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THE IMPACT OF INFLATION ON ECONOMIC GROWTH: A COMPREHENSIVE LITERATURE STUDY

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Abstract

The general rise in prices of goods and services that occurs in a country is called inflation, an economic phenomenon. Its impact on economic growth can vary depending on its level and stability. Controlled inflation is often considered a sign of economic health as increased demand for goods and services drives economic activity, investment and increased wealth. Conversely, runaway inflation or hyperinflation can undermine confidence in the domestic currency, reduce consumer purchasing power and weaken economic growth. In addition, inflation also has a major effect on investment and savings. High inflation lowers the real value of savings, makes saving less attractive, and encourages short-term consumption. This can reduce resources for long-term investment needed for sustainable growth. Uncertainty due to uncontrolled inflation can discourage companies from making new investments or expanding business, leading to economic stagnation. Therefore, maintaining a stable and predictable inflation rate is a key challenge for economic policies supporting long-term growth.

Keywords: Inflation, Economic Growth.

Introduction

A country's economy cannot be separated from the turmoil of inflation, which is the main measure of economic stability. Inflation symbolizes the status where the general prices of goods and services in the economy rise over a period of time. Inflation that is contained within a certain threshold is considered part of growing chaos, but uncontrolled inflation can cause severe complications in the economy.

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Economic progress is an important goal of many countries' economic policies. High and stable economic growth rates indicate a country's opportunity to expand the production of commodities and services. However, high economic development is also often accompanied by a rise in inflation (Karki et al., 2020). This indicates a complex relationship between inflation and economic growth. In some studies, inflation is said to promote economic growth when it is at a rental level. However, inflation that is too high or too low can slow down economic growth (Wogari, 2023).

Inflation affects various aspects of the economy, from people's purchasing power, income distribution, to monetary policy. Meanwhile, continued economic development is highly dependent on price stability. This price stability affects the confidence of economic actors in the market, be it buyers, producers or investors. When inflation is at an unstable level, the confidence of economic actors will drop and lead to uncertainty in investment and spending. (Khairi & Haryanti, 2024).

Literature shows that inflation control is a challenge for many countries. On the one hand, inflation that is too low can indicate weak demand in the economy, which in turn can slow down the pace of economic growth. On the other hand, inflation that is too high can cause the cost of living to rise, reducing purchasing power and making it difficult to plan for the future. Both conditions indicate that appropriate economic policies are needed to keep inflation within reasonable limits. (Rokhimah et al., 2024)..

Various studies reveal that a moderate inflation rate is considered a catalyst for economic growth. Moderate inflation can encourage producers to increase production and innovation in order to meet growing market demand. (Dinh, 2020). However, there are also studies that suggest there is a "threshold" where inflation starts to have a negative impact on economic growth. This threshold differs greatly between countries, depending on the economic conditions and industrial structure of each country (Morvillier, 2020). (Morvillier, 2020).

In Indonesia, inflation is one of the main focuses of economic policy. Bank Indonesia regularly releases inflation-related reports and sets annual inflation targets. Countries with high economic growth such as Indonesia often face challenges in balancing economic growth and inflation. In recent years, Indonesia has managed to lower its inflation rate to a level that is considered more stable, although challenges remain especially in dealing with commodity price volatility and international prices. (Ghossoub, 2023).

Apart from monetary policy, various external factors such as fluctuations in world oil prices, changes in foreign exchange rates, and changes in global economic conditions also affect the inflation rate. The influence of economic globalization also cannot be ignored as economic linkages between countries are getting closer. In this context, the study of the impact of inflation on economic growth includes not only analyzing domestic data but also considering international economic conditions. (Sinha, 2022).

It appears that the relationship between inflation and economic growth requires a comprehensive analytical approach. Therefore, a comprehensive literature study is needed to understand the dynamics of the relationship in more depth. This study aims to collect, analyze, and synthesize findings from existing literature on the impact of inflation on economic growth.

Research Methods

The study conducted in this research uses the literature research method. The literature research method is an approach used in academic and scientific research to collect, analyze, and present relevant information on a particular topic from secondary text sources. (Helaluddin, 2019); (Sanusi, 2015); (Wekke, 2020).

Results and Discussion

Economics Related to Inflation and Economic Growth

An economy is a system that serves to regulate the production, distribution, and consumption of goods and services within a country. Two key indicators that are often monitored in the economy are inflation and economic growth. Inflation, as measured by the consumer price index (CPI) or producer price index (PPI), reflects the general change in prices of goods and services. (Batrancea, 2021). On the other hand, economic growth is measured by gross domestic product (GDP) which indicates the total value of goods and services produced by a country. The balance between inflation and economic growth is one of the challenges faced by economic policy. (Kumari, 2021).

