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The Impact of High Oil Prices on Our Economy

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Oil prices have reached record levels, with crude trading at $57 per barrel. Rising crude prices pushed gasoline prices to an average of $2.14 per gallon last week across the U.S. At these levels oil prices are causing serious harm to our economy.

It now costs most people between $30 and $70 to fill up! The average Florida household spent approximately $1,200 on gasoline last year, but this year the cost will jump to $1,800. This loss of $600 per household is equivalent to a $4.8 billion tax on Floridians. Obviously, this means that discretionary spending will be somewhat lower than otherwise and, therefore, economic growth will be a bit lower.

The escalation of energy prices not only acts like a tax on current earnings but also reduces wealth. Look at what has happened to the stock market. The Dow Jones Industrial Average was closing in on 11,000 just a few weeks ago, reaching 10,940. Then oil prices shot up, and the market stumbled. Since then the Dow is off 370 points for a loss of over 3 percent. When people perceive that they are wealthier, they spend more, especially on discretionary things like vacations.

Higher energy prices directly impact tourism in central Florida, but the impact is not obvious. History teaches us that high gasoline prices do not have much effect on the number of tourists visiting Florida. As long as gasoline is readily available, high prices are not a deterrent to travel. However, because of high gas prices, visitors have less to spend on their vacation. So they still come, but they spend a bit less per person, and this has a huge impact on central Florida's economy.

Finally, federal reserve policy makers are meeting today. What they may say and do about high oil prices and inflation will have important implications for the economy. Last month policy makers touched on rising energy prices, but they didn't worry much about it, concluding that "despite the rise in energy prices, inflation and inflationary expectations have eased in recent months." I doubt that they will come to the same view today. The rise in gasoline prices this month alone will add three-tenths of a percent to March inflation, and as higher energy prices ripple through the economy, they will add a total of 2 percent or more to inflation this year. Note too that the CPI has increased by more than 3 percent over the last twelve months. The Fed cannot ignore these trends and will probably increase the federal funds rate by another quarter percentage point to 2.75 percent marking, the seventh increase since June. This is the final way higher oil prices are affecting our economy … they are causing interest rates to rise as well.

This is Hank Fishkind for 90.7 FM, WMFE News.