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ECONOMIC TALKING POINTS

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Could $100 to $150 Be The "New Normal" For Oil Prices?

The growth momentum the economy entered the year suddenly hit a major speed bump. And there could well be more speed bumps down the road.

The geopolitical shocks across North Africa and the Persian Gulf has everyone ---investors, retailers, manufacturers, consumers, and policymakers --- speculating now how high oil prices will go and how long it will stay there? The rub is we may not know the answers for months, and that uncertainty has begun to permeate the decision-making process in the U.S. private sector.

From our talks with business leaders just the last 48 hours, it is becoming apparent that the turmoil across oil producing regions and the subsequent surge in energy prices are beginning to have an impact on corporate decisions over capital spending and hiring plans. Business managers are starting to get orders to hold off on major transactions until there is greater clarity where oil and gasoline prices will settle. After all, no one wants to be in a position to fill stockrooms and back lots with inventory if economic activity is about to slow. Why ramp up hiring if there is risk that consumer and business spending may taper off? Why seek to expand operations when there is a likelihood any new capacity will sit idle? Clearly, a wait-and-see attitude is starting to emerge in the business community.

Perhaps the single greatest concern is that these geopolitical events might herald in a "new normal" where oil prices will settle in the range of $100 to $150 a barrel for the long term. We don't mean to be alarmist here. It is a reality check: The old order for some countries across North Africa is gone, but we know little of what comes next. Elsewhere in the Persian Gulf, other regimes may fall or lose influence in the coming months. Such amorphous states in politically and economically important regions of the world will keep risks elevated for years, and that is why oil prices may settle at a much higher level.

Adding to the geopolitical chaos is some disturbing news on the U.S. economic front. Orders for durable goods took a surprisingly steep fall in January. Corporate bookings plunged 3.6% last month if you take out the wildly volatile transportation component. It was expected to show an increase, according to the consensus survey! An even steeper fall occurred in the core measure of business capital goods orders. Bookings for non-defense, ex-aircraft equipment plummeted 6.9%, the biggest drop in two years!

Also out this morning is the less well known, but still noteworthy Chicago Federal Reserve National Activity Index (CFNAI). This measure is a weighted average of 85 national economic indicators and gauges how the overall economy performed in January. Well, the news was not particularly good. The index slipped to a negative 0.16, after showing a positive 0.18 in December.

Then there was disappointment with new home sales too. It tanked by 12.6% in January, to a 284,000 annual pace. That decline was also greater than many had forecast.

There was at least one fairly good piece of news. The number of new applications for unemployment insurance did drop in the week ending February 19th. Claims fell to 391,000, which was 22,000 less than the previous week. The return to a pace below 400,000 is certainly encouraging…but we have to wonder whether it will be sustained if employers begin to question the future strength of the recovery.

Bottom line:

What is worrisome is that the declines in durable goods orders, the Chicago Fed index and new home sales probably do not yet reflect the transformative events in the Middle East and higher price oil prices. Remember, the geopolitical timeline really started in the second half of January. The precipitating event occurred on January 14th when Tunisia's President Ben Ali fled the country in response to widespread unrest. That, in turn, brought protestors into the streets in Egypt, Jordan, Morocco, Yemen, and Algeria. It was, however, the resignation of Egypt's Mubarak on February 11th that made clear we were witnessing changes of enormous strategic importance. For that reason we will be monitoring more closely the economic barometers for February and March to better understand on how the private sector is reacting to the sweeping historical events.