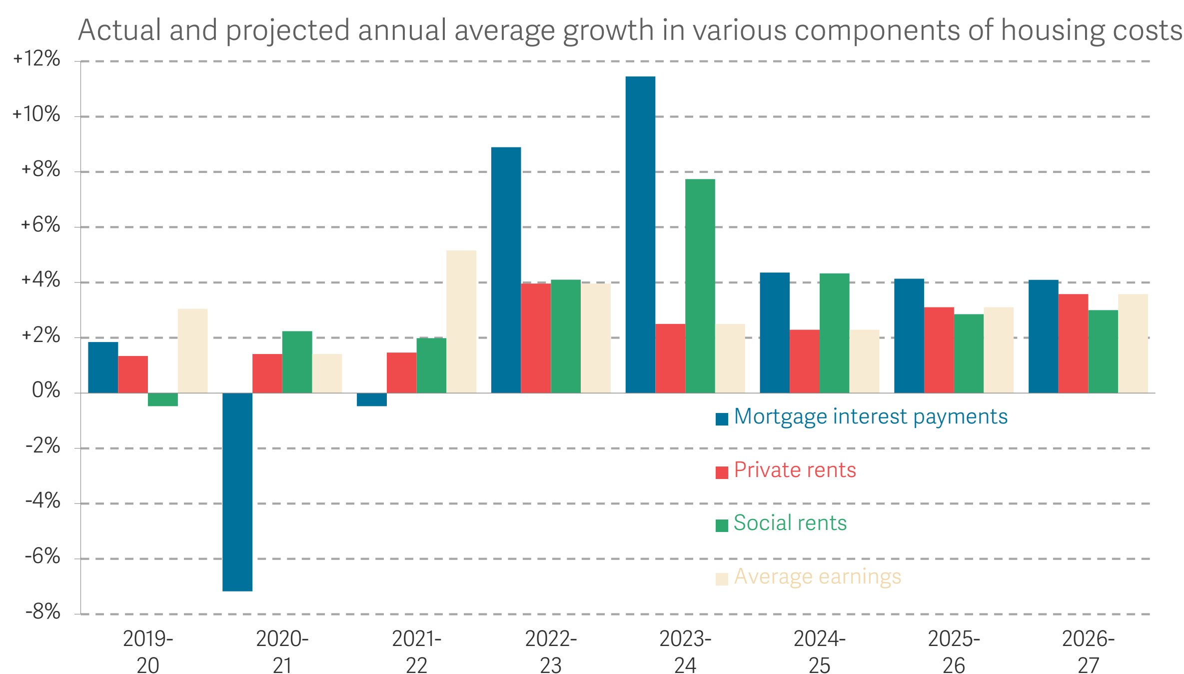
Interest rates have fluctuated significantly over the last couple of years, and are likely to change in the coming years too, with implications for mortgage interest payments. Interest rates were reduced from 0.75 per cent to 0.25 per cent, then 0.1 per cent at the start of the Covid-19 crisis, which led to average payments of mortgage interest rate falling by 7.2 per cent in 2020-21 – shown in Figure 12.[46] However, interest rates have since been increased by the Bank of England's Monetary Policy Committee (MPC) in an attempt to help bring inflation back to the Bank's target of 2 per cent: in December 2021, the MPC voted to increase interest rates to 0.25 per cent,[47] and in February 2022, interest rates were increased to 0.5 per cent.[48] Market interest rates underlying the Bank of England's latest projections (made in early February 2022) suggested that the Bank's policy rate was expected to rise from its current level of 0.5 per cent to hit 1.3 per cent

45 See: L Judge et al., Housing Outlook Q4 2021: The impact of higher inflation on social renters' housing costs, Resolution Foundation, December 2021. However, social rents may not be uprated by this figure, as the figure is the maximum uprating allowed under the settlement. Scotland has no social rent uprating settlement. In Wales, social rents can be uprated by a maximum of CPI plus 1 per cent as long as CPI stays within a prescribed range. Source: Welsh Government, New social rent policy balances tenant affordability with ambitions to build more homes – Julie James, Welsh Government, December 2019.
46 RF Analysis of Bank of England, Official Bank Rate History Data from 1694.
47 Bank of England, Monetary Policy Summary and minutes of the Monetary Policy Committee meeting ending on 15 December 2021, Bank of England, December 2021.
48 Bank of England, Monetary Policy Report – February 2022, Bank of England, February 2022.

in Q1 2023, what would be its highest rate since 2009.[49] Since then, market expectations have risen further, and although the Russian invasion of Ukraine has led to some tempering of those expectations, the latest market curve (2nd March) suggests rates could rise to around 1.7 per cent in Q1 2023. Although only a small minority of households have 'floating rate' mortgages (around 6.9 per cent) explicitly linked to changes in the Bank of England's policy rate, higher rates will over time result in increased housing costs for households with mortgages.[50] As a result, last autumn's projections from the OBR forecast that mortgage interest payment growth rates would grow by 8.9 per cent in 2022-23, and 11.5 per cent in 2023-24.

FIGURE 12: **Changes to interest rates and inflation result in higher mortgage and social rent payments in 2023-24**

Actual and projected annual average growth in various components of housing costs



NOTES: Private rents are calculated as the percentage change between averaged rents for the financial years for 2019-20 and 2020-21. For 2021-22, the data is calculated as the change between the average of private rents from April-December 2020 to April-December 2021, due to more recent data being unavailable. For 2022-23 onwards, OBR projections of average earnings growth are used for private rents. Social rent data is for England only, and uses Bank of England inflation projections. The settlement on social rent uprating of CPI+1 per cent lasts until April 2025; we assume it continues to April 2026.
SOURCE: OBR, Economic and Fiscal Outlook November 2020, March 2021, October 2021; ONS, Experimental Index of Private Housing Rental Prices; Bank of England, Monetary Policy Report February 2022; ONS, CPI Private rents, registered social landlord rents and local authority rents for the period January 2005 to May 2020.

In Figure 12, we show private rents increasing at the same rate as average earnings, in line with the usual assumptions made by the OBR. However, there are many reasons

49 RF Analysis of Bank of England, Official Bank Rate History Data from 1694.
50 J Leslie & J Smith, What goes down must come up: The Bank of England becomes the first major central bank to raise rates but impact will be small with fiscal policy key to Omicron response, Resolution Foundation, December 2021.

why the outturn could be different. Pre-crisis, private rents hadn't typically increased above CPI inflation for a sustained period of time, apart from in London.[51] The weak economic outlook and squeeze on household budgets could result in lower private rents if a reduced income means tenants are less able to pay. On the other hand, any rise in interest rates could cause landlords to seek higher rents to match their higher mortgage payments. Furthermore, it is still not clear what the long-run impact of Covid-19 on the rental market is. In London, for example, the annual change in rental prices has fallen in 7 months of the last 12, and it is not clear how rents will change in future.[52]

This section has set out the main determinants of household income over the next five years: inflation, unemployment, participation, energy policy and prices, wage growth, benefit policy, tax policy and housing costs. Although the war in Ukraine has added a considerable amount of volatility to what were already uncertain projections, the high level of inflation over the next year or so, and the weak growth in nominal earnings over the medium-run, mean that household finances are in for rough ride over the next few years. In Section 3, we show the outcomes of our detailed modelling for household incomes across the distribution.

51 L Judge & D Tomlinson, Home improvements: action to address the housing challenges faced by young people, Resolution Foundation, April 2018.
52 RF analysis of Office for National Statistics, Experimental Index of Private Housing Rental Prices.

Section 3

Prospects for household incomes

Putting together all of the factors discussed in Section 2, we can model and project changes in household disposable incomes. Focusing on median living standards – and excluding pensioners – our modelling suggests that household incomes were relatively protected in 2020-21 (with growth of perhaps 1 per cent) and grew again in 2021-22 (by another 1 per cent). In contrast, there is an incomes recession ahead of us. Inflation of around 8 per cent in 2022-23 would leave the typical real household income for non-pensioners 4 per cent – or £1,000 – lower than in 2021-22.

Even if we assume no significant fallout from the situation in Ukraine, real incomes are also projected to fall in 2023-24 – with typical incomes dropping by 2 per cent due to falling real wages, rising mortgage costs and the abrupt change from a £350 energy support package in 2022-23 to a £40 levy in 2023-24. Projections based on the Bank's forecasts of weak nominal earnings growth and rising unemployment imply negligible growth in 2024-25 and 2025-26 (0 per cent) and only weak growth of 1 per cent in 2026-27.

A scenario where nominal earnings growth remained at 4 per cent a year after 2022-23 (rather than growth dropping) and where unemployment remained near its current rate (rather than rising) would improve prospects, but growth in typical incomes in 2023-24 would still be negative. And even with these less pessimistic labour market outcomes – and assuming (unrealistically) that there is no long-run impact of the war in Ukraine on UK living standards – the typical real income would still be lower in 2026-27 than in 2021-22.

These trends are far from uniform across the income distribution. The incomes of the poorest were boosted in 2020-21 by the temporary boost to UC and Tax Credits – but the removal of these boosts, alongside rising inflation, led to falling incomes for lower-income households in 2021-22. Incomes in 2022-23 are projected to fall right across the income distribution, but the impact of the benefit rollercoaster means that the poorest may see a smaller income fall than better-off households in 2023-24.

Comparing four or five-year periods corresponding to Westminster parliaments, we find that 2019-20 to 2024-25 is currently on track to be the worst on record for income growth – with the typical non-pensioner income falling 2 per cent.

Pulling together all the components of household income, the outlook is weak, with large real income falls projected for 2022-23

Having set out the prospects for prices, earnings, jobs, benefits, taxes and housing costs in Section 2, we now turn to what all of that means for our central measure of living standards: real, equivalised, household disposable incomes, after housing costs.[53]

Figure 13 sets out how the median household income of non-pensioners has changed each year since 1961, according to official data, and – after 2019-20 – the changes implied by our projections.[54] It shows, for example, falling incomes after the financial crisis; a 'mini-boom' when fossil fuel prices fell between 2014 and 2016; and a more mixed picture up to 2019-20, with a period of weak growth due to high inflation in the year or two after the Brexit referendum of 2016, but seemingly strong growth in 2019-20 itself.[55] Over the entire period from 1961 to 2019-20, the typical real income for non-pensioners has almost tripled – growing by around 1.9 per cent a year on average.

