

**Money, Land and Housing, General Education Programme, CUHK
UGEC2910**

1. Why Housing can be a Good Hedge of Inflation?

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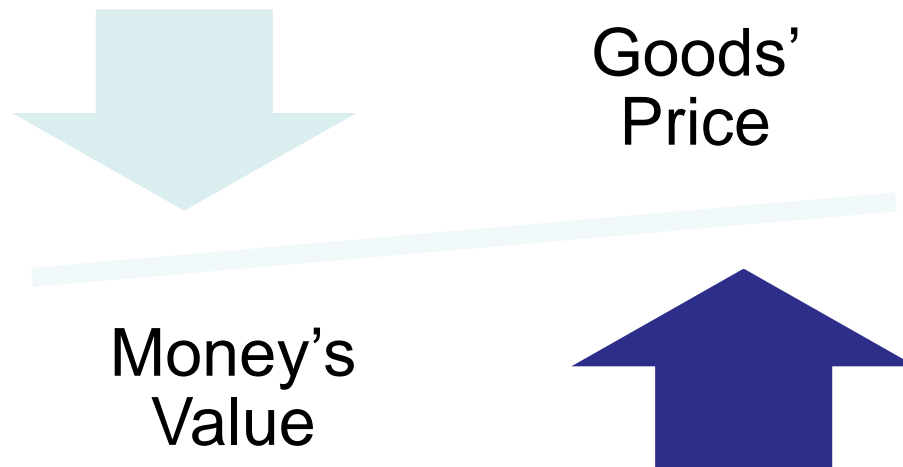
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Expected Outcomes

- What is Inflation?
 - Equation of Exchange
- Why governments and homeowners like inflation?
- Why land and housing are good hedge of inflation?

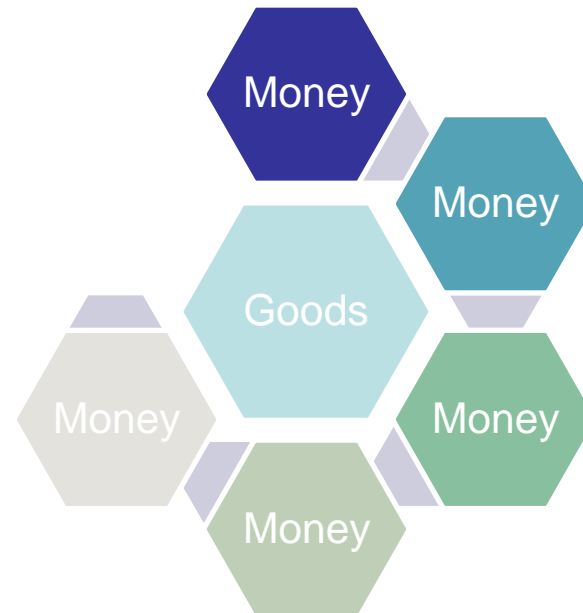
What is Inflation?

- The value of a dollar does not stay constant when there is inflation.
- The value of a dollar is observed in terms of purchasing power, which is the real, tangible **goods** that **money** can buy.



Causes of Inflation?

- Demand-Pull Inflation:
 - Too much money chasing too few goods; and
- Cost-Push Inflation:
 - Insufficient supply of a common factor of production.



Monetarism's Definition of Inflation

- Inflation is defined as “a continuing rise in the general price level usually attributed to an **increase in the volume of money and credit** relative to available goods and services.” (Webster)



Equation of Exchange

- $MV = PQ$
 - M is the total nominal amount of money in circulation
 - V is the velocity of money
 - P is the price level (P hike implies inflation)
 - Q is an index of real expenditures
- PQ is the nominal GDP
- If V & Q are fixed, then M (money supply) causes inflation (a monetary phenomenon)

Why Govts Like (mild) Inflation?

- Borrow more now, repay less debts later;
- Deflation and recession can cause social unrest;
- Encourage spending and investment -> more income;
- Can set a lower nominal interest rate to boost the economy; and
- Profit tax can be guaranteed.
- “For a central banker, inflation is the dream, deflation is a nightmare.”

