# Consumer Demand Pushes Tie Prices Higher
# Will It Last? Other Forces Are At Play

By Petr Ledvina

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On July 13, 2021, the U.S. Bureau of Labor Statistics released its reading on prices for June. The Consumer Price Index (CPI) jumped an extraordinary 5.4 percent year-over-year, beating expectations by 0.5 percent. The Producer Price Index (PPI) of 7.3 percent for the same time frame was 0.5 percent above expectations. In addition, average hourly earnings rose by 3.6 percent, just 0.1 percent lower than expected.

These statistics revived discussion of prolonged inflation. In spite of this, the bond market was unfazed. In fact, bond prices went up, brushing off inflation concerns. Also, some commodity prices have peaked since the data for PPI was collected.

While inflation itself may not be a direct concern for the tie market, competition for the same log, or shifting production to softwood, is. Thus, a number of factors, such as development in consumer demand for shipped goods, the tight housing market, and rising oil prices could all contribute to a tighter tie market in the near future. Yet, the following evidence may provide clues indicating that this pressure may be transitory.

An article in the May/June 2021 edition of *Crossties* focused on container shipping issues caused by higher consumer demand and the impact this had on pallets and pricing. While problems with unloading container ships have eased since then, this may be temporary, as holiday season orders hit the ports. Nonetheless, the "velocity" of pallets' circulation seems to be improving as the Los Angeles and Long Beach ports have increased the throughput of containers and as the railroads are carrying them closer to their final destinations (see Business Trends graphs).

By some accounts, the severe shortage of pallets has eased slightly (*Transport Topics*, June 1, 2021). Nevertheless, there is still a high demand for containers and wooden pallets resulting from the consumption of goods manufactured abroad. Consequently, the price of cants continues to increase (Figure 1).

As a result of this strong demand, container shipping costs from Asia increased significantly, and the spot rates between Shanghai and Los Angeles increased by 229 percent to stand at $9,631 for a 40-foot container, compared to the same period in 2020 (Supply Chain Advisors, July 8, 2021). Yet, this increase is not the result of demand and supply chain issues alone.

Figure 1

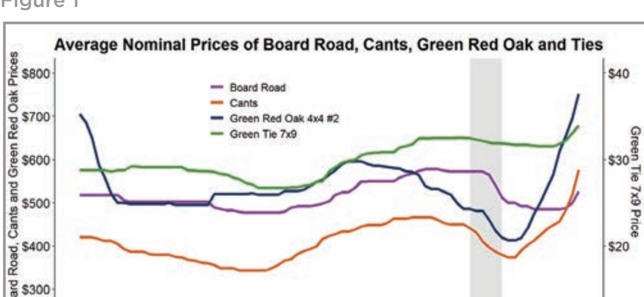
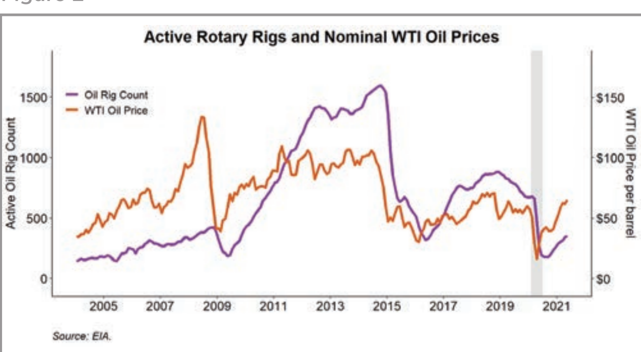



Figure 2




Before the 2008 financial crisis, there were 20 or so shipping lines. These were consolidated to 10 during the recovery period. These remaining companies formed three major alliances akin to the airline industry. The alliances of Maersk, CMA CGM, and Hapag Lloyd control about 80 percent of the global market (*Supply Chain Management Review,* Oct. 6, 2020, NPR). Because of this concentration, the industry's profitability has increased substantially, in part by maintaining capacity discipline. In turn, higher shipping prices have put upward pressure on consumer prices.

> *"All things considered, significant forces are weighing upon the markets for wood and crossties."*

Though the U.S. oil production industry is far less concentrated, oil price slumps starting in 2015 caused many bankruptcies and restructurings and provided an opportunity for some consolidation.

For example, there were about 142 bankrupted companies in 2018 and 107 in 2020. Further consolidation is expected (*Houston Chronicle*, Jan. 20, 2021). In addition, the OPEC countries, which control about 40 percent of world oil production (EIA), are holding about 4.5 million barrels/day capacity temporarily off-line in an attempt to stabilize oil prices during the COVID-19 crisis.

This challenging environment has caused many U.S. oil-producing companies to change business strategies to focus on better cash flow management rather than on supply growth (S&P Global report, June 10, 2021). Nevertheless, the number of active oil rigs is rising as the price of oil is approaching $80 per barrel (Figure 2).

Why is the rising oil price important for the ties market? As argued in a research article "Board Road, Crane Mat

Analytics Provide an Economic Twist for Ties," published in the March/April 2020 issue of *Crossties*, rising oil prices are likely to contribute to higher demand for board road lumber, thus pushing tie prices higher.