At the time of writing, household income data is not yet available for 2020-21 and 2021-22 (though the former should be released soon after the publication of this report). But we do of course know a great deal about how economic circumstances have changed over the past two years (as set out in Section 2), and so our 'nowcasts' are largely based on hard data. As we have shown in previous work (discussed in Box 5), household incomes were relatively protected in 2020-21 (despite GDP falling by 11 per cent), with projected growth of 1 per cent in the real typical non-pensioner income. Although 2021-22 is not yet quite over, our nowcast for this year also suggests real growth of 1 per cent.

53 'Real' means adjusting for CPI inflation (though a special variant is used that includes no housing costs, so as not to double count the impact of housing costs). 'Equivalised' means accounting for household size, reflecting the fact that a couple with several children need a higher income than a single person to have the same standard of living. 'Household' income means we are concerned with a household's total income rather than individual-level incomes (and it is assumed for simplicity that incomes are shared within households). 'Disposable income' means we account for taxes paid, benefits received and pension contributions made. And we measure incomes 'after housing costs' to account for the fact that an outright homeowner on £15,000 will have very different living standards to a private renter with an income (before housing costs) of £15,000 (an alternative would be to measure the homeowner's 'imputed rental income', but this is not straightforward). This is all in line with the income statistics produced by the Government: see DWP, Households below average income: for financial years ending 1995 to 2020, March 2021.

54 We tend to exclude pensioners both because their household incomes are driven by different (longer-term) trends and because these changes are more difficult to accurately model. We use person weights, so the median refers to the median person (excluding pensioners) when ranked by household income rather than the median household.

55 See: K Handscomb, K Henehan & L Try, The Living Standards Audit 2021, Resolution Foundation, July 2021.

BOX 5: Our previous projections

More detailed discussion of how household incomes fared in 2020-21 can be found in previous Resolution Foundation reports. In 'The Living Standards Audit 2020' we took a rapid look at real incomes during May 2020 – when approaching 9 million employees were furloughed.[56] This analysis suggested that the typical income had fallen sharply at the start of the pandemic compared to 2019-20. However, as we explored in 'The Living Standards Outlook 2021'[57] and 'The Living Standards Audit 2021'[58], the full year of 2020-21 now shows relatively strong growth – particularly at the bottom of the income distribution – as we demonstrate again in this report.

Our nowcast for 2021-22 in this report is less pessimistic than the forecast in 'The Living Standards Outlook 2021', and this is to be expected: unemployment fared much better than external forecasts expected (with the furlough scheme also being extended); earnings have done better; and the £20 a week benefit boost was continued for an additional six months, and followed by the permanent (albeit smaller) UC increases. As we explore below, however, our projections for the next few years – which we previously hoped would be a 'recovery' period – have got much worse.

Turning to the future, however, the prospects for real household incomes are poor. With inflation now forecast to be 8 per cent for 2022-23 as a whole, we project a fall in the typical real non-pensioner income of 4 per cent.[59] This is a scale of fall only previously seen around the recessions of the financial crisis, early 1980s and mid-1970s (with 1975 being the only year that shows a larger income fall, in Figure 13).

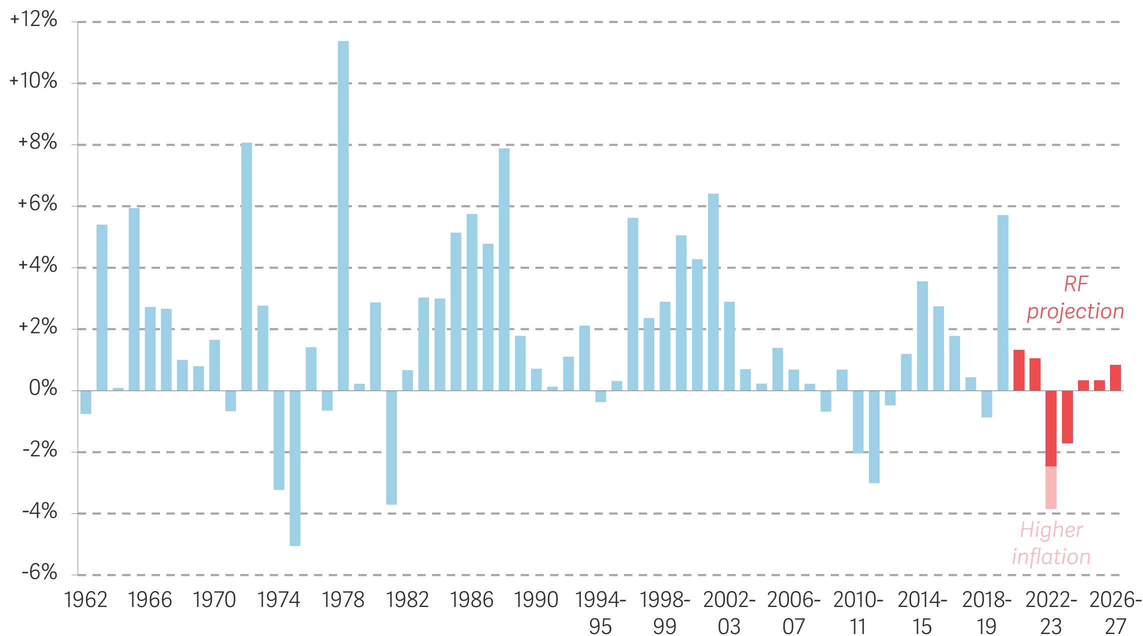
Real incomes are also projected to fall in 2023-24 – with typical incomes falling by 2 per cent, in part due to falling real wages (in the Bank's forecast) and rising mortgage costs.[60] It should be noted that we have treated the £150 Council Tax rebate and the £200 Energy Bill Rebate as income in 2022-23, and then treated the £40 added to energy bills as a deduction from incomes in subsequent years. As we discuss in Box 6, this £350 reduces

56 D Tomlinson et al., The Living Standards Audit 2020, Resolution Foundation, July 2020.
57 M Brewer et al., The Living Standards Outlook 2021, Resolution Foundation, January 2021.
58 K Handscomb, K Henehan & L Try, The Living Standards Audit 2021, Resolution Foundation, July 2021.
59 If we instead use the Bank's February (pre-Ukraine) forecast of inflation, we project a real income fall of 2 per cent: still very large by historic standards.
60 Our projections beyond 2022-23 are based on pre-Ukraine economic forecasts. This might mean we underestimate benefit uprating in 2023-24 slightly relative to our supplementary 2022-23 inflation forecast, but the situation could of course lead to higher inflation and lower growth beyond 2022-23.

the scale of the income hit in 2022-23, but this then turns into a £40 surcharge (meaning a £390 income hit) in 2023-24 as the policies are unwound.

FIGURE 13: **The projected fall in typical real income in 2022-23 is of a scale that has not been seen outside of recessions**

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



NOTES: Based on economic forecasts from before the war in Ukraine, with the exception of the 'higher inflation' projection for 2022-23 (see Box 1 for further discussion). 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.

Falls in typical real income for two successive years have never been experienced outside of recessions. But the forecast beyond 2022-23 and 2023-24 is not encouraging either, with no rapid rebound from the period of high inflation. Zero growth is projected for 2024-25 and 2025-26 (when rounded) – driven by the very weak real earnings growth forecast set out in Section 2 (although, as we discussed there, this should be seen as particularly uncertain). It is only at the end of our projection period, in 2026-27, that typical real incomes start growing faster – though even this projected growth of around 1 per cent is less than half the average growth rate since 1961.

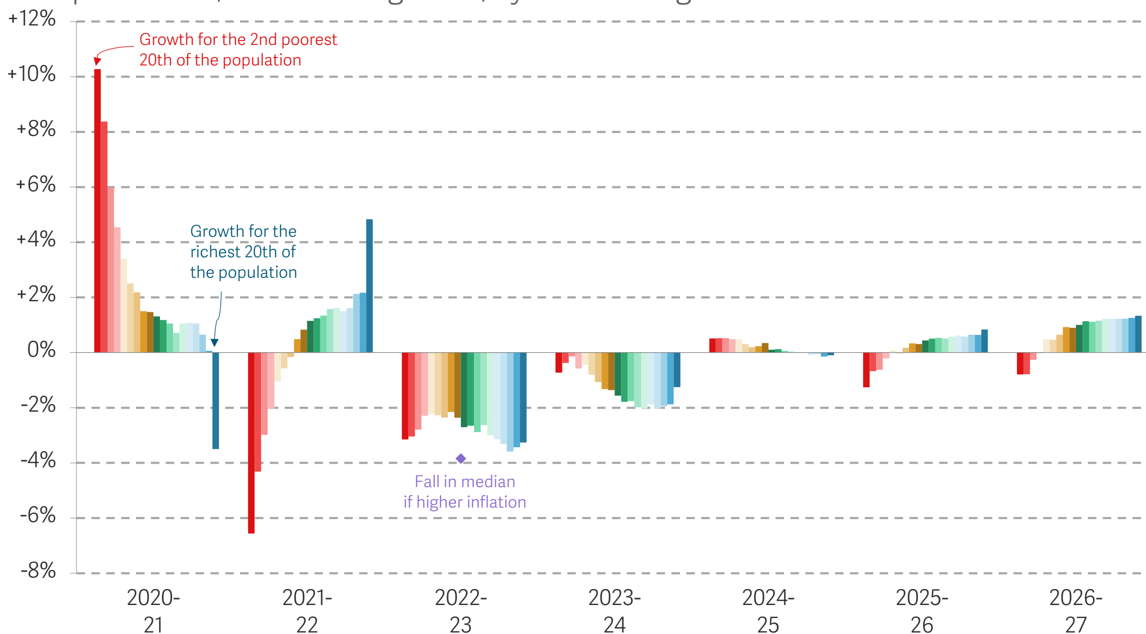
Growth rates will not be equal across society, however. Figure 14 shows projected real changes in incomes across the entire distribution in each year. People in lower-income households (in red) saw higher income growth in 2020-21 than the rest of the population, driven by the temporary increases to UC and the other benefits, but the ending of this support saw large income falls for low-income households in 2021-22, even allowing for

the extra money for working UC recipients announced last October. At the other end of the spectrum, the highest-income twentieth of the population (in dark blue), likely saw falling incomes in 2020-21 as dividend income collapsed; but then saw a large recovery in 2021-22.

But after the rollercoaster of changes in 2020-21 and 2021-22, 2022-23 is projected to be a terrible year for income growth across the entire income distribution. The £350 support package for energy costs does provide a greater proportional help for low to middle income households, but this is partly offset by the fact that (as with 2021-22) the expiration of temporary benefit increases has a negative impact on the income growth of the poorest. In 2023-24, although inflation is set to be lower (around 3 per cent), and even the pre-Ukraine forecasts were for benefits to be uprated by over 6 per cent in April 2023 – protecting the poorest to a significant degree – this is essentially offset by the removal of the £350 support package and its replacement with a £40 per household energy levy. Nominal pay growth in 2023-24 is also currently forecast to be lower than inflation, at only 2.5 per cent.

