Purchasing power defined

Household purchasing power refers to the amount of goods and services an individual or household can afford to buy with their income. It's a measure of how much their money can buy, taking into account prices and the cost of living.

Key Concepts

- **Inverse Relationship with Prices:** Purchasing power has an inverse relationship with the price level of goods and services. When prices go up (inflation), your purchasing power goes down, meaning you can buy less with the same amount of money. Conversely, when prices go down (deflation), your purchasing power increases.
- **Erosion Over Time:** Due to inflation, the purchasing power of money typically erodes over time. The same amount of money will generally buy less in the future than it does today.

Why is Purchasing Power Important?

- **Reflects Real Value:** It gives a more accurate picture of the value of your money than just the nominal amount.
- **Impact on Living Standards:** Changes in purchasing power directly affect what people can afford, influencing their standard of living.
- **Economic Indicator:** It's a key metric for understanding the health of an economy. A decline in purchasing power can signal economic challenges.
- **Financial Planning:** Understanding purchasing power is crucial for long-term financial planning, such as retirement, as it helps estimate future costs.
- **Investment Decisions:** Investors consider purchasing power to assess the real return on their investments after accounting for inflation.
- **Wage Negotiations:** Workers consider purchasing power when negotiating wages to ensure their income keeps pace with the rising cost of living

Sources- multiple

Purchasing power calculated

To grow your purchasing power, increase disposable income faster than expenditures

(1) Disposable income exceeds your cost of living, resulting in **positive purchasing power each year**.

(2) **Real earnings are positive** since the change in wages (4.5%) exceeds changes in CPI (2.9%) in 2024.

My Purchasing Power

For illustrative purposes

Input with your personal data

		2023		2024		$ Change	% Change
Disposable Income[1]	**$**	**73,800**	**$**	**77,490**	**$**	**3,690**	**5.0%**
Gross income[2]	$	90,000	$	94,500	$	4,500	5.0%
Note: Wage income	*$*	*88,000*	*$*	*92,000*	*$*	*4,000*	*4.5%*
Taxes[3]	$	(16,200)	$	(17,010)	$	(810)	5.0%
Cost of living[4]	**$**	**56,740**	**$**	**60,312**	**$**	**3,572**	**6.3%**
Total necessary expenditures	$	57,500	$	61,200	$	3,700	6.4%
Note: Debt payments[5]	*$*	*32,100*	*$*	*33,800*	*$*	*1,700*	*5.3%*
Credit card rewards[6]	$	(760)	$	(888)	$	(128)	16.8%
Note: Change in inflation rate (CPI)[7]		*3.4%*		*2.9%*		*-0.5%*	*-14.7%*
My Purchasing Power[8]	**$**	**17,060**	**$**	**17,178**	**$**	**118**	**0.7%**
Savings[9]	**$**	**9,000**	**$**	**10,395**	**$**	**1,395**	**15.5%**
Discretionary balance[10]	**$**	**8,060**	**$**	**6,783**	**$**	**(1,277)**	**-15.8%**
Debt-to-income ratio[11]		**35.7%**		**35.8%**		**0.1%**	**0.3%**

(3) In 2024, cost of living (6.3%) increased faster than disposable income (5.0%) due to above-average price increases in housing, insurance, and healthcare expenses.

(4) Even with a higher cost of living, **purchasing power increased** year-over-year, boosted by cash-back rewards.

(5) Lenders generally prefer a debt-to-income ratio of **no more than 36%**, but the cutoff can sometimes be as high as 50%.

Worksheet download

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