



International Journal of Research Publication and Reviews

Journal Homepage: www.ijrpr.com ISSN 2582-7421

Impact of Inflation on Household Savings and Investment Patterns

Dr. Ratnavalli¹ and Bitra Nikitha²

¹ Assistant Professor, Department of Management, Koneru Lakshmaiah Education Foundation, Vaddeswaram, Andhra Pradesh, India

² Student, Department of Management, Koneru lakshmaiah Education Foundation, Vaddeswaram, Andhra Pradesh, India

DOI : <https://doi.org/10.55248/gengpi.07.1026.3210>

ABSTRACT

A number of macroeconomic factors will affect the income and thus the savings and investment choices of a household. Inflation is clearly the main one. If there is an increase in the general level of prices i.e. inflation occurs, real disposable income of consumers fall and they will have to spend more of their income in consumption, leaving them less for saving and investing. Moreover, the inflation also entices families to move out of deposits and conventional financial instruments into hard assets such as real estate, equity or gold.

The present paper examines the effect of inflation on saving and investment behaviour of households in general with a focus on Indian economy. In line with this, literature implies that inflation seems to have a negative impact on household saving, which is considered a result of its destructive value on accumulated savings of households and the uncertainty inflation creates about future prices and the income of households. However, the impact of inflation on savings is not certainly adverse, since households may as well be encouraged to invest larger portions of their savings into some kind of financial assets and investments as a hedge against future inflation. Evidence from India recently available indicates that the patterns of household saving has shifted, both within the categories of financial assets and towards and away from the category of physical assets as well.

For the methodology, the researcher advises using a quantitative research strategy and gathering primary data through a survey questionnaire Secondary data: Secondary data will be collected from RBI publications, Govt. records, research articles etc. With the help of the study we will be able to know how the inflation affect a household's saving capacity, their choice of investment products, perception towards risks, their awareness about various financial products and much more

Keywords: Inflation, household savings, investment habits, buying power, financial assets, physical assets, how people handle their money, India.

1. Problem Statement

Effects of inflation Inflation reduces the real purchasing power of the money held in the hands of households as the real value of their money savings fall. When prices outpace the earnings of consumers then they will have less amount of money available to buy goods and services and save money.

Inflation also affects household finances by eroding the real return from investments and savings. Consider a household that deposits money at 6% interest while inflation runs at 7%—its nominal bank account balance will increase, but the actual, real value of money held in that account will decrease. Domestic households in turn might reconsider their expectations of the real return of financial assets and decide on their asset mix.

Evidence for India shows that inflation induces reduction in household savings because it creates uncertainty with regard to future real value of assets and real returns on savings. Simultaneously, there has been a diversification of household savings towards financial assets at the cost of physical assets. RBI data suggests huge variation in recent years across household financial savings, financial liabilities and physical savings.

Therefore, inflation's effects on household savings must not only be determined in terms of quantity but also composition of savings.

2. Introduction

Inflation represents one of the key economic determinants involved in the household financial decision-making process. Inflation stands as a symbol of persistent rise in prices of goods and services as well as a progressive decline in purchasing power of money. Since inflation is felt through increased costs of a variety of goods and services – such as food, accommodation, transport, education and health care – households will need to earn more income to maintain the same level of living, which will leave fewer funds for savings or investing.

Household saving promotes the economic development as it is collateral for investment and it contributes for the development in economy. In the households' sector, they save for varied reasons by creating pool of savings, in readiness to face or tackle with some unforeseen circumstances, educating their children, acquiring of shelter, securing a future, a medical, etc. When prices rise faster than income, household savings could be impacted negatively by inflation.

Inflation affects how much household savings are worth. For a financial asset to provide a positive rate of return, its return must be greater than the rate of inflation. For instance, if a household is earning 6% interest on a bank deposit in an economy with 7% inflation, the real interest rate is about -1%. This leads the household to query whether certain forms of savings vehicles that might not give them a 'real' rate of return is appropriate for them.

Inflation has also impacted family investing behaviors. As prices rise, families might be less inclined to put money in regular instruments like savings accounts and fixed deposits with lesser real return. Other than that, some families would invest their extra income into gold, properties, equities or mutual funds or in any other financial instrument as they feel will provide them with much higher yields or act as an inflation hedge. Nonetheless, these decisions are contingent on one's income level, age, financial literacy, risk appetite, investment objectives, and knowledge about financial products.

