Economic Commentary – While higher crude oil prices impact the U.S. economy, recession risks are still low

March 7, 2022

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What happened

Surging global energy prices are among the consequences of Russia's military invasion into eastern Ukraine. U.S. crude oil crossed above $130 per barrel (West Texas Intermediate) for the first time since mid-2008, up more than $35, or 25%, in the past week. U.S. natural gas prices (Henry Hub) have increased nearly 10% over the same span.

Much of the rise has been related to sanctions against Russia by Western leaders — primarily the U.S., Europe, and the U.K. Russia is among the largest crude oil exporters at over 7.5 million barrels per day.

While the sanctions largely exclude energy exports, which would cripple European economies, most of the largest global maritime companies (62% of global shipping capacity) have already halted all shipments into or out of Russia due to insurance and liability concerns during a military conflict.

Our take – While it hurts U.S. growth, we still don't see a recession on the horizon

As we have said in recent commentaries, the direct impact of rising energy costs is significantly higher on Europe than on the U.S. and could push some European nations into recession. Nonetheless, that would cool U.S. exports marginally and complicate European-based supply chains due to factors such as hampered production. Ultimately, the difficulty is that this is a geopolitical problem on top of already high inflation.

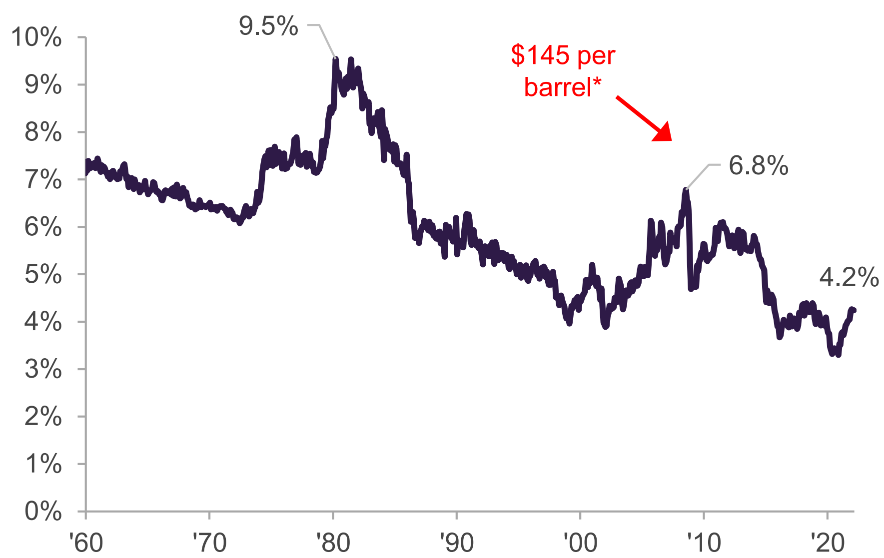
Our key takeaway points for the U.S. economy for crude oil:

- **The biggest impact to the U.S. economy is it aggravates inflationary pressures.** Importantly, less than 5% of consumer spending is on energy, though it will disproportionately impact low-income Americans (see slide 2).
- **We see a minimal impact if the U.S. cuts off Russian oil imports, or about 1.4% of total U.S. crude oil imports** (see slide 3).
- **We expect crude oil prices to remain elevated given declining U.S. drilling investment and the brief lifecycle of shale wells** (see slide 4). **We also anticipate the recent price volatility as well as turbulence in the broader markets will persist for months**, pushed around by headlines and developments.
- While the Federal Reserve (Fed) will debate crude oil's impact, **we still expect a quarter point rate hike at its March 16 meeting.** The market will remain very focused on the Fed outlook and approach.
- **Given strong economic momentum recently, the risk of a U.S. recession remains low**, as evidenced by U.S. payroll growth in February, which jumped 678,000, the largest increase in seven months. Additionally, Americans have a substantial cash hoard to buffer higher energy prices, with nearly a quarter from wage & income growth rather than simply pandemic assistance (see slide 5).
- **Our view is the U.S. economy remains on solid footing**. While higher oil prices will likely reduce growth somewhat, we expect economic growth above 3% year over year in 2022, which remains faster than the pre-pandemic 10-year trend of 2.3%.
- Lastly, **we reiterate we could see an unusually-wide range of outcomes from a cease-fire or a roll-back of hostilities to an escalation of the conflict.**

