Factors Influencing Purchasing Power

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Purchasing power is an economic theory relating to an individual's or business' ability to buy goods or services in the economic marketplace. Purchasing power usually is measured by calculating how many items a consumer can buy with a fixed dollar amount. Government agencies and economists often track consumer purchasing power because consumer purchases make up a large part of a nation's overall economy. Several factors can influence consumer purchasing power.

Supply & Demand

Supply and demand is a basic economic theory relating to the amount of goods or services supplied by companies versus the demand for goods or services by consumers. Supply increases occur when companies produce more consumer goods or services than are being purchased. An increase in supply often leads to a reduction in consumer prices. Companies lower prices to reduce unsold inventory and recapture business costs relating to the production or manufacture of consumer products. Lower consumer prices usually allow the purchase of more goods or services with fewer dollars. Higher demand has the opposite result of increased supply. High consumer demand coupled with low supply usually results in higher consumer prices. Higher consumer prices mean more dollars must be spent to purchase the normal amount of consumer goods or services.

Credit & Interest Rates

Credit plays an important factor in consumer purchasing power. Consumers typically use credit to purchase big-ticket items in the absence of adequate cash. Credit is a double-edged sword in the purchasing power process. While consumers will be able to purchase more goods using credit, once the available credit decreases, consumers must repay the creditor. This creates higher purchasing power early on and can reduce purchasing power later, since consumers may not have enough cash to repay credit balances and continue to make future purchases. Interest rates work in tandem with credit in purchasing power analysis. Consumers using credit for various purchases usually must repay creditors with interest. High interest rates reduce consumer purchasing power because more capital will be spent on repaying interest along with the initial credit balance.

Inflation

Inflation is commonly defined as too many dollars chasing too few goods. This phenomenon can relate to the natural growth of a free-market society or a nation's monetary policies. Inflation increases consumer prices over a period of time and reduces consumer purchasing power. Consumers living in economies of high inflation must use more dollars to purchase a basic amount of goods. Inflation also can reduce the amount of money consumers earn from saving money and generating passive income through various business or economic investments.