Why Govts Hate Deflation?

- Real gains from deflation cannot be taxed
- Deflation increases the real value of government debt
- Deflation also increases the real value of private debt
 - Refer to Rickards (2014)
- People would defer consumption, resulting in more unemployment, thus causing a deflation-spiral
 - Refer to Hong Kong 2003

Why Home Owners Like (mild) Inflation?

- Homeowners with mortgages are debtors;
- Larger mortgage, longer repayment years remaining, larger the benefit.
- Mortgage monthly repayment \$10,000 in 2004 = \$3,365 in 2014 (if discount rate = 2%)
- Option to earn housing price appreciation;
- Very low risk due to the high leverage and moral hazard.

2004	2005	...	2012	2013	2014
\$10,000	\$9,804	...	\$4,902	\$4,102	\$3,365

See ppt 3 - Why interest rate and inflation rate affect housing price?

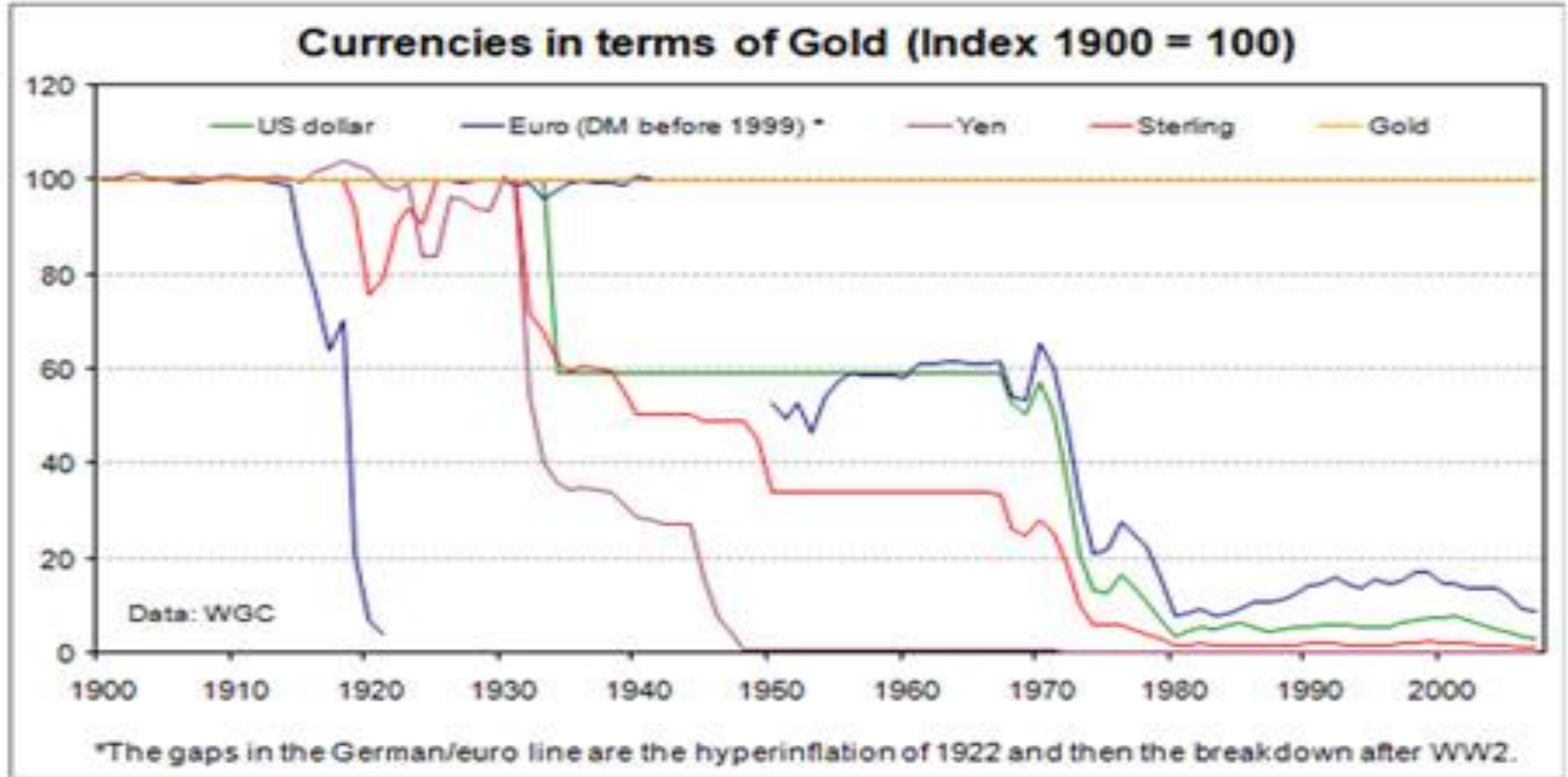
Who Hates Inflation?

