

# The effect of rising energy and consumer prices on household finances, poverty and social exclusion in the EU

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## ABSTRACT

This report contains an empirical analysis based on microdata from European household surveys (EU-HBS, EU-SILC) to provide a preliminary assessment of the potential social consequences of increasing energy and consumer prices in the EU. It uses detailed information on recent price developments and the structure of household expenditures to quantify the extent of living cost increases and purchasing power losses in a granular and customised manner across different household types and income groups across all EU Member States. The Report is also the first attempt to calculate the potential effects of rising prices on indicators of material and social deprivation, energy poverty and absolute poverty.

The empirical analysis concerns five separate but closely related investigations, each of which take up a separate section of the Report. I start with presenting recent Eurostat data on HICP inflation in the EU, highlighting the severity and unevenness of consumer price trends across Member States and product categories, and discussing the potential implications of these for EU policy objectives and priorities. Second, I present a detailed analysis of the expenditure patterns of European households, and assess the heterogeneous impact of rising energy and food prices on the living costs of various population segments across the EU. The remaining three building blocks are devoted to quantifying the potential effects of recent inflation on various social policy-relevant outcomes. First, I estimate the direct effects of cost of living increases on the AROPE indicators of material and social deprivation (MSD), using the observed statistical relationship between the incidence of deprivation and households' real income position in the EU-SILC microdata. Second, I quantify the predicted impact of soaring energy costs on the level of energy poverty using a range of different indicators based on EU-HBS and EU-SILC data. Third, I calculate the effect of consumer price inflation on monetary poverty in the EU, using a novel experimental measure of absolute poverty (ABSPO) developed by the JRC that adequately reflects households' minimum needs and living costs.

The empirical analysis presented in the Report is preliminary and subject to various limiting assumptions. Its preliminary character is due to the fact that it relies on a snapshot of observed price developments as of August 2022, while inflation levels and inflation profiles are bound to keep changing continually with time. As for the limiting assumptions, three merit particular attention. First, I assume that official CPI data adequately represents price trends faced by different household types at the national level. Second, I assume that the observed structure of household expenditures remains stable and households do not substitute away from products and product categories hit by above-average inflation. Third, I do not consider built-in fiscal stabilisers or impending government interventions that can limit the effect of rising prices in the medium and long term. There is ample empirical evidence that these aspects are all important, but modelling them in the current context and in a forward-looking manner is very difficult and beyond the scope of this study. For this reason, it is important that the findings presented in this Report receive additional scrutiny as well as further scholarly and policy attention in the future.

These limitations notwithstanding, the main conclusions of the Report appear robust: the negative welfare and social effects of rising consumer prices are substantial throughout the EU. Given the large cross-sectional differences in price developments and consumer expenditure patterns, the social implications of the current situation are rather different across Member States and various population segments. The prospects are particularly alarming in many Central and Eastern European countries, where low-income households and vulnerable groups (such as large households, rural population, children or elderly persons) face particularly high risks of financial distress and social exclusion under the current circumstances. At the EU level, inflation has increased the cost of living of median households by around 10%, the incidence of material and social deprivation by around 2 percentage points, the rate of energy poverty and absolute monetary poverty by around 5 percentage points. In selected Member States and among vulnerable groups, the corresponding welfare effects are expected to be several times higher. This heterogeneity in the social consequences of inflation is expected to further deepen existing gaps in poverty and social exclusion between EU15 and non-EU15 countries, and calls for a strong and coordinated policy response.

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