INVESTING SPECIALISTS

What's Your Real Inflation Rate?

Calculating a personalized inflation rate is a start.

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If you've been paying even passing attention to inflation--and it has been hard to ignore--you know that the latest inflation readings have been ugly. In February 2022, the Consumer Price Index notched a 7.9% increase from the year prior, marking nearly a 40-year high.

What you may not have stopped to think about, though, is that the CPI is a blunt instrument because it aims to reflect the experiences of consumers at large. To calculate the CPI, the Bureau of Labor Statistics uses a consumption basket of goods and services, with each item weighted by how much of the typical U.S. household's budget it represents. Categories like housing receive

the biggest weighting in the CPI calculation, while recreation and apparel get smaller weightings.

But what your household spends money on almost certainly differs from the typical U.S. household's. Take, for example, a new homeowner who has a sizable mortgage and is also making substantial home improvements while simultaneously purchasing furnishings, window treatments, and garden implements. Housing-related outlays are apt to be a bigger share of the new homeowner's budget than is likely to be the case for the population at large. Meanwhile, a retired older adult who no longer has a mortgage will likely have smaller housing-related outlays, as a percentage of household spending, than the general population, but healthcare expenditures may well be a bigger share of the budget.

Calculating Your Own

Given those variations, it can be helpful to use the CPI's weightings as a *starting point* for understanding inflation's impact on your household and how aggressively you need to defend against it. But you can get closer to a personal inflation rate by looking at your actual spending in each of the major categories and blending that with the inflation we're seeing in those areas.

On this spreadsheet, you can input your spending in each of the major categories, then calculate a personalized inflation rate that incorporates

inflation by spending category. We've populated it with some sample data, but you can look back on your actual spending over the past year; you can also tweak the inflation expectations for each line item to align with your own experiences.

One factor that will probably jump out as you calculate a customized inflation rate is the importance of transportation costs in driving recent increases in inflation. If you've had to purchase a car over the past year or even if you just frequently fill up the tank, you've probably seen a substantial increase in your outlays to get around. City dwellers who bike or walk, on the other hand, have been much less affected by rising transport prices.

Food costs have seen the second-highest rate of inflation over the past year, and they're less likely to be variable among different consumers. (Everyone has to eat!) Even so, there are some interesting variations in the rates of inflation among subcategories, and they might affect whether your personal rate of food inflation is higher or lower than the baseline food inflation rate of 7.6% reflected in CPI. For example, the cost of food prepared at home has increased at a nearly 9% rate over the past year, whereas the cost of food consumed away from home (for example, in restaurants) has jumped by just 7%. Meat prices have increased by 14%--a major driver of the rate of food-price inflation--whereas fruit and vegetable prices have escalated by a less painful 8%. Alcoholic beverage prices have seen a relatively mild inflation rate of 3.5%, but coffee drinkers have contended with a more painful 11% inflation rate over the past year.

As interesting as it can be to come up with a personalized inflation estimate, it's important to not come away with a false sense of precision about inflation. For one thing, inflation statistics are ephemeral: The one-year figures provided in the spreadsheet capture price changes in various categories amid a booming economy and supply-chain disruptions.

Moreover, the number that really bears paying attention to is the trend in your actual, all-in spending, which depends on a few key variables: your fixed and discretionary expenses as well as what's going on with inflation in each of the spending categories. Ultimately, your actual household spending trend matters

more than examining inflation on a small scale because you exert a level of control over some of your spending, whereas inflation is out of your hands.

Inflation for Older Adults

Life stage tends to play a role in the inflation experience, too, as reflected in a statistic called CPI-E, the Consumer Price Index for the Elderly, which captures the spending of adults who are age 62 and above. The Bureau of Labor Statistics has been calculating CPI-E since 1982, so there are now almost 40 years' worth of data. By comparing CPI-E to CPI-U, the latter of which includes people of all ages, it's possible to see how people post-age 62 spend their money relative to the broader population and also what rates of inflation they experienced.

For the one-year period ended December 2020, CPI-E was 6.4%. That was a hair below the 7.0% CPI for the broad population during that same period. Since the Bureau of Labor Statistics began calculating CPI-E in 1982 through 2021, it averaged 2.96%--a touch higher than CPI-U, which inflated about 2.77% per year, on average, over that same stretch.

The difference in the inflation rates owes to differences in the consumption baskets of older adults (CPI-E) and the general population (CPI-U). Older adults spend more on medical care than the general population--more than 4 percentage points more of their budgets go to cover those costs than in the population at large. And while the medical-care inflation rate has recently been even lower than the general inflation rate, its historical average is more than 5%, which has had a disproportionate effect on older adults.

Meanwhile, housing is also a higher share of older adults' consumption baskets than it is for the general CPI. That seems counterintuitive, in that

many older adults live in paid-off homes. But the statistic relates to how the Bureau of Labor Statistics calculates housing costs. Given that many older adults own their homes rather than rent them, it's possible--even likely--that CPI-E overstates housing-related costs for many older consumers.

On the other side of the ledger, older adults' outlays for other budget line items are lower--notably transportation and education. Older adults commute less than younger people do, and their years of heavy education spending are typically behind them, too. Food expenses--both dining out and food prepared at home--also consume a smaller share of older adults' budgets than is the case for younger adults. Thus, rising food costs--the category with the second-highest inflation over the past 12 months through February 2022--have probably hurt older adults a bit less than the broad population.

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