

Systematic Monetary Policy and the Effects of Oil Price Shocks

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Abstract

Macroeconomic shocks such as oil price increases induce a systematic (endogenous) response of monetary policy. We develop a VAR-based technique for decomposing the total economic effects of a given exogenous shock into the portion attributable directly to the shock and the part arising from the policy response to the shock. Although the standard errors are large, in our application, we find that a substantial part of the recessionary impact of an oil price shock results from the endogenous tightening of monetary policy rather than from the increase in oil prices per se.

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