

Lower gas prices offer rare good news for squeezed UK consumers

Persistent falls in UK retail sales are another reminder that the UK is still entering a downturn. The good news is that lower gas prices mean the Treasury can afford to do away with April's planned increase in household energy bills, a move that would lower headline inflation by 1-1.5pp through the latter half of the year



Retail sales have fallen - again

British consumers spent almost 4% more on retail spending last year, but received almost 6% less for their money, accounting for the surge in UK inflation through 2022. That's according to the latest year-on-year retail sales figures, which also showed that real-terms spending has fallen in 12 out of the last 14 months, and that December alone saw a 1% drop in expenditure. Coupled with another dip in consumer confidence released overnight, recession still looks like the base case for the UK economy.

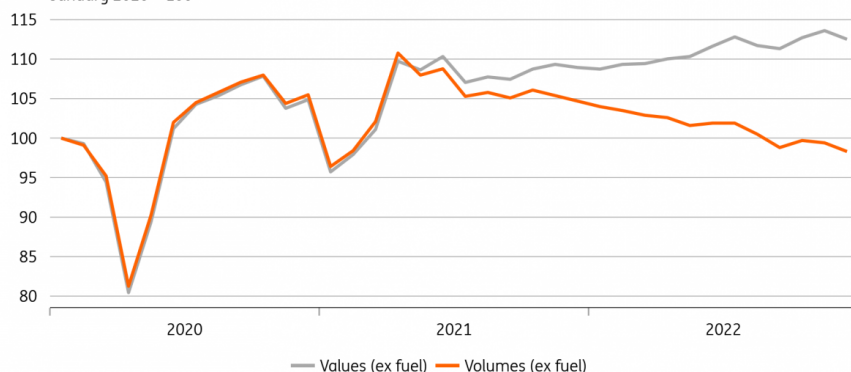
Admittedly, fourth quarter GDP is likely to come in flat, which is partly down to an artificial bounce-back in activity during October following the Queen's funeral last September. But assuming ongoing weakness in consumer spending, coupled with some potential declines elsewhere (construction and manufacturing look vulnerable), we think first quarter GDP could see a fall in

output in excess of 0.5% ([Read more](#)).

UK retail sales are down 6% year-on-year in real terms

UK retail sales, excluding fuel

January 2020 = 100



Source: Macrobond

The fall in gas prices is welcome news for consumers

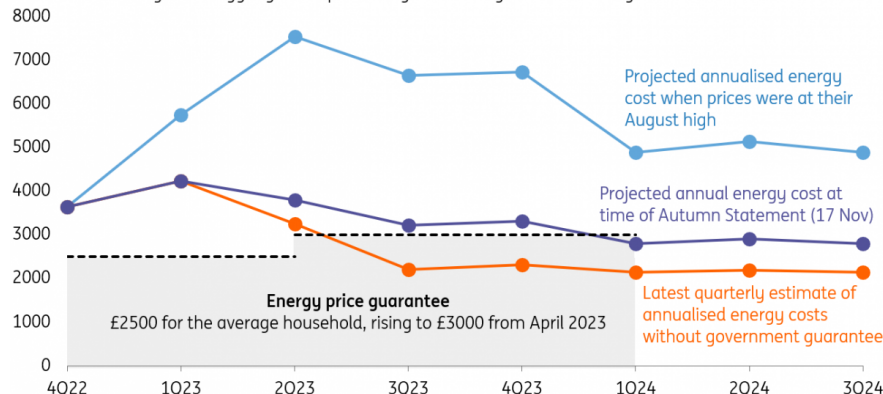
The good news, at least, is that the squeeze on household incomes looks like it won't be quite as bad as first feared. The recent fall in gas prices means the Chancellor can probably do away with his planned increase in energy bills in April, or failing that, can lower them again in July. Current plans would see a less generous household 'price guarantee' take the average annualised bill from £2500 currently (or £2100 accounting for an extra discount), to £3000 from April.

When that change was envisaged last November, the average energy bill was projected to be well above that level until early 2024 in the absence of any government support. But recent falls in wholesale prices suggest that will only be the case during the second quarter. Our latest estimates, based on the regulator's pricing methodology, suggest the average annualised bill will have fallen back to roughly £2200 in the third quarter, without any government intervention at all.

