Time Value Of Money

There is no doubting that financial planning is one of the most vital aspects anyone has to look into. Carol Yip provides readers with some valuable hints and pointers on how to make your money work for you.

Carol Yip is the founder of Abacus for Money, an organisation that provides personal financial coaching and money skills education programmes to help people understand their relationship with money.

What is Time Value of Money (TVM)?

Have you experienced a time when you pay more for the same item at a later date? For instance, in your school cafeteria, do you pay more for candies or meals nowadays compared to before? Or maybe, for the same amount of money that you paid, the quantity of candies you got in exchange is less than before?

If you need to pay more money to buy things that you need or like because the value of money has decreased, don't you think you need to have more and more money when you grow older? Don't you think you need to be smarter and wiser to earn and make more money for the future?

The effect of inflation rates on your money

The value of today's RM1 will not be the same as the value of RM1 in the future. Why is this so? It is because of inflation – the increase of prices of the things or services that you use. In a simple explanation, the rate in price (%) is called inflation rate. Inflation erodes the purchasing power of your money.

Inflation Rate

What is the difference between the economic inflation rate published by the Government and your personal inflation rate?

The economic inflation rate published by the government is an index computed based on a basket of goods and services that are consumed by the general public. The basket is made up of consumable goods and services, like petrol, rice, sugar, flour, food supplies and the list goes on.

Your personal inflation rate is calculated based on a basket of goods and services that you consume personally. For example, clothes, groceries, supplies, toiletries that you buy, places where you have your meals, holidays that you go to, and this not necessarily the same basket of goods and services adopted by the government.

Rule of 72

Rule of 72 helps you to do a quick computation of the time period your value of money will be reduced to half from today's value for a given amount of money that you have now, depending on the quantum of the inflation rate or interest rate you experience.

How do you compute your personal inflation rate?

Refer to your Cash Flow Statement every month and check the % of increase in the prices of items that you pay for every month.

For instance, if the price of the same item that you pay for monthly has increased by 10% on the average, then your personal inflation rate will be also be 10% on the average.

Why is it important to know your personal inflation rate?

Because you want to make sure that you can control and manage your spending in order to avoid spending excessively. Your personal inflation rate is an indication of your personal lifestyle.

How does your personal inflation rate affect the value of your money in relation to time?

The higher your personal inflation rate, the faster the value of your money will be reduced to half.

Example: If the inflation rate is 4%, the purchasing power of RM1 today will be worth only 50 cents in 18 years' time (Take 72 divided by 4% = 18 years)

Refer to the example above, the value of your money in your savings will be half of today's value in 18 years' time if your personal inflation rate is 4%.

What will happen then if your personal inflation rate increased from 4% to 10%?

When your personal inflation rate increases to 10%, the value of the money in your savings will be half of today's value in 7.2 years' time! (Take 72 divided by 10% = 7.2 years)

There are possibilities where your lavish and expensive lifestyle could be indicated by a higher personal inflation rate. As a smart money-user, you need to be mindful of your cost of living, at all times!

Powerful Money Principles

Here are some useful money principles you can look into:

1. Live within your financial means.
2. Spend less than you have.
3. Saving money is your first priority.
4. Make the power of interest to work for you.
5. Be disciplined in managing your money.
6. Do not use credit cards or borrow money to spend unless you have the money to pay back the debt as quickly as possible.
7. Spend money on what you need and not what you want.
8. Be mindful of inflation rates.
9. Compare prices before you actually spend your money.
10. Plan your spending on a regular basis and avoid spending based on emotion.
11. Think carefully before you decide to spend your money, consider the advantages and disadvantages of your spending.
12. Do not buy things that you cannot afford.
13. Do not let your friend, peer pressure or family make you spend your money unnecessarily.
14. Do not easily get attracted to advertisements, internet, radio, TV or the latest trends and technology that make you spend your money unnecessarily.
15. If you have a hobby, passion or interest, make sure you don't spend more than what you can afford.
16. Take stock of your personal possessions on a regular basis and see if you can:
    - Recycle some of the things so that you don't have to buy
    - Sell some of your things as second-hand items
    - Donate to charity things that you don't need or want

You must start to take action and begin planning for your financial future. The time is NOW. Better to start young than to regret later!

Information excerpt from "**Smart Money-User**", by **Carol Yip**.