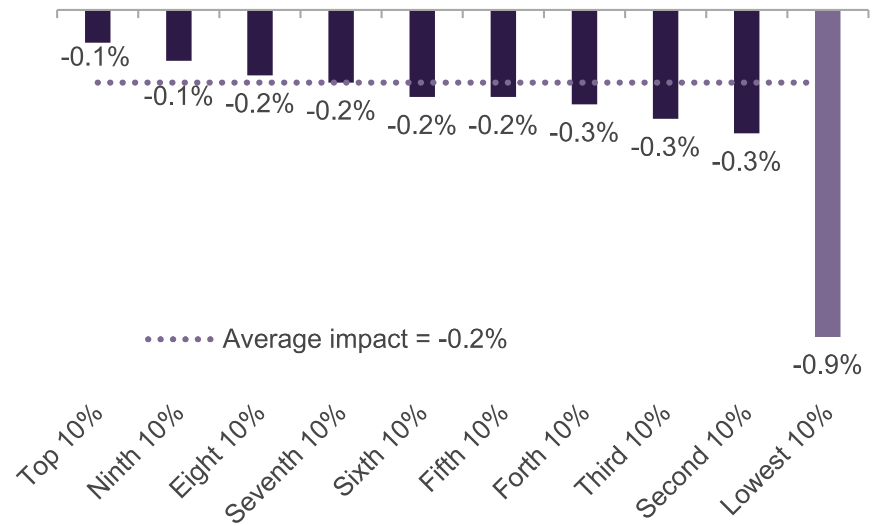
Consumers don't spend much on energy compared to the past, but higher prices greatly impact lower-income Americans

U.S. consumers spend just 4.2% of after-tax income on energy goods and services—even when crude oil hit $145 per barrel, it was less than 7%. With gasoline prices up 10% in 2022, it shaves off just 0.2% from overall consumer spending. However, higher gasoline prices disproportionately impact Americans in the lowest income decile.

U.S. spending on energy (gasoline + electricity + nat gas) as a percentage of consumer spending



Impact of a 10% gasoline price hike on consumer spending

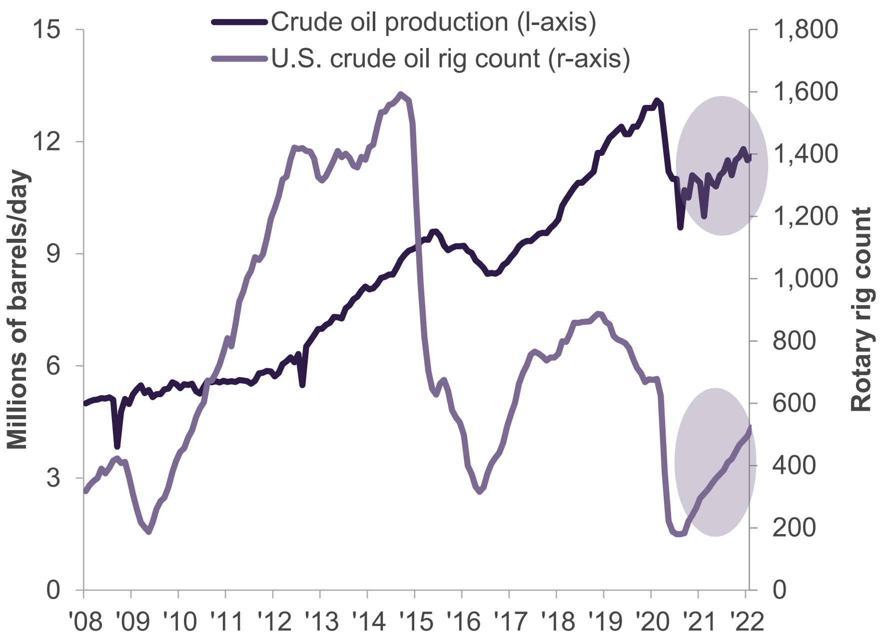


Data sources: left chart: Truist IAG, Bloomberg; energy spending consists of gasoline and other energy goods and of electricity and natural gas services used for household utilities; spending as percentage of disposable personal income; monthly data through February 2022. *West Texas Intermediate crude oil price was $145 per barrel in July 2008. Right chart: Truist IAG, PSC Macro.

