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Economics Group

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U.S. Consumers are Driving A Hybrid (Economy) Today

The recent increase in oil and gasoline prices is rekindling concerns about the ability of the U.S. consumer to continue to remain at the driver's seat of the U.S. economy.

Better Prepared to Adjust to Higher Gasoline Prices

We have been down this road repeatedly over the past several decades: petroleum and gasoline prices rise, which, in turn, cuts into U.S. consumers' purchasing power. For several months now, we have been heading down the "cutting into" portion of this purchasing power phenomenon. The good news is that real disposable income has been recovering during the past year or so and is expected to continue to improve as economic growth strengthens. Part of the growth in real disposable income that started in 2014 can be attributed to a very large decrease in gasoline prices (top graph).

Gasoline prices are much higher today than they have been for a while, which, as discussed, has negatively impacted the U.S. consumer. However, as the middle graph shows, gasoline prices are still relatively low compared to prices that characterized the pre- and post-Great Recession days. Furthermore, according to the Energy Information Administration, gasoline prices are expected to decline over the next several years. While there are many geopolitical risks that could make this forecast incorrect, these risks are very difficult to quantify and thus cannot be seriously entertained from a forecasting perspective.

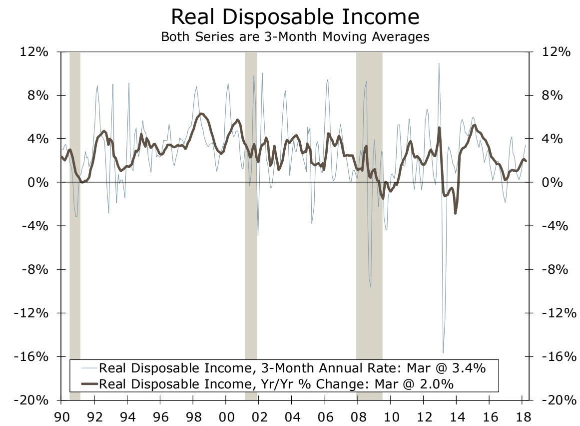
At the same time, Americans have actually been decreasing their consumption of gasoline as the price of gas has increased over the past year on a per-capita basis. As the bottom graph shows, there is plenty of room for American gasoline consumption to continue to adjust downward in the scenario in which the price of gasoline continues to increase.

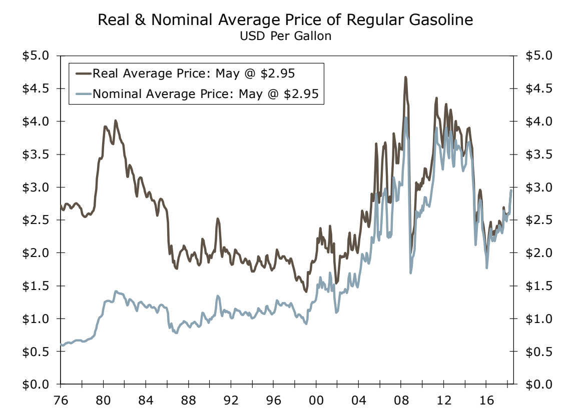
Economic Growth is Expected to Improve

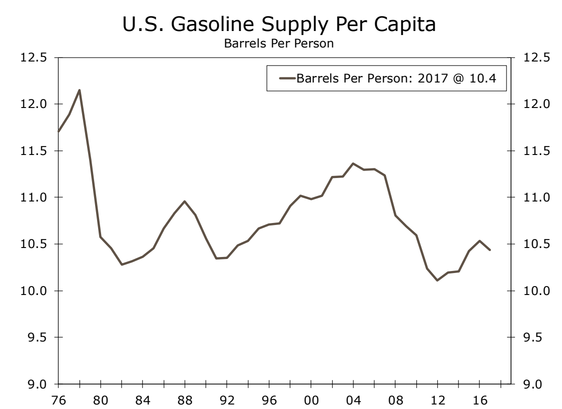
Rising petroleum and gasoline prices are never good for U.S. consumers, but are great for U.S. petroleum and gasoline producers. Higher gasoline prices add a new worry for American consumers as they try to adjust their already stretched incomes. This is especially true for middle-to-low income Americans, as consumption of gasoline requires a larger share of their disposable personal income than the share for higher income groups.

However, economic activity is improving and some measures of wage and salary growth are trending up, which will likely reduce the negative effects of higher prices of gasoline. Furthermore, the tax reform has put more money into the pockets of American consumers, which should provide a cushion to disposable income in the case that higher gasoline prices are here to stay.

The sudden surge in petroleum and gasoline prices in the 1970s was a negative shock to the U.S. economy of a much larger magnitude. Geopolitics played an integral role in that instance. The gradual rise in petroleum and gasoline prices occurring today will certainly affect the U.S. economy, but will likely not unsettle economic growth in any meaningful way.







Source: U.S. Energy Information Administration, U.S. Department of Commerce and Wells Fargo Securities

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