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Life Conference 2022

23-25 November, ACC Liverpool

#LifeConf





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The Inflation Genie...

Luke Andrews, FIA CERA

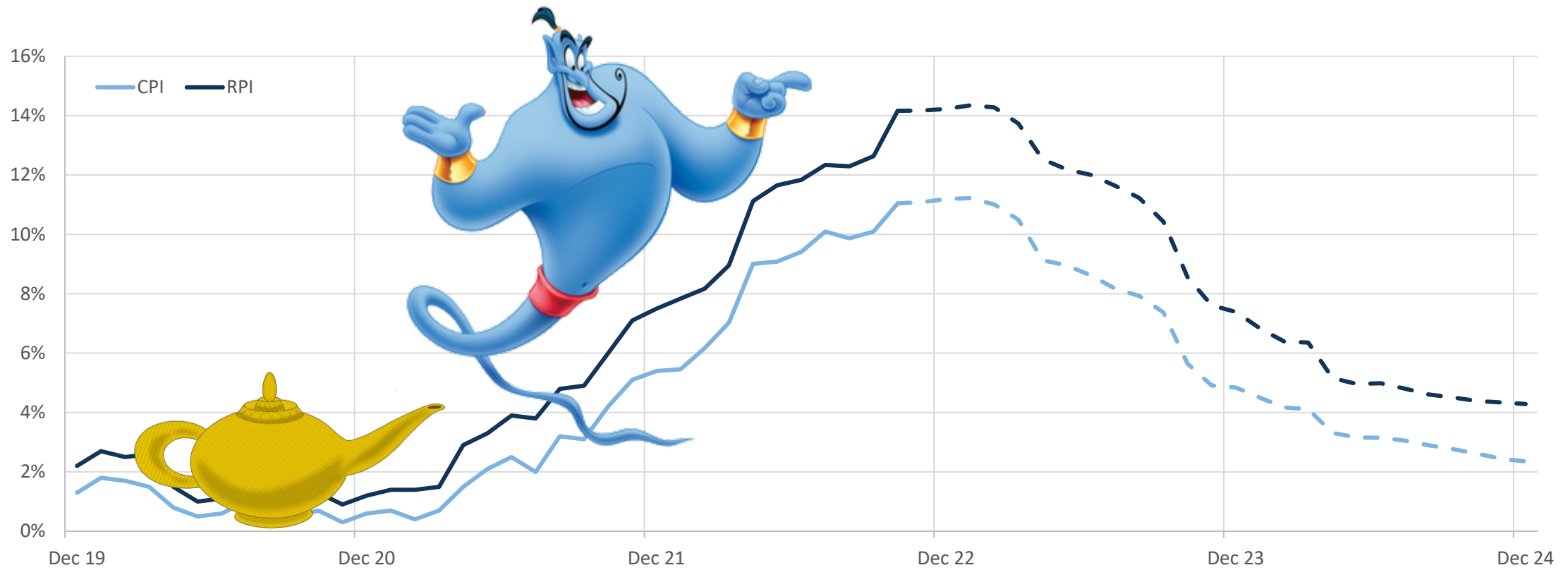
Suanne Chong, FIA

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Inflation Genie...



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Agenda

- **Interest rates and inflation:** what's happened / what's to come?
- **Pension scheme hedging:** implications / activity to-date
- **Bulk annuity deals:** typical market flows
- **Looking forward:** how might evolving conditions affect behaviour?



