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HEDGING INFLATION RISK IN THE 2020s:

REACTING TO RPI REFORM AND INFLATIONARY PRESSURES

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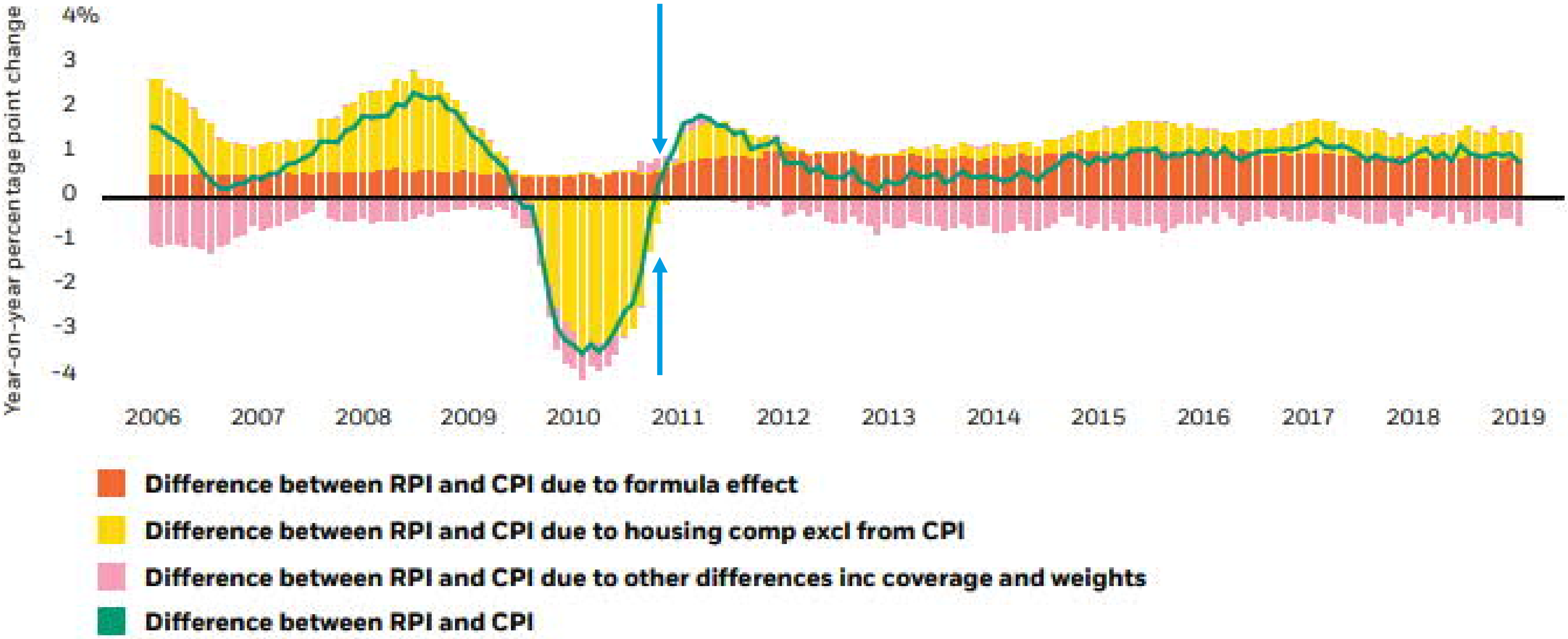
20 February 2020


UK 20-year yields
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
-3%
Jan-2005
Jan-2006
Jan-2007
Jan-2008
Jan-2009
Jan-2010
Jan-2011
Jan-2012
Jan-2013
Jan-2014
Jan-2015
Jan-2016
Jan-2017
Jan-2018
Jan-2019
Nominal
Real
Inflation

Are you able to raise you right hand?



Source: ONS via BlackRock

"From 2030 RPI will be defined in line with CPI-H"

