Institute for Public Policy Research

PRICE CAPS AND ECONOMIC STABILITY

HOW TO MANAGE THE IRAN WAR ENERGY SHOCK?

Pranesh Narayanan, William Ellis, Sam Alvis and **Carsten Jung**

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SUMMARY

The Iran war energy shock will impose significant costs on the UK economy, even if the government does not offer a universal support package. As it drives up inflation, we estimate the Treasury could lose up to £8 billion a year from higher debt payments and lower tax revenues that result from lower economic growth.

Relying solely on interest rates to combat the inflation spike would be a mistake: they are a blunt tool, largely ineffective against supply shocks, and would take around 18 months to have an effect. It would also weaken growth and increase the cost of investing in green energy, prolonging the UK's exposure to shocks. This is a threat to fiscal sustainability and living standards.

A well-designed intervention that caps energy prices can limit inflation and insure against the worst outcomes, keeping inflation expectations in check and limiting second round effects, which would otherwise keep inflation higher for longer. **The government should set a cap on energy bills of £2,000, triggering automatically if Ofgem's quarterly projections cross that threshold, alongside an immediate temporary 10p fuel duty cut.** Ideally, the energy bills cap would only apply to 80 per cent of historic consumption in line with Germany's well-designed 2022 'energy price break'. We also recommend a similar cap for business energy costs

This support should be withdrawn next spring unless explicitly reauthorised. It would cost up to £5 billion in a contained shock or around £24 billion in a more drawn out stalemate in the Middle East, but reduce peak inflation by 0.7 and 2 percentage points respectively. We estimate that the upfront fiscal cost is offset by higher growth and lower debt payments over the following quarters, such that the cost is near-neutral in central scenario, but the government could stand to avoid almost £10 billion a year in costs if permanent economic damage is prevented.

To make this work, the government needs to learn the lessons from previous crises. The problem with the 2022 intervention was not universal support, but poor design and the wider policy package.

- **Limit inflation directly via price caps, but set fiscal limits for the intervention.** The 2022 energy price guarantee cut the consumer price index by around 2 percentage points, but other schemes added fiscal cost without hitting prices and they were also accompanied by large unfunded tax cuts, which led to a strong bond market reaction. Our proposal is more nimble, temporary and cost-limited.
- **Secure market credibility through coordination, transparency and a coherent fiscal response.** Learning lessons from 2022, the government should consult the Office for Budgetary Responsibility, aim for a joint inflation statement alongside the Bank of England and work with European partners on subsidy design and gas purchases. The intervention should be paired with progressive, targeted taxes such as extending windfall levies, coordinating with Europe on energy-trading profits, and raising air passenger duty - offsetting costs without suppressing broader demand. In an escalation, broader-based measures such as income tax should be considered.
- **Pair the intervention with energy demand reduction.** The government can limit the cost of intervention with campaigns to help households and businesses save energy and reduce fossil fuel demand through short-term behavioural changes that encourage more efficient driving or boiler usage. This would supplement measures government is already taking to boost the transition to electrified transport and heating.

1. THE UK'S EXPOSURE TO THE IRAN WAR ENERGY SHOCK

THIS IS PREDOMINANTLY AN OIL SHOCK, 2022 WAS ABOUT GAS

The world is facing a second energy crisis in four years. While the UK's economy will again suffer from a geopolitical rupture, the similarities between the current Middle East crisis and the Russia-Ukraine crisis are limited.

The Middle East conflict has damaged oil and gas infrastructure in the Persian Gulf, and closed off global supplies. The International Energy Agency has warned that this is potentially the biggest oil and gas shock in history. However, the market reaction has been muted relative to this alarming assessment.

Natural gas wholesale prices have roughly doubled to around 130 pence per therm since the conflict began, and crude oil prices have gone from around $65 per barrel to around $120. This is very different to the effects after Russia's invasion, where gas went north of 600 pence per therm, although crude oil peaked closer at around $125 a barrel.

There is huge uncertainty around how prices will evolve, though. It depends on how long the Strait of Hormuz is closed, the extent of damage to infrastructure and what differences in oil and gas trading arrangements emerge.

