

THE MACROECONOMIC IMPACT OF HIGHER ENERGY PRICES ON THE UK ECONOMY

SUMMARY

This article explores the possible impacts on the UK economy of the increasing price of oil and gas since 2004.

Most finished goods and services are likely to require inputs of oil and or gas at some stage in the production process. Therefore, even though energy intensity varies considerably across products and industries, the aggregate price level will still be affected. In addition, the rise in energy prices will tend to squeeze the purchasing power of labour income through a fall in the real consumption wage of individuals, lowering consumer spending.

Together these have negative implications for economic growth. However, the article argues that non-labour income is likely to increase as a result of higher energy prices, and this may offset part of the inflationary costs. Firstly, oil and gas extraction companies receive greater profits which feed through to benefits to households who own shares in these companies. Secondly, post-tax incomes are boosted by a household tax reduction made possible by extra corporation and energy taxes earned by the government from domestic based energy extraction. The article also assesses the possible monetary responses – either allow nominal spending to increase, or reduce nominal demand – and the implications of this for inflation.

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