Many Americans Find Themselves in A Catch-22 As Inflation Keeps Prices, Interest Rates High

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To rein in inflation, there will be pain, Federal Reserve officials say.

Last week, the Fed boosted its short-term interest rate by three-quarters of a percentage point for the third time to help curb inflation, which continues to hover near a 40-year high.

The rate hikes "will also bring some pain to households and businesses," said Fed Chair Jerome Powell at a conference in August. "These are the unfortunate costs of reducing inflation.’’

Inflation is indeed soaring. Americans are paring their diets, debating which bill to pay when, and lining up at food banks. But it is a bleak irony that those hit hardest by inflation — lower and moderate-income Americans — may also be harmed most by the Fed's actions to bring prices down.

'Barely making it' Americans are getting creative to combat inflation's devastating costs

"You're immediately hurt by higher interest rates while the effect on inflation may take some time," said Michael Weber, an associate professor of finance at the University of Chicago's Booth School of Business. "Low and moderate-income Americans are indeed hit quite hard."

Higher interest rates make it more expensive and difficult to buy a home at a time when the average rent has reached a record that may go higher as landlords pay more for properties and for loans to repair them. Americans will pay more interest on their credit card debt, even as they rely more on those cards to pay for food and other essentials.

And if the unemployment rate rises as Fed officials predict, millions may end up out of work.

So what to do in the meantime, as interest rates climb and inflation remains high? Can we do more to help lower and middle-income Americans seemingly caught in a financial Catch-22?

Butter, eggs, cereal see double-digit price hikes

How Americans are affected by rising interest rates and costs may differ depending on where they sit.

What do Fed hikes mean?: Fed hikes interest rate 0.75 percentage point to tame inflation, and sees aggressive increases ahead. What's it mean for you?

Recession? Probably: A recession is now likely in 2023. Here's what could trigger a sharp downturn in the economy

"The lowest-income households, say bottom 20%, tend to not carry a ton of debt having incomes too low often to even qualify for significant loans," L. Josh Bivens, research director with the left-leaning Economic Policy Institute (EPI), said in an email.

However, "the next 40% up from that and into the more comfortable middle-class carry quite a lot of mortgage and credit card debt," he says. So they "will indeed feel a bigger pinch from higher interest rates."

Meanwhile, the poorest Americans may be particularly pressed by the soaring costs of groceries. Among income earners in the lowest 20%,15.8% of their annual spending goes towards food, according to the Bureau of Labor Statistics. That compares with income earners in the top 20% whose share of yearly spending on food is 10.9%.

The prices of some of the most basic items on a family's kitchen table have increased by double digits. Eggs spiked roughly 40% between August 2021 and August 2022, while the cost of cereals rose over 16%. Dairy prices increased more than 16% and butter and margarine cost 29.3% more.

"The impact is going to be most severe on people on the bottom, and that’s the concerning part," says Nada Eissa, associate professor of public policy and economics at Georgetown, and research associate at the National Bureau of Economic Research (NBER).

And then there is the specter of rising unemployment.

Job growth remained robust this summer, with the U.S. adding another 315,000 jobs in August and average hourly pay rising 5.2% annually. But the Fed forecasts the 3.7% jobless rate will increase to 4.4% by the end of next year, far above its previous projection that unemployment would bump up to 3.9%.

What's the Inflation Reduction Act: Inflation Reduction Act of 2022: Answering your common questions about the legislation.

Getting inflation under control "will require slower employment growth and a somewhat higher unemployment rate," Susan Collins, head of the Federal Reserve Bank of Boston, said Monday according to written remarks.

And while it's not certain who will wind up losing their jobs, lower-income workers have been more likely to be laid off during past downturns than their higher educated, higher-paid peers, says Andrew Stettner, a senior fellow at The Century Foundation, a left-leaning think tank.

Turning to credit cards

So, with their costs rising and so much uncertainty, many Americans have been leaning on credit cards to get by.

A LendingTree survey in March found that 56% of those surveyed wouldn't be able to pay all their monthly bills without using a credit card. And nearly one in four of those consumers needed to charge essentials like groceries and housing.