We developed two scenarios to understand the potential impacts on the UK (table 1.1):

1. **Contained:** gas and oil prices spike to reach 40 per cent and 80 per cent of 2022 peaks, respectively – with a quick conflict resolution and speedy price drop (broadly consistent with market expectations). Oil and gas prices are not permanently elevated, and the Bank of England (BoE) does not raise rates in response.
2. **Stalemate:** gas and oil prices spike to reach 50 per cent and 90 per cent of 2022 peaks, respectively. The conflict still resolves this year, but near-term negotiation breakdowns causing more prolonged supply disruption – and oil and gas prices are higher for longer as a result. The BoE raises rates in response.

TABLE 1.1

The shock represents a signficant increase on the OBR's expectations

Maximum per cent difference from baseline for oil and gas prices under our scenarios

	Maximum oil price impact (vs OBR baseline)	Maximum gas price impact (vs OBR baseline)
Contained	+60%	+81%
Stalemate	+90%	+139%

Source: Authors' assumptions based on internal analysis and OBR forecasts (2026a)

The UK economy is more vulnerable to gas shocks than oil shocks. Gas prices set electricity prices around 70 per cent of the time and gas is the primary fuel used to heat homes during winter. This gas shock is likely to be less severe for the UK than in 2022 because it impacts Qatar's production and export of liquefied natural gas (LNG) which only supplies 1.3 per cent of the UK's gas demand.

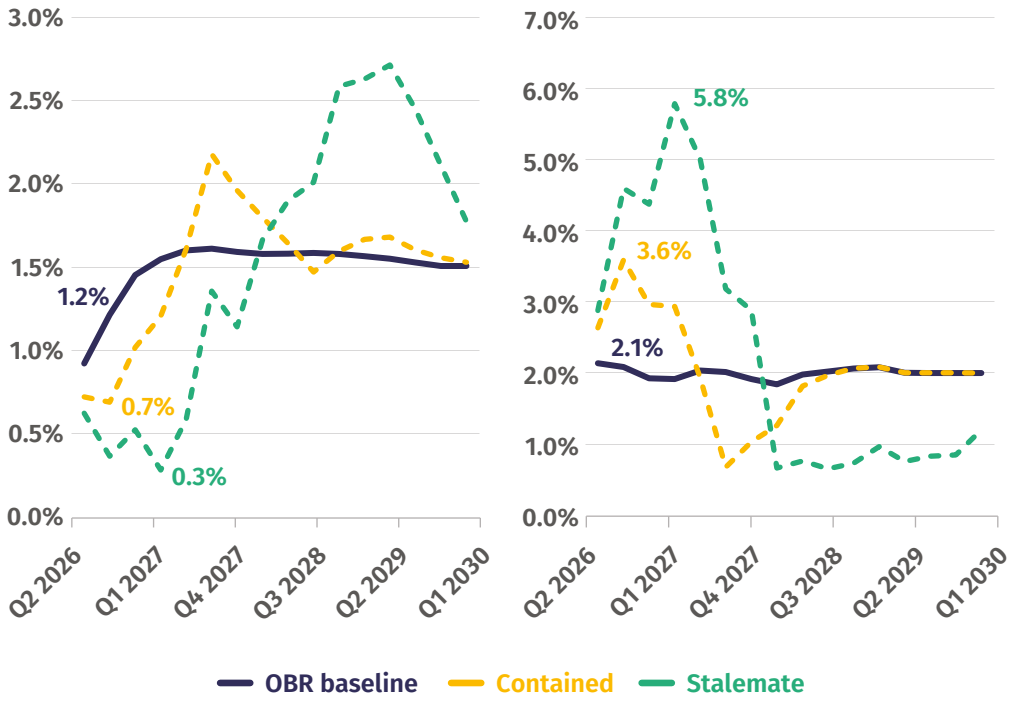
The shock to UK oil supplies is relatively higher this time, mainly affecting the cost of transportation. There are further supply chain impacts from a loss of supply in fossil fuel-derived chemicals, such as in fertiliser or asphalt, but this will take longer to feed into UK prices. Energy is an input that is fundamental to virtually every economic activity and therefore any price shocks can still have a cascading effect on inflation (Weber et al 2024).

The macroeconomic context is different. The 2022 energy crisis layered a supply shock onto an economy just emerging from Covid-19 lockdowns. There was significant excess demand with people unwinding savings built up during the pandemic. The labour market was tight when the shock hit, leading to greater pressure on wages. Demand-driven inflation was already widespread when the post-Ukraine war shock came. In 2026, the labour market has been cooling, unemployment ticking up and demand is muted. Inflation was therefore on a downward trajectory when the war started.

