The Prospects for Growth

By Fred Norrell

The economic outlook is particularly unsure at this time, threatened with ominous possible disruptions to future growth. Yet, railroad executives are planning bold capital investments. How can this be reconciled? Railway Tie Association (RTA) research examines this apparent paradox, and in this article provides a forecast of new wood crosstie purchases.

The U.S. recession's wake has been long, and confidence has suffered, as has growth in jobs, consumer spending, GDP and railroad freight volume.

A very long aftermath is typical for balance sheet recessions, and this poses a challenge to the timing of recovery predicted by mainstream economic forecasts. In addition to the curse of excessive debt, a number of other threats loom, including Euro area financial problems and recession, damage from high oil prices, and widespread political paralysis. In reference to the political environment at the start of 2012, a recent article in *The Economist* is titled, "The Year of Self-Induced Stagnation." The concern is that Western governments will cut spending (viewed as a reasonable policy direction) at the wrong time (too soon, as the long wake drags on) and risk further recession.

Table 1: Comparative Real GDP Growth Forecasts (percent)

Source	2011	2012	2013	2014	2015
S&P	1.74	2.13	2.35	3.40	3.35
NABE	1.74	2.3	2.7		
Economist*	1.74	2.2	2.3		

* *Survey of economists published in* The Economist *magazine, May 5-11, 2012 issue.*

Economic Expectations

Mainstream thought appears to be captured in Standard & Poor's May forecast for the United States. This is a fairly benign assessment, with jobs growth gently accelerating over the next few years.

The unemployment rate drops from 9 percent in 2011 to 8.1 percent the next year and continues down to 6.5 percent by 2015. One would expect real consumer spending to react. And it does—but only modestly, staying in a range of 2 to 2.36 percent during the same period. In contrast, housing starts recover more noticeably, up from 0.58 million units in 2010 to 1.69 million by 2015.

In deference to the self-induced stagnation theme, real federal government spending is projected to decrease over the forecast horizon and is not offset by increases in state and local expenditures, so the government sector acts as a drag on the economy.

Exports exhibit steady growth, and outpace import growth despite oil prices (West Texas Intermediate) that are projected to rise from 2011's $95 to almost $113 by 2013, with little relief thereafter. Inflation is little affected, remaining at or below 2.2 percent over the next few years. The upshot of all this is that real GDP grows a little over 2 percent in 2012 and 2013, then picks up to exceed 3 percent in the subsequent years (see Table 1.)

Returning to the balance sheet recession theme, researchers Carmen and Vincent Reinhart and Kenneth Rogoff find historical basis to conclude that "debt overhang" (sustained periods of high public debt relative to GDP) is followed by very long periods of sub-par economic growth (1.2 percentage points lower than other periods on average, taken from 26 historical episodes.)

According to these researchers, the United States is a little more than a year away from entering what they define as debt overhang. Should the current direction be unaltered, GDP would presumably be constrained to a path below current predictions.

A survey of professional forecasters by the National Association of Business Economists (NABE) exhibits a more optimistic view, yet their outlook is described as a "sub-par recovery." A similar survey of economists by *The Economist* magazine is a bit less optimistic, as Table 1 shows.

Business Expectations

Many business leaders express caution, but this is not necessarily the case for railroad executives. Indeed, the Association of American Railroads announced that Class 1 capital budgets for 2012 set a

Table 2: New Wood Crossties (in thousands)

Year (approx.)	Real GDP	Class 1 Purchases	Small Market Purchases	Total Purchases	Pct
2006	2.7%	15,937	5,110	21,047	11.7%
2007	1.9%	15,285	5,349	20,634	-2.0%
2008	-.03%	16,761	3,907	20,668	0.2%
2009	-3.5%	16,216	3,432	19,648	-4.9%
2010	3.0%	16,379	3,200	19,579	-0.4%
2011	1.7%	16,525	5,363	21,888	11.8%
2012	2.1%	17,671	4,498	22,169	1.3%
2013	2.4%	17,915	4,462	22,377	0.9%
2014	3.4%	18,652	4,223	22,874	2.2%
2015	3.4%	19,360	4,474	23,834	4.2%

record at $13 billion. It would appear they are undaunted by the threats to growth, and if so, this may be based on their own industry's metrics.

