What is Your Personal Inflation Rate?

Hildy Richelson and Stan Richelson, Scarsdale Newsletter, 6/18/2013

Though inflation is rising very slowly – 1.4 percent in May of this year – and there are hints of possible deflation, we still worry what will happen if inflation takes off. However, a better look at the Consumer Price Index (CPI) tells us that the wealthy are not affected by its measurements in the same way as people with lesser means.

The monthly CPI "is the result of prices paid by urban consumers for a representative basket of goods and services." It is a rather inexact measure of inflation. There should be two measures, the current one for a typical family of 4 making between $40,000 and $60,000 per year, and another one for wealthier people.

This is because the current CPI has a significant weighting to shelter (31%), commodities (20%), food (14%) and energy (10%), which makes up a large percent of the budget of a family of modest means, but has little effect on the rich family.

How meaningful is the concept of "imputed rent" or how much your rent would rise if you rented your own home, if you actually own your own home and if you are rich?

There is also a heuristic negative adjustment which reduces inflation if costs go down. A heuristic is a rough cut solution to a problem, good enough to get the job done, but not perfect. For example, memory for your computer goes down in price, reducing inflationary pressures. However, the same amount of memory in your computer will not run the new programs, so you need to purchase more memory, which is not taken into consideration.

There is also no adjustment for your possible flexibility. For example, you might increase your purchases of beef if the price of chicken rises, or vice-versa.

To correct for this, the Bureau of Labor Statistics has begun to use the Chained Consumer Price Index (C-CPI-U). It will reflect the effect of substitution that consumers make when they switch from beef to chicken. Unlike the CPI, it is able to adjust for consumers' switches across categories. It is supposed to be a closer approximation of a cost-of living increase and it may be the basis for adjustments to Social Security.

There are many indexes that take into account a variety of items, geographic areas, and populations covered. If you do not fit the profile of the index sample, then it not a meaningful number to use as a basis of your investment decisions. As long as the interest payments from your bonds adds enough income to reduce the uncertainties in your life, you can smile.