Your Financial Journey

by Sophia

WHAT'S COVERED

In this lesson, you will learn how basic economic concepts drive the decisions you make each day about how you earn, spend, save, and invest your money. Specifically, this lesson will cover:

1. Introduction to Economics

What does the cost of groceries have to do with international relations? How do you know if it's the right time to buy a new computer or look for a new job? Should you save your holiday bonus or spend it?

The study of **economics** helps you answer these questions and more by examining how society produces, consumes, and exchanges wealth and resources every day. In fact, everything we do—from the choices we make about our careers to the cost of living and how much we're able to spend and save—is influenced by the economy. And understanding the science of economics can give us the confidence to navigate our personal financial future.


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In each lesson in this course, we will introduce you to concepts in economics and **personal finance**, and you'll explore the essential skills that will help you to improve your personal, professional, and financial well-being. We'll also discuss what it means for you to invest in your most valuable resource... *you*!

WATCH

It's easier to understand economic concepts if we break them down into digestible pieces. Watch this video to uncover some quick tips about investing and interest rates to get you started in this lesson.

TERMS TO KNOW

Economics
The study of how humankind uses its limited resources (such as time, money, goods, and services).

Personal Finance
Deciding how to allocate your personal resources to best support yourself and your family.

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2. Economics Drives Decisions

Any exploration into economics starts with the basics. Let's look at how the foundational concepts of economics impact our decision making to help us solve problems in our daily lives.

2a. Scarcity

We all have wants and needs. For example, you might want to buy that new touring bicycle at the bike shop. But can you afford it? If the bike is too costly, then that purchase is not within reach. **Scarcity** is a limitation or the gap between limited resources and excessive wants and needs. Scarcity is what forces us to prioritize our spending decisions and problem solve. When faced with such decisions, a conscious consumer will usually choose to satisfy their basic needs before pursuing those ever-so-tempting wants.

Problem Solving: Skill Reflect

Have you ever wanted something you cannot afford? You may have decided to hold off on the purchase, but did you consider options to be able to afford it in the future? Your problem is not necessarily having enough money for something you want. Strong problem solving skills can allow you to find a solution without any negative impacts on your finances.

TERM TO KNOW

Scarcity
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2b. Trade-Off Decisions

A **trade-off decision** is when we choose one activity as more valuable than another. For example, you choose to spend time learning a new software program to file your own taxes instead of going hiking with friends at the lake.

EXAMPLE Ava is a single working parent who is trying to juggle the cost of going back to school with her necessary living expenses. It can be a real challenge. However, last month she unexpectedly inherited $10,000 from a relative. The money presents Ava with several options. She can use the money to pay for school, put it into a savings account, or use it to purchase a new vehicle.

Whatever Ava decides, she will be making a trade-off decision. For example, if her decision is to save the money, her trade-off is not using the money to pay for school or purchase a new vehicle. In economics, when one decision is made, it often means a different decision cannot be made. Such decisions are unique and personal based on your financial situation.

TERM TO KNOW

Trade-Off Decision
When we choose one activity as more valuable than another.

2c. Opportunity Costs

An **opportunity cost** refers to something an individual must give up or do without when they make one choice over another. In other words, what are the costs associated with choosing one of two options? Let's look at an example.

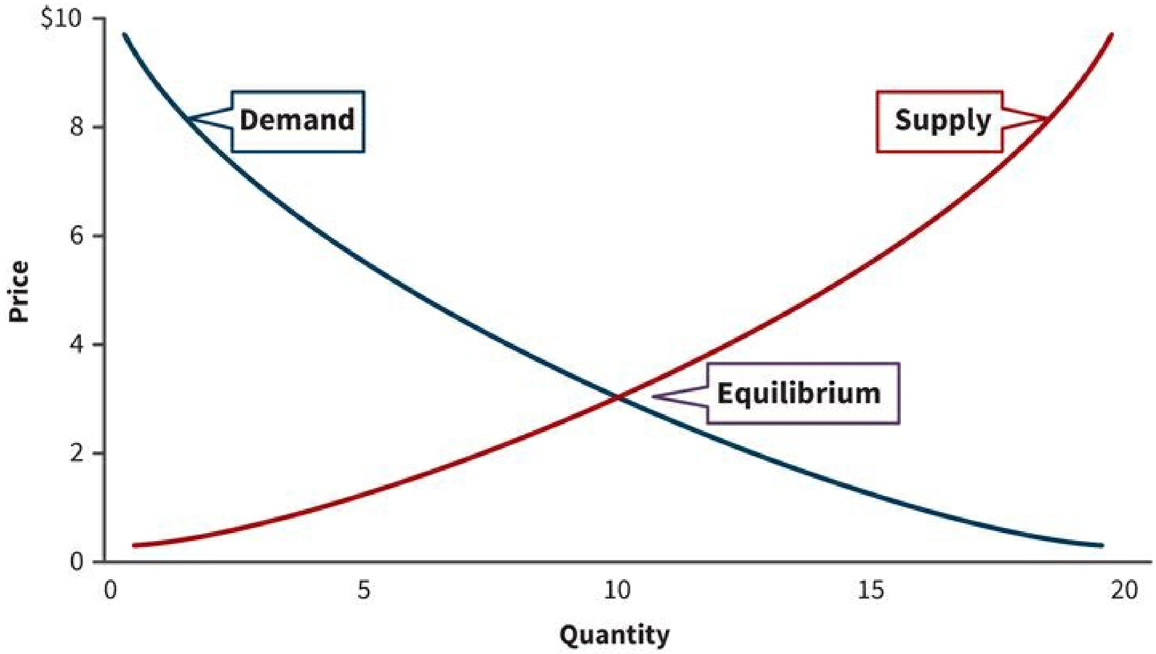
EXAMPLE Imagine you've earned a $1,000 bonus from your employer. You choose to set the money aside for a rainy day fund rather than investing it in the stock market. The cost of that decision is the loss of any profits you could potentially make in the stock market.

