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U.K. Government to Cap Household Energy Prices for Two Years

Businesses will have their energy prices capped for six months

By Max Colchester Follow *and Paul Hannon* Follow

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LONDON—The U.K. government said it would cap household energy prices over the next two years, a costly bailout aimed at staving off a deep recession and bringing down inflation, but one that could add to growing worries about the British government's financial health.

The package, which economists say is likely to be worth more than $120 billion, marks one of the largest U.K. state interventions in peacetime and underscores how the war in Ukraine is now fundamentally reshaping energy markets across the West. It also marks the first big act in office for new U.K. Prime Minister Liz Truss, who took over from Boris Johnson this week.

"Extraordinary challenges call for extraordinary measures, ensuring that the United Kingdom is never in this situation again," Ms. Truss said.

Starting in October, the government will cap energy prices charged to households and make up the difference to utilities between the cap and the market price. A separate initiative will cap energy prices for businesses for six months. The move is aimed at preventing inflation from rising even faster in a country that already has the highest rate among Western nations at 10.1%.

To boost energy supply, the government will allow fracking, which was previously banned, and issue licenses to ensure more oil and gas can be extracted from the North Sea. U.K. government officials say the policy will bring peak U.K. inflation down by four or five percentage points compared with the 13% to 18% previously expected by economists.

U.K. government officials declined to estimate the cost of the bailout beyond saying it would run into the tens of billions of pounds but it is expected to be one of the largest announced across Europe so far. A government breakdown of the cost is expected later this month, though the actual amount could vary, costing more if wholesale gas prices rise further or less if they fall.

"Given the scale of the package, the failure to provide any official sense of a costing was extraordinary, and deeply disappointing," said Paul Johnson, director of the Institute for Fiscal Studies, a nonpartisan research body that scrutinizes government tax and spending policy.

Economists at Berenberg Bank said support for households could cost £100 billion—or $115.35 billion—the equivalent of 4% of annual economic output, while support for businesses could cost a further £50 billion.

"The measures may be politically astute for a new prime minister," wrote Berenberg economist Salomon Fiedler in a note to clients. "But in economic terms, the government could have used less money more wisely."

The IFS said help for households and businesses would likely cost £100 billion over the coming 12 months, with further costs likely after that. The research body said the price cap for households is "a blunt way of providing support" with richer households benefiting slightly more than poorer households.

The move will add to the U.K. government's already large debt pile. In July, government debts were equivalent to 95.5% of annual economic output, up from 94% from a year earlier. That was the highest burden since the early 1960s, when the government was still repaying the money it borrowed to fight World War II.

Yields on U.K. government debt are already at their highest levels since 2014 and the pound is trading at its lowest levels against the dollar since 1985, with investors nervous about the cost of the bailout and the threat of recession for the country.

Upon taking power this week as the fourth consecutive Conservative Party prime minister since 2010, Ms. Truss vowed to tackle the issue of energy price increases.

