Nataliia Turlo
Academy of Labour, Social Relations and Tourism, Kyiv, Ukraine (corresponding author)
E-mail: natalyturlo@gmail.com
ORCID: https://orcid.org/0000-0002-0007-7521
Elena Litvin
Academy of Labour, Social Relations and Tourism, Kyiv, Ukraine
E-mail: litvin_eg@ukr.net
ORCID: https://orcid.org/0009-0009-3340-4005

Inflation and its Impact on Employees' Real Incomes

Abstract

The purpose of the paper is threefold: firstly, to analyse the impact of inflation on real incomes of employees in Ukraine; secondly, to identify the main trends and factors that determine this impact; and thirdly, to assess possible ways to minimise the negative effects of inflation on the welfare of the population. *Methodology*. The present study is grounded in the analysis of statistical data obtained from official sources, including the State Statistics Service of Ukraine, the National Bank of Ukraine and the Ministry of Finance of Ukraine. The comparative analysis method was used to assess the trends, and econometric modelling based on multivariate linear regression was used to quantify the relationship between inflation and real incomes of employees. Moreover, a comprehensive review of the extant scientific literature and government policies aimed at mitigating the deleterious impact of inflation was conducted. The study employs a systematic approach that encompasses economic, social, and political dimensions of the issue, enabling the formulation of cogent conclusions and the development of recommendations for enhancing the well-being of the population. The survey results indicated that inflation in Ukraine has a substantial impact on the real incomes of employees, particularly in the context of inadequate wage indexation. Econometric analysis confirmed the existence of a strong inverse relationship between the inflation rate and the purchasing power of the population. The findings of this study indicate that the implementation of effective anti-inflationary policies and the establishment of social protection mechanisms can serve as effective countermeasures to mitigate the adverse consequences of inflation on the overall welfare of the populace. *Practical implications*. In order to mitigate the adverse consequences of inflation on the real incomes of employees, it is imperative to enhance the mechanisms for indexing wages in accordance with inflation, fortify government social protection programmes for the most vulnerable segments of the population, utilise monetary and fiscal policy instruments to regulate inflation, and foster labour productivity and economic competitiveness. *Value / Originality*. The significance and originality of the article are predicated on the exhaustive analysis of the impact of inflation on real incomes of employees in Ukraine, utilising econometric modelling to quantify this relationship. The study combines macroeconomic and social approaches, taking into account the current challenges and specifics of the Ukrainian economy, and offers practical recommendations for mitigating the negative effects of inflation.

Keywords
inflation, real incomes, purchasing power, wage indexation, social policy, economic stability, state regulation

JEL: E31, J31, E24

DOI: https://doi.org/10.30525/2500-946X/2025-1-9

1 Introduction

Inflation constitutes a pivotal macroeconomic challenge, exerting a direct influence on the living standards of the population, economic stability, and the dynamics of the country's socio-economic development. In the context of the contemporary Ukrainian economy, the issue of inflationary pressure is especially pronounced due to a multitude of complex internal and external factors, including the

repercussions of global crises, structural imbalances, and financial system instability. Consequently, the repercussions of inflation on the real incomes of employees represent a pivotal concern within the domain of economic research. This is due to the fact that this indicator is a crucial barometer for evaluating the general welfare of the population and the efficacy of government economic policy.

The novelty of this study lies in its comprehensive approach to analysing the relationship between inflation and changes in real incomes of the Ukrainian population. Utilising econometric modelling based on multivariate linear regression facilitates not only the quantification of the strength and nature of the impact of inflation, but also the identification of the primary factors that modify this impact. Furthermore, the study incorporates a political and social analysis of the issue, enabling the formulation of comprehensive recommendations for enhancing the population's living standards within the context of inflationary growth.

The objective of the present study is to analyse the current state of inflationary processes in Ukraine, assess their impact on real incomes of employees, and identify effective measures aimed at minimising the negative consequences. Specifically, the study aims to analyse the dynamics of inflation in Ukraine and its primary determinants; to study the trends in real household incomes; to assess the relationship between the inflation rate and employees' incomes using econometric analysis; and to consider state mechanisms for combating inflation and their effectiveness.