TERM TO KNOW

Opportunity Cost
The loss of a benefit that you would have received by choosing another option.

2d. Supply and Demand

At some point during your academic career, you probably have seen a**supply and demand graph**, like the one shown in the image below, which illustrates the fundamental building blocks of modern economics.



- In almost all cases, as the price of a product falls, the demand for the product increases, and vice versa.
- *Equilibrium* is the point at which the two lines meet. This is where demand "equals" the supply of an asset. In this example, the equilibrium price is $3.

When it comes to tangible investing, demand is much more important than supply.

> ↪ EXAMPLE Imagine a dealer who purchases your vintage video games. She will almost always be willing to pay more for a game that she knows can sell quickly (i.e., there is high demand). This is true even if there are thousands of these games available (i.e., high supply). If the demand is high enough, then she will be willing to pay you more because she knows she can flip the asset quickly.

This rule is evident in pawnshops where collectibles, such as gold and silver, have small spreads between the bid and ask price because these assets have strong local and worldwide demand. However, with other niche collectibles, like baseball cards, the spread may be small, not because the card is not valuable, but because the market is so small.

Agility: Skill Tip

Supply and demand for any item or good can fluctuate based on different factors. It is important that you can use your agility skill to adjust your actions based on those changes.

TERM TO KNOW

Supply and Demand Graph

A fundamental building block of modern economics showing how prices increase when supply decreases and demand increases.

2e. Inflation

Inflation generally happens so slowly that you hardly see it. One reason inflation is so elusive is that at any time some prices are increasing, some remain the same, and some prices fall. Think about tuition compared with the price of electronics. Tuition at colleges and universities has been increasing steadily for more than 30 years, while the cost of most household electronics has been declining steadily. Even so, prices of goods and services generally tend to increase over time. Economists are comfortable assuming that prices usually go up by about 2.5% to 3.0% per year. (Although rare, note that you may encounter **deflation** at some point during your lifetime financial journey. Deflation occurs when general prices decline.)

The **consumer price index (CPI)** is one measure that you can use to determine if inflation is occurring.

- The table below shows how the price of several products and services changed over the period 1983–2017.
- If you are in college today, you will be disappointed (but probably not surprised) to learn that tuition has gone up by far more than the CPI inflation rate.

What does all this mean for you in the context of your lifetime financial journey? The answer is simple: If you earn less than the inflation rate on your investments, then you are falling behind in terms of purchasing power. This is the sure pathway to financial troubles in the future. You do have a solution, however: use your productivity skill to take smart risks with your investments to earn higher returns!

	Price in 1983	Inflation-Adjusted Price in 2017 (2.67% per year)	Actual Prices in 2017
Average cost of a home	$89,800	$218,945	$295,000
Price of a postage stamp	$0.20	$0.49	$0.49
Cost for a gallon of gas	$1.24	$3.02	$2.50
Price of a dozen eggs	$0.86	$2.10	$1.45
Tuition/Room/Board	$3,877	$9,453	$16,500
Median household income	$20,885	$50,920	$56,516

Source: www.bls.gov/data/inflation_calculator.htm.

Your ability to stay flexible and adapt as situations and circumstances arise is part of practicing your agility skill. In this course and your career, practicing agility will not just help you make sound financial decisions, it will help you solve a range of personal and professional problems. Part of honing your agility skill, for example, is understanding how to pivot or change directions to achieve your goals, such as knowing when to change to a new health insurance provider to lower your insurance premiums or changing your workout routine so you can build up the endurance you need to compete in a marathon.

TERMS TO KNOW

Inflation
Rising prices in the economy that tend to erode purchasing power.

Deflation
Falling prices in the economy that tend to restore purchasing power.

Consumer Price Index
Measures the change in the level of consumer goods and services prices over time.

SUMMARY

In this lesson, you discovered how **economics drives decisions** and how identifying and responding to economic trends can benefit you in terms of **personal finance**. Each day, you make **trade-off decisions** based on **opportunity costs** because resources are limited, or **scarce**. **Supply and demand** and **inflation** are two fundamental concepts behind many of those decisions. You also exercised agility, productivity, and problem solving in this lesson to help you understand where you are financially, plan for where you'd like to be, and stay resilient in the face of financial challenges. **Investing in yourself** and reaching and maintaining a place of financial well-being is a journey. This lesson presented several skills to help you navigate that journey successfully!

ATTRIBUTIONS

- Consumer Price Index (CPI) Inflation Calculator | **Author:** U.S. Bureau of Labor Statistics | **License:** Public Domain

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