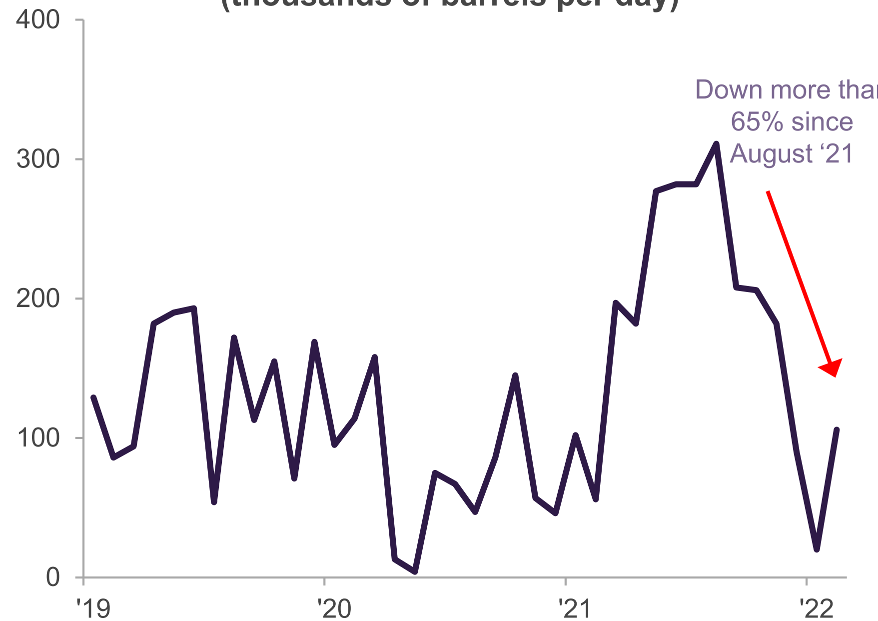
U.S. crude oil production is climbing again, boosting supply and should help stabilize prices in 2022; Russia a small fraction of U.S. supply

After roughly 16 months of declines, U.S. crude oil production is finally heading higher. Rig counts hit a 16-year low in the fall of 2020 but are rising again. Still, U.S. crude oil production remains 6% below its all-time high of 13.1 million barrels per day achieved in February 2020. Thus, increased crude oil supply should help stabilize the price of gasoline, but it will likely remain elevated throughout 2022. Also, Russia accounts for just 1.4% of total U.S. crude oil imports, which are down more than 65% since August.

U.S. crude oil production vs. rig count



U.S. crude oil imports from Russia (thousands of barrels per day)



Data sources: Truist IAG, Bloomberg, U.S. Department of Energy; monthly data through February 2022.

Crude oil prices should stay elevated given declining U.S. drilling investment and the brief lifecycle of shale wells

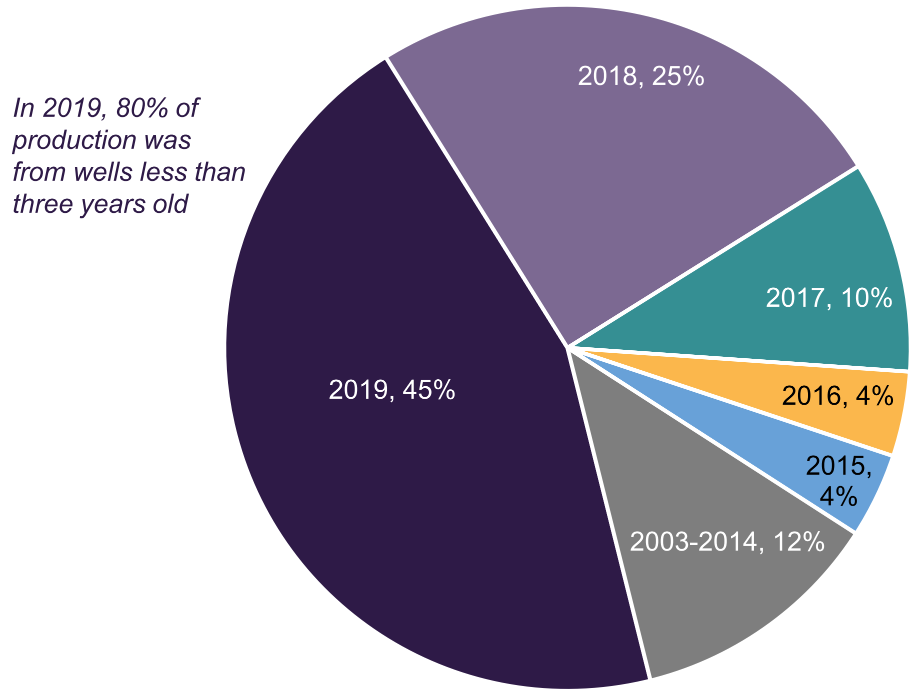
Shale crude oil wells produce for five to seven years, unlike conventional crude oil wells which have an average life span of 20 to 30 years. Also, shale drilling techniques can significantly increase the investment required to extract oil.

