# Impact of Inflation on Retirees

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After many years of low inflation, inflation rates have risen to much higher levels in the last year. Salaries and wages are also rising in response to a labor shortage, but that does not affect retirees. The stock market has declined after a period of increasing values in 2021. Retirees in the U.S. generally have income from Social Security once they claim benefits, and that income is indexed for inflation. A decreasing number of retirees also have income from defined benefit pension plans. However, except for retirees covered by public employee pensions, most of these plans do not provide for indexing income for inflation.

Many retirees have lower resources than are ideal for retirement, and lower than what is called for by commonly accepted retirement planning models. Society of Actuaries Research Institute (Institute) research provides insights into how retirees have managed over the last twenty years, and how they have viewed their situation. The more than 20 years of research includes a biannual survey of Post-Retirement Needs and Risks (Risk Survey) and focus groups with recently retired individuals and with individuals retired 15 years and more, as well as a multi-faceted study of individuals aged 85 and over.

The ideas in this paper are my ideas. They are heavily influenced by some earlier Institute research including the report *Spending Patterns and Debt*[1], a special issue-based report from the 2015 Risk Survey. The supplemental data in this report includes information on spending by age group from two different sources, and information about transfers between older adults and their children. My views are also influenced by some of the questions in the Institute Age 85+ survey[2] which included a number of questions on high age spending. Issues from that survey included how spending compared to income, how expenses changed over time, and what expenses caused difficulty to individuals in that age group. They were also influenced by the comments in Institute sponsored focus groups that indicated retirees preferred to cut spending and not spend down assets, and that they seemed quite satisfied with being frugal.

The ideas in the papers were also influenced by my personal observations of and discussions with older individuals. I have talked to many people and noticed that a number of them no longer want to acquire more stuff. Rather they say they are trying to get rid of stuff, and it is unusual for them to buy more clothing or things for their households. I have observed people who could afford to spend more reluctant to do so, and this issue has been discussed in some committee project discussions. My understanding is that older persons in the UK and Australia are also reluctant to spend as much as they can afford to spend. I also believe that the COVID 19 period caused people to change their behavior temporarily, but at the same time, some people rethought their values and that this reflects their current and likely future behavior. My ideas in this essay are based on a synthesis of these influences.

[1] https://www.soa.org/49387b/globalassets/assets/files/research/projects/research-2016-spending-patterns-debt.pdf
[2] https://www.soa.org/493464/globalassets/assets/files/resources/research-report/2018/post-retirement-experiences-85.pdf

This research offers insights that are useful in understanding where retirees were when the recent inflation started. Some highlights of the findings from the Institute include:

- Concerns about inflation have been in retirees' top three risk concerns consistently in the eleven risk surveys.
- Overall, the retirees were generally resilient and reducing expenses was a major method of risk management. The individuals retired for a number of years often had been reducing expenses to adjust to their situations.
- There are often gaps in planning, and some of the people who plan say their planning is primarily focused on short-term cash flows.
- Health care costs have increased more rapidly than inflation, and Medicare related premiums have often gone up more than Social Security benefits.[3]
- Average retiree household spending declines with increasing age, except for medical care.[4]
- Retirees were often able to deal with a variety of shocks, but the areas that were flagged as not manageable included a major long-term care event requiring paid long-term care, helping family over a longer-term and divorce after retirement. Multiple shocks were a much bigger problem than a single shock.
- Housing costs are the largest area of spending for retirees.[5]
- Retirees seemed to accept being frugal.
- When retirees were asked how they wished to generate regular income or spend down their assets over time, the response generally was that they wished to retain the assets and reduce their spending.

All of the Institute research can be found on the Aging and Retirement website within the SOA website. The risk survey and focus group findings are summarized in a 2021 report on *The Journey Through Retirement*, and the age 85 and over research is summarized in a 2019 report titled *Retirement Experiences of people age 85 and Over*. See Tables 1 and 2 below for information on spending by age group and type of expense.

