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The Monthly Itinerary

The ABA Foundation's Monthly Tour Through the Economy

May 2023

MAY SUMMARY

Problems with the US economy continue to mount. As this issue of *The Monthly Itinerary* is being written, JP Morgan Chase is taking over the assets and liabilities of Republic National Bank in the second largest bank failure in US history. In addition, the most recent GDP report issued by the Bureau of Economic Analysis showed that the US economy grew by just 1.1 percent during the first quarter. It is extremely likely that this will be revised downward as more data come in.

As of now 67 percent of economists believe that we will be entering a recession in 2023, but whether there is another technical recession or not, it has become obvious that the country has entered into an extended period of stagflation.

The Federal Reserve is using the only instruments that they have available to blunt inflation, but higher short-term interest rates and a slow decline in the money supply are being offset by increased deficit spending and regulatory growth by the federal government. Simply put, more money being dropped in peoples' bank accounts increases demand for goods and services. At the same time, regulatory overreach is reducing the production and availability of these same goods and services. This is a recipe for both higher prices and higher unemployment.

Another issue, as was mentioned above, is the onset of a new banking crisis. Republic National Bank will not be the last major regional bank to go belly up in 2023. Following the last financial crisis, banks were encouraged to purchase treasury securities. These would not be included in the asset base that banks were required to "mark to market" prices. This was not a problem when interest rates were kept right at the zero bound; however, as depositors flee banks for money market funds and higher yielding demand deposits, banks are being forced to sell the treasuries – often at a substantial loss.

As bank assets and liabilities become increasingly imbalanced, there will be more bank failures, and more federal spending as subsidies will be required to make depositors whole, and to pay larger banks to absorb the failing institutions.


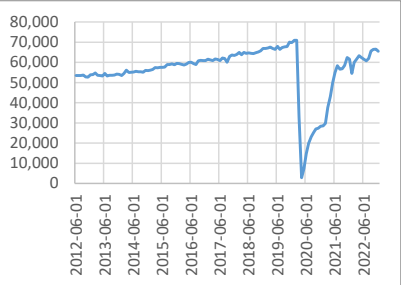

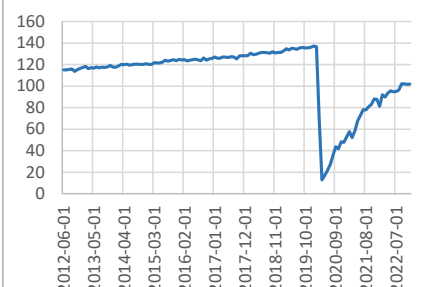
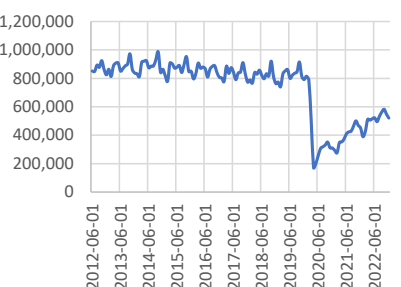
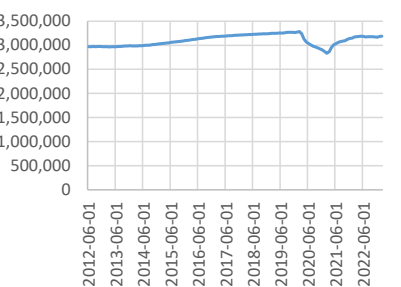
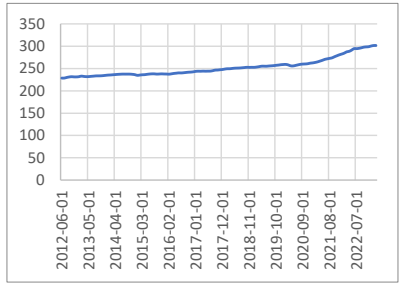
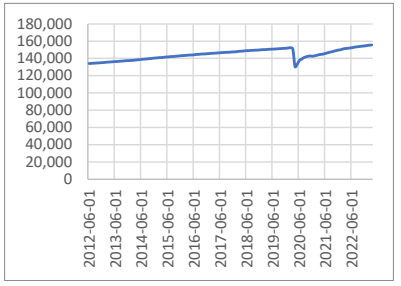
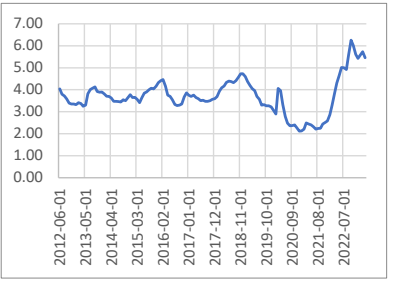
On top of this, commercial real estate loans and loans to start-up enterprises, many of which simply burn cash, will reduce banks' asset bases further. The Federal Reserve may be forced to drop rates to protect the banking system, something that will lead to even more inflation.

From the standpoint of motorcoach operators, strong travel demand should make it possible to increase prices, at least to the levels of inflation. Continued depressionary trends in the commuter sector will keep coach prices low, and softness in the trucking sector (which peaked last August) is freeing up drivers. On top of this, the number of operators has plummeted following the COVID-19 shutdowns, limiting competition. This suggests that those operators that are in strong markets should thrive even though the economy will remain soft.

Now, more than ever, the motorcoach industry is subject to the whims of the economic environment. Keeping abreast of key economic trends will be an important part of determining strategies to prosper in difficult economic times. *The Monthly Itinerary* reports on some of these key indicators. Please let us know if there are any other indicators that you believe are important to track going forward in 2023.