FIGURE 14: **Rapid changes in benefit policy, prices and benefit uprating mean large swings in household income for the lowest-income households**

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



NOTES: Based on economic forecasts from before the war in Ukraine, with the exception of the 'higher inflation' point for 2022-23 (see Box 1 for further discussion). 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.

Towards the end of our projection period, growth is weakest at the bottom of the income distribution. This is in the keeping with the fact that most benefits are due to stay constant in real terms, and others are due to be cut – as discussed in Section 2 – such as the freezing of Local Housing Allowances and the roll-out of the two-child limit, while earnings should begin to grow in real terms.

BOX 6: **Accounting for 'rebates'**

As set out in Section 2, the Government's response to the April 2022 rise in the energy price cap is dominated by two unusual policy interventions – a £150 Council Tax rebate and a £200 Energy Bills Rebate. It is not yet clear how statistical bodies such as the ONS will account for these.

In this report, our main measure of income is net of Council Tax. So it makes sense that a £150 rebate delivered through the Council Tax system should be added to incomes. This rebate will not affect the Consumer Price Index as Council Tax is not part of this basket of goods and services; but the ONS will have to decide whether it will affect CPIH, which does include Council Tax.

The ideal treatment of the Energy Bills Rebate is less clear. On the one hand, it can be seen as an interest-free (compulsory) loan to electricity bill-payers, with the boost in 2022-23 perfectly offset by losses over the following five years, and so it is tempting to ignore it. But it is not formally a loan, and it does make a difference to household finances (it is not that different to a universal benefit now followed by a tax over the next five years).

As the rebate is delivered through electricity bills, one scenario is that the ONS incorporate this when calculating the CPI: this would have a material impact on inflation rates in 2022-23 and 2023-24. But the ONS have indicated that it will not necessarily be accounted for in this way, as it is a one-off payment, and it should not affect demand for electricity (because it does not change the marginal price). Some previous rebates – including the £12 Government Electricity Rebate that existed in 2014 and 2015 – have instead been considered as income by the ONS.

The Family Resources Survey and derived Households Below Average Income (HBAI) data will also need to decide how to treat the two policies. It is possible that neither will be counted as household income: there are, after all, many types of government spending that are not counted as disposable income; and household income surveys tend to exclude 'irregular' income such as pension lump sums, capital gains

and inheritances, as we have explored in previous work.[61] On the other hand, the HBAI data does count a free TV licence as income (for those pensioners that are entitled to one), and the energy price discount could be seen as analogous to that.

To try and best reflect households' cashflows, we have treated both policies as providing additional household income in 2022-23. To be symmetric, this means that we have to count the compulsory £40 a year levy from 2023-24 onwards as if it were a per-household lump sum tax. And this means that what was a £350 boost to incomes (for those in Bands A to D) becomes a £40 a year deduction, and so a swing of £390 when comparing 2022-23 to 2023-24.

Across the distribution, incomes are currently expected to be lower at the end of this parliament than at the start

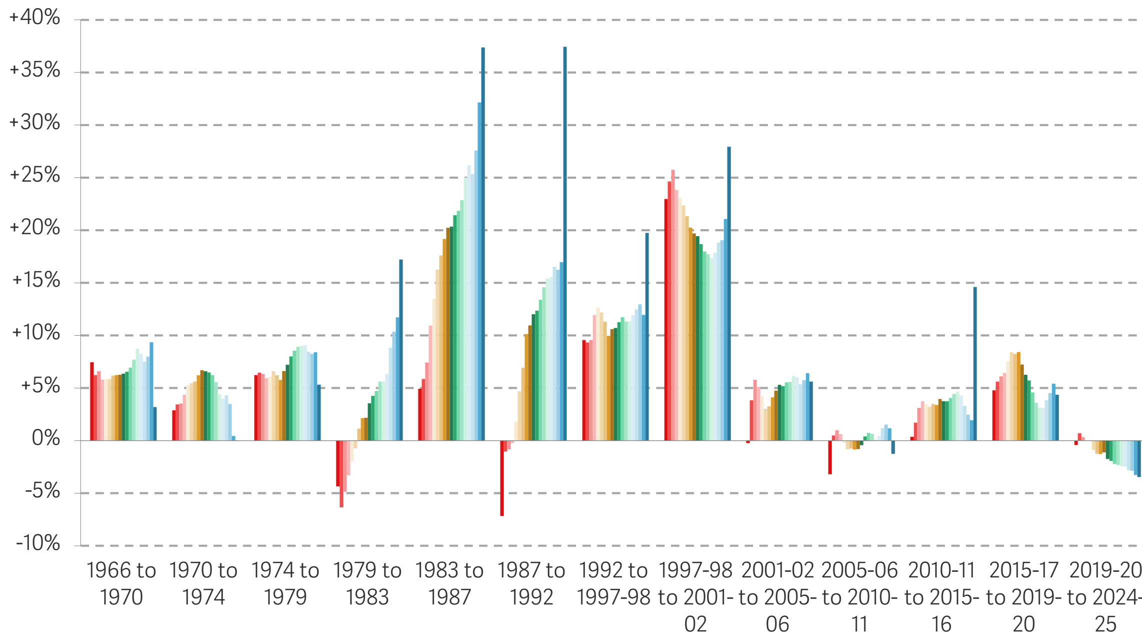
Growth figures for a single year can reflect merely temporary policy interventions, or (potentially) temporary price spikes. But we can also zoom out and look at how real incomes may change over the five years from 2019-20 to 2024-25 as a whole: from pre-pandemic to a year when policy and the economy will have hopefully returned to more of a steady state; and from the last election to the next (at least according to the not-yet-repealed Fixed-term Parliaments Act). Here, we base our projections on the Bank of England's February forecasts, which is equivalent to assuming that the war in Ukraine has no long-run impacts on UK household incomes.

As the columns on the right of Figure 15 shows, our current projection leaves non-pensioner real incomes – across the income distribution – lower in 2024-25 than in 2019-20, with the median 2 per cent lower. It would not take a large forecast change to make the results positive, but a historical comparison makes it clear that growth of anywhere around zero would be unusually weak. Indeed, there have been two four-year periods where typical real incomes grew by 20 per cent (from 1983 to 1987, and from 1997 to 2001-02). The only comparable result is the parliament from 2005-06 to 2010-11,[62] when the typical income fell by 1 per cent.[63]

61 A Advani, A Corlett & A Summers, Who gains? The importance of accounting for capital gains, Resolution Foundation, May 2020.
62 As our data is based around financial or calendar years, this is only an approximation of the income growth that occurred between precise election dates.
63 We made a similar point in previous work, using a slightly different measure, arguing that this parliament was set to be the worst on record for growth in total household income per person, with growth of under 1 per cent between Q4 2019 and Q2 2024. See: A Corlett, Are you better off today? Real income growth under different governments since 1955, Resolution Foundation, November 2021.

FIGURE 15: **This Parliament risks being the worst on record for real household income growth**

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



NOTES: Based on economic forecasts from before the war in Ukraine. Some periods are four years long and others five years. The chosen time periods correspond to the years of past general elections (plus 2024), 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.

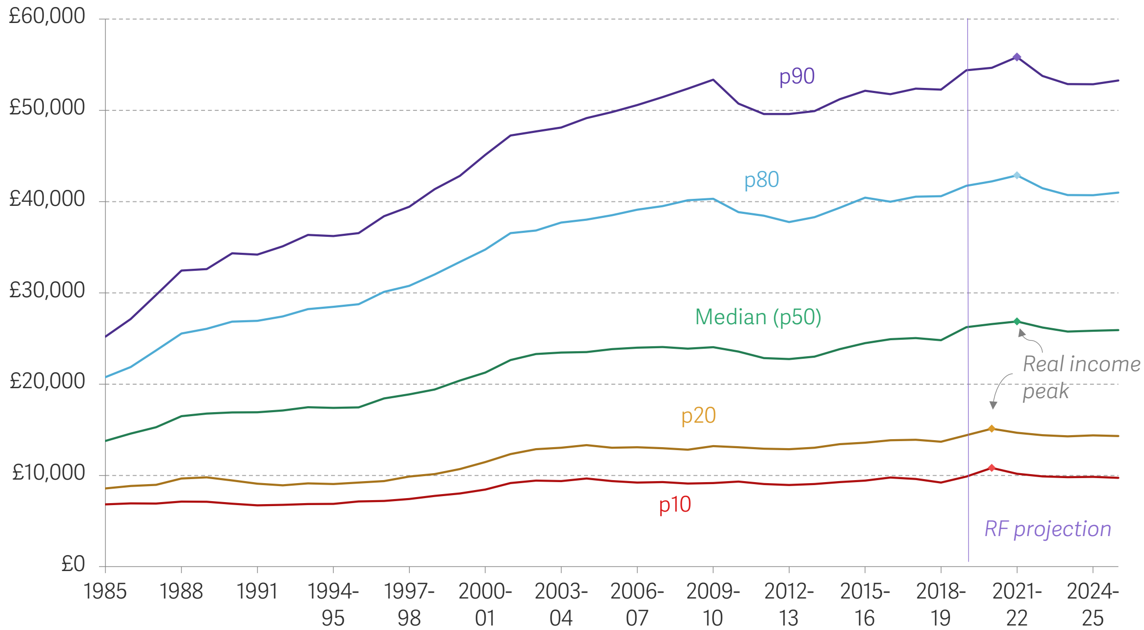
Remarkably, this weak growth, together with forecasts for only slightly improved growth after 2024-25, also means that incomes are expected to be lower in 2026-27 than in 2021-22 (again, we stress that this is using a set of pre-Ukraine forecasts). For the poorest, the peak income year in our forecast is actually 2020-21, while for most of the income distribution the peak year is 2021-22 – as highlighted in Figure 16.

