

Ben Raybould, Upper Sixth Student Solihull School**RES Essay Competition:**

Which types of individuals/households are most affected by the current inflation situation and why?

The phrase 'cost of living crisis' has dominated newspaper headlines in recent months. Ending of pandemic restrictions has led to soaring demand following months of economic shutdown, placing huge pressure on the production of goods globally. This has caused supply chain disruption as firms failed to adapt to post-pandemic conditions, fuelling inflation. This has been exacerbated by geo-political events in 2022, with the Ukraine war driving energy and food commodity prices higher. The central banks' typical response to inflation in raising interest rates aims to encourage saving and reduce net spending as the cost of debt increases. As we will see, rising prices and interest rate hikes impact households and certain sectors of the economy differently.

Inflation, as defined by the IMF, is 'how much more expensive a set of goods and services has become over a certain period, usually a year'¹. Inflation is often determined by the 'Consumer Price Index' (CPI), which monitors the changing prices of a basket of the 500 most commonly purchased goods and services over a year.

¹ 'How Economies Function, Inflation: Prices on the Rise',
<https://www.imf.org/external/pubs/ft/fandd/basics/30-inflation.htm>

As can be seen from the chart below, inflation in the UK has reached a thirty year high of 9% in May 2022.

How inflation has changed since 1970

Consumer Prices Index



Source: Office for National Statistics



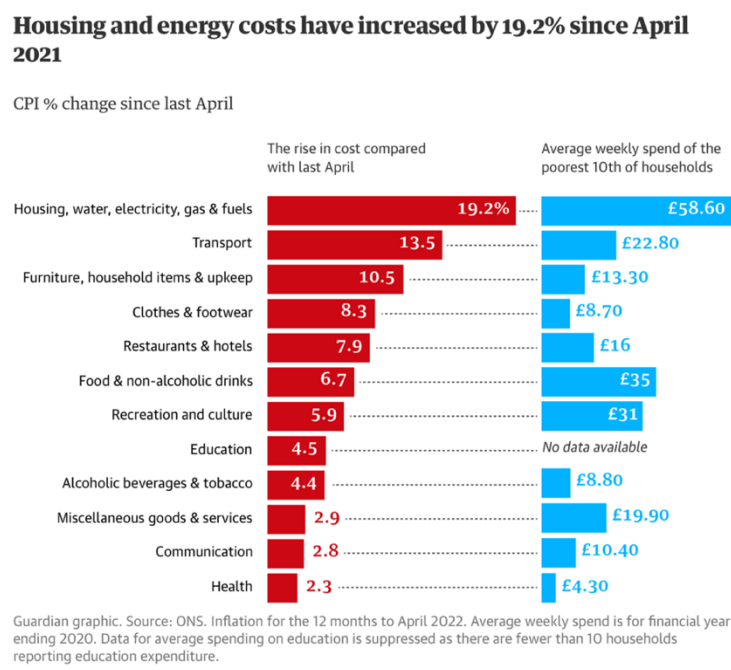
How does all this impact individuals and households?

Rising prices means real incomes fall, with goods and services becoming less affordable as they take up a larger share of consumers total income. When combined with rising interest rates increasing the real value of debt, households are forced to make choices about what goods and services to purchase.

The impact of inflation on individuals and households is not always uniform. Indeed, the income bracket of the consumer often influences their net outcome. As mentioned above, current inflationary conditions have been driven largely by price increases in essential

goods, whether that be food, fuel, or energy. The cost of these staples as a proportion of total net income for the lowest earning household is much higher (20.9 % of total spending)² in comparison to their richest counterparts (just 11% of total spending)³.

The chart below illustrates the impact of inflation on different aspects of low income household's spending.



Therefore, as the cost of the basket of essential goods increases, it will have a much more profound impact on the financial welfare of lower earning families. This is compounded by the recent withdrawal of the £20 Universal Credit uplift, and the fact that many low income

² 'Rising Cost of Living in the UK', House of Commons Library, <https://researchbriefings.files.parliament.uk/documents/CBP-9428/CBP-9428.pdf>

³ 'Rising Cost of Living in the UK', House of Commons Library, <https://researchbriefings.files.parliament.uk/documents/CBP-9428/CBP-9428.pdf>

earners work in the 'gig economy', so lack the bargaining power to push for wage rises compared to stronger unionised jobs.

