United Policyholders
Empowering the Insured

Liz Weston: 3 inflation-savvy moves to make now

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Inflation is proving to be a stubborn, unwanted houseguest.

No one particularly likes paying more for food, fuel and other living costs. But so far, the Federal Reserve's attempts since March to evict inflation with higher interest rates haven't worked. Because we may be stuck with this unpleasant roommate for a while, we should consider how best to cope.

The following moves could help.

CRAFT A BETTER PLAN FOR YOUR CASH

Many people live paycheck to paycheck with little savings. Other people have the opposite problem: They're letting too much cash sit idle in bank accounts that aren't earning their keep.

As of October, the national average interest rate on savings accounts is just 0.17%, according to the Federal Deposit Insurance Corp. Meanwhile, inflation as measured by the consumer price index is over 8%.

"There's just no way that cash in the bank is going to keep up with inflation, so it's going to lose value," says certified financial planner Ben Henry-Moreland, who blogs at Kitces.com, a site for financial advisers.

You can get inflation-beating returns by using savings to pay down any high-rate, variable debt, such as credit card balances. If your credit card charges 18% interest, for instance, you're effectively getting an 18% guaranteed return by paying off that balance.

Setting goals and timelines for your cash also may help you get more for your money, Henry-Moreland says. For example, financial planners typically recommend maintaining an emergency fund equal to three to six months' worth of expenses. That money should remain somewhere safe and accessible, such as an FDIC-insured bank account, because you may need it at any time. But you don't have to accept a brick-and-mortar bank's negligible return; several online banks are offering interest rates of 2% or more on savings accounts.

Perhaps you'll earmark some savings for the vacation you want to take in a year or the down payment on a house in five years. You could lock your vacation money into a one-year certificate of deposit (some online banks are offering 3% on those), while the down payment could be invested in a Series I savings bond, which is yielding 9.62 %. That's a great rate, obviously, but Series I bonds have several restrictions: You can't withdraw money for the first 12 months, and you'll forfeit three months of interest if you withdraw money in the first five years. You're limited to buying $10,000 in I bonds electronically at TreasuryDirect.gov each year and $5,000 more in paper bonds annually using your tax refund.

Consider using excess cash to beef up your retirement accounts or investing that money in a taxable brokerage account, Henry-Moreland says. A diversified portfolio of stocks is likely to outpace inflation over the long run, although the potential for short-term losses means you shouldn't invest any money you'll need within five years or so.

REVIEW YOUR HOMEOWNERS INSURANCE COVERAGE

Building costs have been soaring, and your homeowners insurance coverage may not be keeping up.

About two-thirds of homeowners who lose their houses to wildfires or other disasters discover their insurance won't cover the complete cost of rebuilding, says Amy Bach, executive director of United Policyholders, an insurance-focused consumer advocacy group.

You can ask your insurance company or agent to review your coverage and recommend appropriate limits, Bach says. But those estimates may rely on problematic industry software that could underestimate the costs, she says. She recommends you also talk to a contractor or appraiser who can give you an estimate of rebuilding costs per square foot in your area.

RUN A TAX PROJECTION

If your earnings increased this year, you may be at risk for "bracket creep." That's when you're pushed into a higher tax bracket — and face higher tax bills — even if your pay isn't keeping up with inflation.

Dozens of federal tax provisions can be adjusted for inflation each year, including tax brackets, standard deduction amounts, limits for retirement contributions and certain credits, says Melanie Lauridsen, director for tax practice and ethics at the American Institute of CPAs. Since 2018, however, Congress has required that the IRS use a measure of inflation called the chained consumer price index that typically lags the consumer price index. What's more, inflation adjustments for the following year are determined using the inflation rate in August, Henry-Moreland notes. If inflation spikes later in the year, as it did in 2021, bracket creep is more likely.

Let's say you got an 8% raise this year to cope with inflation. But the standard deduction and tax brackets increased by only about 3% for 2022. That means you could find yourself in a higher tax bracket when you file your returns in April.

Calculating your likely 2022 taxes now can alert you to any looming tax bill and give you some time to cope — by stuffing more money into pre-tax retirement accounts, for example, or filling out a new W-4 to adjust your withholding.