Figure 16 also shows that the current living standards squeeze is not the only one UK households have faced relatively recently. It was, of course, preceded by the massive impact of the financial crisis, and the period of falling real pay and the benefit freeze that followed the Brexit referendum. And even before the Great Recession (from around 2003-04 to 2007-08), growth in real disposable incomes had been weak for much of the income distribution, for a range of reasons including rising housing costs.[64]

64 A Corlett et al., The Living Standards Audit 2018, Resolution Foundation, July 2018.

FIGURE 16: **Even before factoring in the impact of war in Ukraine, real disposable incomes are expected to be lower in 2026-27 than in 2021-22**

Distribution of annual equivalised household disposable incomes for non-pensioners, after housing costs, 2021-22 terms: GB/UK



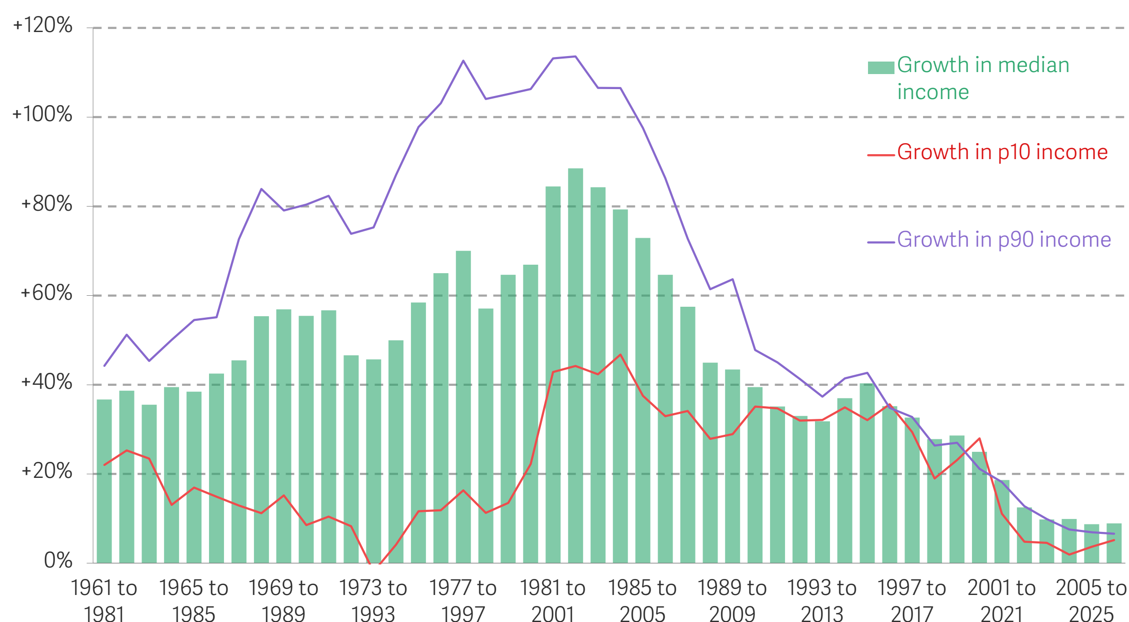
NOTES: Based on economic forecasts from before the war in Ukraine. 'p10', for example, is the income of someone whose household income is higher than (only) 10 per cent of the population.
SOURCE: RF analysis of DWP & IFS, Households Below Average Income; and RF projection including use of the IPPR Tax Benefit Model, ONS data, and Bank of England and OBR forecasts.

Given this combination of earlier crises, growth in typical incomes over the twenty-year period from 2001-02 to 2021-22 is likely the weakest on record (Figure 17). And the current squeeze is likely to break that record, with twenty-year income growth falling to 9 per cent for the period from 2005-06 to 2025-26 even under pre-Ukraine scenarios. This would leave an enormous growth shortfall: if incomes over this period had grown in line with the previous long-term trend, the typical income in 2025-26 would be 43 per cent (£11,000) higher than currently projected.

Near the bottom of the income distribution ('p10') – real incomes in 2024-25 are projected to be unchanged from 2004-05. Such weak growth was also evident over the period from 1973 to 1993. But the last twenty years are notable for combining weak growth for the entire income distribution, with the worst growth ever at the median and 'p90', as well as near-zero growth for the poorest.

FIGURE 17: **The period from 2005-06 to 2025-26 is currently forecast to be the worst two decades on record for real income growth**

20-year real growth in median income, p90 and p10: GB/UK



NOTES: Based on economic forecasts from before the war in Ukraine. All figures beyond 2019-20 are projected. 'p10', for example, is the income of someone whose household income is higher than (only) 10 per cent of the population.
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.

It should be borne in mind that real household incomes are generally at or near record highs (see Figure 16 again), and will remain so. But it is clear that the current outlook, if realised, would be a bad result in terms of growth.

There are many ways in which this outlook might improve, but ultimately stronger real wage growth is needed

Section 2 set out the many factors that help to create this weak outlook, but also the high degree of uncertainty about many of these. To illustrate this uncertainty, Figure 18 presents our base scenario (with and without an upwards inflation revision in 2022-23) alongside two more optimistic scenarios.[65]

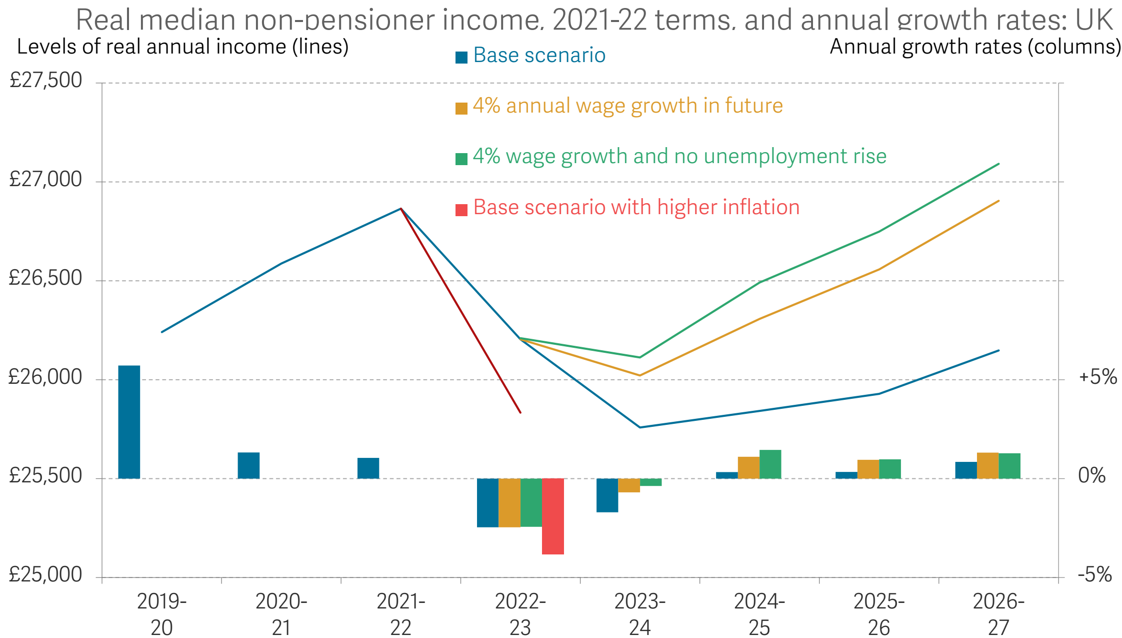
In one scenario (in yellow), average wage growth remains at its projected 2022-23 level of 4 per cent a year, rather than falling. However, we (generously) assume this higher pay growth would not affect inflation, rents, mortgage costs, investment income or anything else. In the second extra scenario (in green), not only does wage growth remain at 4 per cent but unemployment also remains at its pre-pandemic level (just below 4 per cent) from 2022-23 onwards; rather than rising as the Bank currently forecasts.

65 We have not attempted to consider the medium-term impact of a prolonged war in Ukraine, but obviously this would a more pessimistic scenario than any of the ones considered.

For the labour market to outperform in these ways would essentially require either a larger (real) economy, a larger labour share than expected, or both.

FIGURE 18: **Three scenarios help show that the forecast could improve but that it would take big changes in nominal earnings to offset the impact of higher prices**

Real median non-pensioner income, 2021-22 terms, and annual growth rates: UK



NOTES: Based on economic forecasts from before the war in Ukraine, with the exception of the 'higher inflation' series. See Box 1 for discussion of potential higher inflation in 2022-23. All figures beyond 2019-20 are projected.
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.

Clearly, these alternative economic parameters would improve the real income forecast: the typical non-pensioner income would be £1,000 higher (4 per cent) by 2026-27 in the most optimistic of the scenarios. Growth in 2024-25 and beyond would be healthier (at around 1 per cent a year). But income growth in 2023-24 would still be negative and, even in the most optimistic of the scenarios, total income growth between 2021-22 and 2025-26 would be zero: this is driven by the weak outlook for 2023-24 and the large income fall in 2022-23 (which we do not vary here except for a marginal unemployment improvement). Similarly, even in the higher wage growth and lower unemployment scenario (which also assumes no long-run impact of the war in Ukraine), median income growth between 2019-20 and 2024-25 would still be lower than over any previous parliament except for that from 2005-06 to 2010-11.

In Section 5, we discuss some of the policy thinking that might be needed to improve the outlook, both in the short-term and the long-term. But first we turn to what our projections for incomes across the income distribution would mean for different groups and for standard measures of poverty and inequality.

Section 4

Prospects for poverty and inequality

We estimate that the significant pandemic-related package of benefit support in 2020-21 contributed to welcome reductions in income inequality, relative poverty and absolute poverty. However, these changes were in all likelihood reversed in 2021-22, despite the permanent UC boost for in-work families from late 2021. Absolute poverty may have fallen from 18 per cent in 2019-20 to 16 per cent in 2020-21, but we project a rise to 17 per cent in 2021-22 and to 18 per cent in 2022-23. Remarkably, the prevalence of absolute child poverty is projected to be higher in 2026-27 than in 2019-20, with a very large rise of 5 percentage points between 2020-21 and 2022-23 (with our adjustment for higher inflation).

After the dip and rebound of 2020-21 and 2021-22, the outlook for relative poverty and relative inequality is comparatively flat, because income growth is set to be weak for everyone. High benefit uprating in 2023-24 may provide a temporary narrowing of inequalities, though relative poverty may continue its pre-pandemic upwards trend after that point, as the two-child limit and abolition of the family element continue to affect more families, and as earnings grow more swiftly relative to social security.

Relative poverty is projected to particularly rise for households with more than two children. In 2012-13, around one-in-three children in large families (households with three or more children) were in relative poverty. By 2021-22 that may have reached a record high of almost 50 per cent – and by the end of our projection period (2026-27) the majority of children in large families may be living in relative poverty.

