In Spite Of Mixed Inflation Data, Tie Demand Remains Resilient

By Petr Ledvina

Good economic reports are flowing in with macroeconomic numbers suggesting real U.S. GDP grew at an estimated annualized growth rate of 2.9 percent in Q4 2022. This betters consensus estimates of 2.6 percent. Also, the labor market is still strong, with one of the best unemployment rates in 50 years at 3.5 percent. Headline inflation is slowing, although consumer spending on goods is still above the pre-pandemic trend. And, within the good economic news, inflation offers some head-scratching numbers for the FED.

Among the good news for the FED was the report of advance retail sales for December, along with personal consumption expenditures for the fourth quarter. Advance retail sales in total declined by 2.8 percent for the second consecutive month. But this does not represent the real picture for the consumer, since it is reported in nominal dollars. For example, nominal advance retail sales increased by 5.2 percent from December 2021 to December 2022. At times of low inflation, one could extrapolate that real retail sales also grew. However, at times of high inflation, comparisons get trickier. Adjusting for inflation, advance retail sales actually declined by 1.1 percent, although they remain above the pre-pandemic trend (Figure 1).

The consumer price index (CPI) report released in January brought more good news. This measure of inflation declined by 0.1 percentage points from November. Even though the CPI grew by 6.5 percent from levels a year ago, the deceleration continues from its peak of 9 percent in June 2022. Major contributors to the improved inflation reading were lower energy and food prices, with some services also starting to moderate.

The decline in the price of goods was partially caused by easing supply chain issues, declines in many commodity prices and lower consumer demand. Consumers also may have been uncertain about the future as they have been bombarded with headlines that a recession is imminent. The decline in nominal spending was perhaps caused by the effort to buy earlier after many people did not receive gifts on time during the 2021 Christmas season.

A head scratcher is also found in that same CPI report. Despite rising mortgage rates, shelter inflation remains stubbornly high (Figure 2). It represents about one-third of the CPI index and is far stickier than food and energy. Between December 2019 and October 2022 housing prices measured by the S&P/Case-Shiller U.S. National Home Price Index rose by 40.8 percent, while the shelter index rose only 12.4 percent. Though housing prices have declined in recent months, it will take some time for shelter inflation to moderate.

Despite the FED's rapid interest rate increases, the situation in the labor market is still a long way from normalized. There are about 10 million job postings for about 6 million job seekers. This imbalance causes upward wage pressures and is a major inflation contributor, although wage increases have started to moderate (Figure 3). In recent months, several companies announced layoffs, especially in the tech industry. For some of these companies the workforce reduction in percentage terms is quite meaningful. In many cases, though, the layoffs represent a very small fraction of the companies' workforce. In the past such layoffs might not even have been worth mentioning. Now, they may not be sufficient to create a meaningful improvement in the labor market imbalance. Still, initial unemployment claims are low, and the unemployment rate remains at historic lows.

Decreasing demand for labor is one way to achieve equilibrium. Increasing the labor force participation rate is another, even though the rate is still about one percentage point below pre-pandemic levels. One alternative could be to streamline and increase legal immigration to help fill existing skilled and unskilled job openings. According to the Department of Homeland Security, the number of legal immigrants declined from pre-pandemic levels of about 1M per year to about 0.7M in 2020 and 2021, resulting in about 0.6M fewer workers entering the labor force. Recently, however, there are signs that the backlog of applications is decreasing and that the number of legal immigrants is increasing (NPR). Nonetheless, a tight labor market is expected in the future. The aging U.S. population, de-globalization, and infrastructure spending are all likely to cause persistent wage pressures.

The reopening of China also sparked a rally of some commodities. If sustained, this could negate price declines of some goods in the United States. There are also unpredictable geopolitical and weather events—war in Ukraine, floods in Pakistan—that may cause significant spikes in commodity prices.