## Social Security and Medicare

Social Security is indexed for inflation and Medicare premiums are also increased each year. In general Medicare premiums and health care costs have risen more rapidly than overall inflation. The increase in Medicare premiums can more than offset the rise in Social Security benefits. There is a safe harbor when this would happen based on the announced premiums which limits the increase so that net Social Security benefits do not decrease.[6] The safe harbor does not apply to the additional Medicare premiums based on income. The net result of the Medicare premium increases is that Social Security benefits after being reduced for Medicare premiums may not go up for

[3] 2022 was different and Medicare premiums did not go up.
[4] See Table 1 below. Data is reinforced by data in Table 2 which shows declines in spending in most areas and also by responses to the Institute's survey of individuals aged 85 and over.
[5] See questions on pages 12 and 13 and tables on page 31 and 32 of *Spending Patterns and Debt*. https://www.soa.org/49387b/globalassets/assets/files/research/projects/research-2016-spending-patterns-debt.pdf. The questions on pages 12 and 13 and the quotes from focus groups documents retirees saying that spending decreases. The tables on pages 31 and 32 offer two sources that both show spending decreasing with age.

[6] https://www.aarp.org/retirement/social-security/questions-answers/ss-decrease-medicare-premium-increases.html

other purchases or the increase is greatly slowed down. To say it another way, many retirees who are heavily dependent on Social Security have very little income increase to offset increasing costs for food, housing, and other expenses. Also, some retirees have income sources that do not last throughout retirement so that their household income may be reduced by various other changes in income.

## COVID-19, Financial Well-Being, and Retiree Spending

COVID-19 had a major impact on the lives of Americans in 2020 to 2022. During the pandemic, individual Americans and businesses made changes to adapt to the new circumstances. The pandemic influenced the financial well-being of many people. The inflation which heated up in 2021 and increased in 2022 was layered on top of COVID-19. It remains to be seen which of these changes will influence well-being, behavior, and decisions in the long run. My view is that when we think about inflation at this point in time, it is layered on top of the impact of COVID-19 and interacts with the longer-term effects of COVID-19.

Institute research found that more people were worse off financially than better off during COVID-19. The largest group was not financially affected.[7]

The people most likely to be worse off financially were those who had job problems and were the younger generations. The oldest generations who were generally retired indicated that the largest number were not affected financially, a few were better off financially, and some were worse off financially. Retirees who had substantial assets were most likely to be better off financially, at least until the market declined.

During the initial period of COVID-19, individuals who were older and in customer facing jobs were particularly likely to be laid off due to safety concerns. Older individuals working in such jobs often also left them voluntarily.

Retiree spending for entertainment and travel was sharply curtailed during the earlier parts of the pandemic.

More retirees were probably called on to help adult children as they were laid off or as their child-care arrangements collapsed. I do not have data on how many of the people who were hurt financially recovered and how many are still worse off. While government aid helped many Americans, such help is now over, and in addition, many small businesses went out of business.

Of the people who were infected and got COVID-19, some will have continuing problems, i.e., long-COVID. The extent of long-COVID and what it may cost is not known. It appears likely that people could have long-COVID even if their initial episode of COVID-19 was not severe.

It seems very likely that some retiree households will have longer term adverse outcomes from COVID-19's effect on them or other family members. It will take some time before data on these topics is available. Note that the databases that provide insights into individuals' income and expenditures take time to collect and release data, and then more time is needed to analyze it.

[7] The Institute included retirement linked COVID-19 content in the most recent Generations and Post-Retirement Risk Surveys, and in special reports. The retirement linked COVID-19 content is summarized in the report *COVID Aging and Retirement Research: What's Been Done and What's to Come*, https://www.soa.org/498e14/globalassets/assets/files/resources/research-report/2022/covid-aging-retirement.pdf

## Focusing on Different Kinds of Spending

This section and the following section reflect my opinion. That opinion is influenced by information about the spending patterns of seniors by age and by the Institute research on individuals at different points during retirement. It is particularly influenced by some of the responses to the survey of individuals aged 85 and over. When asked about what forces had a significant impact on their finances in the last five years, the top-ranking response was increases in utility costs (see Table 4 below). That indicates to me that relatively small increases in mandatory costs can have a big influence, particularly among a group of people who have been gradually reducing spending over a period of years. I found this response to be surprising but also generally consistent with the responses in the age 85 and over research and the earlier focus groups about being frugal and reducing expenses so that they could preserve assets.

Housing: Housing is the largest expenditure for retirees.[8] There is a lot of variation in individual household situations. Many retirees are homeowners, some with houses paid off and others with mortgages. Some are renters and some retirees live with other people, or in special retirement communities.

