Inflation vs. COLA

The silent thief of your comfortable federal retirement and why you should never ignore it.

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Most of us never really give inflation a second thought, though we know it exists. A loaf of bread that recently cost $ 2.69 is now $ 3.09 and we think it's only 40 cents. True, but it's also a price increase of nearly 15%. When did you last receive a 15% raise? Right. Never. We know inflation in the late 1970's and early 1980's, was 12% - 14% which impacted mortgage rates, car loans and credit cards. It was truly a bleak time for consumers. Today, higher inflation can be harmful to the overall economy, and severely curtail consumer spending. What is behind this and how does it potentially affect your federal retirement?

If you lend someone $100 today, you want them to pay you back sooner instead of much later. Why? If they pay you back in 10 years, aside from the potential loss of earnings from that money, that $100 is worth less to you, meaning it buys less. Then doesn't it make sense that keeping inflation low is in the best interests of everyone? Maybe not. Strange as it may seem, inflation can benefit the U.S. government, since they pay their debt back (U.S. Treasury bonds, Savings Bonds, etc.) with "future cheaper dollars". Still, the U.S. Federal Reserve tries to balance a robust and growing economy with modest but controllable inflation. Leaning too much one way or the other can cause a domino effect of economic problems.

The Federal Reserve monitors the inflation rate with various indexes, one of which is the Consumer Price Index (CPI), which is calculated by the Bureau of Labor Statistics (BLS). It includes a basket of goods and services. While the relative weighting of each component in the index is different, some of the main categories of the CPI index include clothing, shelter, medical care and recreation. Of course, there are other components as well.

One potential weak link often cited is this core CPI index excludes food and energy costs. The BLS does watch them, but they usually do not use them to completely gauge the inflation rate. That said, most people are more concerned with rising food and gas prices than the price increases of plants, pens or pianos.

Federal employees often tell me inflation is of little concern since they receive a cost-of-living adjustment (COLA). This theoretically, offsets the negative effects of inflation, and keeps them "whole". Is that true? In fact, how *does* the CSRS COLA and FERS COLA get determined? And does it really make them "whole"? The short answer is no, not even close.

Keep in mind the FERS and CSRS COLA spread:

- If the CSRS COLA is more than 3%, the FERS COLA is 1% less
- If CSRS COLA is more than 2% but less than 3%, then the FERS COLA is 2%.
- If the CSRS COLA is less than 2%, then the FERS COLA is the same

The chart below details 21 years of inflation compared to federal COLA adjustments. Two decades is sufficient to produce an analysis and then draw some trend conclusions. Figures courtesy of BLS. Note, the 2021 COLA = 1.30%.

Year	Inflation %	CSRS COLA %	Percent Net +/-	FERS COLA	Percent Net +/-
2021	5.37	1.3	-4.07	1.3	-4.07
2020	1.2	1.6	.40	1.6	.40
2019	1.71	2.80	1.09	2.0	.29
2018	1.90	2.00	.10	2.00	.10
2017	2.13	0.3	-1.83	0.3	-1.83
2016	1.26	0	-1.26	0	-1.26
2015	0.12	1.7	1.58	1.7	1.58
2014	1.62	1.5	-0.12	1.5	-0.12
2013	1.47	1.7	0.23	1.7	0.23
2012	2.07	3.6	1.53	2.6	0.53
2011	3.16	0	-3.16	0	-3.16
2010	1.64	0	-1.64	0	-1.64
2009	-0.34	5.8	6.14	4.8	5.14
2008	3.85	2.3	-1.55	2	-1.85
2007	2.85	3.3	0.45	2.3	-0.55
2006	3.24	4.1	0.86	3.1	0.86
2005	3.39	2.7	0.69	2	-1.39
2004	2.68	2.1	-0.58	2	-0.68
2003	2.27	1.4	-0.87	1.4	-0.87
2002	1.59	2.6	1.01	2	0.41
2001	2.83	3.5	0.67	2.5	-0.33
2000	3.38	2.4	-0.98	2	-1.38
Average:	**2.245%**	**2.123%**	**-.088%**	**1.763%**	**-0.435%**

This chart should frighten <u>every</u> federal employee. Over this period, inflation averaged 2.24%. During that time, the CSRS COLA was 2.12%. After subtracting the effects of inflation from the CSRS COLA, CSRS employees showed an average return of their wages, equal to -.088%. To put this into perspective, $10,000 invested for one year would net, $9991.20. That's simply depressing. FERS employees fared worse. During the same time-period, FERS employees showed an average return of minus .435%. A FERS $10,000 investment was worth only $9,956. *<u>Both CSRS and FERS employees posted either a net loss or near breakeven of their purchasing power, for twenty years</u>*. What does that potentially do to your purchasing power and quality of living? Especially with your federal pension and social security deposits?

To put this all into perspective, let's look at some simple numbers. If you received $2500/ month in the year 2000, by 2021, that would be worth approximately $1568, meaning your purchasing power eroded by more than one third. To put it differently, that same $ 2500 of goods and services in the year 2000, would now cost you, in 2021, $3985. **Uh oh**. What will your monthly retirement expenses cost you in 10 or 20 years? Will you have to give up something to live?

Another, less obvious example of stealth inflation?

Let's look at simple benchmark showing the rise of inflation, the price of a first-class stamp. At the start of 2000, the price of a U.S. stamp was 34 cents. Today it is 55 cents. Yes, it's only a 21-cent increase. During that time, stamp prices rose nearly 62%, an *<u>average of 2.95% per year</u>*, exceeding the federal COLA. Did your COLA increase by that amount every year since 2000? No. Of course not.

[First Class Stamp Price History:]

1/7/01	$34 cents
6/30/02	.37
1/8/06	.39
5/14/07	.41
5/12/08	.42
4/17/11	.44
1/22/12	.45
1/27/13	.46
1/26/14	.49
4/10/16	.47
1/22/17	.49
1/21/18	.50
1/27/19	.55

The next time you review your retirement income figures, pay close attention to all your sources of income and how, if at all, they are pegged to rising inflation. If you do not uniformly calibrate your retirement income to rising costs, your federal COLA might become a diet-COLA. Forced part-time work in retirement is no one's goal. It's critical to plan with structure and discipline. Call or email to schedule your confidential one-on-one fiduciary retirement assessment.

To discuss this further, and see how your specific retirement might be affected, please call me at 202-465-8738 or email: rich@federalretirementbenefitscenter.com.