The investment outlook of Indian households has changed significantly over the years too. Household savings are basically classified into financial savings and physical savings. Broadly speaking, financial assets include bank deposits, life insurance, provident fund & pension fund, mutual funds, securities/shares, etc. Whereas physical assets generally refer to gold, residential and other real estate etc. As per data from the Reserve Bank of India, even the contribution towards the make of Household Savings moved to and fro—from financial savings towards physical savings and back and forth. Families can adjust not only how much they save, but in what form they save.

Inflation expectations are equally fundamental. consumer, investment, and savings plans will be affected based on what they think if further rise is expected. For some households, investing more in inflation-hedged assets may result, while in others, saving would decrease, because households would now need to spend more to cover the costs of living. Inflation, both past and expected, influences household financial planning.

Thus, that relationship is not simple. The fall in value of money might cause lower levels of household savings as households spend more, whilst also serving as an incentive to explore investment opportunities. Moreover, this impact might differ by type of income. Low-income families may be more affected as a larger percentage of their earnings go towards paying for essentials; wealthier families will be able to more easily distribute their investments.

In the Indian Context understanding of the impact of inflation on household saving and investment behaviour becomes all the more important because of the crucial role played by the household sector in saving–investment process in India. The findings of the research are meant to allow financial institutions adapt their product offering, help policymakers promote financial stability and help individual investors make better informed financial decisions.

Consequently, in this study, the impact of inflation on household savings and investment decisions has been looked into in terms of their ability to save, investment preferences, expected rate of return and financial vulnerabilities. The study will therefore be significant as it will shed light on the behaviour of households during times of inflation and the factors that influence their behaviour.

3. Review of Literature

3.1 Samantaraya (2014)

The researcher of the present study in a separate work uses ARDL and investigates saving determinants in India. It is inferred from the study findings that GDP, the dependency ratio, the interest rate and inflation play a major role in the variation of household savings in both the short and long run. The conclusions reached indicate the adverse effects of high inflation on household saving, pointing as well to the vital role of price stability in sustaining it.

3.2 Ghosh and Nath (2023)

Based on time series data, Ghosh and Nath (2018) studied the determinant of private and household saving of India, with annual data period of 1960–2016. The outcomes of the investigation indicated that the banking convenience as well as the actual earnings motivate saving, yet rapid inflation deters household savings owing to anxiety regarding the purchasing ability as well as the future importance of their investments.

3.3 IMF (2014)

The study of saving-investment nexus by IMF in India in revealed that inflation being protracted resulted into fall in real returns, imports of gold increased, and household financial savings fell. The report notes how inflation has caused households to move from standard financial assets into alternative store of wealth products.

3.4 Reserve Bank of India

This indicates that household financial savings are undergoing a rapid shift. The net financial savings of households increased significantly in 2020-21 on the back of restrictions which restricted consumption opportunities during the pandemic. Households ran down some of this accumulation of net excess savings over subsequent years, once consumption and investment opportunities started to reopen from the pandemic period. Net resources position of the household sector had shrunk in 2022-23 when growth in liabilities had increased even as the quantum of physical savings remained high.

3.5 Bhoskar and Pilgulwar (2025)

In Maharashtra, Bhoskar and Pilgulwar observed how inflation influences householders' investment and savings decisions. They observe that the prices hike certainly affecting the savings habits and compels the family to look for a substitute, mainly Gold, Property and Equity/Shares. Also it reveals disparities in urban and rural households on the tendency to save.

3.6 Nazir and Mir (2025)

Nazir and Mir (1990-2020) inflation and household consumption expenditure in India Nazir and Mir (2016) analysed inflation and household consumption expenditure in India for the period 1991-2020. According to them inflation impact on the consumption pattern of household which may also affect savings and investment behavior by lowering the purchasing power and real value of nominal assets.

3.7 Ghate, Gopalakrishnan and Saha (2025)

The Great Indian Savings Puzzle Their paper examines India's secular savings trend and the relationship between inflation and savings. Inflation, demographics, and productivity growth are the key factors contributing to the changes in India's savings rate, a research has found.