Homeowners with fully paid off houses still have maintenance, real estate taxes, insurance, utilities and energy costs to pay[9]. Homeowners with mortgages also have payments to make and if the mortgage has an adjustable rate, interest costs will rise. Renters are faced with rapidly rising rents in some areas as well as a decreasing supply of rental units.

Some homeowners will downsize and may substantially reduce their housing costs. It should be noted that there are huge variations in housing cost by area, and housing costs can be reduced by moving to a less expensive area. The impact of inflation on housing costs is that it will generally increase costs except for people who downsize, go to a less expensive area, or move in with someone.

Retiree homeowners can also reduce their net out-of-pocket current housing costs by using a reverse mortgage. Reverse mortgages allow homeowners to increase monthly income by gradually borrowing on their home. They generally do not require repayment until the homeowner leaves the home. The reverse mortgage can be used for regular monthly payments, one-time payments, or drawn down as needed. They can be incorporated into various financial strategies.

Food: Food costs are rising pretty rapidly[10]. A first line of defense is to shift to less expensive food items, but many retirees have already done that. Increases in food costs may cause difficulty for retirees with lower resources. Food insecurity is a huge issue in the United States, and it increased during COVID-19.[11]

[8] See Tables 1 and 2 below for an indication of the magnitude of housing costs compared to other costs.

[9] The data from the Age 85 and Over survey as shown in Table 4 below indicates that the expenses experienced by homeowners with paid off mortgages had a significant impact on their finances in the last five years in a period of low inflation. The impact will probably be greater in a period with more inflation.

[10] See this department of Agriculture website for food price increase data. https://www.ers.usda.gov/data-products/food-price-outlook/summary-findings/. An article posted by CNBC provided a table showing cost increases for a variety of different expenses by retirees. It compared the increase for 2022 with price increases. Konish, Lorie, "Average Social Security retirement benefit fell short by 46% in 2022." This article showed the costs that went up the most. https://www.cnbc.com/2022/12/20/average-social-security-retirement-benefit-fell-short-by-46percent-in-2022.html

[11] https://www.feedingamerica.org/hunger-in-america

Health costs: Health costs have increased more rapidly than inflation over many years and this seems likely to continue. In addition, individuals often need more health care as they age. Some households will have added costs due to long-COVID. While this is not an inflation related expense, it will interact with inflation related expense increases. Medicare defines what it will pay for various Medicare covered health services and how much the patient may be billed. Health care costs are likely to be particularly challenging if services are used that are not covered by Medicare or if someone in the household has a particularly expensive drug with limited coverage under Medicare. Most long-term care is not covered by Medicare. Individuals not yet eligible for Medicare have much more severe problems.

Energy costs: Energy costs can be a big factor in inflation, depending on home heating and air conditioning costs and the energy component of transportation. Relatively recent retirees are more likely to go places than older retirees, so transportation related energy cost increases overall will affect them more. The impact of energy costs on housing costs varies depending on the situation.

Clothing and other purchases: My view is that older retirees buy fewer and fewer tangible items as they age. Many people are trying to downsize rather than acquire more things. An exception to this is retirees remodeling homes or moving or some who do a lot of travelling. For older retirees, inflation affects food costs, utility costs and transportation costs. They probably do not buy items such as cars, clothing, household furnishings or furniture very often.

Helping family: One of the areas of retiree expenditure is financial help to adult children. Some retirees are providing such help on a regular basis. Inflation could have a big effect here as the gap between the income and needs of the person being helped may grow a lot due to recent inflation.[12]

## How Retirees Are Likely to Be Impacted

Retirees are in very different situations and how inflation will impact them depends on their specific situation and how it interacts with their spending pattern. It likely affects the financial situation of everyone, but the groups that experience difficulty in managing are more limited and are more likely to be individuals who spend all of their income.[13] My expectations are as follows with regard to different groups:

Lower resourced retirees dependent primarily on government benefits: These benefits are a mixture of Federal and state benefits and vary by state. Often such benefits do not keep up with inflation. I would expect that this group will have a difficult time. Food and housing insecurity will likely increase for them.

