



Consumers beat expectations despite higher payroll tax

Despite 2013's higher payroll taxes, late refunds and higher gas prices, consumer spending is surprising economists.

Tim Mullaney – February 25, 2013

When the payroll tax climbed by nearly a third Jan. 1, Upstate New York car dealer Bill Fox thought he would lose business as workers in a cash-strapped area faced skinnier paychecks.

It hasn't worked out that way.

"We had our best January since 1979, and better than some Junes and some Aprils," said Fox, a partner at Fox Dealership in Auburn, N.Y. His dealership sold 23% more cars than last January, and February sales are up about 9%. "People need cars, and interest rates are laughable."

Despite warnings last week from Wal-Mart and other companies about flat sales this quarter and more price-conscious shoppers, consumers look surprisingly resilient. Some economists say spending looks better than they expected, considering what's been thrown at consumers in the first two months of the year: a payroll tax increase on Jan. 1, late tax refunds and a 44-cent-a-gallon increase in average gasoline prices since New Year's Eve.

"The hard data we follow as economists has held up better than we thought," said Citigroup economist Steven Wieting. "The spending letdown has been remarkably small."

The payroll tax increase cost consumers about \$10.5 billion in January, and the IRS' late start in processing tax refunds this year temporarily deprived consumers of an additional \$15 billion through Valentine's Day, Wieting said.

Despite those headwinds:

- Auto sales climbed in January to a seasonally adjusted annual rate of 15.2 million. That's up 14% from a year ago, and a percentage point more than the full-year gain for 2012. Some of the biggest gains were for gas-guzzling trucks, said Tom Kloza, chief analyst at the Oil Price Information Service.
- Sales of gasoline, measured in gallons, are up 2.8% so far this year, according to government data. Usually, usage would be flat or down slightly at this time of year, Kloza said. "Despite the payroll tax and everything else, people have returned to the road and are driving more than last year," he said.
- Retail sales rose 0.1% in January, to a pace 4.4% above last year. That includes a 6.5% gain from last year in spending on restaurants, a highly discretionary purchase that stayed steady from December.

Weekly figures from Johnson Redbook released Feb. 20 show retail sales rose 2.8% in the first two weeks of February. Retail sales gains were about what economists expected, and slightly smaller than in late 2012.

Now, the question is what's ahead for consumer spending, which is 70% of the economy. January's strength may not persist with Congress and President Obama at loggerheads about how to deal with \$85 billion in spending cuts scheduled through September, says Mark Zandi, chief economist at Moody's Analytics.

"It may have taken a few weeks for the payroll tax hike to impact spending, and January sales may have been temporarily supported

by the surge in dividend income and early bonuses late last year," Zandi said.

On the other hand, a pickup in IRS tax refunds could give more consumers reasons to go shopping in the weeks ahead. Wal-Mart executives said last week that although delayed refunds caused some customers to postpone purchases earlier this month, sales rebounded last week in tandem with the government's improving rate of processing returns.

A better job market, gains in personal income, low interest rates and rising home and stock prices are keeping consumers in stores and on the road, said **Bernard Baumohl, chief economist at Economic Outlook Group.**

He argues that recent data provide ample evidence "that underscore how ready, willing and able consumers are to ramp up spending."

With the Bush-era tax cuts now made permanent for almost all Americans, they "are now more likely to unleash much of the pent-up demand that's been built up over the years," **Baumohl said.**

###