Energy bills should have fallen to £2200 in 3Q, without any government support

Estimated average annualised household gas and electricity bill (GBP)

ING estimate of Ofgem energy regulated price using wholesale gas and electricity futures

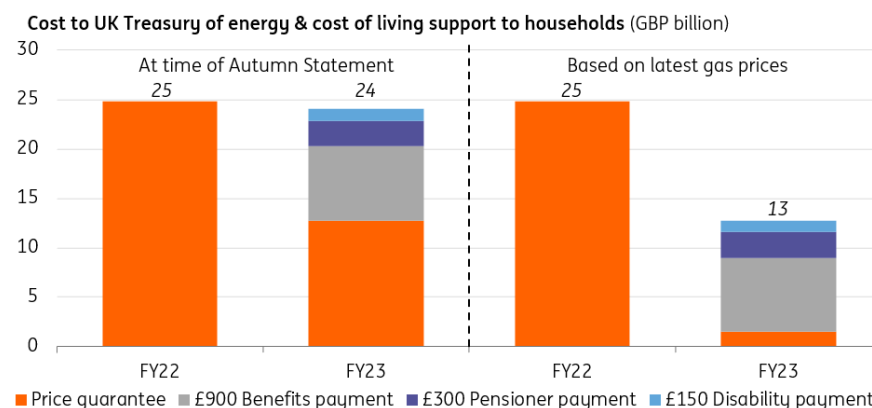


Source: Macrobond, ING calculations, Ofgem

The Energy Price Guarantee will currently see the average household energy bill increase from £2500 to £3000 from April

As well as improving the outlook for consumers, this is also good news for the Treasury. Suppose the government caps the average bill at £3000 in the second quarter and allows them to return to a level determined by market prices in the third. In that case, the cost in FY2023 will fall from almost £13bn to £1.5bn (excluding additional benefits/pensions payments the Treasury has committed to). If the Chancellor does away with the planned increase in unit prices altogether and keeps the average bill at £2500 in 2Q, the cost would be £4.5bn in FY2023, still well below November's projections.

Treasury looking at £11bn saving even if price guarantee is scrapped in 3Q



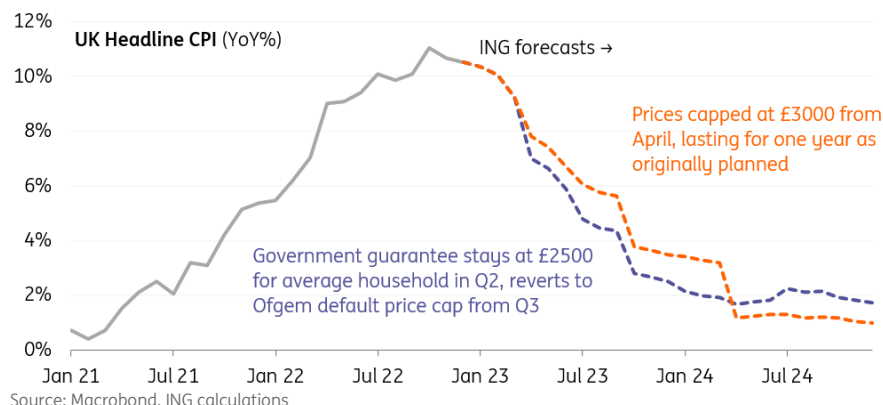
Source: UK Treasury, ING calculations

The November figures, as well as the fixed welfare payment costings, are based on UK Treasury estimates. Our projections assume the average household energy bill increases to £3000 in April as planned, but falls back in Q3 to the standard Ofgem regulated price.

Headline inflation should also be lower as a result. If household bills return to the default price level set by the regulator Ofgem, then we'd expect CPI to come in 1-1.5pp lower than currently forecast. For the Bank of England that's a double-edged sword – lower headline inflation would undoubtedly please the hawks most worried about inflation expectations de-anchoring. But lower gas prices mean a less pronounced hit to economic activity, potentially justifying tighter policy.

In reality, the Bank will probably lean more towards the former argument, and we still think we're close to the peak in terms of Bank Rate. That said, it looks like the combination of persistent wage pressures and higher core services inflation will unlock one more 50bp hike at the February meeting, potentially followed by a final 25bp move in March.

UK inflation set to be 1-1.5pp lower if bills below £3000 government guarantee



Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.