

Industry Update

Canada Truck Transportation



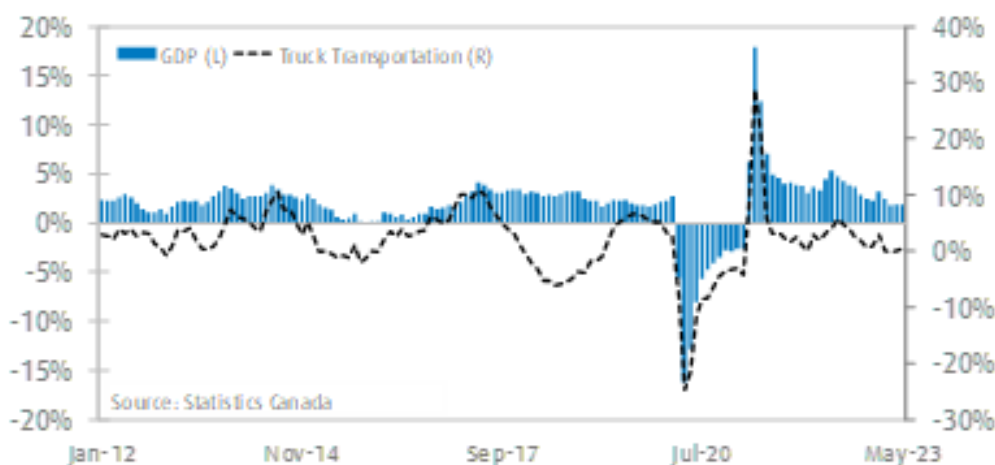
Key Developments

- The Greater Vancouver Board of Trade said in a statement that \$10.7 billion in traded goods were affected in the 13 days of labor disruption involving more than 7,400 workers at more than 30 B.C. port terminals and other related sites.
- A **Women in Trucking (WIT)** survey has concluded that women account for nearly 12.1% of North America's professional drivers, but preliminary 2021 Census data suggests Canadian-specific totals are far less than that. Women now hold 16.4% of Canadian jobs in trucking, logistics, and warehousing – up from 15% in 2015 — but account for just over 4% of Canada's truck drivers.
- Canadian enforcement teams placed 20.5% of inspected vehicles out of service during the most recent **International Roadcheck**, compared to a 19.3% out-of-service rate in the U.S. Canada's top 5 vehicle violations were brake systems 23.5%, defective service brakes 15.3%, lights 13.7%, cargo securement 13.6%, and tires 11.3%. The top 5 driver violations were hours of service 74.2%, false logs 6.9%, wrong class license 5.4%, other 4.2%, and drugs 3.1%.
- Pablo Rodriguez was sworn in as Transport Minister, replacing Omar Alghabra, who had been in the seat since January 2021 but decided not to run in the next election.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

The trucking environment remains sluggish as choppy freight volumes are held to a stalemate (at best) by a gradual increase in freight-carrying capacity. Welcome freight tailwinds include seasonal consumer spending as fall approaches, cooling inflation, repaired supply chains, a recent uptick in residential construction, and a mid-Summer bounce in commodity prices. Conversely, lackluster merchandise trade flows, softening employment, household credit exposure to multi-decade high interest rates, less aggressive fiscal stimulus, potential labor turmoil in the auto sector, and an ongoing consumer tilt toward services will pose formidable challenges to the freight market for several more quarters. As such, the possibility of policy rate cuts by Spring 2024 may be the next best window for sustained improvements in the freight cycle.

Canada Monthly GDP Y/Y Growth (Seasonally Adjusted)



Canadian real GDP rose by a moderate 1.2% annualized in Q2, a disappointing result following a solid 2.4% gain reported in the U.S. for the same period. The underperformance, however, is not all that surprising given that the economy was dealing with the civil servant strike, wildfires, and swings in the auto sector.

Except for a brief surge in January, **growth in the truck transportation sector** has been decelerating since peaking last summer. Nonetheless, the industry has recorded positive year-over-year activity during 25 of 27 months through May. Still, nominal industry activity during May was essentially the same as in February 2020, just before the pandemic started.

