Fixed tariffs within the energy market

Summary

Around a third of domestic customers are now on fixed tariffs, this proportion having increased in recent years. Fixed tariffs are where the amount a customer pays for their energy is fixed for a predetermined period. The current cheapest tariffs consumers can switch to are generally fixed tariffs. Average annual fixed bills in 2015 were cheaper than average annual variable by £143 for a direct debit duel fuel customer. This difference has grown substantially in the past few years from £20 in 2012.

Introduction

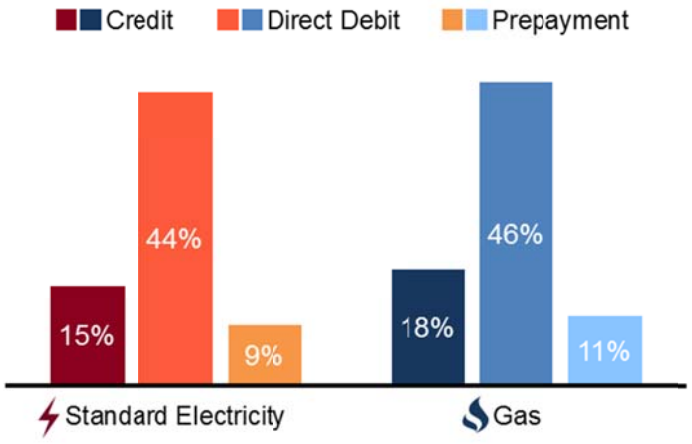
Within the Domestic Energy Market, suppliers offer a large array of different tariffs. Historically almost all tariffs on the market were variable, fluctuating in price following trends in the wholesale market. In recent years however, fixed tariffs have been offered. Fixed tariffs offer consumers a set rate for their energy for a pre-determined period of time. If a company introduces price increases within this period, due to changes in the wholesale energy market, the customers' bills will remain unaffected. However, if price decreases are implemented the bill a customer pays on a fixed tariff will continue to remain unaffected and therefore will not benefit from these price falls.

Data presented at the start of this article is from DECC's Domestic Fuels Inquiry survey[1] which covers the big 6, representing nearly 90% of the domestic market. The proportion of customers that are on fixed tariffs[2] with smaller suppliers may differ compared to the big 6. Data presented on the tariffs currently available has been sourced from a publically available switching site[3].

The growth of fixed tariffs

At the end of March 2016, the majority of standard electricity and gas customers in Great Britain[4] were on variable tariffs leaving over 30 per cent of customers on fixed tariffs. As seen in Chart 1, the proportion of customers on fixed tariffs varies greatly by payment type. Direct Debit customers are the most likely to be on fixed tariffs with around 45 per cent of these customers on a fixed deal. A very low proportion of pre-payment customers are currently on fixed tariffs, as a result pre-payment will not be included in the rest of this article.

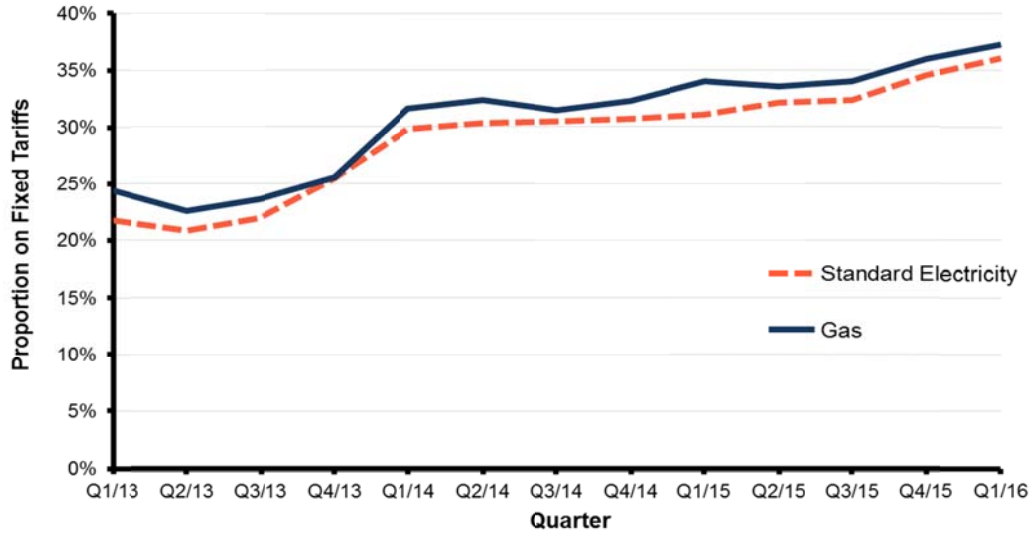
Chart 1 Proportion of customers on fixed tariffs by payment type



[1] www.gov.uk/government/publications/domestic-energy-prices-data-sources-and-methodology
[2] The method used to determine a fixed tariff is dependent on the tariff name and DECC's research of tariffs. It is therefore possible that some fixed tariffs have not been identified and may well have been incorrectly classified as a variable tariff.
[3] Data from www.UKpower.co.uk.
[4] Northern Ireland is not included in this article as it has a different market structure.

