Inflation is continuing to rise—here's how it could affect your money

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Travel prices are on the rise as the U.S. reopens. Twenty/20

Last month, the U.S. consumer price index, a survey of a variety of goods, rose 5% compared with a year ago. The gain was a bit more than anticipated and the largest increase since the summer of 2008, according to the Labor Department.

That has Wall Street buzzing about what inflation means for markets and the economy. But what does it mean for, you know, normal people? Mostly, higher prices.

But first, it's important to understand what inflation is and where it comes from. Essentially, inflation is the rise in prices you'll pay for goods and services. You'll have to spend more to get the same things. Some level of inflation — around 2% — is normal.

“While inflation has a negative connotation for many people, inflation itself isn’t inherently good or bad,” says Jill Fopiano, president and CEO of O’Brien Wealth Partners. “Some level of inflation is a sign that the economy is healthy.”

Inflation is a feature of economic recovery. In the U.S. right now, it’s being driven by a few overlapping factors resulting from the Covid-19 pandemic: low interest rates set by the Federal Reserve, several rounds of direct government stimulus to both consumers and businesses, and pent-up consumer demand that is being unleashed as the U.S. reopens.

All of this has led to demand outpacing supply, causing shortages and price spikes in categories of goods including semiconductor chips, used cars and housing, among others.

“It was just 12 short months ago that many were afraid to even emerge from their homes,” says Deron McCoy, chief investment officer at investment advisory firm SEIA. Meaning: People weren’t spending. But now they plan to make up for lost time, as we discussed a few weeks ago.

With that in mind, many economists and other financial experts say that the current rate of inflation is nothing to worry about — it’s temporary and expected, even if it is unclear when it will eventually fade. And today’s increase is nothing compared with the 1970s, when several unique shocks led inflation to hit double digits, says McCoy.

However, there will be sticker shock this summer, says McCoy, as supply chains catch up with consumer needs post-pandemic.

For the time being, here’s how higher inflation could cost you and what you should do about it.

Consumer goods

Inflation erodes the average person’s purchasing power. Everyone’s true inflation rate is different, because we all buy different products and services.

You can expect to pay more for used cars and car rentals, furniture, airline fares, hotels and everyday essentials like groceries and gas. Used car prices rose 29.7% compared with last year, for example, while clothing costs 5.6% more. Housing and remodeling supplies are also sky high.

“All of this means your paycheck is not going as far as it once did unless your wages are increasing at the same pace, which has not been the case for most individuals,” says Steven Saunders, director and portfolio advisor at Round Table Wealth Management.

That’s no reason not to spend money, though, especially after the past 15 months, says Marguerita Cheng, certified financial planner and CEO of Blue Ocean Global Wealth. “You just want to be mindful of the increased prices.”

Savings accounts

With interest rates on savings accounts already hovering just above 0% nationwide, inflation can make your cash worth even less. But that’s no reason to move it around, especially your emergency fund, says Cheng.

“Savings is not designed to make you rich,” she says. It’s meant to provide a financial cushion, should you need it.

That said, if you have more idle cash than you need in an emergency fund (experts recommend having three to six months’ worth of expenses stashed away, sometimes more), then you might consider investing some of it, she says.

Investments

It’s impossible to predict how inflation will affect all of your investments, but it will decrease the value of long-term bonds, which generally pay a fixed income amount every year, says Brian Spinelli, certified financial planner and senior wealth advisor at Halbert Hargrove. Higher inflation means that fixed amount doesn’t go as far.

Gen Z, millennial and younger Gen X investors don’t really need to worry about these short-term impacts, experts say. They should be fine sticking with their current investment plan, which is probably stock-heavy. Stocks can provide a decent hedge against inflation, because they can generate returns in excess of inflation.

With that in mind, long-term investors should continue investing in a broadly diversified portfolio of low-cost stock index funds, says Tony Molina, certified public accountant and senior product specialist at Wealthfront. If you have a 401(k) or IRA invested in a target-date fund or other stock index fund, then you don’t need to do anything.

“It’s human nature to want to react in times of uncertainty, but it’s best to not get too caught up in the news around inflation,” says Molina.