

— YOUR GUIDE TO —

INFLATION AND HOW IT CAN AFFECT YOUR WEALTH

How has inflation affected the cost of living in the UK?

INFLATION AND RETIREMENT:
COULD IT ERODE YOUR SPENDING POWER?

The Retail Price Index:
How has your grocery bill changed?

2 WAYS YOU COULD PROTECT YOUR RETIREMENT INCOME FROM INFLATION

YOUR GUIDE TO INFLATION AND HOW IT CAN AFFECT YOUR WEALTH

“ *Inflation is taxation without legislation.*

- Milton Friedman, American economist, statistician, and recipient of the 1976 Nobel Prize in Economic Sciences



You've likely seen headlines about high inflation in the past few years and may have noticed general expenses such as energy bills or groceries increasing too.

Indeed, according to the Office for National Statistics (ONS), inflation reached a peak of 11.1% in October 2022.

In simple terms, inflation means the cost of goods rise. The higher the rate of inflation, the quicker prices are rising. Rising costs, especially when it's at a rate higher than expected, can place families and businesses under financial pressure.

Fortunately, price rises have slowed in recent years but inflation could still affect your finances.

In fact, data from the ONS reveals that between 7 May and 1 June 2025, 86% of UK adults said the cost of living crisis was one of the most important issues the country faced.

Understanding inflation and how it affects your wealth is crucial for creating an effective budget. It can also help you understand how the value of your assets will change over the long term. As inflation isn't something you have control over, it can be difficult to calculate the effect it can have on your plans. Read on to find out more about inflation and what it could mean for you.



HOW IS INFLATION CALCULATED?

In the UK, the ONS is responsible for measuring inflation and reporting the findings, while the Bank of England (BoE) is tasked with for keeping inflation stable.

The headline figures for inflation you see in the news are usually from the Consumer Price Index (CPI). To calculate this, the ONS looks at 180,000 prices for around 700 different items that it puts into a "shopping basket" of goods. The items in the shopping basket change depending on shopping habits and range from food to transport. Back in 1940, women's corsets and condensed milk were staples included, whereas in 2025, virtual reality (VR) headsets, exercise mats, and pre-cooked pulled pork were added.

The average cost of the goods in the basket is then compared with the cost of the previous year to deliver an inflation rate.

Using the CPI, in the 12 months to May 2025, the rate of inflation was 3.4%

While CPI can give you a useful snapshot of how the cost of living has changed, it does have limitations. For a start, it only measures items that are in the basket. The data can also be skewed if one area of spending has seen prices rise rapidly.

There are other ways of calculating inflation too. The Retail Price Index (RPI) is similar to the CPI but also includes mortgage interest payments, so it's influenced by house prices and interest rates. As a result, the RPI in May 2025 was higher than the CPI at 4.3%.

Confusingly, the UK uses both the CPI and RPI when calculating price increases. So, while your State Pension may increase by inflation as measured by CPI under the triple lock, an index-linked annuity purchased in retirement may be linked to RPI.



Is inflation good or bad?

A bit of inflation can be a good thing for the economy. It can encourage people to spend now as they expect prices to rise in the future. This, in turn, means businesses have the money to invest.

However, too much inflation can have the opposite effect. Rather than encouraging people to spend more, people may choose to delay spending either because they think they'll get a better deal by waiting or because they're worried about other costs increasing.

Maintaining the "right" level of inflation is the responsibility of the BoE. The Bank has a target to keep inflation around 2%. This is designed to stimulate the economy without encouraging people to hoard money.

Why high inflation is linked to rising interest rates

When inflation is high, one of the things the BoE can do is raise interest rates. Higher interest rates mean the cost of borrowing rises, so consumers and businesses have less money to spend. As a result, it can help to slow down inflation.

The BoE implemented this approach by increasing its interest base rate multiple times, reaching a peak of 5.25% in September 2023. The rate has since fallen to 4.25% as of July 2025.

3 other "-flations" that could affect economies and wealth

Inflation is covered a lot in the news, but there are other "-flations" in finance that can affect economies and wealth.

Deflation: This is the opposite of inflation, and occurs when the price of goods and services fall. It typically signals that there is high supply but low demand.

Hyperinflation: Hyperinflation refers to a period of extreme inflation, typically when prices have increased by more than 50% in a month.

Stagflation: When the economy is experiencing slow growth and high levels of unemployment at the same time, it is known as "stagflation".

HOW HAS INFLATION AFFECTED THE COST OF LIVING IN THE UK?

“ The arithmetic makes it plain that inflation is a far more devastating tax than anything that has been enacted by our legislatures. The inflation tax has a fantastic ability to simply consume capital.