Speakers



Luke Andrews, FIA CERA
Insurance & Pensions, Content &
Solutions

Luke.Andrews@natwestmarkets.com



Suanne Chong, FIA
Insurance & Pensions, Content &
Solutions

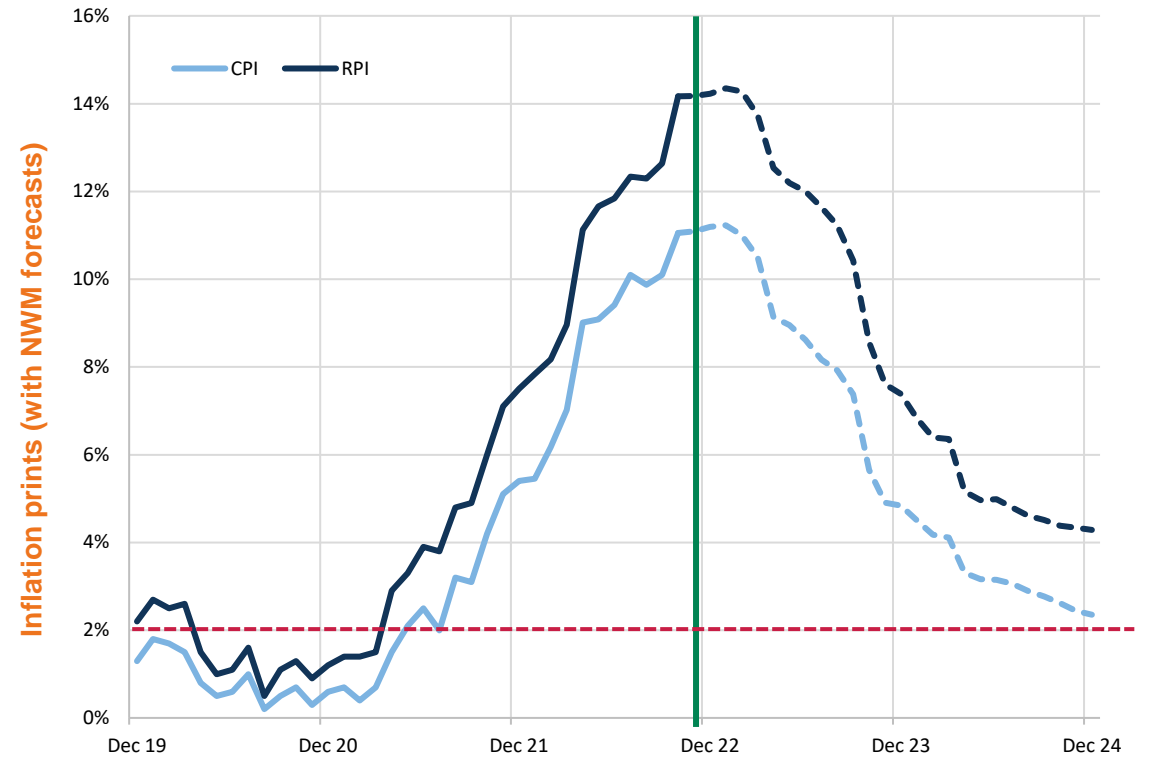
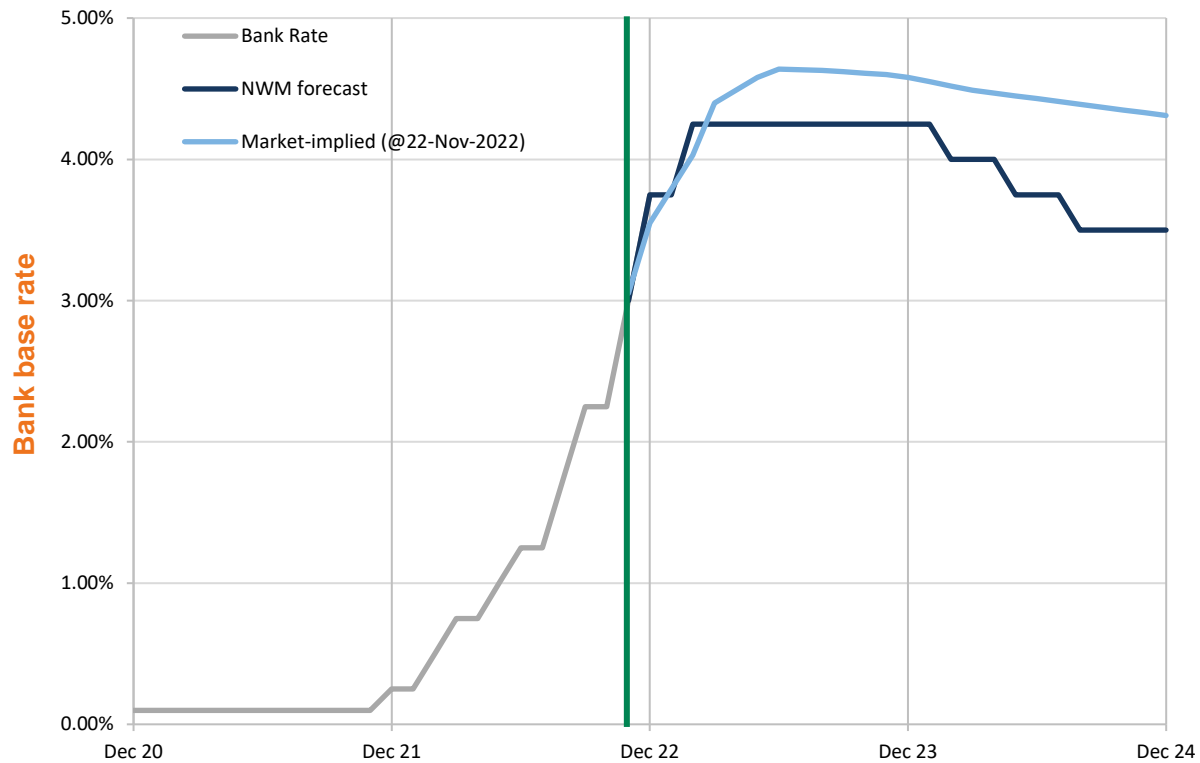
Suanne.Chong@natwestmarkets.com



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Expectations

Three wishes for central bankers...?