Raise your hand if you agree

Source: Insight and Bloomberg

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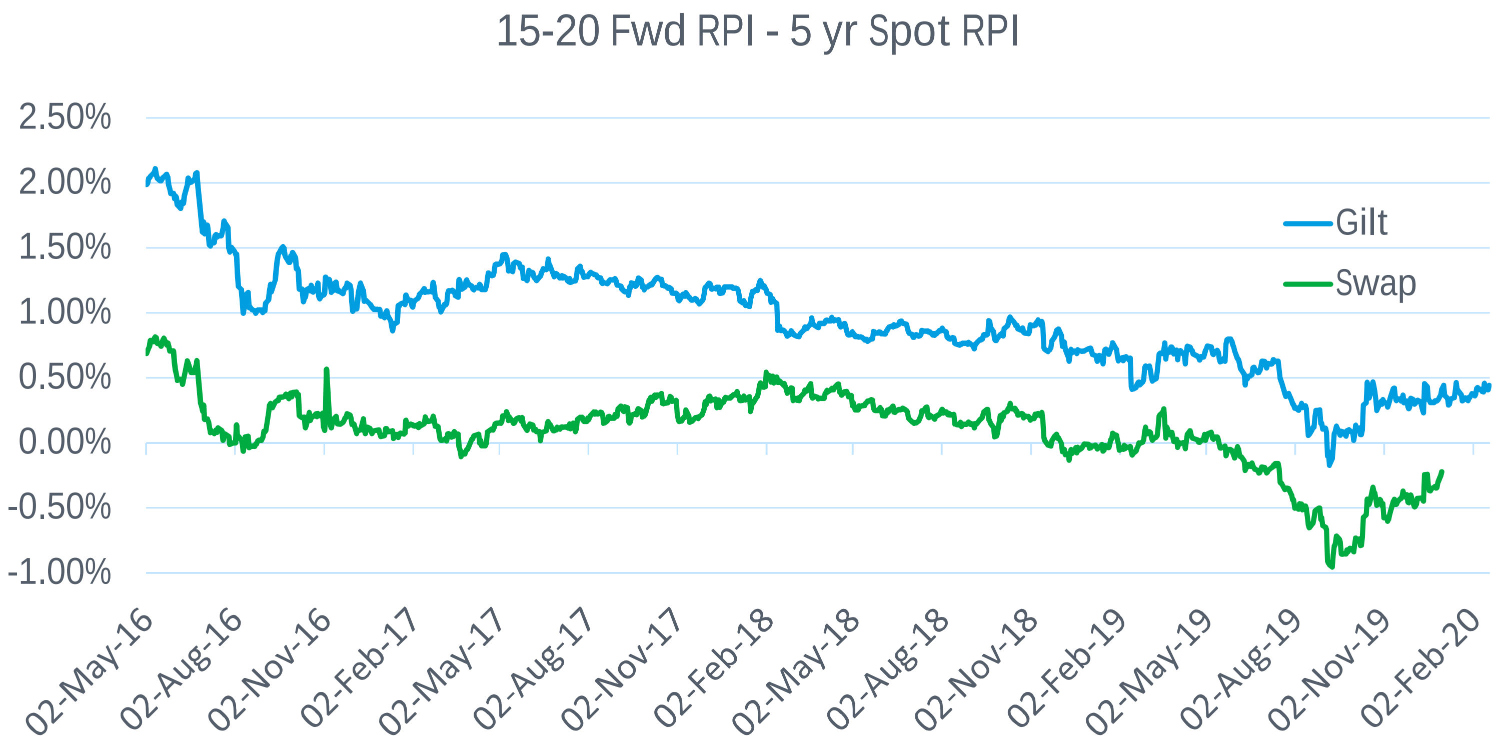
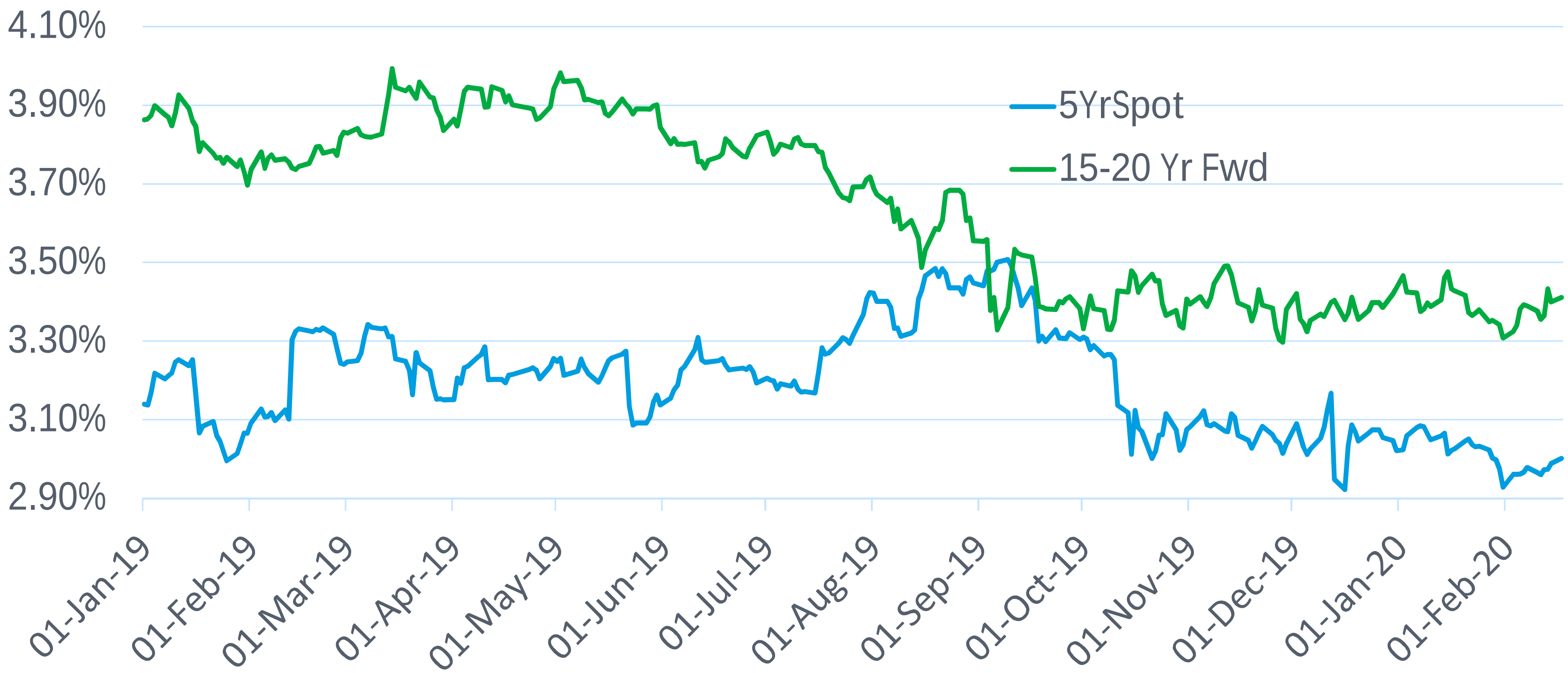