Trucking Business Influencers

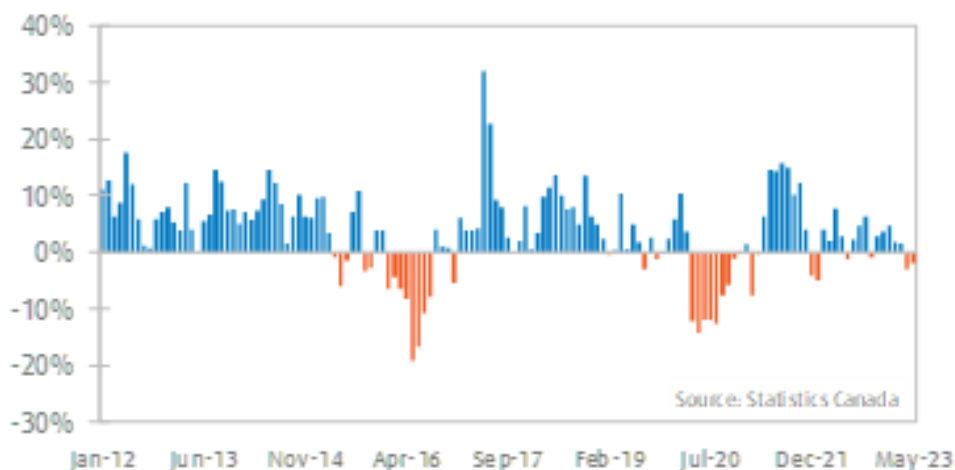
Canada Weekly Diesel Fuel Retail Price (Cents/Liter)



Since the invasion of Ukraine, **Diesel fuel prices** have been on a high-altitude roller-coaster. Over the past year, mirroring a sharp decline from last fall and, more recently, a bounce in WTI crude prices, the national average weekly Diesel price of \$1.81/litre in mid-August had increased \$0.30 (+20%) from a recent low in mid-June but was still down \$0.50 (-22%) from an all-time high last November.

The crude price increase over the past two months reflects increasing odds of a soft landing and Saudi Arabia's unilateral decision to cut production by a hefty 1 million barrels per day. As such, the current BMO outlook for WTI suggests that crude prices will remain elevated during the 2nd half of the year before settling in to average \$80 per barrel during 2024.

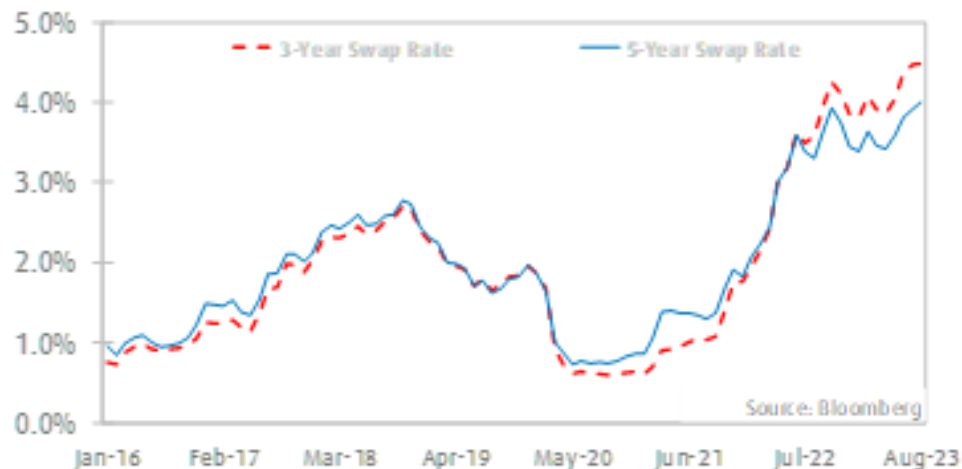
Canada Crude Oil Production Y/Y % Change



Canadian drilling is largely seasonal as rigs are prevented from moving to new drilling sites in the Spring, partly because the ground is thawing, making access by heavy equipment difficult. In an average year, the active rig count will fall 85-90% from its peak in the winter to its minimum in April and May.