The logic of the material presentation is structured in such a way as to first define the theoretical foundations of the impact of inflation on the welfare of the population, and then proceed to the analysis of statistical data and the results of econometric modelling. The proposed recommendations for enhancing macroeconomic policy are then derived from the findings. This methodological approach facilitates not only the identification of the predominant patterns of inflation's impact on workers' incomes, but also the formulation of pragmatic proposals for enhancing the economic sustainability of the population.

2 Theoretical Foundations of Inflation Research

The theoretical foundations of the study of inflation were established by the seminal works of economic science. For instance, in 1911, the quantitative theory of money was developed to explain the relationship between the money supply, the price level, and inflation (Fisher, 1911). In his seminal work The General Theory of Employment, Interest and Money, John Maynard Keynes conceptualised inflation as a tool of state regulation of the economy. Keynes emphasised the role of aggregate demand and noted that, in the short term, inflation can have a stimulating effect on employment, although its excessive growth leads to a depreciation of wages (Keynes, 1936). Monetarists posited that inflation is a purely monetary phenomenon, determined by the growth rate of the money supply, and in the long run does not affect real economic performance as the economy adapts to the new price level (Friedman, 1968).

Recent studies have examined more intricate elements of inflationary processes, encompassing the influence of inflation on economic growth and social disparity, accentuating its deleterious effect on nations experiencing unstable economies (Barro, 1997). The impact of inflation on innovation and labour productivity is also studied within the framework of the endogenous economic growth model (Aghion & Howitt, 1992) and macroeconomic mechanisms for regulating inflation. The importance of the balance between inflation targeting and employment support is investigated (Blanchard, 2017).

Of particular relevance are studies analysing inflation in the context of global crises and the COVID-19 pandemic, as well as the impact of inflationary shocks on the labour market and real incomes (Reinhart, & Rogoff, 2009).

The focus of Ukrainian researchers is on the macroeconomic aspects of inflation, with particular attention given to its impact on economic growth, financial stability, and welfare. In their works, they analysed the mechanism of inflationary processes in Ukraine, considering it in the context of global economic trends and domestic structural imbalances (Geets, 2000). Moreover, from the standpoint of economic theory, the study of inflation focuses on its socio-economic consequences and the relationship with fiscal and monetary policy, anti-inflationary measures, and recommendations to minimise its negative impact on the country's economy (Bazylevych, 2000).

A separate area of Ukrainian research is devoted to the methodological aspects of modelling inflationary processes, analysing the advantages and disadvantages of various econometric models for assessing inflationary processes during periods of economic booms and busts, as well as practical recommendations for their use in Ukraine, in particular during financial crises (Lukianenko, 2009). Concurrently, the pivotal factors influencing the development of inflation in Ukraine were examined, and economic and mathematical models were formulated to estimate the inflation rate. This endeavour aimed to facilitate more precise forecasting of inflationary trends and the establishment of effective macroeconomic regulatory measures (Averkina & Katok, 2018).

The analysis of Ukrainian and foreign sources enables the identification of key approaches to the

study of inflation, its causes and consequences. The comparison of these approaches contributes to a more profound comprehension of the general trends and particularities of inflationary processes in Ukraine in comparison to other countries. To systematise the findings, Table 1 summarises the main areas of study of this phenomenon.

The impact of inflation on workers' incomes can be analysed in terms of nominal and real incomes. Nominal wages are determined in current prices, while real wages are determined by taking into account the purchasing power of money. The theoretical framework employed to analyse this impact is the concept of an inflation tax, which delineates how inflation reduces the real value of fixed income and savings.

The impact of inflation on workers' real incomes can be seen through several key channels:

1. Changes in purchasing power. If nominal wage growth is slower than the consumer price index (CPI), real incomes decline, leading to a lower standard of living.

2. Disparities in income changes between different groups of the population. Public sector employees, pensioners, and people receiving fixed payments are the most affected by inflation, as their incomes are not always subject to prompt indexation.

3. The money illusion effect. Due to the cognitive characteristics of economic agents, people may underestimate the impact of inflation on real incomes based on nominal values, which distorts their financial decisions.