4. Research Gap

Though there have been countless studies about household savings and inflation, there are still areas, as listed below, that have not been investigated yet:

1. Scarcity of studies on savings and investment combined: Most research papers stress mainly on savings.
2. Changing investment pattern of people: Due to availability of mutual funds, shares, on-line trading and other schemes needs to be re-analyzed in order to study the consumer investment behaviour.
3. Inflation réelle ou ressentie: L'inflation courante peut être très différente de l'inflation ressentie ou anticipée par les ménages.
4. Changes in portfolio of preferences: It is worth observing whether households display a preference shift for investment from bank deposits towards other forms of assets such as gold, real estate, mutual funds, or equities, in an inflationary economic environment.
5. Household Evidence: Evidence regarding domestic households within India, most studies have traditionally concentrated at a broader macroeconomic level in recent times. A better way to understand the experience and financial behaviour of individual households is via more primary evidence.
6. Socio-economic factors: Income level, age, education, occupation, financial literacy and geographic location can all have a bearing on the impact of inflation on savings and investment decisions.
7. Post-pandemic changes: Household financial behaviour has changed a lot post the Covid pandemic, thus warranting a fresh study.

5. Objectives of the Study

Objectives of the study include

1. To analyse the impact of inflation on savings of household.
2. Investigate whether household investment behaviour changed under the pressure of inflation.
3. Investigating the effect of inflation perception on household financial decisions.
4. To identify the determinants of household choice when it comes to investing in either a financial or physical asset.

6. Research Methodology

6.1 Research Design

The design of the research of this paper is both descriptive and quantitative. A descriptive research design is used to understand saving and investment behaviour of household whereas a quantitative research design is used to explore the relationship between inflation and saving-investment behavior of the households.

6.2 Research Approach

The use of the questionnaire format was proposed.

6.3 Population

They are members of the population, those who earn incomes and decide savings and investments.

6.4 Sample Design

Depending upon the accessibility of the respondents, either convenience or purposive sampling will be adopted

A reasonable sample size for an academic type project would be in the region of 100 – 150 participants.

6.5 Data Collection

Primary Data

Collecting primary data through a questionnaire featuring:

- Population inquiries
- Financial queries
- Saving habits
- Investment choices
- Inflation Awareness
- Changes of investment behavior when inflation occurs
- Views on risk and reward

Secondary Data

Sources for gathering secondary data

- RBI releases findings
- Indian Government Releases
- Statistics and Programme Implementation Ministry
- Scholarly publications
- Academic studies
- IMF updates
- Economic and financial journals

The RBI maintains data on households' financial assets, liabilities, and savings, which serves as one of the most important secondary sources for this study

6.6 Data Analysis

Analyzing the collected data with :

- Rate and proportion

- Average
- Deviation measure
- Analyzing Relationships
- Chi-square analysis
- Analyzing Regression

We could for example use regression analysis to explore if perceived inflation is a significant predictor of changes in saving or saving preference

7. Conceptual Background

This research is based on the theory that inflation affects consumer financial behavior through various channels.

Inflation → Purchasing Power

A more inflation pushes up prices of the goods and services and it reduces the buying power of household incomes

Inflation → Savings Capacity

The money you use for basic needs, such as a place to live or food, will eat away at how much of your paycheck is actually going to grow.

Inflation → Real Return

When the rate of inflation is greater than the rate of return on an investment the value in real terms of an investment will be declining.

Real Return $\approx$ Nominal Return – Inflation Rate

Let's say an investment total return is 7% and inflation is 5%, it's just about 2%

Inflation → Investment Preference

The family could also reallocate investments to assets they perceive as hedge against inflation, like:

- Precious Metal
- Property market
- Ownership
- Investment funds
- Inflation-tied assets

At the same time, risk-averse families are likely to continue relying on their usual avenues like bank savings, fixed deposits, insurance and the government's small saving schemes.

Inflation Expectations → Financial Decisions

People might be willing to spend more on your products if they think prices are going up.

