ASSOCIATION OF AMERICAN RAILROADS | POLICY & ECONOMICS

Rail Industry Overview

JULY 2024

Freight Rail Data Show Economy Chugging Along Despite Economic Uncertainty

In June 2024, the rail freight industry painted a nuanced picture, mirroring the broader economic landscape where some sectors were thriving while others faced challenges. Intermodal volumes continued to grow, driven by robust consumer spending and increased port activity, marking a bright spot in the industry. However, total U.S. carloads remained stagnant compared to previous years, primarily due to ongoing long-term declines in coal shipments. This decline is buoyed by an uptick in other sectors, including chemicals, motor vehicles, and petroleum products, underscoring the industry's resilience amid headwinds and economic uncertainties.

To provide insights into the volume of goods moved by rail and their broader economic implications, we turn to AAR's Freight Rail Index (FRI), a useful barometer that tracks the transport of economically sensitive products (intermodal shipments and carloads excluding coal and grain). Historically, the FRI and GDP tend to rise and fall in tandem, as the transportation of goods directly reflects economic activity. An increase in the FRI generally indicates higher economic output, as more goods are being transported due to increased production and consumer demand. Conversely, a decline in the FRI can signal an economic slowdown. This relationship underscores the importance of the FRI as a leading economic indicator.

Key Takeaways

- **June rail data, closely tied to economic performance, suggest a cautiously optimistic outlook for economic growth amid prevailing uncertainty.** Potential interest rate cuts later in 2024 or early 2025 are expected to stimulate industrial output, which has historically driven growth in rail carload volumes across key commodities.

- **Recent data indicating an uptick in industrial output brings a beacon of hope, hinting at a possible end to the prolonged manufacturing slowdown.** If this activity continues, rail volumes for raw materials and finished goods are likely to follow.

- **Intermodal transport continues to shine, fueled by robust consumer demand.** This sector's sustained growth is essential for maintaining overall economic momentum, particularly in the retail sector.

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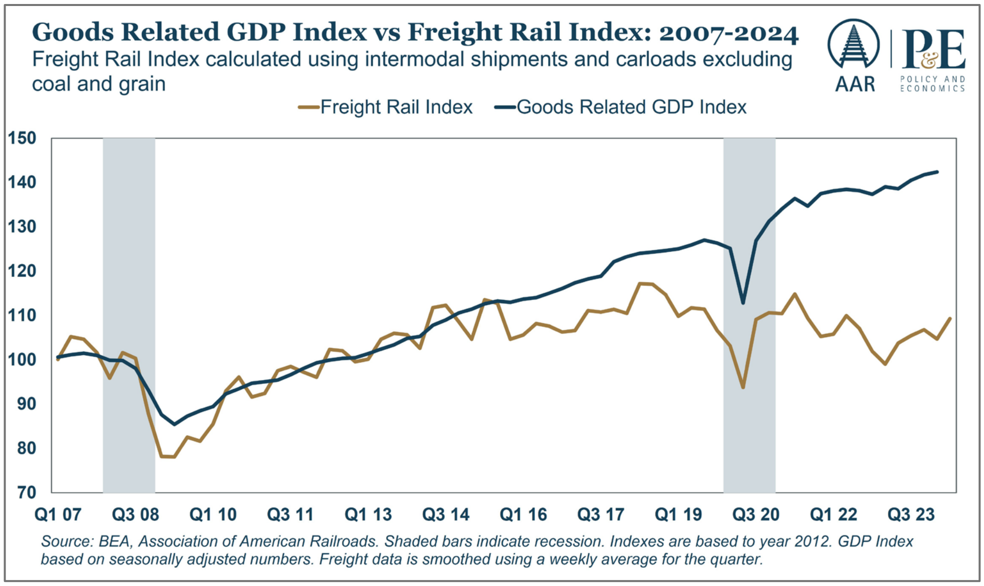
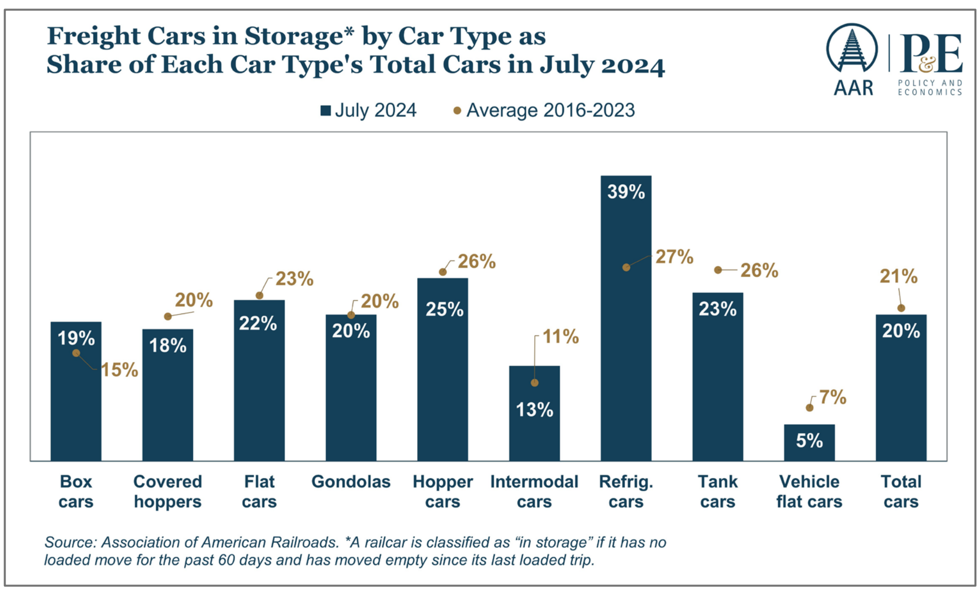