Retirees with relatively low financial assets who are frugal: These retirees, particularly those who have been retired for a few years or more may now have a hard time because they were managing on a slim margin. Some of them may move from a situation of managing well to having a very hard time. Depending on how much they had already cut expenses, they may find that there is little left to cut without more serious consequences. Some may move in

[12] EBRI discusses family transfers in *Intra-Family Cash Transfers in Older American Households*, Issue Brief 415, June 2015. The EBRI report shows that 38% to 45% of older households make cash transfers to younger family members. On the other hand, only 4% to 5% of older households receive transfers from younger family members. The cause of the transfer is not identified. The older households are age 50 and older, and analysis covers 1998 to 2010. The HRS was the underlying source of the data. This data is cited in the SOA Research Institute *2015 Retirement Risk Survey Report: Spending Patterns and Debt*.

[13] Note that some households regularly withdraw money from their assets and use those withdrawals to support their spending. Their financial picture will probably be affected, but they will not have difficulty unless their spending reaches levels that affect the resources that can be prudently spent. This group may well have a number of areas of spending where they can cut spending by changing behavior.

with other family members to reduce expenses.  It would not be surprising to find more multi-generational households.

Retirees with better resources:  These retirees may need to adjust some of their spending but, they are much less likely to be in trouble. Many of them spend less than their income giving them some margin.  Their assets and financial situation are likely to have been affected, and depending on how much margin they had, they may be challenged.  Those with long-COVID may have a lot of problems.

## Conclusion

I believe that it is very likely that many retirees, particularly those who are financially fragile or who are spending available income and have relatively limited assets, will have an adverse impact from inflation.  Some have income that is not inflation indexed, and some have income that covers daily regular expenses, but not items such as home and car repairs, larger dental bills, etc.  Some will move from managing to not being able to manage, and some will still be able to manage, but not on the same basis. Some have more resources than they are using, and while inflation may impact their financial picture, it will not push them into changing their lifestyle.  As data on the population emerges, it will be possible to do much more analysis to estimate how many are in various groups and how serious the impact on retirees is.

The question was raised about whether retirees would be more or less affected by inflation than younger generations.  Financial fragility is a big problem in the U.S., and it has been examined as part of the Institute's Generations Research.  My view is that the financially fragile are likely to be hit hard by inflation in that they are likely to experience a lot of difficulty. According to Institute research, there are more financially fragile individuals at younger ages.

Changes in asset values have the most impact on those with the most assets.  This essay does not provide any answer about the relative impact of inflation on retirees vs. younger generations.  This is a question for more research and exploration, and it will likely require data that will emerge over time.

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## Appendix A: Supplementary Data Tables and Information

Tables 1 and 2 provide information on spending by age group. They are from the Institute's 2015 Retirement Risk Survey report *Retirement Risk Survey Key Findings and Issues: Spending Patterns and Debt*[14] and are shown in the analysis of spending at the end of the report (pages 31 and 32). Both of these tables are based on analysis of major Federal databases by very reliable researchers.

Table 1

HOUSEHOLD SPENDING BY AGE GROUPS – AGE 65 AND OVER
MEAN AND MEDIAN HOUSEHOLD SPENDING IN 2011 ADJUSTED TO 2013 DOLLARS

| | Age 65-74 Mean | Age 65-74 Median | Age 75-84 Mean | Age 75-84 Median | Age 85+ Mean | Age 85+ Median |
|---|---|---|---|---|---|---|
| Home | $18,720 | $12,642 | $14,732 | $10,805 | $13,111 | $8,781 |
| Food | 4,526 | 3,982 | 3,994 | 3,228 | 2,520 | 2,152 |
| Health | 4,383 | 3,104 | 4,624 | 3,109 | 6,603 | 2,814 |
| Transport | 5,169 | 4,025 | 3,666 | 2,794 | 1,972 | 1,241 |
| Clothing | 1,311 | 724 | 950 | 569 | 888 | 434 |
| Entertainment | 4,300 | 2,380 | 3,277 | 1,655 | 1,609 | 714 |
| Other | 3,583 | 1,148 | 3,565 | 1,034 | 3,188 | 734 |
| | | | | | | |
| Total | $42,805 | $34,036 | $35,315 | $29,884 | $30,610 | $22,263 |

Source: *Retirement Risk Survey Key Findings and Issues: Spending Patterns and Debt*, Data from Figure 2 of EBRI notes, Sept. 2014, *How Does Household Expenditure Change with Age for Older Americans?* EBRI analysis used data from the Health and Retirement Survey (HRS), a major national longitudinal database. That database has data on the same households collected every two years.

