

# *The Impact of Inflation on Residents' Consumption Behavior*

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**Abstract:** Inflation is an important phenomenon in the economic field, which profoundly affects residents' consumption behavior. This paper comprehensively analyzes this impact. Firstly, it elaborates on the concepts and measurement indicators of inflation, including CPI, PPI, etc. Inflation changes residents' consumption behavior by influencing consumption capacity (such as the shrinkage of real income, wealth effect), consumption structure (adjustment of consumption of necessities and non-necessities, durable and non-durable consumer goods) and consumption expectations (changes in consumption decisions based on price trend expectations). Different income groups are significantly differently affected, with low-income groups being highly sensitive and high-income groups being relatively stable. Changes in residents' consumption behavior, in turn, have a reverse impact on the macro-economy, affecting aggregate demand and price levels. Finally, countermeasures are proposed from the government, enterprise and resident levels, aiming to stabilize the consumer market and promote the healthy development of the economy.

## **1. Introduction**

In modern economic society, inflation is an inevitable and highly-concerned economic phenomenon. With the development and fluctuation of the economy, continuous changes in price levels have a profound impact on the daily lives of residents. As the main body of consumption, residents' consumption behavior has undergone many changes in an inflationary environment. Research on the impact of inflation on residents' consumption behavior has important practical significance. On the one hand, it helps to deeply understand the consumption decision-making mechanism of residents in the face of economic environmental changes, thereby improving residents' ability to cope with inflation and ensuring the quality of residents' lives; on the other hand, from a macro perspective, residents' consumption is an important driving force for economic growth. Analyzing this impact can provide a basis for the government to formulate reasonable macro-economic policies, maintain the stability of the consumer market, and further promote the healthy development of the entire economy. This paper will use multiple research methods, such as the literature review method to sort out existing research results, and the data analysis method to explore the quantitative relationship between inflation and residents' consumption behavior, to conduct in-depth research on this important topic.

## 2. Overview of Inflation

In the process of economic operation, the emergence of inflation results from the interaction of various complex factors. From the demand side, when the aggregate social demand grows excessively and exceeds the capacity of the aggregate social supply, inflation will be triggered. For example, during the economic boom, consumers have a strong demand for goods and services. Enterprises expand production to meet the demand. However, if the growth rate of demand far exceeds the growth rate of production factor supply, it will lead to a rise in prices. This demand-pull inflation reflects the situation where too much money in the market chases relatively fewer goods and services.

From the cost perspective, cost-push is also an important cause of inflation. The increase in raw material prices, the rise in labor costs, and other upward cost pressures faced by enterprises will prompt enterprises to raise product prices. For example, a sharp increase in international crude oil prices will lead to a significant increase in production costs in many industries that rely on oil. In order to maintain the profit level, these enterprises have to raise product prices, thus driving up overall prices.

Changes in the money supply have a fundamental impact on inflation. When the central bank increases the money supply, if the output in the real economy does not grow correspondingly fast, too much money will flow into the market, causing prices to rise. This is like injecting excessive funds into a relatively stable market<sup>[1]</sup>. These funds will inevitably chase limited goods, thus driving up prices.

There are multiple indicators for measuring inflation, among which the Consumer Price Index (CPI) and the Producer Price Index (PPI) are the most commonly used. The Consumer Price Index reflects the price changes of a basket of goods and services purchased by consumers. It covers various consumer goods in daily life, such as food, housing, transportation, and medical care. Changes in CPI directly affect the living costs of residents and are an important indicator for measuring the impact of inflation on residents. The Producer Price Index mainly measures the price changes of production materials purchased by enterprises, including raw materials, intermediate products, etc. Changes in PPI are often a leading indicator of changes in CPI, because changes in enterprise production costs will eventually be transmitted to the consumption end and affect the prices of consumer goods.

