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Some Consumers Don't Take the Bait When Economists Project Inflation

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When consumers expect inflation, they go shopping, according to new research from the University of Chicago Booth School of Business. That would mean, in theory, that with the Fed to raise interest rates later this year and inflation to move in tandem, consumers would increase their purchasing now and give the economy a healthy shot in the arm.

"Central banks around the world try to raise inflation expectations via unconventional monetary policy measures to increase spending," University of Chicago Booth School of Business professor Michael Weber said in a released statement.

In their newly published paper, Weber and co-authors surveyed data collected from German households from 2000 to 2013 and found that when consumers expected inflation to rise, they were more likely to spend money on consumer durable goods, such as cars, electronics and other household goods. These findings suggest that consumers increase their buying on the expectation of a rising inflation, because they would save money when the decrease in the value of money in the future was considered. Therefore, the cost of durable goods would be comparatively less.

"The positive effect of inflation expectation on residential real estate might be somewhat muted and smaller [compared to cars]," Weber says. "What makes real estate different from, say, larger electronic items or cars, is that the market for residential real estate is less liquid, consumers have to incur higher search costs, transaction costs are also higher as well as borrowing constraints."

Weber and colleagues believe that educated consumers understand the implications of inflationary projections and plan their purchasing habits accordingly.

Conservative Consumers

However, not everyone agrees with this interpretation.

"There is no reason to suppose any simple cause-and-effect relation between announcements of impending inflation and consumer spending on durables," says George Selgin, director of the

Center for Monetary and Financial Alternatives at The Cato Institute. "For one thing, the announcements could merely be anticipating price hikes driven by increased spending, instead of spurring it."

Then, he added, if inflation is anticipated at all, it's lenders who are keeping a watch on it. That would, in turn, increase consumer borrowing rates.

Individual consumers are inclined to agree that they don't rush to swipe their plastic for fear of increased prices and reduced purchasing power.

“I do not spend more when I expect prices to rise,” says Holly Wolf, chief marketing officer at Conestoga Bank. “As a conservative spender, or as others might say frugal person, I generally maintain the same spending habits.”

Wolf does buy household durable goods, such as toothpaste, shampoo, and shaving cream, in bulk—five at a time, but only to reduce shopping excursions to a few times a year, without regard to monetary policy fluctuations.

“Staying out of the stores prevents me from spending,” Wolf says. She also seeks out value rather than quantity to save money.

“A good quality pair of black pants will last years, an inexpensive pair maybe just one year," she says. "An investment of $100 could last four years or more while $40 will last one year.”

Derek Handova, a content marketing writer for a B2B company in the wireless networking industry, also says he doesn’t change his buying habits, either, when prices are rising.

“As an average consumer in the very high cost of living San Francisco Bay Area, I worry about prices rising, too," he says. "However, because I live in a relatively modest condo with limited storage space, I tend to only buy what I can use in a reasonable time frame.”

As far as food staples go, he only buys want he can immediately cook and eat. "People tend to forget that something is only a bargain if you actually use it,” he says.

"Households always have to compare the utility from more consumption today to saving more and having higher consuming tomorrow," Weber says. "The price of today's consumption becomes cheaper with higher inflation and -- all else equal -- households save less and consume more today. Households would, however, not want to buy another car if they have bought a new car last week. The same applies to electronic goods, furniture, or real estate."

This is one reason why permanent higher inflation might not be a reasonable policy tool, Weber says.

"Temporary higher inflation does spur consumption while permanent higher inflation might actually lead to lower consumption," he says.

Whether consumers actually allow their purchasing behaviors to respond to the Fed, depends on how sensitive they are to the value of their money.