# Expenses

Have no fear of perfection. You’ll never reach it.

* Salvador Dali

BUDGETING IS one of the most disliked and neglected aspects of the financial planning process. However, the sustainability of a financial plan can only be determined with a reasonably clear idea of personal expenses and how they could change over time. Having a realistic budget can secure your financial future and ensure peace of mind.

My chapter objectives:

* Understand the importance of calculating personal expenditures
* Learn how spending might change over time
* Identity a personalized inflation rate
* Estimate longevity
* Pick a realistic retirement date

## 2.1: Being Real

BEING REALISTIC about retirement expectations means setting achievable goals and understanding the financial implications of these goals. It's an essential first step in the financial planning process. If married or in a partnership, both individuals must be on the same page about what they want out of retirement. By 'being real,' we mean setting goals within your financial means and understanding the potential challenges and adjustments that may be required to achieve them.

A financial plan with a high probability of failure “baked in” is unrealistic.

The 2022 EBRI Retirement Confidence Survey, a comprehensive study conducted by the Employee Benefit Research Institute, provides valuable insights into the retirement landscape and the financial preparedness of individuals. This survey is a reliable source of information for our discussion on retirement planning.

According to the EBRI survey, the top reasons workers retired earlier than expected were due to:

* Health-related reasons
* Job changes or obsolescence
* Feeling financially capable

### Are retirees being real?

Historically, the same study has consistently reported that of the individuals surveyed, 7 in 10 workers and 8 in 10 retirees were “confident in having enough for a comfortable retirement.”

Additionally, 70% of workers think they will continue to work for pay in retirement, yet only 27% of retirees reported actually doing so. This response has been consistent with responses in prior surveys.

Earlier, EBRI Retirement Confidence surveys reported that most workers or their spouses have never tried to calculate how much money they will need to save for retirement to live comfortably. This response has also been consistent with EBRI survey responses over the past decade.

Of those taking the survey and among those who have attempted to calculate expenses, most admit they have not relied on professional advice.

## 2.2: My Expenses

FOR PLANNING to be effective, individuals must have a reasonable sense of the relationship between available cash flow and ongoing expenses. The difference is the “firepower” needed to achieve financial objectives. Understanding personal expenses empowers the individual to take control of their financial situation.

Having a reasonable system to identify expenses helps the planning process. That’s because no realistic assumptions for positive cash flow can truly ever be determined. As a result, no financial planning strategy can be relied upon, so confidence in the plan is diminished. The relationship between expenses and cash flow is where the “rubber meets the road.”

Breaking the budget once in a while is human nature. Plan on it.

Fortunately, creating a helpful budget can be simple. It can be as simple as isolating essential and non-essential or “discretionary” expenses.

A realistic budget will identify:

* Available cash flow needed to achieve financial goals
* Non-essential or “discretionary” expenses that can be eliminated or reduced (if required)
* General spending behaviors and patterns

### How do I keep a budget?

Creating an accurate budget is not just a step in planning; it's the cornerstone of cash flow analysis. A realistic budget comes with understanding a financial plan's long-term sustainability. It can be simple but essential for many critical financial decisions.

The most challenging part of the budgeting process is gathering information. But don't worry, it's much more manageable than it seems. You can easily download all your year-end expenses from the bank in a .csv or spreadsheet format. Open the file and copy and paste all the values into the course material spreadsheet.

Once done, ensure the values are positive numbers. If not, you can quickly convert negative values to positive ones using the ABS function.

To simplify, Copy (ctrl+c) and Paste special → Values only (Ctrl+Shift+V). Now, all the hard work is done.

Once you've got all the numbers in the spreadsheet, classify them. The sheet should automatically populate the embedded chart with your data. But don't stop there. Add more colors, customize, and get creative to get the results you're looking for. Your budget reflects your financial goals and aspirations, so take pride in finessing them.

For most people, reworking a budget more than once a year is probably unnecessary. However, how frequently remains a personal choice. We recommend revisiting it every so often to maintain a sense of expense. It can be helpful when working with a financial professional who may need to know how much expense pressure to assume when modeling withdrawal scenarios. In particular, those approaching retirement should revisit the exercise before and after formal retirement.

## 2.3: Understanding Inflation

MONEY’S PURCHASING power erodes over time. Solely depending on what has been the historical inflation rate is no guarantee of future inflation.

