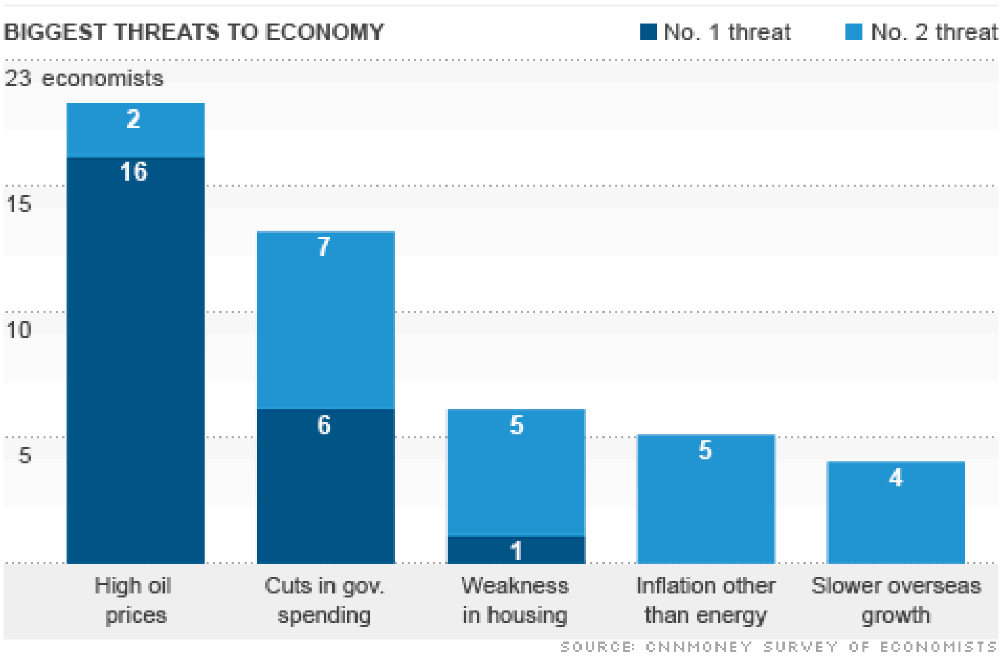
What has economists most on edge: Oil prices



By Chris Isidore, senior writer
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NEW YORK (CNNMoney) -- The U.S. economy faces numerous obstacles that threaten to derail the recovery. But economists are most fearful of one major headwind: oil prices.

More than two-thirds of the 23 economists surveyed by CNNMoney identified high oil prices as the most serious risk facing the economy.

As uprisings spread across the Middle East and North Africa, prices have soared about 15% in the past two months, pushing gas prices higher. And as the situation in Libya escalates, economists are growing more jittery about oil prices, even in the face of other threats to the economy, like the crisis in Japan, cuts in government spending and continued weakness in the housing sector.

"Oil and gasoline remain a very big worry for me which have been compounded by the events going on in Japan," said **Bernard Baumohl,** head of the Economic Outlook Group in Princeton, N.J. "But we don't have any let-up in the events going on in the Middle East and North Africa."

Baumohl thinks high oil prices are jeopardizing the recovery by hitting consumers' wallets and keeping businesses on edge. He's cut his forecasts for growth this year nearly a full percentage point to 2.8%.

Economists are particularly worried that gasoline prices will continue to rise, choking off economic growth.

"As we go into peak driving season, the basic seasonal pressures will take a toll on gasoline prices," said Bruce McCain of Key Private Bank. "It'll be more a matter of blunting growth than causing a new recession. But the growth has been fragile through this entire recovery."

The Federal Reserve appeared to dismiss higher oil prices as a threat at its March 15 meeting, saying the rise in energy prices was likely to be "transitory" and that underlying price pressures -- measured by core inflation, which strips out volatile food and energy prices -- remain in check.

But several of the economists said the Fed is missing an important reality in that assessment -- the effect of oil prices on consumer attitudes.

"I think the Fed has got a credibility issue," said John Canally of LPL Financial. "People go to the gas station and grocery store several times a week, and those prices are rising, and that's what they see." He said oil is a major reason behind the recent drop in consumer confidence.

Still, Canally is more worried about the risk of future price increases, saying that current oil prices are a "nuisance, not the end of the recovery."

Economists are also concerned about spending cuts by local, state and the federal governments. Six of the 23 economists surveyed say that's the biggest headwind for the recovery, while another eight identified it as the second greatest threat.

While economists are in broad agreement that debt needs to be brought under control, many are worried about the impact of cuts.

Continued weakness in housing is another serious threat to growth cited by economists, although most saw it as a secondary headwind, not a primary drag on growth. Slowing growth overseas and rising inflation pressures outside of oil ranked lowest in the survey.

When asked what impact the earthquake and tsunami in Japan might have on the recovery in the United States, economists had some concerns, but did not see it as a major long-term threat.

"While there is a risk from Japan if things get significantly worse, the odds are very low," said David Berson of the PMI Group.