Market Outlook 2004:

Consumer Confidence On Rise, Recovery On Track

By Fred Norrell

Our mid-year outlook called for modest U.S. economic growth, with 2003 Gross Domestic Product (GDP) pegged at 2.2 percent. Surprisingly, third quarter GDP grew at 8.2 percent and further signs of strength are coming into view.

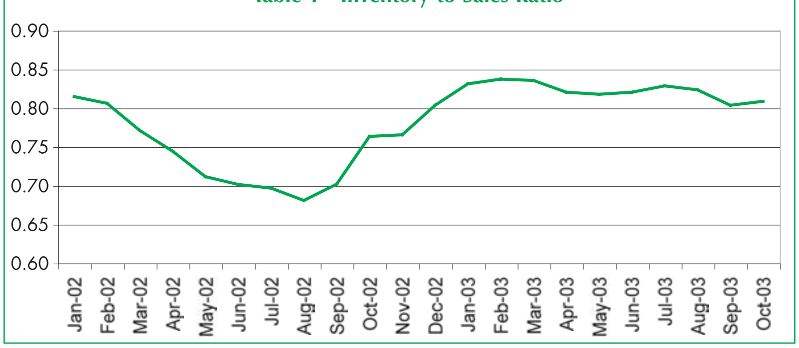


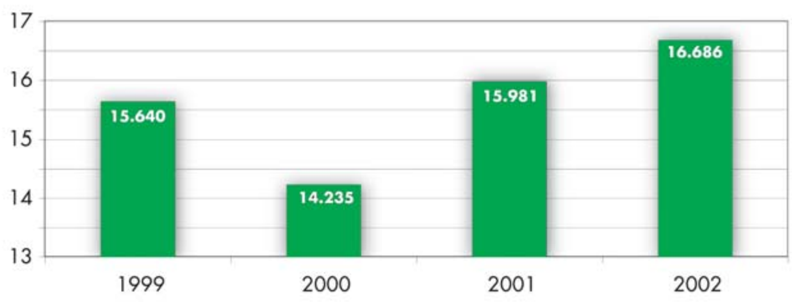
Table 1 - Inventory-to-Sales Ratio

As of October 2003, industrial production increased 0.6 percent over the year; admittedly this is not very fast, but it reverses months of negative reports. Two basic ingredients for future growth are jobs and business investment.

As of November, total civilian employment has increased at an annual rate of 1.4 percent over the year; thus, the labor market is finally getting on its feet. Also, during the third quarter, business investment increased at an annual rate of 14 percent. This is a critical development, since fresh investment has been discouraged by excess capacity for more than two years. The outlook is improving, as shown by the Conference Board's consumer confidence index, which leaped more than 10 points in November, reaching its highest level for the year. Current GDP forecasts are up; the survey published by *The Economist* magazine calls for 2.8 percent in 2003 and 4.2 percent in 2004. Elsewhere, the Paris-based Organisation for Economic Co-operation and Development predicts global growth to make a recovery, though not as pronounced as in the United States.

However, there are some dark clouds on the horizon. The U.S. dollar continues to drop. But, due in part to currency policies in Asia, the Euro is taking most of the pressure and appreciating steadily. Producers from that region are becoming alarmed and are calling for political action. The United States dropping its steel tariffs should help reduce frictions, but other protectionist policies are being advanced for consideration, both here and abroad.

Table 2 - Purchases (in millions) from RTA Members



Another cloud hovers over the housing sector. Have homebuyers taken on too much debt? Will future household spending be constrained by large mortgage payments? A good part of the answer lies in one's inflation outlook; higher inflation eases the repayment burden. However, few forecasters see that happening,

And, if wages and salaries do not rise as in past years, paying off those notes may be more difficult than originally planned. But this is a long-term phenomenon. On a short-term basis, consumers are extracting cash from refinancing and spending it, thus contributing to current economic growth.

The Federal Reserve System (Fed) appears confident that its policies are on target and has recently renewed its pledge to keep interest rates low for a considerable time. Implicit here is that inflation is expected to remain low. Another point to consider is political timing. Historically, the Fed has avoided interest rate increases during presidential election years.

All this suggests widespread confidence, among consumers, business and government, that the recovery is on track. In the past, faster economic growth has driven rail freight volume and resulted in increased demand for crossties. Reports from the first 46 weeks of the year indicate freight volume is up by 1.3 percent, which is somewhat less than our models predicted. Through October 2003, crossties purchased from Railway Tie Association (RTA) members are down 0.7 percent compared to last year. Despite the decline, this is not a weak market. In fact, 2003 is shaping up to be the second strongest market since 1998. During this five-year period, purchases through October averaged 13.8 million, and we are currently about 6 percent above the average.

Looking ahead, we assume economic growth of 3.4 percent in 2004, which is slightly lower than what most sources are saying. Given this, our forecasting model predicts U.S. Class 1 railways will install new wood crossties totaling 12.8 million ties in 2004, up from an estimated 12.4 million this year.

In the exclusive RTA survey, regional and local railways expressed significant reduction in planned purchases, and this half million reduction puts a drag on the total market outlook for 2004. The survey reveals an 8 percent increase in Canadian ties authorized for 2004. Adding up the numbers from various sources, market-wide purchases are pegged at about 16.7 million crossties, both in 2003 and 2004. This forecast is taken from econometric model results, which are supplemented by RTA survey results. In a companion article, industry sources are tapped to reveal their expectations of the year ahead. §

Survey Shows Mill Owners Struggled During 2003, Look For Better 2004

Editor's Note: The following is excerpted from the Lumberman's Annual Survey, which was published in the December 2003 issue of Southern Lumberman *magazine.*

Numerous national and international events in the last few years—the terrorist attacks of September 2001, the war on terror, the war in Iraq and more—have played a major role in shaping the U.S. economy this year. But it was the weather that wreaked havoc on the forest products industry; unseasonably cool and wet weather for the entire eastern half of the country made logging almost impossible, while the West dealt with forest fires. But, things are looking up, according to the results of *Southern Lumberman's* 2003 annual survey.

According to the survey, thirty-six percent of respondents said that sales were up from 2002. An analysis of profit levels showed that 36 percent reported an increase in profits, 45 percent said that profits were down, and 10 percent maintained consistent profit levels from the previous year.

With regard to sales, it made a difference whether a mill was producing hardwood or softwood. Fifty-one percent of hardwood producers responded that sales were up over 2002, while 21 percent of softwood producers said that sales were up. Profit levels also varied depending on whether the mill produced hardwood or softwood. Fifty-two percent of hardwood respondents reported profits up over the previous year, while only 14 percent of softwood respondents reported increased profits. The majority of mills producing both hardwoods and softwoods reported that sales and profits in 2003 were even with 2002.

Respondents commented on how they altered operations in order to remain competitive and profitable, with 58 percent saying they added new equipment, 32 percent reducing the number of employees, 21 percent shortening the work week, 30