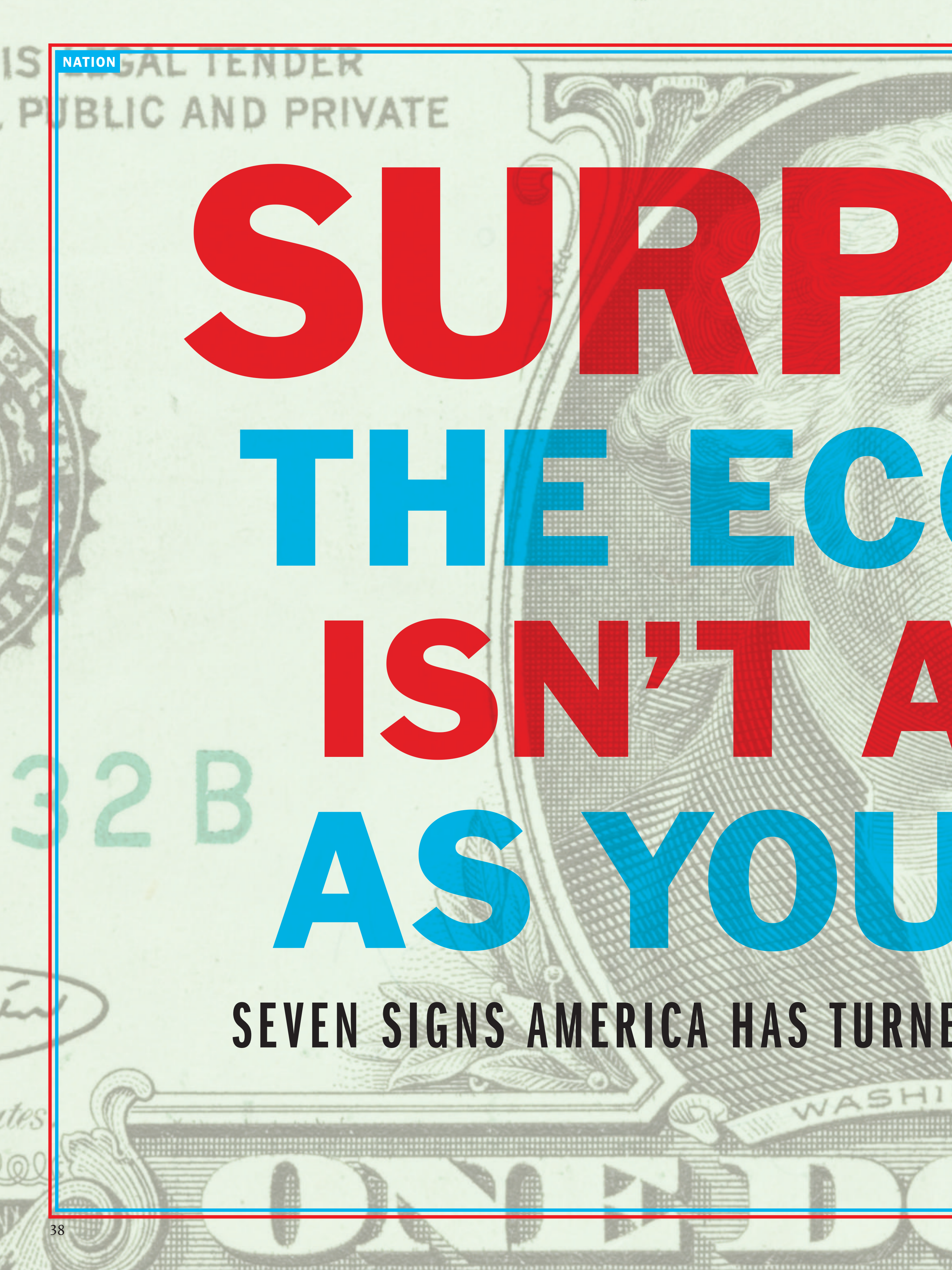

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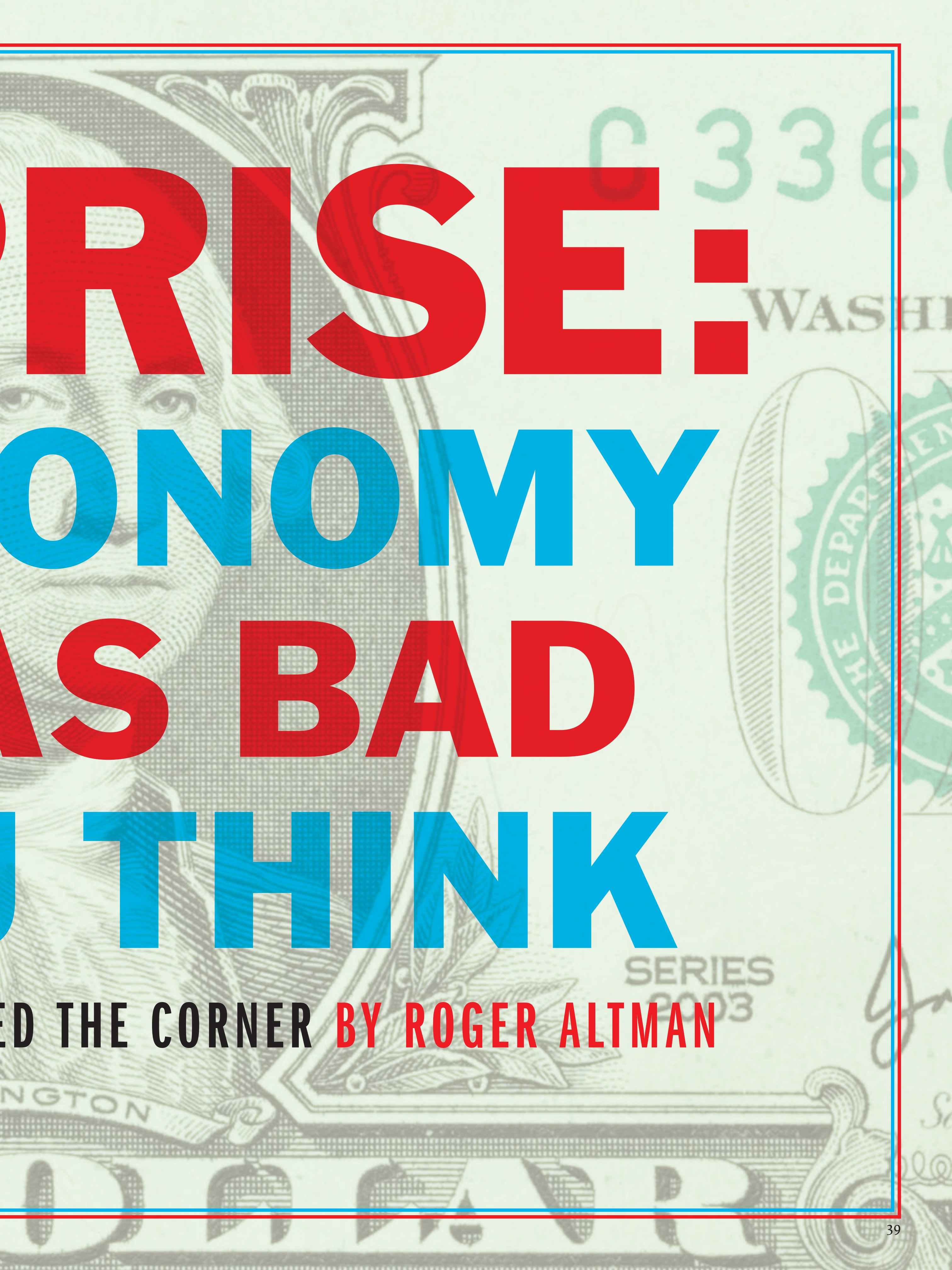

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ONOMY
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ED THE CORNER BY ROGER ALTMAN

NEARLY SEVEN YEARS AFTER THE ONSET OF THE GREAT RECESSION, THE NATIONAL MOOD REMAINS TROUBLED.

Surveys find entrenched pessimism over the country's economic outlook and overall trajectory. In the latest NBC News/*Wall Street Journal* poll, 63% of respondents said the U.S. is on the wrong track. It's not difficult to see why. Set aside the gridlock in Washington for a moment and appreciate the weakness of the economic recovery: Households whose finances were too weak to spend. Large numbers of unemployed workers who couldn't do so either. Younger Americans who couldn't afford their own homes. Banks that were too broken to lend. Yet nearly a year ago, I wrote an essay for TIME suggesting that the economy could surprise on the upside. That hypothesis looks even more valid today.

