

# IMPACT OF INFLATION ON SPENDING HABITS OF MIDDLE-INCOME GROUPS: A STUDY IN INDIA

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## Abstract

*The rise in inflation affects different categories of people. From the point of view of the common man, inflation means increase in the price of goods and services on a day-to-day basis. People with fixed incomes, both in public or private sector organizations or self-employed, working in the unorganized sector are considered victims of rising inflation, as inflation affects households' consumption, expenditure and investment practices. This study includes correlation and regression analysis to find out the relationship as well as significant impact of inflation on spending habits of middle-income groups in India. The purpose of this study is to assess the relationship between inflation and consumer spending habits in India. The empirical findings of this study complement economic theories and evidence that inflation also increases the price of living goods, reducing the chances of obtaining commodity jobs. This situation directly affects a consumer's income and their spending habits.*

**Key Words:** Inflation, Spending habit, Middle-income groups, Correlation, Regression

## 1. INTRODUCTION

Growth in Indian economy is widely evidence since the introduction of new economic policies in 1991. Positive growth in the economic condition of the nation has given positive sign of growth and prosperity in the life of common man living in this country (India), where people prefer to spend whatever money they earn to build-in their comfort level or to enhance its standards. In an economy, if common man become thrifty and they start spending ever single penny they earn, it leads to money velocity, that in turn increase inflation rates. Consumer spending emanating from economic decisions of more than 200 million households in India forms a major portion (about 60 per cent) of GDP as private final consumption expenditure. Consumers' purchase choices affect not only the aggregate size of the economy but also influence prices and inflation, making it pertinent to examine households' inflation expectations and their relationship to consumer spending. Understanding this relationship can provide useful inputs for monetary policy. Besides, the above mentioned factors there are various external growth in production level, increase in crude oil price at international level, increase in import cost, rise in dollar value etc growth in production level, increase in crude oil price at international level, increase in import cost, rise in dollar value etc factors like: economic development, The issues created by rising inflation is very critical and its need to solve then and there to prevent both economy and common man from its damages. From common man's point of view inflation means increase in price of goods and services on day to day bases. People with fixed income employed in either public or private sector organisations or Self-employed, working in unorganised sector are considered as victims of rising inflation, as inflation influences the consumption, spending and investment practices of the households.

## 2. LITERATURE REVIEW

Traditional micro-models of consumer spending consider a trade-off between consumption and saving. An expected increase in prices results in shifting planned future spending to the current period. Higher expected inflation also lowers the real interest rate, which leads to lower returns, less savings and thus more current spending. On the other hand, higher inflation creates uncertainties about the future which can cause downward revision in real income expectations leading to lower current consumer spending (Juster and Wachtel 1972). The exact direction of this relationship is important for macroeconomic policy. For instance, researchers like Eggertsson and Woodford (2003) and Krugman (1998) have argued that central banks should commit to policies that raise expectations of future inflation, thereby affecting a decline in real interest rates and encouraging greater current spending. This viewpoint suggests that purchases of large consumer durables and residential housing, purchases that are readily substituted across time and that are often financed with debt, should be particularly sensitive to an increase in expected inflation. Goyal and Parab (2019) discover an important role played by RBI communications in guiding household inflation expectations. This study obtains a similar result using the CCS dataset, suggesting the result is robust. When people are uncertain about the price level in the economy, they tend to anchor their inflation expectations to the data published in newspapers or any information from TV news or other media, which in an economy like India is heavily influenced by official

sources. Ravallion (2000)<sup>1</sup> looks at the interrelationship over more than thirty years between food prices, poverty and wages in India to analyze whether agricultural reform helps or hurts the poor. While corroborating other work that shows inflation reduces rural expenditure, he notes that once agricultural output and overall inflation are taken into account, food prices do not appear to have an independent effect on (real) wages. Thus while households may take an immediate hit when food prices rise, in the longer run, rising rural productivity will affect both food producers and the wages of rural labourers, which would reduce rural income inequality.

### 3. OBJECTIVES OF THE STUDY

1. To measure the inflation impact on spending habits of middle-income groups in India.
2. To find the association between inflation and consumer spending in India.
3. To find out how the inflation is influencing the consumer confidence during the period of study.