Source: Mercer based on gilts prices from Trade-web

Gilt Yield Development



Source: Mercer based on gilts prices from Trade-web

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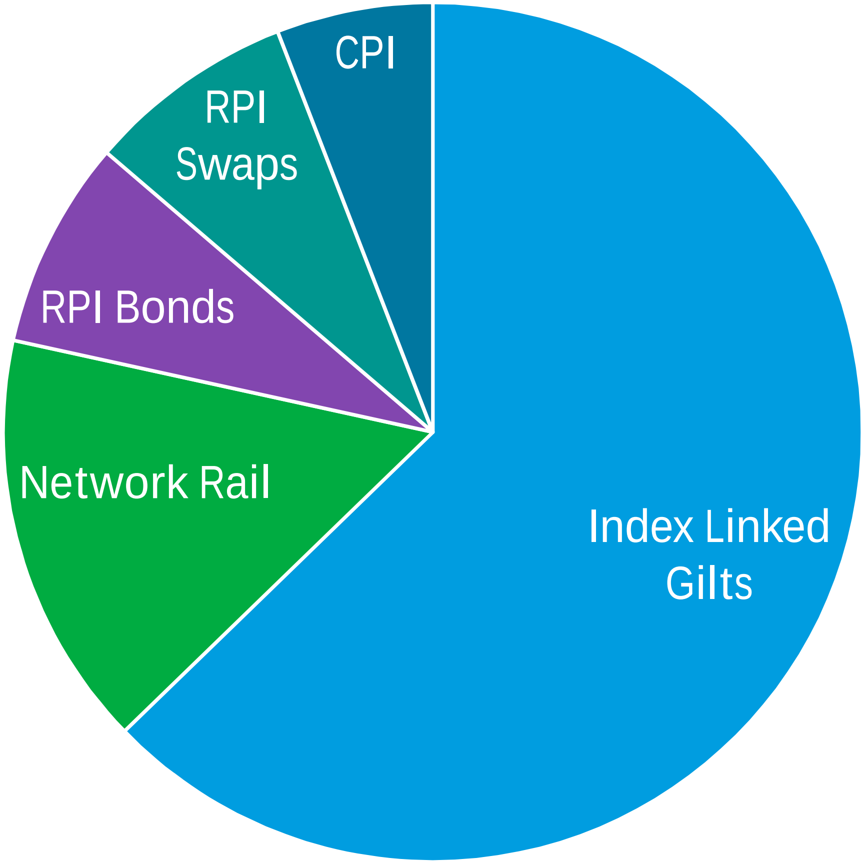
"The potential impacts of the RPI review are reasonably priced into the market"

