Raging Inflation: These Are the Worst Money Mistakes You Can Make During High Inflation

Description

Supply shortages, higher demand, low interest rates — by now we all know the story of high inflation in Canada. As of writing this, inflation continues to climb upward, clocking in at 5.1% in January — the highest it's been in 30 years.

Inflation makes people do weird things with their money, like buy gold and crypto (not guaranteed inflation hedges, by the way). It has a way of inducing panic, and we all know how panic affects our money decisions: badly. If you're feeling a dose of inflationphobia right now, here are four money mistakes you should avoid making.

1. You hold on to large wads of cash

Now, don't get me wrong. Holding lumps of cash can serve a purpose. It could be an emergency fund. Or it could be a down payment on a home. In these cases, you don't want to risk losing your cash, and it's okay to hold them in a savings account.

Aside from these, however, holding on to cash in high inflation is a bad idea. Not a single savings account will help your cash pace with inflation, not even high-yield accounts. Even if you're not losing money directly, inflation will eat into your cash's power to buy what you want.

Consider investing your cash in growth stocks, ETFs, index funds, or other investments that have a greater potential to earn you money. As long as you choose your investments wisely, you can outpace inflation, not to mention help you gain enormous returns over the long run.

2. You invest in GICs

A GIC is an investment that offers you a higher interest rate than savings account — that is, if you agree to lock your money away for a fixed period of time.

Of course, like any investment, every GIC comes with different rules and loopholes that make access to your money more or less difficult. A cashable GIC, for instance, typically has a one-year term but will allow you to access your money after only a few months. Redeemable GICs, however, allow you to withdraw your cash at any time.

No matter what GIC you choose, now is the *worst* time to get one. In this climate of low interest rates, a high rate on a GIC is still more than a few hundred points below inflation. You might earn 1.50% back if you lock into a five-year non-redeemable GIC. With inflation at 5.1%, you're basically losing 3.6%, at least until inflation falls.

3. You take out high-interest debt

In periods of high inflation, taking out high-interest debt is one of the worst decisions you can make.

High inflation benefits lenders, not borrowers. Imagine for a moment that you borrow $32,000 to buy a car this year. Last year the same model car would have cost $30,000, which means inflation pushed the price up $2,000. You take out a loan for $32,000 with a 10% APR. This is great for the lender: they'll make more money off the $32,000 loan then they would have made off the $30,000 one. So, not only are you paying more for the car, but you're also paying more to borrow money.

But then consider this: when prices stabilize — when supply chains loosen up and demand cools — that car's value could drop again to $30,000. Your loan will still be for $32,000, which means now you're paying more in APR for an overinflated vehicle. Take about a lose-lose situation.

4. You hoard credit card rewards

Just like inflation can erode the purchasing power of your cash, it can devalue your credit card points.

For instance, let's say you got a welcome bonus of $200 on a cash-back card in March 2021. You saved that bonus, and now, at the end of March 2022, you plan to redeem it on a grocery bill. Well, considering that the overall price of groceries has gone up by 3-5%, your cash-back bonus is now worth around $194 to $190 in 2021 dollars.

The easiest way to protect your rewards points from inflation is to "earn and burn." That means, use them as soon as you earn them. This prevents inflation from eating into your earnings, and it helps you get the most value.

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