The proportion of customers on fixed tariffs has increased in recent years[5] as seen in Chart 2. When prices of variable tariffs are increasing, or at least not decreasing, customers may be more tempted to switch to the cheaper fixed rates. This could explain the sharp increase seen in quarter 1 2014 on the chart below which correlated with an increase in the price of standard variable tariffs. When wholesale prices are low, there are generally more cheap fixed tariffs available, this may explain the continued increase in customers on such tariffs in recent quarters.

Chart 2 – Percentage of standard electricity and gas customers on a fixed tariff from Q1 2010 to Q1 2016 in GB



Fixed tariff bills

Domestic energy prices are published with DECC's Quarterly Energy Prices (QEP)[6] publication. The tables within QEP currently present the average annual bills for domestic gas and electricity (with economy 7 separately[7]). The average bills in QEP include all tariff types and do not show a breakdown for those on fixed tariffs.

In 2015 average ***fixed*** bills[8] for customers on direct debit (the most common and cheapest form of payment in GB) was £522 for standard electricity which is ***£61 cheaper*** than the average variable bill. For gas, the average bill was £633, which is ***£82 cheaper*** than the average variable tariff bill. For standard credit the difference between fixed and variable is less prominent than the average standard electricity for fixed customers being £576, £46 cheaper than the average variable bill. While for gas the average fixed bill being £739 only £25 cheaper than the average variable tariff bill.

Charts 3 and 4 show how the differences between the annual bills of fixed and variable tariff have increased in recent years for both electricity and gas when paying by direct debit.

[5] Data on the percentage of people on fixed tariffs can be found in Table 2.4.2 for standard electricity and Table 2.5.2 for gas.
[6] www.gov.uk/government/collections/domestic-energy-prices
[7] Economy 7 electricity tariffs have a separate unit cost for the night and day and are designed for use with night storage heaters. By contrast, standard electricity tariffs have no distinction in price between night and day. The majority (87%) of all electricity customers are on standard electricity tariffs. Throughout the analysis electricity data corresponds to standard electricity only.
[8] DECC standard consumption levels used of 3,800kWh electricity and 15,000Kwh gas.

Chart 3 – Average GB direct debit fixed and variable bills for standard electricity since 2011[9].

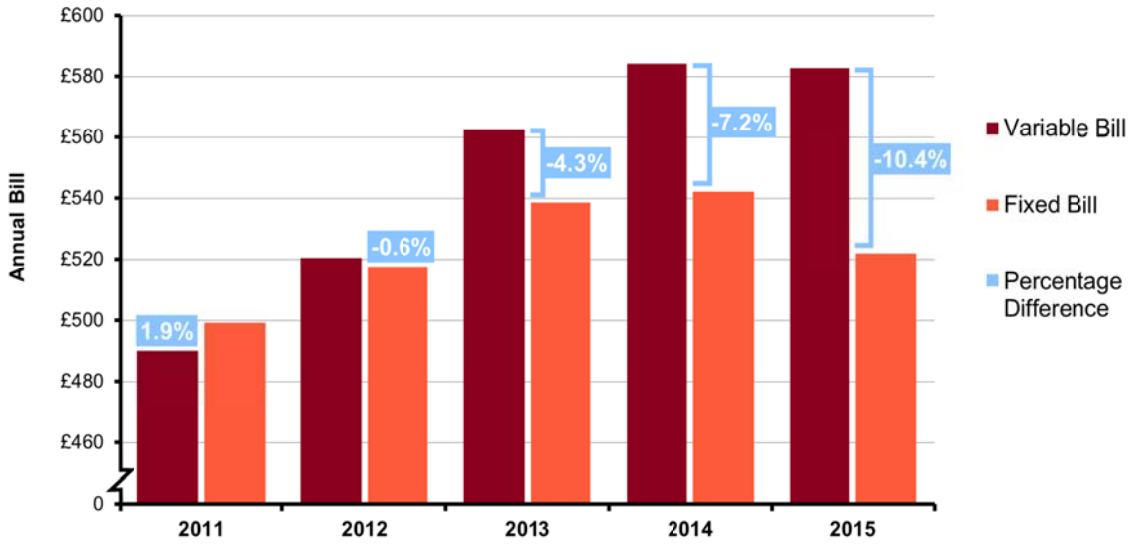
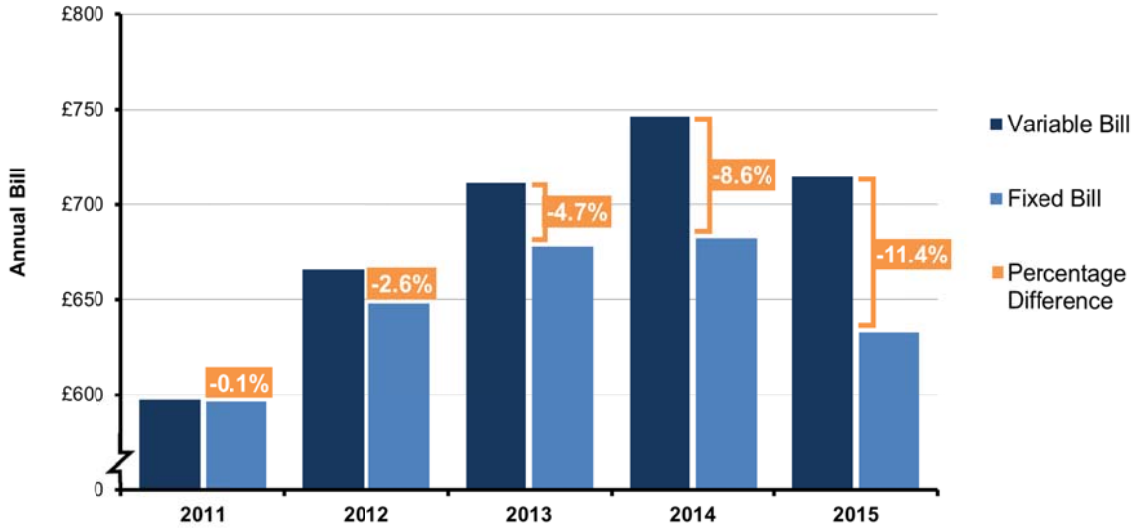