The FRI has exhibited notable fluctuations in recent years, reflecting broader economic conditions. In 2022, the FRI faced significant challenges due to supply chain disruptions and reduced manufacturing activity.

However, recent data indicate a recovery in freight activity in late 2023 and into 2024. In June 2024, the FRI increased by 1.5% from the previous month and 5.4% from the same month the previous year. This positive trend is an encouraging sign for the broader economy, bolstered by robust consumer spending and efficient supply chain operations.

Despite these improvements, the sector still faces headwinds such as high input costs and volatile global demand. Overall, the FRI remains 7.4% below its peak level from October 2018, indicating that the freight industry has not yet fully rebounded to pre-pandemic levels.

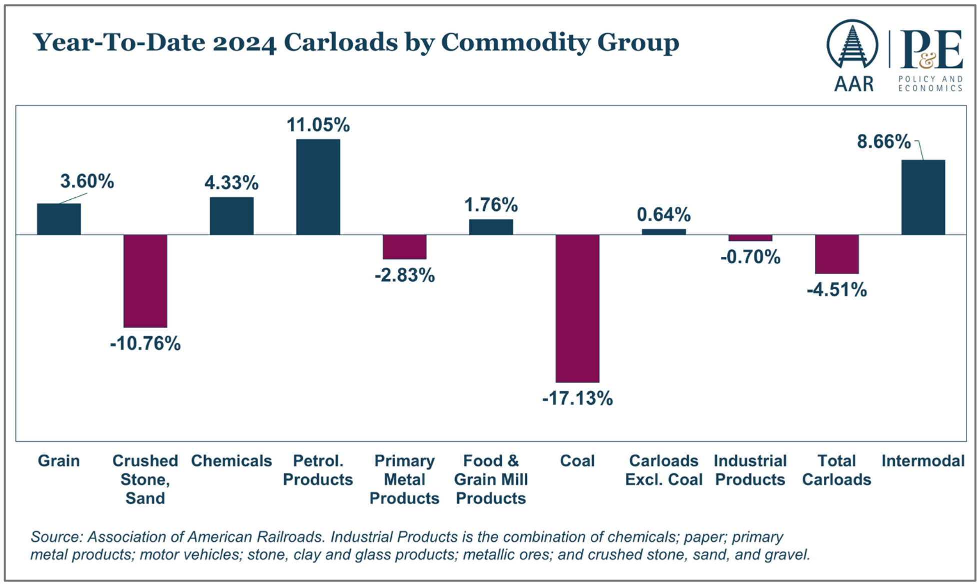


Other indicators, such as railcar storage data, offer further insights into the economic landscape. Fewer freight cars in storage suggest an increased demand for rail transportation, indicating that more goods are being moved.

