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VIDEO

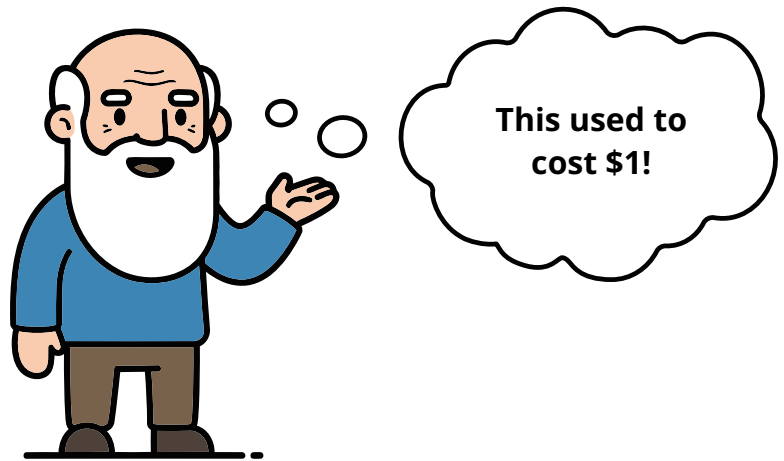
Inflation & Purchasing Power

What + Why: Understand how inflation affects what your money is actually worth so you can make more informed decisions about saving and investing over time.

You've probably heard someone say, "Back in my day, this only cost a dollar." And honestly . . . they're not wrong.

Over time, prices increase. This is called **inflation**.

Think about your favorite fast food spot. You might see a value menu where the cheapest item costs a few dollars. But that used to be the dollar menu, where everything was one dollar. That change happened because of inflation.



Dollar Menu

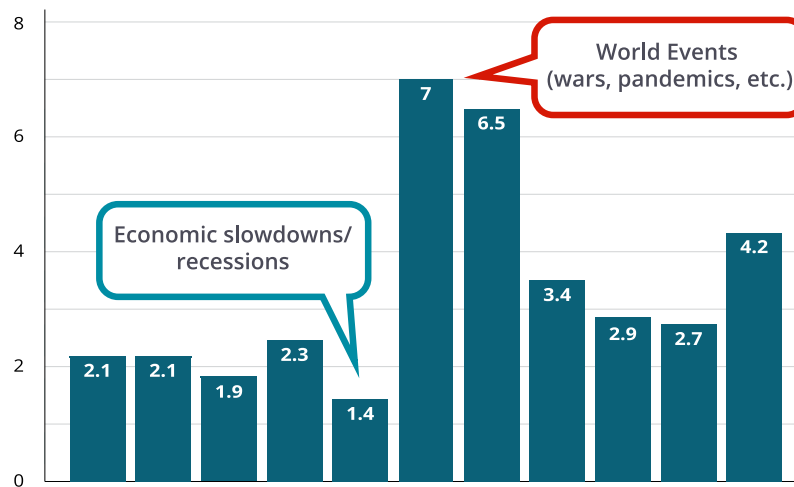


Value Menu



Inflation doesn't move at the same rate all the time. It can rise faster in some periods and slow down in others. Sometimes world events—like wars, pandemics, or supply chain disruptions—can push prices up more quickly. During economic slowdowns or recessions, inflation may ease or even stay very low for a period. But whether inflation is rising faster or slower, even small increases in prices can add up over time and make a big difference in your finances.

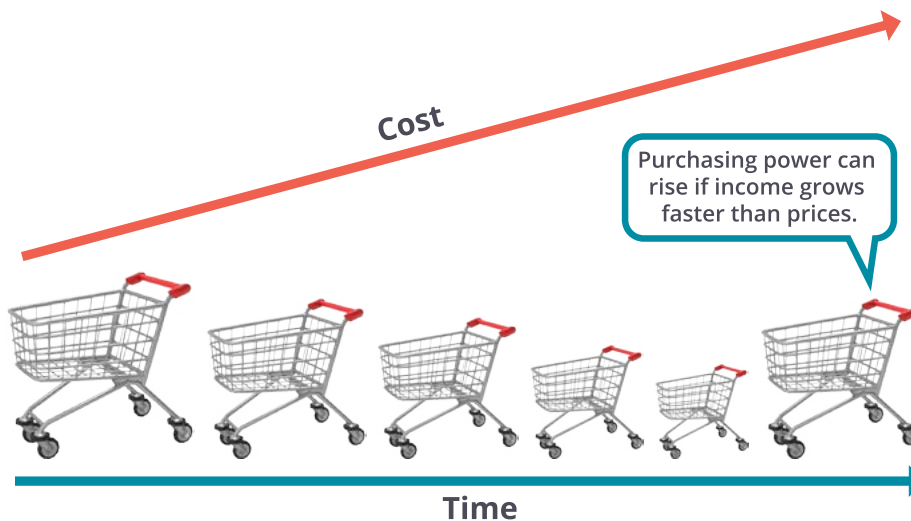
United States Annual Inflation Rates



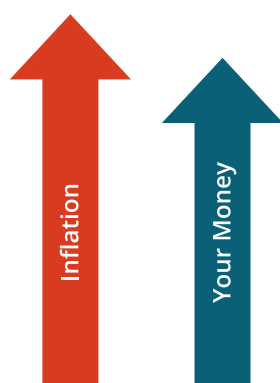
Even lower inflation rates add up over time

Purchasing power is what your money can actually buy. As prices rise due to inflation, your purchasing power goes down. The money itself doesn't change, what it can buy does. Your purchasing power can also rise if your income grows faster than the price of goods and services.

Purchasing Power = What Your Money Can Buy



Your savings and investment accounts might grow over time, but that doesn't always mean you're gaining real value. For example, if your savings earns 2% interest, but prices rise 3% in a year, your money is growing, but your purchasing power is shrinking. That means you're effectively losing about 1% in real value, even though your balance went up. That may seem small, but over time those losses can add up. If your money grows slower than inflation, it's losing purchasing power.

Losing purchasing power**More Money ≠ More Value**

It adds up!

$$2\% \text{ Return} - 3\% \text{ Inflation} = -1\% \text{ Real Return}$$

When you invest, your money can grow over time. The return you see—how much your investment increases—is called the **nominal return**. But what really matters is the real return. **Real return** is how much your money grows after inflation is taken into account. That shows what your investment can actually buy in the future.



When you invest, it's not enough for your money to grow. It has to grow faster than inflation. Otherwise, your real return isn't increasing, even if your nominal return is.

Question 1

Because prices increase over time, what happens to your purchasing power if income and investments don't keep pace with inflation?

- ☐ a. It increases.
- ☐ b. It stays the same.
- ☐ c. It decreases.

Answer: c. When prices go up, also known as inflation, your money buys less, so purchasing power decreases.

Question 2

If your investment has a positive nominal return, but inflation is higher, what happens to your real return?

- ☐ a. It increases.
- ☐ b. It stays the same.
- ☐ c. It decreases.

Answer: c. If inflation is higher than your nominal return, your real return decreases.

Key Terms

- **inflation:** a general increase in prices of goods and services over time, which results in a decrease in the purchasing power of money
- **purchasing power:** the amount of goods and services a given amount of money can buy