THE RELATIONSHIP BETWEENHOUSEHOLD CONSUMPTION AND OIL PRICES: EVIDENCE FROM PANEL DATA MODELS

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Abstract - This study examines the influence of changes in oil prices on total household consumption along with sub-components of household consumption. In order to assess this relationship empirically, we utilize a panel vector error correction model of 29 European countries over period 1996 to 2015. Besides oil prices, our model specification also includes two main household consumption determinants: income and wealth. Results available from impulse responses and Granger causality tests suggest unanticipated increase in oil prices dampen personal consumption. These results are robust to changes of proxies for income, wealth and oil prices, changes of variables ordering and estimation method. Our findings also suggest temporary oil price hikes from recent past create uncertainty and adaptive expectations about future oil price hikes, which in turn have the power to decrease the consumption more than the actual oil price increases. Non-linear oil price definition that takes into account only oil price increases also produces larger drop in consumption when compared to linear oil price change, suggesting the presence of non-linear facet of oil price – consumption relationship. All consumption components decrease as a response to increasing oil prices, but as expected, consumption of durable goods exhibits a strongest decline after an oil price shocks.

Keywords - Oil Prices, Household Consumption, Panel VAR, European Countries
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