Accordingly, maintaining or increasing U.S. crude oil production requires more investment, which hasn't happened for several years due to many reasons, including the rise of ESG, the pandemic, etc.

In fact, by one key metric – the number of U.S. crude oil rigs (see slide 3, left chart) – investment peaked in 2018.

This likely means the price of crude oil will remain elevated for the foreseeable future barring increased imports or a major new technological change.

Percentage of 2019 U.S. shale crude oil production by well vintage year



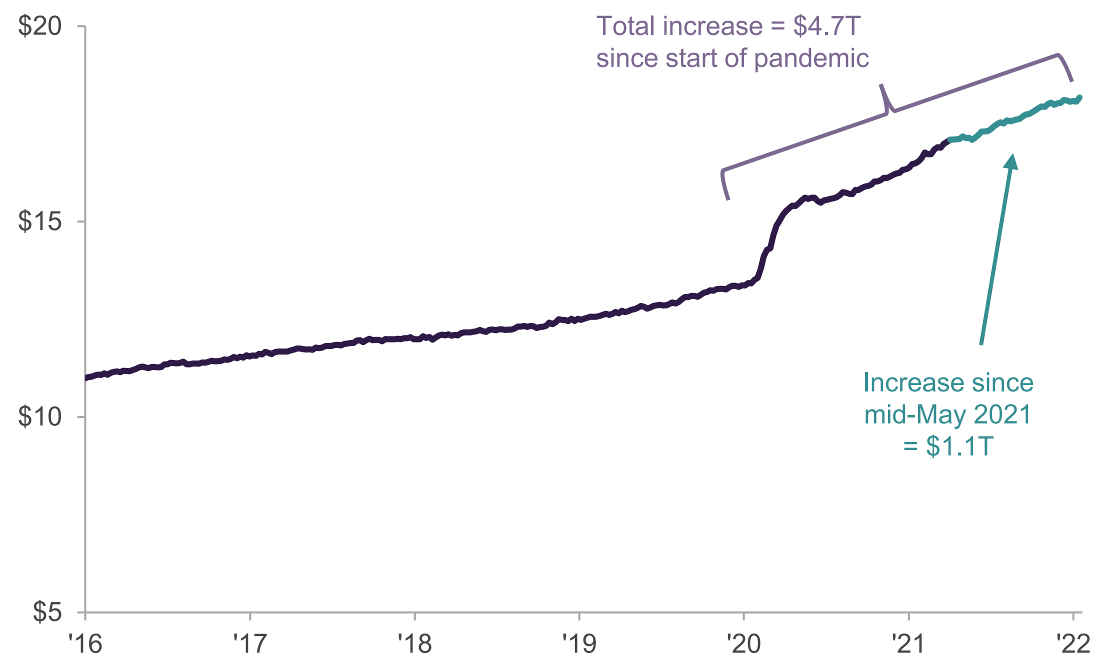
Data sources: left: Truist IAG, Journal of Petroleum Technology. Right: Truist IAG, Bloomberg, Energy Information Administration; data through May 2021. Vintage denotes the year the well went into production.

Americans have a substantial cash hoard to buffer higher energy prices, with nearly a quarter coming from wage & income growth

Most Americans are currently sitting on a lot of cash, which provides most Americans with a sizable buffer to deal with higher energy prices.

While a substantial amount was a result of the pandemic assistance programs, including the CARES Act in 2020 and the American Rescue Plan checks in 2021, those programs largely ended prior to mid-May 2021. Since then, cash has increased by $1.1 trillion and has primarily come from higher wages and incomes.

Weekly bank deposits & savings in U.S. commercial banks (in $trillions)



Data sources: Truist IAG, Bloomberg; weekly data through February 23, 2022.

Disclosures

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CN2022-4490028.1 EXP 03-2023