- Employees - salary normally rises slower and lesser than inflation, tax payable increases;
- Savers - esp. NRIR (purchasing power drops);
- Retirees - living standard decays;
- Renters – housing price unaffordable.

Inflation is a Crime

- Inflation by money supply is a crime!
- The first batch (bankers/borrowers) who got the money sure wins by buying land and housing;
- The last batch (employees) who fights for income increase to reduce the loss of purchasing power sure losses by paying higher rent, deteriorating living standards.

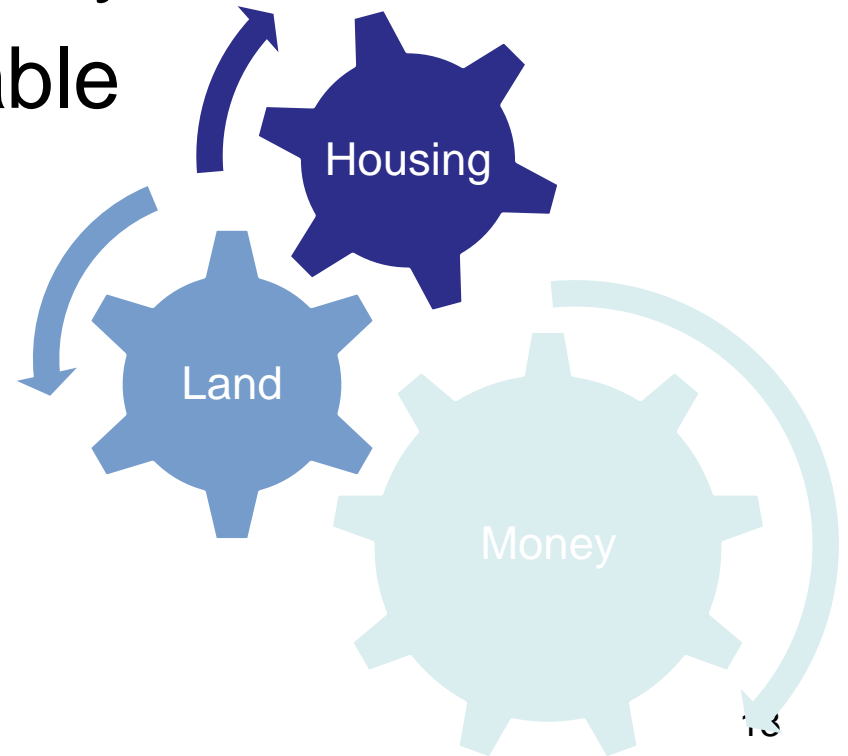
Extent of Inflation since 1900



Currencies in terms of Gold (Index 1900 = 100)

Properties of a Good Hedge

- Limited or fixed supply (very expensive to increase supply)
- High utility and commonly treasured
- Durable, Non-degradable
- Hard to fake
- Examples
 - Gold
 - Oil
 - Land / Housing
 - Knowledge



Why Land / Housing are Good Hedge of Inflation?

- Land and housing are excellent **store of value**
 - Limited supply, esp. land
 - High utility and commonly treasured
 - Durable, esp. land
- Land and housing are MONEY?

