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On the macroeconomic determinants of long-term volatilities and correlations in U.S. stock and crude oil markets*

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Abstract

Using a modified DCC-MIDAS specification, we endogenize the long-term correlation between crude oil and stock price returns with respect to the stance of the U.S. macroeconomy. We find that variables that contain information on current and future economic activity are helpful predictors of changes in the oil-stock correlation. For the period 1993-2011 there is strong evidence for counter cyclical behavior of the long-term correlation. For prolonged periods with strong growth above trend our model predicts a negative long-term correlation, while before and during recessions the sign changes and remains positive throughout the economic recovery.

Keywords: Oil-stock relationship, long-term volatility, long-term correlation, GARCH-MIDAS, DCC-MIDAS

JEL Classification: C32, C58, Q43

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