Nonetheless, despite a significant decline in the price of crude compared to a year earlier, **crude oil production** was down only slightly year-over-year during April and May while still showing a slight gain year-to-date.

Interest Rates: 3 & 5 Year Interest Rate Swap Pricing

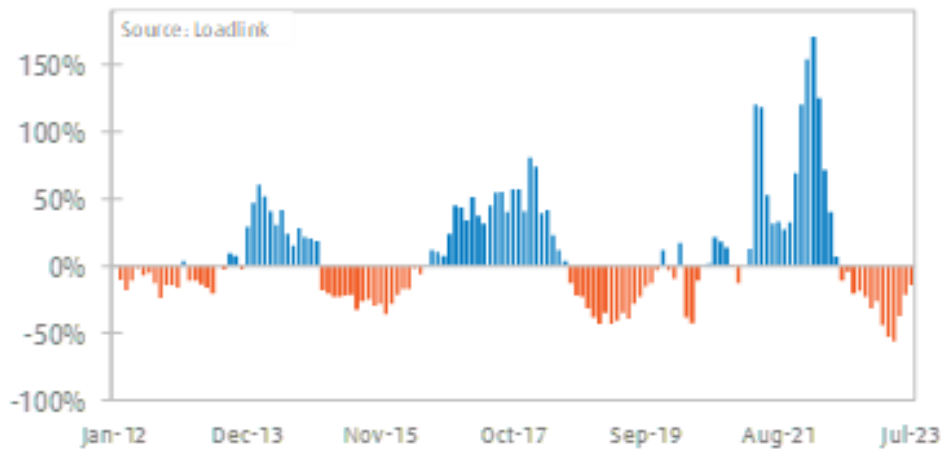


Interest rate swaps are derivative instruments commonly used by financial institutions to mitigate interest rate risk on a loan portfolio. The pricing of interest rate swaps (swap rates) mirrors expectations of interest rates' future direction.

After a brief shift lower early in the year, rates have reversed course and shifted higher primarily in response to the most recent two rounds of policy rate increases. However, as elevated short-term rates eventually weigh on the macro picture, the current steep inversion will likely flatten as policy rates revert to a more stimulative posture. As of mid-August, BMO's economists were forecasting that policy rates have likely peaked but that a rate cut will probably not materialize until the 2nd quarter of 2024.

Freight Indicators

Canadian Truckload Spot Freight Volume Index Y/Y % Change

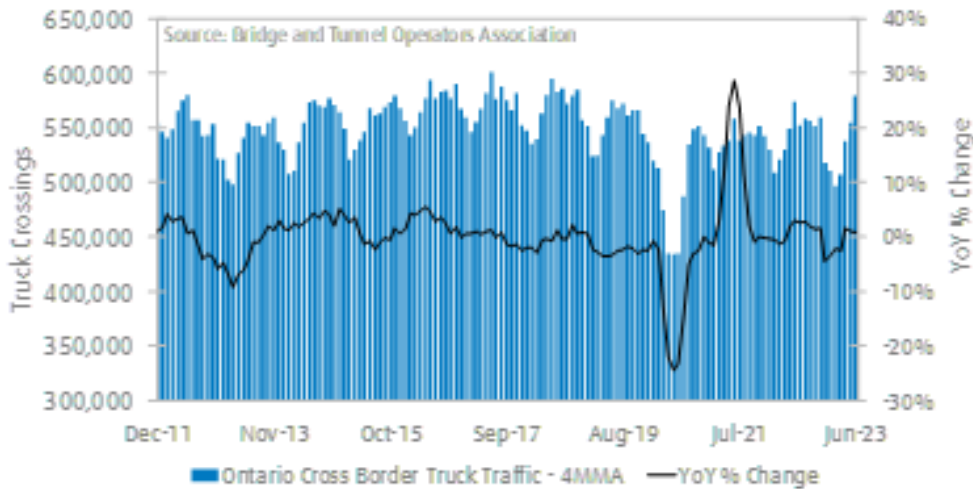


Truckload spot freight volume was choppy through the first half of the year, with a strong start in January followed by generally weak seasonal trends that reached a low point in July. Although spot freight volume declined year-over-year for thirteen consecutive months through July, the rate of decline has shown significant improvement.