- Warren Buffett, American business magnate and investor



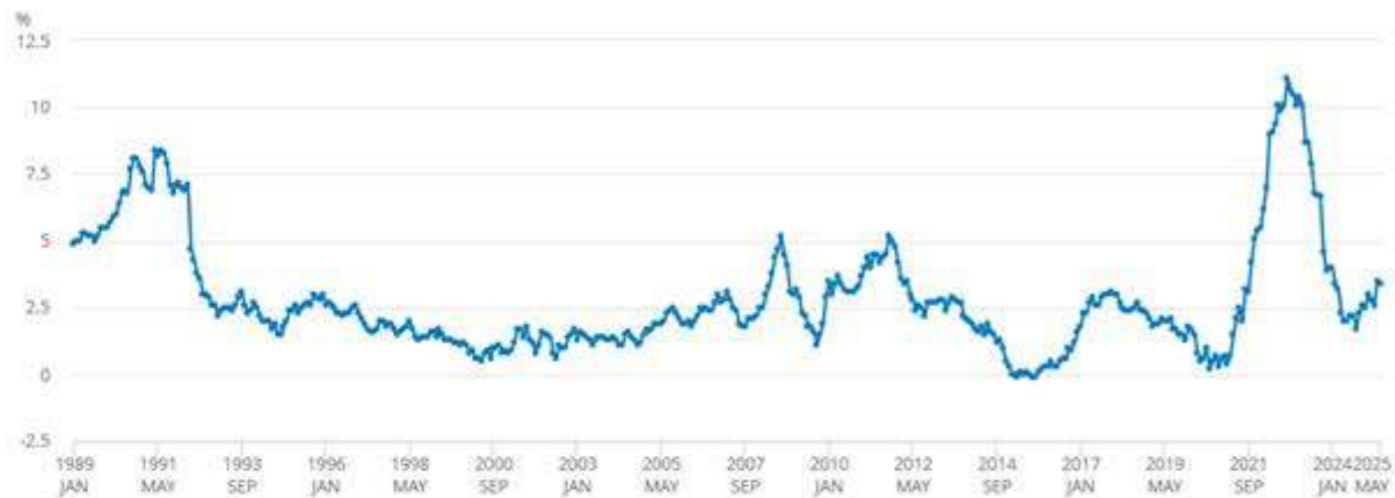
The UK has benefited from relatively stable rates of inflation for more than a decade. Even so, you will have noticed that the cost of living has increased.

The average annual increase in inflation can seem insignificant when you look at it in isolation, but inflation has a compounding effect. For instance, if you had an income of £1,000 a month in 1989, the [Bank of England](#) (BoE) calculates that you'd need to earn an income of £2,651.39 a month in May 2024 to meet the same standard of living.

Inflation will provide an idea of how your overall

expenditure has changed or will change. However, there will be a large difference between different items included in the CPI measurement. Wider market conditions mean household energy bills increased at a much faster pace than the headline CPI figure in 2021, for example. So, you may notice some of your expenses rising due to inflation more than others.

As the graph below demonstrates, the rate of inflation in the UK has varied a lot. There have been periods where the cost of living decreased, and others where it's exceeded 11%.



Source: [Office for National Statistics](#)

Since 1989, the highest point of inflation was 11.1% in October 2022, but you may remember inflation being much higher in the 1970s and 1980s. An oil crisis led to inflation reaching 12.9% in March 1974, which led to many families struggling and unemployment rising.

WHY HAS INFLATION INCREASED IN RECENT YEARS?

While between 2021 and 2024, inflation didn't reach record highs, the figures were still well above the BoE's target.

The BoE explained that there's more than one reason why the rate of inflation started to rise in 2021, but a lot of it had to do with the economy recovering from the Covid-19 pandemic. As lockdown restrictions eased and the economy reopened, people began spending more money.

However, lockdowns around the world created supply shortages and challenges in shipping goods, and this block in the supply caused prices to rise.

The last few years have presented unique challenges to families, businesses and economies, but as the recovery continues, the inflation rate has returned to lower levels.

RISING INFLATION AFFECTS THE COST OF BORROWING TOO

Inflation doesn't just affect the cost of purchasing items or services - it also affects the cost of borrowing.

One of the things the BoE can do to control inflation is to increase interest rates. This is a step the Bank took in the past few years when it increased the interest base rate several times, reaching 5.25% in September 2023. While interest rates are falling again, they remain relatively high, and the rises have affected millions of families.

If you are repaying debt that doesn't have a fixed interest rate, the amount of interest you pay is likely to rise as the BoE changes the base rate. For larger forms of debt, such as a mortgage, even a small change in the interest rate can have a huge impact on expenses and disposable income.

The table shows how even a relatively small increase in interest rates can affect the cost of a £200,000 repayment mortgage over a 25-year term.

Interest rate	Monthly repayment	Interest paid over the full term
3%	£948	£84,478
4%	£1,055	£116,570
5%	£1,170	£150,882
6%	£1,289	£186,658

Source: [Money Saving Expert](#)

So, as inflation and interest rates rise, families also need to consider how it will affect their borrowing and long-term plans.

THE RETAIL PRICE INDEX:

HOW HAS YOUR GROCERY BILL CHANGED?

The Retail Price Index (RPI) measures how regular purchases have changed in value. From what you pick up at the supermarket to electronic goods, RPI is used to measure the rate of inflation in the UK.

