

# The Inflation- Hedging Characteristics of Forest Ownership, Private Housing and Stocks in Finland

This paper investigates the extent, which forest ownership, private housing and stocks are a hedge against the expected and unexpected components of inflation in Finland over the period 1973–2003.

The expected inflation is proxied by using inflation forecasts of the Research Institute of the Finnish Economy (ETLA). Unexpected inflation is the difference between actual inflation and this inflation forecast. ETLA's inflation forecast for the current year published in March is used as an estimate of expected inflation for use in annual data. The advantage of this forecast is, that it is regularly available to the public at a predetermined time. The inflation hedging characteristics of forest ownership are also considered with respect to different inflation forecasts by ETLA. In sensitivity analysis ETLA's previous year's September forecast and previous year's March forecast are used as a proxy for expected inflation instead of the current year's March forecast.

The inflation-hedging characteristics of

forest ownership are also examined in a portfolio context, forest ownership with stocks or private housing. Forest ownership is also an asset class which requires a long investment period. The longer the investment period for a particular asset is, the more important inflation-hedging characteristics are. Five-year and ten-year holding periods are used to study long-run interactions between forest ownership return and inflation.

Forest ownership has not provided a hedge against expected inflation. Private housing and forest ownership have, however, provided a hedge against unexpected inflation. Stocks have not provided a hedge against inflation at all. It is valuable to have a hedge against unexpected inflation, because the inflation hedge against expected inflation can often be obtained through bond markets.

When inflation-hedging characteristics of forest ownership are studied in a portfolio context with stock returns, the results do not change. Forest ownership remains an effective asset class to hedge against unexpected inflation, but not against expected inflation. In longer five-year and ten-year holding periods, forest ownership has provided some hedge against expected inflation and very effective hedge against unexpected inflation as well.

When the previous year's inflation forecasts (either September or March) are used as a proxy for expected inflation, forest ownership has not offered any hedge against expected inflation. With September forecast, forest ownership has provided hedge against unexpected inflation. But when earlier March forecast, and less accurate forecast, is used, forest ownership has not provided hedge against unexpected inflation any more. The hedge against unexpected inflation is fairly sensitive to inflation forecasts. ■