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The Role of Inflation on Your Retirement Income

by Steven Podnos, Md, Cfp • July 20, 2015 • 1 min read • original

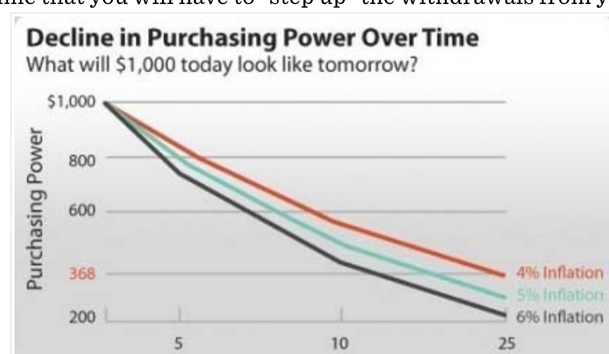
When my firm does retirement planning, we look for sources of income from which to provide lifestyle expense needs. There are a few to consider.

First, we assume Social Security will help. Next, we look for other "pension" income, in which an entity has agreed to pay a lifetime of income to the retiree (this might be a military, government, or corporate plan). Then, we consider non-portfolio income such as an income stream from a business interest or real estate. Finally, we look to income from a portfolio of liquid savings.

Since a retirement may span three decades to four decades, we need to consider the effect of inflation on our funds coming from different sources.

As you can see on the graph, at various rates of interest, you would need to double or triple your money every 15 years to 25 years just to purchase the same goods. Luckily, some of the income streams can keep up with this need.

Social Security is adjusted annually by a measure of inflation (consumer price index or CPI). Although "your" rate of inflation may be different than the CPI, the annual adjustment is a real positive. Some pension streams allow inflation adjustments (mostly government based). If your income stream from a corporate pension is "fixed"," you have to account for a steady loss of purchasing power in your planning. One assumption is to assume that you will have to "step up" the withdrawals from your investment portfolio over time.



Courtesy: Handsonbanking.org

Non-portfolio income may adjust for inflation— especially in a growing business or with rental income. On the other hand, business income is subject to the vagaries of any small business.

Income from an investment portfolio at an acceptable distribution rate (say 4 percent in the seventh decade) assumes adjustments for inflation.

Another consideration in all this is the typical spending patterns in retirement. Many studies have addressed this and find that in the early years, spending is not too different than in pre-retirement. Later in the eighth decade and after, spending tends to decrease. This is worth consideration but is not to be relied on with the coming changes in healthcare costs.

Calculating what will be an adequate amount of income in a long retirement is a complex decision with a number of moving parts. Get some skilled and impartial help in your review.

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