The survey also found that 28% of consumers said their use of credit cards had risen as of March compared with the same time in 2021. Millennials, families with small children, and consumers earning less than $35,000 relied on credit the most.

That increased use comes at a time when credit-card interest rates will rise because of the Fed's actions.

Now, some economy watchers and financial experts say that benefits aimed at helping Americans weather the COVID-19 crisis need to be revived or extended during this latest financial blow.

Fighting inflation: Here’s the Federal Reserve’s best tool against inflation — and how it has worked for 40 years

The federal financial relief during the pandemic included multiple stimulus payments and an expanded child tax credit, which reduced childhood poverty and gave many lower-income Americans a much-needed financial cushion, various researchers have found.

"Even if the Fed is successful in its fight against inflation, it’s going to take time to have a really significant impact and to knock down inflation in a major way," says Matt Schulz, chief credit analyst for Lending Tree. "And in the meantime, you have folks who really need help."

Low-income families tended to have 70% more cash in September 2021 than they did in September 2019, before the global health crisis, according to the JPMorgan Chase Institute.

And a report by the Food Research & Action Center found that 95% of large school districts said pandemic-related waivers that enabled all students to get free meals at school, no matter their family's income, reduced hunger among children.

But one by one, those economic supports have ended. Free school meals for all stopped in September. And a month after the expanded child tax credit ended in December, 3.7 million children fell into poverty, according to a study by Columbia University's Center on Poverty and Social Policy, with Black and Hispanic children seeing the highest increases.

The next benefit, set to expire at the end of September, is a federal provision that increased the amount of fruits and vegetables that could be purchased with vouchers issued by the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).

Given the rise of inflation, that food assistance is even more critical, says Schulz of Lending Tree. "It’s an important service," he says, "and it’s certainly worth examining continuing this benefit expansion."

Tariffs, Taxes and Targeted Benefits

Some economists and conservative lawmakers argue however that it was the flood of financial assistance during the pandemic that helped stoke inflation in the first place.

“The general idea is that we would have had some inflation, but the fiscal stimulus definitely increased it substantially,’’ says Scott Lincicome, director, general economics and trade for the Libertarian-leaning Cato Institute.

Enacting similar spending measures to help Americans deal with rising interest rates and inflation would make the economic situation worse unless there is a definite way to pay for them, he says.

“Spending more money without any offsetting tax hikes would inevitably throw another log on the inflationary fire," said Lincicome.

But many people are struggling to put food on the table and keep a roof over their heads. And they will likely suffer even more as they wait for economic forces beyond their control to have an impact.

Median income didn't budge: Median income for US households was flat in 2021 when adjusted for inflation, Census Bureau reports

"We are seeing some signs of an increase in food insecurity," said Eissa of Georgetown. "I expect to see ... an increase in debt over time. We have already seen some of the large employers announce job cuts. "

So, federal officials might want to think more expansively. Even if some pain for consumers is unavoidable, perhaps there are steps that can be taken to make the experience less severe.

A lifting of tariffs could help reduce prices for instance, Lincicome said. Import taxes are typically passed on to consumers, he explained, so eliminating them would lower costs and also trim the prices of competing U.S.-made products, at least initially.

"It's not going to solve the inflation problem," Lincicome says. "It's a one-time benefit, but it’s something the president can do unilaterally."

Another way to slow rising prices is to process visas faster to enable immigrants to fill positions in industries like construction and food services that have been scrambling to find workers, he says. That struggle has driven up wages, or led businesses to produce less, meaning consumers ultimately pay more.

While not politically popular, raising taxes to slow spending could be part of a broader package of measures aimed at bringing down inflation, said Weber at the University of Chicago.

And while the type of massive relief rolled out during the pandemic may not be feasible, or even necessary, more selective benefits could go a long way toward helping lower and moderate-income Americans stay afloat during a turbulent time.

"I think we need to be prepared to deliver targeted aid to individuals who will suffer during the whiplash from rate hikes," saysStettner, of The Century Foundation. "Enhanced unemployment benefits and expanded food stamps are two examples of targeted aid that can reduce the suffering of a downturn without increasing inflation."

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