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Pension funds gain £20bn on RPI plan

By Steve Johnson

Pension funds have already seen their combined deficits fall by £20bn as a result of controversial proposed changes to the calculation of the UK's inflation rate.

The UK's Office for National Statistics is evaluating potential changes to the measurement of clothes price inflation, which are expected to reduce retail price index inflation by about 30 basis points a year. RPI inflation could fall by 90bp a year if the proposal to calculate inflation using a geometric, rather than arithmetic, mean is extended to all goods and services.

Lower RPI inflation would hurt holders of index-linked gilts but benefit most private sector pension schemes, which have to uprate payments in line with the RPI.

Mercer, the consultant, has calculated that the combined pension scheme deficits of FTSE 350 companies fell from £94bn in the middle of May to £72bn at the end of the month as a result of a "sharp" decline in the expected future rate of RPI inflation since news of the potential revamp emerged.

The 20-year RPI spot rate has fallen from 3.34 per cent on May 11 to just 2.99 per cent, accounting for the "vast bulk" of the narrowing of deficits, according to Ali Tayyebi, pension risk group leader at Mercer.

"This fall in inflation appears to be co-incident with publication of minutes from the Consumer Prices Advisory Committee, commenting on its review of the RPI / CPI [consumer price index] inflation measures, which is looking at the possibility of closing the gap between the two measures," said Mr Tayyebi.