Despite the pessimistic mood, America is experiencing a profound comeback. Yes, too many Americans are out of work and have been for far too long. And yes, we have a huge amount of slack to make up. In fact, if the 2008 collapse had not happened, the U.S. GDP would be $1 trillion—or more than 5%—higher than it is today.

But in terms of the growth outlook, the news is good. Goldman Sachs and many private-sector forecasters project a 3.3% growth rate for the remainder of 2014. The first half of 2014 saw the best job-creation rate in 15 years. Total household wealth and private employment surpassed 2008 levels last year. Bank loans to businesses exceeded previous highs this year. And income growth will soon improve too. America is finally returning to where it was seven years ago.

As halting as the U.S. recovery has been, the economy is now leaner and more capable of healthy, sustained growth through 2016 and beyond. Our outlook shines compared with that of the rest of the industrialized world, as Europe and Japan are stagnant. The 2008 economic crisis and Great Recession forced widespread restructuring throughout the U.S. economy—not unlike a company gritting its teeth through a lifesaving bankruptcy. Manufacturing costs are down. The banking system has been recapitalized. The excess and abuse that defined the housing market are gone. And it's all being turbocharged by an energy boom nobody saw coming.

It's not just economic trends that are looking up: crime rates, teen pregnancy and carbon emissions are down; public-education outcomes are improving dramatically; inflation in health care costs is at a half-century low. That points to something I did not foresee last year: that the social health of America seems to be mending. Americans may still feel discontented, but winter is finally over.

13%

SETBACK
Percentage of households that suffered "substantial financial stress" during the recession

26%

RECOVERY
Increase in the average home price in 20 key metro areas since April 2012

AMERICANS ARE SPENDING LIKE THEY MEAN IT

THE BIGGEST PIECE OF the U.S. economy, by far, is the consumer sector. It represents 70% of GDP in most years. But consumers suffered historic setbacks in 2008 and 2009. According to a Federal Reserve Board report, 13% of households experienced "substantial financial stress." This compares with only 1% during the previous two recessions. And it is why consumer spending fell so sharply in 2009, as frightened households cut back.

It has taken years for total household finances to recover fully, but now they have. Total household net worth is now well above its 2007 peak, driven by the recovery in stock prices and home values. Household debt-to-income ratios are the lowest in more than 30 years. And the first half of 2014 has seen employment begin to take off.

Indeed, consumer spending is strengthening alongside consumer confidence, which is nearly back to prerecession levels. For all of 2014, consumer spending should grow around 3% as real disposable income rises and the savings rate moderates. With an average of 248,000 new jobs having been added in each of the past five months, the unemployment rate is probably on course to fall to 5% in 2016. Although part of the decline in the unemployment rate to date is due to stubbornly low labor-participation rates, the overall outlook for consumer spending, the engine of our economy, is healthy again.

HOUSING HAS COME BACK TO LIFE

A GOOD RECOVERY IN the housing sector was inevitable because both the supply of viable housing and household-formation rates had dropped to very low levels. That combination finally triggered a snapback.

At first, it was housing prices that turned up. Over the past year, they rose in each of the 20 largest metropolitan areas. And since its low point in early 2012, the Case-Shiller Home Price Index has risen more than 25%. This revived the housing market and helped restore overall household balance nationwide.

Single-family and multifamily housing starts have also recovered strongly. They exceeded 1.5 million annually in the decade before the crisis but collapsed to less than 500,000 in its aftermath. Now they are over 1 million and should go higher. Most forecasts envision a rate of roughly 1.2 million next year, continuing to rise to 1.6 million over the next few years. Keep in mind that new housing construction and renovations drive a wide range of manufacturing and services output, from appliances to trucking. Indeed, private residential investment has jumped by more than 27% since 2012.

Finally, economic hardship forced record numbers

PREVIOUS PAGES: GETTY IMAGES

of grown kids to stay with their parents, depressing household formation to rates far below normal. But this too is improving. Harvard's Joint Center for Housing Studies estimates that formation rates will double to 1.2 million annually as kids finally move out and the adult population increases.

AMERICAN-MADE MAKES SENSE AGAIN

A NEW FACTOR TO ADD since my previous analysis is manufacturing. A near consensus that this sector was in permanent decline has existed for many years. It was accentuated by the loss of nearly 6 million manufacturing jobs from 2000 to 2010 and by the sense that much lower wages in Asia made continued offshoring inevitable.

