The impact of oil-market shocks on stock returns in major oil-exporting countries

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PII: S0261-5606(18)30319-X
DOI: https://doi.org/10.1016/j.jimonfin.2018.05.003
Reference: JIMF 1914

To appear in: *Journal of International Money and Finance*

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December, 2017. Revised May, 2018

Abstract

The impact that oil-market shocks have on stock prices in oil exporting countries has implications for both domestic and international investors. We derive the shocks driving oil prices from an oil market model that explicitly identifies speculative trading in the crude oil market. We study the nonlinear relationship of oil price shocks with stock market returns in major oil-exporting countries in a multi-factor Markov-switching framework. Flow oil-demand shocks have a statistically significant impact on stock returns in Canada, Norway, Russia, Kuwait, Saudi Arabia, and the UAE. Idiosyncratic oil-market shocks affect stock returns in Norway, Russia, Kuwait, Saudi Arabia and UAE. Speculative (oil-inventory) shocks impact stock returns in Canada, Russia, Kuwait and the UAE. Flow oil-supply shocks matter for the UK, Kuwait, and UAE. Mexico is the only country where stock returns are unaffected by oil-market shocks. A portfolio that uses the Markov-switching probabilities to switch between equities in the low volatility state and T-bills in the high volatility state outperforms a buy and hold strategy for some countries.

JEL Classification: E44, G15, Q43

Keywords: Markov-switching; oil-exporting countries; oil-market shocks; stock returns.

[†] The authors thank, without implicating, referees and participants at the WEAI 2016 and WAMS 2017 meetings for helpful comments.