DO YOU KNOW WHAT *YOUR* CPI IS?

The federal government announced in mid-January that consumer prices, as measured by the Consumer Price Index, rose 3.3 percent in 2004—the highest increase since 2000. But do you know what your personal inflation rate was for 2004? Or why it's important to gauge how much it rose? Or what you can do about it?

Your personal CPI and the national CPI are not likely the same. They may not even be close. As the Bureau of Labor Statistics notes, the national CPI "seldom mirrors a particular consumer's experience."

The CPI is a measure calculated by the U.S. Bureau of Labor Statistics of the average change in prices paid by urban consumers for a fixed market basket of goods and services. The measure is taken monthly, then annualized for the previous 12 months.

There's been much debate about how the CPI is calculated and whether it accurately reflects true price changes. Regardless, it's a widely used number. Social Security uses it to adjust benefit payments to retirees, it's a bargaining chip in wage negotiations, and the Federal Reserve uses it as one of many indicators in deciding whether to raise or lower interest rates (lately, the Fed has been raising interest rates in order to ward off more serious inflation).

But what does the national CPI say about your personal cost of living? Probably not a lot.

Take, for example, three major expenses for many families: housing, medical care, and college. Some critics say the national CPI underestimates the impact of these expenses. But beyond that, your personal CPI may differ dramatically from the national CPI depending on where you live and how much these three expenses figure into your cost of living.

The housing component of the national CPI average, which is based primarily on changes in rents and which factors out equity gains for homes, came in a mere 2.6 percent in 2004. So for renters, the national CPI might be closer to their personal CPI, but not for someone buying a home.

According to the National Association of Realtors, the national median existing-home price rose 8.8 percent in 2004. And in nearly half of 129 metropolitan areas surveyed, home prices rose in double-digit figures, including a 47 percent increase in Las Vegas and better than 30 percent increases in certain markets in California and Florida.

Yet in some regions, prices barely budged. Even within a specific market, price increases can vary depending on the price range of the type of house you're looking for.

While the national CPI's medical-care component rose only 4.2 percent in 2004, the reality for many people is that the cost of medical care rose dramatically faster. This is especially true for older people who typically spend much more on health care than the average person.

Families with children in college also will have a different—typically higher—personal CPI than families who don't have children in college. The "education and communication" component of the national CPI showed a mere 1.5 percent increase. Yet the average increase for the cost of tuition for in-state students at four-year public colleges for the 2004–2005 school year rose 10.5 percent, according to the College Board. That came on the heels of a 13 percent rise the year before.

All of this illustrates that your personal consumer price index may be quite different from the national CPI, and you need to plan your finances accordingly. In some cases, personal CPIs may be lower than the national average, but for others it will be higher. What can you do with your own CPI?

Plan for it. When calculating your budget or perhaps future retirement needs, be sure to take into account *your* inflation rate.

Trim high inflation areas. You may have the flexibility to trim expenses in some areas. If necessary, you can send your child to a less expensive college or you can buy a less expensive home. It's more difficult for some expenses such as medical care, though one can make savings there, too.

Review your investments. A diversified portfolio can go a long way toward helping combat inflation. Assuming you have ample investment time ahead—say at least five to ten years—you should consider investments that have a history of outpacing the rate of inflation, such as stocks and investment real estate.

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