FIGURE 1.1

The UK economy is expected to suffer a significant inflation and real GDP shock due to the conflict

Annual growth in real gross domestic product (GDP), left, and inflation (CPI), right



Source: OBR 2026a

Note: *March 2026 Economic and Fiscal Outlook* forecast for baseline. Authors' calculations for scenarios.

Without intervention, CPI peaks well above the BoE's 2 per cent target and the OBR's forecast — up to 5.8 per cent in stalemate and 3.6 per cent in a more contained scenario. GDP falls to only 0.3-0.7 per cent annual growth, and there is quick recovery to baseline GDP growth, with an overshoot afterwards as GDP 'catches up' and we assume that none of the shocks are strong enough for permanent scarring effects.

THERE ARE SIGNIFICANT ECONOMIC RISKS IF WE RELY ON INTEREST RATES TO FIGHT INFLATION

So far, the government has favoured a response targeting support to the most vulnerable on the grounds of fiscal sustainability and fairness. This approach leaves inflation to the Bank of England, which only has one tool – interest rates. We know from 2022 that higher rates are ineffective in supply shocks.

Inflation is driven not just by expectations of average price rises, but how much weight businesses and households place on the worst-case outcomes. As gas prices spiked in 2022, people expected extreme prices not just in that year but in the years beyond, and started treating the peak as a new normal. Firms and workers set wages and prices against the worst case - keeping inflation elevated long after the shock had passed (Meeks and Monti 2023, Chibane and Kuhanathan 2025).

In the absence of temporary price caps, the BoE will be under pressure to raise rates or risk the credibility of their 2 per cent inflation target. Before the conflict, markets expected two rate cuts to 3.25 per cent this year; now they expect two rises to 4.25 per cent. The governor previously pushed back on this (Reuters 2026b), but admitted rate rises are now possible. Model-based scenarios published by the BoE in April show that bank rates could be up to 1.5 percentage points higher on average, raising rates by around 2 percentage points at peak (BoE 2026).

Higher rates do not fix energy price volatility or imported inflation. Instead, they squeeze households and firms by hiking borrowing costs. While this eventually cools inflation, the BoE shows an 18-month lag before these effects fully take hold. Crucially, this broad demand suppression hits capital-intensive renewables harder than fossil fuels. By slowing the clean energy build-out, rate hikes prolong exposure to energy shocks (Serebriakova et al 2026).

THE UK'S PUBLIC FINANCES ARE ESPECIALLY VULNERABLE TO AN INFLATION SHOCK

Higher inflation and interest rates weigh on growth and ultimately reduce tax receipts. There are also direct impacts on the government's finances. If higher inflation is expected (and higher interest rates), markets will demand a higher return on government bonds as the real value of that set return is lower. This means higher debt payments.

All countries face these pressures. However, the UK faces an additional cost because over a quarter of its debt is tied to inflation (DMO 2025). If the UK's inflation rate was one percentage point higher this fiscal year, this would cost around £7 billion in higher payments (OBR 2026b). Despite the chancellor's efforts to maintain fiscal sustainability, the outlook deteriorates the longer supply side inflation is unaddressed.

TABLE 1.2

Higher inflation and weaker growth create fiscal costs even without new support

Average annual fiscal cost of crisis (£bn), with intervention (2026Q2–2030Q1)

	Total cost	Borrowing costs		Cyclical costs	
	Lost revenue (£bn)	RPI-linked gilts (£bn)	Debt interest (£bn)	Welfare payments (£bn)	Tax revenue lost (£bn)
Contained	-1	-0.2	0.4	-0.1	-1.4
Stalemate	-8	-4.3	1.6	-0.6	-5.0

Source: Authors' calculations

Note: Under the stalemate scenario, we assume that the Bank of England lowers rates slightly after the shock in response to lower inflation, causing a small fiscal gain through lower debt interest costs – if rates instead remain high, costs will be higher. A similar (but smaller) effect plays through the expectations channel for the contained scenario.

We find that up to £8 billion a year on average could be lost depending on the size of the shock, and how long inflation remains elevated. Under the stalemate scenario inflation remains elevated for longer, meaning the government must pay more to holders of RPI-linked debt.