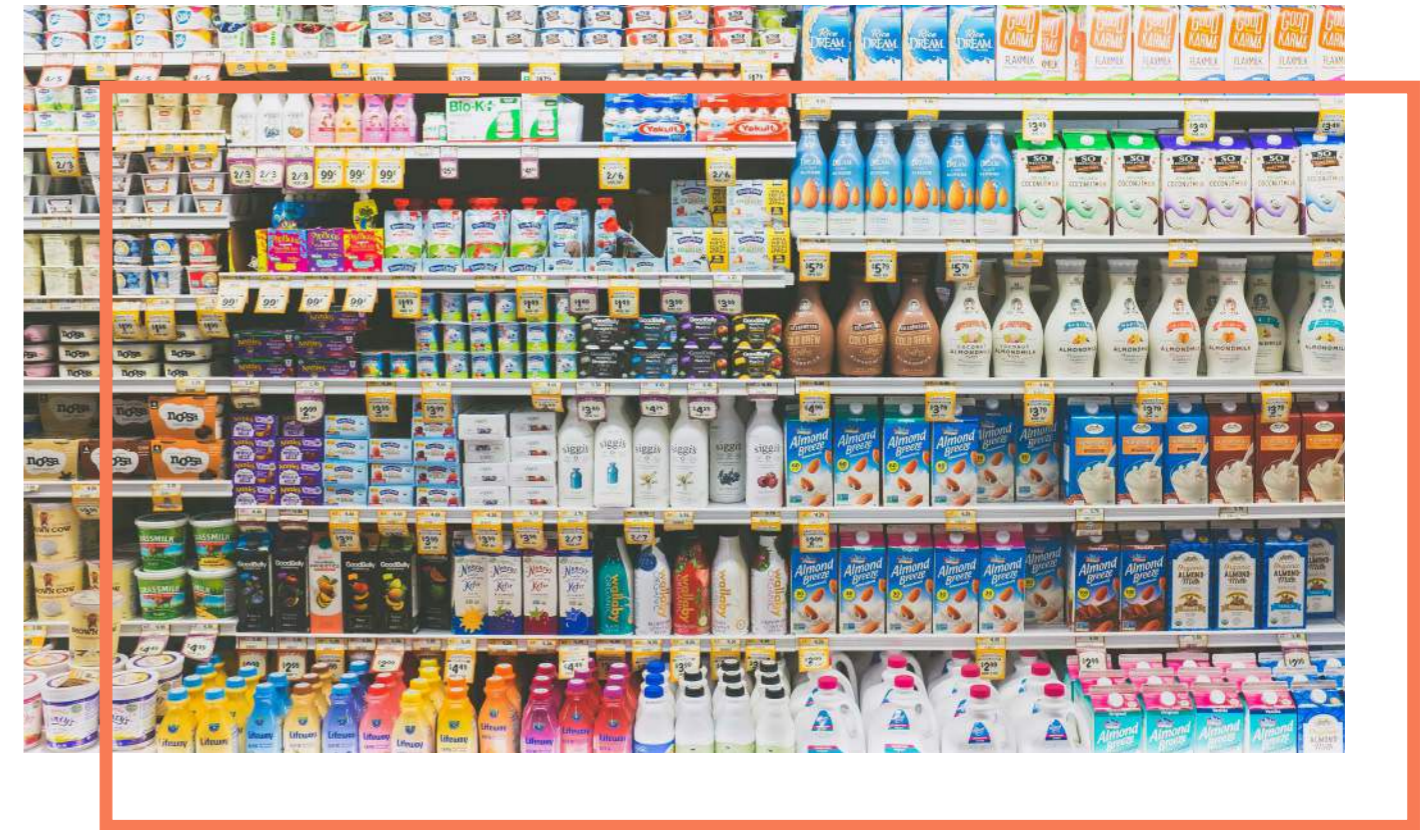
When you look at how supermarket staples have changed in price, you might be surprised to see

that some of the things you regularly put in your basket have changed little over the years, and in some cases, have even become cheaper.

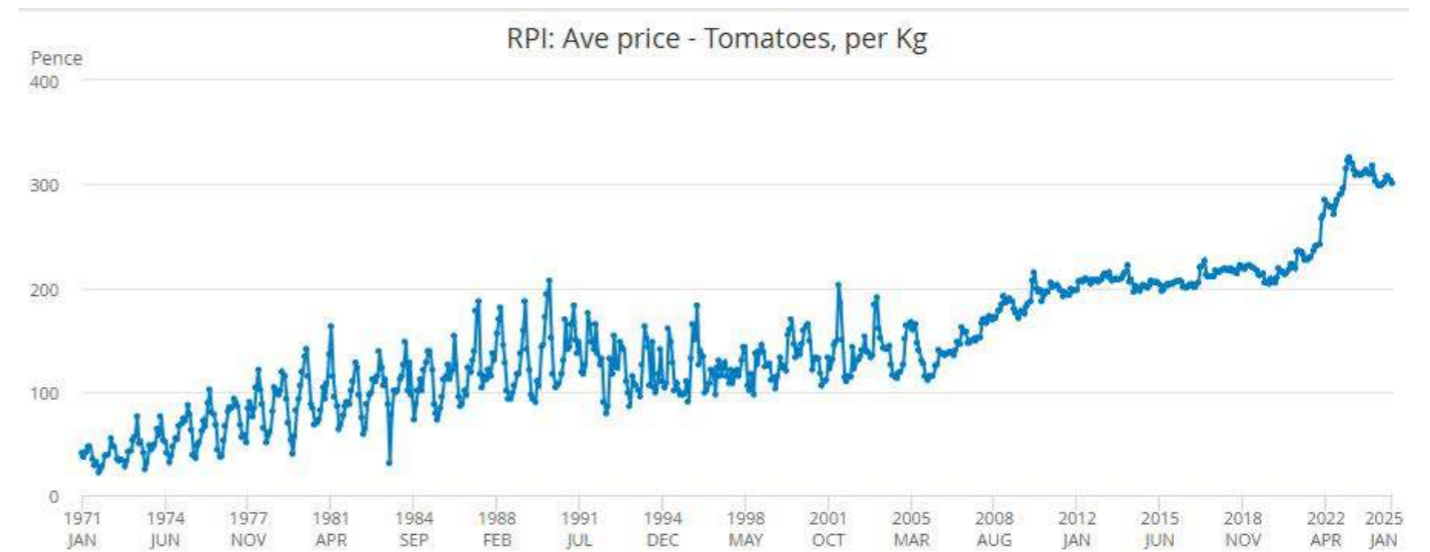
Here are how some of your kitchen essentials have changed in price between January 1995 and May 2024.