The FED's monetary tightening has been felt by the railroads. The decline in residential housing construction manifested itself in the decline of lumber, wood products and building material shipments. Slowing consumer demand resulted in lower intermodal shipments across the railroad network. These

Table 1

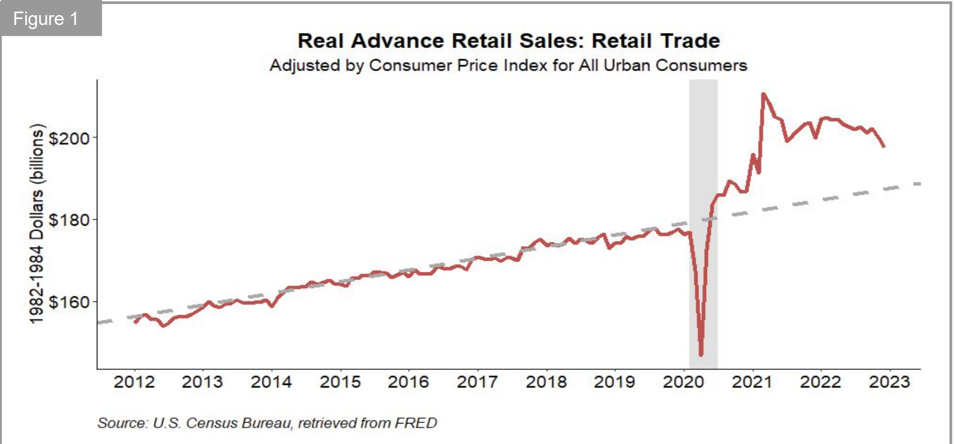
New Wood Crossties (in thousands)					
Year	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Pct
2020	-3.4%	15,309	3,175	18,483	-0.5%
2021	5.7%	14,813	3,948	18,761	1.5%
2022	1.8%	14,609	4,046	18,654	-0.6%
2023	-0.1%	14,488	3,915	18,403	-1.3%
2024	1.4%	14,441	4,191	18,632	1.2%

headwinds were partially offset by shipments of automobiles, grain and food products as well as coal and fracking sand, as natural gas prices were well above average (various Class I Q4 earnings conference calls; AAR weekly reports). Despite lower shipments, the railroads managed to increase earnings through favorable pricing and cost savings measures. As a result, the aggregate railroads' CapEx should be somewhat higher in 2023 in nominal terms, but marginally lower in real terms due to higher input costs for labor, ties and other materials.

If there is a silver lining for the supply of ties from slowing consumer spending, it might be that the demand for pallet lumber is easing and the price of cants has moderated as a result (Figure 4). Container throughput at U.S. ports has been in decline for several months now. The 12-month moving average declined from its peak in June by 4.3 percent compared to December 2022. The same applies to railroad intermodal traffic. During the second half of 2022, container shipments declined by 3.5 percent from the first half (see Business Trends). There are some mills that finally caught up with back orders for pallet lumber (Hardwood Market Report 1/20/2023 issue). Going forward, the demand for this type of lumber could further soften as consumer demand declines further due to the economic slowdown. In conjunction with tepid demand for board roads/mats, tie production is coming to the forefront. This is encouraging news for the railroads since the inventory-to-sales ratio has been depressed for many months, mainly because of low tie inventories (see Tie Statistics & Trends).

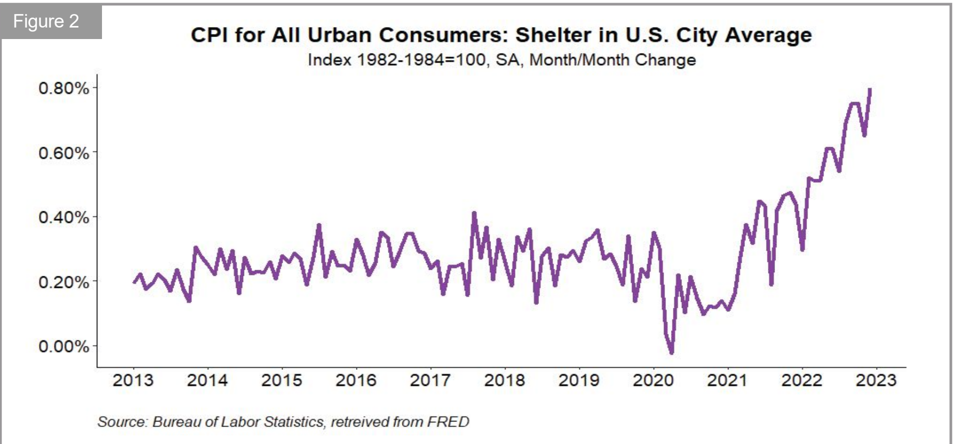
The RTA tie demand forecast predicts slightly lower demand by 1.3 percent in 2023, with a modest increase in 2024 of 0.9 percent. This forecast is about 0.5M ties lower compared to the September 2022 forecast, as the outlook for economic growth in 2023 has been revised downward from 1.6 percent to -0.1 percent (mild recession), the coal production forecast was lowered by almost 12 percent, and as forecasts also predict lower U.S. oil production and nominal changes in crude oil prices. By 2024, tie demand should recover modestly, as the economy is expected to grow by 1.4 percent. A detailed tie demand outlook is in Table 1.

