Impact of high inflation over a sustained period

April 2023

The purchasing power of cash-based savings will be severely impacted if the current high levels of inflation are sustained.

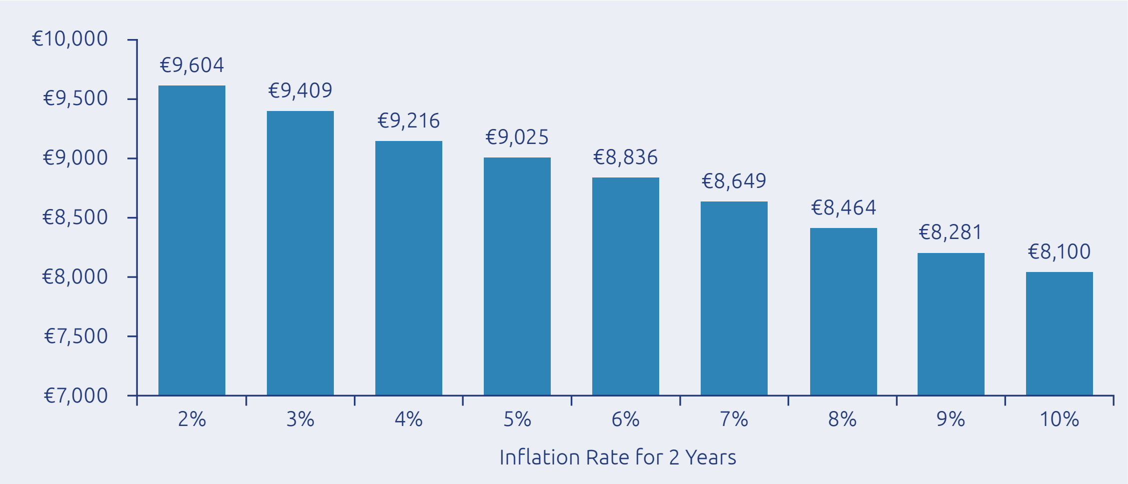
After a sustained period of low inflation in Ireland, there has been a significant spike recently, and people are undoubtedly worried about the impact on their hard-earned savings.

As Irish inflation soared to a near 40-year high[1] of 9.2%[2] in October 2022, consumers have had to contend with rising household energy bills, escalated cost of food and transport as well as the decreasing purchasing power of their money, deepening the cost-of-living crisis for many. Inflation was 7.7% in March 2023, mainly due to falling energy costs[3].

Here we look at the extent to which savings can be affected by inflation, and in particular the impact that a prolonged period of high inflation could have. For example, €10,000 in savings earning no interest would drop in buying power to just €8,464 after a two-year period of 8% inflation.

In contrast, if inflation was 2%, the European Central Bank's target level, after two years its purchasing power would be €9,604. Savers are consequently at risk of seeing their money erode in value quickly if the current situation lasts.

Impact of inflation on savings after 2 years



* For a €10,000 savings pot, assuming 0% interest for both years. This chart is for illustrative purposes only. Although the average deposit rate is currently 0.03%, higher interest rates will reduce the impact of inflation.[4]

The Irish economy has been feeling the effects of rising prices over the past year, as fuel, energy, and food costs surge. However, central banks are now forecasting a gradual decline in inflation levels, with both headline and core inflation now expected to be lower than previously forecast in 2023, at 5% and 3.5%, respectively.[5]

Deposit Guarantee Scheme

Although inflation may eat into your savings, it is important to note that your deposit may be protected by the Deposit Guarantee Scheme (DGS). The DGS is part of the Central Bank's strategy to ensure that the best interests of consumers of financial services are protected. The DGS is administered by the Central Bank and is funded by the credit institutions covered by the scheme. However, please note that the deposit guarantee scheme does not cover deposit options through insurance wrappers.

DGS protects:

- Eligible depositors in the event of a bank, building society and or credit union authorised by the Central Bank being unable to pay deposits.
- Up to €100,000 per person per institution.
- Current accounts, deposit accounts, share accounts in banks, building societies and credit unions.