This often means that industries are ramping up production, requiring more capacity to transport raw materials and finished goods. As of July 1, 2024, 19.6% of the 1.64 million North American rail car fleet was in storage, below the historical average. The below-average levels for many rail cars, particularly covered hoppers, tank cars and vehicle flat cars, indicate robust shipments for commodities such as grain, ethanol, crude oil, and motor vehicles, often correlating with robust economic performance and supply chain activity.

Overall, the rail freight industry's mixed performance highlights a complex economic outlook. Consumer-driven sectors show strength, while the industrial sector continues to face broader challenges. While recent trends in the FRI suggest a cautiously optimistic outlook for economic growth in the near term, potential interest rate cuts later in 2024 could ease borrowing conditions for manufacturers, driving a recovery in manufacturing activity. This recovery would likely boost rail carload volumes for chemicals, petroleum products, steel, and autos — critical components of the economy and significant contributors to rail transport.

Rail Traffic Analysis



June rail traffic continued the trends we've seen throughout the first half of 2024. Total U.S. rail carloads have decreased by 4.5% (263,003 carloads) in the first six months of 2024 compared to the first six months of last year and are down 1.7% from June 2023. Meanwhile, intermodal volume was the highest in eight months.

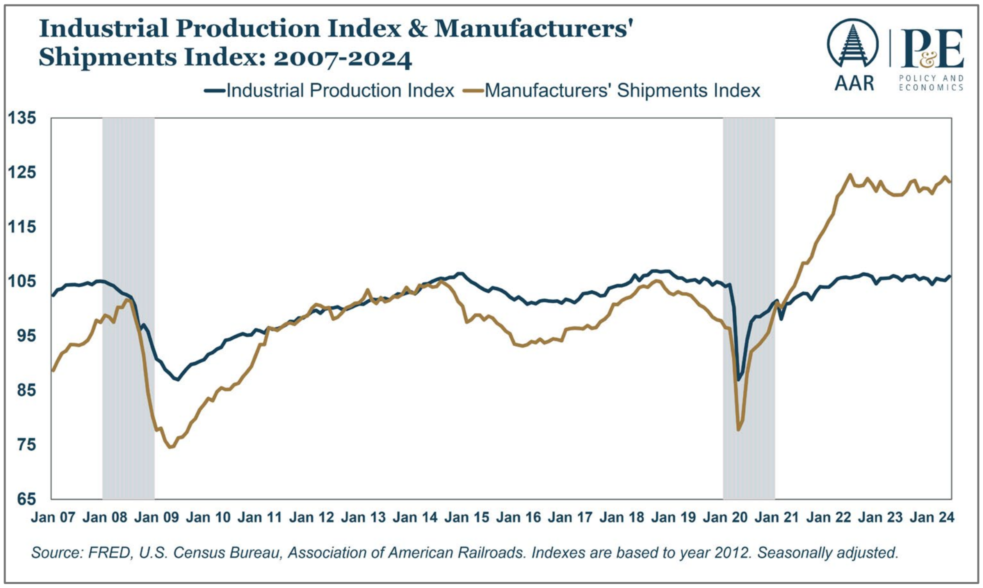
The largest decrease was again seen in coal, which is dragging down total carloads. Year-to-date coal carloads in 2024 through June were down 17.1%, or 289,401 carloads, from last year. This year is by far the lowest January-to-June carload total for coal in our records. The decline in coal shipments reflects ongoing changes in the energy sector rather than broader economic health. Excluding coal, carloads were up 1.7% in June, marking five consecutive months of increases. Other commodities that saw declines in June included metallic ores, crushed stone, sand and gravel, and lumber and wood products.

Despite the overall decline, there are bright spots in several key categories. Of the 20 carload categories we track, 10 showed gains compared to the first six months of last year, including grain (up 3.6% year-to-date) and petroleum and petroleum products (up 11.1% year-to-date).