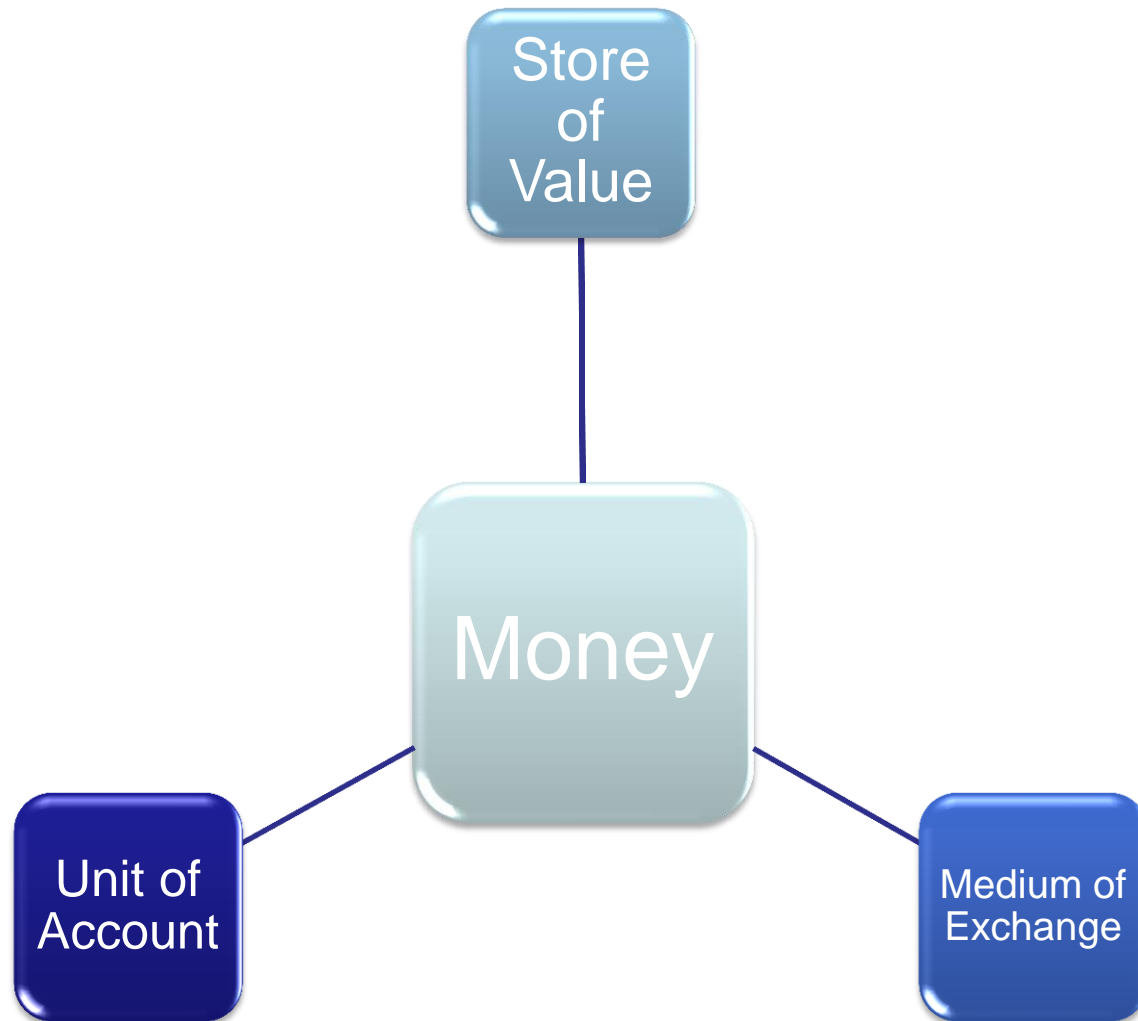
Shortcomings of Holding Land / Housing

- Land and housing are NOT commonly used as money, because:
 - Non-divisible
 - Lumpy
 - Quality not standardisable
 - Latent defects, esp. housing
 - Immovable and illiquid
 - High transaction costs
 - Government interventions

What is Money?



