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Evaluating a Year of Oil Price Volatility

*By Troy Davig, Nida Çakır Melek, Jun Nie, A. Lee Smith,
and Didem Tüzemen*

After a period of relative stability, crude oil prices fell sharply starting in mid-2014. Over the last 14 months, the average price of oil has fallen by about 60 percent. Although this price volatility is not unprecedented—oil prices also fell by over 50 percent during the Great Recession—its source is somewhat different. Unlike the decline during the Great Recession, only a portion of the recent oil price decline appears to be due to softening global demand. Instead, changes in expectations of future supply relative to demand appear more important.

Troy Davig, Nida Çakır Melek, Jun Nie, A. Lee Smith, and Didem Tüzemen review possible sources of the recent oil price decline using two empirical approaches. The authors find that shifting expectations of future oil supply—coupled with concerns about weakening future demand—appear to have primarily driven the recent volatility in oil prices.

Monetary Policy Shocks and Aggregate Supply

By Willem Van Zandweghe

Economic growth has been sluggish over the past six years, leading policymakers to question whether the Great Recession may have harmed the U.S. economy's productive capacity. A sustained period of weak demand could erode the economy's productive capacity through various channels. Workers may have lost skills during long spells of unemployment, and businesses may have held back on innovation and capital formation. However, if weak demand has eroded capacity, then monetary policy may, in turn, be able to expand capacity by stimulating economic activity.

Willem Van Zandweghe analyzes three major sources of variations in labor productivity to examine monetary policy's effects on labor productivity and potential output. Although monetary policy shocks do not seem to have had long-lasting effects on labor productivity in the past, some evidence suggests monetary policy has boosted output and labor productivity substantially in the current recovery.

Has Forward Guidance Been Effective?

By A. Lee Smith and Thealexa Becker

Since 2008, the Federal Reserve has relied on unconventional policy measures to pursue its dual mandate of stable prices and maximum employment. One such unconventional measure, forward guidance, relies on communication about the future path of policy rates to influence the market's expectations. But has forward guidance been effective?

A. Lee Smith and Thealexa Becker examine the channels through which forward guidance can influence economic activity and compare forward guidance's effects with those of conventional policy changes. They find that forward guidance, as practiced by the FOMC since 2008, has had similar effects on employment and prices as past changes in the effective federal funds rate. In this sense, forward guidance appears to have been a successful substitute for changes in the effective federal funds rate.

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