ABSTRACT

This study is to reexamine the hedging performance of real estate market (residential, retail, office and industrial sector) against inflation in Hong Kong over 1984 to 2003, in terms of both short and long term approaches. The short term analysis is undertaken by OLS regression models proposed by Fama and Schwert (1977). Our results provide evidences to support that real estate in Hong Kong is somewhat effective hedge against actual, expected and unexpected inflation in short run.

In terms of long term tests, we employ the cointegration models, the Granger causality test and the test of volatility (impulse response functions and variance decomposition) to explore the long run relationships between property and inflation. In contrast to the short term, there is only a long-run equilibrium relationship between office nominal return and inflation. However, from the result of the impulse response function and variance decomposition, there is little interaction between two variables. We can conclude that the inflation hedging power against inflation in short-term is better than long-term. The evidence about Granger causality tests reveal that residential and office property nominal return provide feedback effect of inflation while there is a unidirectional causality from retail and industrial property nominal return to inflation. The impulse response functions and variance decomposition show that inflation and real estate cannot contribute to influence each other significantly. Various economic factors are mixed with inflation and make the relationship between inflation and property returns less straightforward.