

## The UK energy bailout

The energy support package Liz Truss presented came in as a big relief with the average household annual energy bill to be capped at £2,500<sup>1</sup> via a new price guarantee for the next 2 years<sup>2</sup> (this is on top of the £400 Energy Bills Support Scheme, which will be paid over the next 6 months). In addition, businesses that are on variable tariffs will receive support as is being offered to households. The scheme is extremely generous – in particular for those living in large houses. But even those living in purpose built flats will even pay less than what the average household is currently paying under the summer price cap – and this is even excluding the £400 rebate they will get on top.

Typical Bills - 2019 median consumption (Dual fuel, annual basis)

Property type	Under October price cap	Under government Energy Price Guarantee	Difference
All dwellings	£3,550	£2,500	£1,050
Houses	£3,800	£2,650	£1,150
Detached	£4,700	£3,300	£1,400
Semi Detached	£3,800	£2,650	£1,150
End Terraced	£3,500	£2,450	£1,050
Mid Terraced	£3,300	£2,350	£950
Bungalow	£3,500	£2,450	£1,050
Flats	£2,450	£1,750	£700
Converted flat	£2,750	£1,950	£800
Purpose built flat	£2,400	£1,750	£650

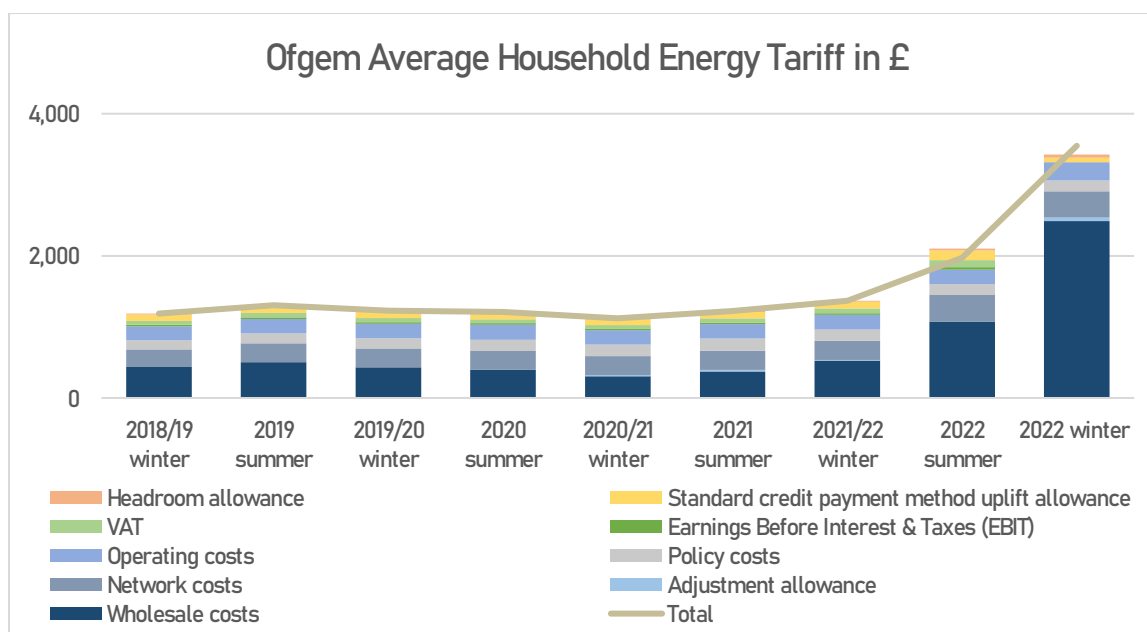
Source: UK Gov

<sup>1</sup> [https://www.gov.uk/government/news/government-announces-energy-price-guarantee-for-families-and-businesses-while-urgently-taking-action-to-reform-broken-energy-market?utm\\_medium=email&utm\\_campaign=govuk-notifications-topic&utm\\_source=37beb942-e43a-4142-9ee7-138e71cdeda0&utm\\_content=daily](https://www.gov.uk/government/news/government-announces-energy-price-guarantee-for-families-and-businesses-while-urgently-taking-action-to-reform-broken-energy-market?utm_medium=email&utm_campaign=govuk-notifications-topic&utm_source=37beb942-e43a-4142-9ee7-138e71cdeda0&utm_content=daily)

