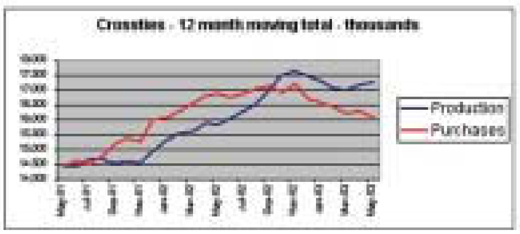
Mid-Year Market Review

Patience, Caution Still Virtues In This Environment

From Staff Reports

The first part of the year has not been robust. Although the U.S. Gross Domestic Product (GDP) has grown about 2 percent, and, compared to the same time period last year, the total volume of railroad freight is up about 1 percent, RTA statistics show that crosstie purchases are down 8 percent, with RTA member production down more than 3 percent.



There are mitigating factors that explain part of this. First, the weather in most tie-producing regions during the winter and early spring was atrocious for logging. Without logs to cut, production suffered. With fewer ties ready to go to track—and tie gangs themselves waylaid for a time by winter weather woes—fewer ties were bought and shipped. And, then, there has been the issue of realigning the industry's production, as Kerr-McGee's exit from the tie industry has had both buyers and sellers scrambling to make a transition.

The encouraging news comes when the larger picture is reviewed. On a 12-month moving total basis, crosstie statistics look better. Through May 2003, purchases are down only 4.7 percent, while production is up 8.7 percent from levels a year ago. This, along with the above factors, suggests that the industry is truly poised for a faster pace in the latter half of the year. The fact that inventories have also been building further bolsters the notion that a lot more ties will flow to track in the coming months.

Yet, because GDP growth was reported at only 1.9 percent for the first quarter of the year, and continuing weak employment reports are still being received, the suggestion that growth will not accelerate much isn't farfetched. A survey of economic forecasters published in *The Economist* magazine predicts only 2.2 percent total GDP growth for this year.

A more optimistic view from a survey of 35 top economists conducted by the Philadelphia Federal Reserve Bank predicted faster growth in the second half of this year. But this could be wishful thinking. With excess capacity still plaguing the manufacturing and high-tech industries, economic improvement would once again rely on the consumer. And, survey notwithstanding, many feel that the consumer may not have a lot of gas left to fuel a faster economic pace.

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Yet, increased growth could occur. With the war in Iraq apparently behind us, confidence in the economy is improving, according to most measures of consumers and business leaders. Plus, rallying stock prices gives the impression that Wall Street is buying the notion that there is light at the end of a shorter tunnel.

Another potential positive is that U.S. exporters, whose products are less expensive for consumers abroad, should benefit from a weaker dollar. But that weaker dollar also makes oil purchases more expensive, which is expected by many economists to act like a tax increase, putting a damper on other consumer purchases. Higher oil prices also places profit pressure on oil-based transportation entities like railroads.

The fact is that the manufacturing sector has not shown any signs of expansion: April production is 0.4 percent below year-ago levels, and job losses continue to be reported. Furthermore, auto sales and production are anticipated by many to further weaken as the year unfolds.

Low interest rates and tax cuts may help pull the economy out of the mud even if the benefits of these stimuli are partially offset by higher oil prices. But, even if significant economic growth is just around the corner, no one seems to be placing any big bets on exactly when it will happen.

Meanwhile on Wall Street, USB Warburg's analysts have cut their earnings forecasts for large railroads. Although the cuts are only modest readjustments of what is expected to be a good year for railroads, they cite rising fuel costs as well as disappointing cargo volume "trends." While U.S. statistics show year-to-date May carloadings are up 0.6 percent, intermodal traffic up 7.1 percent and overall volume up 0.9 percent compared to the prior year, some of these figures are a bit lower than what analysts had expected. The average growth rate for overall railroad volume (1981 to 2001) is 2.4 percent.

So, at mid-year what is the outlook? The questions about the economy and the reports on railroad incomes give no reason to celebrate. Yet, the batting averages for Wall Street analysts have not exactly impressed anyone lately. And, the pent-up demand and continued inventory build-up suggests that railroads are still planning to install more ties in the second half of the year than they did in the first. If this occurs it will fulfill the RTA January forecast of a steady, stabilized marketplace for 2003.

