The elderly inflation rate

In 1987, Congress directed the Bureau of Labor Statistics to begin calculating a Consumer Price Index for the elderly. Does the CPI accurately reflect the changes in the cost of living experienced by retired Americans, and so have the inflation adjustments to Social Security benefits have been done appropriately? An experimental CPI-E was created for the population aged 62 and older, using 1982 as the base year.

Analysis by the BLS of the first quarter-century of the CPI-E found that the elderly have experienced slightly higher inflation than the population at large. As a share of expenditures, older Americans spend twice as much on medical services, 10.81% of their purchases, as does the population generally (5.27%). As the cost of medical services has outpaced inflation, this burden falls upon the elderly disproportionately.

Still, the differential is not as much as might be supposed. During the period of the study, the elderly experienced average annual price increases of 3.3%, versus the 3.0% benchmark that was used to adjust Social Security benefits for inflation. What's more, the gap has been narrowing in recent years, the authors concluded.

Inflation's impact

The more important problem for retirement income planning is the erosion that inflation causes to everyone's purchasing power. That 3.0% annual price increase can really add up over time.

The table below is based upon actual inflation experienced over the past 30 years, not projections of hypothetical rates. In the table, we've assumed that a retiree had $40,000 of purchasing power in the year of retirement, and then we used the BLS calculator to determine the equivalent in 2010 dollars.

For example, if you retired with $40,000 of expenses in 2005, you would need $44,573.68 to have the same purchasing power this year. But if you retired in 1985, at the beginning of President Reagan's second term, at the same $40,000, you'd need more than double that amount to maintain the same standard of living.

Retirement purchasing power

Year of retirement	Amount required in 2010 to equal $40,000 of purchasing power in retirement year
1980	$105,646.12
1985	$80,903.72
1990	$66,604.74
1995	$57,121.00
2000	$50,553.08
2005	$44,573.68

Source: Bureau of Labor Statistics, M.A. Co.

Some sources of retirement income, such as Social Security benefits, are indexed for inflation, but many others are not. That's where sound portfolio management has to fill the gap. We can help you with that problem.

(May 2010)

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