<sup>2</sup> <https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022>

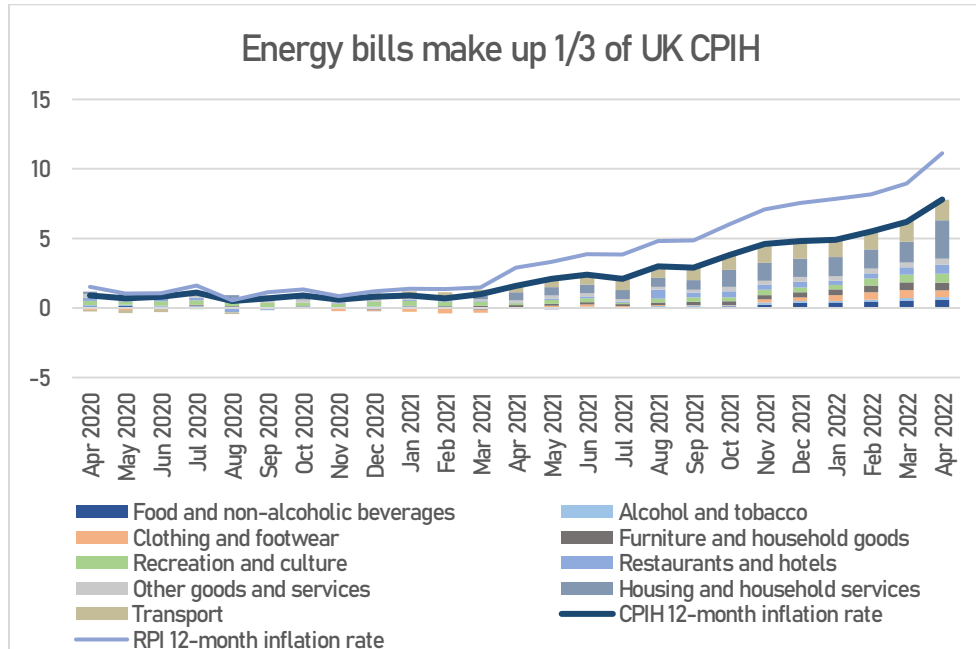
## The cap could save the government money in 2022

While this package is being presented as support for the low-income families, in fact it is a much bigger support for the wealthy with large homes and high energy consumption. But there is another twist as to who benefits the most: The UK tax payer. With 24% of debt linked to inflation the UK has the largest percentage of inflation linked debt amongst all countries (US = 6.4%). UK Inflation linked debt payments soared from £5bn in May to £16.7bn in June amidst a 1.6% m-o-m increase in CPIH (although inflation linked debt is still linked to RPI, the CPIH can be used as a rough guide – RPI rose 3.43% in April). The main driver behind the higher interest payment is the rise in energy bills, which the Ofgem tariff sets bi-annually (now quarterly in 3-1.5-12 monthly setup, meaning the price cap from Jan-Mar 2023 will be based on forward prices from mid-Aug to mid-Nov 2022<sup>3</sup>). The April price cap rose by £601 to £1,971 (40% rise) for the average annual household bill compared to the October 2021 price cap. The next October price cap is set at £3,549, a £1,578 increase (80% rise) for the average annual household bill. This increase, all else equal, could therefore have led to inflation linked debt payments to rise to £30bn for the month of October in December (2 month lag). In comparison, by capping the tariff at £2,500, the UK pays for a total of 27.8mio households only £7.29bn for the period Oct-Dec (difference between £3,549 Oct price cap and £2,500 government price cap).