	Price in January 1995	Price in January 2025
 1kg oven-ready chicken	£1.96	£3.78
 1kg British-farmed minced beef	£3.39	£8.43
 1kg of old white potatoes	£0.58	£1.52
 Cauliflower	£0.86	£1.25
 1kg of dessert apples	£0.66	£2.14
 1kg of oranges	£0.22	£0.42
 Pint of milk	£0.37	£0.65
 250g of teabags	£1.21	£2.64

Source: [Office for National Statistics](#)



When you look at how inflation has affected the value of goods, you can see that grocery prices have become more stable, particularly for fresh produce. The graph below shows the price of 1kg of tomatoes. Throughout the 20th century, the price was affected by the seasons far more than the last two decades.



Source: [Office for National Statistics](#)

It's not just the food and drink that you purchase in shops that are considered either; from restaurant meals to a drink in the pub, your spending in a variety of places is affected by inflation.

In February 1987, if you wanted a pint of draught lager, you'd expect to pay around £0.92. It's been many years since a pint was less than £1 and in January 2025, the average price of a pint was £4.83. That's a price increase of 425%.

As well as food and drink, measuring inflation considers everything from electricity to packaged holidays.

QUIZ

HOW MUCH DOES IT COST?

While you've probably noticed your grocery shopping has crept up over the years, can you remember how much items used to cost?

1. In May 2025, a pint of milk would set you back £0.65. What did it cost in 1990?

6. How much would 1kg of Cheddar cheese cost you in 1997? Today, it would cost around £8.63.

2. A white loaf of sliced bread cost £1.40 in 2025. What was the average price in 2013?

7. Iceberg lettuce cost £0.92 in 2025, but how much was it at the end of 2004?

3. A 250g butter block cost £2.43 in 2025. What did it cost in 2016?

8. If you purchased a kilogram of bananas in 2025, it would cost £1.02. What would it cost in 1995?

4. In 1992, how much would you pay for 1kg of best beef mince? In 2025, it was £8.43.

9. 100g of pure, instant coffee cost £3.85 in 2025. How much was the same item in 1992?

5. 1kg of chicken to roast cost £3.78 in 2025. What was the price in 2007?

10. How much would you pay for 250g of tea bags in 1986? In 2025, it would set you back £2.64.

Answers are on page 24

Source: [Office for National Statistics](#)



THE ECONOMIC IMPACT OF DEFLATION



It's not just periods of hyperinflation that can affect the economy – deflation can too. Perhaps one of the most well-known periods of deflation occurred during the economic depression of the 1930s, dubbed the “Great Depression”.

The depression started in the US in 1929 and lasted until 1933. On 29 October 1929, the stock market crashed on a day that's become known as “Black Tuesday”, when investors traded some 16 million shares on the New York Stock Exchange in a single day. Between 1929 and 1932, it's estimated that worldwide GDP fell by 15%. This compares to a fall of less than 1% during the 2008/09 financial recession.

In the US, prices fell an average of 10% a year between 1930 and 1933, and coupled with a dramatic drop in output, it had a profound impact on the economy. Deflation affected prices and led to firms laying off workers and struggling to meet debt obligations. In turn, this affected household income and increased the chances of families defaulting on debts too, which led to banks failing. This created a vicious circle as the money stock contracted further and prices, employment and output all continued to decline.

BALANCING INFLATION

While the aforementioned case studies of deflation and hyperinflation are extreme examples, they do highlight why managing inflation is an essential part of the Bank of England's (BoE) responsibilities. Too much inflation can lead to currency devaluing, too little can play a role in an economic recession.

The rate of inflation has a huge effect on the way people, businesses, and governments spend or use their money. The BoE's 2% inflation target aims to keep the UK's inflation low and stable.

HAVE YOUR ASSETS AND INCOME KEPT PACE WITH INFLATION?

