



Change · Challenge · Opportunity

**Injury & Disability
Schemes Seminar**

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SYNOPSIS

Challenge • Inflation • Opportunity.

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Key words: challenge; inflation, opportunity; gap; cosmetic; real yield.

Purpose of your paper: Examine the use of indexed bonds to determine a market-based inflation forecast.

Synopsis: Actuaries live and die by the gap between yields and inflation. Commonly-used inflation forecasts pose some challenges when it comes to estimating the gap. Typically, these inflation forecasts are made at different times to yield forecasts, causing an information misalignment – which can lead to volatility in the gap.

The market for index-linked bonds has deepened in recent years so a market-based estimate of future inflation is possible. In the first instance, we test a market-based inflation forecast for pricing longer-tailed insurances where stability of premium is a material consideration. Pushing further, a market-based inflation forecast may have application in long-tail valuation. It can be a legitimate way to determine liability using a market-based “economic gap”, as opposed to other approaches which are heavily reliant on convenient assumptions.