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Kilian and Park (IER 50 (2009), 1267-287) find shocks to oil supply are relatively unimportant to understanding changes in U.S. stock returns. We examine the impact of both U.S. and non-U.S. oil supply shocks on U.S. stock returns in light of the unprecedented expansion in U.S. oil production since 2009. Our results underscore the importance of the disaggregation of world oil supply and of the recent extraordinary surge in the U.S. oil production for analysing impact on U.S. stock prices. A positive U.S. oil supply shock has a positive impact on U.S. real stock returns. Oil demand and supply shocks are of comparable importance in explaining U.S. real stock returns when supply shocks from U.S. and non-U.S. oil production are identified.

Do Consumers Benefit from Supply Chain Intermediaries? Evidence from a Policy Experiment in the Edible Oils Market in Bangladesh

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Commodity traders are often the focus of popular resentment. Food price hikes in 2007-2008 resulted in protests and food riots, and spurred governments to regulate traders. In March 2011,
Government of Bangladesh banned delivery order traders in the edible oils market, citing cartelization, and replaced them with a dealer's network appointed by upstream refiners. The reform provides a natural experiment to test alternative models of marketing intermediaries. This paper develops three models and derives testable predictions about the effects of the reform on the intercept of the margin equation and pass-through of international price. Using wheat as a comparison commodity, a difference-of-difference analysis of high frequency price data shows that the reform led to (i) an increase in domestic prices and marketing margins, and (ii) a weakening of the pass-through of imported crude prices. The evidence is inconsistent with the standard double-marginalization-of-rents model wherein intermediaries exercise market power while providing no value-added services, or with a model where delivery order traders provide credit to wholesalers at below-market interest rates. The evidence supports a model where delivery order traders relax binding credit constraints faced by the wholesale traders.

"Oil Prices and the Global Economy: Is it Different this Time Around?"  
*USC-INET Research Paper No. 16-21*

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The recent plunge in oil prices has brought into question the generally accepted view that lower oil prices are good for the US and the global economy. In this paper, using a quarterly multi-country econometric model, we first show that a fall in oil prices tends relatively quickly to lower interest rates and inflation in most countries, and increase global real equity prices. The effects on real output are positive, although they take longer to materialize (around 4 quarters after the shock). We then re-examine the effects of low oil prices on the US economy over different sub-periods using monthly observations on real oil prices, real equity prices and real dividends. We confirm the perverse positive relationship between oil and equity prices over the period since the 2008 financial crisis highlighted in the recent literature, but show that this relationship has been unstable when considered over the longer time period of 1946-2016. In contrast, we find a stable negative relationship between oil prices and real dividends which we argue is a better proxy for economic activity (as compared to equity prices). On the supply side, the effects of lower oil prices differ widely across the different oil producers, and could be perverse initially, as some of the major oil producers try to compensate their loss of revenues by raising production. Taking demand and supply adjustments to oil price changes as a whole, we conclude that oil markets equilibrate but rather slowly, with large episodic swings between low and high oil prices.

"Hedging Size Risk: Theory and Application to the US Gas Market"  

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A large number of corporate positions exhibit combined exposure to tradable market prices and nontradable idiosyncratic size elements (e.g., volume, load, and business turnover). We devise and solve the problem of designing a tailor-made financial instrument aimed at reducing the joint exposure to price and size fluctuations. Optimal hedge is searched within the class of contingent claims written on the pair of market price and any additional index showing correlation to the size component. We derive analytical expressions for the resulting price-index custom hedge as well as for alternative market strategies based on linear contracts. The hedging proposals are extensively analyzed through detailed comparative statics and an empirical test on a US gas market dataset. Results suggest that a suitable tailor-made security combining price and a wisely selected index outperforms optimal vanilla hedges. This effect exacerbates along with increasing correlation between naked position's size and hedging index.
"Long-Term Swings and Seasonality in Energy Markets"

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This paper introduces a continuous-time model for commodity pricing under the assumption that logged prices converge to a mean level that experiences smooth, periodic fluctuations over long periods of time. Our model incorporates that assumption by modelling the mean reversion level through a Fourier series. To validate the model, we perform an empirical study of futures prices on Natural Gas, Crude Oil, and Heating Oil. We provide evidence that such long-term fluctuations are present in the price of these energy commodities, possibly together with standard seasonal and cyclical components. We analyse the empirical performance of our pricing model versus two alternative competitors, namely, those proposed in Schwartz (1997) and Lucia and Schwartz (2002). Our findings show that our model outperforms both benchmarks, providing a simple and powerful tool for portfolio management, risk management and derivative pricing.

"Monetary Policy and the Oil Futures Market"
Bundesbank Discussion Paper No. 35/2012

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We assess the transmission of monetary policy shocks on oil prices using a VAR model. We identify monetary policy and financial activity shocks disentangled from demand and oil supply shocks using sign restrictions. We obtain the following main findings. (i) Monetary policy and financial activity shocks both have a significant effect on the oil price. (ii) Monetary policy has made large positive contributions to oil price growth in 2008. (iii) Monetary policy affects the oil price primarily through fundamental (supply and demand) channels rather than through financial activity.