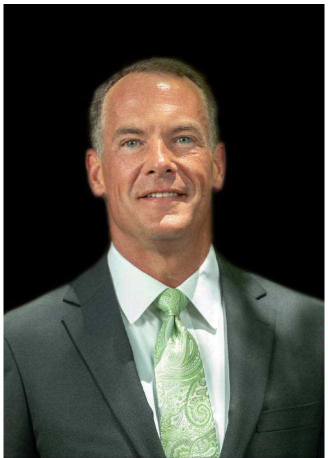
Inflation and Your Retirement



Roger Green, MSFS, CFP©
Green Financial Resources

Inflation is something frequently overlooked in retirement planning. Inflation can be defined as an overall upward price movement of goods and services in our economy as measured by the Consumer Price Index (CPI), and it is what makes most things cost more today than they did in prior years. **Because ongoing inflation increases the cost of goods and services, it takes away the buying power of your money. You will need more money to live on in the future than you need currently to maintain your standard of living, and this is very important to keep in mind when setting goals for retirement.**

After hitting numbers like 13.4% inflation in 1980 and 5.2% in 1991, inflation had been trending downward from its most recent peak of 3.6% in 2011. But after dipping to 0.4% in 2015, it is now again on the rise. Inflation was at 1.00% in 2016, 2.14% for 2017, and then hit 2.5% for 2018. The 2019 projection is for around 2.0%. *(Statista 2019).*

The average annual inflation from 1990 through 2018 was 2.46%, but the total cumulative inflation for the 28 years from January 1990 through December 2018 is 102.46% *(InflationData.com).*

This rate of inflation means something that cost $100 in January of 1990 would cost over $200 in December of 2018 - in other words prices more than doubled (i.e. purchasing power fell by half) *and that is what happens at relatively "low" inflation rates.*

According to the Bureau of Labor Statistics website calculator, if you look back further to the span between January 1956 and December 2018, inflation was much higher, making what you could buy for $100 back in 1956 cost you over $930 in May 2019. To drive home this point, depending on your age, you may now be driving a car that cost more than your first home!

Why is this important to your retirement planning? Inflation turns your retirement goals into moving targets. You want to be able to afford the things you need and want in retirement, often years in the future; so inflation must be accounted for in your planning.

What must you always do to hit a moving target? You must lead the target to hit the target. **There is a useful financial tool, called the "Rule of 72" that can be used to help you calculate how many years it will take for prices to double, based on the current inflation rates.** To apply this rule, you divide 72 by the inflation rate. For example, 72 divided by 3% average inflation equals = 24. This means it would take 24 years for prices to double based on an average 3% inflation rate. If the average was 4%, then it would only take 18 years for this to occur.

Applying the Rule of 72 and this example to your retirement planning, you could say that if you are 24 years from an age 65 retirement (age 41), you would need double the annual income you calculate in today's terms for each year of your retirement.

Using a 3% average inflation rate, if you anticipate needing $25,000 a year in retirement based on today's figures, then you would need double that figure – or $50,000 per year for retirement at 65.

Inflation doesn't stop at retirement, so if you retire at age 65, the income you will need will effectively again double every 24 years (by age 89) if a 3% average annual inflation rate continued during that timeframe.

With today's earlier retirements and long life spans, many people may see <u>two or more doublings in cost during their retirement period</u>, depending on the inflation rate.

And that isn't all - due to the high cost of healthcare, the effective inflationary rate for seniors has actually trended significantly higher than it has for the overall economy *(Bureau of Labor Statistics)*. Healthcare accounts for about 13% of expenditures by those 65 and older, but only 5% for other age groups *(2015 Center for Retirement Research at Boston College)*.

Your retirement planning must include planning for the impact of inflation. For most people, simply saving is not sufficient and they need growth, earnings, and the power of compounding on their money - *even throughout retirement* - to help their assets grow enough to keep pace with inflation.

To learn more, we recommend you register for one of our retirement planning classes offered through Gwinnett Technical College. No time for class? Contact us today for a no-cost consultation. Please visit www.RogerSGreen.com or call our office at 770.931.1414 for more information. *We are here to help!*