2. CAP PRICES AND REDUCE DEMAND

FISCAL ACTION TO SUPPRESS INFLATION CAN AVOID STAGFLATION

The UK spent £76 billion on a combination of universal and targeted support in response to the 2022 energy crisis. Some of this was delivered under the Johnson and Sunak administrations, but the reputational damage of the UK's approach was done by Liz Truss's premiership. This was caused by avoidable issues from wider economic failures and poor handling of financial markets, rather than the tools themselves.

On 8 September 2022, Truss announced the energy price guarantee (EPG) and the energy bill relief scheme (EBRS) to cap energy prices. The market reaction was muted. Two weeks later, her government announced some of the largest income tax cuts in 50 years, funded by more borrowing, during a period of runaway inflation. It was following this huge fiscal expansion when gilt yields shot up and the BoE had to stabilise financial markets.

A premium grew on UK debt due to poor market management. The Office for Budget Responsibility (OBR) was sidelined and no effort was made to communicate a broader fiscal strategy or coordinate with the BoE. This came after forcing out the most senior official at the UK Treasury. The approach signalled a government that was unserious about fiscal sustainability.

TABLE 2.1

The problem in 2022 was not universal support, but poorly targeted fiscal design
Breakdown of the post-Ukraine energy shock support package

Policy scheme	Cost	Support type	Inflation impact
Energy price guarantee (EPG)	**£27.0bn**	**Universal**	**Direct**
Energy bills support scheme (EBSS)	**£11.9bn**	**Universal**	**None**
Energy bill relief scheme (EBRS)	**£7.3bn**	**Universal (non-domestic)**	**Indirect**
Energy bills discount scheme (EBDS)	**£0.5bn**	**Targeted (non-domestic)**	**Indirect**
Means-tested, pension and disability payments	**£9.0bn**	**Targeted**	**None**
Council tax rebate (£150, bands A–D)	**£2.9bn**	**Broadly universal**	**None**
Autumn statement 2022 cost-of-living payments	**£12.3bn**	**Targeted**	**None**
5p fuel duty cut	**£4.8bn**	**Universal**	**Direct**
Total cost	**£75.7bn**		

Source: IPPR analysis of OBR 2023a, 2023b

Table 2.1 shows that the cost was not driven by choosing universal over targeted support. Some universal elements of the support like EBSS (a £400 energy bill rebate) and the council tax rebate had no bearing on inflation while costing £15 billion.

Other elements of the universal support did impact inflation – the EPG, EBRS and fuel duty. The EPG, in particular, reduced inflation by at least 2 percentage points (OBR 2022). This substantiates research that shows price caps can be an optimal response to external shocks when designed well, allowing supply chains time to readjust whilst avoiding long-term economic damage (Krebs and Weber 2024).

LOWERING ENERGY PRICES CAN GENERATE FISCAL SAVINGS

A supply shock imposes a fiscal cost whether or not government intervenes. Our modelling finds that the total fiscal cost is lower with a high price cap in place than without it. The direct cost of intervention is real, but it is offset by avoided losses.

The inflation shock so far is limited, but a drawn-out stalemate could inflict lasting damage. The conflict has already lasted longer than expected. Economic damage from previous shocks has permanently reduced GDP a decade after, this is typically more pronounced for energy shocks (Aikman et al 2022).