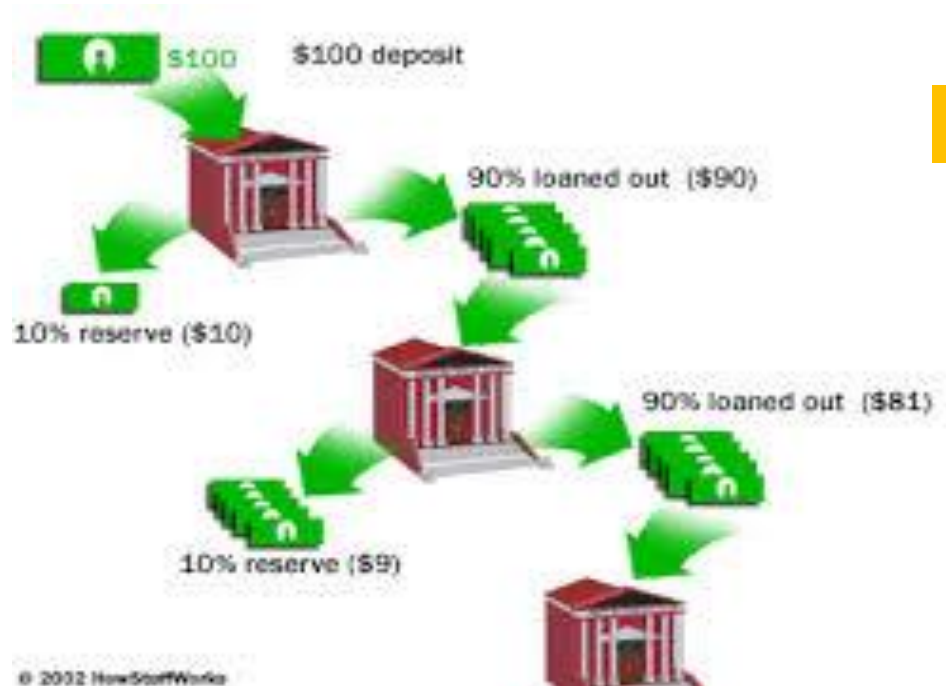
3 Roles of Money



Characteristics of Money

Items	Roles	Characteristics
1	Unit of Account	Anything that can be counted and divisible (\$, pea, ...)
2	Medium of Exchange	Anything that one side supplies and the other side demands (food, salt, cloth, ...)
3	Store of Value	Highly inelastic supply (or fixed supply), common treasured utilities, durable, hard to destroy, verifiable quality, easy to store, carry and exchange (gold, silver, land, housing, ...)

How Bankers Create Money?



See Basel I, II, III Accords

“Central banks act like a 9-year-old-boy who sees fifty dollars in his wallet and steals one dollar thinking she won’t notice. This kind of slow, steady inflation is the central banks’ goal” (Rickards, 2014)

Gold-backed Bank Notes to Land-backed Bank Notes

- Early 18th century
- Scottish economist John Law introduced an idea:
 - An institution could offer more notes than it had gold to back them,
 - By securing the notes at a future value with government land rather than gold.
 - It becomes a forerunner of the modern bank system

Land-backed Bank Notes

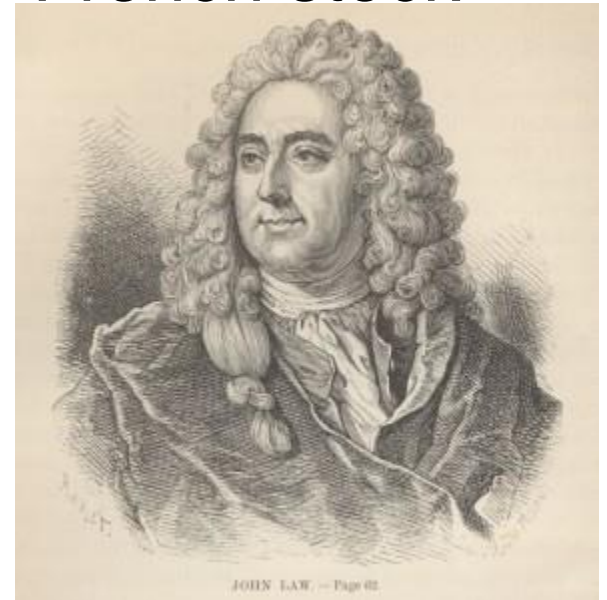
- This novel concept catapulted France from a struggling nation to a solvent one; and
- Created so much new wealth for so many that
- The French coined the new word “millionaire”.
- Because new land supply was almost unlimited in the short run at that time.

