Oil Price Jump Adds to Jitters Over Economy

By DAVID LEONHARDT

The most common cause of recessions, a surge in oil prices, is again afflicting the global economy.

Just as they have before every American downturn over the last 40 years, energy costs have risen significantly in the last year, capped by a sharp spike since December. With more money being spent on gasoline and heating fuel, economic growth has slowed in both the United States and Europe, and the uneven recovery that began in late 2001 is facing perhaps its biggest threat yet.

Most forecasters expect the United States economy to avoid a new recession this year, saying that only an unexpectedly protracted war in Iraq would keep oil at its current price or higher. But any war is an unknown, and the price increases for both oil and natural gas have already caused consumers to cut back on other spending. The increases have also created a new problem for businesses trying to emerge from the hangover of the late-1990's boom.

"The economy is extremely fragile," said Mark M. Zandi, the chief economist at Economy.com, a research company in West Chester, Pa. "We've got some real problems if this drags on for any length of time."

Energy costs began rising more than a year ago, when the Organization of the Petroleum Exporting Countries cut production in response to the weak global economy. The potential war in the Persian Gulf, political chaos in Venezuela and a cold winter in the United States caused the price of a barrel of oil to soar to almost $40 on Thursday, the highest since Iraq invaded Kuwait in 1990, before it retreated to $36.60 on Friday in New York. That is up about 69 percent from a year ago.

Every time that oil prices have risen by at least 60 percent since World War II, a recession has occurred in the United States, with the exception of a one-month blip in oil prices in 1987. The current annual increase is similar to the jumps of late 1990, when a recession was starting, and the summer of 2000, nine months before another began.

Higher energy costs reduce economic growth by effectively forcing families and businesses to send more money to a small number of oil-producing countries, leaving less to be spent on goods and services that create jobs at home.

Energy prices affect Europe and Japan even more severely than the United States, which produces more of its own oil and natural gas. Britain reported last week that its economy had grown at the most sluggish pace in 10 years during the last three months of 2002. The German economy shrank at the end of last year for the first time in a year.

"The single best cyclical indicator for the world economy is the price of oil," said Andrew J. Oswald, an economist at the University of Warwick outside Coventry, England. "Nothing moves in the world
In recent weeks, a number of big American manufacturers have blamed higher energy costs for cuts in their earnings forecasts. A few have cited oil prices while postponing new investments that could add jobs, even as an overall rise in business spending has suggested that the economy might be picking up speed were it not for energy.

For example, DuPont, the large chemical maker, recently delayed until June an expansion of its business that had been scheduled to start in February, according to Ann K. M. Gualtieri, a spokeswoman.

In Elkhorn, Wis., Hudapack Metal Treating, which employs 125 people, is investing in technology to make its furnaces less dependent on natural gas — which costs more than twice what it did a year ago — rather than spending to increase its production of bolts for pickup trucks.

"You can't take an extra $20,000 a month, throw it at gas prices and expect to be profitable," said Gary Huss, the president of Hudapack, which is merely breaking even.

The ailing airline industry is also being hit hard. American Airlines will probably spend about $200 million more on fuel this quarter than it did a year ago. Standard & Poor's lowered the company's credit rating on Friday, saying fuel costs were one reason that American might have to file soon for bankruptcy protection.

Many companies buy advance fuel contracts, a practice known as hedging, to protect them from some of the short-term price increases. United Parcel Service has purchased gasoline hedges, but it will still increase the fuel surcharge on its deliveries to 1.5 percent tomorrow, from 1.25 percent, because of increased costs.

Rising oil prices appear to be helping keep layoffs at a pace that few analysts expected, according to government figures, delaying any major improvement in the nation's moribund job market. The economy employs almost two million fewer people than it did two years ago.

Consumers, paying almost 50 percent more for gasoline than a year ago, in turn are reducing their spending on other goods. Over all, purchases at American retail chain stores fell 1.1 percent in January, according to the Bank of Tokyo-Mitsubishi, which adjusts its numbers for seasonal variations.

At 7-Eleven, people are buying smaller cups of coffee than they did in January and more individual sodas in place of 12-packs, said James W. Keyes, the chief executive. Consumers are also buying less premium gasoline.

"We see the change immediately," Mr. Keyes said. "A 20- to 30-cent-a-gallon shift at the pump can take as much as $50 from the working person each month."

Sales of sport utility vehicles and pickup trucks have fallen recently, while car sales are still rising. The largest trucks, like the Chevrolet Tahoe and Lexus LX 450, are selling particularly poorly compared with a year ago, according to Morgan & Company, a research firm. Analysts are divided over whether fuel prices are a reason, noting that some carmakers have recently reduced discounts for many trucks.

Over all, families are spending about 5 percent of their budgets on energy, up from 4.1 percent in early 2002, according to Economy.com.
About one-third of Americans say the recent spike has caused them "financial hardship," according to a recent Gallup poll. More than one-quarter said they thought that gas prices would be near their current level six months from now, and about one half said they would rise.

"I think it's going to get much worse," said Teri Chavez, a public relations executive in Denver, as she filled the tank of her blue Volvo station wagon last week. "Does it mean that I'm going to stop driving? No. But I might think twice before I take my car up in the mountains."

In 1991, oil prices fell almost as soon as the United States attacked Iraq, and many economists think the same could happen this year. Even if a war temporarily reduced the supply of energy, President Bush could release oil from the nation's Strategic Petroleum Reserve to bring down prices, analysts note.

But because oil inventories are lower than they were 12 years ago, a price decline could be smaller today than at the outset of the Persian Gulf war. Based on the price of oil futures contracts, investors are expecting oil prices to remain around $38 a barrel through April and then gradually decline, falling below $30 by the end of the year.

At those levels, oil prices would still probably prevent the economy from growing rapidly this year. But they would also make a new recession unlikely, particularly because business executives have recently shown signs of optimism, increasing their investments in new technology and equipment after almost three years of cuts.

"It's definitely a negative," said William C. Dudley, the chief United States economist at Goldman, Sachs, referring to the cost of energy. "It's just not at the point where we think it's recessionary. But it's fair to say people have generally underestimated the impact of oil-price spikes."