The *Monthly Itinerary* is designed to provide members of the ABA with an ongoing series of data and commentary on key economic and transportation statistics of importance to the motorcoach and motorcoach tourism industry. For more information or to comment on this report, please contact Melanie Hinton at mhinton@buses.org or 202-218-7220.

APRIL STATISTICS

<p>National Diesel Prices</p>  <p>April-23: 4.10 Down 2.66 Percent</p>	<p>Domestic Enplanements</p>  <p>November-22: 65,537.00 Down 1.53 Percent</p>	<p>Dow Jones Transportation Index</p>  <p>January-23: 14,157.42 Down 0.44 Percent</p>
<p>Transportation Services Index (Psg)</p>  <p>December-22: 101.90 Up 0.2 Percent</p>	<p>Transit Ridership</p>  <p>December-22: 520,286,000 Down 5.03 Percent</p>	<p>Highway Travel</p>  <p>February-23: 14,157.42 Up 0.14 Percent</p>
<p>Consumer Price Index</p>  <p>March-23: 301.81 Up 0.05 Percent</p>	<p>Employment</p>  <p>March-23: 155,569.0 Up 0.15 Percent</p>	<p>Corporate Loan Rate</p>  <p>April-23: 5.46 Up 0.74 Percent</p>

MAY ECONOMIC NEWS

- The failure of First Republic Bank will likely lead the Federal Reserve to once again reverse its policy of Quantitative Tightening (QT); however, during the first week of May it was able to reduce its balance sheet by about \$62 billion. Any additional Quantitative Easing (QE) will continue to spur inflation.
- Diesel fuel costs have continued to decline in the face of reduced production of crude oil. As of May 1, they averaged \$4.02 nationwide. Remarkably, the price of natural gas in the US has continued to stay below pre-COVID levels, at

just above \$2 per million BTU (even falling to just \$1.87 on April 14), as a warmer than expected winter led to higher stocks.

- The Bureau of Economic Analysis announced that in the first quarter GDP grew at an annualized rate of 1.1 percent. This is in line with stagflationary growth levels but is likely to be revised downward in the next two releases.
- Meanwhile the Consumer Price Index rose 0.1 percent in March and at a rate of 5.0 percent over the past 12 months, suggesting that the Federal Reserve will likely continue tightening. We expect at least one more 25 bps increase in the Federal Funds Rate this cycle. Inflation in Canada was at 4.3 percent in March.
- Full-time employment jumped for the first time in a year, as the Bureau of Labor Statistics reported an increase of nearly 233,000 new jobs in March. Canadian employment was up by 0.2 percent in March.
- Air travel numbers continue to stay at about 2.5 million per week, in spite of much higher prices. This is a sign that consumers are continuing to shift resources toward travel, increasing demand for motorcoach trips, hotel room stays and attractions throughout the country.

MAY COMMENTARY

If you look at the business shows on television, you will undoubtedly hear a lot of noise about what the “Fed” is doing. The “Fed” is the Federal Reserve Board of Governors and is the body that among other things, sets the Federal Funds Rate. This is the interest rate at which banks are obligated to lend overnight funds to each other. Banks do not generally hold enough liquid money to cover all demands in a given day. Some banks will end the day with surplus cash, while others will have a deficit. Banks lend money to each other to cover these deficits overnight when deposits and withdrawals clear. It is an important role of the central bank and allows individual banks to operate with smaller levels of reserves.

When the Board of Governors increases this interest rate, banks must pay more for these overnight loans, and this higher interest rate spreads throughout the system. Higher Federal Funds Rates lead to higher interest rates for savings, and higher rates for loans. Importantly mortgage rates, credit card rates and personal and business loan rates tend to rise in concert with the overnight rate.

The logic behind the Fed raising interest rates in response to higher inflation is that this will serve as an inhibitor to demand. In effect higher interest rates on credit cards should reduce credit card purchases, and higher auto loan rates should reduce new car sales. As this reduced demand flows through the economy, prices should fall. In addition, the reduction in demand generally triggers a recession, which leads to lower wages and spending as people lose their jobs.

Higher interest rates also impact bank balance sheets, and asset prices. Over the past two decades, the cost of capital has been extremely low. This allowed companies (and wealthier individuals) to borrow at what were in effect, negative interest rates. As all operators know, a company uses an analysis of expected returns when it makes an investment. When the cost of capital is low, it is possible to purchase assets like buildings, buses, other companies, etc. with a lower expected return than when the cost of capital is high. Unfortunately for many businesses, as the cost of capital increases, many of these asset purchases become worth less than the expected return, and in some cases, the only recourse is to default. As we discussed last month, the long period of negative effective interest rates led to a lot of malinvestment, and the COVID-19 shutdowns made matters worse. Companies (including banks) with a lot of commercial loans on their balance sheet, or companies that over expanded or had operations that only could survive in a world of negative interest rates (think WeWork, or Silicon Valley Bank, or pretty much any Crypto exchange) could no longer meet their capital requirements and quickly went belly up or had to restructure. The same is true in the travel sector; however, strong demand resulting from huge cash infusions on the part of the federal government have helped prop up the sector coming out of COVID.

In an economy where stagflation will likely be the name of the game for some time, it is unlikely that the Fed will be able to lower interest rates anytime in the near term, no matter how much the financial markets scream. This would only cause inflation to surge. It is wise to make plans based on these higher rates. If we are wrong, and rates fall, then marginal opportunities might have been missed. But if we are right, a conservative strategy now might lead to a rewarding future.

The Monthly Itinerary produced by John Dunham & Associates and is provided as a service by the American Bus Association Foundation. It is not intended as investment advice. If you would like more information, or if you would like us to track additional indicators, please feel free to contact Melanie Hinton at mhinton@buses.org or 202-218-7220.
