

Managing inflation risk in the New Dutch Pension Contract

“Protecting new pensions against inflation is a realistic option”

Rens van Gastel¹, Niels Kortleve¹, Theo Nijman², Peter Schotman³ – ¹PGGM, ²TiU, ³UM

Draft texts for the **Wet Toekomst Pensioenen (Dutch Future of Pensions Act)** often mention maintaining purchasing power but devote limited attention to the risk of inflation. This is hardly surprising because, since the late 1990s, inflation has been very moderate without large persistent shocks. However, for the future inflation risk remains an important risk factor. We investigated various options for hedging against inflation and unexpected inflation shocks in the New Pension Contract. And we assessed the impact of these measures on pension outcomes.

Principal Findings

- In the long term, protection against nominal interest rate changes leads to considerable uncertainty in purchasing power.
- Real protection has positive, though quantitatively small, welfare effects in times with low inflation risk, and a strong added value in the event of persistent stagflation.
- Applying such protection in normal times when there is little risk leads to very little welfare loss.
- Furthermore, adapting hedge returns and allocation rules to the real protection objective does not lower the certainty equivalent for any age cohort. However, it does improve the certainty equivalent for the younger generations.

Correlation Nominal / Real

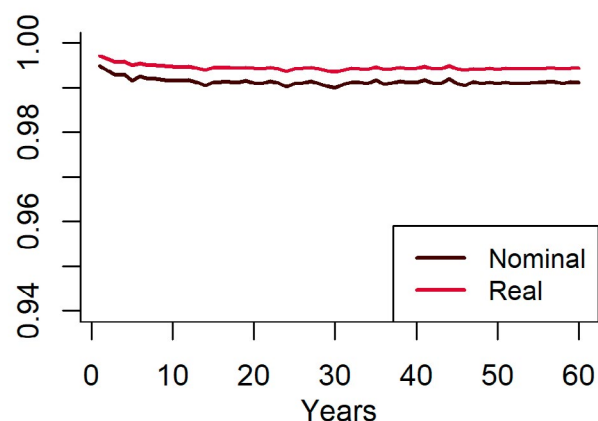


Figure: The figure shows the almost perfect correlation between returns on index linked bonds and nominal bonds with the same maturity. Being calibrated to the last two decades, it highlights the limited inflation risk in recent history and the need to critically evaluate existing scenario generators.

Key Takeaways for the Industry

- Policy decisions should incorporate inflation risks.
- Conventional scenarios should be critically evaluated with respect to inflation scenarios.
- The New Pension Contract should include possibilities to manage inflation risks via real 'projection' rates and real hedge returns.
- The impact of inflation risk sharing on other cohorts within the pension fund should be investigated.



Want to know more? Read the paper '[Een reële oriëntatie van het nieuwe pensioencontract](#)'