Inflation can arise due to a variety of factors such as an increase in aggregate demand, rising production costs, or high inflation expectations. Moderate inflation is often seen as a sign of economic health as it reflects increased demand for goods and services. However, too much inflation can reduce people's purchasing power, discourage investment, and narrow the scope for economic policy. (ABOUDI &

KHANCHAOUI, 2021). Therefore, central banks and governments usually try to keep inflation at a manageable level through monetary and fiscal policies.

Economic growth, on the other hand, describes the increase in output and productivity in the economy. Sustainable economic growth can be achieved through efficient investment, improved quality of human resources, technological innovation, and supportive government policies. High economic growth allows for increased income, poverty reduction, and improved living standards. However, growth that is not matched by inflation control can lead to overheating in the economy (Dahal et al., 20). (Dahal et al., 2024).

The relationship between inflation and economic growth is complex and often fluctuates. In some cases, moderate inflation can be a supportive factor for economic growth by keeping price expectations up and encouraging consumption and investment. (Lubocheng, 2024). Conversely, too high inflation can create economic uncertainty and discourage long-term investment. Therefore, understanding and managing the relationship between inflation and economic growth is crucial for creating economic stability and achieving long-term development goals. (Macia, 2024).

It is a fact that inflation rates and economic growth are influenced by various internal and external factors. On the one hand, domestic conditions such as government monetary and fiscal policies play a role in maintaining economic stability. But foreign factors play a part, such as fluctuations in global commodity prices and the performance of trading partners. Crude oil volatility, for example, can drive inflation through production and transportation costs. In open regions, trade flows also have a significant impact. Increased exports have the potential to boost GDP growth, while global uncertainty can slow it down. (Uddin, 2021).

The government tries to balance inflation and economic growth through various policies. Monetary policies such as interest rates and fiscal policies such as state spending and taxation are meant to stabilize the economy. Tight policies can reduce inflation but risk slowing growth, while loose policies can boost growth but increase the risk of inflation. (Sinha, 2022).

Structural reforms are important to support sustainable growth, such as infrastructure investment, quality education, market deregulation, and strong institutions. With reforms, countries can improve efficiency, attract foreign capital and stimulate long-term growth. This helps overcome the economy's structural bottlenecks, broaden the production base, and improve competitiveness (Ayele et al., 20). (Ayele et al., 2023).

In conclusion, inflation and economic growth are interrelated and require wise management. Controlled inflation and sustainable growth are signs of a healthy economy. The government and central bank play a role in maintaining this balance through appropriate policies and supportive reforms. Economic stability ultimately benefits people's welfare, improved living standards, and long-term development goals.

Factors Affecting the Effect of Inflation on Economic Growth

The effect of inflation on economic growth is influenced by several important interrelated factors. The main factor is price stability, which is the confidence of investors and consumers. (Ramzan, 2021). Uncontrolled high inflation creates uncertainty in the market, discouraging investors from investing. This also hampers the process of investment and innovation essential for growth. Consumers worried about rising prices then hold back on spending, reducing total demand and economic growth. (Uddin, 2021).

Then there are the monetary and fiscal policies of the government and central bank in tackling the impact of inflation. Tight monetary policies such as raising high interest rates to curb inflation can slow down short-term economic activity as borrowing costs are more expensive. (Adaramola & Dada, 2020). However, subsidies and spending on infrastructure projects can boost growth despite inflation. So the effectiveness of economic policy to balance inflation and growth is crucial (Maiga, 2024).

The third factor is labor market efficiency and labor productivity. Inflation can affect workers' purchasing power and undermine the relationship between wages and productivity. If inflation pushes up wages out of balance with productivity, there can be a price-wage spiral that exacerbates inflation. Flexible and dynamic labor markets also support growth amid inflation by adjusting without high unemployment. (NY et al., 2024).

Finally, there are external factors such as global commodity prices and economic conditions of trading partners. High commodity prices on the world market can trigger imported inflation, especially in countries dependent on imported fuel and raw materials. Unstable global economic conditions can also exacerbate domestic inflation and damage growth prospects through trade and investment. Therefore, an open economy needs to pay attention to global dynamics in addition to domestic conditions in facing the challenges of inflation and economic growth. (Haliru, 2021).

In conclusion, various related factors influence the effect of inflation on economic growth. Price stability that controls market uncertainty is the basis for investor and consumer confidence. Appropriate monetary and fiscal policies play a role in balancing controlling inflation and promoting growth. Labor market efficiency and productivity are also key to keeping the economy growing despite inflation. In addition, external conditions such as global commodity prices and the economies of trading partners also affect the dynamics of inflation and domestic economic growth. In the face of inflation, comprehensive and appropriate policies are needed to ensure sustainable economic growth.

Relationship between Inflation and Economic Growth

The relationship between inflation and economic growth is a complex issue that affects each other. Inflation, defined as a general and sustained rise in prices, can have both positive and negative impacts on economic growth. (Kashyap & Tantri, 2023).. At reasonable levels, inflation reflects a prosperous economy where demand for goods and services increases. However, if the inflation rate is too high, it can reduce people's purchasing power, erode savings, and create economic instability which in turn will slow down growth (Maran, 2021). (Maran, 2021).