With predictions that high inflation is likely to continue throughout 2023 and potentially beyond, how can you help ease your concerns about the effect on your investments?

1. **Revisit your financial goals** – the effects of increased prices will mean your current financial goals could take longer to reach than originally planned, or they might need to be adjusted. So now could be a prime time to revisit your plans and consider if you need to change. Is a significant portion of your savings/investment in deposits or cash funds? If you want to give your savings the opportunity to potentially grow in line with the rate of inflation (and, importantly, stand a chance of beating it) you may consider investing in funds over the medium to long term, which is generally five years or more. We recommend you speak to your financial adviser before making your decision.
2. **Have a direct debit detox** – Many of us rack up memberships and subscriptions that we could probably live without, so you may consider shopping around for a better deal.
3. **Prioritise spending** – Whilst times are tough, it's worth seeing if you can put off purchases you'd planned for a while longer. If it's not essential, you might be better waiting until you're confident that making that purchase now won't impact your standard of living. However, if you've been thinking about making a big purchase, such as a car or a required home improvement and have the capacity to do so, you might be better off going ahead now rather than waiting until later when prices could be even higher and the euro in your pocket worth less.
4. **Clear any outstanding debt** – When inflation rises, interest rates are generally increased to help control the economy. If you have any variable-rate loans or mortgages, the regular payments may go up as a result. So, it's best to review debt arrangements as a priority, making sure to reduce interest being paid as much as possible.

Warning: Past performance is not a reliable guide to future performance.

Warning: An investment in funds may be affected by changes in currency exchange rates.

Warning: The value of an investment in funds may go down as well as up.

Warning: If you invest in funds, you may lose some or all of the money you invest.

5. **Make the most of tax efficient savings:** The tax benefits on pension payments can be significant, effectively meaning it costs less to save more into a pension plan. So even if you're focussed on short-term finances at the moment, it's important to continue contributing to your pension: time in the market is one of the most important factors in investing, and if you choose to stop contributing, you may miss out on valuable contributions.

6. **Impact on Investment Returns:** It is important to note that inflation affects all aspects of the economy. Thus, understanding inflation is crucial to investing because inflation can reduce the value of investment returns.

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Check out our Fund Centre for our range of investment options or talk to your Financial Adviser.

[1] Source: REUTERS, Irish inflation hits 38-year high of 9.2%, 10 November 2022.
https://www.reuters.com/markets/irish-inflation-hits-38-year-high-92-2022-11-10/

[2] Source: CSO, Consumer Price Index, 10 November 2022. **https://www.cso.ie/en/releasesandpublications/ep/p-cpi/consumerpriceindexoctober2022/#:~:text=Prices%20on%20average%2C%20as%20measured,Beverages%20%26%20Tobacco%20(%2B8.7%25)**

[3] Source: CSO, Consumer Price Index, 13 April 2023. **https://www.cso.ie/en/releasesandpublications/ep/p-cpi/consumerpriceindexmarch2023/#:~:text=Key%20Findings,has%20been%20at%20least%205.0%25**

[4] Source: Central Bank of Ireland, Statistical Release – Retail Interest Rates – January2023, 09 March 2023.
2023m01_ie_retail_interest_rate_statistics.pdf (centralbank.ie)

[5] Source: Central Bank of Ireland, Quarterly Bulletin 2023:1 –inflation easing but expected to remain elevated, 08 March 2023.
https://www.centralbank.ie/news/article/quarterly-bulletin-2023-1-inflation-easing-but-expected-to-remain-elevated#:~:text=Inflation%20remains%20high%20but%20has,tight%20labour%20market%20conditions%20continuing

The information in this document should not be construed as financial advice or an investment recommendation and is based on our understanding on 14 April 2023. Never underestimate the importance of financial advice. Your financial adviser understands your financial position and your goals. They've worked with you to create your financial plan, know your attitude to risk and understand why markets rise and fall. Before making any decision, we recommend you speak to them. Past performance is not a reliable guide to future performance. The value of investments can go down as well as up and may be worth less than originally invested.