

How to beat low returns on savings

Savers and those set for retirement will be hit the hardest by QE2, writes James Charles

SAVERS have been told to think twice before locking into the only remaining accounts that promise to beat inflation after calculations showed that fixed-rate accounts could be better.

The Bank of England's move to inject £75 billion into the flagging economy last week will keep interest rates lower for longer, heaping more pain on savers already facing poor returns.

There are now only a handful of accounts on the market that beat the combined effect of tax and inflation, currently 4.5% on the consumer prices index (CPI) and 5.2% on the retail prices index (RPI).

However, while CPI is likely to rise to 5% in the coming months, it is forecast to fall below 2% in the medium term as temporary factors such as higher utility bills fall out of the equation. Savers who take out inflation-linked accounts could therefore find their returns are lower than expected over the next three to five years.

Last week, BM Savings, part of Lloyds Banking Group, reintroduced five-year fixed-rate savings accounts and Isas linked to the RPI, following a similar move by the Post Office earlier in the week.

Meanwhile, savers nearing retirement could see thousands of pounds wiped off their pension incomes as annuity rates fall following the latest round of quantitative easing (QE).

SAVINGS

The five-year inflation-linked Isa account from BM Savings

pays 0.5 percentage points above the annual change in RPI for five years. The best five-year Isa, from Halifax, pays 4.4%.

Figures from Hargreaves Lansdown, the adviser, show that savers with a £5,000 deposit would earn £1,474 in interest from the Halifax Isa over five years, compared with only £973 from the BM Savings inflation-linked account — a difference of £501.

Returns from the inflation-linked account are based on a Treasury survey of economists in August, who forecast that RPI would average 3.62% over the next five years.

Returns on the BM Savings account will be paid in December, based on the RPI figure published in the previous November. Danny Cox of Hargreaves Lansdown said: "If you believe inflation will fall, you are clearly better off in a fixed-rate account."

Unlike the BM Savings Isa, the Post Office five-year inflation-linked account is taxable. It will not begin paying interest until February next year, when it will pay one percentage point above the annual change in RPI to the previous January. The three-year bond will pay 0.25 points above the annual change in RPI.

The best-buy five-year account is from the AA, paying 4.6%. Hargreaves Lansdown said a higher-rate taxpayer would be £365 better off in the AA account compared with the Post Office.

Those over 65 can apply for a five-year account from Saga paying a fixed rate of 4.65%.

PENSIONS

Since the last round of quantitative easing in March 2009, yields on government bonds, known as gilts, have fallen from 4.38% to 2.83%, pushing down the benchmark annuity rate from 6.24% to 5.49%, according to figures from the Better Retirement Group.

A man aged 65 buying a two-thirds joint-life annuity with level payments with a £100,000 pension fund has seen his income fall to £5,487 a year, from £6,236 a year in 2009.

Tom McPhail of Hargreaves Lansdown said: "You would expect annuity rates to fall even further following this latest move by the Bank."

It comes as pension pots have been hit by the recent turmoil in the financial markets, providing a double blow to those about to retire.

McPhail argues that those coming up to retirement should not delay buying an annuity in the hope of a short-term bounce in rates, although an alternative option is to "phase" your annuity purchase.

He said: "Investors who have greater flexibility over the timing of their annuity purchase might consider buying their annuity in stages. No purchase should be under £10,000 to ensure a full range of annuity companies will provide a quote."

To do this, you will need to divide your pension pot into parts, switching some to an annuity provider, and keeping the rest in income drawdown.

You can gain up to 40% more income by shopping around for your annuity, rather than taking one from your pension provider.

Alternatively, you could go into income drawdown, which lets you take 25% of your pension fund as a tax-free lump sum, while leaving the rest invested.

Under new rules introduced in April, those in drawdown who have income of less than £20,000 from other sources, such as the state pension, will be limited to withdrawing 100% of the monthly annuity



James Johnson-Ferguson, 47, who lives near Lockerbie, is sticking with a tracker mortgage as rates should now stay low for longer. The marketing manager of thebookpeople.co.uk, pictured with wife Rachel, 46, and children Phoebe, 14, Edward, 13, Henry, 10, William, 8, and Cicely, 6, obtained his deal through largemortgageloans.com.

income that you would be able to buy on the open market — a reduction from the previous level of 120%.

The reduced limit, combined with significantly lower gilt yields, is expected to hit those who went into drawdown in 2006 who are now coming up for their first five-yearly review.

MORTGAGES

Lenders are expected to introduce competitive 10-year fixed-rate deals following the latest round of QE, allowing homeowners to lock into a rate below 4% for a decade, while the cost of five-year fixes could also fall.

Ray Boulger at John Charcol, the broker, said: "Although

demand for longer-term 10-year fixes is small at the moment, lower rates should tempt more to fix for longer."

The yield on 10-year gilts, which are linked to the cost of funding 10-year fixes, fell by 10 points to 2.26% immediately following the announcement of further QE. The most competitive 10-year deal is from York-

shire building society at 4.19%, available for those with a 25% deposit, with a £995 fee.

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Big blow to work pensions

Alexandra Goss

BLACK holes in company pension funds could increase sharply after the Bank of England's decision to pump £75 billion of new money into the economy, experts have warned.

The Bank's first £200 billion of printing money — known as quantitative easing — has raised pension fund deficits by a staggering £74 billion so far, according to calculations from the Pension Corporation, which manages scheme assets.

The National Association of Pension Funds has called for an urgent meeting with the regulator to discuss ways of protecting pensions from the negative effects of QE.

Joanne Segars at the association said: "QE makes it more expensive for employers to provide pensions and will weaken the funding of schemes as their deficits increase. All this will put additional pressure on employers at a time when they are facing a bleak economic situation."