TALKING POLICY

THE 'R' WORD REARS ITS UGLY HEAD

Are rising gasoline prices an omen of recession?

The Memorial Day holiday is always good for a few news articles about gasoline prices, and this year was no exception. Prices are rising, and reporters and commentators are talking about what it means.

A few commentators are throwing out the "R" word. Will rising gasoline prices help bring about the next recession? The answer is probably not, but all bets are off if the current rise turns into a price spike.

Of course no one likes a recession. And no one outside of oil-producing states like Texas wants expensive gasoline. So the two are correlated in our minds as unpleasant economic events. The causal link, however, is tenuous.

Why are gas prices rising? There are short-term reasons such as the annual transition to summer blends, but the broader reason is the steadily rising price of oil.

We've been enjoying a reprieve from an long-term upward trend in oil prices. In the 1990s, global demand began to outstrip supply as emerging markets industrialized and their citizens started buying more cars and fuel. Few people noticed it until the shortages caused by Hurricane Katrina in 2005. By mid-2008, prices rose to more than $140 per barrel.

Andrew Brod is a senior research fellow in UNCG's Center for Business and Economic Research. Reach him at 336-707-6439 or acbrod@uncg.edu. An archive of his columns is available at http://cber.uncg.edu.

The Great Recession burst the bubble and sent prices down to $30 per barrel by the end of the year. But the fundamentals were unchanged, and for a few years oil prices bounced between $80 and $110. Since mid-2014, the advent of fracking in the U.S. pushed prices back down to the $30 range, and that kept gas prices low for a few years.

Oil prices have been rising gradually since 2016, spurred by recent decisions to cut production, and we're finally seeing the effects at the gas pump.

Some commentators have claimed that these higher gas prices are pointing us toward a recession. But demand-side recessions like the Great Recession are caused by drops in overall spending. They're not caused by reallocations of spending.

For example, if $5 of every $100 of household income is spent on gasoline and then rising prices make it $10, that's annoying. But in macroeconomic terms, all it means is that $90, rather than the previous $95, will be spent on food, clothing and so on. The $100 is still spent. Demand-side recessions happen when the household's total spending falls to, say, $80.

The effect with retail sales is similar. The primary effect of higher prices is a reallocation of spending, away from blue jeans and iPods and toward gasoline.

To be sure, high oil prices have wreaked havoc on the U.S. economy, but usually because the increase was huge or rapid or both. And prices usually affect the economy from the supply side. A price spike can handcuff businesses and lead to layoffs. A resulting jump in unemployment makes households poor and nervous, and that's what causes them to cut back on spending.

The American Automobile Association estimates that higher prices didn't appreciably deter travelers over the Memorial Day weekend. Clearly, most drivers are adjusting to higher prices even while they're spending more on gasoline. It seems unlikely that further gradual price rises will lead to economic turmoil. We won't like it, and it'll hit poorer families the hardest, but that'll be it.

Besides, the news this week is that Saudi Arabia will ease its production cuts, and other producers are sure to follow. Oil prices are already falling a bit. If a recession hits in the near future, it won't be because of "pain at the pump."