4. Changes in the cost structure. High inflation forces households to change their consumption behaviour, reducing spending on long-term assets and investing in human capital (education, healthcare, etc.).

5. Problems with wage indexation. Despite the existence of indexation mechanisms, in many cases it does not compensate for the real losses of employees, especially if there is high price volatility.

In order to effectively assess the impact of inflation on the economy and household incomes, various methods of analysis are used (Figure 1).

These methods of inflation analysis allow not only to assess the current level of inflation, but also to predict further developments.

Thus, inflation is a complex macroeconomic phenomenon that has a profound impact on various aspects of economic activity. It not only changes the price level, but also transforms the structure of income, affects socio-economic equilibrium and financial stability. An analysis of scientific approaches to the study of inflation shows the multidimensionality of this process and the need for a comprehensive approach to its regulation. In the context of instability and global economic challenges, the study of inflation remains a priority area of economic science, especially in the context of forecasting its effects and developing effective macroeconomic policy strategies.

Further theoretical research on inflation may focus on extending methodological tools for more accurate forecasting of inflationary processes, assessing the impact of digitalisation and financial technologies on price dynamics, and studying the relationship between inflation and social inequality. Another important area is the analysis of the effectiveness of modern monetary and fiscal policies in combating inflationary risks in the context of global economic instability.

3 Regression Analysis of Inflation and Real Wages

In recent years, Ukraine has been facing rising inflation, which has a significant impact on the

TABLE 1 Key aspects of inflation research

Aspect	Characteristics
Inflation essence	The process of increasing the general price level, which reduces the purchasing power of money.
Key macro-economic causes of inflation	Excessive money supply, budget deficit and its monetisation, rising production costs, declining labour productivity, devaluation of the national currency, external economic shocks, militarisation of the economy, inflationary expectations.
Inflation types	*By the rate of growth*: moderate (0-10%) is a normal price increase that is considered controlled and does not threaten the economy; galloping (10-100%) is a rapid price increase that makes it difficult to do business and devalues money; hyperinflation (over 100%) is a rapid, uncontrolled price increase, usually over 50% per month, which is equivalent to over 12875% per year due to the effect of compound interest (Cagan, 1956). *By cause*: demand inflation; cost inflation; structural inflation; imported inflation. *By predictability*: expected inflation; unexpected inflation. *By the degree of controllability*: managed (controlled) inflation; uncontrolled (spontaneous) inflation. *By the form of manifestation*: open inflation; hidden (suppressed) inflation.
Key macro-economic indicators of inflation	Consumer price index (CPI); producer price index (PPI); import price index; GDP deflator; expected inflation; core inflation; real wages.
Inflation consequences	Economic: depreciation of money, reduction of purchasing power, growth of interest rates, inhibition of investment, etc. Social: falling living standards, rising poverty, uneven redistribution of income, social tensions.

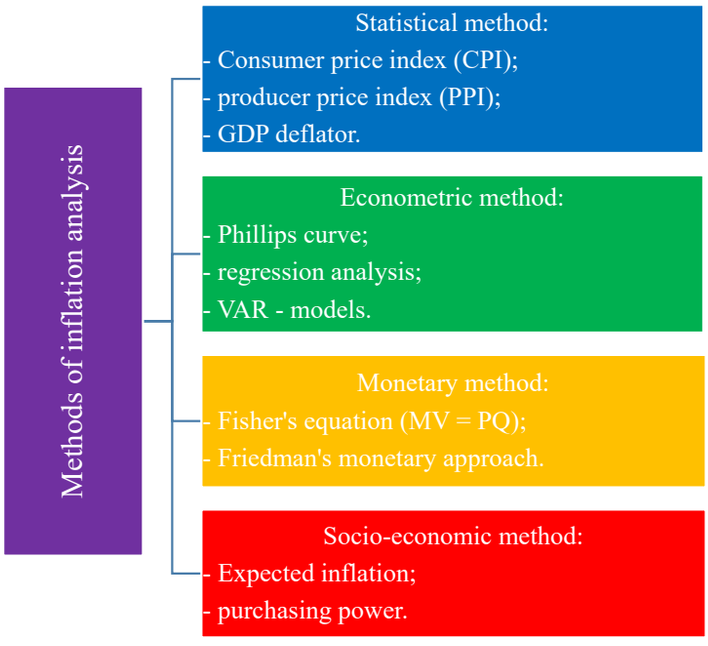

FIGURE 1 Inflation analysis methods

purchasing power of the population. In order to assess inflationary processes within the country, it is necessary to analyse several indicators simultaneously, including the consumer price index (CPI), core inflation and the producer price index (PPI).