### 4. METHODOLOGY

This study is purely based on secondary sources. This study reflects the impact of inflation on spending habits of middle-income group. To measure the spending habits consumer confidence index and consumers spending habits in percentage has been taken in to consideration by collecting the data from RBI report, hand book of statistics, CIME database, various working paper pf RBI and report of World bank. Statistical tools correlation and regression has been used to find out the association and significant relationship between inflation and spending habits for five year from 2014 to 2019.

### 5. THE HYPOTHESIS

- H1: There is a negative relation exist between inflation and spending habits of middle-income groups in India.  
H2: There is a significant relationship exist between inflation and spending habits of middle-income groups in India.

### 6. DATA ANALYSIS AND INTERPRETATION

#### A. Association between inflation rate with the spending habits of middle-income groups in India.

As per table-1 the association between inflation and other variables are high and negative. The association between inflation on the spending habits of middle-income groups is negative. This means when the inflation increases, consumer spending habits decreases. The correlation between inflation and consumer spending is minus 81percent. This means the correlation between inflation and spending habits is very high. Similarly, correlation between inflation with consumer spending on groceries, housing utility, transportation, health and education also negative so, it is clear that there exists a negative high correlation between inflation and spending habits of middle-income groups in India during the period of study, there by accepting the hypothesis (H1).

Table: Correlation between inflation and spending habits of middle-income groups

	Inflation rate	consumer spending groceries	housing and utility	Transportation	Health	Education
Inflation rate	1					
consumer spending	-0.65979752	1				
groceries	-0.81935229	0.963580975	1			
housing and utility	-0.58988618	0.985349044	0.922722	1		
Transportation	-0.65308343	0.99774654	0.954555	0.980446873	1	
Health	-0.613935	0.997818954	0.945139	0.992285819	0.995699309	1
Education	-0.62382868	0.9987562	0.951859	0.985277139	0.997147559	0.99884

Source: Author's calculation SPSS and data from RBI and World Bank

#### B. Analysis of significant impact of inflation on spending habits of middle-income groups

Table-2: Impact of inflation on spending habits of middle-income groups

Independent Variable	Dependent Variable	P-Value	Hypothesis Decision
Inflation	Consumer Spending	0.2256	Reject
Inflation	Groceries	0.0896	Reject
Inflation	Housing and Utilities	0.2951	Reject
Inflation	Transportation	0.232	Reject
Inflation	Health	0.2706	Reject
Inflation	Education	0.2607	Reject

Source: Author's calculation SPSS and data from RBI and World Bank

From the table-2 analysis it is clear that inflation put a significant impact on spending habit of middle-income groups in India. As the p-Value in all the dependent variables are more than the significant level 0.05 percent, hypothesis H2, there is no significant relationship exist between the inflation and spending habits is rejected. This is found from the analysis that inflation put a significant impact on spending habits as well as spending habits of middle-income groups on different consumption segments like groceries, housing and utilities, transportation, education, and health.

## 7. FINDINGS

It is found from the study that inflation and spending habits of middle-income groups are negatively correlated. There is a high level of association exist between inflation and other consumption segments of middle-income groups. As per the study inflation put a significant impact both on the spending habits of middle-income groups and their spending on various segments. These findings are in sync with results obtained by Ichiue and Nishiguchi (2013) for Japanese consumers. The commonality of consumer behaviour in Japan and India might be attributed to conservative spending traits and also the fact that both these economies witnessed very low 'real interest rates' until very recently. These results are, however, in contrast to the findings of Arnold et al. (2014), Bachmann et al. (2015) and Burke and Ozdagli (2013) wherein a negative insignificant relationship was observed. This difference could possibly be due to the different nature of data used. The findings of Bachmann et al. (2015) and Burke and Ozdagli (2013) were based on the US micro-survey data on 'readiness to spend on large household durables' while Arnold et al. (2014) used to save portfolio data.

## 8. CONCLUSION

There are various possible reasons for such behaviour observed among Indian consumers. Being a developing economy, Indian consumers' major expenses are on basic sustenance needs like food, health and education. With a majority of the consumers being in the low/middle income group, there are future aspirations to be met through education. Going forward, similar studies with diverse consumers would help in improving our understanding of consumer spending habits. The intertemporal results can be improved with a study of a panel of respondents. The present study covers one of the high inflation phases of the Indian economy and the robustness of results can be established covering various phases of an inflation cycle especially during low and stable inflation periods. With availability of long time-series data this issue can be revisited. Further studies on essential and discretionary spending will also help in improving our understanding of inflation and spending habits of other income groups.

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