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Policy Brief

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IMPACT OF HIGHER GAS PRICES ON SAN DIEGO'S ECONOMIC GROWTH AND HOUSEHOLD BUDGETS

KEY FINDINGS

- After the recent run up in prices, San Diego households are projected to spend 6.2% of household income on gasoline in 2012; up from 4.3% in 2010
- This equates to an additional $463 spent on gasoline this year
- In the short term we forecast only a very slight decline in demand for fuel
- Increased gasoline costs are likely to be offset by weaker consumer spending. For example, $463 on gasoline would be 220 fewer Venti coffees
- Assuming prices remain around $4.37 for the rest of the year, economic growth will be lower in the region by approximately 0.3%

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In little more than 2½months,the average priceof gas paid at the pumps in San Diego has increased 25% or $.86 per gallon(from $3.50 on Dec 21, 2011to $4.37 as of March 12, 2012). This dramatic increase inprice of fuel will have significant impacts on the region'sstillstruggling economy and tenuousrecovery inconsumer spending.

According to the latest (2009-10) U.S. Department of Labor's Bureau of Labor Statistics (BLS) survey in San Diego of consumerexpenditures, transportation costs accounted for the second largest portion of local consumer budgets, only exceeded by total expenditures for housing. The average household in San Diego spends13.4 percent of their annual budgeton transportation, including4.3 percent forgasoline and motor oil.

Withgas prices increasing since that time, NUSIPR projects the ratio of gas expenditures climbed to 5.3 percent in 2011. With further 25% increase ofgas prices so far in 2012 the percentage is estimated to have further enlargedto 6.2%. San Diego consumers will potentially spendan average of $463 more on gasthis year than they did last year (assuminggas prices hold steady for the rest of the year at $4.37).

The extra expenditures on gasoline will depress other discretionary spending. For example, consumers will need to forgo buying 220 "Venti Coffees"at Starbucks (about one each work day), or 165 fish tacos at Rubios over the course of the year, in order to pay for the added gas costs. Put anotherway, the increase ofgas price alone is more than the average household in San Diego spends on all their consumption of cereal and bakery products, orthe entireaverage annual budget for public transportation.

To be sure, in the longer term, consumers will adjust how much they drive and how much they spend on gas in response to paying higher prices at the pump. However, research suggests that in the short term demand will remain near constant. Research during other spikes has shown the price elasticity of demand for gas to berelatively low –about -0.25. This means for every 10% increase in price of gas,consumersconsume 2.5% less gas. This is likely because so much gasoline is consumed as part of family's work commutes and, in the short term, it is very difficult for them to make alternative arrangements to reduce consumption.

With the high ratio of spending on gas, a tipping point for recession may have already beenbreached. The U.S. consumer and stock market tend to respond negatively to higher energy prices, although the response usually comes with some lag. In other words, it will take a few months for higher energy prices to really begin to put a drag on the economy. In 2011, for example, gasoline and crude oil prices began to spike early in the year but national economic data did not begin to really disappoint expectations until April and May.

With the added costs of gas taking nearly 2.0 percent from San Diego's consumer budgets, spending on other goods and services by necessity willreduced by an equal proportion, especially if consumers are not able to increase their spending budgets. This assumes residents in the short term do not significantly reduce gas consumption, and instead lower their spending on other discretionary consumption.

NUSIPR previously forecast San Diego's economic growth in 2012 would be relatively fragile at 1.8 percent. If the increasesin gas prices remain elevated throughout the year, this could carve 0.3 percent from our already projected slow rate of growth.

Paradoxically, corporate state and local taxes are expected to rise, largely because gasoline is subject to sales tax while many of the items likely to see decreases in demand are exempt from California sales and use tax.

Although higher gas prices eventually encourage consumers to cut back on driving or switch to more fuel-efficient vehicles, in the short-run they may have few options but to cut back on other expenditures in the family budget. Since low- and moderate-income families are likely to spend most of their income, in the very short run they can only choose between spending less on other items or perhaps go further into debt.

In addition, less spending on other items operates much like higher taxes in slowing an incipient recovery. In other words, higher gas prices drain purchasing power from the economy. That means families get hit twice: once by the direct impact on household budgets and a second time when higher prices restrain economic recovery.

NOTE: The projections of gas and other consumer expenditures are derived from the U.S. Department of Labor, Bureau of Labor Statistics'*Consumer Expenditure Survey* and *Consumer Price Index* for San Diego. Average gas prices in San Diego were taken from daily reports by*SanDiegoGasPrices.com*.