The wind changes

Greg Ip *WASHINGTON, DC*

But the deeper economic worries won't get blown away

The American economy will at long last enjoy a solid cyclical recovery in the year ahead. But in the process the country will also discover how deep its structural problems run.

Annual growth since the recession ended in 2009 has averaged a paltry 2.2%, and 2013 has been the weakest year of the lot. For that, the blame lies with some familiar headwinds: overindebted households and banks; the Federal Reserve's inability to cut interest rates below zero; Europe's lingering sovereign-debt woes; and fiscal policy at home that flipped prematurely from stimulation to strangulation.

In 2014 none of those excuses will apply, and as the headwinds subside, growth will climb to between 2.5% and 3%. Banks, having rebuilt capital to well above pre-crisis levels, are eager to make loans. Just as important, households now want them, because their balance-sheets are back in order. Their debts, which peaked at 135% of disposable income in 2007, had fallen to 109% by the middle of 2013, close to the long-term trend.

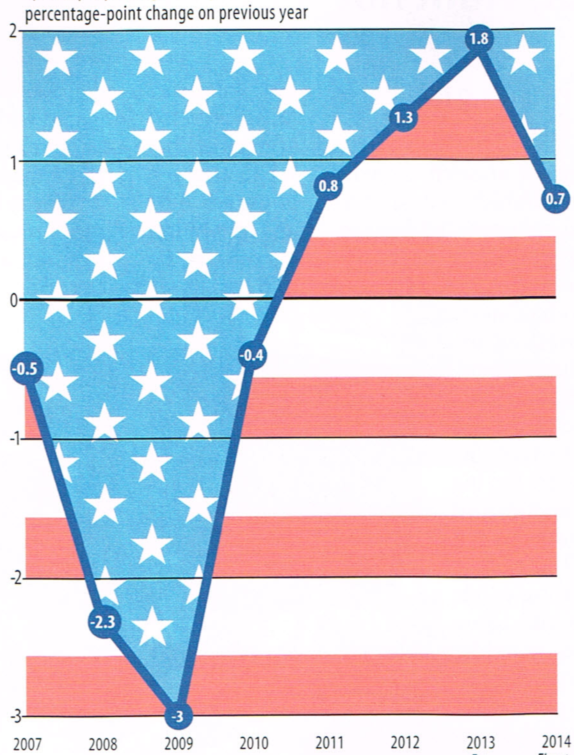
The glut of vacant homes is almost gone. Construction in late 2013 was running 40% below its long-term trend, and so still has plenty of room to grow. House prices bottomed in early 2012 and have risen steadily since. Along with higher stock prices, that lifts household wealth, which in turn will boost consumer spending, as will lower petrol prices.

Exports will be helped by a cheaper dollar. With its sovereign-debt crisis in remission, the euro zone emerged from recession in mid-2013. Besides juicing American exports, that will salve some of the stress in the global financial system.

Finally, the fiscal squeeze should soon end. Four years of job-cutting by state and local governments came to a halt a year ago as revenues at last turned up. Some 40 states are expected to boost outlays in fiscal 2014 (which ends in June). Unfortunately, as austerity was ending at state and local governments, it went into overdrive at the federal level: a payroll-tax cut and other stimulus measures expired, while Barack Obama and Republicans in Congress agreed, after a bout of acrimonious and disruptive brinkmanship, to swingeing tax increases and spending cuts. In all, fiscal policy subtracted roughly 1.8 points from growth in 2013 (see chart). The good news is that no new austerity is scheduled for 2014, so fiscal policy will exert a much smaller drag on growth.

Star-spangled drag

Cyclically adjusted general-government fiscal deficit as % of GDP, percentage-point change on previous year



Source: IMF

Meanwhile, in Washington

Policymakers pose the biggest risk to this reasonably rosy picture. The ideological fissures that shut much of the government and nearly provoked a debt-ceiling crisis in late 2013 remain. The deal that ended that battle expires in early 2014, raising the spectre of another confidence-eroding stand-off. But that is not the likeliest outcome: the political drubbing Republicans in Congress suffered for October's debacle will sap their enthusiasm for a repeat. Although they and Mr Obama remain far apart on taxes, the two could strike a deal that modestly slows the long-term growth of spending on health care and other social programmes in exchange for modestly higher near-term spending, a welcome switch from repeated doses of austerity.

The Federal Reserve has used ever more forceful and creative ways to support the economy since 2008 but will find that far harder in 2014. Janet Yellen, who takes over as chairman from Ben Bernanke in February, will seek early in her tenure gently to pare back "quantitative easing" (QE), under which the Fed buys $85 billion a month of bonds with newly printed money. Ms Yellen will couple these plans with repeated reminders that short-term interest rates will stay at zero at least through 2015, and possibly longer. The Fed has already promised not to raise rates so long as unemployment is at least 6.5%; Ms Yellen will add a new condition: no tightening if inflation is projected to stay below 2%.