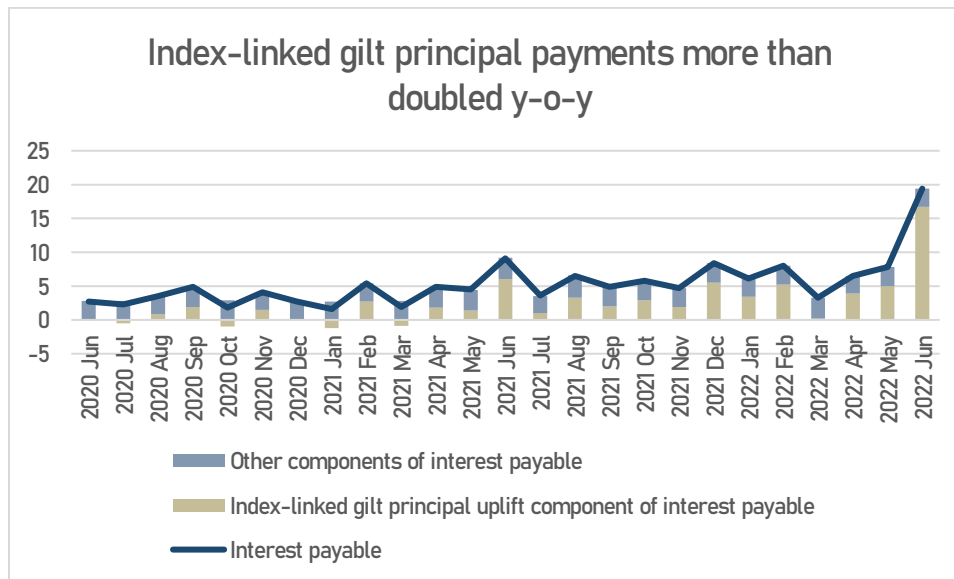


Source: Ofgem

<sup>3</sup> <https://www.ofgem.gov.uk/publications/price-cap-final-guidance-treatment-price-indexation-future-default-tariff-cap-periods>



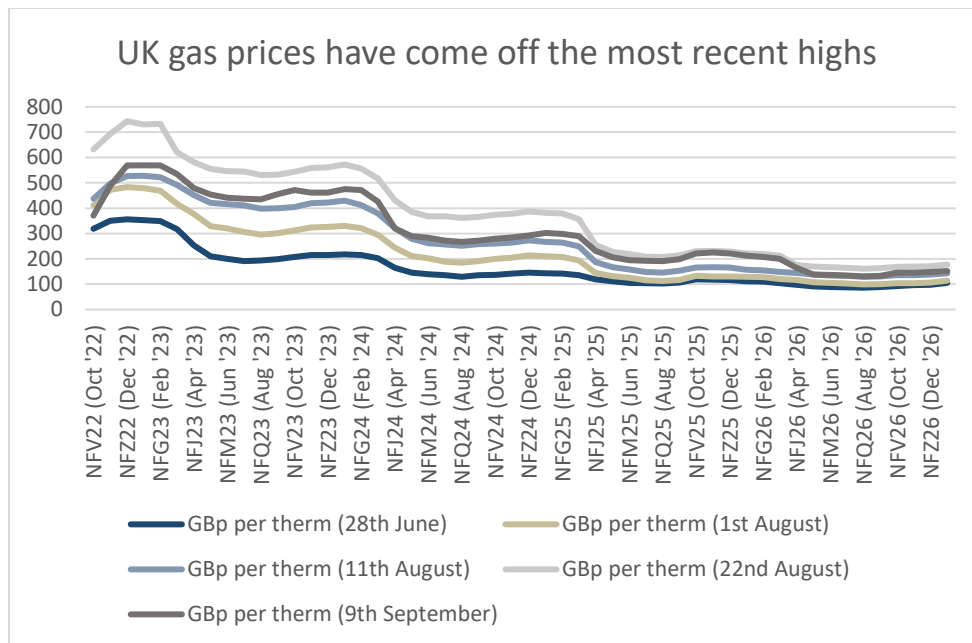
Source: Office for National Statistics



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## What happens in 2023?

The FT and other estimates put the total cost of the energy bailout at £150bn over two years and estimates the savings on inflation linked government bonds due to the cap at £25bn. However, if the Ofgem tariff will average at around £3,500 over the two years, the total costs would only be £60bn and savings on inflation linked bonds would still come in at around £25bn. It's too early to estimate the January Ofgem tariff at this point, but given that the calculation began in mid-August when we had a record rise in gas prices, some analysts have estimated that bills will rise to as much as over £7,000 for the average UK household – this would further rise interest payments on inflation linked government bonds in March 2023 and could end up costing over £50bn in interest payments on inflation linked debt. However, if the tariff comes in at £7,000 for the average UK household, the UK government would end up paying £31bn ( $27.8\text{mio households} * (7k - 2.5k)/4$ ) for the Jan-Mar 2023 period alone. Ultimately, the UK government had no choice but to implement the cap due to the savings in inflation linked debt payments and this is likely the real reason behind.



Source: Barchart



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