One important link between inflation and economic growth occurs through monetary policy. Central banks such as Bank Indonesia use monetary policy instruments to control inflation, such as by raising or lowering interest rates. This policy has an impact on the level of investment and consumption in the country. For example, an increase in interest rates may suppress inflation but also potentially slow growth as higher borrowing costs may discourage investment and consumption. (Sekarwati et al., 2024)..

On the other hand, too low inflation or deflation is also potentially bad for economic growth. Deflation, which is a general decline in the prices of goods and services, can lead to delayed consumer spending and reduced corporate investment due to expectations that prices will continue to fall. (Eshov & Benetti, 2023).. These conditions can form an intractable deflationary cycle, where the decline in demand causes production to shrink and unemployment to rise, which will further hamper economic growth (Ahmad, 2024). (Ahmad, 2024).

Therefore, keeping inflation at a stable and manageable level is crucial in supporting sustainable economic growth. The government and central bank must work together to formulate balanced policies to stabilize prices while boosting economic activity. In addition, improving productivity and efficiency in the country

also contributes greatly to creating a conducive environment for healthy economic growth, even under reasonable inflationary conditions. (Buthelezi, 2023).

The implications of inflation are complex and vary across a number of economic sectors. The manufacturing industry as well as agriculture are vulnerable to rising production costs triggered by rising raw material prices and labor wages. The tendency of producers to pass on cost increases to selling prices can reduce people's purchasing power and demand for goods. The service sector is also not immune to the effects of inflation where operational costs such as employee salaries and other operational expenditures will rise, eroding business profits. (Sarkhanov & Baghirov, 2023).

High inflation tends to be followed by an increase in interest rates as a central bank action to stem price pressures. The increase in interest rates has the potential to affect the stock and bond markets as investors direct their investments to safe financial instruments. This situation has the potential to trigger volatility and economic uncertainty. (Sinha, 2022).

Inflation control demands a comprehensive and coordinated policy approach between monetary and fiscal authorities. Monetary authorities through interest rate setting and open market operations regulate the money supply. Tight monetary policy can reduce inflation by suppressing aggregate demand but must be careful not to hamper economic growth. (Sipahutar, 2024).

The government, through fiscal policy, also plays a role in controlling inflation by managing public spending and taxation to adjust aggregate demand. For example, reducing spending or increasing taxes can reduce demand as well as inflationary pressures. However, fiscal policy must also be careful not to disrupt people's purchasing power and investment. (Bayanova, 2024).

Some nations have practiced that a balance between inflation and economic growth can be achieved through the right policies. For example, Germany is often regarded as an example of managing inflation while maintaining resilient economic growth. Tight monetary policy and disciplined fiscal policy have helped Germany keep inflation at a low and stable level, which in turn supports a healthy investment climate and consistent economic growth. (Mandeya & Ho, 2021).

In contrast, some developing countries often experience high and uncontrollable inflation, which can hinder economic growth. Argentina and Venezuela, for example, have experienced hyperinflation that undermined people's purchasing power and reduced investor confidence. This highlights the importance

of price stability and disciplined economic policies to create an enabling environment for economic growth. (Matthews & Ong, 2022).

In conclusion, inflation and economic growth have a complex and interdependent relationship. Moderate inflation can be a sign of a healthy economy, but high or too low inflation (deflation) can hinder growth. Effective monetary and fiscal policies and coordination between the central bank and the government are critical in controlling inflation and supporting sustainable economic growth. The experience of various nations shows that price stability is key to creating a stimulating environment for investment and economic activity. Therefore, comprehensive, targeted and adaptive policy formulation is needed to pursue sustainable economic growth in the context of controlled inflation.

Conclusion

Inflation is an economic phenomenon that refers to the general increase in prices of goods and services in an economic system. While controlled inflation can support economic growth, uncontrolled inflation can have a negative impact. Moderate inflation often indicates that the economy is expanding, as it is usually associated with increased demand for goods and services. Strong economic activity can encourage investment, both domestic and foreign, and can improve household welfare. However, too high inflation or hyperinflation can undermine confidence in the domestic currency and reduce consumer purchasing power, which in turn can weaken economic growth.

On the other hand, the impact of inflation on investment and savings is also significant. High inflation can lower the real value of savings, making saving less attractive and encouraging people to consume more in the short term. This can reduce the resources available for long-term investment, which is essential for sustainable economic growth. Moreover, the uncertainty caused by uncontrolled inflation could also discourage companies from making new investments or expanding their businesses, resulting in economic stagnation. Thus, maintaining a stable and predictable inflation rate is one of the key challenges for economic policies that aim to support long-term economic growth.

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