MARKET OUTLOOK: 2005

Resilient Economy Expected To Produce Stronger Tie Purchases

By Fred Norrell

Our recent forecasts have called for healthy growth—in the economy, in railroad freight and in crossties purchased. Recent data look pretty healthy, too. Third quarter GDP has been revised to 3.9 percent growth, U.S. Class 1 freight was up 5 percent through October 2004, and new wood crosstie purchases from RTA members have increased 8.2 percent for the past 12 months.

The U.S. economy has once again demonstrated its resilience, as jobs and business investment have poured into the mix. Industrial production is 5 percent higher than one year ago despite the struggle in Iraq and high oil prices. In mid-October 2004, oil peaked at about $55 per barrel and has since continued to drop. OPEC announced plans to reduce production quotas, probably in February, and aims at holding prices where they are. This would exacerbate deficits in the U.S. trade and current account balances.

Foreign banks and investors are holding large quantities of dollars, treasuries and other U.S. financial instruments. The flood of dollars abroad is pushing down the dollar, and the threat of further fall could bring about pressure for higher U.S. bond yields—higher to compensate for expected capital losses. If higher yields make their way into long-term bonds, the Federal Reserve could do little, and U.S. economic growth could be slowed, stopped or reversed.

The nature of these economic threats has been visible for some time, yet forecasters remain positive. *The Economist* polls economic forecasters from around the globe, and their average forecast calls for 4.4 percent U.S. GDP growth in 2004 and 3.4 percent in 2005. The Organization for Economic Co-operation and Development forecasts 3.3 percent in 2005 and 3.6 percent in 2006.

Incorporating this into RTA's Class 1 econometric model shows a freight growth of 11 percent in 2004 and 2 percent, then 3.6 percent in subsequent years. Recent reports indicate railroads are not able to accommodate the sudden growth in freight, so the forecast is on the high side. A slight track reduction is reported in RTA's latest exclusive annual survey of railroads, and a continuation of this, plus the freight projection, yields a U.S. and Canadian Class 1 tie purchase prediction of 15 million in 2004, then 15.1 and 15.6 million in the following years.

U.S. non-durable manufactured goods have been stagnant for the past decade, the victim of increased international competition. The dollar's fall will result in a relative reduction in their prices, providing an avenue for modest growth. This should stimulate the volume of freight, especially for the regional and local railroads. Back to the negative perspective, diesel prices move with oil prices, and the dollar's fall will result in increases for both of these commodities.

The market for other (non-Class 1) tie buyers is composed mostly of regional and local railroads.

RTA's model for this segment suggests that tie purchases increase with non-durable manufactures and decrease as real diesel prices go up. In the model, the slight positive push from non-durables is offset by the increased price of diesel, so the projection calls for about 2.9 million ties purchased for each of the years from 2004 to 2006. Thus, total purchases from RTA members, as forecast by models, is 17.9 million in 2004 (right on target as of October 2004), 18 million in 2005 and 18.5 million in 2006.

Stepping back from the details, Class 1 purchases from 2004 to 2006 are projected to be higher than for any year since 1987—a pretty strong statement. RTA's forecast for other crosstie buyers conveys a weaker outlook but excludes any increases from regional and local railroads that might be expected from recently legislated tax credits. Just how big this will be is the subject of a related article in this issue (see page 12). All considered, the outlook is good for business. §