1. The Consumer Price Index (CPI) is a statistical indicator that reflects changes in the cost of goods and services purchased by the population. It is widely regarded as the primary indicator of inflation, with implications for the purchasing power of citizens.

2. Core inflation shows the dynamics of prices excluding goods and services whose prices may change under the influence of seasonal or administrative factors (e.g., utility tariffs, fuel, food with unstable prices). This indicator helps to assess long-term inflationary trends.

3. The producer price index (PPI) measures the change in the cost of goods at the production level before they reach retailers. If this index is rising, one can expect consumer prices to rise in the future as producers pass on cost increases to the final consumer.

The comparison of these variables enables the comprehension of the factors that precipitate price growth, the assessment of the impact of inflation on the economy, and the formulation of forecasts for the future (Figure 2).

During the 2014-2015 period, there was a marked increase in the consumer price index (CPI), which rose from 124.9% to 143.3%. This indicates a substantial increase in the price of goods and services. The primary factors contributing to this surge were the more than threefold devaluation of the hryvnia, precipitated by the political and economic crisis, the military conflict in eastern Ukraine, a substantial rise in energy prices, and the necessity to align utility tariffs with market rates. A comparative analysis of these factors enables a comprehensive understanding of the causes of price growth, an assessment of the impact of inflation on the economy, and the formulation of future forecasts (Figure 2).

After 2015, inflation gradually decreased and stabilised in 2019-2020 (101.4%-105.0%). However, inflation accelerates again in 2021 (CPI – 110.0%), driven by a number of factors: global economic instability following the COVID-19 pandemic, supply chain disruptions, rapidly rising global energy and food prices, and higher producer costs due to higher prices for imported raw materials.

The core inflation index demonstrates a comparable trend to the CPI, yet its fluctuations are less pronounced. Significant peaks in 2015 and 2021 indicate that inflationary pressures were driven not only by temporary factors but also by fundamental changes in the economy. The relative stability of core inflation in 2018-2020 may indicate the efficacy of the NBU's monetary policy.Following 2015, the inflation rate underwent a gradual decline, stabilising in 2019-2020 (101.4%-105.0%). However, in 2021, inflation accelerated again (CPI 110.0%), driven by a number of factors. These include global economic instability following the pandemic, supply chain disruptions, rapidly rising global energy and food prices, and higher producer costs due to higher prices for imported raw materials.

The PPI was significantly higher than the CPI in 2015 (153.7%) and especially in 2021 (162.3%). This means that producers faced high costs, which were gradually passed on to consumers. In 2022, the PPI jumped again to 126.6%, which could have led