Chart 4 – Average GB direct debit fixed and variable bills for gas since 2011.



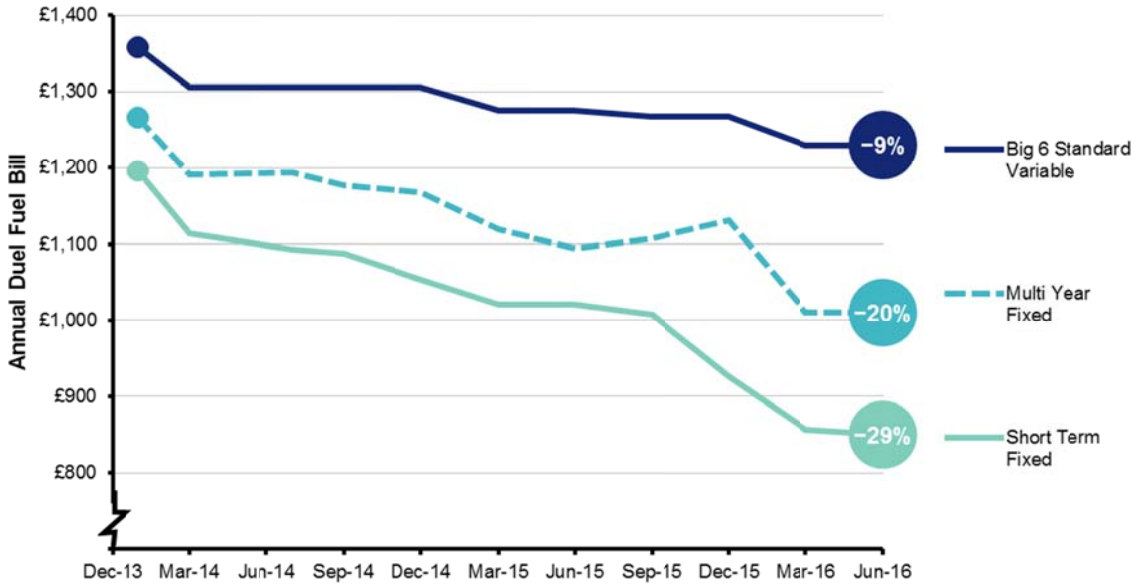
Average annual ***fixed*** bills have been ***cheaper*** for direct debit since 2012 compared to the average annual variable bills for direct debit for both gas and standard electricity. The difference between fixed and variable tariffs has been increasing since this point. In 2015 the average standard electricity bill for fixed tariffs were 10.4 per cent lower than the average variable annual bill, this difference having increased from a 0.6 per cent difference in 2012. For gas 2015 fixed tariff bills were 11.4 per cent lower than variable annual bills this difference having increased each year from a 2.6 per cent difference in 2012.

