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The asymmetric impact of economic policy uncertainty on global retail energy markets: Are the markets responding to the fear of the unknown?

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HIGHLIGHTS

- We studied the response of retail energy markets to uncertainty and oil price changes.
- We used the nonlinear ARDL modeling framework.
- We find that rising uncertainty significantly increases retail energy prices.
- There is rockets and feathers effect in all the countries, except Canada.
- Likelihood of rent-seeking exists mainly in diesel and heating oil markets.

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ABSTRACT

Following the paucity of empirical studies on the effects of economic policy uncertainty (EPU) on global retail energy markets and the need to reassess the markets for the prevalence of rockets and feathers effect and rent-seeking behavior by retailers during the Covid-19 pandemic, we studied the asymmetric response of the markets to changes in EPU and crude oil costs. We estimated nonlinear autoregressive distributed lag models over the period 2004 M11-2020 M6 using data for global and domestic EPUs as well as gasoline, automotive diesel, domestic heating oil, industrial fuel oil and crude oil markets. We find that rising uncertainty significantly increases retail energy prices both in the short-run and long-run, especially in UK, Japan and Europe. The asymmetric patterns show that many of the markets respond more to rising uncertainty than declining uncertainty, suggesting the prevalence of the "fear of the unknown". Our results also showed significant evidence of rockets and feathers effect in all the countries, except Canada. Furthermore, the likelihood of rent-seeking by retailers was observed in the diesel and domestic heating oil markets in Italy, UK, and France. The study concluded that these findings have important policy implications, particularly as they relate to consumer welfare, antitrust policies and stability of the policy environment.

1. Introduction

In the last two decades, the global economy has witnessed several uncertainty-inducing events. Examples of such events include: the 2007–2009 Global Financial Crisis, also known as the Great Recession; the escalating global trade disputes, especially the trade tensions between the United States and China that degenerated in 2018 and 2019; the BREXIT vote and the subsequent negotiations between the United Kingdom and the European Union; the March 2020 oil price war between Russia and Saudi Arabia; the European sovereign debt crisis; the COVID-19 pandemic that crippled economic activities globally; and the ongoing Russia-Ukraine war that has led to the imposition of

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