

Understanding Inflation

What's inflation? Simply put, inflation refers to the rate of change or increase in the average prices of goods and services typically purchased by consumers. When the price level rises, every dollar you have buys a smaller percentage of a good or a service.

Comparing prices now and then

The effects of inflation really add up over time!

- Fast-food hamburger – 1950s: 15¢ // Today: \$2.18
- Movie ticket – 1950s: 46¢ // Today: \$7.96
- Ounce of gold – 1950s: \$34.72 // Today: \$1,474

Understanding the Consumer Price Index

It seems like a dramatic difference when you compare prices from the 1950s with today, but in reality, inflation changes quite slowly.

- To gain a better understanding of inflation, it's important to understand the consumer price index (CPI). The index tracks the percentage change in the prices of a basket of 80,000 goods and services.
- It is computed each month by the U.S. Bureau of Labor Statistics and is used to track the progress of inflation in the United States.
- Depending on the year, the CPI can vary from less than 1% to over 3%.

Inflation affects more than prices

While the costs of goods and services rise over time, so does income—for some, much more than others.

Household segment and today's mean income

- Top 5% – \$332,347
- Top quintile – \$194,053
- 2nd quintile – \$87,834
- Middle quintile – \$54,041
- 4th quintile – \$31,087
- Bottom quintile – \$11,676

Now that you see how the prices of goods and services rise, as well as how incomes rise, let's dig a little deeper.

- Gallon of gas – 1950s: 27¢ // Today: \$2.57

It looks like gas prices have gone through the roof! However, when you adjust for inflation, you can see that a gallon of gasoline today costs about what it did in 1950.

- Gallon of gas – 1950s: \$2.48 // Today: \$2.57

Things you can do to keep up with inflation

Your income should keep up with inflation

It's a smart idea to check on the Consumer Price Index (CPI) rate at least once a year. It's a good indicator of the total cost-of-living increase that you can expect in the current year. Whether you have an hourly or salaried job or you are self-employed, to keep pace with inflation, you should strive to increase your income by at least

the annual CPI rate.

Strive for your savings to keep up as well

Investing can help you counteract the negative effects of inflation. Again, strive for your rate of return to be greater than the inflation rate.

Absolutely no guarantees

All investments made in stocks, bonds and mutual funds carry the risk of losing some or all of your money, even when made through a financial advisor or financial institution.

Sources: Forbes, United States Department of Labor (Bureau of Labor Statistics), United States Census Bureau