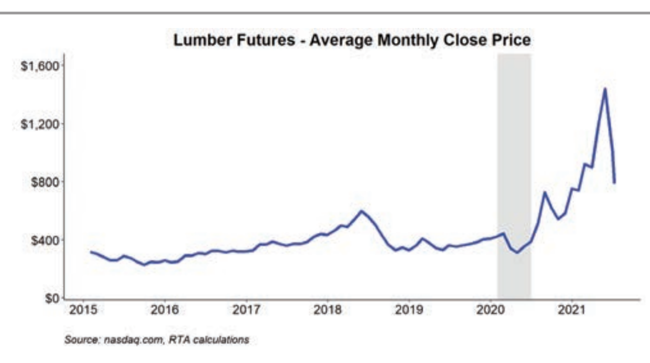
However, EIA forecasts balanced market conditions in the second half of 2021, with oil prices around $70 per barrel. Also, drilling activity is likely to be modest despite higher prices (Dallas FED President Robert Kaplan). Currently, *Hardwood Market Report* observes the demand for board roads to be steady, so demand should rise only modestly, if at all.

As argued in a previous *Crossties* article, with the expiration of federal government economic relief for consumers, resumption of debt payments, opening of the leisure economy and higher prices, the demand for consumer goods should fall, as most consumer households will face budget constraints unless there is a significant increase in wages. The average hourly wage increase of 4.91 percent from Q1 2020 to Q1 2021 may not be the best gauge of wage increases at this time.

For example, the employment cost index shows only a 2.99 percent increase. The issue with the average wage number in Q1 2021 may be that the low-wage workers most affected by COVID-19 are not in the sample, making the average wage appear to be higher.

As BEA points out, "because average hourly earnings vary widely across industries, the large employment fluctuations since February 2020 complicate the analysis of recent trends in average hourly earnings." In addition, the still low labor force participation rate at 61.6 percent should help to contain the current higher wage inflation. As stated at the beginning of the article, calculating hourly earnings and the CPI, it appears that real wages are not keeping up with price increases, and the only federal support going forward will be the additional child tax credit.

Meanwhile, there are already some indicators pointing to a stabilization of prices in the construction lumber sector. Most notably, in the softwood lumber market, the WSPF KD #2&Btr 2x4 price dropped from $1,618 in May to $900/thousand BF in June (*Madison's Lumber Reporter*, week 26). Since this report became available, prices have fallen still more. The price development in this market can be illustrated by lumber futures (Figure 3).➤

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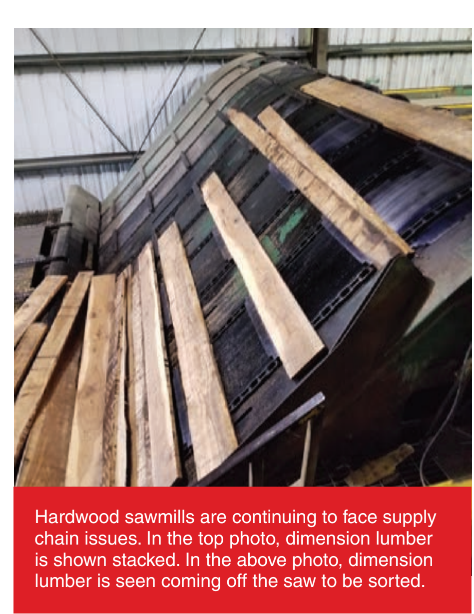
The reason for the drop is attributable to increased production and lower demand. As prices skyrocketed, home builders were not buying as much, due in part to seasonality and in part to the fact that they were taking a wait-and-see approach in hopes that prices would cool off. For similar reasons, remodeling and renovation projects were put on hold. Instead, spending appears to have been redirected to the leisure and hospitality sector. For example, visitation to Yellowstone National Park increased by 11 percent in May compared to May 2019 (National Park Service). Also, as prices dropped, there was an increase in volume, suggesting a healthier marketplace (*Madison's Lumber Reporter,* mid-summer update).

However, the June heat wave in British Columbia and the western United States may stop the trend toward stabilizing prices, or even cause them to go back up. In a small town about 160 miles northeast of Vancouver, the temperature reached 121 degrees Fahrenheit (49.6 degrees Celsius). In a subsequent wildfire, an entire town of 250 people was destroyed in 15 minutes (BBC).

In fact, there were about 200 wildfires burning at that time across British Columbia (CTV). This situation caused the government to impose a logging ban that could last for some time, possibly as late as October. By some accounts, sawmills seem to have sufficient log inventory to cover at least some of the logging shortfall for some time (*Madison's Lumber Reporter*). By other accounts, they do not have sufficient inventory, and the expectation is that prices could rise by 30 percent by Labor Day weekend (Yahoo Finance, July 2, 2021, John Duncanson, timber analyst).

There are still some supply chain issues that hardwood sawmills are facing. As pointed out in the June *Hardwood Market Executive Report*, this resulted in part from an insufficient number of truck drivers, and also from a lack of labor and a rise in freight rates. Despite these issues, sawmills increased production (*Hardwood Market Report*, June 4, 2021). There may be a further glimmer of hope, since the recent BEA report shows a gain of 6,000 employees in truck transportation (BEA July 2, 2021, release). Furthermore, the e-commerce delivery business may cool down as consumers return to brick and mortar stores.

Because of the lucrative margins in cutting construction lumber, a number of mills are still using some capacity to process softwood logs instead of hardwoods. This may change eventually as the margin differential between cutting softwood versus hardwood closes. With the current tie inventory-to-sales ratio above the 10-year average (see Tie Trends, beginning on page 20), and with good log availability (RTAStats.org), the disruption to the tie market in the short term may not be an issue. However, should the price of construction lumber spike and persist, tie supply may be affected in the mid-term. All things considered, significant forces are weighing upon the markets for wood and crossties.



Hardwood sawmills are continuing to face supply chain issues. In the top photo, dimension lumber is shown stacked. In the above photo, dimension lumber is seen coming off the saw to be sorted.