Source: NWM, Bloomberg, BOE, ONS



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Recent Experience

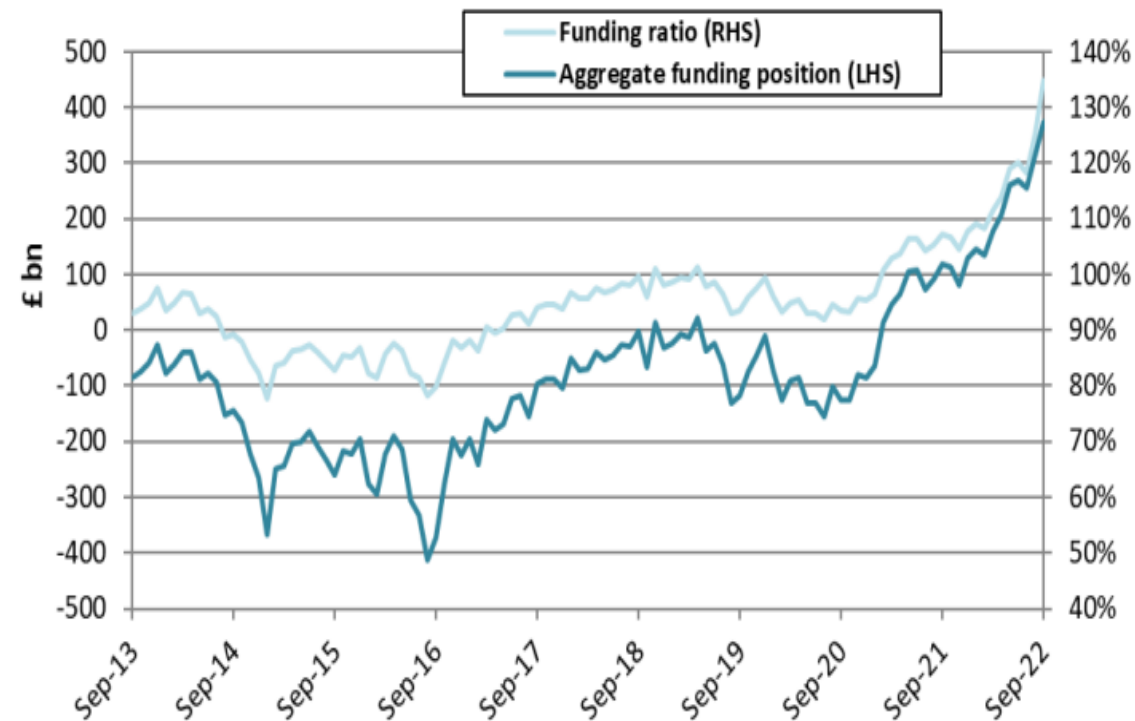
Shining a lamp on events...

Gilt yields



Source: BoE yield curve data, PPF 7800 update October 2022

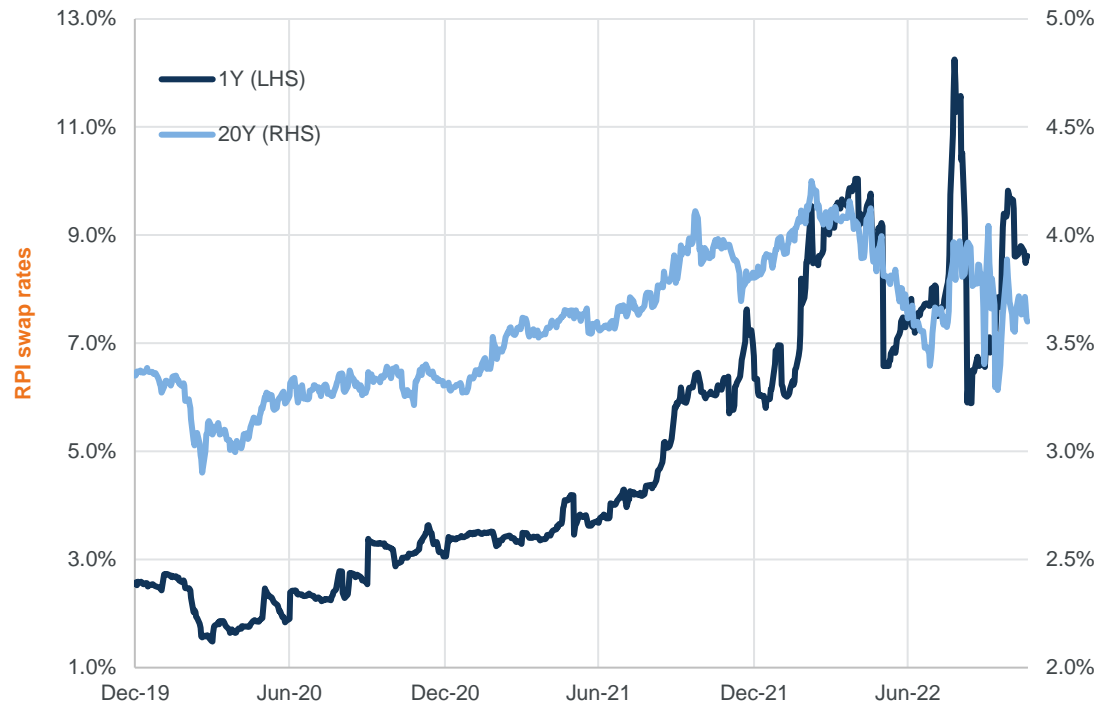
Historical aggregate position of schemes in the PPF universe (s179 liabs)