Raise your hand if you agree

Inflation Hedging Assets



Source: Mercer

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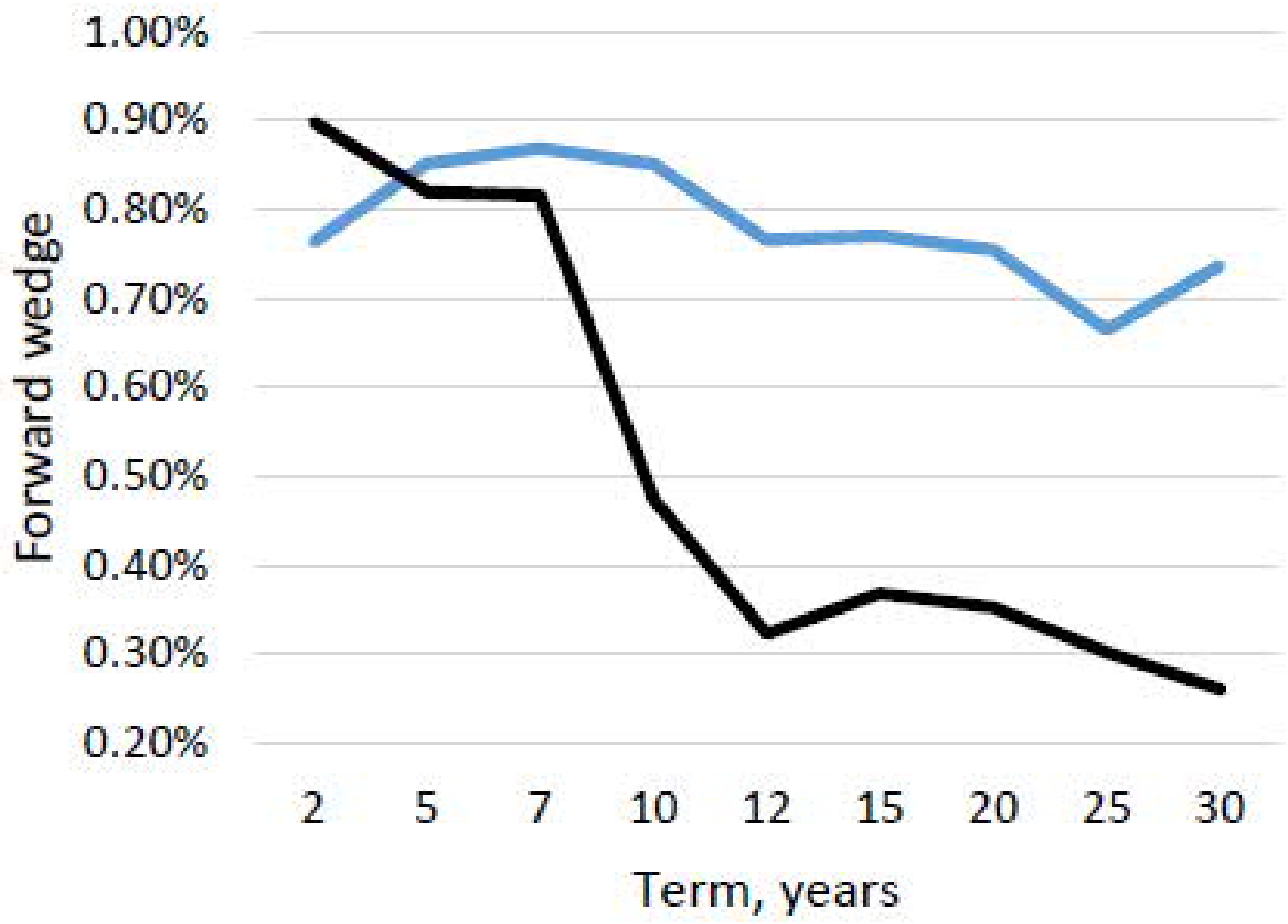
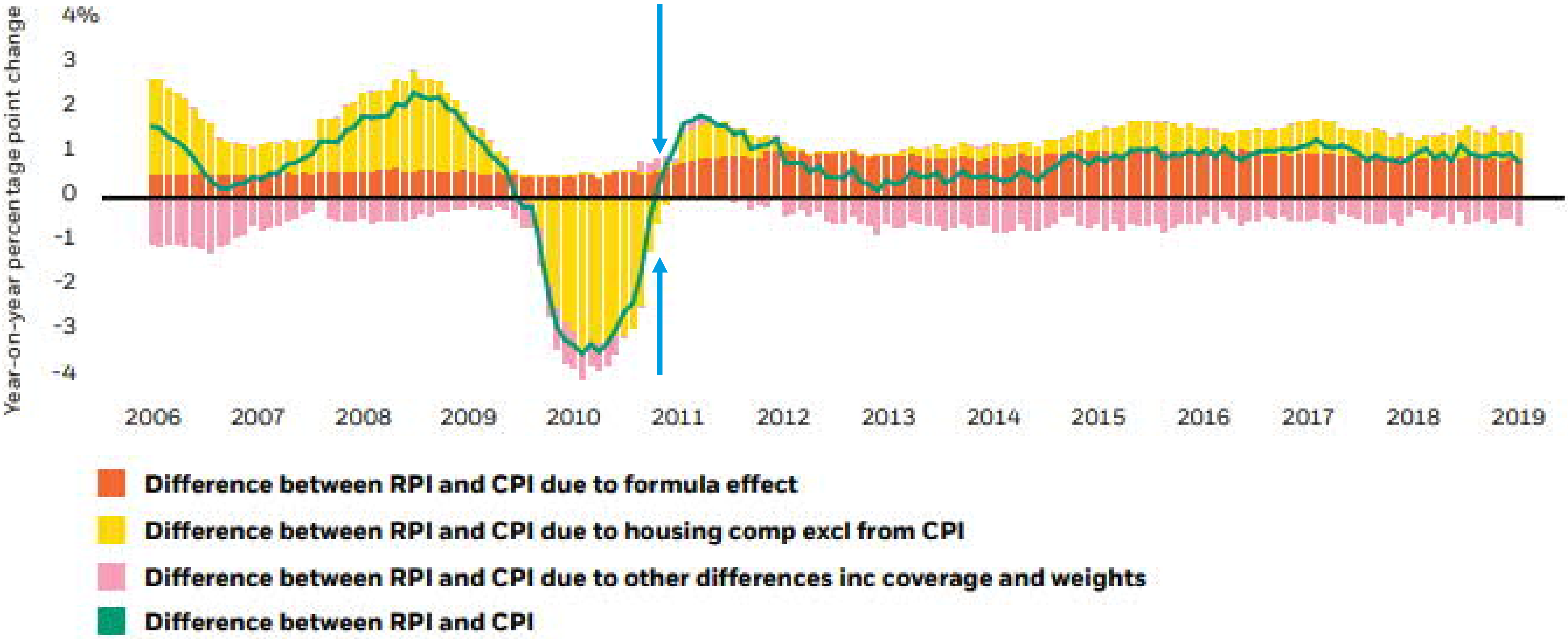