That is not all bad, especially considering the transitions that this industry faces in production realignment this year and next. Another plus for this scenario is that an overall steady pace for the year as a whole may mean that this level of tie purchasing is at hand for several years. This would be a welcome relief from the boom/bust trends of recent cycles. Patience and caution will continue to be virtues in this environment. §

TABLE 1

	Mo/Yr	Tie Production	Tie Inventory	Change In Inventory	Tie Purchases	Annual Purchases Rolling Total	Inventory To Sales Ratio
1998	Jan	1,363	10,283	148	1,215	18,664	0.55
	Feb	1,438	10,340	57	1,381	18,734	0.55
	Mar	1,556	10,018	(322)	1,878	18,936	0.53
	Apr	1,653	10,220	202	1,451	18,098	0.56
	May	1,487	10,182	(38)	1,525	18,667	0.55
	Jun	1,746	10,244	62	1,684	18,275	0.56
	Jul	1,752	10,273	29	1,723	18,355	0.56
	Aug	1,799	10,568	295	1,504	17,838	0.59
	Sep	1,954	11,264	696	1,258	17,966	0.63
	Oct	1,938	11,798	534	1,404	17,066	0.69
	Nov	1,664	12,715	917	747	16,772	0.76
	Dec	1,749	13,284	569	1,180	16,950	0.78
1999	Jan	1,507	13,549	265	1,242	16,977	0.80
	Feb	1,597	13,519	(30)	1,627	17,223	0.78
	Mar	1,854	13,633	114	1,740	17,085	0.80
	Apr	1,320	13,511	(122)	1,442	17,076	0.79
	May	1,267	13,750	239	1,028	16,579	0.83
	Jun	1,539	13,981	231	1,308	16,203	0.86
	Jul	1,189	13,972	(9)	1,198	15,678	0.89
	Aug	1,363	14,009	37	1,326	15,500	0.90
	Sep	1,251	14,178	169	1,082	15,324	0.93
	Oct	1,187	14,089	(89)	1,276	15,196	0.93
	Nov	1,175	14,086	(3)	1,178	15,627	0.90
	Dec	1,007	13,900	(186)	1,193	15,640	0.89
2000	Jan	1,151	14,263	363	788	15,186	0.94
	Feb	1,103	14,153	(110)	1,213	14,772	0.96
	Mar	1,059	13,750	(403)	1,462	14,494	0.95
	Apr	1,038	13,129	(621)	1,659	14,711	0.89
	May	1,191	13,002	(127)	1,318	15,001	0.87
	Jun	1,218	12,636	(366)	1,584	15,277	0.83
	Jul	1,036	12,143	(493)	1,529	15,608	0.78
	Aug	1,385	12,177	34	1,352	15,634	0.78
	Sep	1,280	12,740	564	716	15,268	0.83
	Oct	1,394	13,174	434	960	14,952	0.88
	Nov	1,239	13,473	299	940	14,714	0.92
	Dec	889	13,648	175	714	14,235	0.96
2001	Jan	1,128	13,811	163	965	14,412	0.96
	Feb	1,117	13,839	28	1,089	14,288	0.97
	Mar	1,274	13,719	(120)	1,394	14,220	0.96
	Apr	1,109	13,398	(321)	1,430	13,991	0.96
	May	1,363	13,009	(389)	1,752	14,425	0.90
	Jun	1,213	12,427	(582)	1,795	14,636	0.85
	Jul	1,267	12,315	(112)	1,379	14,486	0.85
	Aug	1,414	12,108	(207)	1,621	14,756	0.82
	Sep	1,147	12,114	6	1,141	15,180	0.80
	Oct	1,415	12,382	268	1,147	15,367	0.81
	Nov	1,226	12,764	382	844	15,271	0.84
	Dec	1,284	12,624	(140)	1,424	15,981	0.79
2002	Jan	1,446	13,057	433	1,013	16,029	0.81
	Feb	1,399	13,118	61	1,338	16,278	0.81
	Mar	1,312	12,760	(358)	1,670	16,554	0.77
	Apr	1,370	12,482	(278)	1,648	16,772	0.74
	May	1,359	11,996	(486)	1,845	16,865	0.71
	Jun-02	1,401	11,735	(261)	1,662	16,732	0.70
	Jul-02	1,533	11,751	16	1,517	16,870	0.70
	Aug-02	1,647	11,602	(149)	1,795	17,044	0.68
	Sep-02	1,611	12,006	404	1,208	17,111	0.70
	Oct-02	1,893	12,927	922	972	16,935	0.76
	Nov-02	1,370	13,174	246	1,123	17,215	0.77
	Dec-02	1,127	13,406	232	895	16,686	0.80
2003	Jan-03	1,288	13,782	376	912	16,585	0.83
	Feb-03	1,143	13,748	(34)	1,177	16,424	0.84
	Mar-03	1,255	13,544	(204)	1,459	16,213	0.84
	Apr-03	1,525	13,354	(190)	1,714	16,280	0.82
	May-03	1,439	13,148	(206)	1,645	16,080	0.82

NOTE: The information in this chart is calculated from reported production and inventory numbers by RTA members. This represents more than 95% of the U.S. and Canadian market for wood crossties. Look for an updated production and inventory report in Tie Trends in the September/October issue, where some of this data will be added to existing information.