What are the effects of inflation on people's lives?

"Inflation is caused by too much money chasing too few goods." ~ Milton Friedman

Inflation, the multi-faceted economic phenomenon is the rate of increase in the price of goods and services over a period of time. Within an economy, an increase in aggregate demand, expansion of money supply or a decrease in interest rates results in inflationary pressures. While stable rates of inflation are desired by governments, they can often fluctuate, impacting individuals across various socioeconomic strata and their economic decisions.

One of the most discernible effects of inflation is the diminishing of consumers purchasing power. As general prices rise, the value of one unit of currency decreases; it buys fewer goods. Turkey has experienced one of the largest inflationary spikes ever recorded, with the inflation rate increasing by 52.71% between 2021 and 2022.[1] This drastic surge in prices has caused a heavier financial strain for Turkish citizens as they are required to allocate a greater proportion of income to meet the costs of necessities such as food, healthcare and energy.

The impact of inflation affects socioeconomic dynamics and contributes to inequality. Inflation tends to hurt fixed-income individuals more, exacerbating prevalent disparities in wealth and income. The income gap widens as those with financial assets can adapt to inflationary pressures more effectively through investments and bonds that outpace the surging prices. However, inflation creates a disproportionate relationship with individuals of fixed incomes; earnings remain constant while the cost of goods and services increases, making it difficult to sustain their quality and standard of living. "People are getting poorer, and they'll live less pleasant lives, most likely." according to Alex Arnon, a research arm of the University of Pennsylvania.[2]

Inflation also has an impact on the incentive to borrow or save money. Central banks often implement contractionary monetary policy to respond to inflationary pressures. As interest rates rise, the cost of borrowing money increases, encouraging consumers to save rather than spend on goods and services.

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[1] (2024). "Turkey Inflation Rate 1960-2024", *Macrotrends*

[2] Iacurci, G (2022). "Inflation poses a 'clear and present danger,' says Manchin: Economists weigh in on how it can hurt and help consumers", *CNBC*

As of December 2023, The Bank of England has raised interest rates 14 times to get inflation down to a target rate of 2%.[3]

Apart from its adverse effects, inflation does have some positive implications. In an inflationary economy, the price of home construction increases due to rising costs of production. As a result, home prices increase, benefitting individuals who own assets. In the United States, home prices rose 4.7% in October 2023, when the inflation rate rose by 0.2%.[4] In addition to homeowners, debtors benefit from inflation. The nominal amount of debt is constant, whereas the real value of debt decreases. As a result, they repay creditors with money less valuable than the money they borrowed in terms of purchasing power.

The effects of inflation permeate through people's lives. While it may erode purchasing power, cause uncertainty or contribute to economic disparities, it is essential to understand its requirement in an economy. When inflation is stable and predictable, people can plan their savings, spending and investments more effectively, allowing the economy to grow and create employment. Policymakers and governments must implement frameworks to keep inflation stable — mitigating its negative impacts while promoting sustainable economic growth and presenting opportunities for individuals.

[3] (2023) "How do Interest Rates affect Inflation?", *The Times*

[4] (2023) "Inflation and the housing market: Decoding the latest numbers", *Bank Rate*

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