Mississippi Bubble

- Unfortunately, Law’s pioneering concept of virtual wealth ..., and his massive land-speculation project in Louisiana,
- Now known as the Mississippi Bubble,
- Led to the utter collapse of the French stock market.

“Thanks to the freedoms offered by paper (fiat) currency, Law was able to increase the the money supply slightly. The ‘stimulus’ brought a new vitality to the French economy and John Law was hailed as a financial genius.”

<http://www.prepareandprosper.net/the-mississippi-bubble-and-the-french-bailout/>



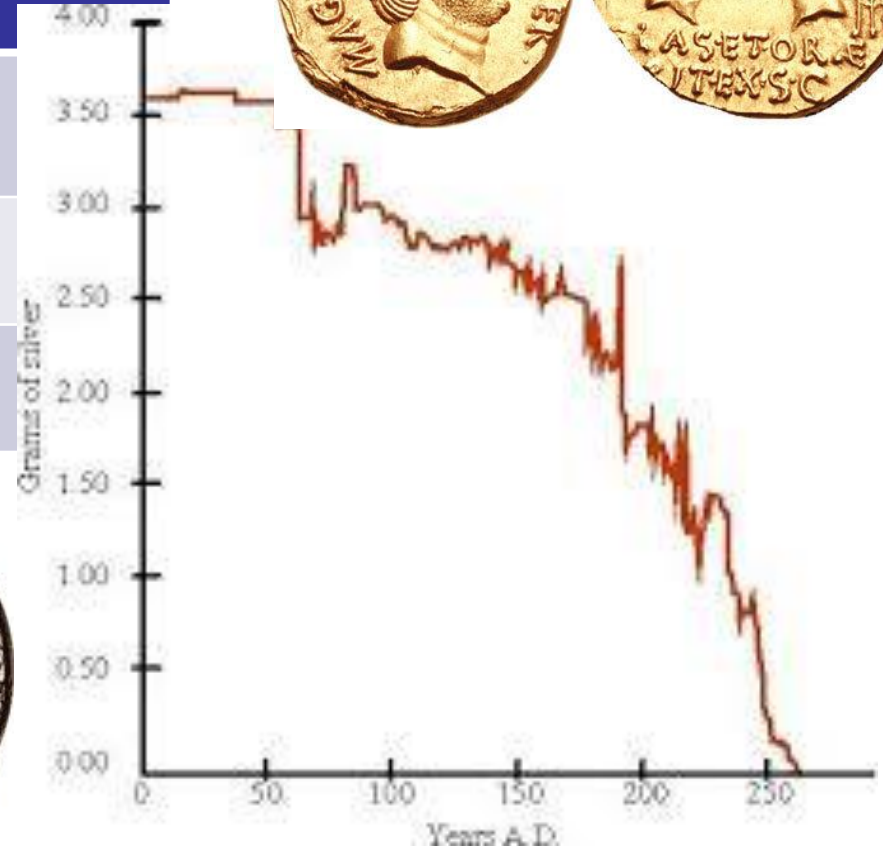
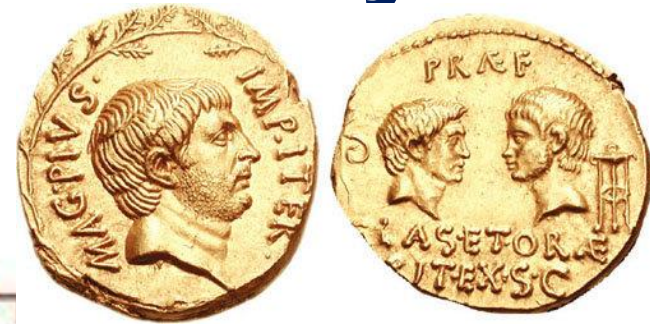
The First Fiat Money

