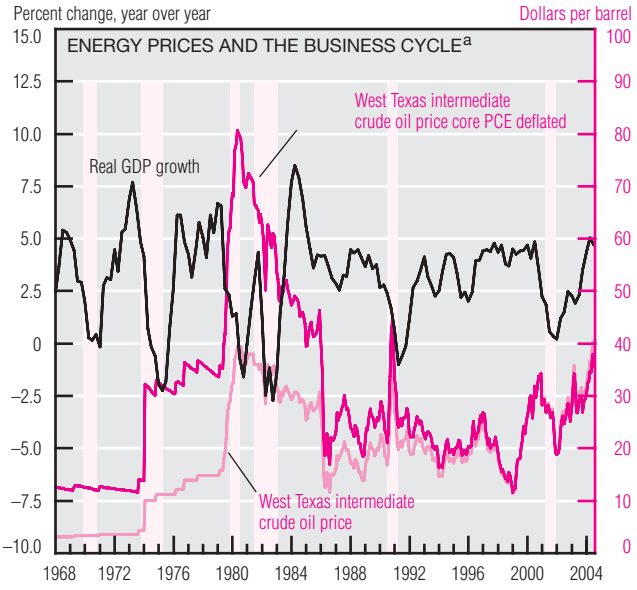
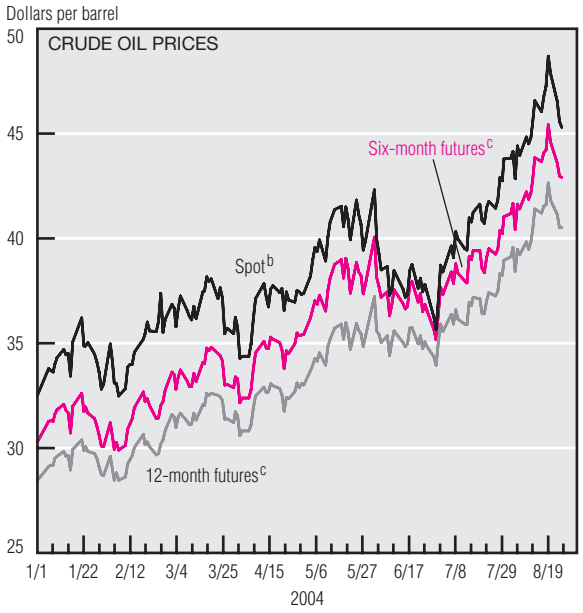
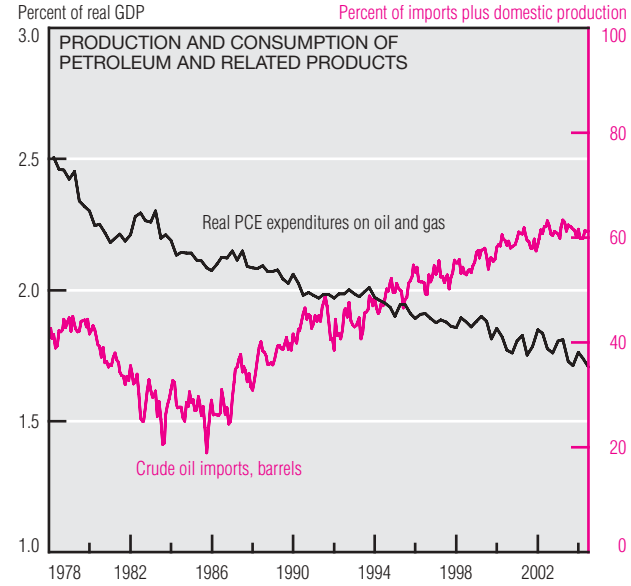
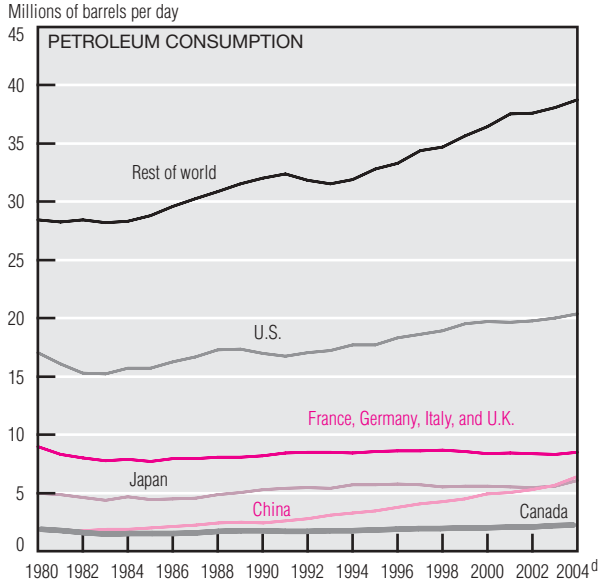
Oil









a. Bars indicate recession periods as dated by the National Bureau of Economic Research.
b. West Texas intermediate.
c. Light sweet crude oil futures. Deliverable grades are determined by sulfur content and API gravity. West Texas intermediate crude oil qualifies for delivery.
d. First quarter only.
SOURCES: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; Energy Information Administration; Nouriel Roubini and Brad Setser, "The Effect of the Recent Oil Price Shock on the U.S. and Global Economy," Stern School of Business, August 2004; National Bureau of Economic Research; New York Mercantile Exchange; *Wall Street Journal*; and Bloomberg Financial Information Services.

Because oil is an important input in the production process, a significant increase in oil prices can retard economic growth. In April and May, spot crude oil prices rose nearly $10 per barrel; during the second quarter of the year, real GDP growth slowed to 2.8%. Just how sensitive the real economy is to oil price shocks depends on several factors. If the shock is only temporary, then the effect on output will be negligible; a permanent increase in oil prices will have much larger effects. How important oil is to production may also determine how adversely production is affected when its price increases. It is often remarked that oil—and energy consumption more generally—has become a smaller share of the economy over the last 30 years, which might imply that output will be less adversely affected by rising energy prices today than it was 30 years ago. Finally, some analysts believe that *where* the input is produced may influence how economic output is affected when the input price goes up. In particular, because the U.S. relies far more on foreign sources of oil than in the past, they believe that an oil price increase will affect output more strongly than in the past.

Rising demand for oil in other areas of the world is a factor that could lead to continued oil price increases. The U.S. is easily the world's leading consumer of oil, but China's consumption has been rising more than the U.S. in recent years. In the 1990s, 23% of oil consumption growth took place in the U.S. In this decade, that share has fallen to 13%.