## 3. Influence Mechanisms of Inflation on Residents' Consumption Behavior

Firstly, inflation directly affects residents' real income levels, thereby changing their consumption capacity. When prices keep rising, the real purchasing power of the money in residents' hands declines. If residents' nominal income does not increase correspondingly and rapidly, the quantity of goods and services they can afford to buy will decrease. For example, in the case of a substantial increase in food prices, the proportion of residents' expenditure on food may be forced to increase, while the expenditure on other non-essential consumption has to be cut. Such changes in consumption capacity will make residents more cautious in their consumption decisions, tending to give priority to meeting basic living needs and reducing the purchase of high-end consumer goods and luxury items.

Secondly, inflation will change residents' consumption expectations. In an inflationary environment, residents expect that prices will continue to rise in the future. Such expectations will prompt them to adjust their current consumption behavior. On the one hand, residents may carry out some consumption in advance, especially for those goods that are more sensitive to price fluctuations and are expected to have higher prices in the future. For example, when expecting housing prices to keep rising, residents with housing purchase needs may accelerate their home-

buying decisions, even if it means taking on higher debt pressure. On the other hand, if residents lack confidence in the future economic situation and personal income growth, and are worried that the continuous deterioration of inflation will lead to excessively high living costs, they may further cut back on current consumption and increase savings to deal with future uncertainties.

Furthermore, the impact of inflation on the consumption behavior of different income groups varies. For low-income groups, since most of their income is used to meet basic living needs, the impact of inflation on them is more obvious. The rise in the prices of basic necessities will quickly squeeze their limited disposable income, putting them in a consumption dilemma. They may have to choose lower-quality and cheaper substitutes or even reduce the quantity of certain basic consumption<sup>[2]</sup>. For high-income groups, although they will also be affected by inflation, relatively speaking, their consumption structure may shift more towards high-end consumer goods, investment products or overseas consumption, and they have more resources to deal with the impact of inflation, such as offsetting the risk of wealth shrinkage caused by rising prices through investment for preservation and appreciation.

In addition, inflation will also indirectly affect consumption behavior by influencing residents' asset allocation. During inflation, some assets such as real estate and stocks may be regarded as tools for preservation and appreciation. Residents may adjust their asset allocation and invest more funds into these assets. If residents invest a large amount of funds in the asset market, the funds available for consumption will be reduced accordingly. Moreover, the fluctuation of asset prices will also affect residents' wealth status, and then affect their consumption confidence and consumption capacity. For example, when the stock market is booming, residents who hold stocks may feel that their wealth has increased and thus increase their consumption; conversely, when the stock market is in a slump, residents may reduce consumption to make up for the shrinkage of asset values.

#### **4. Differences in the Impact of Inflation on Different Income Groups**

Low-income groups are often in a rather vulnerable position during inflation. Due to their relatively low income levels, most of their income is used to meet basic living needs, such as food, housing, and basic medical care. During the inflationary period, the increase in the prices of basic necessities will directly hit their already limited budgets. For example, the rise in food prices will increase their expenditure on food, and the proportion of this expenditure in their income may become larger, thus squeezing their disposable income for other aspects. They may not have enough financial leeway to cope with the price hikes and are forced to choose lower-quality and cheaper substitutes, and in some cases, they even have to reduce the quantity of basic consumption. Moreover, low-income groups usually lack effective countermeasures, such as investment, to resist the risk of wealth shrinkage brought about by inflation, which further intensifies their living pressure in an inflationary environment, and their consumption behavior is more of a contractionary consumption to maintain basic survival needs.

In contrast, high-income groups are affected by inflation in different ways. High-income groups still have a large amount of surplus after meeting basic living needs. Their consumption structure is more diversified<sup>[3]</sup>. Although they will also face the pressure of rising prices during inflation, relatively speaking, the proportion of their expenditure on basic living aspects in their total income is small, and the impact is not as direct and severe as that on low-income groups. Their consumption may shift more towards high-end consumer goods, investment products, or overseas consumption. For example, high-income earners may increase their consumption of high-end artworks and limited-edition luxury goods during inflation, or invest their funds in overseas real estate and other fields with potential for preservation and appreciation. At the same time, they have

more resources and means to deal with the impact of inflation. They can achieve the preservation and appreciation of wealth through diversified investment portfolios, such as investment in financial assets such as stocks, funds, and bonds, or participation in high-end commercial investment projects, thus offsetting the risk of wealth shrinkage caused by rising prices and maintaining or even expanding their consumption scale to a certain extent, and their consumption behavior shows stronger flexibility and selectivity.

