

**Non-technical summary of “Is the Discretionary Income Effect of Oil Price Shocks a Hoax?” by Baumeister, Kilian and Zhou, forthcoming: *Energy Journal*:**

The large and persistent fall in the real price of oil in 2014-16 has renewed interest in the question of how oil price shocks are transmitted to the U.S. economy. A recent study by Baumeister and Kilian (2017) provided evidence that the overall effect of this oil price decline on U.S. real GDP growth has been close to zero, consistent with the absence of an economic boom in the U.S. economy after June 2014. Subsequently, Ramey (2017) questioned the methodology and findings of this study, claiming that the existing literature on the transmission of oil price shocks is fundamentally confused about the question of how to quantify the effect of oil price shocks. In particular, she asserted that the discretionary income effect on private consumption, which plays a central role in contemporary accounts of the transmission of oil price shocks to the U.S. economy, makes no economic sense and has no economic foundation. She also claimed that the effects of the oil price decline of 2014–16 on private consumption are smaller for a multitude of reasons than suggested by existing empirical models of the discretionary income effect, and that her views are widely shared by U.S. policymakers.

We review the arguments in Ramey (2017) and show that none of her claims hold up to scrutiny. First, our analysis highlights the theoretical basis of the discretionary income effect, as discussed in Kilian (2008, 2014), Hamilton (2009, 2013), and Blanchard and Galí (2010). We demonstrate that the discretionary income effect on private consumption is closely related to the terms-of-trade effect of a change in the real price of oil on real domestic income. The key difference is that it explicitly allows for the fact that consumers purchase motor fuel rather than crude oil. Second, we show that state-of-the-art regression methods for quantifying the consumption stimulus of unexpectedly low oil prices are consistent with the implications of New

Keynesian dynamic stochastic general equilibrium models. We further provide quotes from speeches that confirm that this view is shared not only by many academics, but also by central bankers and other U.S. policymakers including the Council of Economic Advisers. Third, we discuss improved regression-based estimates of the discretionary income effect that allow for changes in the dependence on oil and gasoline imports. Finally, we demonstrate that there is no evidence that the regressions used to estimate the economic stimulus for 2014-16 suffer from structural breaks. We conclude that there is no reason to rewrite the literature on the transmission of oil price shocks. Existing models are theoretically sound and consistent with the empirical evidence.