[14] https://www.soa.org/49387b/globalassets/assets/files/research/projects/research-2016-spending-patterns-debt.pdf

Table 2

ESTIMATED ANNUAL HOUSEHOLD EXPENDITURES FOR SELECT AGE GROUPS

GAO ANALYSIS OF BUREAU OF LABOR STATISTICS CONSUMER EXPENDITURE SURVERY FOR 2013

| Expenditure Type | Mid-Career 45-49 | Young Retirees 65-69 | Mid-Retirees 75-79 | Older Retirees 80+ |
|---|---|---|---|---|
| Housing | $18,400 | $15,200 | $11,400 | $11,300 |
| Transportation | 10,200 | 7,900 | 5,900 | 3,600 |
| Food | 8,500 | 6,900 | 5,600 | 4,800 |
| Personal insurance and pensions | 7,800 | 4,100 | 1,300 | 900 |
| Health | 3,500 | 4,900 | 4,800 | 4,700 |
| Entertainment | 3,000 | 2,400 | 1,400 | 1,100 |
| Apparel | 1,400 | 900 | 500 | 400 |
| Other | 5,600 | 4,500 | 3,600 | 4,700 |
| | | | | |
| Total | $58,500 | $46,800 | $34,700 | $31,400 |

Source: *Retirement Risk Survey Key Findings and Issues: Spending Patterns and Debt*, Data from Table 2, page 11 of the *GAO Report 16-242: Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement.* The GAO analyzed the 2013 BLS consumer expenditure data. Note that the age of greatest spending is mid-career. Average household sizes are 2.9 for mid-career, 2.1 for young retirees, 1.7 for mid-retirees and 1.5 for late retirees.

Table 3

SPENDING RELATIVE TO INCOME

BASED ON SURVEY OF INDIVIDUALS AGED 85 AND OVER

QUESTION: THINKING ABOUT YOUR SPENDING EACH MONTH, WOULD YOU SAY THAT YOU SPEND,,,,

| | Total Respondents | Respondents with less than $50,000 in assets | Respondents with more than $50,000 in assets |
|---|---|---|---|
| A lot more than your income | 3% | 4% | 2% |
| A little more than your income | 11 | 13 | 8 |
| All of your income, but no more | 19 | 20 | 16 |
| A little less than your income | 47 | 47 | 49 |
| A lot less than your income | 16 | 14 | 24 |
| Don't know/no response | 2 | 3 | - |

Source: Question 21 of the Institute's telephone survey of individuals aged 85 and over. Note that the question has frequently arisen whether people are spending less at higher ages because they must or whether it is a choice. Since 63% in this group say they are spending less than their income, many respondents are making a choice to spend less rather than being forced to spend less. Note that the period covered by this survey was a period of low inflation. Note the survey population does not include higher net worth individuals. The maximum financial assets of respondents were $400,000.

Table 4

IMPACT OF VARIOUS EXPENDITURES ON FINANCES OF INDIVIDUALS AGED 85 AND OVER
QUESTION: HOW BIG AN IMPACT HAS EACH OF THE FOLLOWING HAD ON YOUR FINANCES IN THE LAST FIVE YEARS?

| | Major Impact | Minor Impact | No Impact | NA |
|---|---|---|---|---|
| Housing Related Expenses | | | | |
| Repairs on your home or condo fee assessments | 13% | 35% | 45% | 7% |
| Increases in real estate taxes | 12 | 22 | 59 | 7 |
| Increases in utilities | 23 | 27 | 45 | 4 |
| Health related expenses | | | | |
| Medical expenses | 19 | 32 | 47 | 1 |
| Dental expenses | 13 | 27 | 58 | 2 |
| Needing assisted living | 4 | 18 | 67 | 7 |
| Transfers to family members | | | | |
| An adult child in need of financial support | 7 | 17 | 69 | 7 |
| Giving gifts to children and grandchildren | 7 | 34 | 52 | 7 |
| Other | | | | |
| Death of a spouse | 21 | 8 | 54 | 16 |
| Car repairs | 5 | 24 | 60 | 10 |

Source: Question 15 of the Institute's telephone survey of individuals aged 85 and over. Note that the period covered by this survey was a period of low inflation. Note the survey population does not include higher net worth individuals. The maximum financial assets of respondents were $400,000. Note that the housing related expenses apply to homeowners regardless of whether they have a mortgage. The relatively large number of people who indicated that increases in utilities had a major or minor impact (50% in total) indicated that relatively small increases in expenses could have a big impact on how people saw their finances.

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