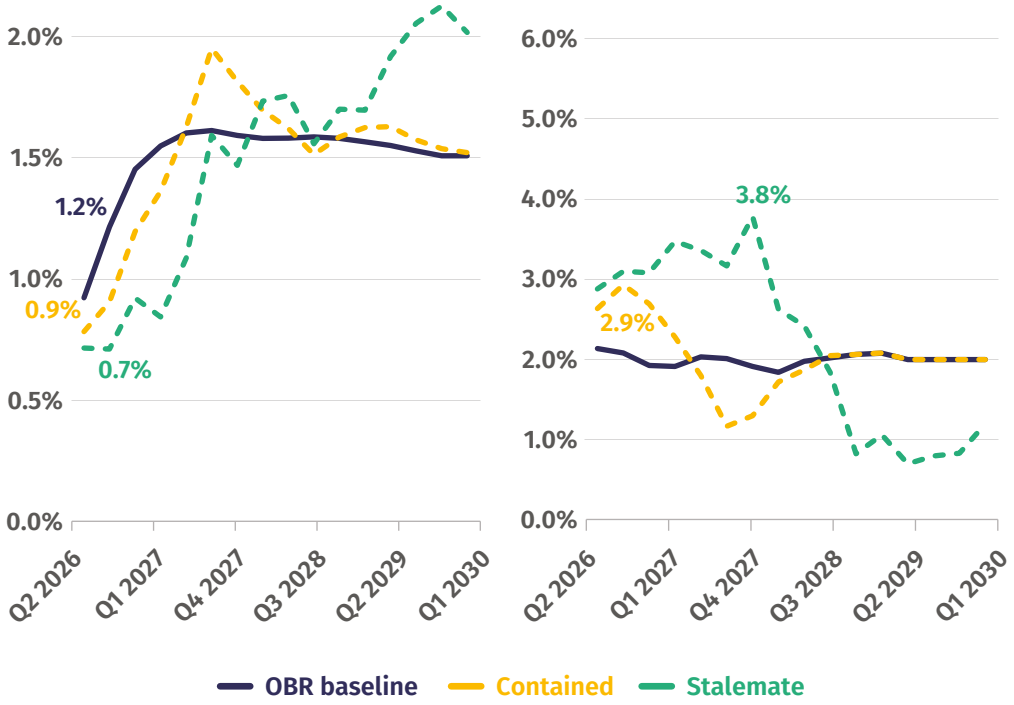
The government should intervene now before this risk crystallises. **The government should set a temporary absolute price cap of £2,000** (well above the current Ofgem cap of £1,641 – like the EPG, subsidising the difference for energy suppliers who still pay wholesale prices), **alongside a fuel duty cut of 10p, from next quarter to the first quarter of 2027**. Our model suggests with this, peak inflation could be reduced by up to 2 percentage points, avoiding interest rate hikes and reducing second-round effects. We also recommend a similar degree of business support to ensure the impact fully passes through to inflation.[1]

1 This support is in line with the ratio of costs given for the EBSS relative to the EPG - approximately £0.3 billion per billion on EPG (see table 2.1).

FIGURE 2.1

Intervening can significantly blunt the impact on CPI and economic activity

Annual growth in real gross domestic product (GDP), left, and inflation (CPI), right



Source: OBR 2026a

Note: *March 2026 Economic and Fiscal Outlook forecast* for baseline. Authors' calculations for scenarios.

AT WORST, THERE IS A MARGINAL COST – AT BEST, THE GOVERNMENT COULD SAVE SIGNIFICANTLY

As designed, the high price cap acts more in the stalemate scenario where prices are highest, and inflation rises to a maximum of 3.8 per cent, compared to 5.8 per cent without intervention (see figure 1.1). The peak impact on real GDP growth is muted by policy action, and the total amount of economic activity lost over the period is lower - reducing lost tax revenue despite initial cost. The impact of business support on inflation and GDP were not modelled so our proposed intervention would have a more favourable impact on both.

TABLE 2.2

The fiscal net impact of intervention in a typical contained or stalemate scenario is broadly neutral

Average annual fiscal cost of crisis (£bn), with intervention (2026Q2–2030Q1)

	Total cost	Savings	Borrowing costs			Cyclical costs		Policy cost
	Lost revenue	vs no intervention	RPI-linked gilts	Debt interest	Market reaction	Welfare payments	Lower tax revenue	Fuel duty cut and price cap
Contained	**-1**	-0.2	0.2	0.3	0.0	-0.1	-0.8	-1.0
Stalemate	**-8**	-0.1	-0.7	1.0	-0.1	-0.4	-3.3	-4.8

Source: Authors' calculations

The net fiscal impact of intervention ranges from a cost of £0.2 billion per year to £0.1 billion per year in a stalemate scenario. The higher cost of policy is offset by reductions in borrowing costs and less tax revenue lost. Given the sensitivity of costs to assumptions, we interpret this as fiscally neutral.[2]

However, economic and fiscal impacts are not linear - **a more disruptive stalemate scenario carries additional risks that strengthen the case for intervention**.

1. Economic modelling of shocks rarely include a permanent 'scarring' effect – despite strong evidence that a significant shock can have lasting effects. A more prolonged growth impact would mean lower tax revenue.
2. If inflation expectations continue to rise above a certain threshold value, the BoE may respond with relatively tighter monetary policy than in our central scenario, to prevent the risk of spiralling inflation. The BoE (2026) signalled this possibility in its April 2026 *Monetary Policy Report*.

