## Inflation and Its Potential Influence on Your Retirement Savings

**6 MIN. READ**

From the first day of your first job all the way through to your last day, you hear about planning for your retirement. You see that FICA (the other name for Social Security) takes a fairly hefty bite out of your paycheck. You also get information about when and how you can get into your employer's retirement savings plan. Plus, you learn whether your employer will match any of your contributions. But, with so much else on your mind throughout your working life, it's easy to forget about another determining factor: inflation.

### Inflation reduces buying power

At its [simplest level](https://www.investopedia.com/articles/insights/122016/9-common-effects-inflation.asp), inflation means that over time the dollars you earn or save buy less than they used to buy. To illustrate, $100 in 1980 is now worth $339.90 in 2021. In other words, today's dollar is [worth less](https://www.inflationtool.com/us-dollar/1980-to-present-value#:~:text=The%20inflation%20rate%20in%20the,in%201980%20equals%20%24339.88%20today.) than one-third of a 1980 dollar. Inflation for this year, economists predict, will be in the [2-3% range](https://www.statista.com/statistics/244983/projected-inflation-rate-in-the-united-states/), with energy costs alone having already risen by [nearly 30%](https://www.bls.gov/cpi/) in the past 12 months. So, what does that mean for your retirement planning?

First, it means you're going to need to save or earn on your savings a lot [more.](https://www.aarp.org/retirement/planning-for-retirement/info-2020/how-much-money-do-you-need-to-retire.html) You may expect to need a million dollars to retire, but remember that today's dollar may be worth only a third of a dollar by the time you retire. So, you may actually need $3 million. Second, it means the sooner you start planning, the better your retirement will be.

One of the facts about inflation is that goods keep getting more expensive. During periods of high inflation, goods are far more expensive than you expected. These price increases will impact your perception of the value of goods at the current price. This perception will encourage you to save rather than spend on over-priced goods. So, you may be more willing to put money aside for the future.

### Inflation planning can help

Inflation planning is the act of proactively building a strategy that mitigates the effects of inflation. The idea is to invest in a way that can increase income or spending power throughout retirement as inflation erodes your buying power. It achieves two goals:

* Produces enough income throughout retirement.
* Allows you to turn on income streams as needed, giving you the peace of mind that inflation will not diminish or keep you from reaching your retirement goals and objectives.

### Watch out for taxes

No matter how well any given investment does, taxes will likely take up some of the profits. A traditional IRA allows you to invest pre-tax dollars in your retirement account. You then pay taxes when you withdraw the funds in retirement.

A Roth IRA uses dollars on which you have already paid taxes. Once you have held the account for five years, you can withdraw the funds tax-free. If you are investing savings in another kind of account, you will need to consider the taxes on the income you earn.

The most common tax-free investments are federal and local government-issued securities. These are most often called, respectively, treasuries and municipals. Federal government bonds are free of state and local taxes. State and municipal bonds are exempt from federal taxes and from state tax in the state in which they are issued. Thus, careful [tax planning](https://investorjunkie.com/taxes/taxes-affect-investment-portfolio/) can increase the actual return you receive on government securities.

### What about Social Security?

Social Security benefits are indexed to keep pace with inflation. However, they are tied to a particular CPI that does not accurately reflect the expenses of retired Americans. Older Americans, for example, spend much more on [medical costs](https://www.ama-assn.org/about/research/trends-health-care-spending) than counted in that index. So, the Cost of Living Adjustment (COLA) will only get you so far. The [last COLA of 1.3%](https://www.ssa.gov/oact/cola/latestCOLA.html) is too low to reflect current inflation.

Another way to increase your Social Security benefits is to put off claiming them. Claiming when you're first eligible at 62 years of age creates a permanent 30% reduction in your overall benefit. Each month you wait beyond your full retirement age to claim results in a small *increase* over your base benefit. Thus, if you wait until age 70, your overall benefit will be [approximately 132%](https://www.ssa.gov/benefits/retirement/planner/delayret.html) of your overall base benefit amount.

### Inflation matters in the retirement long run

When you retire, your income will likely be far more fixed than it is now. Your Social Security benefit is based on your highest earning years and won't change much. You won't have as much flexibility in dealing with inflation as you did in your working years.

Thus, you should work with a [financial professional](https://fta-ria.com/contact/) at [COMPANY NAME] to make sure that what you're doing now is right for the long term. Planning now can reduce the impact of inflation on your retirement. Contact us to learn more about how we can help you, no matter what stage of retirement planning you are in.

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