If the value of your assets doesn't rise at the same pace as inflation, they are losing value in real terms.

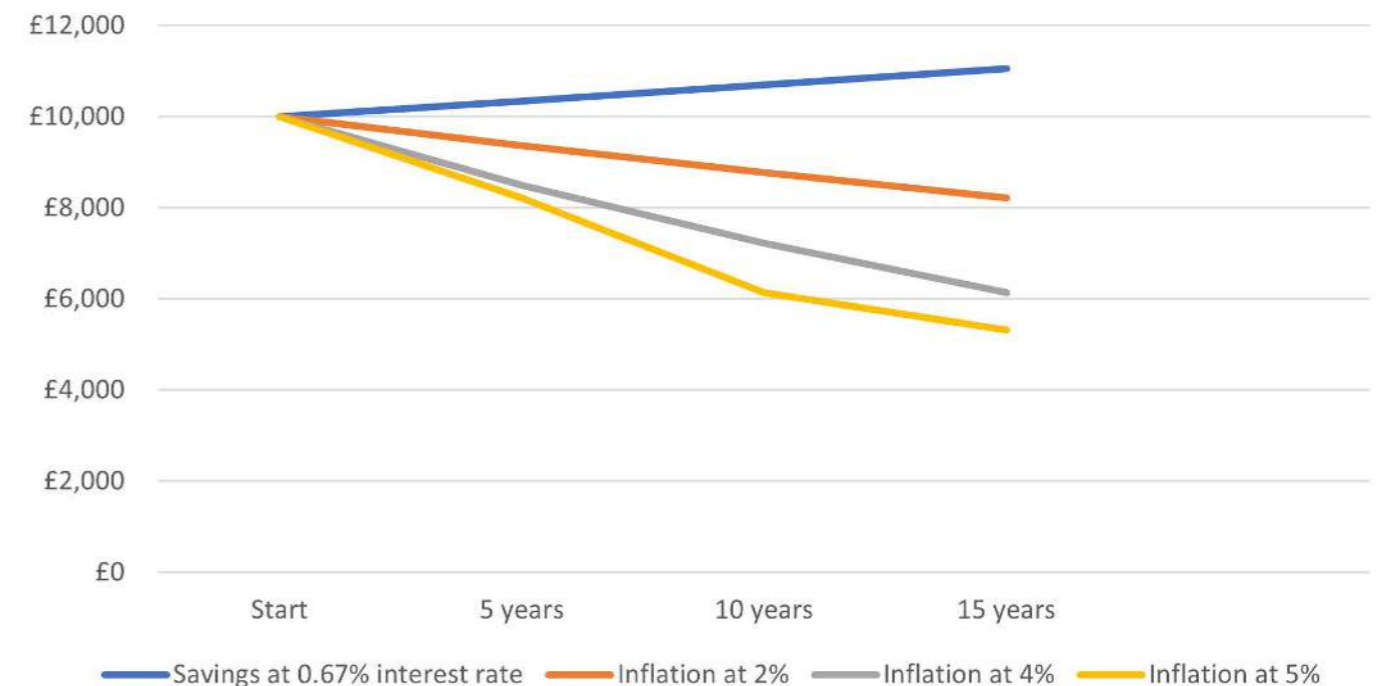
How the value of your assets has changed over time will depend on a plethora of things, but the data below can give you an idea of how your assets and income may have increased or decreased in value over time.

SAVINGS VS INFLATION

While money sitting in a savings account doesn't change in value, other than some interest normally being added, its spending power can decrease. As the cost of goods and services rise, savings that aren't earning enough interest to match or outpace inflation will gradually be able to buy less and less.

Royal London compared the growth of £10,000 held in a savings account over 5, 10, and 15 years, assuming an interest rate of 0.67%. The below graph highlights how different rates of inflation will reduce the value of your savings in real terms over time.

Value of £10,000 in a savings account with a rate of 0.67%



Source: [Royal London](#)

