

Illustrative example

Index-linked Savings Certificates are designed to be held for the full term. This shows how deflation could affect an investment in Index-linked Savings Certificates, based on hypothetical figures for the RPI. For the example we're assuming that there is deflation in the first year of the investment followed by inflation in the next two years.

Investment

£1,000 in the 18th Issue of 3-year Index-linked Savings Certificates on 10 February 2009, paying an overall compound rate of 1.00% AER in addition to index-linking.

Year-by-year Interest figures

Initial investment	+ index-linking for year 1	+ 0.85% of initial investment	= 1 st anniversary value
1 st anniversary value	+ index-linking for year 2	+ 0.95% of 1 st anniversary value	= 2 nd anniversary value
2 nd anniversary value	+ index-linking for year 3	+ 1.21% of 2 nd anniversary value	= maturity value

Hypothetical RPI figures

Index start figure (ie the figure for December 2008)	212.9	Index applicable on 1st anniversary	200.0
Index start figure for year 2	200.0	Index applicable on 2nd anniversary	202.0
Index start figure for year 3	202.0	Index applicable on 3rd anniversary	204.0

In this example, on the first anniversary the index has fallen from 212.9 to 200.0 (deflation) but we don't apply "negative index-linking" on an anniversary, so we don't take any money off the value of the Certificate.

Year-by-year calculation

Year 1

Amount of investment:	£1,000.00	
Index-linked value at end of year 1:	£1,000.00	
Interest:	(1,000 x 0.85%)	£8.50
1st anniversary value:		£1,008.50

Year 2

1st anniversary value:	£1,008.50	
Index-linked value at end of year 2:	(1,008.50 x 202.0 ÷ 200.0)	£1,018.59
Interest:	(1,008.50 x 0.95%)	£9.58
2nd anniversary value:		£1,028.17

Year 3

2nd anniversary value:	£1,028.17	
Index-linked value at end of year 3:	(1,028.17 x 204.0 ÷ 202.0)	£1,038.35
Interest:	(1,028.17 x 1.21%)	£12.44
Maturity value:		£1,050.79

You can see from this example that even though the RPI figure was lower at the end of the 3-year investment term than at the start, we still added index-linking to the Certificate in years 2 and 3. We treat each year of the investment term as a separate calculation, and in this case the RPI was higher at the end of year 2 than at the end of year 1, and higher at the end of year 3 than at the end of year 2.