- Nov 1023, Sung Dynasty of China
- 1023年11月，宋仁宗剛登基，批准成立「益州交子務」，正式啟動了人類歷史上第一次主權信用貨幣的發行。

After the series of bank runs in about 1000 AD, the Chinese government banned all private printing of paper money, but made it a government monopoly in Nov. 1023. It supplied 1,256,340 strings of iron-coin equivalent paper money (jiaozi), with about 28.7% reserve ratio (i.e. 360,000 strings of iron coins). It became the world's first fiat money with less than 100% commodity support, and the money value is based on the trust of the government's future income. <http://ecyyiu.wordpress.com/2014/05/04/the-first-fiat-money-in-the-world/>

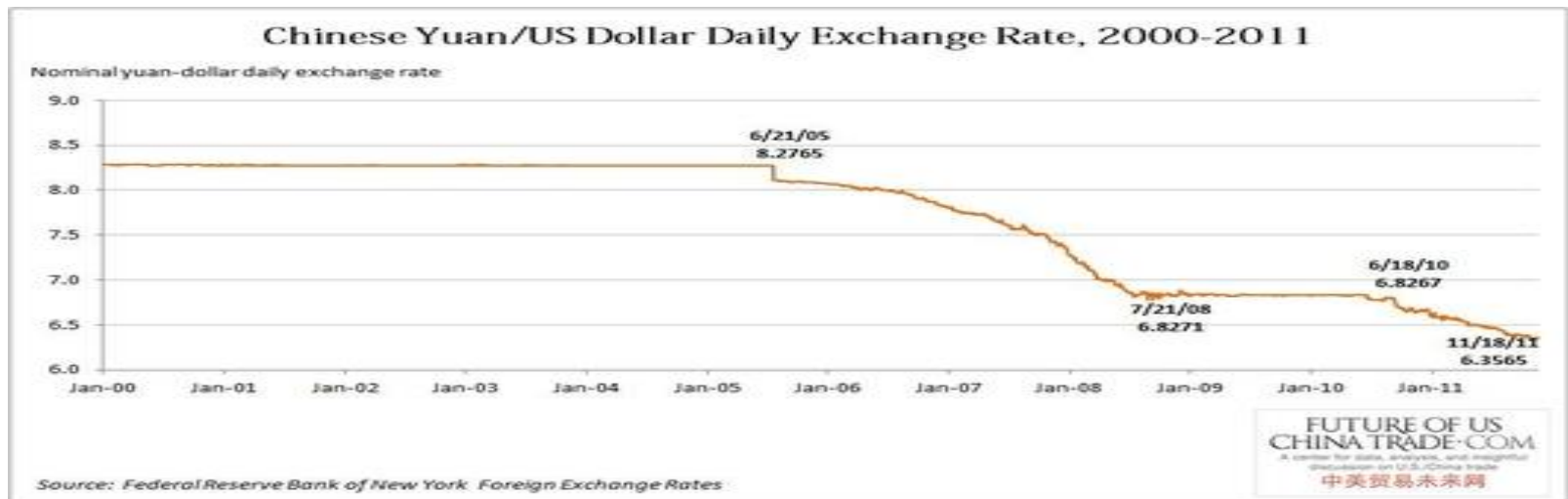
Collapses and Fiat Money

Period	Country	Money System
9 th century	China	Fiat money
479 BC	Greece	Debasement
215 AD	Rome	Debasement



