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Growing poorer? Inflation vs. cost-of-living | Biz Brain

By Karin Price Mueller | NJMoneyHelp.com for NJ.com
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Q. What's the difference between cost of living and the inflation rate? - Falling behind

A. Inflation may be reported as low, but the cost of living surely isn't.

Inflation can be defined as a general increase in the price of a basket of goods and services over a specific period of time, said George Kiraly, a certified financial planner with LodeStar Advisory Group in Short Hills.

He said inflation is a measurement of how much prices have risen and can be viewed as a broad, economy-focused number. It can also be described as a decrease in the real purchasing power of money, he said.

"If you're not seeing an increase in your income or savings equal to the rate of inflation, then you're likely growing poorer," he said. "For example, with a 5 percent inflation rate, you'll be able to buy 5 percent less goods at the end of the year, assuming your income stays the same."

Most consumers are familiar with the Consumer Price Index (CPI), a broad measurement of inflation. The CPI was designed to help the U.S. government, businesses and individuals plan and adjust financially for the impact of inflation, Kiraly said.

Social Security benefits are adjusted each year by an amount equal to the change in the CPI, called cost-of-living adjustments, or COLAs, he said. Other payments adjusted by the CPI via COLAs include federal tax brackets, wages, rents, alimony payments and child support payments.

That's not always helpful to consumers in practical terms.

There was no COLA adjustment for Social Security and other government programs in 2016, Kiraly said, and for 2017, there will be a +0.3 percent adjustment.

"So theoretically, there has been little or no inflation over the last two years," Kiraly said. "Surely, the real cost of living for most consumers has been accelerating at a rate higher than the number the government uses. What gives?"

Kiraly said "cost of living" is a consumer-focused number. It measures how much you need to spend to achieve a certain lifestyle.

"It's tied to the cost of an accepted standard of living that includes many variables, including food, housing, utilities, taxes, transportation, education and health care," he said. "Depending on where you live, the cost of these basic necessities varies, as does their rate of acceleration."

This means you can have "official" inflation at a low level, while the amount you actually spend out-of-pocket rises at a faster rate, Kiraly said.

Now, get this: Core CPI excludes items that tend to go up and down in price dramatically or often, like food and energy even though those items are a big part of the average consumer's monthly expenses.

"Surely tuition costs have been rising significantly faster than CPI. And medical costs? You bet," Kiraly said. "How about property taxes? Absolutely!"

So, he said, if your main expenses include food, housing, energy, tuition and health care, then you're probably facing inflation at a rate that is outpacing the national CPI inflation averages.

Bottom line, Kiraly said, is that the CPI is not a perfect measure of inflation.

"This 'official' rate of inflation is not the same as your annual increase in cost of living," he said. "Your specific cost of living comes down to your geographic location and your own personal exposure to specific cost items."

So when money gets tight -- and even before then -- Kiraly said a general rule should be to focus on spending less and trying to earn more each year to keep pace with inflation.

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