A stalemate scenario risks both. Real GDP damage runs close to the threshold in which permanent damage could occur.[3] UK households and businesses have faced repeated inflation shocks and a long period of above-target inflation, and recent increases in inflation expectations have been larger than the shock.[4] Table 2.3 covers variants of the stalemate scenario that consider these risks.

TABLE 2.3

By intervening now, the government hedges against further risk – and finds significant savings if these risks materialise

Average annual fiscal cost (£bn) with intervention: scarring and de-anchoring scenarios (2026Q2–2030Q1)

	Total cost	Savings	Borrowing costs			Cyclical costs		Policy cost
	Lost revenue	vs no intervention	RPI-linked gilts	Debt interest	Market reaction	Welfare payments	Lower tax revenue	Fuel duty cut and price cap
Standard	-8	**-0.1**	-0.7	1.0	-0.1	-0.4	-3.3	-4.8
Scarring	-15	**6.3**	-0.7	-0.6	-0.1	-0.8	-8.1	-4.8
De-anchored	-9	**9.5**	-0.7	0.1	-0.1	-0.4	-3.3	-4.8

Source: Authors' calculations

Note: Scarring scenario assumes a permanent 1.5 per cent loss in GDP over the forecast window, in-line with evidence from Aikman et al (2022). In the de-anchored scenario, the MPC raise rate sharply to avoid the risk of de-anchoring inflation expectations (by around 1.5 with intervention, and around 3.75 percentage points without intervention).

2 The total fiscal impact is highly sensitive to path of inflation and interest rates, where there can be reasonable disagreement. The inflation shock is assumed to be asymmetric and persistent such that second round effects are well within the MPC's 18 months window for intervention, consistent with recent evidence presented by the BoE (Taylor 2026). We assume that the BoE looks through a contained scenario but increases rates by around 1 percentage point under a stalemate scenario without intervention, compared to 0.5 percentage points with intervention.

3 Author calculations based on Aikman et al (2022), finds that scarring can occur at around 1.2 per cent real GDP growth.

4 March data shows the same level of short-term inflation expectations as observed when CPI peaked above 10 per cent in late 2022 (Reuters 2026c).

The fiscal case for intervention is much clearer if these risks crystallise. Savings increase to between £6 billion to almost £10 billion per year, as intervention stops permanent damage and sharp rate rises in a de-anchoring scenario. This is not a novel finding. IMF research found that 'unconventional fiscal policy' (eg price caps) in 2022 had "limited effects on raising inflation by stimulating demand and instead modestly help stabilise longer-term inflation expectations" (Dao et al 2023).

Acting now hedges against uncertainty. A cap set above current prices kicks in if wholesale costs rise, so the cost of capping unnecessarily is small and self-limiting. The costs of failing to cap in a worse scenario - entrenched second-round inflation, higher interest, scarring effects - are not.

A single announcement should **put in place the fuel duty cut immediately** since prices at the pump are already rising. For households, the government should communicate that an energy price guarantee will be in place from July **if the May Ofgem price cap projection crosses £2,000**. Support should be reviewed ahead of each subsequent quarterly Ofgem announcement and withdrawn once wholesale gas prices settle at a new equilibrium price.

If prices never breach £2,000, or fall back quicker than expected, the costs of the energy price cap would be negligible. The political difficulty of withdrawing a fuel duty cut could be managed by a mechanism that **automatically raises fuel duty in line with falling crude oil prices**, until it returns to levels it should have reached in line with the government's 2025 budget plans.

To further mitigate these risks **government should include a time and cost-bound review**. Ofgem's quarterly assessment should not just trigger support, but as prices fall the tapering and withdrawal of support. We also explore below an absolute cost limit to support of £25 billion.

Finally, the increased aggregate demand from the policy intervention (about £24 billion in total within the forecast period in the stalemate scenario) would likely not lead to significant upward pressure on inflation, given the large output gap at present. It would be far outweighed by the direct reduction of inflation and beneficial impacts of second round effects, as previous IMF work has shown (Dao et al 2023).

REDUCING FOSSIL FUEL DEMAND IS THE ONLY WAY TO LOWER THE COST OF SUPPORT

Capping energy bills at £2,000 preserves some incentive to cut demand since it sits above current costs. Government should reinforce it: every kWh unused is a kWh of subsidy avoided. Lowering demand also matters internationally - the more the UK pays to import, the less available for countries facing physical scarcity.