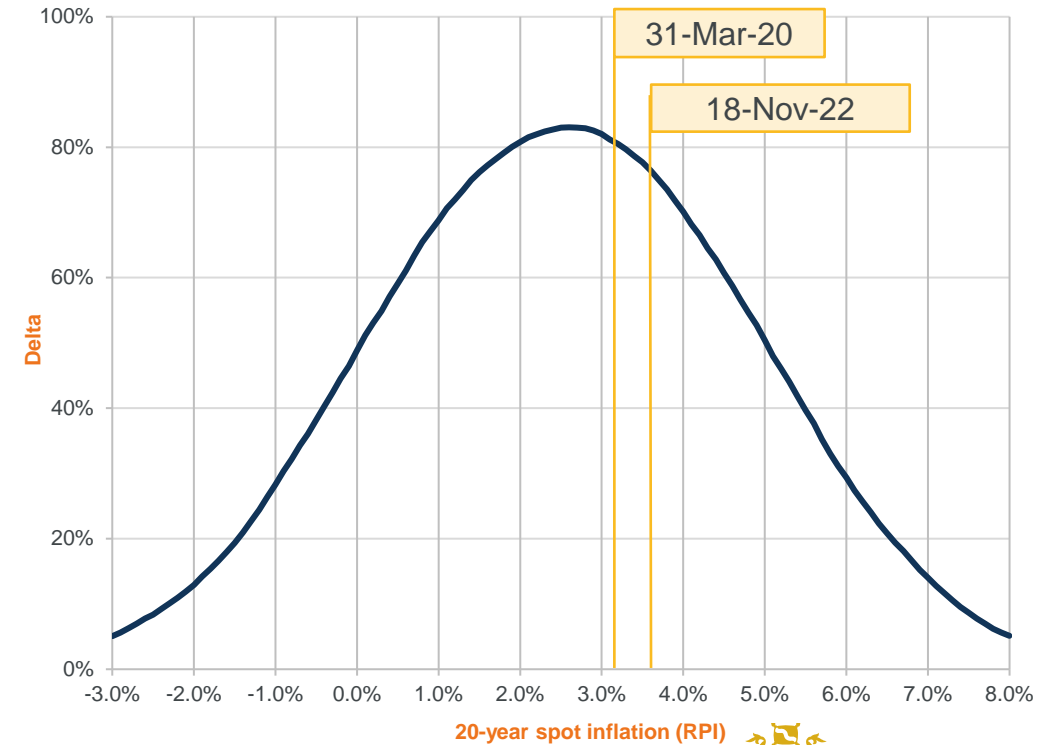
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Pension Scheme Hedging Activity

LPI – Example RPI(0,5)