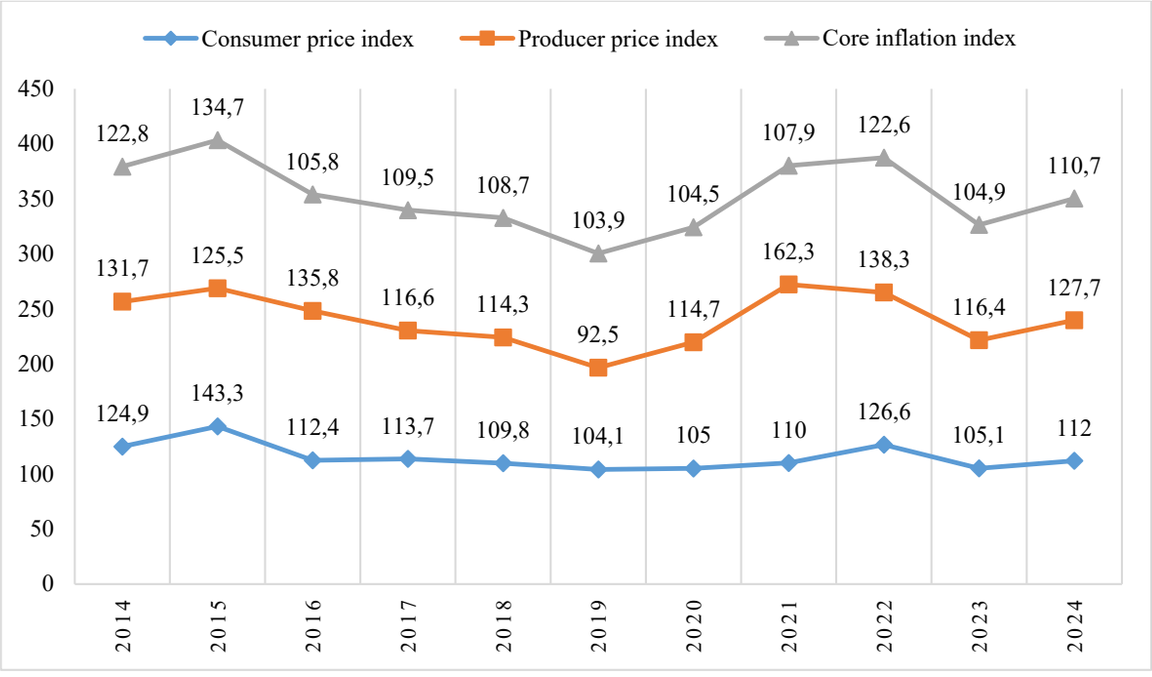

FIGURE 2 Changes in the CPI, RPI, and core inflation in 2014-2024

to a further increase in consumer prices. In the last few years (2023-2024), the PPI is between 119.6% and 127.7%, indicating further inflationary pressure, although not as rapid as in 2021.

In order to assess the impact of production costs on inflation, a regression analysis was carried out using the CPI as the dependent variable and the PPI, its lagged values and the core CPI as independent variables (Table 2).

The multivariate linear regression model was chosen for the analysis:

$$Y = b_0 + b_1X_1 + \ldots + b_pX_p, \quad (1)$$

where the values X_1 ... X_p are the inputs to the system, the coefficients b_0, $b_1 \ldots b_p$ are the model parameters calculated from the measured data, and Y is the output value predicted by the model.

The calculations showed its high explanatory power, which is confirmed by the value of the coefficient of determination (R^2 = 0.9922), indicating a strong relationship between the variables and the CPI. The statistical significance of the model is also confirmed by the low value of the F-value (0.0048). The residual analysis revealed no significant deviations, thus indicating that the model is adequate.

The regression analysis enabled the estimation of the impact of production costs (PPI) and the core price level (Core CPI) on the consumer price index (CPI). The resulting regression equation is as follows:

$$CPI(Y) = -8{,}4547 + 0{,}0041 \cdot PPI(X_1) + 0{,}0439 \cdot PPI(t-1) - 0{,}0285 \cdot PPI(t-2) + 1{,}0711 \cdot CoreCPI(X_2). \quad (2)$$

Interpretation of coefficients:

1. PPI(X1) (current period producer price index) has a coefficient of 0.0041, which indicates a weak direct impact of producer prices on CPI in the current period.

2. PPI(t-1) (producer price index with a lag of one period) has a coefficient of 0.0439. This indicates that

TABLE 2 Input data for regression analysis of inflation

Year	CPI (Y)	PPI (X_1)	PPI(t-1)	PPI(t-2)	Core CPI (X_2)
2016	112,4	135,8	125,5	131,7	105,8
2017	113,7	116,6	135,8	125,5	109,5
2018	109,8	114,3	116,6	135,8	108,7
2019	104,1	92,5	114,3	116,6	103,9
2020	105,0	114,7	92,5	114,3	104,9
2021	110,0	162,3	114,7	92,5	107,9
2022	126,6	138,3	162,3	114,7	122,6
2023	105,1	116,4	138,3	162,3	104,9
2024	112,0	127,7	116,4	138,3	110,7

Source: compiled by the authors on the basis of [13-14]

an increase in PPI in the previous period has a more significant impact on CPI than in the current period.

