



# SHOULD YOU INFLATION PROOF YOUR PENSION?

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Inflation can possibly turn a comfortable retirement income into a life of growing hardship.

You save all your working life, arrange an annuity to guarantee an income for the rest of it – only to see the value of that income steadily shrink as inflation erodes the value of money.

The UK inflation figure stands at 3.8% in July 2025. This is a far cry from the double-digit inflation during the cost-of-living crisis. But it is considerably higher than the Government's 2% target.

And you could spend 30 years in retirement. Inflation could return with a vengeance, and even if it does not, 30 years of 2% inflation every year could more than halve the spending power of your pension.

But there could be a solution, with an inflation-linked annuity.

## Annuities explained

An annuity is the traditional way to use a pension pot to create a pension income. You sell your pot to an insurance company, who in return provide an annuity, an income fixed for the rest of your life.

Annuities fell out of favour in the last few years, when rates offered were low. They have seen a major comeback as interest rates in general have gone up, taking annuity rates with them. A 65-year-old who retires today with a £100,000 pension pot can currently get up to £7,881 as annual income from a basic annuity.

This amount stays the same for the rest of their life. If our 65-year-old lives another 30 years, they will get back £236,430.

But what will £7,881 be worth in 2055? No-one knows what level inflation will be running at over the next three decades, but it's fair to assume that it will buy much less than it does now.

You can inflation proof your pension for the future, but it means having a smaller pension now.

## Inflation-linked annuities

Recognising the problem, the pension industry created an alternative to the level annuity. An inflation-linked annuity, also known as escalating or index-linked annuity increases each year, usually in a way pegged to inflation.

Its buying power could be the same in 30 years as it is now.

There is of course a trade-off for this generosity from annuity providers. Inflation-linked annuities have a lower starting value than a level annuity.

With an inflation-linked annuity rising at 3%, with a five-year guarantee,

our 65-year-old can get £5,785 per year as their starting amount. This is more than £2,000 lower than the income with a level annuity.

Level annuities pay a higher starting income than inflation-linked annuities, but the inflation-linked could prove better over the long term.

## Level or inflation linked?

So, is it worth taking out an inflation-linked annuity? It depends on two factors, neither of which you can be sure about. The first is the level of inflation for the rest of your life, and the second is how long you will live.

Level annuities are the most popular choice. According to the Association of British Insurers (ABI), 81% of all annuities sold in 2024 were of this type.

The remaining 19% were escalating annuities. The proportion of escalating annuities sold seems to be increasing, probably prompted by the cost-of-living crisis.

If you live long enough, you might be better off with an inflation-linked annuity.

## The annuity that is appropriate for you

Annuities can be worry-free and are guaranteed for life, which makes them the simple answer for pensions.

But getting the most suitable kind of annuity is vital. Would you be better off with a level annuity and a larger pension now, or plan for the long term, and link it to inflation?

## Might an alternative like drawdown be more suitable for your needs?

To get the answer you need for your pension, you need expert advice and someone who can help you shop around for the most competitive rate.

To get it, call us at Continuum.

## Sources

[Inflation and price indices | Office for National Statistics](#)

[Inflation reaches highest level since January 2024 | BBC](#)

[Best annuity rates May 2025: compare pension annuities | Which?](#)

[Is an inflation-linked annuity or a level annuity better? | MoneyWeek](#)

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