The government has recognised that electrifying demand is the most durable way to insulate the UK from fossil fuel shocks, announcing significant acceleration of electrification (DESNZ 2026). This is right, reducing marginal exposure now and the UK's structural dependence on oil and gas. But supply chain constraints mean accelerated deployment may not materially reduce demand this winter – behaviour change is necessary in the short-term.

The public would respond well to reducing fossil fuel use if the scale of the problem is made clear. In 2022, 60 per cent supported a government asking people to reduce energy use, versus 25 per cent opposed (YouGov 2022); 50 per cent now want more information to reduce consumption (DESNZ 2024).

Lowering oil use means driving combustion engines slower, and less often

Three-quarters of UK oil is used in transport, with three-quarters of that for road transport and one-quarter for aviation.

Subsidised public transit increases ridership but is not an alternative to fuel duty cuts. Evidence shows people switch from walking and cycling rather than driving (Hess 2017). Victoria, Australia has seen the same reduction in car usage this crisis as New South Wales, despite the former making public transit free (Haghani et al 2026). Targeted subsidies could help those struggling with cost, but access, familiarity and transit time matter as much or more.

Instead, many countries are putting in place measures to reduce driving and lower speeds – as recommended by the International Energy Agency (2026). The government should take a dual win in lower speeds (20mph for urban areas, 60mph on motorways) – lowering fuel demand, while safer streets support swapping short trips to walking and cycling. This should be packaged with advice on how to drive more efficiently alongside recommendations for increased home working and carpooling.

Rising petrol prices have accelerated the EV switch - March saw record sales (Reuters 2026a). Cutting fuel duty risks slowing this shift. The government's announced deregulation on cross-pavement charging and permitted development rights will help deliver the infrastructure needed to make the shift, but more is needed to lower the barrier for low- and middle-income households. Further measures should focus on making EV ownership easier and cheaper, such as an expanded electric car grant.

Spread gas demand throughout the day

Gas generates 20-35 per cent of electricity, heats 85 per cent of UK homes, and is widespread in industrial heat.

Price caps will not blunt the demand signal if designed well. Germany's 2022 cap subsidised only 80 per cent of previous consumption - gas demand fell 17.5 per cent against the 2018–2021 average (Bundesnetzagentur 2023), and inflation came in 0.4 per cent lower (Bundesfinanzministerium 2024). UK implementation is more complicated given persistent data-sharing issues between the government and the energy industry (Energy UK 2025), but the government's kickstarter scheme (DSIT 2026) could focus on consumption making such design possible.

Gas is a 'last resort' supplier of UK electricity during high demand. Spreading electricity demand across the day would allow greater use of low-carbon and less use of gas. Government can encourage people to use appliances during off-peak times. Bringing forward planned support for solar panels will also help, but crucially pairing intervention with support for home batteries (or EVs) can better spread demand. These technologies unlock a wider range of energy tariffs that use prices to reinforce behaviour change.

Heating will become an issue in autumn, since demand for gas is highly seasonal (Thornton et al 2019). In December 2022, the 'it all adds up' campaign encouraged households to save energy through tips like lowering boiler flow temperature. This came too late. The government should reinvigorate this campaign now and also use it to raise awareness of Warm Homes Plan funding to switch from gas boilers to more efficient electric heat pumps. The public information campaign should come alongside steps to remove the final renewables obligation levies from electricity bills from July 2026 – for example restricting uptake of government's new wholesale contract for difference (CfD) to those that give up their renewables obligation. This combines higher awareness of the benefits of switching with better financial incentives to do so.

3.
HOW TO MANAGE THE RISKS

COORDINATION BETWEEN THE OBR, BANK OF ENGLAND, AND EUROPEAN PARTNERS IS ESSENTIAL

The 2022 mini-budget showed how poor policy design, communication and coordination trigger market panic, and remains 'etched into the psyche' of gilt investors (Financial Times 2024). Fiscal scrutiny falls harder on a progressive government, making market management crucial.

Legislation requires the OBR to cost support exceeding 1 per cent of GDP within a fiscal year (HMT 2026, Parliament 2024). Support is unlikely to exceed this, but **the OBR should be consulted regardless,** this would also be seen as prudent by markets.