Recent events couple modestly growing rail freight volumes with increased pricing power, enhancing railroaders' confidence and willingness to make bold capital investment plans for the next few years.

Those plans may result in crosstie purchases in excess of the RTA forecast, which is tied to broad-based economic drivers contained in the Standard & Poor's forecast.

RTA's Econometric Forecast of Tie Purchases

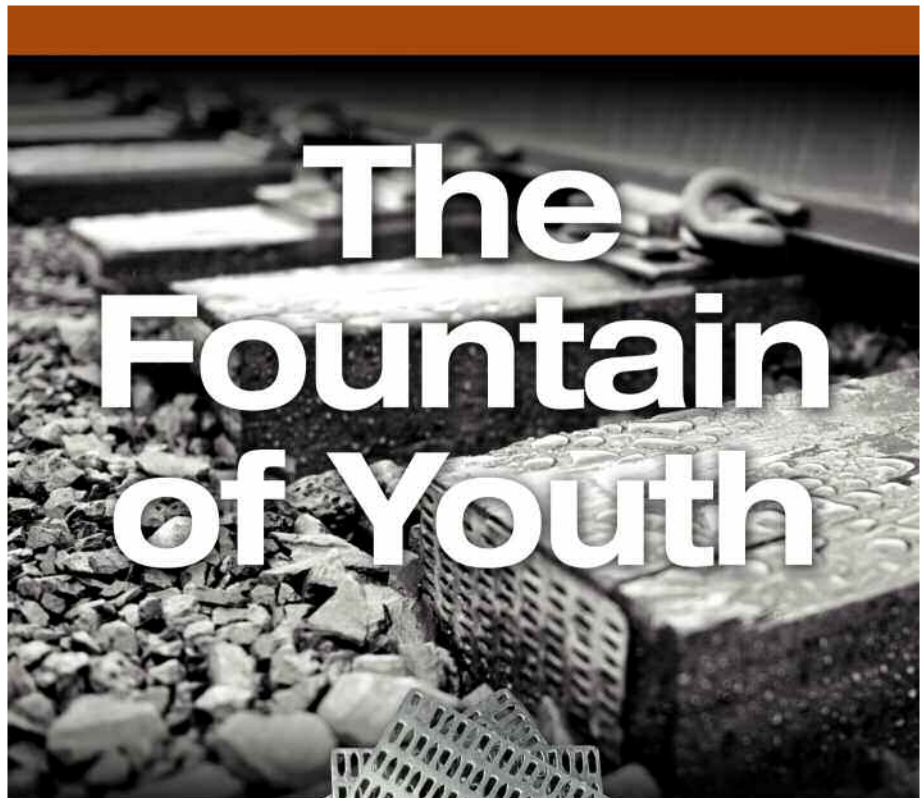
The econometric model's main flow is that growth in real GDP causes growth in railroad freight volume, which causes wear on ties and results in more crossties purchased.

From Table 1, one can see that U.S. economic growth is forecast to be rather slow during 2012 and 2013 and then pick up speed. The model has other, less important variables, and some time lags are involved, so that tie purchases do not track real GDP as closely as one might suspect.

The forecast is adjusted for RTA assumptions. One is that Class 1 investment in track and roadway will reflect optimistic outlooks, at least in part. Another assumption is that during January through April 2012, regional and shortline railroads expected the passage of an investment tax credit, and invested accordingly. The result of all this is displayed in Table 2.

One can now see the impact of economic growth on the new wood crosstie business; total purchases grow slowly in 2012 and 2013 and then accelerate. One must wonder if the future will be this bright considering the aforementioned threats to growth.

Yet, in many past episodes, economists have warned of threats to growth, only to see the U.S. economy shoot through the gauntlet, keep its balance, and defy the problems of less flexible economic systems. ■



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