Debt Management: Personal Inflation

What is Your Personal Inflation Rate?

By: Joe the Investor

We have all heard inflation statistics being announced in the media or in business reports. (1)(2) The numbers you are hearing are average numbers for a region, like Canada or Ontario. Do these numbers really apply to you? The answer is yes and no. The numbers apply to you because they are used to determine pay raises, pension raises, price increases, and long term project costs. The numbers may not apply to you if you are doing personal planning and trying to figure out how much spending power your money will have in the future.

As with everything that is calculated and averaged, there are always assumptions. The first one is: do you personally spend money like the average person? What is the average person? Statistics Canada deems the average person spends money in a certain way. If you allocate your money very similar to the average, the inflation numbers will apply to you very well. If not, the numbers are less meaningful.

The second assumption is – will you continue to spend money the same way as the average person in the forseeable future? The answer to this question is likely no, as spending and saving patterns change depending on demographic, income level, preferences and so on. The proof of this is marketing for various segments of a market or population, or different prices being charged to different age groups. The calculation method for inflation can also change over time, and if your spending pattern stays the same and the calculation does not, this disparity may cause financial issues down the road.

The third assumption is – do the inflation calculations reflect your entire financial picture? In other words, are there items included in the inflation number that you do not buy? Are there items included in your budget that the inflation number does not track? The way to answer these questions is to compare how the numbers are calculated and how your personal budget expenses rise or fall each year.

How do you find your inflation rate? If you already watch your money and know where it is spent over time, you may already know what your inflation rate is. To make it obvious, take the money you spent last year, break it down into items like food, shelter, utilities, education, leisure, taxes etc. and do the same thing for the following year. To see a trend, do this for a number of years and you will start to see the areas where more money is being spent, and where less money is being spent. If you already do a budget, the numbers used there will have most of what you need. There is an example table below to see how this works.

To get an actual percentage rate, use the current year total in an area of your budget, and divide it by the total in that same area in the previous year, subtract 1 and multiply by 100 to get a percentage. If the total was $1000 last year and $1050 this year, you would have $1050/$1000 = 1.05 – 1 = 0.05 x100 = 5%. In this area of your budget, prices went up 5%.

Total Expenses

Item	Year 1	Year 2	Difference	Percentage
Food				
Meat	$800	$900	$100	12.50%
Grains	$700	$750	$50	7.14%
Fruit	$1,000	$1,050	$50	5.00%
Vegetables	$1,200	$1,245	$45	3.75%
Other	$1,300	$1,340	$40	3.08%
Alcohol	$800	$900	$100	12.50%
Cigarettes	$400	$500	$100	25.00%
Clothing	$2,000	$1,500	($500)	-25.00%
Hygiene Products	$800	$850	$50	6.25%
Insurance				
Car	$1,500	$1,550	$50	3.33%
House	$400	$350	($50)	-12.50%
Life	$2,000	$2,100	$100	5.00%
Disability	$200	$200	$0	0.00%
Utilities				
Heat	$1,000	$1,100	$100	10.00%
Hydro	$1,200	$1,210	$10	0.83%
Water	$500	$565	$65	13.00%
Telephone	$400	$350	($50)	-12.50%
Cable	$800	$850	$50	6.25%
Internet	$1,000	$1,000	$0	0.00%
Property Taxes	$3,000	$3,100	$100	3.33%
Cell Phone	$600	$700	$100	16.67%
Car Expenses				
Gasoline	3000	3200	$200	6.67%
Maintenance	500	600	$100	20.00%
Total	$25,100	$25,910	$810	
Average				3.23%

Another assumption being made here is that your spending patterns are not changing much year over year. If this is not true, for example if you just moved and you bought all new furniture, the increase will not reflect inflation but your needs during the year. The inflation rate is assuming you are buying the EXACT same quantity and quality of items year over year, so you see only the price change and nothing else. If you have a number of items, use the cost per unit of the item. If you bought 5 pairs of running shoes in one year, then bought 3 pairs the following year, the price per each pair is what you would zero in on. A better calculation would be the price for the same brand or running shoe, so that you are getting a comparison of two of the same product. What can get tricky is if the item changes form one year to the next, or the quality gets better or worse. The best items to do this calculation are items that are standardized, like utilities, property taxes or commodities like gasoline. I would zero in on these items first, and then start applying the calculation to all other items, but you will have to note as things change how the changes are accounted for.

Not all items go up in price. Technology is one obvious exception to this rule, and cars may be another if you factor all of the new bells and whistles that come with new cars versus those of 10 or 20 years ago. Clothing can be another area, or service plans on products if a lot of new competition comes into an industry.

You will also see how things like taxes affect your budget. You can isolate sales taxes quite easily for the items you buy because the taxes are separated out. Expenses that come on your paycheque should also be included in your calculation, like health insurance, pension contributions, union dues, taxes of all forms, or deductibles. These expenses are benefits to you, but how much you pay does not change how much benefit you receive. If you pay $5 per month for an eye glasses deductible, versus $7 per month, you will still get $200 worth of eyeglasses when you make the claim. These expenses come from your income, even though they are taken before the money reaches you. Should you be in a scenario where you are changing jobs, or have options on these expenses, you will know how much they are, and how fast the expenses are rising. You will then be a better judge of what the career change will do to your bottom line.

Why bother to know your personal inflation rate? This calculation will tell you how much money you will need more accurately then the government's number assuming you are accounting for your personal preferences and you are doing it for at least 3 years. You can then monitor the prices of the things you use the most and see if they are rising faster than everything else, or slower than everything else, and where you should put your attention or not. As you get older, your priorities will change, but you will better understand how to prepare your financial situation than just assuming that the published inflation numbers will cover the increases in your expenses.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what your options are. **Note: This site is intended for people who want to learn about the world of finance and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**

Sources:

1) http://www.ctv.ca/CTVNews/TopStories/20120518/annual-inflation-rate-120518/
2) http://www.statcan.gc.ca/daily-quotidien/120518/dq120518a-eng.htm
3) http://www.rateinflation.com/consumer-price-index/canada-cpi.php