Find out how inflation impacts your investment returns

Ten odd years ago, a Blackberry phone for Rs. 10,000 felt like a status symbol that only the wealthy could afford. Fast forward to 2022, and the newest Apple phone has been launched for Rs. 1,29,900. Evolutionary changes in technology have affected prices. However, the steep rise in the cost of phones is also because of inflation. Inflation impacts the cost of all goods and services, making things expensive. This is why you need to invest your money. Read on to understand the relationship between inflation and investments.

What is inflation?

Inflation is the surge in the prices of goods and services in a country. It also denotes the decreasing power of money. For example, you have to spend Rs. 1,000 for a pair of jeans today that you could buy for Rs. 500 ten years ago. In this case, the value of Rs. 500 falls, while the price of denim increases.

To know inflation better, you must understand the reasons for it.

Causes of inflation

- Increase in population: If there are more people, there needs to be more products in the market. Higher demand and the failure to meet everyone's needs lead to price hikes.

- Rising exports: If more and more products are exported from the country, their demand may increase due to domestic scarcity. This can result in inflation.

- Government spending: When the money supply increases in the economy, people have more money at their disposal. This creates demands and gives rise to inflation.

- Low agricultural growth: For an agrarian economy like India, the low agricultural output can severally lead to shortage and, ultimately, high demand and prices.

Now that you have understood inflation and its causes, it is time to know its impact on your investments, such as mutual funds. This can help you with financial planning.

What are mutual funds, and how does inflation impact their returns?

Mutual funds are investments that pool money from various investors and invest it in other securities like equity, debt, cash, etc., depending on the fund's objective.

When inflation rises, the returns from your investments lose their value. For instance, if you invest in funds that offer lower returns than the average inflation rate, your investments may not be helpful to you. This is why picking mutual funds that can garner inflation-beating returns is essential.

Some mutual funds may also be directly impacted by inflation, like debt funds. Debt funds primarily invest in fixed-income securities like bonds. Bonds are inversely proportional to inflation. When the Reserve Bank of India (RBI) increases interest rates to tackle inflation, bond prices fall. And you earn a lower return.

Now, if you are wondering what to do to counter inflation, here are some tips that can help.

Ways to tackle inflation

- Move to equity: Equities have the potential to offer inflation-adjusted returns in the long run. Thus, switching to equity may be a good idea. You can consider equity mutual funds since they offer professional management as against direct equity trading.

- Use tax saving schemes for dual benefits: An Equity-Linked Savings Scheme (ELSS) is an equity mutual fund that offers tax benefits under Section 80C of the Income Tax Act, 1961. You can use this to build wealth for the future and save money in the present.

- Opt for Systematic Investment Plans (SIPs): SIPs can be easier to add to your monthly budget than a large lump sum investment. If you are finding it hard to take out money for investment, you can plan smaller instalments according to your capacity through SIPs.

- Spend less: Monitor your spending habits to save money and continue investing in inflation-beating instruments, as advised above.

Conclusion

Inflation is beyond your control. But you can control your choice of investments. Try to shift your money to inflation-beating options as and when time demands.