Look Who's Spending: It's Rich People—Of Course

By CNBC's Jeff Cox

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Rich people are likely picking up much of the slack in consumer spending, with the rest of the burden taken up by those working in a "shadow economy" of under-the-table cash payments, according to some economists. Working families have gotten slammed with a one-two punch of higher taxes and gas prices, yet retail sales hit a six-month high of 1.1 percent in February.

That increase came despite expectations that consumers would be pressured through the beginning-of-the-year expiration of the payroll tax cut on top of gasoline prices that have surged to $3.70 a gallon nationally.
In fact, the pump-price increase actually contributed to the positive February results.

But the rest of the difference was made up primarily by shoppers at luxury stores who have yet to feel the full effects of their loss income loss.
"There is evidence that spending among wealthier households has climbed higher while spending among lower-income households has slowed," Nomura Securities economists said in a report. "This dynamic makes sense given the disproportionate burden on lower-income households from higher taxes."

Tax increases tend to hit lower earners harder because they derive most of their income through salary, while higher earners get more of their wealth through investments. Also, the payroll tax expiration, which will reduce personal income by about $114 billion this year, hits only the first $113,700 of income.
With the tax cut in place, lower earners used the extra money to pay down debt, which has recently grown to $40 trillion nationally, according to the Federal Reserve.

But more disposable income plus higher stock market prices pushed the wealthy into spending, Nomura said.

As the effects of the tax cut are felt more over time, that trend could reverse. "If ... households are simply taking longer to adjust balance sheet priorities to the new reality of lower disposable income in 2013, then some spending weakness may lie in the months ahead," the firm said.

That's not the firm's most likely scenario, though, and other indicators are showing that the consumer resiliency could hold up as long as stock prices keep pushing higher, and while other workers maintain jobs paying salaries that don't necessarily show up on the government's monthly reports.

A substantial "underground economy" exists in which more and more people are making a living "by repairing computers, doing carpentry or handyman work, selling goods at flea markets, tutoring, housecleaning or using their car as a private livery service," said **Bernard Baumohl, chief global economist at the Economic Outlook Group.**

"Severe recessions have historically driven jobless Americans into the shadow economy, and we suspect the destructive nature of the last downturn and the prolonged weak recovery pushed a record number of people into that murky world of cash transactions," he said. "Doing so allows them to earn money without reporting their income, leaving more available to spend."

Citing academic studies, **Baumohl** said these working arrangements could account for 8 percent to 14 percent of gross domestic product, or $2 trillion. "That's a lot of cash that can be spent by Americans," he said. "Never before ... have we seen retail sales grow at such a vibrant pace with the unemployment rate so high."

Indeed, that is part of the consumer spending conundrum.
The unemployment rate as reported by the Labor Department dropped to 7.7 percent in February, due in large part to generational lows in the labor force participation rate, which measures those working and looking for jobs.

"Despite the sharp drop-off in the labor force participation rate, consumer spending has nevertheless continued to surge," **Baumohl** said. "One explanation is that many of those who have left the labor force since the last recession have managed to earn income in the shadow economy."

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