Signs of recovery in the U.S. industrial production sector have positively impacted several of these traffic categories. According to the Federal Reserve, industrial production increased by a preliminary 0.9% in May from the prior month, marking the largest month-to-month gain in 10 months. Manufacturing output also rebounded, rising a preliminary 0.9% in May from April after sequential declines of 0.4% in April and 0.1% in March. This increase in industrial activity has translated into higher demand for freight rail services, as more raw materials and finished goods need to be transported.

Notably, chemicals saw an increase of 8,273 carloads in June 2024, up 6.7% from June 2023 and 4.3% year-to-date compared to the same period in 2023. Carloads of motor vehicles and parts also increased, growing 1.3% in June year-over-year. This sector's performance is a critical indicator of consumer demand and manufacturing health, both essential for economic growth.

However, carload volumes for other key industrial commodities such as steel, lumber, crushed stone, and sand have been declining. This is mainly due to the broader ongoing challenges in the manufacturing sector, as indicated by the Manufacturing PMI® — below 50% for 19 of the past 20 months.



This prolonged contraction, the worst since the Great Recession, has reduced rail volumes for these commodities. Furthermore, capacity utilization, a measure of industrial potential, remains nearly a full percentage point below its long-run average, despite slight improvements in recent months. These figures indicate room for further growth in industrial production, which is poised to bolster freight rail carload volumes.

Robust consumer demand fueled the intermodal sector's expansion.

With the decline in coal carloads, intermodal shipments have become a key growth engine for the rail industry. In June, U.S. railroads originated 1.07 million intermodal containers and trailers, marking an 8.7% increase from June 2023 and the tenth consecutive year-over-year gain. Year-to-date intermodal units through June reached 6.64 million, up 8.7% from the previous year, nearing the January-to-June average of 6.69 million from 2015 to 2023. This rebound indicates a return to normal levels after a subpar 2023 and suggests a strong foundation for future growth, dependent on continued consumer spending on goods.

Intermodal transport efficiently moves a diverse array of goods, including retail products and industrial items like auto parts. The movement of these goods heavily relies on consumer spending, which is a major driver of economic growth in the U.S. Despite a downward trend in the share of consumer spending on goods over the past two years, a reversal occurred in Q1 2024. Inflation-adjusted spending on goods rebounded with a preliminary increase of 0.6% in May from April, following a 0.7% decline in April from March. In contrast, inflation-adjusted spending on services rose by 0.1% in both April and May. This renewed focus on goods consumption is significant for the rail industry, as it drives the movement of retail products, industrial items and agricultural commodities.

Nonetheless, there are signs that U.S. consumers, who have resiliently powered the post-pandemic economy, might be losing steam. The Federal Reserve's interest rate hikes over the past two years have significantly curbed household borrowing, with consumer credit growth now at about 2%, its slowest pace outside of a recession. Pandemic-era savings are largely depleted, making consumers more cautious, especially with big-ticket items like vehicles and furniture. Additionally, consumer confidence remains well below pre-pandemic levels, with the Conference Board's Index of Consumer Confidence falling slightly from May to June. The index's three-month average as of June is the lowest in nearly two years, driven by worries over high food and gas prices, political instability and global conflicts. It remains to be seen how consumer spending will evolve in the coming months.

Overall, while the decline in coal carloads has impacted the total figures, the growth in other categories and the resurgence of intermodal transport highlight the resilience and adaptability of the rail sector in the face of evolving market conditions. Moving forward, the trajectory of consumer spending will significantly influence rail volumes.

Navigating the Road Ahead

The trajectory of rail traffic volumes for the rest of 2024 will heavily depend on the pace of economic growth, influenced by job market performance, inflation rates and the Federal Reserve's monetary policies. Despite a sharp decline from their peak in June 2022, both the consumer price index (CPI) and the Fed's preferred inflation measure — the price index for personal consumption expenditures —remain above the Fed's 2% target and have recently plateaued. Rising raw material costs continue to challenge suppliers, impacting manufacturers and the overall supply chain. For railroads, lower overall inflation could lead to higher consumer confidence, increased demand for goods and a greater need for shipping services. It also means more predictable and manageable input costs, providing a more stable environment for long-term planning.