

Re: \$75 Oil Will Kill The Economic Recovery Dead

showed up was in retail sales, since a

dollar spent at the gas pump is a dollar that can not be spent elsewhere.

Since last Christmas, prices at the pump have climbed sharply, as shown in the first graph. While prices are still

far below the levels of a year ago, the current levels are high enough to start hurting, especially those who have

seen their incomes drop due to the recession. Dr. Hamilton calculates that the current prices would be consistent

with energy taking up over 6% of total personal consumption expenditures, up from 4.85% back in December.

As the second graph shows, that would be about the share of spending energy had back in the mid-1980s. The mid-

1980s were not exactly the worst period of our economic history, so such a level in and of itself should not be a

real problem for the economy. And we faced a far more serious problem with energy prices in the 1970s than we did

even at the worst energy price levels we saw a year ago.

Still, this is coming at a time when the economy is still very fragile. Retail spending on goods other than energy

face strong headwinds from both the need for consumers to rebuild their personal balance sheets (pay down past

debts and build up savings) and from much worse personal income statements (unemployment, hours and wages cut,

lower interest rates on savings). This is just one more unhelpful factor that will pressure sales, particularly for

stores that sell discretionary items, including clothing stores like The Gap (GPS) and appliance stores like Rex

Stores (RSC) and HH Gregg (HGG). Higher oil prices are of course good news for the energy sector, but for the

overall economy high energy prices are a significant negative.

The rise in oil prices does not seem to be consistent with the overall weakness of the world economy, but there are

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several reasons why it just may be sustained or extended, even in the absence of a global economic rebound. The

first is that oil is a good hedge against future inflation, and given the expansion of the Fed balance sheet, that

may be a very serious concern down the road. Currently the bigger threat is deflation, but it will be hard for the

Fed to sop up all the liquidity that has been created to fight the deflationary fire.

A second and somewhat related reason is that China has been increasing its purchases of all sorts of commodities,

trying to take advantage of the lower prices (note that the price of other commodities like copper have also

increased sharply from the lows of last winter, but remain well off the highs of last summer). OPEC has also shown

greater discipline this time around than they have in the past. How long that will last nobody knows, but so far

they have been keeping it together.

The third reason is that the looming danger of peak oil has not gone away, it has only been masked by "peak demand"

caused by the economic downturn worldwide. Any incremental oil is now coming from very expensive sources like the

Canadian oil sands or the very deep waters of Brazil, both of which require oil prices in the mid-\$60 s to be

economically viable.

With oil prices rising above those levels, the drilling off Brazil should pick up steam. There are, however, very

few rigs capable of drilling at such depths. Most of those are controlled by two firms, Transocean (RIG) and

Diamond Offshore (DO), both of which will benefit enormously if oil prices stay high.

In short, the current levels of oil prices are not exactly fertilizer for the "green shoots," but will not kill

them off either. Other developments, such as long-term interest rates, will have more of an impact. The very low

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prices at the pump in the first quarter may have been one of the key reasons why consumer spending in the quarter

was higher than expected (but probably not as big a factor as increases in transfer payments). However, if they

continue to rise towards the \$100 level, the world economy could easily fall back into the abyss

The 16% increase in gasoline prices between December and February resulted in an additional \$37 billion spending by

consumers at an annual rate on gasoline and fuel oil, increasing the share of energy purchases in consumer budgets

from 4.85% in December to 5.17% in February. The additional 40% increase we've seen in the retail price of gasoline

since February has likely brought that expenditure share back up above 6%.

Read more :

<http://www.etfresources.com/article/142428-will-rising-oil-prices-prevent-a-recovery>

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