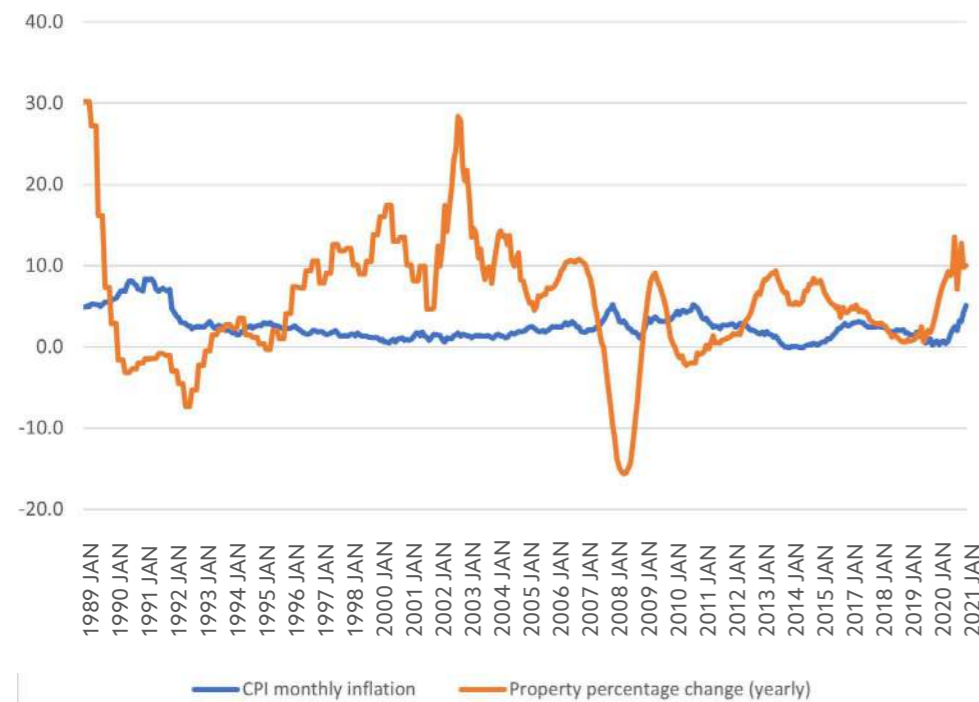
While interest rates have started to rise in the last couple of years, the rate of inflation may still be higher. If you hold money in a savings account, when you consider the effects of inflation, the value of your savings may be decreasing in real terms.

PROPERTY VS INFLATION

Property prices have been soaring in recent decades. According to the ONS, the average UK house price was £265,000 in the 12 months to April 2025. For many people, their home is one of the largest assets they own. So, how have property prices fared against inflation?

The graph below shows the annual percentage change of property prices in the UK compared to the inflation rate. While there are some occasions where property prices have fallen sharply when compared to inflation, notably during the 1990s recession and following the 2008 financial crisis, property prices have largely outpaced inflation. If you've been a homeowner for several decades, it's likely the value of your property has increased in real terms.

Inflation vs Property



Source: [Land Registry](#)



WAGES VS INFLATION

Inflation doesn't just affect how much the items you buy cost, but how far your income will go. If your income fails to keep up with inflation, you may have to adjust your budget and plans.

The graph below shows how average wage growth compares to inflation between 2001 and 2021. At times, wages have increased at a faster pace, so, on average, spending power will have increased, but there are times when your income may have been worth less in real terms.

Inflation vs Income



Source: [Office for National Statistics](#)

The data highlights how economic factors affect wage growth. The two largest dips occur following the 2008 financial crisis and in 2020, when many workers received a lower income due to being furloughed during the Covid-19 pandemic, with a sharp rise following the pandemic restrictions being lifted.



WHY INFLATION COULD MEAN THE VALUE OF YOUR SAVINGS IS FALLING IN REAL TERMS

Putting your money in a savings account is often seen as a safe way to preserve your wealth. After all, it's there to access whenever you need it and the figure in the account isn't going to decrease. Assuming you stay within the limits of the Financial Services Compensation Scheme, your money is protected even if a bank or building society fails.

However, once you factor in inflation, the value of your savings is probably falling in real terms. As the cost of living rises, the spending power of your savings has decreased. So, while your savings may remain the same, or grow modestly, you will be able to buy less with the money.

For short-term saving goals, the effects of inflation on your savings will be minimal. But, if you're planning to hold that money for a long period, annual inflation can quickly compound.

If you deposited a lump sum of £40,000 into your savings account in 2010, it will have needed to grow by more than £15,478.96 just to provide you with the same spending power in May 2025, according to the [Bank of England](#).

If your savings account has matched the pace of inflation, your savings will be worth the same in real terms. However, it's likely the interest your savings have earned has been below the rate of inflation.

Interest rates were at historic lows between 2008 and 2021. As a result, it's likely that any savings you have will have fallen in value in real terms over the long term.

What's more, as inflation is falling, the base rate is also coming down, potentially making it more difficult to secure favourable interest rates on your cash savings.

When you consider how inflation might affect your savings, which you may have thought of as "safe", it's easy to see why inflation could be a significant threat to your personal finances.

What is the Financial Services Compensation Scheme (FSCS)?

The FSCS protects your money when financial firms fail.

If you hold money with a UK-authorized bank, building society, or credit union that fails, you will automatically be compensated up to:

- £85,000 for each eligible person, per bank, building society, or credit union.
- £170,000 for joints accounts, per bank, building society, or credit union.

Temporary high balances, such as inheritances or insurance pay outs, of up to £1 million are also protected for six months from when the amount was first deposited.

It's important to note that if you have money in multiple accounts with banks that are under the same banking group, they are treated as one bank under the FSCS.

You can find which banks share a licence [here](#).



“Inflation is as violent as a mugger, as frightening as an armed robber, and as deadly as a hitman.”

– Ronald Reagan, 40th president of the USA

DOES INVESTING PROVIDE A SOLUTION?

For some savers, investing could provide a way to ensure their wealth keeps pace with inflation or exceeds it.

Investing your money in stocks, shares, bonds, and other assets could deliver returns higher than the interest rate you receive on a savings account. This can help you maintain your spending power or even help to grow your wealth over the long term.