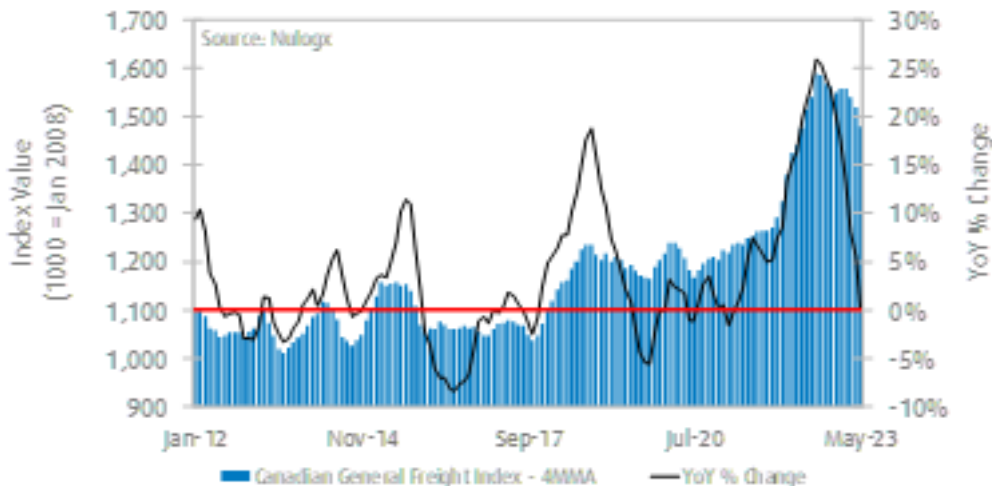
Despite the weak trends in volume, available capacity has been increasing. The truck-to-load ratio in July of 4.85 was 21 percent higher (looser) than the 4.01 trucks for every load posted in June and 38 percent higher than the 3.51 posted a year earlier. As expected, the increase in capacity during a sluggish freight environment has kept downward pressure on freight rates (see below).

Given improving auto manufacturing supply chains and the elimination of mandatory vaccines for crossings on both sides of the border, the 4-month moving average of truck border crossings has shown positive year-over-year growth since April. Further, since bottoming at -21% year-over-year in December last year, truck crossings year-to-date through the first half are up 2.7%.

Ontario Cross Border Truck Traffic



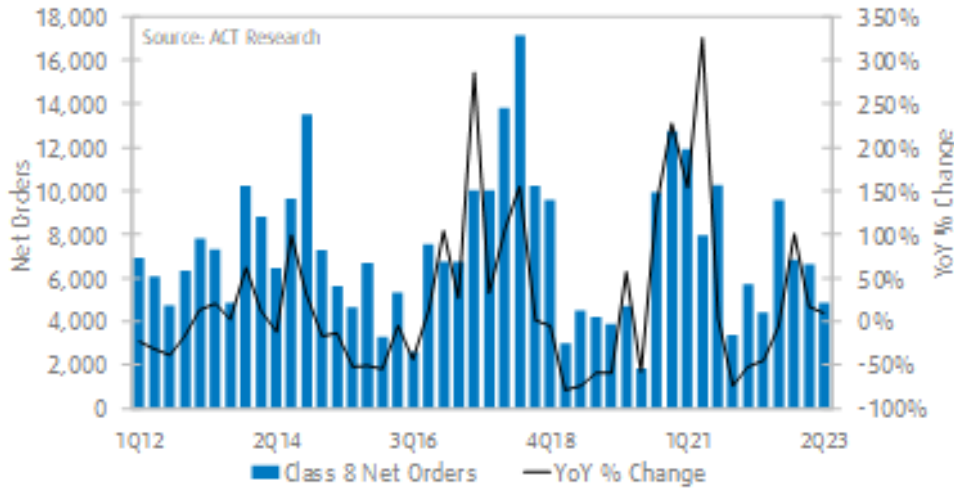
Canadian General Freight Pricing Index



Since reaching an all-time high about a year ago, an index representing the total cost (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers has gradually declined. Although base rates remain elevated and higher than pre-pandemic levels, most of the overall surge in total freight costs over the past couple of years is attributable to rapidly increasing fuel surcharges. That said, the fuel component of the index declined during eight out of the past ten months through May. Fuel was 25.07% of base rates in May compared to 32.77% at last July's peak and 31.69% a year earlier. Overall, total shipping costs during May were flat year-over-year, far below the peak of nearly +26% last August, and Canada's overall inflation rate of 3.4% during May.

