

Investment-Uncertainty Relationship in Oil and Gas Industry

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Abstract

This study investigates the relationship between investment and uncertainty for a panel of U.S. firms operating in oil and gas industry. We decomposes oil price uncertainty to be driven by the shocks to supply of oil, global consumption demand and other oil market-specific demands, to investigate whether investment-uncertainty relationship depends on the drivers of uncertainty. The findings show that oil market uncertainty lowers investment when it is caused by global demand shocks. When uncertainty is driven by oil supply and oil market-specific demand shocks, there is no significant effect on investment. Stock market uncertainty is found to have negative effect on investment. The results show no positive relation between investment and uncertainty but the negative relation is not always seen. This is in line with the option theory of investment and implies that irreversibility effect of increased uncertainty dominates the traditional convexity effect.