Energy price cap: earnings before interest and taxes (EBIT) allowance methodology update

Publication date: 26 August 2026

We are publishing this note to outline our final approach to the RPI-CPI wedge input used to set the EBIT allowance from 1 October 2026, announced on 26 August 2026. This change of input reflects the planned reforms to RPI from 2030.

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Summary

The energy price cap includes an allowance for Earnings Before Interest and Tax (EBIT). As part of the annual update of the EBIT allowance, we refresh a range of external data inputs used within the methodology. One of the inputs used in this calculation relates to the Retail Prices Index (RPI), which is being aligned with the Consumer Prices Index including owner occupiers' housing costs (CPIH) from 2030.

Because of this change, one of the inputs we would ordinarily use in setting the EBIT allowance (the RPI-CPI wedge) we no longer consider is appropriate to use, as it would now be significantly affected by the planned reform of RPI from 2030 rather than prevailing market conditions.

Context and previous approach

The Office for Budget Responsibility (OBR) publishes forecasts of RPI and CPI on their website. An ‘RPI-CPI wedge’ used in our EBIT allowance is the difference between the two measures of inflation at a given point in time. The purpose of the RPI-CPI wedge is to convert RPI-indexed gilt yields, which are used as part of our assessment of the risk-free rate, into a consistent inflation measure for use within the EBIT calculation.

Historically, we have used a RPI-CPI wedge estimate by taking the difference between the CPI and RPI measures for a single year, 5 years ahead. However, this means we would now be using 2030 inflation numbers, which are impacted by the government decision to no longer use RPI as an official metric.

Initial proposal for accounting for the 2030 RPI reform

On 4 August 2026 we notified industry participants of our intention to use a 5-year average of the RPI-CPI wedge from the period of 2026 to 2030. We considered this approach would provide a more stable and representative estimate of the long-run RPI-CPI wedge than the previous approach and would avoid a sudden step change in our EBIT inputs driven by the planned reform of RPI from 2030.

Revised approach used to inform the 1 October 2026 price cap EBIT allowance

After considering representations from a number of industry stakeholders, we have made further refinements to our initial proposal set out on 4 August. We consider that these refinements support the accuracy of the wedge input, and therefore contribute to protecting the interests of consumers.

We consider the most appropriate figure to use is a 10-year average of inflation wedges, to align with 10-year UK government index-linked gilt maturity period the inflation wedge will apply to.

For years where OBR annual forecast information is available for both RPI and CPI, (currently 2026 to 2030), we will use these figures to calculate the annual wedge. For years where OBR inflation forecasts are not available (currently 2031-2035), we will use the OBR estimate of the long-run CPIH-CPI wedge (0.4%). This ensures that inputs are available for all years.

We will use a weighted average of the RPI-CPI wedge between years, weighted by a discount factor based on the ten-year real yield using the last month end figure (July 2026) from the Bank of England. This weights more recent years slightly more highly than later years, to reflect the greater impact on investors' decisions due to the time value of money. Further details can be found in the'3K EBIT' worksheet of the Energy price cap levels: pre-levelised rates model for the period 1 October to 31 December 2026, available on Ofgem's Energy price cap (default tariff) levels webpage.

This revised input gives an RPI-CPI wedge value of 0.57% which will be used in the price cap model from 1 October 2026 to 30 September 2027.

If you have any questions regarding the change to the RPI-CPI wedge input outlined in this note taking effect from 1 October 2026, please contact RetailPriceRegulation@ofgem.gov.uk.