3. PPI(t-2) (producer price index with a two-period lag) has a negative coefficient of -0.0285. This may imply that, over time, rising producer prices do not necessarily result in an increase in CPI, or that there is a correction after preceding periods of inflation.

4. Core CPI (X2) (the core consumer price index) has the highest coefficient of 1.0711. This finding suggests that core inflation is the primary driver of changes in the overall consumer price index (CPI).

Production costs (PPI) thus have a lagged effect on inflation, confirming the hypothesis that production costs are gradually passed on to final consumers. The core CPI is the most important determinant of the CPI, indicating that inflationary processes in the economy are sustainable. The forecast for 2025 based on the model shows that the CPI is expected to reach 115.3%. In order to contain inflation, it is important to control the underlying level of prices and production costs, which requires a prudent monetary policy of the NBU.

As CPI directly affects household consumption expenditures, its growth may lead to a decline in real wages for employees if inflation outpaces wage growth. This is especially important to take into account when assessing the socioeconomic consequences of inflationary processes in 2025 (Figure 3).

The analysis of inflation and real wages in Ukraine between 2012 and 2025 (with forecasts) revealed a consistent increase in inflation, particularly during crisis periods (2015, 2022-2023). This rise in inflation significantly exceeded the growth of real wages.

Since 2015, there has been a sharp inflationary spike caused by macroeconomic shocks, hryvnia devaluation, and other factors. In 2022, inflationary pressures escalated once more, resulting in a widening of the gap between the indices. Projections for 2023-2024 and the forecast for 2025 indicate that a considerable disparity between inflation and wage growth rates persists, thereby diminishing the purchasing power of the population.

Preliminary regression analysis indicates that inflation exerts a substantial influence on real wages in Ukraine. The analysis reveals a disparity wherein price growth outpaces wage growth, a phenomenon that exerts a deleterious effect on the purchasing power of the population. This phenomenon engenders potential socio-economic risks, including heightened inequality and a deterioration in the living standards of workers.

Further research should concentrate on evaluating the impact of various factors, including monetary and fiscal policy, on the dynamics of inflation and real incomes. It is also important to study the mechanisms of adaptation of wages to inflationary changes and develop strategies to reduce the negative impact of inflation on the socio-economic situation in the country.