Overall inequality is set to remain high, after a brief drop in 2020-21, but may fall over the parliament as a whole

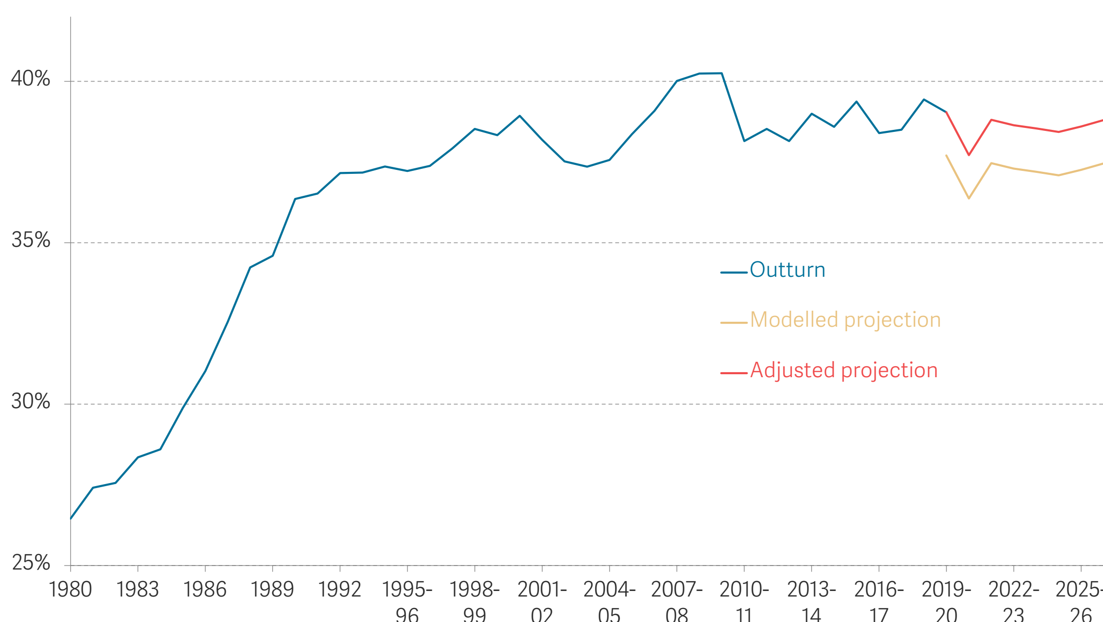
In Section 3 we set out how incomes are projected to grow (or shrink) across the income distribution of non-pensioners. However, it is useful to boil these patterns down into standard measures of inequality and poverty that look at the whole population (including pensioners), and to look in greater depth at the potential outlook for particular groups. All

of these forecasts are based on pre-Ukraine scenarios.[66]

Looking first at overall inequality in the (relative) distribution of household incomes,[67] Figure 19 shows (in red) what default Government policy in each year, together with the latest economic projections set out in Section 2, implies for the Gini coefficient – a measure of inequality where zero represents complete equality and one (or 100 per cent) represents the most extreme inequality possible.

FIGURE 19: **Overall income inequality is likely to have fallen in 2020-21, but has since bounced back**

Gini coefficient for equivalised household disposable income, after housing costs: GB/UK



NOTES: Data source changes in 1994-95. GB from 1994-95 to 2001-02. Our modelling produces lower inequality 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.
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 most notable finding (matching the trends set out in Section 3) is that 2020-21 is likely to have seen a relatively large drop in income inequality (from 39 to 38 per cent), but that this may have been largely reversed in 2021-22. Over subsequent years, and our entire forecast period as a whole, there is little change in this measure of inequality (although it should be noted that our modelling does not include any inputs that would allow future growth in top market incomes to significantly differ from typical wage

66 Higher inflation on its own does not have any direct impact on measures of relative poverty and inequality, but could change the value of benefits relative to earnings in the medium-term, which would have an effect.
67 Following convention, we stick to measuring 'relative' inequality here, whereby a doubling of everyone's incomes would leave inequality unchanged – even though the 'absolute' gaps between groups would also double in that case. For further discussion, see: A Corlett, G Bangham & D Finch, The Living Standards Outlook 2018, Resolution Foundation, February 2018.

growth, for example).[68] On these numbers, inequality as measured by the Gini coefficient would be slightly lower in 2024-25 than at the start of the parliament in 2019-20, as benefit income would be better-protected than earnings from high inflation over this time scale. Very similar results are found for some other measures of inequality – specifically, the '90/10' and '50/10' income ratios (not shown).

The most notable finding (matching the trends set out in Section 3) is that 2020-21 is likely to have seen a relatively large drop in income inequality (from 39 to 38 per cent), but that this may have been largely reversed in 2021-22. Over subsequent years, and our entire forecast period as a whole, there is little change in this measure of inequality (although it should be noted that our modelling does not include any inputs that would allow future growth in top market incomes to significantly differ from typical wage growth, for example).[69] On these numbers, inequality as measured by the Gini coefficient would be slightly lower in 2024-25 than at the start of the parliament in 2019-20, as benefit income would be better-protected than earnings from high inflation over this time scale. Very similar results are found for some other measures of inequality – specifically, the '90/10' and '50/10' income ratios (not shown).

As set out in Section 3, this stable outlook for inequality overall is not a result of strong, shared growth, but rather of terrible but shared prospects.

Progress in reducing relative poverty in 2020-21 is being undone

The outlook for overall inequality is broadly mirrored in the outlook for relative poverty. Again, it looks likely that there was a notable reduction in relative poverty in 2020-21, both across the whole population (including pensioners) and for children specifically, but this may have been entirely reversed in 2021-22. Relative poverty rates may dip in 2023-24 as the incomes of the poorest are expected to fall less than everyone else's, as benefit rates in April 2023 catch up with the rapid inflation seen in 2022. Towards the end of the projection period, though, relative child poverty begins to rise, as family benefits continuously fall behind relative to earnings growth and the two-child limit continues to be rolled out. In our scenario of faster wage growth (not shown), relative poverty rises slightly faster.[70]

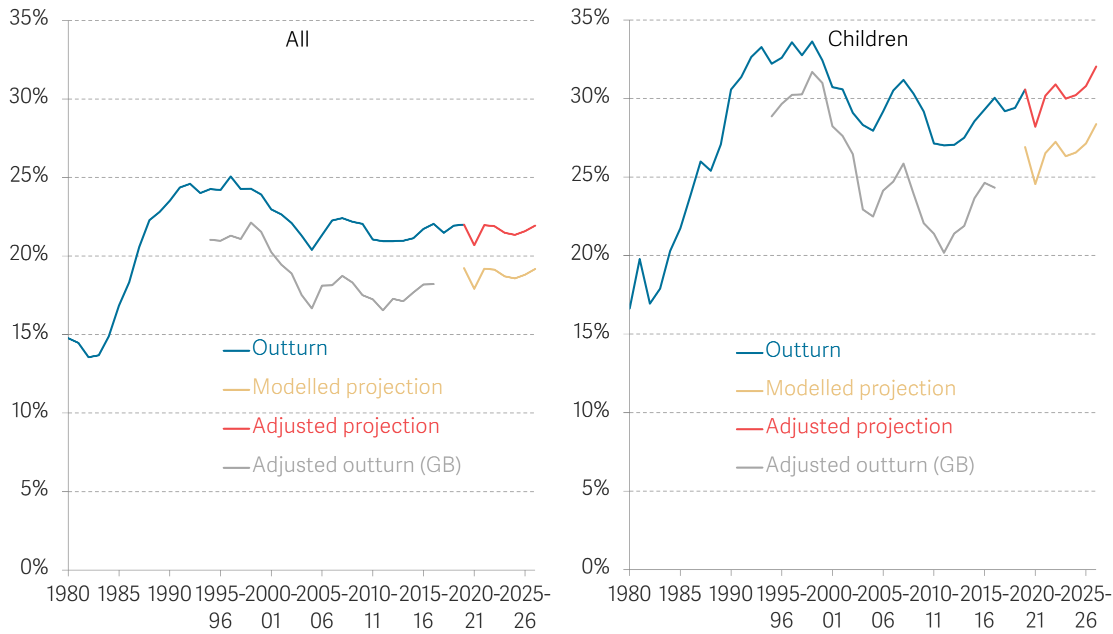
68 These projections use the Bank of England's pre-Ukraine forecasts, and not the higher inflation that we project for 2022-23 that we set out in Box 1, but any higher inflation in 2022-23 will have no direct impact on the Gini coefficient.

69 These projections use the Bank of England's pre-Ukraine forecasts, and not the higher inflation that we project for 2022-23 that we set out in Box 1, but any higher inflation in 2022-23 will have no direct impact on the Gini coefficient.

70 These projections use the Bank of England's pre-Ukraine forecasts, and not the higher inflation that we project for 2022-23 that we set out in Box 1, but any higher inflation in 2022-23 will have no direct impact on relative poverty measures.

FIGURE 20: **Relative poverty is likely to have fallen in 2020-21 but then bounced back**

Proportion of people/children 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. The grey line shows an attempt to instead adjust the outturn data to account for missing benefit income, from A Corlett et al., The Living Standards Audit 2018, Resolution Foundation, July 2018.
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.

It should be noted that poverty numbers may be revised (likely downwards) in the years to come, and this is discussed in Box 7. Accordingly, Figure 20 also shows our actual modelled projections (not adjusted to match the published data in 2019-20), as well as previous Resolution Foundation work estimating how historic data might be changed if certain data problems were resolved.

BOX 7: Income and poverty figures are expected to be revised over the next few years

In this report, outturn household income data largely comes from the DWP's Households Below Average Income (HBAI) data. This is an excellent resource but, like most household surveys, should not be considered perfect. In particular, we know that benefit income is under-reported. We have previously shown that around £40 billion per year of benefit spending is missing from the HBAI data, and that this naturally leads to biases in the level and trend of income statistics, particularly for poverty.[71] For example, our earlier work suggested that the proportion of pensioners living in relative poverty (in 2016-17) may have been not 16 per cent but 11 per cent.

To avoid confusion, we have used DWP-based figures for levels of poverty, income and inequality, and set our projections to be consistent with these in terms of levels (though we do not adjust our projected changes to account for HBAI's biases).

However, the coming years will hopefully bring developments in correcting or supplementing the survey data. DWP is now able to link 94 per cent of survey responses to the department's administrative data.[72] This should allow incorrect survey responses about benefit income to be corrected, and for weightings to be adjusted to ensure that the missing sum of around £40 billion a year is accounted for. Doing so was a recommendation of a review by the Office for Statistics Regulation,[73] and is part of the Government Statistical Service's 'vision for [the] coherence of income and earnings statistics'.[74]

Exactly when this work begins to feed through to the DWP's public data (and that of the ONS); how far back revisions can be made; and precisely what impact it will have, remains to be seen, but these changes should represent a significant improvement to the UK's income statistics.

