RTA's Forecast Model: Recovery

By Fred Norrell

Yearly Forecast Summary
New Wood Crossties (in thousands)

Year approx.	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Percentage.
2006	2.4%	15,937	4,848	20,785	11.1%
2007	2.3%	15,285	5,396	20,681	-0.5%
2008	0.0%	16,761	4,003	20,763	0.4%
2009	-2.6%	16,216	3,821	20,038	-3.5%
2010	2.8%	15,681	4,036	19,717	-1.6%
2011	2.6%	15,927	4,431	20,359	3.3%
2012	2.9%	16,851	4,017	20,869	2.5%
2013	3.2%	17,193	4,175	21,369	2.4%

Consumer spending went on a tear in the late 1990s, sending the personal savings rate to new lows. Yet, from 2006 to 2008, households seemed to suddenly realize that holding some wealth in savings was a very wise move and an important ongoing endeavor. In a period of less than three years, the household savings rate leapt from below 2 percent to almost 6 percent.

Consumer spending, which had already displayed signs of slowing in late 2005, was in full retreat by early 2008, dropping 2.4 percent over the next six quarters. U.S. GDP demonstrated the same pattern, dropping nearly 4 percent during those same six quarters.

Business investment (including new home construction) had turned down even earlier, before the financial crisis emerged, falling in 12 of 13 quarters starting in the second quarter of 2006. This was due in large part to prior over-investment in real estate.

Employment stopped growing by late 2006, and was in retreat a year later. More than 5 percent of civilian jobs have been lost since the approximate official start date of the recession in November 2007.

To offset the lack of private spending, federal government spending ramped up starting in 2008. This has added significantly to the national debt.

The Railroads

U.S. Class 1 freight declined in 2007 for the first time in 20 years; the next year witnessed a sideways move, followed by a 15 percent decline in 2009.

North American Class 1 crosstie installations followed a similar pattern, as did total crosstie purchases from RTA members, with declines in 2007 and 2009.

The Forecast

Although employment has yet to show gains, consumer spending began a comeback in the third quarter 2009; GDP and investment followed suit. It looks very much like recovery is in progress.

Standard and Poor's (S&P) predicts better than 1 percent job gains in 2011. If that happens, it should help fuel consumer spending. This forms a large part of S&P's forecasted 2.6 percent growth rate in GDP for 2011 (see table above.)

This is important to RTA members as GDP is the main variable in RTA's model that predicts crosstie purchases. As GDP increases, so does railroad freight. As freight increases, ties are worn out at a faster rate, requiring replacement. So as the economy recovers, tie market demand should follow. Readers will note in the following discussion that tie replacement lags behind economic recovery by a measurable amount.

The table above shows the RTA model results for tie demand. Other factors are at play; Positive Train Control (PTC) is expected to put a strain on railroad capital budgets, and this may reduce tie purchases to levels somewhat below the model's projections. Although response to investment tax credits is not a sure thing, the recent enactment of the short line infrastructure investment tax credit for 2011 may offset some of the drag PTC may induce in the tie demand realized for 2011. These issues are explored further in the accompanying article on page 9. ■

A Happier New Year!

Railroads Poised To Benefit From Improving Economy

By Jim Gauntt

Tie industry officials will remember 2010 as one of the most difficult to navigate in at least a decade. Tie production stunned even the most experienced tie guys with a whopping 22 percent plummet to 17.2 million ties (through November 2010), down from 22.2 million in 2009.

Purchases of ties also took a hit. Following a 6.2 percent fall off in 2009, the year saw a tepid 0.7 percent gain in system-wide demand for crossties. On the bright side, this still will leave the industry north of the 19 million tie sales mark for five years running. This should be noted as a modern era record for tie demand by railroads (see Table 1).

What's in store for 2011? Without appearing too flushed with optimism, let's just say the future is beginning to look quite a bit brighter. Even in the face of a Positive Train Control (PTC) mandate, investment in ties looks like it will inch forward for Class 1s overall in 2011. Couple that with increasing growth in short line traffic and a recently extended 45G tax credit for infrastructure investment for small roads, and some analysts are positively positive that 2011 will mark the beginning of the next growth phase for the rail and tie industries.

RTA's econometric model agrees. If U.S. GDP growth is not constrained by unforeseen events, the model points to at least 3 percent growth in tie demand in 2011, bounding forward to plus 20 million then 21 million in 2012 and 2013, respectively.

Are these prospects realistic? There are doubters for sure; those who continue to say that the recovery is a paper tiger ready to blow away with the least puff of wind. But, without something catastrophic occurring, it would appear that the slow-growing economy is indeed plodding forward whether the bears on Wall Street like it or not.