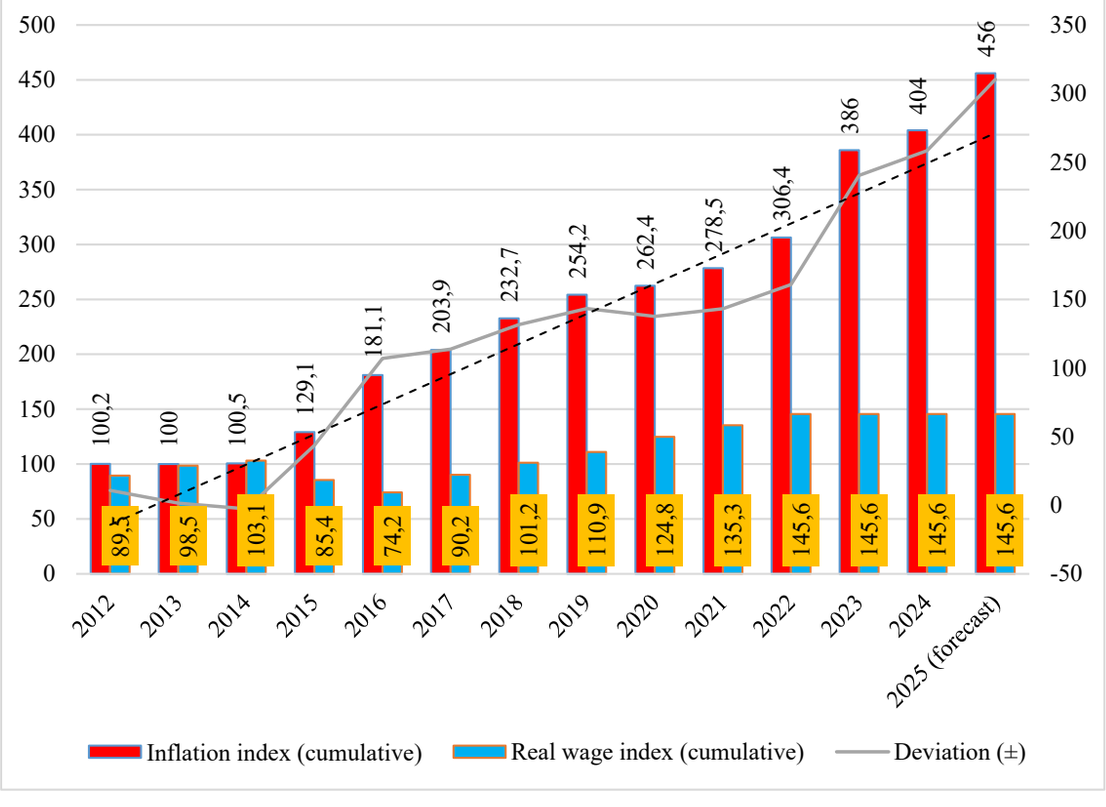

FIGURE 3 Dynamics of changes in inflation and real wages in Ukraine in recent years (cumulative total)

4 Fighting Inflation and Protecting Employee Income

The discrepancy between the indices examined in the preceding section evinces a negative trend, characterised by price growth outpacing wage growth. This phenomenon can precipitate grave social and economic ramifications. In order to address this issue, it is essential to implement effective monetary policies aimed at curbing inflation, as well as government initiatives aimed at increasing real incomes. In this context, the primary strategies employed to combat inflation in Ukraine and their respective effectiveness are examined (see Table 3).

The measures taken to combat inflation have thus been partially effective: they have helped to stabilise the economic situation, but their long-term effects remain uncertain. Monetary policy has helped to contain inflation, but at the same time it has slowed down economic activity. Fiscal measures played an important role, but led to an increase in the budget deficit. Price controls were only effective in the short term.

To improve the effectiveness of anti-inflationary policy, the following steps should be taken: gradual reduction of the key interest rate without drastic changes to stimulate economic activity, striking a balance between social support for the population and budgetary stability, modernisation of tax policy to reduce the burden on businesses, and development of domestic production to reduce dependence on imports.

To improve the effectiveness of the fight against inflation, Ukraine should take into account international experience, in particular strategies aimed at protecting real incomes. Table 4 shows the main mechanisms that can help preserve workers' purchasing power in the face of rising prices.

The implementation of strategies to protect workers' incomes is an important element of the fight against inflation. However, in order to achieve sustainable economic development, it is necessary to take into account international experience and adapt it to Ukrainian realities. The following are the main strategies used in different countries to effectively control inflation and maintain economic stability:

1. Tight monetary policy (Germany, Switzerland). Germany and Switzerland are renowned for their conservative monetary policies, which are designed to ensure price stability. The central banks of these countries have historically pursued a policy of regulating the money supply and establishing explicit inflation targets. This strategy is designed to curtail inflationary processes and thereby ensure confidence in the national currency. The significance of German monetary policy in influencing EU policy-making underscores the efficacy of this approach (Michael, 2012).

2. Income indexation (EU, USA). In the European Union and the United States, wages and social benefits are indexed to inflation. This ensures that citizens' incomes are automatically adjusted to reflect rising consumer prices, thereby helping to preserve the purchasing power of the population even in the face of inflation. This social protection mechanism serves to mitigate the adverse impact of inflationary processes on the living standards of citizens.

3. Progressive tax system (Scandinavian countries). Scandinavian countries, including Sweden, Norway and Denmark, are renowned for their progressive tax systems, which are characterised by higher tax rates for high-income earners and lower tax rates for low-income earners. This approach is said to contribute to the reduction of income inequality

