

THE EFFECTS OF INFLATION

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Inflation is the general increase in the prices of goods and services over time. It is measured by the annual percentage change in the consumer price index (CPI), which tracks the prices of a basket of goods and services that represent the average consumption of a household. Inflation affects the purchasing power of money, as it reduces the amount of goods and services that can be bought with a given amount of money.

Inflation can have both positive and negative effects on the economy. On the positive side, inflation can reflect a healthy and growing economy, as it indicates that there is strong demand for goods and services. Inflation can also encourage consumption and investment, as people expect prices to rise in the future and therefore have an incentive to buy and invest now. Inflation can also reduce the real value of debt, which can benefit borrowers and stimulate economic activity.

On the negative side, inflation can erode the real income and savings of people, especially those on fixed incomes or with low incomes. Inflation can also distort relative prices and create uncertainty, which can hamper economic efficiency and planning. Inflation can also reduce the competitiveness of exports, as domestic goods become more expensive relative to foreign goods. Inflation can also trigger a wage-price spiral, where workers demand higher wages to keep up with rising prices, which in turn pushes up production costs and prices further.