Figure 1



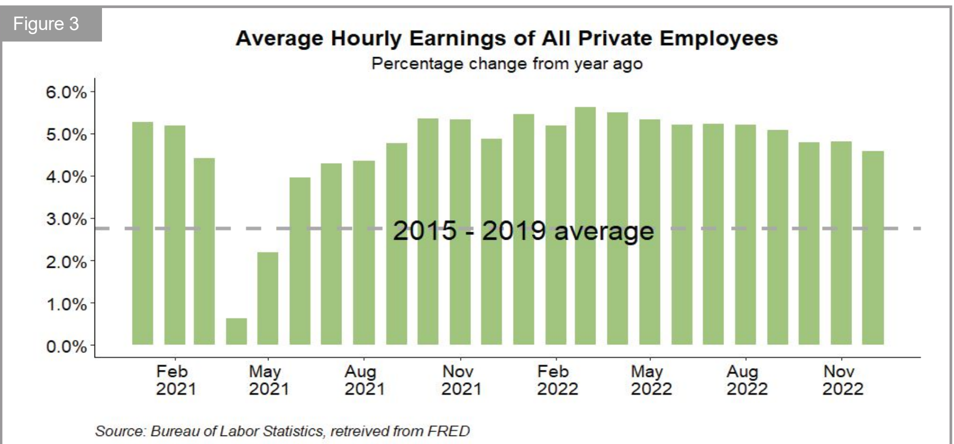
Source: U.S. Census Bureau, retrieved from FRED

Figure 2



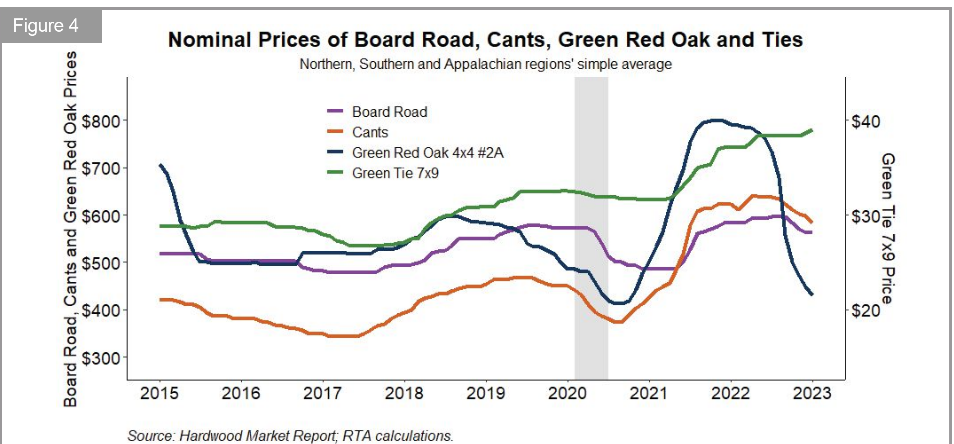
Source: Bureau of Labor Statistics, retreived from FRED

Figure 3



Source: Bureau of Labor Statistics, retreived from FRED

Figure 4



Source: Hardwood Market Report; RTA calculations.