RPI – CPI forward wedge curves

Source: Bloomberg and Lloyds via BMO

“The UK Government will pay compensation to index-linked gilts holders”

Raise your hand if you agree

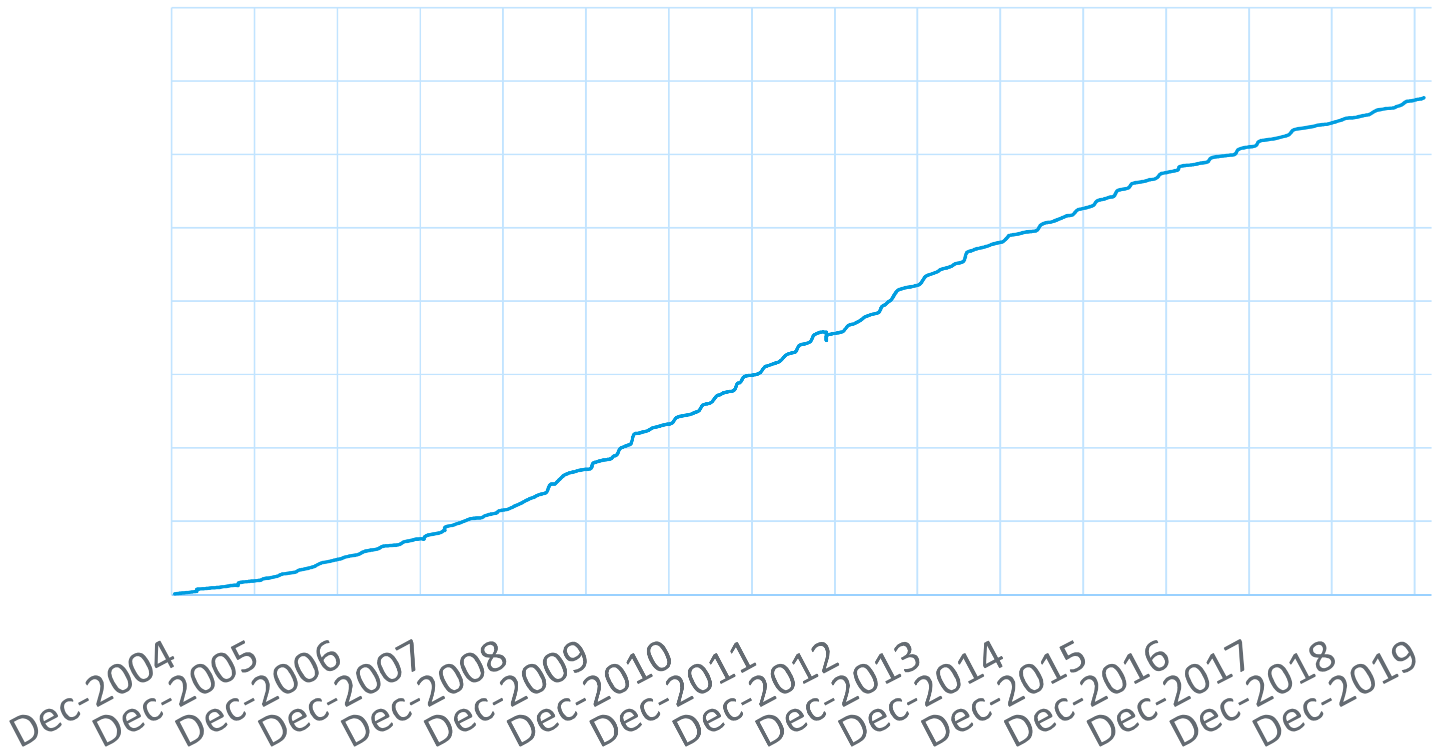


Source: ONS via BlackRock

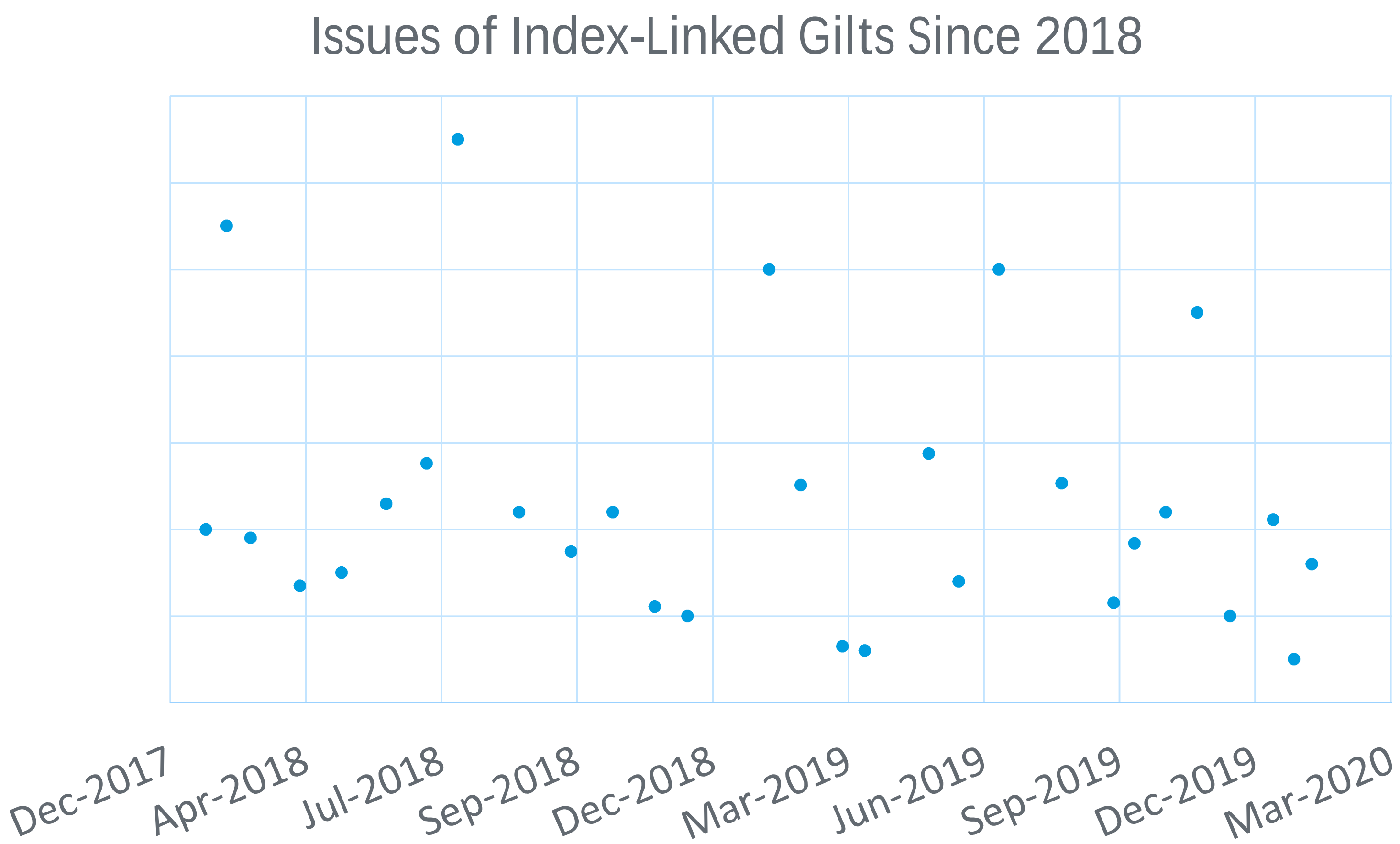
“Even if gilts holders receive compensation, member compensation will be very rare”

