

# UNIVERSITY OF THE PEOPLE

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Periods of changing inflation create unique financial environments that can benefit either borrowers or lenders, depending on the circumstances. When inflation rises unexpectedly, borrowers can take advantage of certain dynamics that make their debt burdens more manageable. Conversely, declining inflation generates favorable conditions for lenders looking to preserve asset values and earn greater returns. The optimal strategy depends on carefully assessing one's position and financial objectives during inflationary shifts.

A primary advantage borrowers have during unexpected inflationary surges is that the money they repay loses real value over time. When they took out loans, borrowers agreed to fixed principal and interest payments. But as rising inflation devalues currency, they end up paying back debt with money that has less purchasing power. This effectively reduces the tangible weight of their financial obligations. For example, a mortgage payment of \$1,000 per month has less of an impact during 5% annual inflation than 2% inflation. This can provide critical relief for borrowers managing debt burdens.

Additionally, borrowers benefit when rising inflation prompts central banks to increase interest rates. Those with fixed-rate loans lock in lower rates before hikes occur. So, while new borrowers pay higher interest costs, existing debtors continue making lower fixed payments. This interest savings effect can persist for years, helping offset inflation's impact on household budgets.

Moderately rising inflation may also encourage economic growth, creating an environment where borrowers can capitalize on opportunities. Businesses and investors often spend and expand operations during inflation upticks as they aim to grow returns. Borrowers can utilize loans to finance promising investments, development projects, or other purchases that may generate

significant future value. If executed strategically, borrowing during rising inflation provides capital to pursue potential growth.

On the other hand, periods of declining inflation generate advantages for lenders looking to protect asset values and increase returns. When inflation falls, money gains purchasing power over time. So as lenders recoup principal repayments, they benefit from currency that can buy more goods and services. This preserves capital against loss and may even generate real returns beyond interest earnings.

Lenders also benefit when inflation drops because interest rates tend to decrease. Central banks cut rates to incentivize borrowing when prices stagnate. Existing loans made at higher rates continue collecting elevated payments. So, lenders earn strong interest income even as new loans charge less. This expanded spread allows greater earnings.

Moreover, lower inflation supports borrowers' ability to repay debts. Reduced living costs enable households and businesses to make loan payments more easily. Lower default risk gives lenders confidence during the lending process, encouraging the flow of capital. By stimulating lending activity, periods of modest deflation can ultimately aid lenders.

In summary, unexpected shifts in inflation generate advantages for either borrowers or lenders depending on circumstances. When inflation rises, borrowers benefit from repaying cheaper dollars and locking in lower fixed interest rates. Meanwhile, periods of declining inflation allow lenders to preserve capital value, earn higher returns, and reduce default risk. By understanding these dynamics, individuals can optimize financial strategies and capitalize on changing economic

environments. The key is carefully evaluating one's position and objectives during inflationary swings.

Reference:

Greenlaw, S., & Shapiro, D. (2017). Principals of macroeconomics 2e. Openstax. Licensed under CC-BY 4.0. <https://openstax.org/details/books/principles-macroeconomics-2e>

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