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House Prices and Inflation

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Abstract

The present paper examines the long-run impact of inflation on homeowner equity by investigating the relationship between house prices and the prices of nonhousing goods and services, rather than return series and inflation rates as in previous empirical studies on the inflation hedging ability of real estate. There are two reasons for this methodological departure from prior practice: (1) while the total return on housing cannot be accurately measured, the total return on housing is fully reflected in housing prices, and (2) given that using returns or differencing a time series leads to a loss of long-run information contained in the series, valuable long-run information can be captured by using prices. Also, unlike previous related studies, we exclude housing costs from goods and services prices to avoid potential bias in estimating how inflation affects housing prices. Monthly data series are collected for existing and for new house prices as well as the consumer price index excluding housing costs for the period 1968–2000. Based on both autoregressive distributed lag (ARDL) models and recursive regressions, the empirical results yield estimated Fisher coefficients that are consistently greater than one over the sample period. Thus, we infer that house prices are a stable inflation hedge in the long run.

Citing Literature

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