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Rising Oil Prices Pose New Threat to U.S. Economy

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The American economy just can't catch a break.

Last year, as things started looking up, the European debt crisis flustered the fragile recovery. Now, under similar economic circumstances, comes the turmoil in the Middle East.

Energy prices have surged in recent days, as a result of the political violence in Libya that has disrupted oil production there. Prices are also climbing because of fears the unrest may continue to spread to other oil-producing countries.

If the recent rise in oil prices sticks, it will most likely slow a growth rate that is already too sluggish to produce many jobs in this country. Some economists are predicting that oil prices, just above $97 a barrel on Thursday, could be sustained well above $100 a barrel, a benchmark.

Even if energy costs don't rise higher, lingering uncertainty over the stability of the Middle East could drag down growth, not just in the United States but around the world.

"We've gone beyond responding to the sort of brutal Technicolor of the crisis in Libya," said Daniel H. Yergin, the oil historian and chairman of IHS Cambridge Energy Research Associates. "There's also a strong element of fear of what's next, and what's next after next."

Before the outbreak of violence in Libya, the Federal Reserve had raised its forecast for United States growth in 2011, and a stronger stock market had helped consumers be more confident about the future and more willing to spend.

But other sources of economic uncertainty besides oil prices have come into sharper focus in recent days. After a few false starts, housing prices have slid further. New-home sales dropped sharply in January, as did sales of big-ticket items like appliances, the government reported Thursday.

Though the initial panic from last year has faded, Europe's deep debt problems remain, creating another wild card for the global economy. Protests turned violent in Greece this week in response to new austerity measures.

Budget and debt problems at all levels of American government also threaten to crimp the domestic recovery. Struggling state and local governments may dismiss more workers this year as many face their deepest shortfalls since the economic downturn began, and a Congressional stalemate over the country's budget could even lead to a federal government shutdown.

"The irony is that we just barely got ourselves up and off the ground from the devastating financial crisis," said **Bernard Baumohl**, chief global economist at the Economic Outlook Group, who had been optimistic about the country's prospects. "The recovery itself is less than two years in, and we haven't yet seen jobs make a decent comeback. Now we're being hit with this new, very ominous event, so the timing couldn't be worse."

Most economists are not yet talking about the United States dipping back into recession, and it is too soon to tell how far the pro-democracy protests that have roiled Egypt, Bahrain and Libya will spread. For now, most analysts are not predicting that Iran and Saudi Arabia, repressive governments that also happen to be two of the world's biggest oil producers, will catch the revolutionary fever.

"But revolutions are notoriously difficult to forecast," said Chris Lafakas, an economist at Moody's Analytics who focuses on energy. Disruptions of oil supplies in Saudi Arabia and Iran in particular, he said, "would be catastrophic for prices. Saudi Arabia alone could cause maybe a 20 to 25 percent increase in oil prices overnight."

In the last week, oil prices have risen more than 10 percent and even breached $100 a barrel. A sustained $10 increase in oil prices would shave about two-tenths of a percentage point off economic growth, according to Dean Maki, chief United States economist at Barclays Capital. The Federal Reserve had forecast last week that the United States economy would grow by 3.4 to 3.9 percent in 2011, up from 2.9 percent last year.

Higher oil prices restrain growth because they translate to higher fuel prices for consumers and businesses. Mr. Lafakas estimates that oil prices are on track to average $90 a barrel in 2011, from $80 in 2010, an increase that would offset nearly a quarter of the $120 billion payroll tax cut that Congress had intended to stimulate the economy this year.

Rising gasoline prices have already led Jayme Webb, an office manager at a recycling center in Sioux City, Iowa, and her husband, Ken, who works at Wal-Mart, to cut back on spending.

In the last month, they have canceled their satellite television subscription and their Internet service. They have also stopped driving from their home in rural Moville to Sioux City on weekends to see Ms. Webb's parents.

Along with making their commutes to work more expensive, rising oil prices have driven up the cost of food for animals and people. So the couple have stopped buying feed for their dozen sheep and goats and six chickens and instead asked neighboring farmers to let them use scraps from their corn fields.

"It's a struggle," said Ms. Webb, 49. "We have to watch every little penny."

A cutback in consumer spending reverberates through the economy by crimping businesses, making it less likely that employers will commit to the additional hiring needed to lower the 9 percent unemployment rate.

"Revenue is down, costs are up, and you can't make any money," said R. Jerol Kivett, the owner of Kivett's Inc., a company that manufactures pews and other church furniture in Clinton, N.C. "You're just trying to meet payroll and keep people working, hoping the economy will turn. But it just seems like setback after setback after setback."

And the money that consumers and businesses spend on oil often does not stay within the American economy. Nor do the expanded coffers in oil-producing countries raise demand for American exports, because they often bank it as reserves.

"The countries that are getting this bonus basically get an enormous benefit," said Raghuram G. Rajan, an economics professor at the University of Chicago. "But if they can't spend it quickly, it doesn't add to aggregate demand."

The rise in oil prices could also create a vicious cycle, as higher energy costs propel already rising food prices, which in turn can lead to more political unrest and more global uncertainty.

Even without the Middle East, the domestic economy has a number of weaknesses that have proved hard to overcome. The recession was provoked by housing and worsened by housing, and housing is likely to remain frail in parts of the country until the end of the decade.

After a couple of brief growth spurts, home prices have started declining again in earnest.

This week, the Yale economist Robert Shiller speculated about another drop as large as 25 percent. Anything close to that would push millions more households to the point where they owe more on their houses than the houses are worth, generating a lot of sour moods — which can depress consumer spending — more foreclosures and potential job losses.

Even absent such a decline, lenders remain cautious, punishing those who never indulged during the boom.

Maria Schneider and Roger Westerman have plenty of equity in their Brooklyn home, and a 17-year record of paying on time. Last fall, the couple tried to capitalize on historically low mortgage rates and refinance.

They estimated they would save $360 a month. But their lender said they were a bad credit risk. The couple, both 48, are self-employed.

“We could be sending all three of our kids to camp this summer instead of just one,” Mrs. Schneider said.

There are some signs that the economy could weather this latest round of buffeting. Revenue at many companies is back to prerecession levels, said Scott Bohannon, a general manager at the Corporate Executive Board, a research and advisory firm. That suggests companies may start adding equipment, factories and, eventually, workers.

“Of course, if a war breaks out in a significant way or something like that happens,” he said, “then I would give you a different answer. Then you’re talking about huge shocks to the system.”