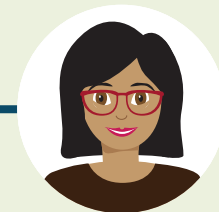


Money & Inflation



LESSON 1

Inflation is the increase in the price of goods and services over time, which means that long-term financial goals will likely cost more than they do today.



Graduate School



Early Twenties

A Place of My Own

Hi, it's Nikki! I can't believe that I'm about to finish graduate school. I'm so proud of my hard work *and* my new job title: Senior Programmer of Robotic Applications! Thanks to my good salary—and the fact that I've been able to save money by living with my parents—I've paid off most of my student loans. Hurray!



I've also got new goals. As much as I love my family, I think it's time I lived on my own. I am a grown-up after all! When I said I wanted to buy a house or a condominium with my savings, Grandma explained that almost no one can afford to buy a home that way. She told me I'd have to make a cash **down payment** (usually equal to 20% of the cost of the home) and then borrow the rest from a bank.



MORTGAGE

This loan is called a **mortgage**, and most people pay it off over 30 years. That's a long-term commitment!

There's one house I absolutely adore (it's got a huge backyard!) that costs \$150,000. A down payment, or 20% of this price, would be \$30,000. I have about \$6,000 in savings now, so I'd have to save \$24,000 more before I could purchase it.



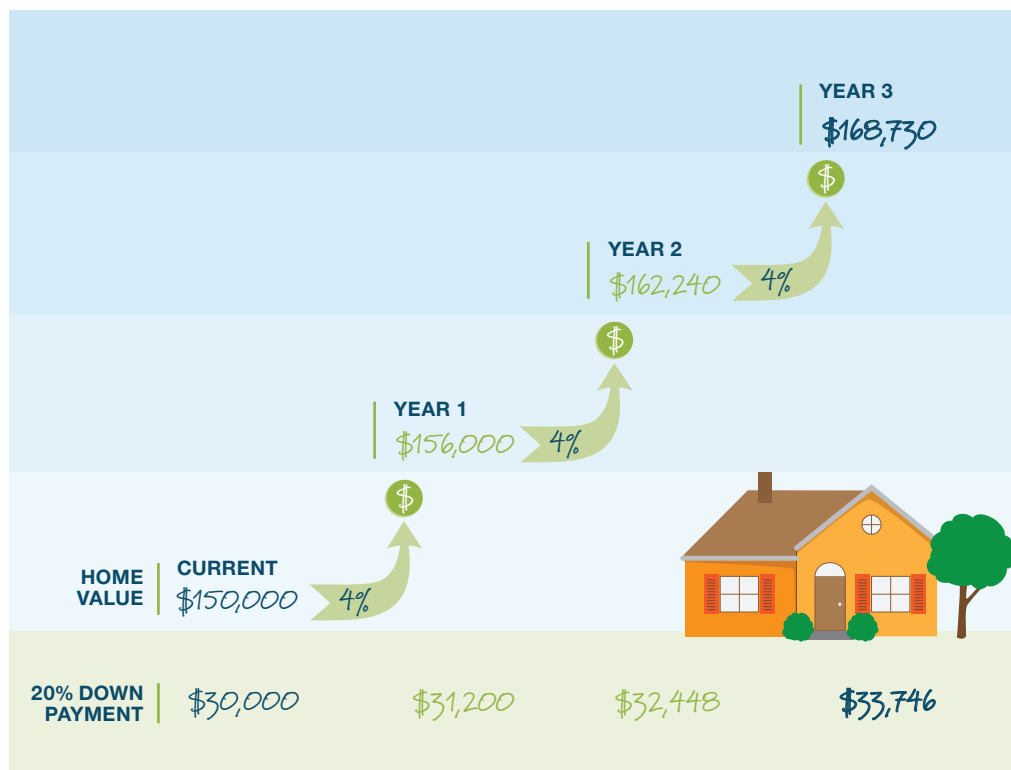
SHORT-TERM TIME HORIZON



SAVING FOR HOUSE
DOWN PAYMENT

I figure my time horizon to save for the down payment will only take me three years!

But then, Grandma kind of bummed me out when she told me about **inflation**, which is the increase in prices over time. She explained that three years from now, my dream house will likely have gone up in value—which means my down payment would also rise. So, if the price of my \$150,000 home increases 4% per year, it will cost almost \$169,000 in three years. At that point a 20% down payment will be \$33,800, not \$30,000! I'll have to save even more than I thought. I'm glad I'm learning this now!



To calculate the effects of inflation over several years:

1. First, **add 100%** to the percentage increase. (So, for a 2% inflation rate, use 1.02%.)
2. Then **convert the percentage** to a decimal (2% is equivalent to .02.)
3. Finally, **multiply the decimal** times the current cost.
4. For inflation over more than one year, **multiply the calculation for year 1** by the decimal. Repeat this operation—multiplying the result by the decimal once for each year.

Example: A \$200 item has a projected 2% inflation rate. After three years, the cost will be \$212.24 (rounded to the nearest cent). Year 1: $\$200 \times 1.02 = \204 ; Year 2: $\$204 \times 1.02 = \208.08 ; Year 3: $\$208.08 \times 1.02 = \212.24 .



WHAT'S THE Big Idea?

When you're planning for a financial goal with a long-term time horizon, you need to consider and plan for the effects of inflation.