



How inflation bites into your hard earned savings

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Kenyans are yet to experience more shocks in terms of consumer prices, analysts including the Central Bank of Kenya have predicted. This is because the country's rate of inflation is said to have hit an all-time high since 1984 when it stood at 28.8 per cent.

The Kenya National Bureau of Statistics says the inflation rate stands at 19.1 per cent, up from 18.2 per cent in January.

A high inflation rate is not only bad for the cost of living but also for investors. According to Mr Perminus Wainaina, an investment analyst with Concept Advisory Services Limited, an investments and financial planning company, high inflation hurts people, especially those who are retired and living on a fixed income.

He says the hardest hit from inflation falls on fixed-income investors. For instance, an investor who bought treasury bills worth Sh1 million yielded about 10 per cent making Sh1.1 million, assuming that the inflation was positive for the year. On the current rate of inflation, though his purchasing power might have fallen, his expected returns will also be less. He explains that the rate of inflation is taken into account when calculating the rate of return. "If inflation was 14 per cent, then the return is really -4 per cent; a negative return," he adds.

The impact of inflation on a portfolio also depends on the type of securities held. Stocks' investors may not have to worry about inflation as in the long run, a company's revenue and earnings increase at the same pace as inflation. However, inflation can discourage investors by reducing their confidence in investments that take a long time to mature.

Jump in inflation

Mr Wainaina says investing in stocks is usually a good choice because a stock is not limited in its growth as compared to financial products such as bank accounts, which have a fixed rate of return. "If there is a jump in inflation over the amount of your fixed interest rate, one will be losing money," he says.

He notes that banks' savings accounts offer fixed interest rates, which are not high enough to take care of inflation. Currently, inflation is at 19 per cent whereas most savings' accounts interest rates are not above 3 per cent. This discourages savings because the money is worth more now compared to the future.

Mr Wainaina says high inflation not only disrupts the operation of a nation's financial institutions and markets, it also discourages their integration with the rest of the world's markets. Inflation causes uncertainty about future prices, interest rates, and exchange rates, which increases the risks among potential trade partners, thus discouraging trade.

As far as commercial banking is concerned, inflation erodes the value of the depositor's savings and that of the bank's loans. The uncertainty associated with inflation increases the risk associated with the investment and production activity of firms and markets.

Inflation also makes it harder for businesses to plan for the future. It is also very difficult to decide how much to produce, because businesses cannot predict the demand for their product at the higher prices they will have to charge to cover their costs.

Small time investors, mainly individuals, are the hardest hit by inflation unlike large investors.

Due to inflation, this individual cannot buy as much as he could previously. Inflation also makes financial planning hard for the common man. It discourages savings as money is worth more presently than in the future. Moreover, with no saving for the future, personal developments such as furtherance of education or even educating one's child may be a big challenge. And where such emergencies and future expenses can be transferred to parties like insurance companies with their education policies and medical cover, individuals cannot afford such services.

Mr Wainaina cautions that as prices of common goods and transport continue to rise, investors may opt to liquidate part of their stock holding before the period they had in mind. Even if they may not opt out, many investors will find themselves unable to save or invest, as their budgets will stretch their finances to the limit.

To beat the rate of inflation, individuals should invest their money with fund managers to achieve superior returns.

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