But recently the greater role of technology in manufacturing and rising wages in Asia have given our manufacturing sector some life. A recent Brookings Institution report on manufacturing stresses how robotics, 3-D printing and the relentless advance of digital technology are transforming big parts of U.S. manufacturing. Moreover, as China's GDP has continued to grow, its wages have risen considerably, narrowing the cost differential with the U.S. In many industries, the cost-to-produce difference is now down to 15%.

That explains why certain U.S. producers are reversing themselves and committing to manufacturing goods at home. Walmart announced that it would sell $50 billion more in American-made products over the next 10 years, and the Boston Consulting Group recently estimated that up to 30% of offshore production would return. Although manufacturing has added 668,000 jobs since the 2010 nadir, continued automation will prevent this sector from being a major contributor of new jobs in the future. But the role of manufacturing in our GDP is stable, and the sense that other sectors of the economy would need to compensate for continued declines in manufacturing is out of date.

ENERGY PRODUCTION IS BOOMING

If ever there was proof of the difficulty of forecasting, it is the stunning recovery in our oil-and-gas production. Virtually no one from ExxonMobil on down saw this coming. Nor the way in which made-in-the-USA technology made it happen. The idea that America, whose oil production has been declining for the past 40 years, is now on track to become the world's biggest producer by 2015 is still hard to grasp. As is the notion that after similar declines in production of natural gas, we now have a 100-year supply of natural gas at current rates of consumption. The U.S. Energy Information Administration expects total U.S. crude-oil production to increase more than 25% to 9.3 million barrels per day by 2015, which would mark the highest level since 1972. Daily natural gas production, which grew by 5% over the past year, is expected to continue climbing, with the U.S. becoming a net exporter by 2018.

This is a plus for growth, for household budgets and consumption, for climate protection and for America's national security. Given our huge new supplies, natural gas is cheaper here—around $4.70 per 1,000 cu. ft.—than anywhere else. This means lower utility bills across the country. It also means that gas is being substituted rapidly for the dirtiest fuel, coal, to produce electricity. And that both America's stake in the unstable Persian Gulf and our borrowing from China are diminished as we import less energy. The rise, fall and rise of the American oil-and-gas sector is probably, together with development of the Internet, the biggest economic breakthrough in this country in 50 years.

OUR ENVIRONMENT IS GETTING HEALTHIER

ALTHOUGH THERE REMAINS a heated political debate over climate change and its causes, few people, regardless of their views on that, actually favor more carbon emissions. But there is also an unexpected positive trend. Carbon emissions in the U.S. actually have been falling. Today they are down nearly 10% from 2005 levels. It is possible that the U.S. will meet its goal of cutting emissions by 2020 to 17% below that 2005 baseline.

Technology and regulation explain this surprising trend. Take the auto industry. At one level, Washington upped fuel-efficiency requirements to a stiff fleetwide average of 54.5 m.p.g. by model year 2025. At another, galloping advances in engine technology and vehicle weight are enabling automakers to improve their mileage more quickly than anyone forecast. And the EPA has just mandated sharp reductions in emissions from coal-fired plants.

The U.S. has been among the worst offenders in emissions. To have any credibility in leading global negotiations on these issues, we need to lead the way.

AMERICAN SCHOOLS ARE WORKING SMARTER

HOW OFTEN HAVE YOU read that America's education system, especially public education, is a failure? It has a long way to go, but it has started to improve. This is crucial because differentials in lifetime earnings by level of education are widening. Driven by globalization and technology, labor markets are demanding higher and higher levels of skills. Therefore, to improve incomes for younger Americans, we must get better educational outcomes.

1971

SETBACK

The year U.S. oil production began to decline

2015

RECOVERY

The year the International Energy Agency predicts the U.S. will become the world's leading oil producer

For 25 years, those outcomes were stagnant. High school graduation rates had fallen to 60% or lower in many large cities and rural areas. And just over half of first-year college students would graduate within six years. These are poor results by the standards of advanced countries.

But beginning in 2006, the decline began to reverse. High school completion rates are now up almost 10 points, crossing 80% for the first time.