Raise your hand if you agree

Cumulative Index Linked Gilts Issuance



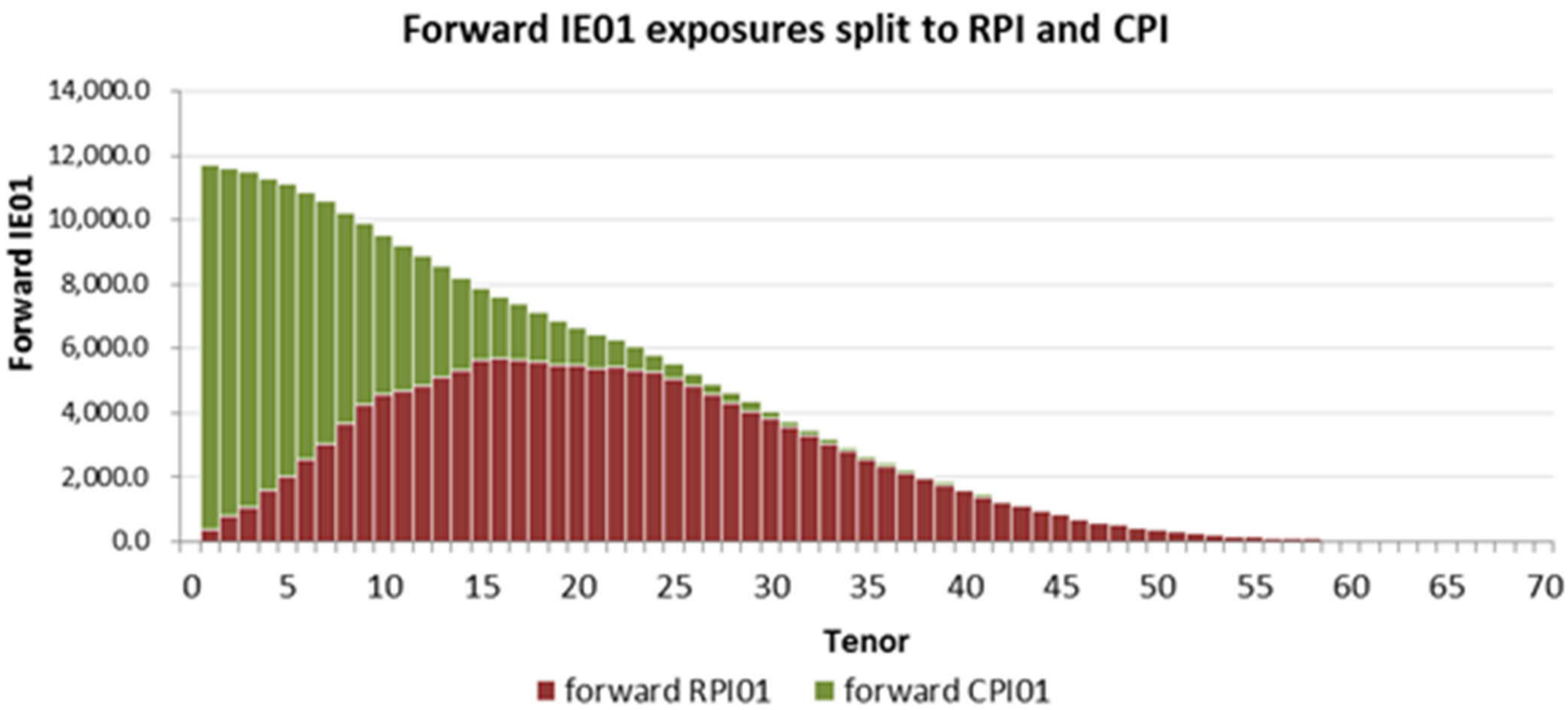
Source: Mercer and DMO



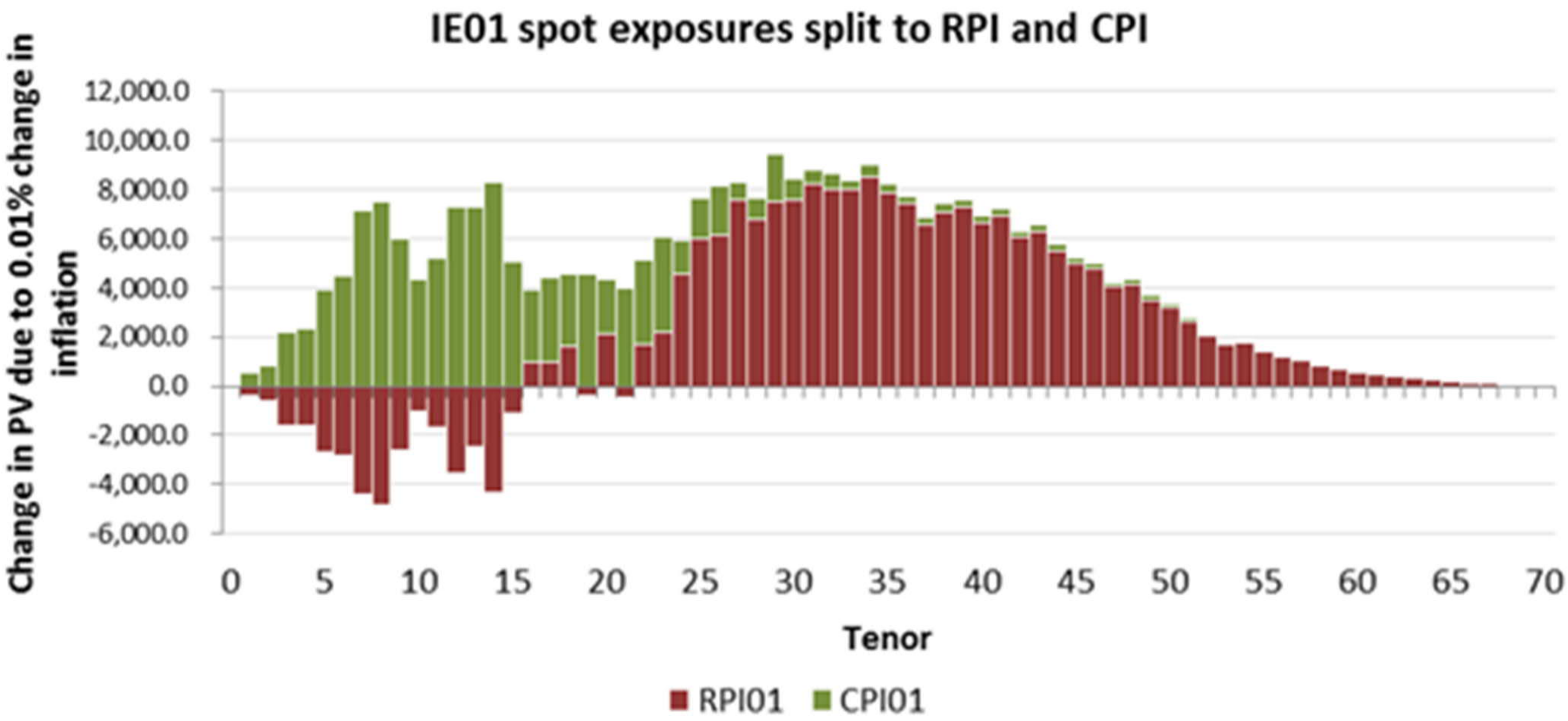
Source: Mercer and DMO

"From 2022 all index-linked gilts will be CPI-linked"