The Consumer Price Index (CPI) can provide a basic understanding of the changes in consumer prices over time and the general direction of an individual's expenses.

### What’s the CPI?

The Consumer Price Index (CPI) is a widely used measure of inflation. It provides a comprehensive overview of the change in prices of a representative basket of goods and services purchased by consumers. In other words, it's a tool that economists and financial planners use to act as a rough benchmark of how the cost of living is changing over time.

However, scholars argue that the CPI doesn’t perfectly report regional price variations for specific groups. For instance, Americans living in expensive cities may have much different spending behaviors than Americans living in suburban or rural areas.

Another consideration of the CPI is that it may only sometimes reflect certain expenses.

Data limitations of the CPI should prompt retirees to consider how inflation might differ among certain expenses.

Examples include:

* Education
* Medical costs
* Housing

### Inflation Rates

Most financial professionals agree that using a 3% inflation rate is a good place to start.

Historically, inflation has averaged about 3% over 30 years.

When adjusting for inflation, the individual may customize an inflation rate for specific items. Common expenses one might separately consider to the standard 3% inflation rate may include:

* Certain medical costs
* Education expenses
* Food preferences
* Transportation requirements

“The improved confidence could be linked to increased confidence in income, with 28% of workers and 32% of retirees attributing their confidence to stable finances.1 This is supported by the U.S. Census data indicating that wage growth is exceeding inflation growth.”

The economic response to the COVID-19 pandemic has resulted in a mixed picture. On one hand, unemployment is currently lower, the stock market is higher, and job creation is faster than pre-pandemic levels. These are positive indicators not seen in recent decades. On the other hand, the cost of living has increased significantly due to inflation, which has affected many countries worldwide. While the US has experienced a tough bout of inflation, it has fared better than other G7 nations in this regard. Currently, wages are outpacing prices, suggesting that workers are gaining ground even with inflation. However, it is important to recognize that these are aggregate figures, and the impact of inflation can vary considerably among individuals and households. It's reassuring to note that the government is actively working to address the issue of rising costs and mitigate the negative effects of inflation.

### It’s Our Economy

Historically, the Federal Reserve and policymakers have used various methods to address rising inflation.

These methods include:

* Monetary Policy: Central banks like the Federal Reserve can raise interest rates to curb borrowing and spending, thus reducing demand and slowing down price increases
* Fiscal Policy: Governments can use taxation and spending to influence the economy and manage inflation
* Supply-Side Policies: Addressing supply chain disruptions, increasing productivity, and promoting competition can help mitigate inflation by increasing the availability of goods and services

### Economic powers beyond inflation

The Bureau of Labor Statistics (BLS) is the primary agency responsible for tracking inflation and wage-related statistics in the United States. The BLS publishes the Consumer Price Index (CPI) and the Producer Price Index (PPI), which are widely used measures of inflation.

The CPI measures the change in prices of a basket of goods and services purchased by consumers. The PPI measures the change in prices of goods sold by producers. Both the CPI and PPI are published monthly and can be found on the BLS website.

Wage growth can positively impact individuals and households by increasing their purchasing power and improving their standard of living.

While wage growth exceeding inflation and falling unemployment rates can be indicators of mitigating inflation under certain conditions, they are not guaranteed solutions.

Indications that support mitigating inflation.

* Increased purchasing power: If wages grow faster than prices, people have more disposable income. This can stimulate demand, leading to increased production and economic growth, which can help counteract inflationary pressures.
* Reduced unemployment: Falling unemployment rates usually mean more people are earning wages. This can increase overall economic activity and potentially dampen inflation through increased supply.
* Increased productivity: Wage growth is sometimes tied to increased productivity. If workers produce more goods and services, this can help keep prices stable or even lower.

Indications that do not support mitigating inflation.

* The Wage-price spiral: Businesses sometimes raise prices to cover increased labor costs. These increases by businesses can lead to a cycle in which wages and prices trend upwards, potentially fueling inflation rather than mitigating it.
* Demand-pull inflation: Increased purchasing power due to higher wages could lead to excessive demand for goods and services, exceeding supply and driving prices up.
* Other factors: Supply chain disruptions and global events can also affect inflation, potentially counteracting any mitigating effects of wage growth and low unemployment.

The relationship between these factors and inflation is complex and influenced by various economic forces.