According to a recent report from Johns Hopkins University, the turnaround reflects countless grassroots efforts toward public-school reform. Instigated by parents, business groups, nonprofits, state and local governments and, in some areas, teacher unions, these efforts have concentrated on teacher training and evaluation, better collection and use of data in supporting students, improved curriculum materials and the restructuring or closing of underperforming schools, sometimes called dropout factories.

It is crucial that these reforms continue because if they do, that same Johns Hopkins study predicts that U.S. high schools will reach a 90% completion rate by 2020. That would be a huge achievement. Over the past decade, college-completion rates also have strengthened, nearing 60%. True, the college readiness of high school graduates has not improved in line with graduation rates. But recent advances that tie online education to different approaches in the classroom may soon improve this too.

SOCIAL TRENDS ARE MOVING IN THE RIGHT DIRECTION

AMERICA HAS SEEN A drop in crime rates that in earlier years would have been universally viewed as impossible. The overall crime rate has plummeted by 45% since peaking in 1991 and by 13% just since 2007—counterintuitively continuing to drop through the recession and sharp spike in unemployment.

Since 1991, according to FBI data, the number of violent crimes has fallen 36% nationally and 64% in the nation's largest cities. And in New York and Los Angeles, our two largest cities, it has fallen even further. Property crime has also become increasingly rare. Incredibly, in New York City, car thefts have plunged 94% in the past two decades.

How is this possible? In the mid-1990s, few saw this decline coming, and many warned that crime would surge once again as teens of that era grew into young adults. Today, criminologists still differ on what has caused the nationwide turnaround in crime rates and why those dire predictions never came to pass. But crime-fighting technology, better policing, aging societies, growing urban populations and declining usage of hard drugs are widely cited.

For many Americans, the drop in crime has resulted not only in a much higher quality of life but in a reduced economic burden as well. Safer cities generally mean stronger urban economies.

In the same category of big surprises, teen-pregnancy rates have fallen to their lowest level in more than 30 years, according to the widely respected Guttmacher Institute. They have declined 51% from their 1990 peak, based on the latest available data, and the teenage birthrate is down 43% from that year's level. Today, fewer teens are becoming pregnant and becoming mothers than at any point since reliable data has been collected by the National Center for Health Statistics. This is also true for women in the 20-to-24 age group. To put it mildly, there were very few predictions to this effect a generation ago.

In addition, overall birthrates in the U.S. have turned up for the first time since 2007—including for children born to women with a college education—to just shy of 4 million.

73%

SETBACK
Percentage of students who graduated from high school in 2006

80%

RECOVERY
Percentage of students who graduated from high school in 2012

THE CHALLENGE AHEAD

OUR COUNTRY'S BIGGEST CHALLENGE NOW IS THE plight of lower-income Americans, who are under severe and sustained economic pressure. Today, America resembles a tale of two cities. Those who own homes or stocks have benefited from the recovery in these asset classes and are moving up again. But 40% of our working-age families earn $40,000 a year or less. Generally they live within 250% of the official poverty level, which is the eligibility threshold for food stamps. Indeed, judging from current trends, half of today's 20-year-olds will receive food stamps during their adult lives. More broadly, median household income is still 8% below the precrisis level, and those who have not completed college are seeing declines in anticipated lifetime earnings compared with their peers with college degrees.

This is our primary economic challenge. If a third of our population has little purchasing power, it will be hard to achieve the rate of long-term growth we want. We need to improve the work skills of this group, strengthen the social safety net and increase the number of young Americans receiving a full college education.

Although doing more to relieve the financial burdens of working Americans is good economics, it is also, and perhaps more important, a matter of values. For much of the 20th century we strove, with much success, to build a fairer and more inclusive society. But today, too many working families are living paycheck to paycheck or even in outright poverty, while the toeholds to economic stability become fewer and farther between.

With our economy's near- and medium-term economic outlook strong, now is the time to remove the barriers that are keeping hardworking Americans walking a far too thin financial line. ■

Altman, who served as Deputy Secretary of the Treasury during the Clinton Administration, is the founder and executive chairman of Evercore Partners

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American manufacturing is brewing something big.

Siemens answers are redefining manufacturing for companies like Schlafly Bottleworks brewery.

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Siemens technology helped this brewery double production.

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Siemens is working with some of the most forward-thinking companies to improve efficiency and productivity, to make more with less and to grow the economy. Because it's not just about making things right, it's about making things right for people, for business and for America.

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