[9] A £12 rebate was applied to all electricity bills in 2014 and 2015

The cost of market leading fixed tariffs compared to other tariff types

Chart 3 and 4 have shown the growing gap between the average fixed and variable bills, however this does not consider the absolute cheapest tariffs currently on the market. Chart 5 shows that the cheapest short term[10] fixed tariffs have been dropping in price more rapidly than other types of tariff. Since the beginning of 2014, the price of the cheapest short term fixed tariffs have fallen by 29 per cent. In the same period, the cheapest multi year fixed tariffs have fallen by 20 per cent and the cheapest standard variable tariffs from one of the big 6 have only fallen by 9 per cent over this time. In June 2016 the cheapest short term fixed was 31 per cent cheaper than the best available standard variable tariffs of the big 6 this difference having grown from 12 per cent at the beginning of 2014.

Chart 5 – Comparison of the cost of the cheapest available direct debit duel fuel tariffs[11] over time in London.



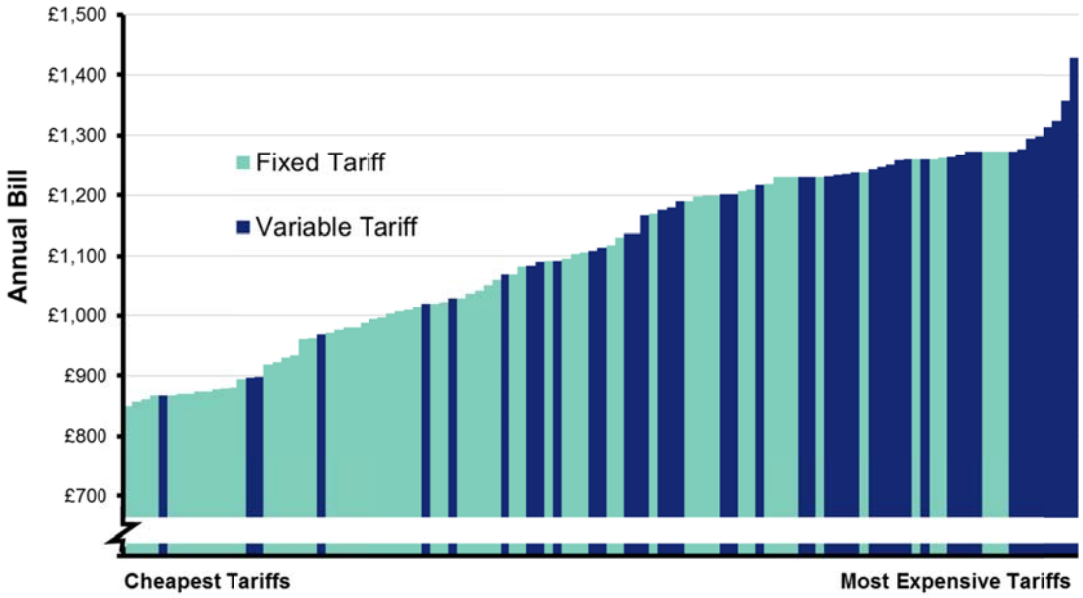
Source: UK power price comparison site

Short term fixed tariffs have generally remained the cheapest on the market, and are offered by most suppliers. However, there have been points where variable tariffs have been cheaper over the past year. These have generally been offered by companies that are newer to the market who are taking advantage of the current climate of falling wholesale prices.

In comparison, most other suppliers do not generally offer these cheaper variable tariffs, offering only a standard variable option (usually more expensive). These suppliers offering short term fixed tariffs as there most competitive tariffs. Chart 6 shows the average annual bill of all of the tariffs available in June 2016, and what type of tariff it is: fixed or variable. This indicates that although a few variable tariffs are amongst the cheapest available to consumers the majority of cheaper tariffs were fixed tariffs.

[10] A tariff is considered to be *Short term* if the period that it is fixed for is less than 2 years.
[11] Data from www.UKpower.co.uk. Consumption levels used were 3,800kWh electricity and 15,000Kwh gas. Comparison of the London region only.

Chart 6: Variations in the price and types of tariffs available to direct debit customers in June[9]



Source: UK power price comparison site

Conclusion

This article has shown that more customers have been moving to fixed tariffs, although the majority are still on variable tariffs. The difference in the average annual bills between variable and fixed bills has been increasing over the last few years and fixed tariffs are now over 10 per cent cheaper than variable tariffs in 2015. Although there are some cheap variable tariffs on the market, many suppliers have focused on offering cheap short term fixed tariffs. This has resulted in the majority of cheap tariffs on offer being fixed. This has widened the gap in price between fixed and standard variable tariffs; increasing the value of switching tariffs to customers.

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