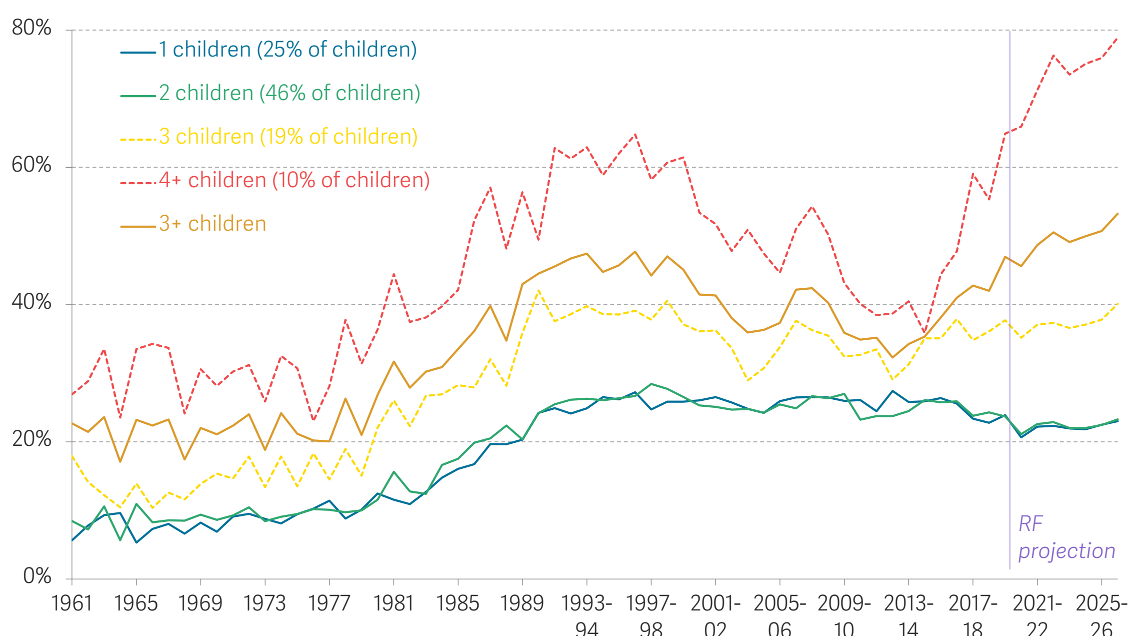
Of course, poverty is far more likely to afflict some groups than others, and Figure 21 breaks down the relative child poverty forecast based on the number of children in the household. Relative poverty is projected to rise significantly for households with more than two children: in 2012-13, around one-in-three children in large families (households

71 A Corlett, S Clarke, C D'Arcy & J Wood, The Living Standards Audit 2018, Resolution Foundation, July 2018.
72 DWP, Income-related benefits: estimates of take-up: financial year 2019 to 2020, February 2022.
73 OSR, Review of income-based poverty statistics, May 2021.
74 Government Statistical Service, Vision for coherence of income and earnings statistics.

with three or more children) were in relative poverty; by 2021-22, that may have reached a record high of almost 50 per cent; by the end of our projection period (2026-27), a clear majority of these children may be in relative poverty. Our nowcast also suggests that over 70 per cent of those in the largest households – those with four or more children – may already be living in poverty. For households with one or two children, meanwhile, the relative poverty outlook is more encouraging – aided by the recent boost to UC for in-work families.

FIGURE 21: **Poverty rates for children in the largest families are rising precipitously**

Proportion of children living in relative poverty, after housing costs, by number of children in the household: GB/UK



NOTES: Data source changes 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.

Absolute poverty is currently rising

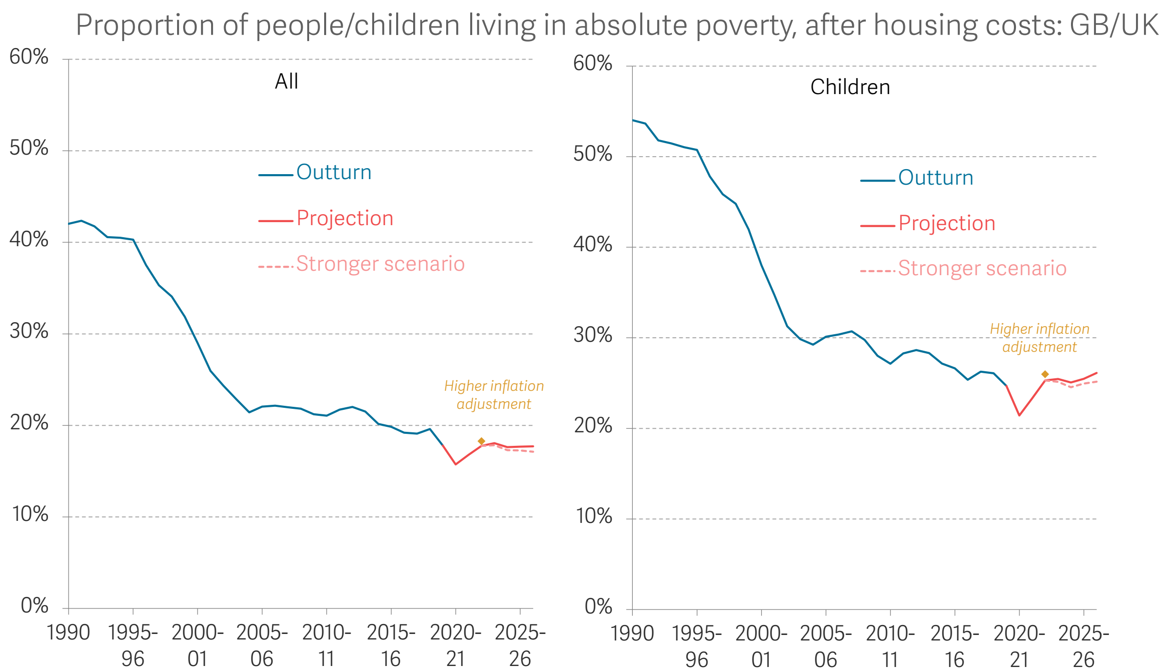
We can also look at the prospects for absolute poverty (whereby the poverty line is a fixed income that only changes over time to reflect inflation). As Figure 22 shows, absolute poverty (using the 2010-11 poverty line) fell dramatically between 1995-96 and 2004-05, but progress has been far slower since then. In 2020-21, however, the significant package of benefit support is likely to have contributed to a notable fall (from 18 to 16 per cent in our model – official figures may differ). Again, however, that is likely to have been completely undone by 2022-23, with both benefit changes and high inflation taking their

toll, pushing the proportion of people in absolute poverty back up to 18 per cent (in both of our inflation scenarios).

Absolute child poverty is projected to be higher in 2026-27 than in 2019-20 (increasing from 25 per cent to 26 per cent), with an extremely large rise of 5 percentage points between 2020-21 and 2022-23 (from 21 per cent up to 26 per cent) when applying our post-Ukraine inflation adjustment. Worryingly, this outlook of rising absolute child poverty over our entire projection period holds even in our scenario of higher pay growth and lower unemployment (and assuming that there are no long-run impacts on incomes from the war in Ukraine), with only marginal improvements from a stronger labour market.

FIGURE 22: **In our nowcast, absolute poverty fell to a record low in 2020-21, but this progress is projected to be unwound by 2022-23, with absolute child poverty higher in 2026-27 than 2019-20**

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



NOTES: Data source changes in 1994-95. GB from 1994-95 to 2001-02. Stronger scenario based on 4 per cent annual pay growth and stable unemployment. See Box 1 for discussion of potential higher inflation in 2022-23.
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.

These are remarkable projections: developed economies should at the very least be able to ensure some medium-term growth in real living standards. But they are in keeping with the general outlook for incomes and living standards presented in this report, and made worse by certain benefit policies that hit low-income households with children hard.

Section 5

Conclusions and recommendations

Our projections up to 2026-27 show the perennial importance of delivering higher productivity that can drive sustained pay growth

As we have shown, remarkably high inflation – driven in part by the spike in energy prices, and now boosted further by the war in Ukraine – is likely to have a very detrimental effect on household incomes over 2022-23 and 2023-24. But high inflation is not the only weak element of the Bank and OBR's latest economic forecasts, as our derived household income projections up to 2026-27 show. The main component of household incomes is earnings from the labour market, and the medium-term nominal pay growth forecasts we have used are weak, dropping towards 2 per cent in 2024-25. This outlook could easily improve (and we will find out what the OBR says in its March 2022 Economic and Fiscal Outlook). But outside the short-run debate about whether inflation will lead to higher wage demands and whether workers are causing inflation by demanding more pay, ultimately the UK needs to see faster growth in productivity – and, ideally, a reversal of the dip in labour force participation seen over the pandemic – to enable us to afford higher growth in wages and incomes.[75] This is why we are working with the Centre for Economic Performance on a project to explore how the UK can make the most of the fundamental challenges it faces in the 2020s and beyond.[76]

The last two years have demonstrated again that policy can rapidly improve the finances of lower income households

This report has focused primarily on the prospects for the coming five years, but it is worth dwelling on the last two, remarkable years.

75 J Oliveira-Cunha et al., Business time: How ready are UK firms for the decisive decade?, Resolution Foundation and the Centre for Economic Performance, November 2021.
76 T Bell et al., The UK's decisive decade: The launch report of The Economy 2030 Inquiry, Resolution Foundation and the Centre for Economic Performance, May 2021.

Soon after the publication of this paper, we should get official statistics on household incomes, poverty and inequality in 2020-21.[77] But our nowcasting, alongside earlier work, has suggested that public policy made a remarkable difference to household incomes: reducing absolute poverty, for example, despite the huge economic impact of Covid-19. The temporary policies that achieved this include the £20 a week boost to UC and Tax Credits (worth around £6 billion a year); restoring Local Housing Allowances to the 30th percentile of local market rents (worth around £1 billion a year); suspending UC's Minimum Income Floor for the self-employed; and effectively restoring some of the English Council Tax Support that was removed over the previous decade (for £500 million a year). The removal of these boosts during 2021-22 or beyond is projected to undo most of the real income progress for the poorest that was achieved in 2020-21, although the £3 billion boost for those in work and receiving UC is very welcome.