Truck Orders

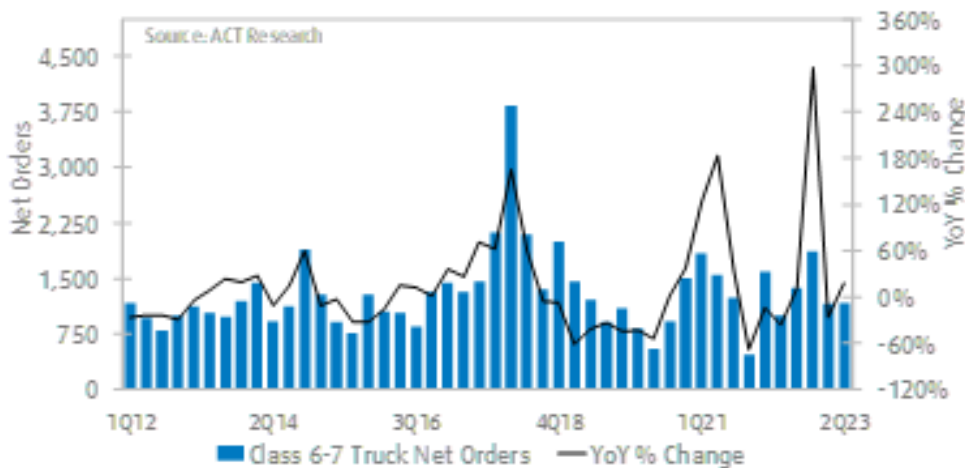
Canada Class 8 Net Orders



As expected, **Class 8 net truck orders** experienced typical seasonal weakness during the second quarter, with much of the demand for 2023 build slots already booked and 2024 slots yet to be opened.

Net truck orders bottomed in April and have since drifted higher through June. Altogether orders during the 2nd quarter were down 27% from the 1st quarter but were 10% higher than the weak year-earlier quarter. Based on prior seasonal trends and next year's build slots opening over the next few months, the near-term order pace will likely gradually drift higher. That said, given expectations of an equipment cycle reset next year and increasingly challenging comparisons, declines in year-over-year orders during the 2nd half of the year would not be surprising.

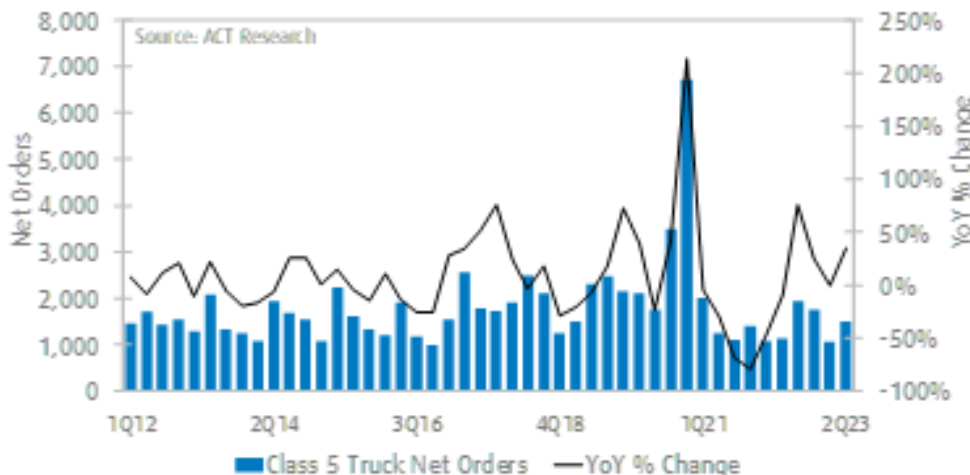
Canada Class 6-7 Truck Net Orders



Class 6-7 net orders surged during the fall of last year as OEMs opened more build slots. More recently, orders have downshifted as pent-up demand for build slots begins to wane, and the headwind of slowing macro trends such as construction activity takes a toll. Overall orders during the 2nd quarter were flat with the 1st quarter but up 18% from the weak year-ago quarter. Moreover, cancellations remain benign at less than 1% of the backlog, well below the 2.1% pre-pandemic average.