This could easily go wrong. Hints by the Fed that it would soon ease, or "taper", QE led to a global stampede out of bonds in 2013. A repeat would do significant damage to the broader economy. Credit Suisse reckons that housing construction and car production, both highly sensitive to interest rates, accounted for a third of GDP growth in late 2013. This will put a premium on clear communication. But the risk that mixed signals will further roil markets is high: the Federal Open Market Committee is divided on the wisdom of QE and may be even more so once up to five of its 19 seats may turn over in the coming year.

Even as a cyclical recovery gathers strength in 2014, structural drags will become more apparent. With each ▶

2014 IN BRIEF

Major League Baseball's opening series takes place in **Sydney**, while the National Football League and National Basketball Association stage matches in London

Greg Ip: United States economics editor, *The Economist*

Waste not, want not

Emily Bobrow

Massachusetts is leading the way in recycling organic waste

Those last dregs of uneaten chowder may look like rubbish, but in Massachusetts such waste is increasingly seen as an opportunity. From July 2014 all companies and institutions in the state that produce more than 1 tonne a week of organic waste—including food, plants and manure—will be banned from sending the stuff to landfills. Instead, the state's biggest wasters (ie, big restaurants, universities and manufacturers rather than households) will need to get creative, donating edible food to charities and using the rest as compost or fodder for anaerobic-digestion facilities, which turn organic waste into energy. Massachusetts creates nearly 1.4m tonnes of organic waste each year. This plan aims to divert at least a third of it away from landfills by the end of the decade.

The Massachusetts ban is the most ambitious example of a new trend. Connecticut and Vermont will also enact laws to divert food waste from landfills in 2014. The rationale is plain: in small and densely populated states, landfill capacity is limited and disposal costs are high: \$60-90 a tonne in Massachusetts, compared with a national average of about \$45. Decomposing food waste also generates methane, a greenhouse gas. But this biogas can be captured and turned into energy through the process of anaerobic digestion, and then be sold into the electricity grid.

Stopping the rot

The technology of anaerobic digestion has been around for a while. Although the industry has been taking off in Europe—especially in Germany and Sweden—it has been slow to grow in America, where vast stretches of cheap land have long meant that there is plenty of landfill capacity and little incentive to build costly waste-recycling plants. But rising electricity prices, dwindling landfill space and some voluntary recycling goals are encouraging states to embrace the potential of biogas.

To help the industry along, Massachusetts has made millions of dollars in low-interest loans and grants available to build new anaerobic digesters. "We believe this will end up saving money," says Ken Kimmell, the commissioner of the state's department of environmental protection.

America wastes around 35m tonnes of food a year

States are sensibly beginning to see rubbish as a resource, not merely a burden. Yet America creates 35m tonnes of food waste a year. It is good to divert this rubbish from landfills, but it would be better still to stop creating so much of the stuff in the first place. ■

Emily Bobrow: online United States editor, *The Economist*

passing year, the evidence mounts that America is growing slowly because it simply can't grow as fast as it once did. The Congressional Budget Office has lowered its estimate of America's potential output by 5% since 2008. Long-term growth rests on labour, capital and innovation and all three seem sickly. Millions of adults have left the labour force, driving the participation rate down to 63.2% from 66% in 2007. They were supposed to return when job opportunities improved; eventually some will, but it appears that most have instead retired, gone on disability insurance or for other reasons chosen not to work.

More troubling is that those with jobs have so little to show for them. Real hourly earnings have grown by just 0.3% a year since 2007. Monthly surveys by the University of Michigan show that households are deeply pessimistic about future income gains, which does not put them in the mood to spend much now.

Several factors are at work. Much of the growth in GDP has gone to profits, not wages, reflecting the weak bargaining position of workers. Higher energy prices have eaten away at real incomes. Most important, over time real wages track productivity and that, too, is weak. This can be traced to lacklustre business investment. After an initial bounceback early in the recovery, it has stabilised at a little over 12% of GDP, well below the 13.5% peak of the previous cycle, which was itself below the 14.5% peak of the 1990s cycle.

The parsimony is puzzling: interest rates are at, or near, record lows, and profit margins near all-time highs. Perhaps companies see less promise in innovation; smartphones and social media offer new ways to communicate, entertain and amuse, but have not revolutionised commerce, information management and supply chains in the way the internet did a decade earlier. Businesses may be waiting for demand to strengthen (something of a chicken-and-egg problem) or for policymakers to stop shooting the economy in the foot. With luck, 2014 will be the year that happens ■

2014 IN BRIEF

A new border-crossing opens between California and **Tijuana airport** in Mexico