The situation of middle-income groups is in between. They have a certain economic foundation to cope with inflation, but not as easily as high-income groups. Under inflation, the increase in basic living costs will affect their quality of life. For example, the increase in housing loans and children's education expenses will bring certain economic pressure to them. They may adjust their consumption structure and reduce some non-essential consumption, such as expenditure on tourism and leisure and entertainment, but they are not like low-income groups that can only maintain basic survival-type consumption. Middle-income groups may try to resist inflation through some stable investment methods, such as savings-type insurance and low-risk funds, but their investment ability and resources are relatively limited, and they also face certain challenges in dealing with inflation, and their consumption behavior reflects a characteristic of seeking a balance between maintaining the quality of life and coping with economic pressure.

## **5. Counter-effects of Changes in Residents' Consumption Behavior on the Macro-economy**

When residents' consumption behavior tends to be conservative, for example, during economic instability or when they have pessimistic expectations for the future, overall consumption expenditure decreases. This will first have a direct impact on the consumer market, causing many consumer-oriented enterprises to face the predicament of declining sales. In industries such as retail, catering, and tourism, the decrease in consumer demand will lead to a reduction in enterprise revenue, which in turn will affect their profit levels. In order to cope with the decline in profits, enterprises may cut back on production scale, reduce the number of employees hired, or lower employees' salaries. This series of measures will cause the unemployment rate to rise and residents' disposable income to further decrease, thus forming a vicious cycle that drags down the growth rate of the entire macro-economy and leads to a slowdown in the growth of the Gross Domestic Product (GDP).

Conversely, if residents' consumption behavior becomes positive and optimistic and consumption demand increases, it will have a positive driving effect on the macro-economy. The growth of consumption demand will stimulate enterprises to expand their production scale. In order to meet market demand, enterprises will increase their input of production factors, including hiring more labor and purchasing more raw materials. This not only helps to reduce the unemployment rate but also drives the development of related industries. For example, raw material suppliers will increase their production volume and revenue due to the increase in demand. Positive consumption behavior will also prompt enterprises to carry out more innovation and upgrading in order to provide products and services that better meet consumers' needs, thereby enhancing the competitiveness of the entire industry. From a macro-level perspective, the growth of consumption demand is an important force for driving GDP growth and can promote the prosperous development of the entire economy and a virtuous economic cycle.

Changes in residents' consumption behavior will also affect the structural adjustment of the macro-economy. For example, when residents' consumption demand for green and environmentally-friendly products increases, enterprises will accordingly adjust their production structures and increase their investment in green industries, which is helpful for promoting the entire macro-economy to develop in a green and sustainable direction. And if residents' preference

for high-end service consumption, such as high-end medical care and education, intensifies, it will prompt resources to flow into these areas, thereby affecting the proportion and layout of various industries in the macro-economy and guiding the optimization and upgrading of the macro-economic structure.

## 6. Conclusion

In summary, the impact of inflation on residents' consumption behavior is multi-dimensional. From consumption capacity, consumption structure to consumption expectations, the role of inflation is ubiquitous. Different income groups show different changes in consumption behavior in the face of inflation, and these differences are further intertwined with the macro-economy. The consumption rigidity and high sensitivity of low-income groups, the relatively stable consumption behavior of high-income groups, and the consumption adjustments of middle-income groups all affect aggregate demand and price levels to varying degrees. In terms of dealing with the impact of inflation on residents' consumption behavior, the government, enterprises and residents all bear their own responsibilities. The government's macro-control policies and income distribution adjustments, enterprises' product and market strategies, and the improvement of residents' financial management awareness and rational consumption concepts are all key factors in alleviating the negative impact of inflation and stabilizing the consumer market. In the future, with the continuous change of the economic environment, it is necessary to continuously pay attention to the dynamic relationship between inflation and residents' consumption behavior in order to better cope with possible economic challenges and ensure the living standards of residents and the sustainable development of the economy.

## References

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