As always, the severe-duty segment of this class will continue to reflect fundamental momentum (or lack thereof) in the energy and construction sectors.

Canada Class 5 Truck Net Orders

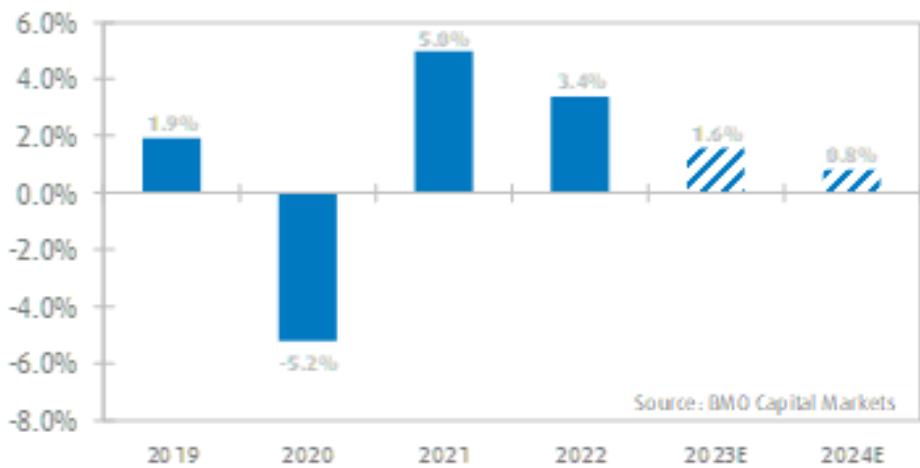


The **Class 5 market** bucked the trend of the larger classes and saw an uplift in net orders during the 2nd quarter. Altogether, orders during the 2nd quarter increased 41% from the 1st quarter and 35% from the year-earlier quarter. Still, the absolute number of quarterly orders has settled into a notably lower range compared to pre-Covid levels.

Nonetheless, the long-term demand outlook remains positive with the support of diverse end markets, consistency in vocational sectors, and the durable tailwinds of e-commerce and last-mile delivery.

Macroeconomic Indicators

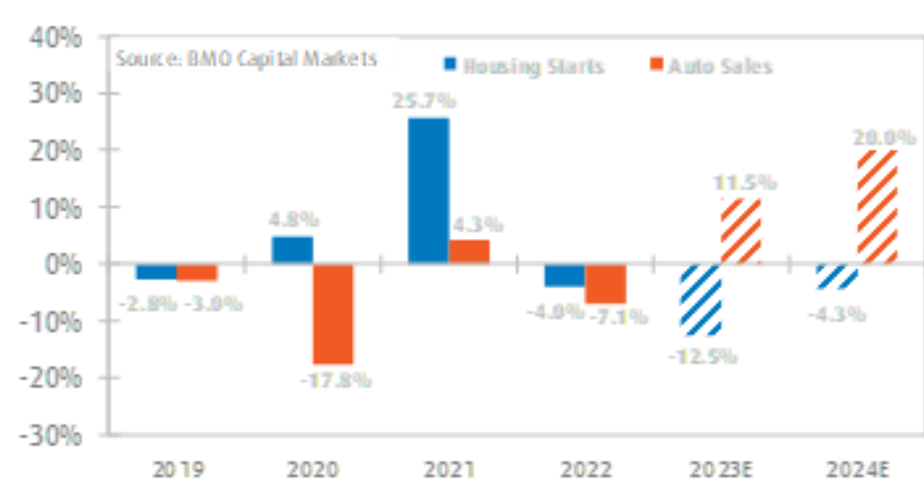
Canada Annual GDP Estimated Y/Y % Change



Given the year-to-date outperformance of the overall macro landscape, BMO Economists have nudged their full-year 2023 estimate for real GDP growth from 1.0% to 1.6%. The near-term outlook, however, calls for a slowdown with a relatively short and shallow contraction consisting of -0.5% (q/q annualized) and -0.1% in the 4th and 1st quarters, respectively.