Table 1: Annual Tie Production & Purchases

Year	Production	Purchases	Inventory to Sales Ratio
2005	19,261	18,745	0.83
2006	22,449	21,333	0.78
2007	20,471	20,302	0.83
2008	20,258	20,896	0.77
2009	22,156	19,606	0.96
2010	17,190	19,736	0.82

This means growth in freight traffic. When railroads move more product, track degrades faster requiring more investment. Rich Timmons of the American Short Line and Regional Railroad Association looks for double-digit growth in carloads in 2011. And while he does not give a firm prediction, the Association of American Railroads' Ed Hamberger points to 2010 as marking the largest year-over-year increases on record for carload and intermodal traffic. One senses that this is a demarcation point in the next phase of railroad growth.

Standard and Poor's (S&P) continues to slowly inch its growth forecasts toward economic optimism. And, even though unemployment remains way too high, doesn't it feel like things are on an upswing, more upbeat?

The Bush-era tax cuts have been extended, and most American workers saw more money in their paychecks starting immediately in 2011. This is due to reduced withholding rates also enacted with the recent tax legislation. Those who are working will have a little more to spend, and odds are that it will get spent.

On the other hand, reports at a recent rail industry contractor event pointed to even more cost for PTC in store for Class 1s. As everyone has been stating for some time now, this impacts capital budgets for almost everything else— including ties.

Even so, the industry appears to be standing on the threshold for the next leap forward in growth, one that would appear to be sustainable. Especially when one looks at the possible impact of the 45G short line tax credit, which could add 400,000 or more ties to the demand in 2011, the picture is pretty rosy. What could go wrong?

Oh, yeah, how about tie production? What is in store for the supply side of the equation? ➤

Table 2: Production, Purchases & Inventory Sales Ratio (ISR)

Year	Annual Tie Production	Percentage Of Growth	Annual Tie Purchases	Percentage Of Growth	ISR Min-Max
2000	13,983	-14.0%	14,235	-9.0%	.78-.96
2001	14,957	7.0%	15,981	12.0%	.79-.97
2002	17,468	16.8%	16,686	4.4%	.68-.81
2003	17,214	-1.5%	17,194	3.0%	.78-.84
2004	19,338	12.3%	17,749	3.2%	.79-.85
2005	19,261	-0.4%	18,745	5.6%	.75-.83
2006	22,449	16.6%	21,333	13.8%	.75-.85
2007	20,471	-8.8%	20,302	-4.8%	.72-.84
2008	20,258	-1.0%	20,896	2.9%	.68-.84
2009	22,156	9.4%	19,604	-6.2	.80-.96
2010	17,190	-24.0%	19,736	1.0%	.81-1.02

The last quarter of 2010 showed a healthy rebound for tie production year-over-year (see graph below). This is good news for tie treaters. But will it continue, and will the growth that the industry is currently experiencing be enough to meet the increasing demands that seem to be headed down the track?

On the RTA website home page, there is an interactive spreadsheet that allows producers and users to postulate growth rates and view the resulting outputs for production, purchases and inventory-to-sales ratios. There are also historical notations for the same items going back to 1987.

In the past 10 years, there have been four years where the year-over-year growth in tie production has equaled or exceeded 9 percent: 2002, 2004, 2006 and 2009 (see Table 2). So, it is certainly not impossible for the sawmill community to rise to the challenge.

Yet, using the scenario planner, one can see that even if production matches the highest year-over-year growth rate of those four years, 16.8 percent, the inventory-to-sales ratio still dips below the five-year average of 0.82 for 11 months of 2011 even if purchases only grow by 2 percent. This may signal tighter than optimal supply even in the most optimistic production scenario.

Some industry analysts suggest that 8-14 percent growth in hardwood production for 2011 will be the upper limit of what is possible. This is suggested for multiple reasons, not the least of which is that by some estimates the hardwood sawmill capacity has shrunk by 25 percent or more in the past four years.

Inputting the lower production growth value estimate of 8 percent to the spreadsheet yields inventory-to-sales ratios that dip below even the long-term inventory-to-sales ratio average for the industry of 0.72 by late summer. If that were to happen, it would mark only the third time this has occurred in the last 10 years (May-September 2002 and June-September 2008 were previous low marks).

Of course, the disclaimer is that no one knows what will happen in tie production over the next 90 days much less the whole year. However, it would seem a safe bet that tie procurement specialists will be working overtime in 2011.

And, if the growth in demand exceeds 3 percent due to the tax credit, navigating 2011 may prove just as challenging yet from a completely opposite perspective than 2010.

RTA believes that tie demand will increase anywhere from 2 to 4 percent in 2011. That would place tie purchases somewhere between 20.1 and 20.5 million ties. Now it looks like it's just a matter of keeping up. ■