A pensioners' bonanza?

State pensions will rise by 3% next April, but it's not all strictly good news.

On the day that a CPI inflation rate of 3% was announced, the BBC website covering the rise had a picture of pensioners "dancing for joy". The supposed reason for their jollity was that the 3% September inflation figure was the one that would be used to fix state pension increases from April 2018.

The BBC's response was understandable, but simplistic. Pensioners will be no better off because their increased income is, in theory, matched by increased prices. In practice they may be marginally better or worse off, depending upon how their spending pattern compares with the "shopping basket" used to calculate the CPI. The twelve components of that index showed annual inflation ranging from 4.3% (alcoholic drinks and tobacco) to 1.4% (miscellaneous goods and services).

…and on private pensions?

At least state pensions have inflation linking. Such protection is by no means certain among private pensions. Most large occupational final salary schemes offer inflation-proofing to their pensioners, although outside the public sector schemes increases may be capped. In the past, many people drawing benefits from personal pensions and similar arrangements have chosen to buy an annuity with no inflation protection. While the initial (level) income was much higher, its real value was steadily eroded by inflation. For example, £1 in September 2007 now has a buying power of 78.7p, based on CPI inflation.

Have your retirement plans allowed for retirement inflation? In today's annuity market, an inflation linked annuity for a 65-year old costs about 60% more than its non-increasing counterpart. You may well choose not to buy any form of annuity at retirement, but the costs of providing enough to be 'dancing for joy' will still be substantial.

Occupational pensions are regulated by The Pensions Regulator. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.