However, investing does expose your money to risk. All investments carry some level of risk and investment markets experience periods of volatility. For this reason, you should only invest if you have a time frame of at least five years. This provides an opportunity for the peaks and troughs to smooth out.

How long you will be investing plays a role in your risk profile, which evaluates what level of investment risk is appropriate for you. Your risk profile should also consider things like your investment goals, other assets you hold, and your attitude to risk. If you'd like to discuss your risk profile, please contact us.

Investment values can fall, and stock market crashes do happen, but looking at the long-term trend is important.



Thinking about investing? An ISA could be right for you

An ISA can provide a tax-efficient way to save or invest.

Returns from investments held in a Stocks and Shares ISA are free from Income Tax, Capital Gains Tax, and Dividend Tax. Choosing to invest through an ISA can reduce your tax bill and help your money go further.

For the 2025/26 tax year, you can place up to £20,000 into an ISA. This allowance can either be held in a Cash ISA, a Stocks and Shares ISA, or spread across both.

This is because, historically, stock markets have recovered following a crash. The crash in 2020 caused by the Covid-19 pandemic highlights this. According to the [Guardian](#), the FTSE 100, an index of the 100 largest companies listed on the London Stock Exchange, fell by 14.3% in 2020, its worst-performing year since the 2008 financial crisis. During those 12 months, investors experienced high levels of volatility.

Seeing investment values fall can lead to concern, yet the markets did recover relatively quickly. Those investors that held their nerve and didn't sell during the volatility are likely to have benefited overall. In fact, in 2021, the FTSE 100 bounced back to finish 14.3% up after its best year since 2016, a [Guardian](#) report finds.

If you are thinking about investing, it's important to note that returns cannot be guaranteed and past performance is not a reliable indicator of future performance. You should take the time to assess your circumstances and how investing can fit into your financial plan.

Why you still need to maintain an emergency fund

When you look at the effect inflation is having on your savings, it may be tempting to move all of your money into investments. However, it's still important to have an emergency fund that you can access when you need it.

As well as being accessible, you know the money held in a savings account won't decrease. In contrast, what if you needed to pay for roof repairs or were unable to work during a period of investment volatility? The value of your investments may have fallen, which could mean you don't have enough or affect long-term plans as you may be forced to sell more units than expected to withdraw the required amount.

How much you should hold in an emergency fund will depend on your circumstances, but three to six months of expenses is often advisable.

What are your options if investing isn't right for you?

Investing your money can be attractive, but it isn't the right option for every circumstance. If holding your money in cash makes sense for you, there are still some things you can do to reduce the effects of inflation, including:

- **Shop around for the best deal:** Even a small difference in interest rate can add up over the long term. Before you find a home for your savings, spend some time shopping around for the best deal.
- **Switch accounts regularly:** If you want to make your savings work as hard as possible, be prepared to switch savings account regularly. Keep an eye out for providers offering incentives to new customers, such as £100 to boost your savings or a higher initial interest rate.
- **Lock your savings away:** If you won't need access to your savings in the short term, locking your money away for a set period, say two years, can mean you benefit from a higher rate of interest.

INFLATION AND RETIREMENT: COULD IT ERODE YOUR SPENDING POWER?

While it can be easy to overlook the effects of inflation day-to-day, it can have a huge effect on your retirement lifestyle if you've not thought about it.

It's not uncommon for retirement to span several decades. Over the years, inflation will add up and your retirement income won't stretch as far. If you overlook inflation, it could mean you struggle financially in your later years or you'll be unable to cover unexpected costs, such as needing some form of care.

The [Bank of England's](#) inflation calculator demonstrates how inflation could reduce your spending power in retirement. Let's say you retired in 2013 and began taking an income of £28,000 to live comfortably. The average annual rate of inflation over the next decade is 3%. So, to achieve the same standard of living in

2023, your income will need to have increased to £37,571.

Now imagine the effect inflation could have over a full retirement that is likely to be two or three times longer, especially if the rate of inflation is much higher. If you hadn't planned to take a greater income in your later years or haven't taken steps to increase your wealth, you risk running out of money or needing to cut back your plans.

According to research from Pensions Age, only 48% of mid-retirees aged 65 to 75 are confident their savings will last throughout retirement. Reviewing your finances at retirement and how your income needs will change over time can provide you with the peace of mind you need to enjoy the next chapter of your life.

How long will your retirement last?

The effects of inflation compound over time. So, it's important to think about how long you will be retired for.

The current State Pension Age in the UK is 66. Assuming you retire at this age, a man has an average life-expectancy of 85, so would spend almost two decades in retirement. For a 66-year-old woman, the average life-expectancy is 87.

While these figures can give you a rough idea of how long retirement can be, keep in mind that many retirees will live beyond the average age. For instance, a woman aged 66 has a 1 in 4 chance of celebrating her 94th birthday.

So, when calculating the effects of inflation on your retirement income, you need to think in decades rather than years.

Source: [Office for National Statistics](#)

2 WAYS YOU COULD PROTECT YOUR RETIREMENT INCOME FROM INFLATION

As you retire, considering how to make sure your income keeps up with inflation can safeguard your future. Among the options to consider are the following two:

1. **Purchase an annuity that's linked to inflation**

An annuity is something you can purchase which will then provide an income for the rest of your life. It's an option that can provide financial security throughout retirement.