8. Conceptual Framework

Here is the plan:

Independent Variable

Inflation

- Price increase
- Views on Inflation
- Expected inflation
- Buying power decline

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Intermediate Variables

Household Financial Conditions

- Spending money
- Living expenses
- Ability to save
- Investment risk perception
- Anticipated gains

↓

Dependent Variables**Household Savings**

- Account savings
- Term deposits
- Coverage
- Retirement savings
- Money reserves

Household Investment Patterns

- Precious Metal
- Property market
- Investment funds
- Stocks
- Public bonds
- Alternative investments

Framework in Simple Form

Price Increase

↓

Rising Living Expenses Reduce Buying Power

↓

Shift in Disposable Income and Saving Power

↓

Shift in Risk Perception and Expected vs. Actual Returns

↓

Shifts in Savings and Investment Trends

9. Key Findings and Analysis

Note: These are the findings you'd expect based on the literature, since we don't have the main survey data.

Finding 1: Inflation can chip away at a family's savings.

Conversely, if households have to pay more for things, it may result in household savings falling. Some earlier studies done in India found that inflation reduces how much households save.

Finding 2: Watching its value disappear because of inflation.

Even if the household's total amount of money went up, it might still be able to buy less than before. Thus, one must take into account the real yield of a fixed-income security.

Finding 3: Households to potentially diversify investments.

High inflation makes families change direction away from traditional savings options to investments such as gold, real estate, stocks, and mutual funds. Indian data also indicates that physical assets play an important role in household saving.

Finding 4: People make investment choices based on how much risk they're willing to take.

Not every household responds to inflation in the same way. A household that doesn't like taking risks might stick to bank accounts and government bonds, while one that's good with finances would be more open to investing in market assets.

Finding 5: Income determines responsiveness to rising prices.

People with higher incomes might be able to avoid spending their savings and can put their investments in different funds while inflation is happening. Conversely, low income earners may need to spend a larger proportion of their income.

Finding 6: Importance of Inflation Expectations.

Existing households might also change the spending that they are currently doing by either accelerating their purchases of durables or saving less if they believe that inflation will be higher in the future. New research shows that these current households might have been a lot more sensitive to inflation than most people

Finding 7: Indian household savings are going through a structural shift

RBI data shows that over time, households have often shifted their savings between financial and physical assets. In 2022-23, household physical saving is stated at 12.7 per cent of GNDI, compared to net financial saving of 5.2 per cent.

10. Future Research Directions

Further studies may extend the present one in these ways:

1. Comparing regions: Look at what households are doing in different Indian states and areas.
2. Compare urban and rural households to see how they differ.
3. Income group comparison: See how people with low, middle, and high incomes are affected by inflation.
4. Age analysis: Screen and compare younger, middle-aged and older households.
5. Financial literacy: Look into whether knowing more about finances changes how inflation affects investing.
6. Explore digital investments: how did digital investment platforms, mobile banking, and fintech apps change the investment decisions of households?
7. Longitudinal survey: tracking households over several years to understand investment patterns over time, and through different inflation cycles.
8. Review how inflation affects gold, real estate, stocks, mutual funds, fixed deposits, and insurance, looking at each one separately.
9. Inflation expectations: Future research could separate real inflation from how people see it.
10. We could also look into whether the way people save money after COVID-19 is a lasting change or just a short-term shift.

11. Conclusion

Households are influenced by inflation in decisions regarding savings and investments. Higher inflation results in a lower real value of household purchasing power and an increased level of households expenditure. Consequently, the households' saving capacity and the real value of nominal financial assets may drop.

Inflation's effect on your savings isn't straightforward. Whilst households will avoid traditional savings as inflation rises, high inflation levels may cause them to seek alternative ways in which to protect their real wealth. Looking at the evidences available on households in India it can be observed that the share of financial assets relative to physical assets in household portfolio has been rising with gold, real estate, equities, deposits, insurance and pension products forming part of household financial behaviour.

Therefore, maintain price stability allows the consumer to maintain his or her purchasing power and it also gives them flexibility to prepare for the future. Financial literacy: Since nominal and real returns aren't the same, people need to pick an investment based on what they expect for inflation, their financial goals, and how much risk they're willing to take.

To sum up, the research shows that inflation can lower how much households save, and it can also influence their decisions about how, when, and where they invest their money.

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