One lesson to take away from this period, therefore, is that welfare policy can very rapidly improve the real incomes of the poorest, at a cost of less than £10 billion a year (around 0.4 per cent of GDP): the level of absolute and relative poverty in the UK each year is to a large extent a policy choice.[78]

Further policy action is needed to protect household incomes in 2022 and 2023

Beyond the perennial challenge of delivering underlying productivity growth and high employment, however, there are also steps that the UK Government can take to help cushion the significant living standards blow facing households over the next couple of years, while also reducing the risk of similar shocks in future. Although the Government has already intervened in response to the April energy price cap rise, there is likely to be another significant price cap rise in October (as set out in Section 2), and the incredibly disappointing outlook for income and poverty set out in this report make it clear that more needs to be done.

The Health and Social Care Levy and Income Tax threshold freeze are certainly significant in scale, and it is unfortunate that the former will hit incomes at the same time as very high inflation. But the NHS and social care really are in need of additional funding, and foregoing the tax rise would do relatively little to improve the outlook for low-to-middle income households. However, better-targeted spending could deliver significant living standards support at a low short-term price, and in some cases at essentially zero long-term cost.

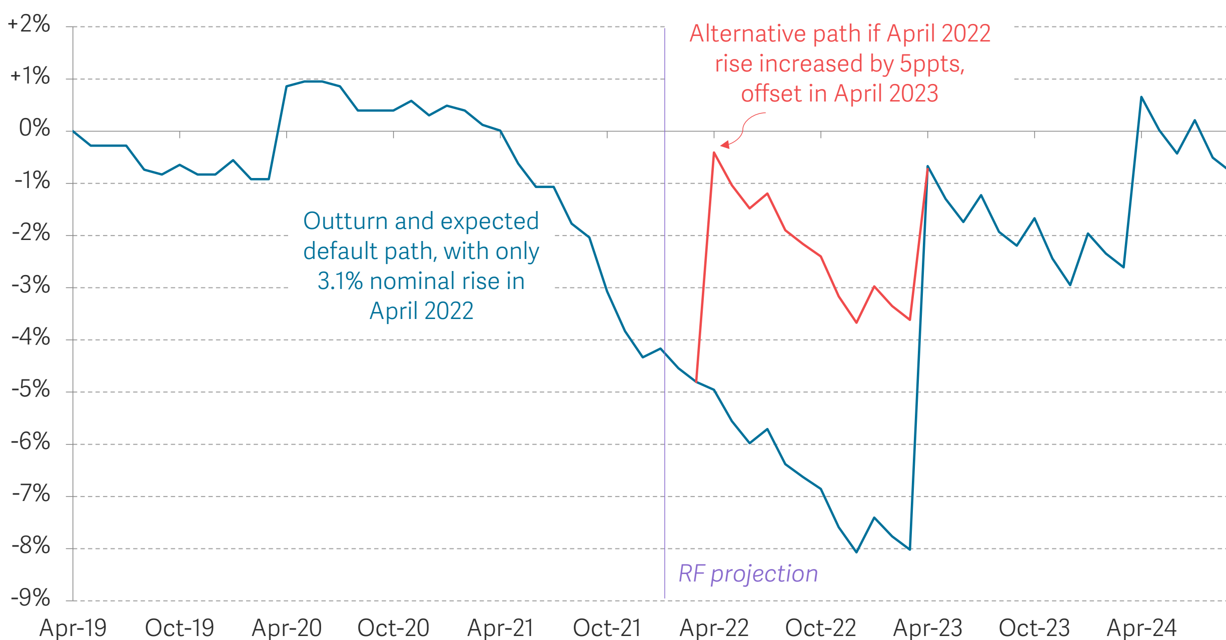
77 See ONS, Household disposable income and inequality, UK: financial year ending 2021, forthcoming; and DWP, Households Below Average Income 2020-21, forthcoming.

78 See also: M Brewer, K Handscomb & K Shah, In need of support? Lessons from the Covid-19 crisis for our social security system, Resolution Foundation, April 2021.

First, and most importantly, the Government should revisit the question of how benefits are uprated to account for inflation. Because each financial year's benefit uprating is based on inflation from the previous September, even the October 2021 energy price cap rise is not due to be reflected in benefit rates until April 2023. The real-terms fall in the value of benefits in 2022-23, something that is just an artefact of using a lagged measure of inflation, represents a temporary £10 billion real cut in income from benefits. Low-income households should not have to wait until April next year for some relief. The Government should therefore increase benefits – including the State Pension – by more this year, and less next year. For as many benefits as administratively possible, but at least UC and Tax Credits, uprating this April should not be 3.1 per cent but 8.1 per cent (a rise of 5 percentage points to roughly match contemporary inflation). Those benefits that are harder to change at short notice should be increased as soon as possible, and at the very latest in October when the energy price cap is now almost certain to rise again.[79] Benefit increases in April 2023 would then be reduced accordingly (e.g. by 5 percentage points). This would not be a permanent change to benefit rates, but would significantly boost real income levels in the difficult year ahead, as Figure 23 illustrates.

FIGURE 23: **Low-income households should not have to wait until April 2023 for the real value of benefits to be protected**

Illustrative cumulative real change in the value of Universal Credit's child element since April 2019: UK



NOTES: Based on the Bank's February 2022 inflation forecast, with a simplistic adjustment to reflect potential additional inflation in 2022-23 as discussed in Box 1.
SOURCE: RF analysis.

79 While we may not wish to emulate every aspect of the 1970s, there were multiple years in that period in which benefits were increased in both April and November.

In the medium-term, the Government should move permanently to a timelier basis (e.g. December inflation figures) for uprating benefits, or even consider uprating benefits twice a year, to reduce the impact that volatile inflation has on benefit recipients.

Second, although the Government has acted to cushion households from rising energy bills, there is more that could be done. As well as being more ambitious on insulating the country's homes,[80] some of the levies that increase electricity (but largely not gas) bills by around £150 a year could be moved off those consumer bills and instead be funded by general taxation.[81] One specific option would be for the Government to shoulder Renewables Obligation costs (which are legacy contractual obligations), taking around £70 a year off household bills (at a cost of around £2 billion a year).[82] If enacted in October, this would offset some of the expected energy price cap rise; if enacted in April 2023, it would offset some of the impact of the £200 Energy Bills Rebate turning into a £40 levy. Ultimately, reducing the UK's dependence on fossil fuels – something we need to do to meet our international and domestic net zero obligations – will reduce the likelihood of future rapid cost of living changes due to volatile commodity markets.[83]

Third, the Government must revisit its default policy that Local Housing Allowances are now permanently frozen in cash terms – regardless of increasing rents – in order to help low-income private renters from April 2023 onwards. And the benefit cap, which has never been increased (only ever decreased), should also be adjusted to ensure real incomes are not slashed for the 180,000 households affected by it (these are mostly single parents).[84] There are many policies that could be suggested to improve the UK's inadequate benefit provision, but a good place to start would be to stop making further real-terms cuts.

Alongside maintaining a long-term focus on pay, productivity and levelling up, the Government will need to take further steps to ease a cost of living hit comparable to past recessions, and make permanent rather than temporary progress in reducing poverty.

80 A Corlett & J Marshall, Shrinking footprints: the impacts of the net zero transition on households and consumption, Resolution Foundation, March 2022.
81 Ofgem, Bills, prices and profits, February 2022.
82 Lord Callanan, Hansard, 23 March 2021. We set out many ways to make the tax system fairer and raise more money in G Bangham et al., Unhealthy finances, Resolution Foundation, November 2020. Should the Government want to announce a matching tax rise (so the move has minimal impact on the public finances), then we note the tax-free treatment of inherited land and businesses currently costs £1.5 billion a year (HMRC, Non-structural tax reliefs, December 2021), and a majority of this relief goes to estates of over £2.5 million. Shouldering Renewables Obligations could cost around £2 billion a year in the short-term, but this will fall over time.
83 A Corlett & J Marshall, Shrinking footprints: the impacts of the net zero transition on households and consumption, Resolution Foundation, March 2022.
84 DWP, Benefit cap: number of households capped to August 2021, January 2022.

Annex 1

Nowcasting and forecasting methodology

As set out in this paper, there are many factors that influence household disposable incomes and therefore need to be modelled when 'casting forward' the latest household income data (DWP's Family Resources Survey / Households Below Average Income, 2019-20) to the years from 2020-21 through to 2026-27. Our approach for projections is as follows.

Projecting underlying demographic change

Part of our forecasting relies on simply altering the composition of the population in the data, in line with actual or projected changes.[85]

- We reweight the population to match ONS forecasts for demographic change by age and gender.[86] This includes modelling changes in the numbers of dependent children of each age.
- We adjust the overall labour force participation rate using the OBR's October outlook.[87]
- The proportion of women aged 70+ who have private pension income is also adjusted each year, rising in line with past Family Resources Survey trends (note that there has been broadly no change among men).
- We do not account for changes in migration patterns (beyond overall demographics and participation), or housing tenure (which we hold constant over time), or any shifts in the number of people living with their parents –though all of these may have had important impacts on household incomes since the start of the Covid-19 pandemic.

Market incomes

Projecting wages and other forms of market income into the present and future is a key part of our modelling, and is done largely through the IPPR Tax Benefit Model.

- Given that unemployment is higher in all of our projection years than in 2019-20,

85 We primarily do this using the 'reweight2' command in Stata: see J Browne, Reweight2: Stata module to reweight survey data to user-defined control totals, IFS, July 2012.
86 ONS, National population projections: 2020-based interim, January 2022.
87 This is broadly consistent with the Bank of England's (heavily rounded) February 2022 forecasts (see Figure 4).

according to the Bank's forecast, we 'make' an additional fraction of employed survey observations unemployed. This is done randomly within private sector earnings quintiles, with larger changes for lower earners (based on analysis of Understanding Society data).

