Technical Annex

Calculating the impact of price caps on inflation:

- The price cap is only applied to gas and electricity indices, in line with standard practice.
- We calculate only the direct effect of the energy price cap on the CPI, via the capping of gas and electricity prices for consumers. There may be indirect effects of lower energy costs on other goods in the CPI too which we do not estimate.

Calculating the impact of spending on demand:

- We estimate the inflation impact of policy 1 and 2 based on the implied ‘inflation multiplier’ estimate, by the Bank of England’s June 2022 Monetary Policy Summary: “Initial Bank staff analysis of the Government’s recent Cost of Living Support package suggests that, all else equal, it could boost GDP by around 0.3 per cent and raise CPI inflation by 0.1 percentage points in the first year, with some upside risks around these estimates given the targeted and front-loaded nature of some of the measures.”
- We assume that the fiscal spending from the two policies we propose, in terms of stimulating GDP and inflation, would follow the same multiplier. We judge that the Bank’s multiplier is likely a lower bound and the inflation impact could be higher. This is why suggest much of any such policy should be tax financed. The Bank did not publish an update of this in its August 2022 report.

Calculating the cost of the illustrative policies:

- We calculate the cost of the measure as the (reduction) in the price cap multiplied by the number of households affected by the price cap (22 million). The energy price functions as a ceiling that limits the amount that energy providers can charge for a kWh of electricity and gas. The quoted figure for the price cap (eg £1,971) represents the amount a household with typical consumption pays for electricity and gas.
- To calculate costs, we assume that the difference between market prices and the price cap is the difference between the price cap and the 82 per cent increase benchmark. We assume that this, as an average, applies to all 22 million households protected by the cap.