Communicating that the intervention reduces inflation, as well as confirming the path of monetary policy in response – which has a significant impact on the fiscal picture. After consulting with the Bank to confirm their reaction, the ideal would be **a joint statement from the chancellor and the governor of the BoE on the expected inflation impact of the price intervention**. If not possible, the announcement should be timed close to an MPC meeting, with the BoE given advance sight. The MPC previously acknowledged government intervention at autumn budget 2025 helped inflation return to target and could repeat this.

The UK would likely meet its fiscal rules even in an extreme scenario if a negative market reaction is avoided - and inflation will mechanically slow if the government limits energy prices. The OBR and BoE are likely to be able to confirm these projects and limit a market reaction.

Working with EU partners can ease the cost of intervention and make the response look proportional and considered to markets. With electricity market linkage in development, altering UK prices and demand affects flows across the channel - open dialogue on subsidy design matters. The UK's pandemic intervention did not spook markets because it was seen as necessary and in line with European action.

The EU is legally obliged to fill its gas storage by 80 per cent before winter, even at elevated prices. The UK will be looking to fill its much more limited storage at the same time. Coordinated buying of LNG can avoid bidding against each other (and other partners). The UK increasingly uses gas storage when renewable supply drops rather than meet peak demand. Given our renewable supply pattern (mostly offshore wind rather than solar) is different to Europe, there is reason to also coordinate gas releases.

TAXES COULD BE USED TO RECOUP COSTS PROGRESSIVELY

This intervention aims to limit demand destruction in the economy, while preserving incentives to reduce fossil fuel use. Broad tax rises would work against this - suppressing demand and hurting growth. These should only be considered once the final cost of intervention is clear, and in the round with other medium-term spending pressures such as defence.

In the near-term, a package of progressive tax changes can limit fiscal impacts and signal a commitment to sustainable public finances. The government is already

moving in the right direction with plans to encourage clean electricity generators on to fixed price CfDs to reduce the impact of gas on electricity prices and raising the electricity generator levy (EGL) for those generators who do not opt for this. The government should ensure that it extends both the EGL, (while lowering the thresholds for capture) and the energy profits levy on North Sea oil and gas producers until 2030. Three additional levers would reinforce the package:

- **Coordinate windfall taxes with Europe, including on energy trading.** Traders made $50 billion in global windfall profits in 2022 (Hunter and Farchy 2024), much of it passing through the City and booked by UK-based majors like Shell and BP who cited trading gains as material to 2022/23 performance. Five countries are now pushing EU-coordinated windfall levies (Rinka 2026). The cross-border nature of energy trading makes a perfect candidate for international alignment.
- **End fiscal losses from quantitative easing.** This could be done via a 'quantitative easing (QE) reserves income' levy, or a reform the BoE's indemnity. QE left commercial banks earning the full bank rate on around £600 billion of reserves at the BoE - a risk-free subsidy not passed through to savers, costing taxpayers £22 billion a year. This windfall could increase if the Iran war shock means interest rates fall more slowly. A levy on reserve interest above a 2 per cent floor would recoup part of the subsidy and raise £4–20bn depending on how much the BoE reduces gilt sales per year a year (Jung 2025).
- **Higher air passenger duty (APD) for private flights.** Raising APD increases revenue while cutting fuel demand. Private aviation is especially undertaxed: many jets pay less APD per passenger than economy (Lloyd 2024). The government should raise rates on small aircraft, tighten definitions to capture converted commercial jets and those below the 5.7-tonne threshold, and extend the base to helicopters.

BROADER-BASED TAXATION SHOULD BE CONSIDERED TO REBUILD HEADROOM IN MORE EXTREME SCENARIOS

Intervention costs are front loaded since support ends in 2027. This means that both fiscal rules are met. The economy recovers and intervention ends well before 2029/30, so the government retains headroom on day-to-day spending within that year. Public sector net financial liabilities still fall as a percentage of GDP in 2029/30 despite sharp early increases from intervention.

If GDP is permanently lower through scarring, tax receipts fall by 2029/30. In this case, there is a limit to how much the government can borrow without spooking markets and eroding headroom for future shocks. We recommend a £25 billion borrowing cap, roughly matching the headroom the government has built, signalling prudence rather than recklessness. Any costs beyond this should be financed through increases to broad-based taxes.

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