Year-on-year throughout, RPI(0,5)



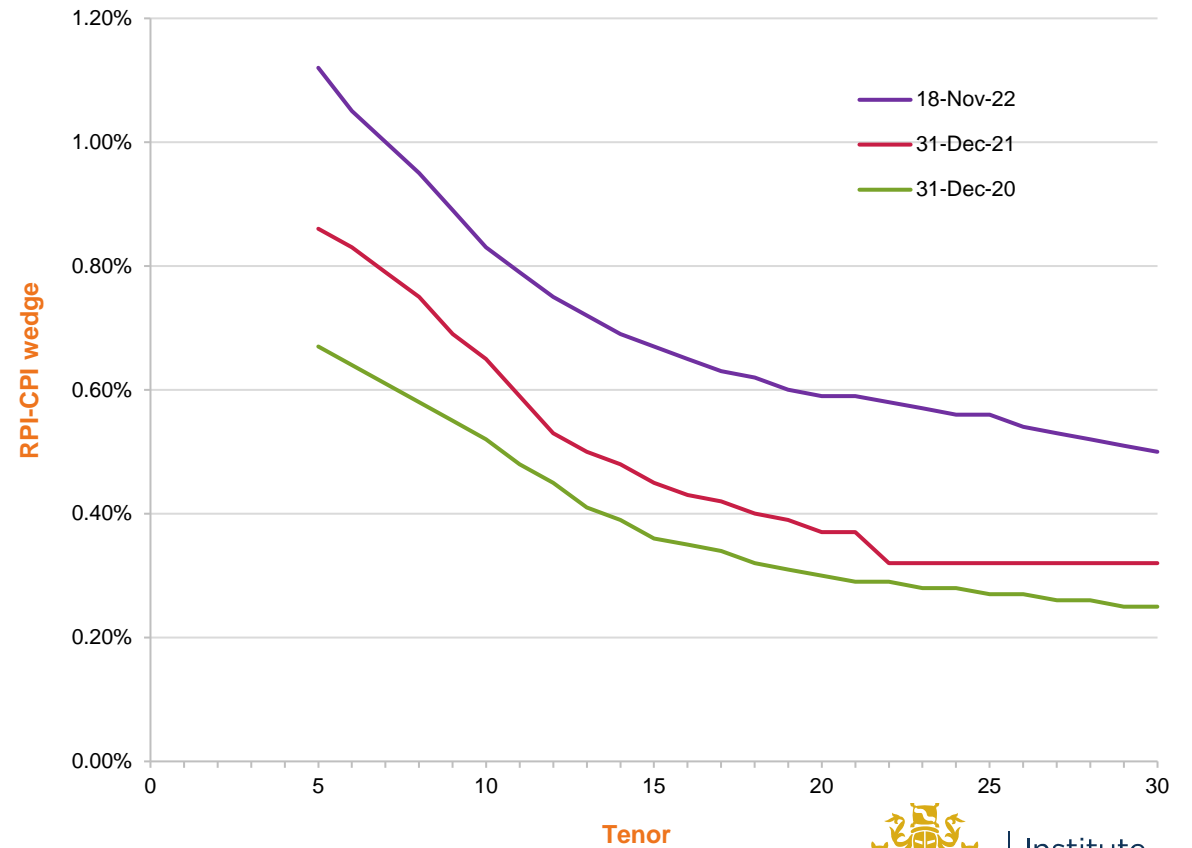
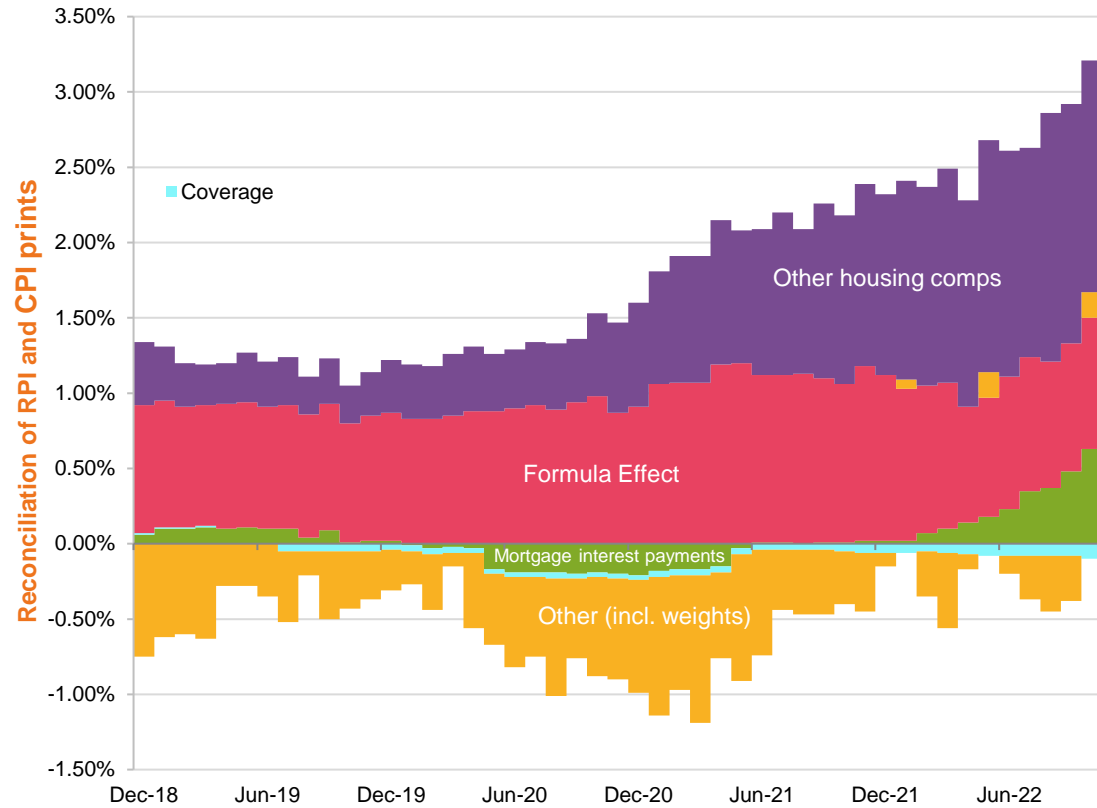
Source: NWM, indicative (assumes constant vol), Bloomberg