Relative to the U.S., where a soft landing has replaced a mild recession as the base case, much of the weaker forecast for Canada reflects the exposure of consumers to larger debt loads with shorter duration (greater refinancing risk), weakening global demand and prices for commodity exports and much less aggressive fiscal policy.

Canadian Annual Housing Starts and Auto Sales Estimated Y/Y % Change



Canadian housing starts increased to 281.3 thousand annualized units in June, representing an impressive 41% month-on-month gain from weakness in May and a 3.5% improvement from a year earlier. Despite the strong month, the momentum is expected to be short-lived as high-interest rates continue to work through the economy. As of mid-August, BMO economists expected housing starts to decline 10-15% during 2023, followed by a flattening but still slightly negative trend next year.

Despite the drag on disposable income from higher interest rates, pent-up demand should propel the **auto sector** to a resumption of strong unit sales growth during 2023 and 2024.

U.S. Dollar per 1 Canadian Dollar



Although the **Canadian dollar** has shown relative weakness since peaking two years ago, BMO economists expect a reversal of the trend as the U.S. dollar starts to feel the headwinds of a Fed pause and market expectations for a Fed rate cut sometime during the 1st half of next year. After averaging C\$1.343 during the 2nd quarter (US\$0.745), BMO economists look for the Canadian dollar to gradually appreciate to C\$1.308 (US\$0.764) by the 4th quarter of this year and, after that, average between US\$0.77-0.78 throughout 2024.

“Voice of the BMO Economics Team”

Given the cross currents of the macro environment so far sidestepping a recession despite 22-year-high interest rates, moderating but still unacceptably high inflation, pressure on commodity prices, and a recent uptick in unemployment, we thought it would be helpful to check in on the BMO Economics Team’s latest near-term outlook for the Canadian economy. For more: <https://economics.bmo.com/en/>

Dog Days of Cycle

Douglas Porter, Chief Economist and Managing Director, August 11th 2023

The still-sturdy U.S. growth backdrop is a major factor behind how the Canadian economy has also managed to stay out of the red, at least so far. We like to say that if you know what the U.S. economy is going to do, you have 75% of the answer for Canada’s outlook. And, largely mirroring the shift in U.S. growth expectations for 2023, Canada’s GDP forecast has been grinding steadily higher since the start of the year. However, we detect some daylight opening up between the two economies, as we now have Canada growing 1.6% this year, a half point slower than stateside, and less than 1% in 2024 despite the helping hand of much stronger population growth. Some of this dimmer forecast reflects the more exposed consumer sector, due to greater debt loads with shorter duration. And some reflects much less aggressive fiscal policy.

The moderately diverging outlook between the two economies is perhaps most clearly highlighted by the jobless rates. While the U.S. rate has been quite stable over the past year in the mid-3s, the Canadian rate has lurched notably higher in the past three months. It’s somewhat astonishing that the 0.5 ppt rise in the unemployment rate from April (and 0.6 ppt from last year’s low) hasn’t generated more attention, as it’s a clear warning flag that conditions may be softening abruptly. Adding to the sense that something has changed recently, one of the nation’s largest retailers (Canadian Tire) noted a drop in discretionary spending late in Q2, corroborating the preliminary estimates from StatCan that retail activity stalled around mid-year.

Beyond the consumer, Canada’s export machine also appears to be sputtering. After adding heavily to growth for three consecutive quarters, it now looks like net exports will drag in Q2, and likely Q3 as well. Merchandise trade has sunk back into deficit, seemingly on a sustained basis, as the rush of last year’s commodity spike has worn off and net volumes have turned south as well. Meantime, on the construction front, Canada is not seeing the factory building boom that the U.S. is experiencing, and the nascent rebound in housing looks to be smothered by the latest 50 bps of Bank of Canada rate hikes. Notably, construction employment has dropped 1.6% y/y in Canada, even as it has risen 2.5% for U.S. payrolls, a stark divergence.

