Struggling Even After a Pay Hike? Lifestyle Inflation Could Be the Culprit

Published on 27th August2024, By Yukta baid

Imagine this: You've just received that much-anticipated appraisal, and it feels like you've conquered the world. Your bank balance looks healthier than ever, but just a few weeks later, you start to wonder where all that extra cash went. Or maybe you got a hefty raise, and suddenly your cosy apartment no longer feels quite right. The allure of a swankier place becomes irresistible If this sounds familiar, you might be experiencing lifestyle creep phenomenon where your spending increases along with your income, leaving you feeling broke despite earning more.

The Allure of Increased Income and Spending

Lifestyle inflation often stems from the newfound financial freedom that comes with a higher income. As clinical psychologist Shreya Manot says, "The financial freedom we experience can lead to spending on things that were previously not a concern." In fact, the National Endowment for Financial Education reports that 43% of people who receive a salary increase spend more on discretionary items rather than boosting their savings. For instance, as your salary grows, moving to a more upscale apartment becomes tempting. "As income increases, so do our expenses, and not all of these are really required," Manot said.

Rajul Kothari, Partner at Capital League Wealth Management, adds a different perspective: "The idea is not just to save; it's to spend on what you want to do and experience." Kothari highlights a shift in priorities among young adults, who are increasingly drawn to fine dining, gadgets, and travel. "Zindagi Na Milegi Dobara is the motto after Covid," she said, reflecting a trend towards living well and savouring experiences. Manot also notes, "The thrill of a higher income often masks the reality of rising costs. People start to feel like they deserve more because they're earning more."

Comparison Is the Thief of Joy:

Another factor driving lifestyle inflation is the tendency to compare oneself to others. Manot observes, "Comparisons are a very common part of the culture." Social media and personal networks often showcase seemingly desirable lifestyles. A Deloitte study found that 53% of millennials are influenced by social media when making purchases. Seeing friends or colleagues enjoying luxury trips or upscale living can create a sense of inadequacy, prompting more spending.

"Sometimes we feel like, okay, I also want this, and now I can afford it," said Manot. This mindset can lead to spending on things we don't need but feel compelled to have. Kothari agrees, noting that "nuclear families and double incomes have increased affordability," resulting in more discretionary spending.

Class Passing and Compulsive Buying:

Manot highlights the concept of "class passing", where a higher income leads to moving within different social circles. "As your income increases, you are surrounded by people in a higher socio-economic class," she explains. This shift can spark a desire to match their spending habits. For example, if you previously lived in a modest apartment but now find yourself among friends who live in luxury, you might feel pressured to upgrade your living situation.

Stress also plays a role in lifestyle inflation. “Stressors are always there, but when we start earning more, we deal with these stressors ourselves,” said Manot. Higher income often comes with increased responsibilities, leading some to use spending as a coping mechanism. “Compulsive buying is a coping mechanism for stress,” she said. For many, spending becomes a way to manage or escape stress, even if the purchases are unnecessary.

The Impact of Easy Credit:

Easy access to credit further exacerbates lifestyle inflation. “Easy access to credit cards allows people to spend more than they actually have,” Manot said. This can lead to debt accumulation, as people may spend beyond their means, expecting to pay off the balance later. This reliance on credit creates a false sense of security, fostering more spending and less saving.

Kothari highlights a related issue—“anticipatory spending”, where people use credit in anticipation of future income. “Before you get your bonus, people are already taking credit,” she said. The ease of credit access leads to more borrowing and taking out loans for things like phones or cars. “Credit card companies like people who don’t pay on time because they earn money on interest,” she said.

Self-Worth and External Validation:

Manot explores how lifestyle inflation is tied to self-worth and the desire for external validation. “Self-worth is definitely a very strong point,” she asserts. Spending money can provide a sense of accomplishment and validation, reflecting how people view their success and how they want to be perceived. “A lot of people want to feel good about themselves, and spending money can be a way to achieve that,” said Manot. This drive for validation can lead to purchases that strain finances.

Conscious vs Subconscious Spending:

Spending behaviour can be both conscious and subconscious, according to Manot. “Conscious spending is when you deliberately save for a particular item or experience,” she said. For instance, saving for a luxury vacation or a gadget is driven by clear goals. Subconscious spending occurs when people make impulsive purchases, rationalising them based on financial comfort. For those who come into money suddenly, such as through inheritance, managing lifestyle inflation can be particularly difficult.

Strategies to Manage Lifestyle Inflation:

So, how can you enjoy a higher income without falling victim to lifestyle inflation? Both Manot and Kothari offer practical advice. Kothari emphasizes, “First, save and invest every month.” She suggests setting aside funds for savings and investments right away to build a strong financial foundation. “Investing is a lot about emotion and behaviour,” she said. Manot highlights the importance of aligning spending with long-term goals. “Creating a budget that reflects your financial objectives can help you see the bigger picture,” she said.

Vishal Dhawan, chief executive officer of Plan Ahead Wealth Advisors, offers additional strategies: “If your SIP is Rs 10,000 now, increase it by 5% with each salary raise, and don't forget to factor in inflation on your expenses. Balance enjoyment with maintaining financial discipline,” he advises. Dhawan also suggests using excess income to pay off debt first, then increasing savings, and investing in areas that support self-care. Prioritise paying off high-interest loans and avoid accumulating unnecessary debt.

Next time your salary bumps up, strike a balance between enjoying that extra cash and practising smart financial planning. After all, a little fun combined with a lot of foresight makes for a financially happy you.