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Pension Scheme Hedging Activity

CPI



Source: ONS, NWM

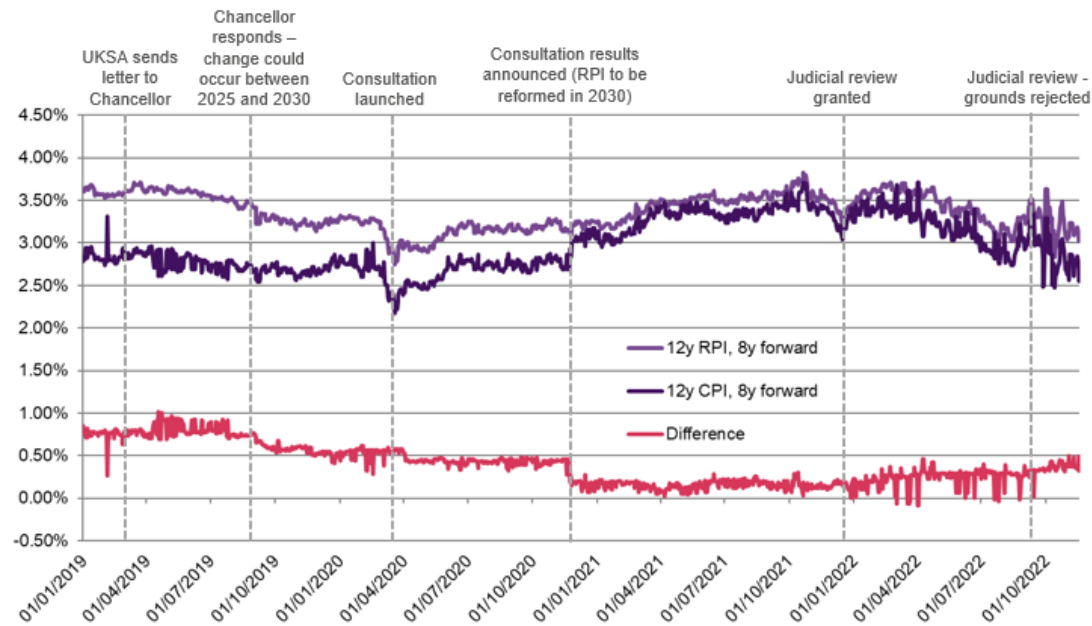


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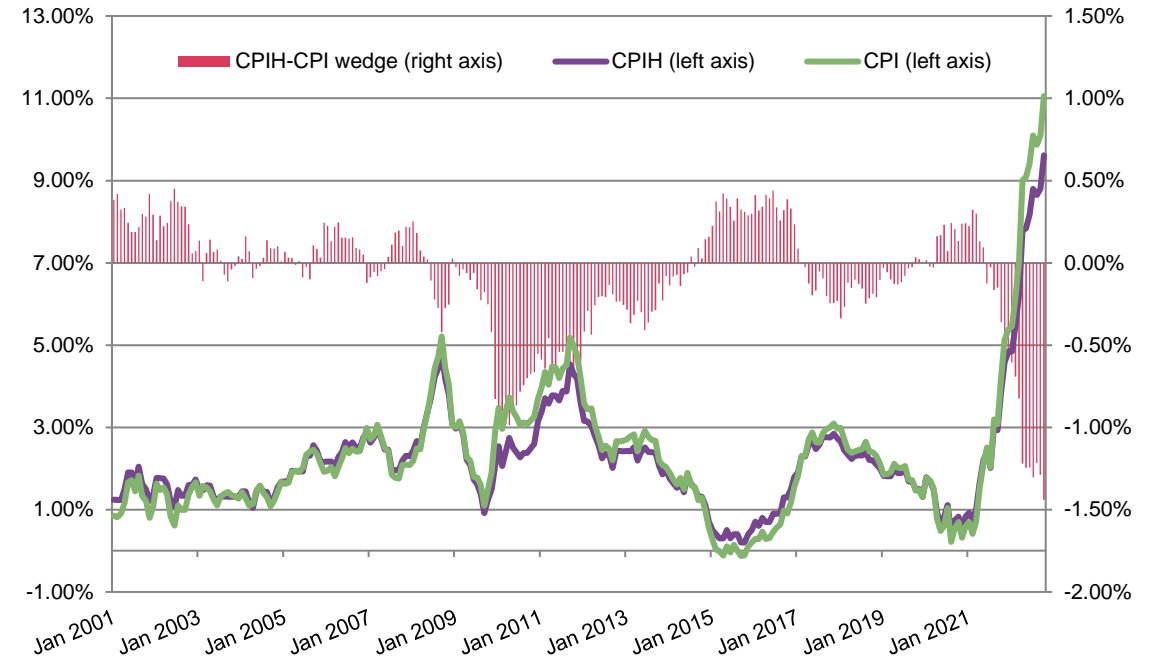
Pension Scheme Hedging Activity

CPI

Timeline of RPI Reform announcements vs RPI-CPI wedge



Realised CPIH-CPI wedge over time



Source: Bloomberg, ONS, NWM



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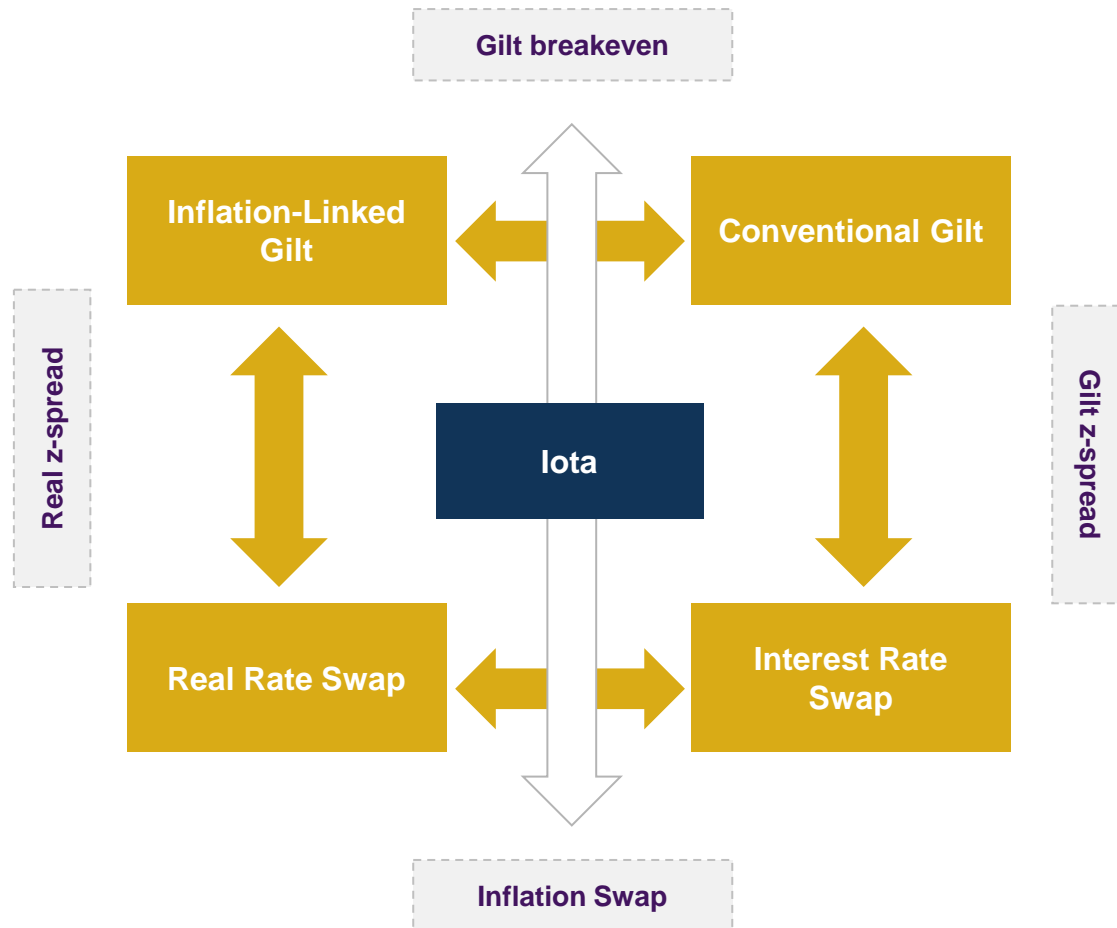
Pension Scheme Hedging Activity

Enough about CPI, what about RPI?

