

## RPI Change on the Horizon – but not just yet!

*On 4 September 2019 the Government announced that it will be consulting on possible changes to the calculation of the Retail Price Index (RPI) as a measure of inflation, although any change will be made no earlier than February 2025.*

### Background

In 2010 the method of collecting price information concerning clothing was changed in such a way that it unexpectedly increased the difference between the RPI and the Consumer Prices Index (CPI) as measures of inflation. This prompted an investigation which highlighted several flaws in the formula used to calculate the long-standing RPI. This in turn led to the production of various new indices. In particular, CPIH was introduced based upon the CPI, but which allowed for housing cost changes omitted from the CPI.

From 14 March 2013 the RPI ceased to be an official National Statistic, and any changes to the RPI were frozen from that date. Nonetheless, the RPI continues to be published, not least because many schemes have rules stipulating RPI as the basis for pension increases, and Government Index-Linked Gilts continue to be issued with coupons and redemption amounts based on the RPI.

### The Office for National Statistics (ONS) Acts

The ONS has discouraged the continued use of the RPI, and on 4 March 2019 the Chair of the UK Statistics Authority wrote to the Chancellor of the Exchequer setting out its view that the methods used to calculate CPIH should be adopted for the RPI in the near future, effectively aligning the RPI with the CPIH Index. Consent to making this change before 2030 is required from the Chancellor due to the impact that it would have on index-linked gilts.

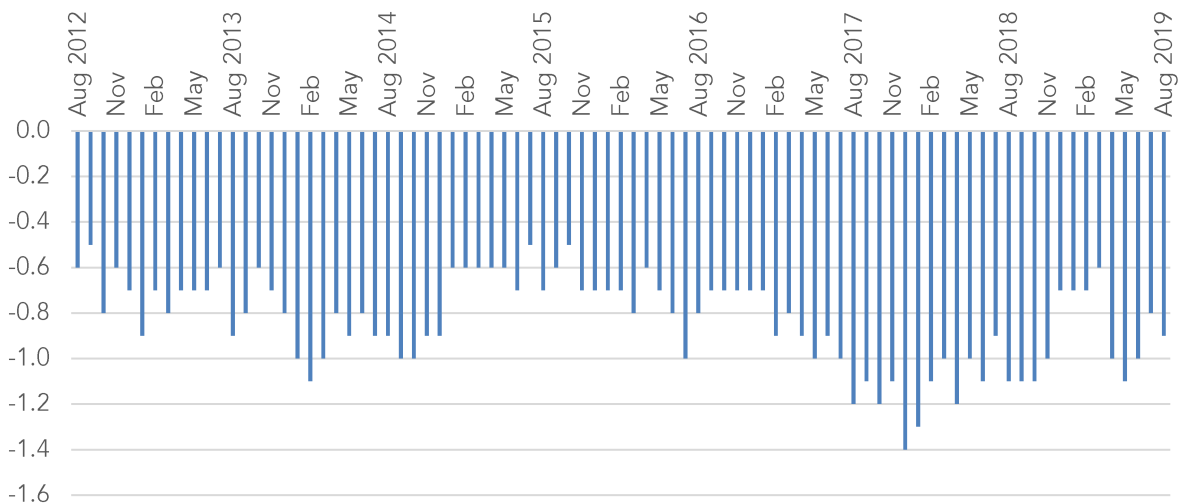
The Chancellor has therefore considered the request, and announced a consultation starting early next year on possible changes to the calculation of the RPI. No change is expected before 2025, but the UK Statistics Authority could unilaterally enforce a change after 2030, when the Chancellor's consent is no longer required.

### Impact

As shown in the chart overleaf, the difference between RPI and CPIH has been similar to that for the CPI index. On average, increases in the CPIH have been between 0.9% p.a. and 1.0% p.a. lower than increases in the RPI since August 2016 (cf RPI less CPI average of 0.9% p.a.):



### CPIH – RPI (% p.a.)



This means that, after 2030, RPI-linked pension increases may be lower than previously expected, and the impact and likelihood of this will be directly priced into financial markets over time. Other measures of inflation (eg CPI) should be unaffected.

As a result, asset and liability values that are linked to the market price of RPI could reduce. The impact on a scheme’s funding position will be scheme specific, depending on the portion of pension increases which are RPI-related, the scheme’s maturity (it will be more significant for less mature schemes) and the extent to which the scheme has already hedged its inflation liabilities with assets whose value may also be affected by this change.

Typically, changes to the technical provisions assumptions will be allowed for at the next triennial actuarial valuation; however, in the meantime there could potentially be good opportunities to buy cheaper assets to increase inflation hedging (eg inflation-linked bonds, Liability Driven Investment or bulk annuities).

So far, the announcement has had only a marginal impact on market-implied RPI, but this may change once the consultation starts and we have a clearer idea of what is proposed.

Noticeably absent from the Chancellor’s announcement is any discussion of possible compensation for existing holders of index-linked gilts, who could claim that this change reduces the value of their holdings, but this is sure to feature heavily in investors’ responses to the consultation.

**If you would like to discuss this further, please get in touch with your usual contact at Cartwright.**

October 2019

Mill Pool House  
Mill Lane  
Godalming  
Surrey GU7 1EY

T: 01483 860201

E: [enquiries@cartwright.co.uk](mailto:enquiries@cartwright.co.uk)

250 Fowler Avenue  
Farnborough Business Park  
Farnborough  
Hampshire GU14 7JP

T: 01252 894883

E: [enquiries@cartwright.co.uk](mailto:enquiries@cartwright.co.uk)

Marlborough House  
Victoria Road South  
Chelmsford  
Essex CM1 1LN

T: 01245 293300

E: [enquiries@cartwright.co.uk](mailto:enquiries@cartwright.co.uk)

The Mansley Business Centre  
Timothys Bridge Road  
Stratford Enterprise Park  
Stratford-upon-Avon  
CV37 9NQ

T: 01245 293300

E: [enquiries@cartwright.co.uk](mailto:enquiries@cartwright.co.uk)