Raise your hand if you agree



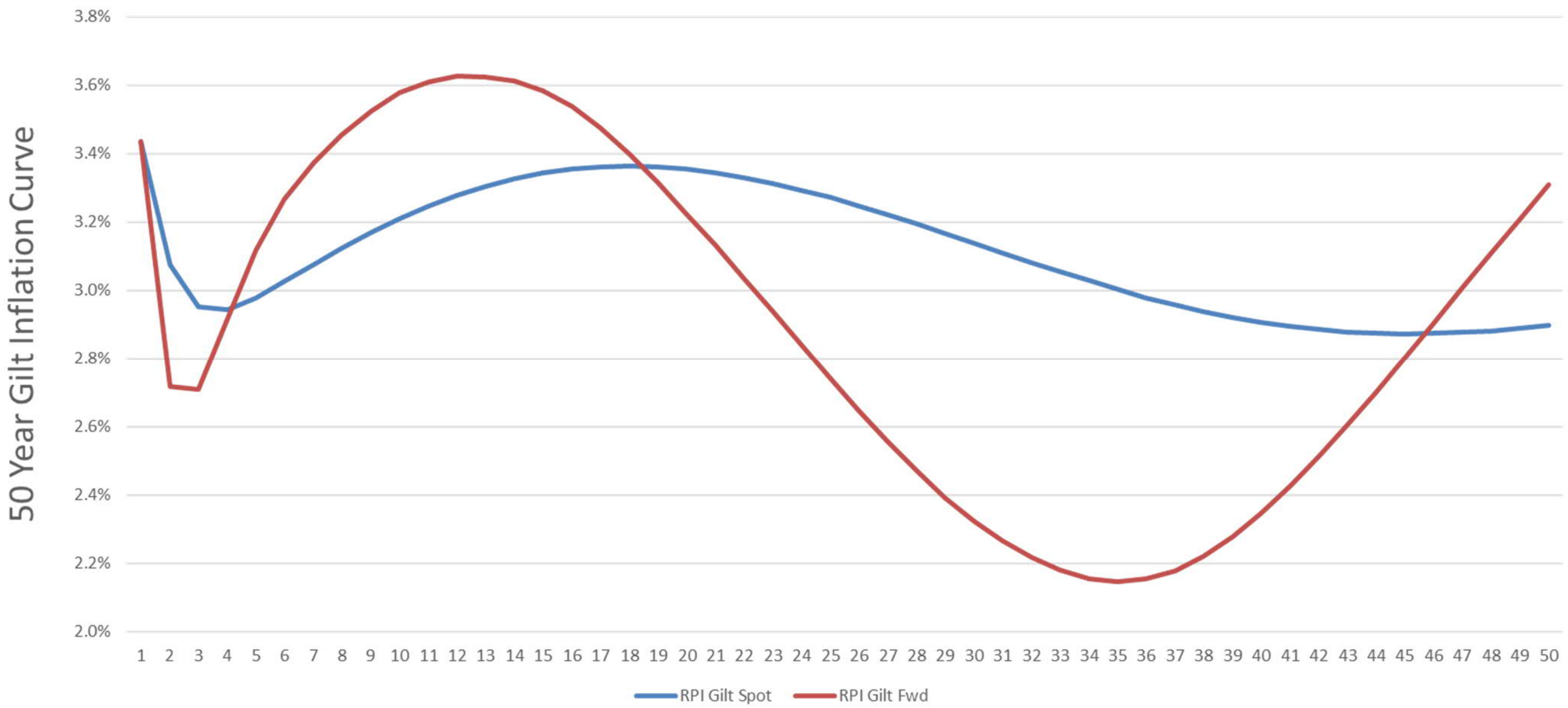
Forward IE01 exposures split to RPI and CPI
14,000.0
12,000.0
10,000.0
8,000.0
6,000.0
4,000.0
2,000.0
0.0
Forward IE01
0
5
10
15
20
25
30
35
40
45
50
55
60
65
70
Tenor
forward RPI01
forward CPI01


IE01 spot exposures split to RPI and CPI
Change in PV due to 0.01% change in inflation
12,000.0
10,000.0
8,000.0
6,000.0
4,000.0
2,000.0
0.0
-2,000.0
-4,000.0
-6,000.0
0
5
10
15
20
25
30
35
40
45
50
55
60
65
70
Tenor
RPI01
CPI01

"Fully CPI linked schemes should reduce their inflation hedge ratio"

Raise your hand if you agree

RPI Gilt Inflation Curve



“Scheme Actuaries should set CPI assumptions direct i.e. not via RPI - wedge ”

Raise your hand if you agree


Discussion