TABLE 3 Main inflation control strategies in Ukraine and their effectiveness

Strategy	Key measures	Efficiency	Problems
Tight monetary policy of the NBU	– Increase in the discount rate (up to 25% in 2022, 14.5% from 24.01.2025); – control of the money supply; – flexible exchange rate.	Reduced inflation (from 26.6% in 2022 to 5.1% in 2023)	Hinders lending and investment
Currency regulation	– Fixing the hryvnia exchange rate in 2022 and gradually moving to a flexible exchange rate; – control of currency transactions and imports.	Prevented currency panic and hyperinflation	Restricted imports and slowed investment
Fiscal policy and social programmes	– Indexation of salaries and pensions; – subsidies for utilities; – progressive taxation.	Supporting the purchasing power of the population	Increases the budget deficit, which creates inflationary pressure
State price regulation	– Control of prices for high-grade wheat flour, pasteurised milk with a fat content of 2.5% (in film), rye-wheat bread and loaf, C1 chicken eggs, poultry (chicken carcasses, chicken carcass quarters), refined sunflower oil; – restriction of trade margins on basic goods (maximum margin on domestically produced food products of no more than 10%, except for goods labelled as organic).	Temporary containment of inflation	Shortage of goods, shadowing of the market

TABLE 4 Strategies to protect employees' incomes from inflation

Strategy	Essence	Example of implementation	Effectiveness
Indexation of salaries and social benefits	Automatic adjustment of income in line with inflation	EU, USA (a mechanism for indexing public sector salaries and social benefits)	Highly effective if real inflation is taken into account, but may lead to an increase in the budget deficit
Income diversification and financial literacy	Training citizens in financial management, investing, and creating passive income	Canada, UK (government financial literacy programmes)	Highly effective in the long term, increases household resilience to economic shocks
Investment mechanisms to preserve purchasing power	Development of in-vestment mechanisms for the population (pension funds, bonds, gold, real estate)	USA (investing through 401(k) (a retirement investment plan, one of the ways to protect income from inflation through long-term investments, as it allows accumulating capital with the prospect of its growth)); EU (government in-vestment programmes).	Moderately effective, effectiveness depends on availability of tools and income level
Role of trade unions in protecting the interests of employees	Negotiating with employers to increase salaries, taking into account inflation	Germany (collective bargaining agreements based on the price index)	Highly effective in countries with strong trade union systems

and the maintenance of social justice. Moreover, the reduction of the tax burden on low-income groups has been demonstrated to have a favourable effect on their purchasing power, which in turn has a positive impact on domestic demand and economic growth.

4. Stimulating domestic production (China, South Korea). China and South Korea have made significant progress in developing domestic production through active government support and stimulation of innovation. These countries are investing in the development of national industry, technology and infrastructure, which reduces dependence on imports and strengthens the national economy. South Korea, in particular, has introduced several stimulus packages to mitigate the effects of economic crises, which has contributed to the rapid recovery and growth of the economy.

For Ukraine, the optimal combination of money supply control, moderate income indexation, tax incentives for the economy and the development of domestic production is optimal. Such a comprehensive approach, based on international experience, can help to effectively control inflation and ensure sustainable economic development.

5 Conclusions

Inflation continues to represent a significant macroeconomic challenge for Ukraine, exerting a direct influence on the welfare of citizens, their purchasing power, and economic stability in general. A thorough examination of the inflationary dynamics spanning the period from 2012 to 2025 reveals that during the economic downturns experienced in 2015 and 2022-2023, there was a marked escalation in prices, which considerably exceeded the rise in real wages. This phenomenon precipitated a substantial decline in living standards and an exacerbation of prevailing socioeconomic challenges.

The anti-inflationary measures implemented in Ukraine were to a certain extent successful. Monetary policy contributed to stabilising the situation, though it also exerted a restraining effect on economic activity. Fiscal measures helped to maintain social benefits, but simultaneously led to an increase in the budget deficit. Price controls were only effective in the short term.

A comprehensive approach is required to effectively address the negative impact of inflation, as demonstrated by international experience. A combination of tight monetary policy, moderate income indexation, stimulation of domestic production, and development of tax mechanisms can ensure macroeconomic stability and reduce the negative effects of inflationary processes.

It is imperative that future research in this domain focuses on evaluating the efficacy of prevailing income protection mechanisms, formulating novel regulatory strategies, and adapting successful international practices to the Ukrainian context. The implementation of a balanced anti-inflationary policy will be a significant step towards strengthening the country's economic security and improving the welfare of its citizens.

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Received on: 17th of January, 2025
Accepted on: 21th of February, 2025
Published on: 31th of March, 2025