



Inflation and Economic Security of the Older Population

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When the rate of inflation increases, lenders at fixed terms experience real losses because they are paid back in a currency with a lower purchasing power than originally anticipated. Because the older population are net lenders, they tend to be economically vulnerable to high and increasing inflation. Their harm from inflation varies by the composition of their economic resources. Some financial assets, such as stocks, convey ownership of real assets. Their value adjusts rapidly to the new, higher inflation because the nominal value of the real asset increases at the new inflation rate. Others, such as certificates of deposit (CDs), pay a fixed interest rate over a short-time horizon. Such assets decrease in real value in the short term but adjust rapidly to the new interest rate. Those who lend money at nominal rates for longer periods, e.g., through long-term CDs, would not see such an effect, but instead suffer real losses. Similarly, those with noninterest-bearing assets such as cash and many defined benefit (DB) pension

payments will see erosion in real value from inflation: Payment streams from these assets are fixed, not increasing when inflation increases. The effects can be profound even under moderate inflation: Over 15 years, an inflation rate of 5% will reduce the real value (purchasing power) of the annual benefit of a nominal DB plan by about 50%. Determining the effects of an increase in inflation on real wealth for the older population requires empirical analysis of household-level assets and informed assumptions about the vulnerability of each asset type.

In the years preceding the COVID-19 pandemic, inflation had been about 2% annually. In 2021 and 2022 inflation increased sharply, exceeding 8% by the summer of 2022. This presented a new period of economic vulnerability for the older population who may have become overly optimistic about inflation stability in managing their retirement assets.

In this research, we used data from the Health and

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Retirement Study and its supplement, the Consumption and Activities Mail Survey, to assess the effects of a spike in inflation on the assets of persons 65 years or older. We first analyzed “asset vulnerability” to identify how inflation affects the value of different assets. We then estimated “economic vulnerability,” i.e., the impact of high and increasing inflation on economic well-being over the remaining life cycle. We simulated how an unexpected increase in inflation would affect the financial security of persons older than 65. We stratified our analyses by education and marital status to show variation by subgroups. Our simulations assumed an annual inflation rate of 2%, like that before the COVID-19 pandemic, and then a permanent increase to 6% from 2020 onward.

Results

Vulnerability of assets to inflation

The average value of all household assets in our sample was \$562,465 (expressed in 2017 dollars), nearly half of which held in housing (averaging \$270,345). Nearly one-fourth were in stocks. Because these assets are effectively indexed, most of the wealth of older households is not vulnerable to inflation. A second group of assets, such as checking and savings accounts and CDs, are subject to short-term losses of 1%, but the rates of return on these typically adjust to changes in inflation within a year, limiting their long-term vulnerability to inflation. A third group of assets, such as long-term bonds and nominal DB pensions, see more substantial, long-term losses. In addition, those with mortgage or other debt will experience a relative increase in wealth as the real value of their debts decreases, at least partially offsetting any losses.

At the median, we found a minimal wealth decline (0.02%) resulting from a 1% increase in inflation. Thus, an increase in inflation from 2% to 6% would result in a wealth

loss at the median of 0.08%. The largest median loss would be among college graduates, for whom a 1% increase in inflation would result in a median 0.19% loss of net wealth. There is considerable variation across percentiles.: For example, among the total population, the 25th percentile of the change in real wealth was -0.50%. This implies that an inflation shock such as that associated with the pandemic would have resulted in a wealth loss of 2.0% for such households.

Economic vulnerability to inflation

Overall, the required adjustments to consumption to avoid running out of wealth later in life are small: Households with fewer economic resources rely more heavily on Social Security benefits to finance remaining lifetime consumption, and those benefits are indexed to inflation. Households with the most resources are most affected by an unexpected increase in inflation.

On average, single persons, who tend to have less wealth than married households, would need to reduce lifetime consumption by just \$500 on a base of \$317,500 to avoid running out of wealth. Married households would need to reduce consumption by \$1,500 on a base of \$667,600. For both single and married persons the effects would be greater among the more educated because of their greater wealth and its composition. For example, among single persons without a high school degree, lifetime consumption would need to decrease by just \$300. The group with the largest effects are married college graduates whose lifetime annuity payments would decrease by \$67,500. However, this would be largely offset by decreased bequests rather than decreased consumption.

Our overarching finding is that most persons older than 65 are not very vulnerable to an increase in inflation of the magnitude experienced in the COVID-19 pandemic.

Social Security plays a leading role in this outcome: It is an important asset for (almost) all older households, with a more even distribution across the population than other types of assets so that its inflation protection has the greatest relative benefit for those with fewest assets. Nonetheless, there is considerable variation in vulnerability

to inflation. For the older population, with their limited ability to make up for losses by returning to work, such unexpected financial shocks create an added sense of vulnerability, reducing their well-being beyond the measured financial loss. ❖

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Sponsor information: The research reported herein was performed pursuant to grant RDR18000002 from the U.S. Social Security Administration (SSA) through the Michigan Retirement and Disability Research Center

(MRDRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRDRC.

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