

New Year, New Administration & The Outlook For Ties

A projected rebounding economy is expected to lead to growth in freight rail and tie demand

By Petr Ledvina



The wood tie industry is looking forward to a more prosperous 2021.

Most people are looking to 2021 hoping it will be better than 2020. The pandemic brought great personal loss and economic pain to many and halted many leisure activities for those who could afford them. But despite the challenges faced by people, businesses and institutions, the unprecedented help from the federal government and the Fed prevented circumstances that would have been far worse.

The new year began with optimism because of the expected distribution of the vaccine, even though the virus still claims lives and even though governments across the globe continue to impose restrictions aimed at containing the virus and preventing health systems from becoming overwhelmed.

The Centers for Disease Control & Prevention estimates that between Jan. 26 and Oct. 3 last year, the number of deaths exceeded normal death rates by 299,000, mainly due to COVID-19. (<https://www.cdc.gov/mmwr/volumes/69/wr/mm6942e2.htm>)

With the resurgence of COVID-19 cases in November and December, the death toll continues to rise. This will lower the number

of consumers and, to a degree, personnel in the labor force, even though the impact on GDP may be marginal. However, there are signs of structural changes in the labor force that raise concerns among economists and policymakers.

The December headline unemployment rate of 6.7 percent does not provide a complete picture of the changes in the labor market. Digging deeper, we can see that the number of workers outside the labor force increased from 95 million to 100 million. These 5 million people are no longer included in the unemployment rate calculation, which reduces the unemployment rate. In contrast, the unemployed population currently stands at 10.7 million. The same report showed the number of employed people declining from 158.7 million to 149.8 million. Hence, the employed-to-population ratio dropped from 61 percent to 57.4 percent (BLS). The longer eligible workers stay out of the labor force or remain unemployed, the harder it will be to get them back to participating in the economy due to age or loss of skill.

In response, the government plans to support the economy with a fifth stimulus

bill, as many Americans are still in dire straits. While it is only a proposal, the new administration is contemplating additional spending of about \$1.8T, of which \$1T is to support consumers directly or indirectly, while the rest of the spending will support the health system and state and local governments. In addition, the FED is still committed to buying \$80 billion of U.S. treasuries and \$40 billion of mortgage-backed securities per month, partly because the benchmark inflation measure is at 1.4 percent, which is well below the 2 percent target.

The real GDP number recently released for Q4 provides some justification for government intervention. Quarter-to-quarter economic growth slowed down significantly from the previous quarter to 1 percent (often reported as 4 percent annual rate), but for the entire year, the economy shrank by an estimated 3.5 percent (see Business Trends, on page 22, for more insight).

This had a negative impact on the railroads, with expected freight measured in ton-miles down by double digit percentage points in 2020. However, traffic rebounded in the third and fourth quarters. According to the Association of American Railroads (AAR) and RailConnect weekly reports, the highest decline was in commodities, while intermodal traffic declined marginally for Class I and rose for small railroads (see Business Trends for more detail).

Intermodal traffic would have been worse, but consumer spending prevented higher losses. After the great recession, it took about six years to recover to pre-recession retail spending levels, but it took less than six months to get to pre-COVID retail spending levels (**Figure 1**).

As the government discusses sending more money to consumers and with the expectation that most of the population will be vaccinated by mid-year, the outlook for consumer spending looks promising. This assumption is further supported by

above-average deposit levels, most likely because of the 2020 stimulus checks, but also because people do not have to spend as much on gasoline and other items in the stay-at-home economy (Figure 2).

This type of economy has also caused an interesting twist in electricity consumption. While industrial and commercial sector demand declined significantly, consumer demand increased despite the mild winter so far. From 2019 to 2020, overall demand for energy declined by 4 percent. This had a negative effect on energy coal demand, as was reflected in AAR and RailConnect reports. However, the EIA predicts demand for electricity will increase by 1.5 percent for the coming year and by 1.7 percent for 2022. As a result, demand for coal should rise as well, with lower-than-average inventories at power plants creating additional demand. In 2021, the EIA forecast suggests coal production will rise by 12 percent and in 2022 by an additional 4.1 percent.

Another economic impact caused by consumers affected the housing market. While new housing starts were up “only” 5.2 percent for the year, sales of new houses were up by 20.8 percent in November, significantly lowering the available housing inventory. As a result of the imbalance between supply and demand, housing prices have risen by 9.1 percent over the last 12 months (S&P/Case-Shiller home price index). This is difficult to understand with unemployment conditions as described above. However, a study done by Equifax sheds some light on the subject.

Equifax found that demand for homes comes from people with higher credit scores, that is, people with higher incomes. Some argue this is caused primarily by the flight of urbanites to the suburbs, escaping restrictions imposed by the pandemic and seeking “fresh air” and more space to accommodate all family members working from home and studying online. Others suggest that people are buying houses as an inflation hedge or as an investment fostered by the low interest rate environment. No matter the reason, the homeownership rate increased to 67.4 percent in Q3 from 64.8 percent a year ago. In addition, vacancy rates of rental properties decreased from

6.8 percent to 6.4 percent in the same time period (U.S. Census Bureau).

Higher housing prices suggest higher building activity in 2021; pent up consumer demand; higher demand for coal; and an economy on the rebound. All point to higher rail freight in the coming year. Freight is expected to grow about 10 percent this year and about 5 percent next year. This in turn points to higher tie demand.

In the table below, the Railway Tie Association (RTA) presents the tie demand forecast for 2021 and 2022. This forecast is based on the assumption that the virus will be contained by mid-year. It also assumes that inflation remains stable. ■



New Wood Cross-ties (in thousands)					
Year	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Pct
2018	2.9%	15,489	5,872	21,361	-8.4%
2019	2.3%	14,471	4,105	18,575	-13.0%
2020	-3.9%*	14,155	3,806	17,960	-3.3%
2021	4.2%	14,016	4,430	18,446	2.7%
2022	3.0%	14,109	4,998	19,107	3.6%

*Forecast was created before the preliminary Q4 2020 GDP number was released.