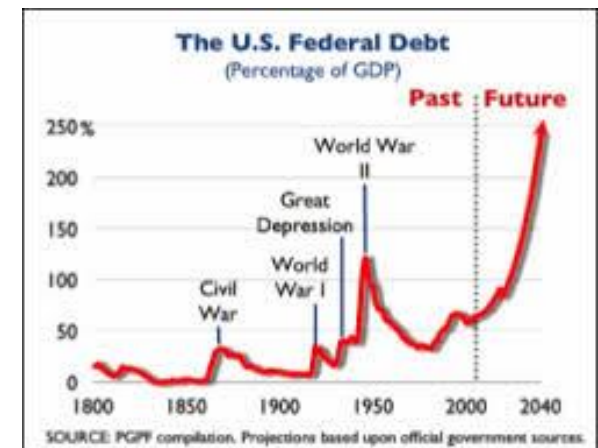
Fiat Money in China

Period		Events
9 th century	Sung Dynasty	交子 http://ecyyiu.wordpress.com/2014/05/04/the-first-fiat-money-in-the-world/
1940s	中華民國	金元券，銀元券
2008	PRC	RMB4000b injection http://ecyyiu.wordpress.com/2010/12/07/%e4%b8%ad%e5%9c%8b%e8%b2%a8%e5%b9%a3%e4%be%9b%e6%87%89-china-money-supply/



Fiat Money is a Debt

- US dollar is a perpetual, non-interest bearing note issued by the Fed
 - It is a debt (see Rickards, 2014)
- Contract Theory of Money (contractism)
 - The US dollar is money
 - Money is value
 - Value is trust
 - Trust is a contract
 - The contract is debt
- Debt-ridden: if people do not buy govt debt anymore, no money to repay existing debt interests.

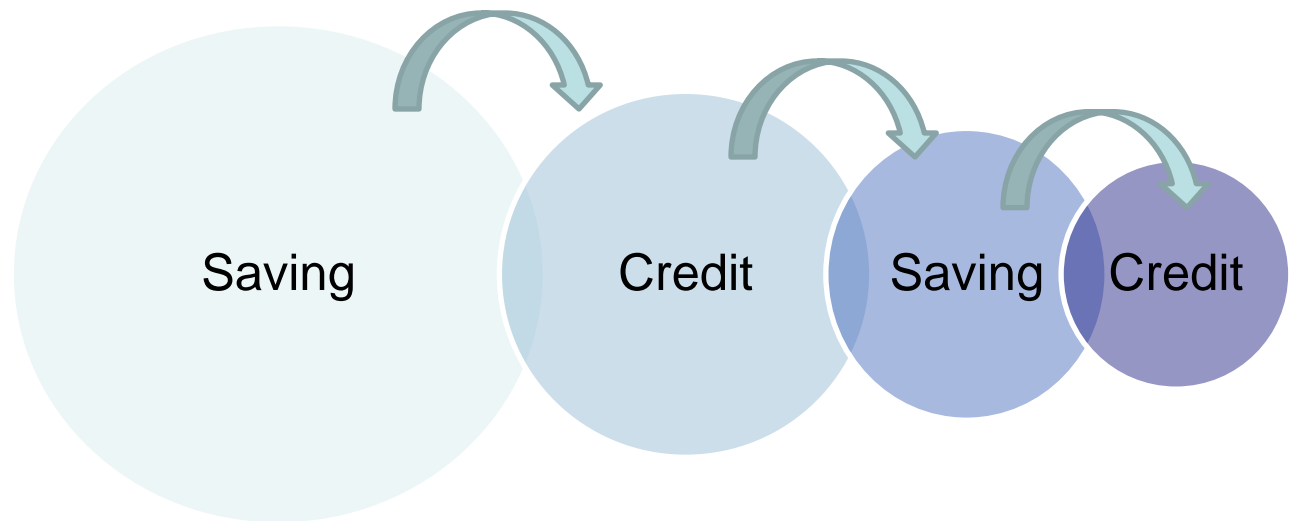


Fiat Money is Tax-supported

- Citizens work for and value money because it can pay for tax.
 - It is a tax coupon (see Rickards, 2014)
- State Theory of Money
 - Chartal money (Chartalism)

Fiat Money includes Credits

- Money into a bank will partially become credit, which increases money supply.
- It loops and expands
- It is a credit generator (see Rickards, 2014)
- Richard Duncan's Quantity Theory of Money
 - Creditism



References

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- Krueger, D. (2013) The Secret Language of Money,
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The End

comments are welcome.

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