While markets are still debating whether the BoC or the Fed will hike again, we believe that the case for the Bank to now stand aside is very strong. Next week’s CPI is likely to largely mimic the U.S. report, with a moderate monthly rise boosting the annual inflation rate a bit above 3% due to challenging base effects (with more to come in August). But the notable softening in the domestic job market, and the slippage in spending, construction, and trade, all suggest that underlying price pressures should ebb further.

A Weight-y Month For Trade

Shelly Kaushik, Economist, August 8th 2023

Canada's merchandise trade deficit widened to \$3.7 billion in June from \$2.7 billion (revised from \$3.4 billion) in May. Thanks to revisions, this is now the fourth shortfall over the last five months. Exports dropped 2.2%, led by metal and non-metallic mineral products (-8%) from high levels in the previous couple of months. Imports edged down a smaller 0.5%; decreases in energy products (-13%, largely on lower motor gas and crude oil) and consumer goods (-2%) were partially offset by a 13% jump in metal and non-metallic mineral products, mainly from higher gold asset transfers in the banking sector.

“Voice of the BMO Economics Team”

A Weight-y Month For Trade (cont.)

On a volume basis, exports fell 1.2% as imports rose 1.2%. In the second quarter, exports were down 1.1% annualized and imports were up 3.8% annualized, meaning trade looks to weigh on growth even more than previously expected. The June numbers suggest weak momentum into Q3, and July trade flows will be further weighed by the B.C. port strike and flooding in Nova Scotia.

In a separate release, the services trade deficit was little changed in June, narrowing slightly from \$1.1 billion to \$1.0 billion as exports edged up 0.4% while imports ticked down 0.2%. In total, Canada’s overall trade deficit widened from \$3.8 billion in May to \$4.7 billion in June.

Key Takeaway: Canada’s merchandise trade deficit widened again in June as the country has now spent four of the past five months in shortfall. Trade looks to weigh on second quarter growth, with momentum at the end of the quarter pointing to a weak handoff to Q3.

Sticking The (Soft) Landing

Sal Guatieri, Senior Economist and Director Economics, August 4th 2023

Unlike the U.S., we have not changed our Canadian economic outlook materially, apart from delaying the expected mild slump by one quarter to the turn of the year. This raised our growth call to 1.6% for 2023, but lowered next year's estimate to 0.8%. Both figures imply a continued decline in per capita GDP (and living standards) given the fastest population growth in seven decades (3.1% y/y). The economy has been buffeted by labour strikes (federal workers in the spring, port and grocery workers more recently), as well as severe wildfires. After a couple of soggy months, real GDP jumped 0.3% in May, but largely reversed course in June according to the flash estimate. This points to growth of little more than 1% annualized in Q2, downshifting from 3.1% in Q1. We expect even softer activity in the second half of the year. Of note, the rebound in housing activity following the central bank's January 'pause' looks to have fizzled in the face of renewed rate hikes. Moreover, employment has fallen in two of the past three months, lifting the unemployment rate to 5.5% in July, up 0.6 percentage points from the multi-decade low of last summer.

There are several reasons why Canada's economy is lagging the U.S., notably in per-capita terms. First, Canadian borrowers are more sensitive than their U.S. peers to higher interest rates as they hold more debt and shorter-term mortgages. Second, U.S. households are keener to spend excess savings, likely because of their lighter debt burden. And third, though keeping a heavy foot on the gas, Canada's government is no longer putting the spending pedal to the metal as in the U.S., and isn't offering as rich subsidies or tax incentives to drive industrial policies.

Where Canada is ahead of the U.S., however, is in lowering inflation. The annual CPI rate fell to 2.8% in June from 8.1% last summer. Several core measures are now trending in the 3%-to-4% range, down from a peak of 5%-to-6%.

The progress on inflation, combined with waning momentum in the economy and labour markets, will likely pull a data-dependent Bank of Canada back onto the sidelines after coming off the bench twice this summer. We expect the current 5.0% policy rate to hold firm until next spring, at which time the Bank will likely gradually nurse rates back to more neutral levels of 2.5%-to-3.0%.

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