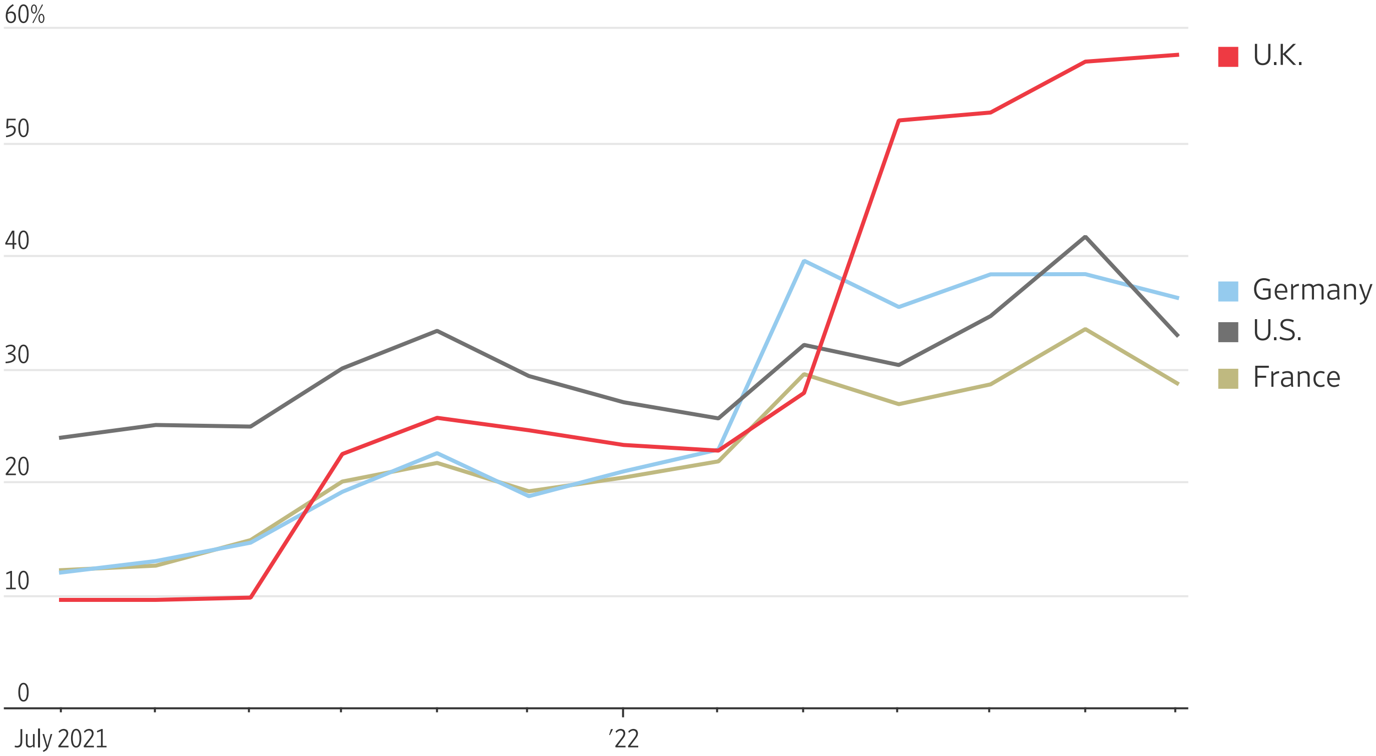
Britain already caps household energy prices but that limit is regularly revised to reflect market prices. In October, household energy bills were due to rise 80%, forcing many into poverty. The cap previously didn't apply to businesses, and economists feared a wave of bankruptcies among small firms absent government help.

Under the plan announced Thursday, prices will be capped at a level for two years that equates to an average annual household energy bill of £2,500, compared with £1,971 currently. Households will also receive a £400 payment to help with their bills. Businesses will benefit from cheaper energy too as the government will move to cap the price of energy provided to businesses for six months. The government will then switch to a new program focusing on more vulnerable industries.

Steepest Climb

Household energy prices in the U.K. have risen more rapidly than in other rich countries.

Household energy prices compared with a year earlier



Source: Organization for Economic Cooperation and Development.

“Done right, this will be a lifeline—protecting jobs, communities and future economic recovery,” said Martin McTague, chair of the Federation of Small Businesses. “However, the announcement is very high level and sparse on detail.”

New Treasury chief Kwasi Kwarteng warned that there will be extra spending but that the economy will grow faster than the nation’s debts. He and Ms. Truss say that, together with tax cuts, the bailout will allow the economy to grow faster and help government revenues through stronger tax collection.

The cost of the support package is smaller than the help offered by the government to households and businesses during the Covid-19 pandemic, which the International Monetary Fund estimates at 19.3% of GDP. But it is larger than the flagship furlough program, which helped pay the wages of 11.7 million workers at a cost of £70 billion. On Sunday, Germany announced its third and largest bundle of measures, costing 65 billion euros and equivalent to about 1.8% of gross domestic product.

Britain, despite only relying on Russia for 4% of its gas imports, is at the mercy of global spot prices for natural gas. Burning natural gas produces 40% of U.K. electricity and the nation relies on imports from abroad. Without intervention, the Bank of England forecast inflation to hit 13% by the end of the year.

Bank of England Gov. Andrew Bailey said Tuesday that state intervention could push down inflation in the near term but that the bank might still need to raise rates. Over the medium term, the energy package and cuts to taxation could keep inflation running at a high rate, he said.

Ms. Truss has ruled out imposing extra windfall taxes on energy producers to pay for the bailout. Opposition Labour Party leader Keir Starmer has said that it is unfair to let energy companies pocket profits and leave individuals to pay back the bailout with higher taxes down the line.

Ms. Truss said such a tax "would undermine the national interest" by preventing investment by energy firms.

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