You can choose to purchase an annuity that will deliver an income that increases each tax year in line with inflation. This option will usually mean the annuity rate you're offered is less, but, as it rises with inflation, it will maintain your spending power.

If you're planning retirement with a partner, you may also choose a joint annuity that will provide an income for your loved one if you pass away (again, this may be linked to inflation).

2. **Leave some of your pension invested**

An alternative to purchasing an annuity is flexi-access drawdown. With this option, you can withdraw a flexible income from your pension to suit your needs, while the rest will typically remain invested.

As the money is invested, it has an opportunity to grow throughout your retirement and help your savings keep pace with inflation. However, investment returns cannot be guaranteed, and you will be responsible for ensuring your pension continues to provide an income for the rest of your life.

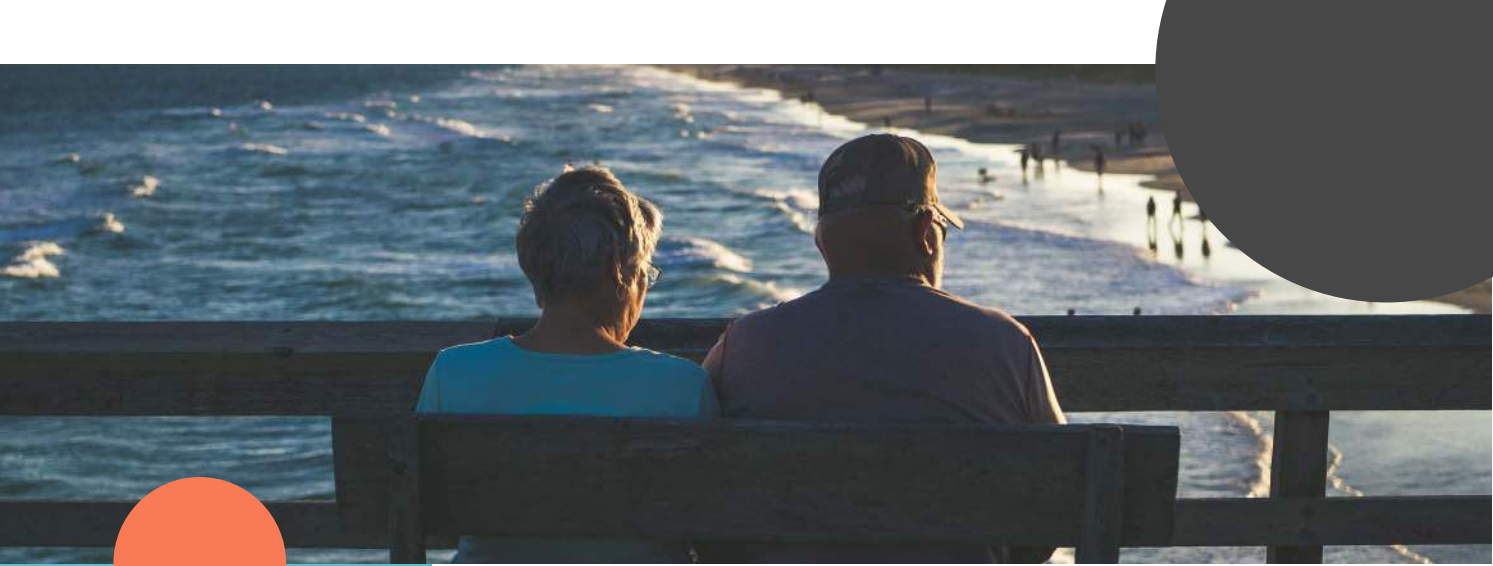
Depending on your circumstances and assets, there may be other options for you. Keeping the long-term effects of inflation in mind when you retire can help you create a robust plan that's right for you.

How will your income needs change over your retirement?

While you may set out how much income you need at the start of retirement, will this change over time? Your lifestyle is likely to change significantly during your retirement and affect what income you need, and inflation may affect this too.

Traditionally, retirees have spent more in the first years of their retirement as they enjoy their new freedom and tick off aspirations before spending settles. However, if you need care later in life, your outgoings are likely to rise significantly. While you may set money aside to pay for care if it's needed, have you considered how inflation will affect the cost?

Alternatively, you may help to financially support children or grandchildren in the future, and you should consider how inflation may affect the level of support you want to provide.



Building a long-term financial plan that considers the effects of inflation

Inflation can affect your day-to-day outgoings and there's a danger that it can affect your long-term plans and financial security too. As a result, it's essential that inflation is considered when you're setting your financial goals and creating a plan that you can have confidence in.

If you're worried about the effect inflation could have on your plans, or want to speak to a professional about the steps you can take, please contact us.

Contact Us

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Please note: This guide is for general information only and does not constitute advice. The information is aimed at retail clients only.

How much did it cost?

Answers: 1. £0.32. 2. £1.27. 3. £1.48. 4. £3.55. 5. £2.47. 6. £5.25. 7. £0.62. 8. £0.81. 9. £1.24. 10. £0.96.