The pandemic has also exposed how wealth inequality is a factor in determining the effects of inflation on individuals. Higher earning households have the financial capacity to build up savings and investments, which act as a buffer against inflation as it gives them more flexibility to absorb price rises. Lower earning households are not afforded the same luxury and are therefore impacted much more quickly by rising prices. Traditional economic theory would suggest substituting their purchases for cheaper, value brands as a mechanism for dealing with falling real incomes. However, many lower earning households are already purchasing these value brands, so do not have the ability to substitute any lower. And for those already buying value brands, economic commentator Jack Monroe highlights a much higher rise in prices compared to CPI, noting that own brand value products 'increased up to 344% in price over the last year'.⁴

This is the issue with the CPI as an index for inflation; it is an aggregated statistic. It does not follow that all goods in the typical basket have increased in price by the same volume, as can be seen above. Therefore we must be careful when evaluating inflation figures reported in the news.

My hometown of Birmingham can be seen as a microcosm for the disproportionate impacts caused by inflation. The region has 'been home to the largest increase in rental demand

⁴ 'The Unequal Impact of Rising Inflation', National Institute of Economic and Social Research, <https://www.niesr.ac.uk/blog/unequal-impact-rising-inflation>

from Q4 2020 to Q1 2021 with a 25.2% rise⁵, forcing rental prices higher. With a housing ownership of just 41.7% across the region (compared to the 64.9% national average)⁶, this will see many lower earning local citizens real incomes squeezed, only serving to intensify cost of living struggles when compounded with raging inflation increasing the cost of essential purchases. This can be seen with local charity, the Human Relief Foundation, reporting 'massively alarming' rising demand for food bank help in Birmingham.⁷ Those in the region with the financial capacity to own a house however are not impacted as much, and are set to benefit from inflation with property consultancy JLL predicting 'house prices in Birmingham are expected to rise more than any city in the UK over the next 5 years'.⁸

There are further reasons for inconsistency. At a macro level, employers are likely to be impacted in different ways. As discretionary incomes are squeezed, consumers are more likely to substitute spending on luxury or high value items than on their regular weekly food shop. As a result, UK supermarket chain Aldi, retailing essential foodstuffs, is likely to retain or even increase business, whereas a furniture retailer may see a dramatic reduction in demand, which may result in the need to make staff redundant.

⁵ 'Major Cities seeing increase in rental demand, Birmingham leads the way', Buy Association, <https://www.buyassociation.co.uk/2021/04/14/major-cities-seeing-increase-in-rental-demand-birmingham-leads-the-way/>

⁶ 'England: share of owner occupied households 2000 to 2021', Statista, <https://www.statista.com/statistics/286503/england-proportion-of-owner-occupied-households/>

⁷ 'Demand for food banks alarming says Birmingham charity', BBC News, <https://www.bbc.co.uk/news/uk-england-birmingham-61499257>

⁸ 'The Black Country areas with the fastest growing house prices', Express and Star, <https://www.expressandstar.com/news/property/2022/03/01/revealed-the-black-country-areas-with-the-fastest-growing-house-prices/>

Conclusion:

In summary, the current high level of inflation and the resulting cost of living crisis impacts much of the economy and households across the board. As we have seen, inflation is an aggregated measure but many essential goods have increased disproportionately in price, impacting people in different ways. Similarly, typical central bank response (raising interest rates) is a blunt tool. Affordability and the types of industry people work in will both determine which households are most impacted. We must hope that governments around the world look to find more tailored responses to bring inflation under control that limit the economic hardship and mental health impact on those worse hit. Indeed, Chancellor Rishi Sunak has made small strides towards this goal, with the introduction of his £150 tax rebate in April alongside his mortgage guarantee scheme. Historically, periods of inflation have led to social unrest, such as the labour and transport strikes seen under Thatcher, as well as changes in government. For a government hanging on its last thread, they will be hoping history doesn't repeat itself.

(Word count excluding title and references: 1045)