- Market demand for long dated UK Government Index Linked Gilts:
 - 2073 Index Linked Gilt curve extension
 - 22nd November 2022 syndication
- We also expect increased future supply:
 - Government borrowing requirements



Iota spread



What do iota spreads tell us?

- Iota shows the difference between an **inflation swap rate** and the corresponding **gilt-implied inflation** (gilt breakeven)
- When **iota** is high, it could be inferred that the **relative demand for inflation swaps** at that point is greater than for inflation-linked gilts

Approximate calculation

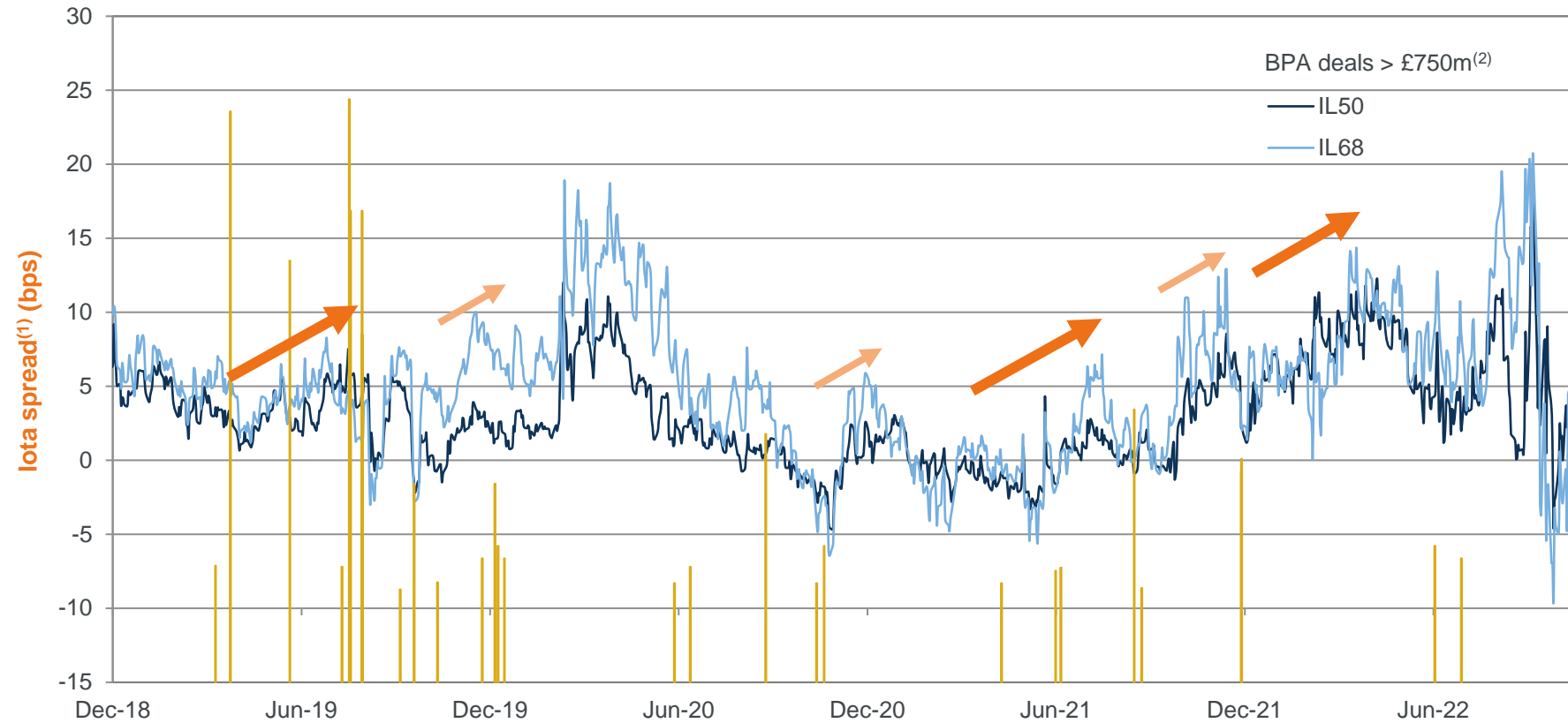
Iota can be assessed by taking the difference between the z-spread of an **inflation-linked gilt** and a corresponding **conventional gilt**:

- **Real z-spread** reflects the difference in an **inflation-linked gilt** over a **real rate swap**
- **Gilt z-spread** reflects the difference in a **conventional gilt** over an **interest rate swap**



Insurer Hedging Activity

RPI



Source: NWM, Bloomberg

Notes: (1) Linker z-spread less nominal z-spread \approx RPI swap less gilt b/even

