Inflation - The Money Devil

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Executive Summary – *An increase in the prices of products and services is known as inflation. Over the years, prices of most products and services increase either marginally or drastically depending on economic conditions, government policies etc. Inflation affects individuals, businesses and the government.*

What is Inflation?

Inflation is a word commonly used by people all around. We see it being talked about in the news often. Let us try to understand the concept of inflation.

You must have heard your grandfather or someone else in that age bracket say that he/she used to get 1 kg of wheat flour for Rs. 5 in their times. Today 1 kg of branded wheat flour costs around Rs.40- Rs.50. Petrol costed Rs. 35 per litre in 2002 and today it costs Rs. 82 per litre (Mumbai price). What can we see here? There has been a rise in the prices of products over the years. This rise in prices of products and services is inflation. It means you need to pay more to get the same thing or you get less of things for the same amount of money today than you used to get in the past.

Inflation affects all items be it cars, homes, groceries, mobile phones or movie tickets. Inflation affects everyone – individuals, families, businesses and government.

How does Inflation affect us?

Inflation affects different aspects of personal finance. It affects our cost of living, our incomes, savings and investments.

Cost of Living means the amount of money we need to live and includes basic expenses like housing, food, medical care etc. Inflation leads to more money being needed to maintain the existing living standards. So cost of living becomes higher with inflation.

It affects our income in the sense that today people earn more in their professions, jobs and businesses compared to say 10 years back. If the rise in income or wages matches the rise in prices, people will not have trouble managing their finances. If the price inflation is very high compared to the rise in income, people will have less money in their hands.

It affects our savings as well. For example, if you get Rs. 500 as an allowance and you spent Rs. 200 on a movie ticket. You would have Rs. 300 with you. But if the ticket price increases to Rs. 250, then you will have only Rs. 250 as savings. Similarly savings are reduced with increasing inflation as we need to pay more money for the same things.

It affects investments as well. You can invest in less of assets like gold or property compared to earlier for the same money as their prices would have also increased due to inflation.

Businesses are also affected by inflation. They have to pay more for raw materials, transportation and wages which will hurt their profit margins.

The Government is also affected by inflation. Government collects taxes to provide services to the people. If prices rise, the Government will need more money (more taxes) to provide the same level of services.

Is inflation good or bad?

Inflation is not as bad as we have been brought to believe. Inflation can be good or bad depending on our personal situation, economic conditions and government policies.

Inflation can be a sign of a growing economy. If the prices of products and services are rising, it means there is more demand for the same which means people have more money in their hands to spend. This would boost the industrial sector. If rise in income matches the rise in prices, people will not have much trouble managing finances. On the other hand, inflation is not good for a retired person who is living off his savings and investments and has no regular income as it would lead to his savings eroding faster. If price rise is higher than rise in levels of income, there is need for concern. Deflation (falling prices) could mean that the economy is weakening as lower prices means lesser demand which means people are not buying less than expected. This could affect business negatively.

As you can see it is not easy to label inflation as good or bad.

We would love to hear your thoughts on inflation.