- For 2020-21 and 2021-22 we model furlough, using figures on the overall (average) number of people furloughed, and an assumption that 30 per cent of these were actually furloughed on full-pay.
- We do not attempt to incorporate the significant decline that has taken place in self-employment relative to the number of employees, partly as some of this apparent shift is likely about recategorisation in response to IR35 policy changes.
- In every year, we model the wage floor: ensuring that no-one in our data falls below their age-appropriate minimum wage, based on OBR figures. We include some 'spill-over effect' for those just above the wage floor. We also model the extension of the National Living Wage from age 25 to ages 24 and 23 in 2021-22; and ages 22 and 21 in 2024-25.
- Beyond these changes, all employee and self-employed earnings are uprated equally in each year. Overall wage growth is constrained to match OBR figures (the Bank's February 2022 projections are largely identical to these), taking into account the effects of the wage floor, furloughing and compositional changes.
- Private pension incomes are uprated using the previous September's RPI inflation, based on the last OBR forecasts (but see also: Projecting underlying demographic change, above).
- For dividends, outturn ONS data is used up to Q3 2021; thereafter, these are assumed to increase in line with the OBR's forecast for NGDP per adult. We have not accounted for any possible forestalling, whereby more dividends might be taken in the rest of 2021-22 and less later in order to avoid the 1.25 percentage point dividend tax rise that happens in April 2022. We do not account for the falling labour share, but – in the opposite direction – nor do we account for the impact of rising Corporation Tax (in April 2023) on dividends.
- Other private income sources are uprated in line with the OBR's average earnings forecast.
- Private pension contributions are increased in line with average earnings. We assume no changes to auto-enrolment after 2019-20, despite a Government

- commitment to implement reforms that would increase contributions for some people in the 'mid-2020s'.[88]
- We do not model student loan repayments (which are deducted from disposable income in HBAI). As graduates making substantial repayments become a larger fraction of the population, this will weigh on income growth, as will planned policies such as freezing or cutting repayment thresholds.

Projecting prices and housing spending

As our focus is on real disposable incomes, after housing costs, we must also account for changes in prices and housing costs.

- Our starting point in accounting for inflation is the Bank's February 2022 CPI forecast. However, we create a specific deflator for 'after housing costs' income, in line with DWP definitions. This removes any housing costs from CPI, in order to avoid double-counting their impact. In this calculation we make use of the OBR's actual rents forecast, with an adjustment for higher social rent uprating. We also explore the potential for inflation to be even higher than the Bank's February projection for 2022-23, as discussed in Box 1.
- Mortgage interest costs are uprated uniformly using OBR projections.
- Private rents are assumed to rise in line with average earnings in future, matching the OBR's assumption. Ground rents and service charges are assumed to do the same. The ONS's Index of Private Housing Rental Prices is used in our nowcasting, but no regional variation in price changes is assumed beyond January 2022.
- Social rents are uprated based on the Bank's inflation forecast and the CPI + 1 per cent policy, as discussed in Section 2.
- Other housing costs (including home insurance and water supply) are uprated using the Bank's CPI forecast.

Modelling taxes and benefits

We model the tax and benefit system in future years using stated government policy (e.g. 2022-23 benefit rates) and default policy (e.g. CPI uprating in many cases). But there are a number of choices to note:

88 G Opperman, House of Commons Written Questions, 21 September 2021.

- We model a mix of UC and legacy benefit systems, with roll-out estimated using DWP projections and other figures. We assume that full roll-out of UC is not completed until 2026-27.
- We model incomplete take-up of the main means-tested benefits. For example, we assume 63 per cent take-up of Pension Credit, and 86 per cent take-up of UC. We assume for simplicity that these figures do not change between years.
- The two-child limit is applied to children born from April 2017 onwards, and so affects a growing proportion of the caseload each year. The abolition of the family element of Tax Credits and UC works in the same way.
- The change in the eligibility of mixed-age couples for Pension Credit in 2019 – with newly-claiming mixed-age couples now receiving (less generous) UC instead, but existing claims protected – is not modelled. We instead use the new eligibility rules for everyone, in every year.
- The replacement of Disability Living Allowance with Personal Independence Payments is not modelled.
- The introduction of the new State Pension for younger cohorts is modelled.
- We model the new means-testing of free TV licenses for those over the age of 75 (as this forms part of the DWP's household income definition), and assume this applies for the whole of 2020-21 onwards.
- Council Tax is assumed to rise in line with OBR forecasts by nation. Detailed changes to Council Tax Support by nation and local authority are not modelled.
- As discussed in Box 6, we also model an extra £200 Energy Bills Rebate payment for every household in 2022-23 (and a £40 levy in following years), and another £150 for everyone in Council Tax bands A-D (plus households in Northern Ireland, though it is not yet clear what policy changes will happen there).
- There are a number of Scottish policy differences that we do not model, such as the Best Start Grant and increased Carer's Allowance. Offsetting this, however, we optimistically assume full take-up of the Scottish Child Payment among those on Universal Credit.
- There were a number of benefit changes within the financial year 2021-22. For our full 2021-22 figures, we use the average benefit rates across the year. For example, the UC taper rate is modelled as around 60 per cent; rather than either 63 (until

- November) or 55 per cent (from December). We also model the suspension of the Minimum Income Floor and extra Council Tax Support as being partially in place in 2021-22.
- We are not able to model the effects of benefit sanctions, which were temporarily suspended during the pandemic.

Projecting changes rather than levels

Using all of the above, we model incomes in the years 2019-20 through to 2026-27.

However, as our modelled estimates can systematically differ from survey data – e.g. due to survey data underestimating benefit incomes (as discussed in Box 7) – we apply income growth rates (and absolute changes in poverty and inequality metrics) from our modelling to the 2019-20 outturn data, rather than directly using the projected levels.

Scenarios

In addition to our main projection, and our consideration of potentially higher inflation in 2022-23, we also look at three more optimistic labour market scenarios:

- Nominal wage growth remaining at its projected 2022-23 pace of 4 per cent, rather than dropping in the following years (and we also reflect this in the State Pension triple-lock);
- The unemployment rate returning to its 2019-20 level in 2022-23 and onwards, rather than rising after 2022-23; and
- The combination of both of these changes.

Annex 2

Table of projections

For ease of reference, Table 1 sets out our headline results, as well as many of the key inputs we have used and the alternative scenarios that we discuss.

Two fundamental caveats should be noted. First, our projections are primarily based on the latest Bank / OBR forecasts at the time of writing, but these forecasts will change: indeed, the OBR are expected to release new forecasts later in March 2022. As we discuss in Box 1, the invasion of Ukraine is likely to further increase inflation in 2022-23, and Table 1 includes some preliminary, adjusted estimates accounting for this, but most of our projections are based on the earlier economic outlook.

Second, we are not attempting to predict what survey data such as DWP's HBAI will show (HBAI 2020-21 should also be released in March 2022): these (invaluable) official results come with large margins of error and their own biases (see Box 7, for example). Most of the single year changes we project will not be able to be confirmed by the survey data to within 95 per cent confidence, even if the underlying economic forecasts and policy assumptions proved to be spot on. We hope that nowcasting and forecasting provide useful indicators of what is happening to living standards and inequalities, far in advance of outturn survey data becoming available.

TABLE 1: **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	Source for projection
Annual changes in economic determinants									
Av. earnings (& private rents from 2022)		2.2%	5.9%	4.0%	2.5%	2.3%	3.1%	3.6%	OBR (Oct)*
Higher earnings growth scenario				*4.0%*	*4.0%*	*4.0%*	*4.0%*	*4.0%*	*RF scenario*
Minimum wage		6.2%	2.2%	6.6%	6.7%	4.0%	3.2%	3.6%	OBR (Oct)*
Dividend income		-25.1%	22.7%	7.1%	3.3%	2.7%	3.1%	3.3%	OBR (Oct) NGDP/person
Main benefit uprating		1.7%	0.5%	3.1%	6.7%	3.3%	1.9%	2.0%	Based on Bank (Feb)
Unemployment rate, 16+, ppts		+0.9%	-0.5%	-0.3%	+0.3%	+0.3%	0%	0%	Bank (Feb) then flat
Lower unemployment scenario				*-0.3%*	*0%*	*0%*	*0%*	*0%*	*RF scenario*
Participation rate, 16+, ppts		-0.6%	-0.1%	+0.3%	+0.0%	-0.1%	-0.1%	-0.1%	OBR (Oct)*
CPI		0.6%	3.9%	6.2%	2.9%	1.9%	2.0%	2.0%	Bank (Feb), then OBR (Oct)
CPI (with Ukraine adjustment)				*7.6%*					*RF adjustment*
CPI excluding all housing costs		0.5%	4.1%	6.6%	2.8%	1.8%	2.0%	2.0%	Derived from BOE, OBR
CPI ex. (with Ukraine adjustment)				*8.1%*					*RF adjustment*
Mortgage interest payments		-7.2%	-0.5%	8.9%	11.5%	4.4%	4.1%	4.1%	OBR (Oct)
RF Projected changes (after housing cost measures)									
Real non-pensioner median h'h' income		+1.3%	+1.0%	-2.5%	-1.7%	+0.3%	+0.3%	+0.8%	
Real median (with Ukraine adjustment)				*-3.8%*					
Relative poverty (all), ppts		-1.3%	+1.3%	-0.1%	-0.4%	-0.1%	+0.2%	+0.4%	
Relative poverty (child), ppts		-2.4%	+2.0%	+0.7%	-0.9%	+0.2%	+0.6%	+1.2%	
Absolute poverty (all), ppts		-2.1%	+1.1%	+1.0%	+0.3%	-0.4%	+0.1%	+0.0%	
Abs. pov. (all), ppts (with adjustment)				*+1.5%*					
Absolute poverty (child), ppts		-3.3%	+1.9%	+2.0%	+0.2%	-0.4%	+0.4%	+0.6%	
Abs. pov. (child), ppts (with adjustment)				*+2.6%*					
Gini coefficient, ppts		-1.3%	+1.1%	-0.2%	-0.1%	-0.1%	+0.2%	+0.2%	
RF Projected levels (based on 2019-20 DWP figures)									
Real non-pensioner median h'h' income	£26.2k	£26.6k	£26.9k	£26.2k	£25.8k	£25.8k	£25.9k	£26.1k	
Real median (with Ukraine adjustment)				*£25.9k*					
Relative poverty (all)	22.0%	20.7%	22.0%	21.9%	21.5%	21.3%	21.6%	21.9%	
Relative poverty (child)	30.6%	28.2%	30.2%	30.9%	30.0%	30.2%	30.8%	32.0%	
Absolute poverty (all)	17.8%	15.7%	16.8%	17.8%	18.1%	17.6%	17.7%	17.7%	
Abs. poverty (all, with adjustment)				*18.3%*					
Absolute poverty (child)	24.7%	21.4%	23.3%	25.3%	25.5%	25.1%	25.5%	26.1%	
Abs. poverty (child, with adjustment)				*26.0%*					
Gini coefficient	39.0%	37.7%	38.8%	38.6%	38.5%	38.4%	38.6%	38.8%	

NOTES: * Bank (Feb) earnings and participation figures are not significantly different from those in OBR (Oct). We use the Bank's median unemployment and inflation forecasts. RF projections include use of the IPPR Tax Benefit Model.

Resolution Foundation

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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