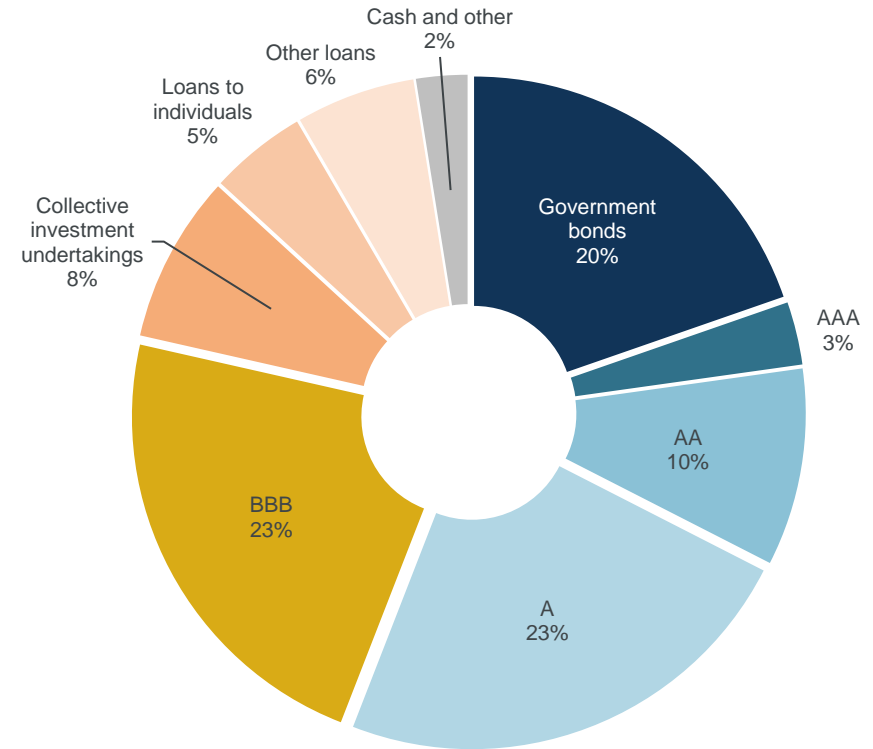
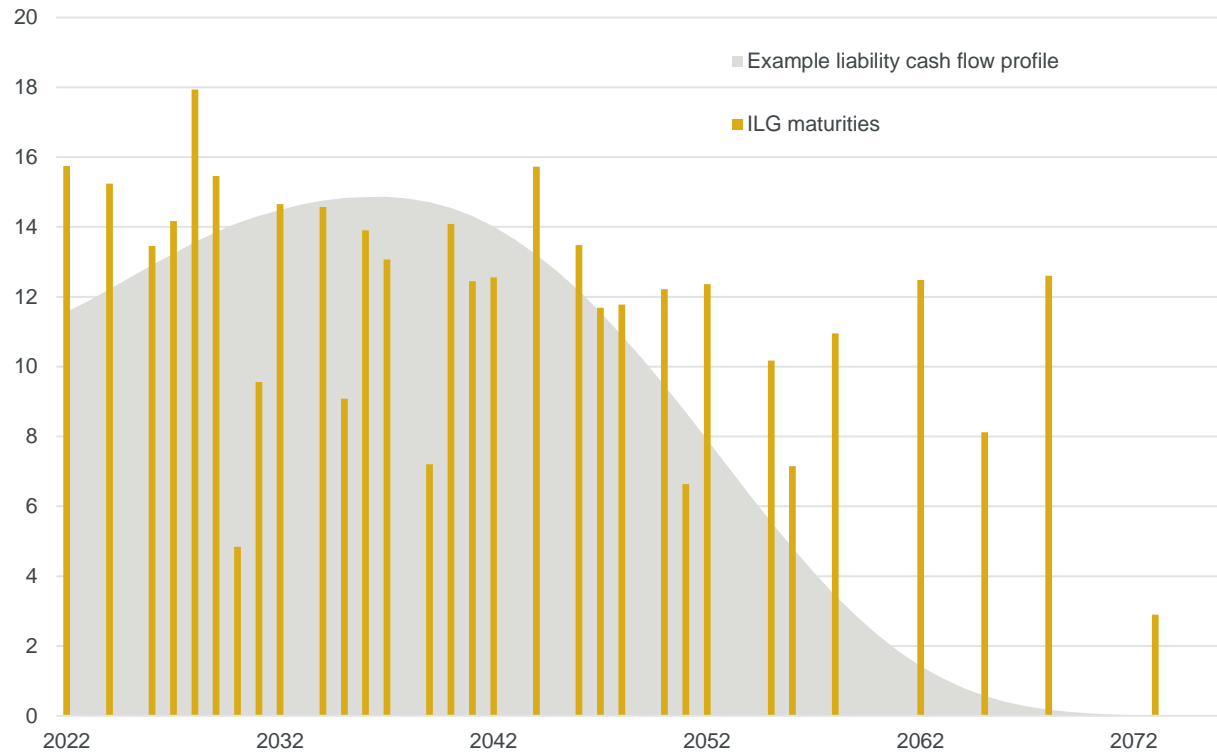
(2) Shown by date of announcement less 6 weeks...



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Insurer Asset Allocation

An Aladdin's Cave...



Source: DMO, Bloomberg, NWM, FY21 Insurance Co Disclosures



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Other type of activities

- Total return swap
- Repo





Looking Forward

- Ongoing market volatility
- Pension scheme funding positions
- BPA supply / demand
- Solvency II reform



Questions

Comments

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