Industry Update

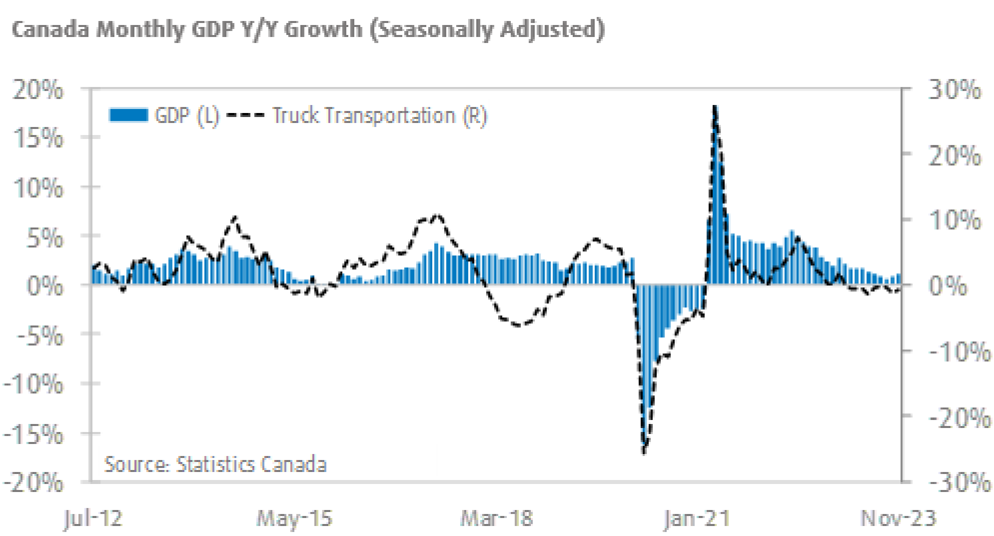
Canada Truck Transportation

Key Developments

- **Trucking HR Canada's (THRC)** latest quarterly Labour Market snapshot shows truck drivers' unemployment rates have dropped sharply. Employment of transport truck drivers increased throughout 2023, averaging 317,300 drivers. Unemployment of truck drivers peaked in April 2023, reaching 6.5%, but dropped over the last three quarters of the year, settling at 3.5% in December.
- A scheduled reduction in international student permit allowances over the next two years will likely pressure truck driving school enrollments, given that many students are foreign-born. Approximately 360,000 undergraduate study permits will be approved for 2024 — a 35% reduction from 2023. Each province and territory will be granted permits according to population, with Ontario likely to see a 50% reduction from present numbers.
- According to the **U.S. Department of Transportation**, the number of truck border crossings (incoming from Canada) in 2023 increased by 1.4%, the first non-Covid distorted annual increase since 2016. Further, trucks moved $36 billion (USD) of freight across the Canada-U.S. border in November, nearly $2 billion more than in November 2022.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

Despite the cumulative headwinds of prior BoC rate hikes, Canada's economy at the headline level has outperformed low expectations. However, conditions in the trucking sector have not kept pace given that until very recently, the services sector has generated most of the growth over the past year while goods-producing sectors have lagged. Still, despite inflation remaining uncomfortably above the BoC's 2% target, decent employment trends, and annual wage gains above 5%, the expectation by BMO economists is for easing monetary policy on both sides of the border by mid-summer. While waiting for those rate cuts and accompanying macro tailwinds, industry supply-demand dynamics will continue to favor shippers until any combination of resurgent freight volumes and fleet rationalization regains the upper hand.

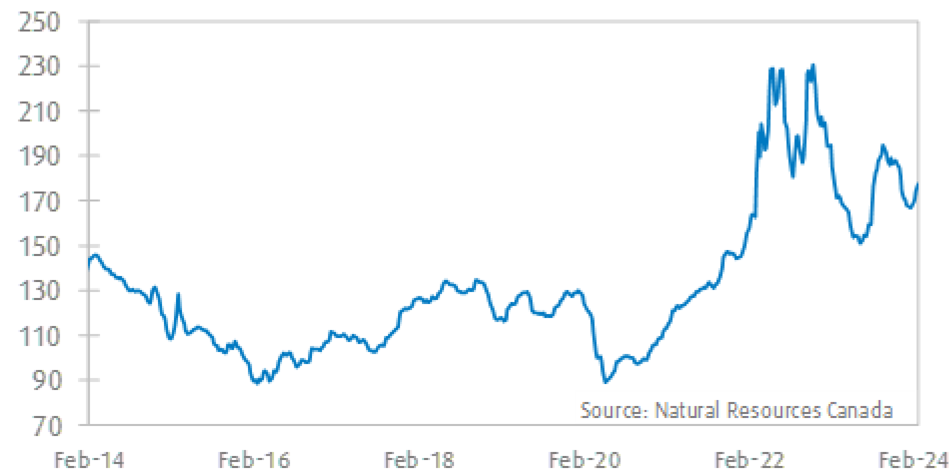


Canadian real GDP exceeded expectations with a respectable 0.2% advance in November and the early reading for December points to an even steeper 0.3% rise. The most recent growth came from goods-producing sectors, particularly manufacturing and resources. Since exports heavily influence these sectors, the surprising resiliency in the U.S. economy is creating demand for some Canadian industries.

Despite the macro tailwinds at the end of the year, the truck transportation sector has yet to see the benefits with year-over-year declines since March of last year. Further, sector activity during November was nearly 3% lower than in February 2020, just before the start of the pandemic.

Trucking Business Influencers

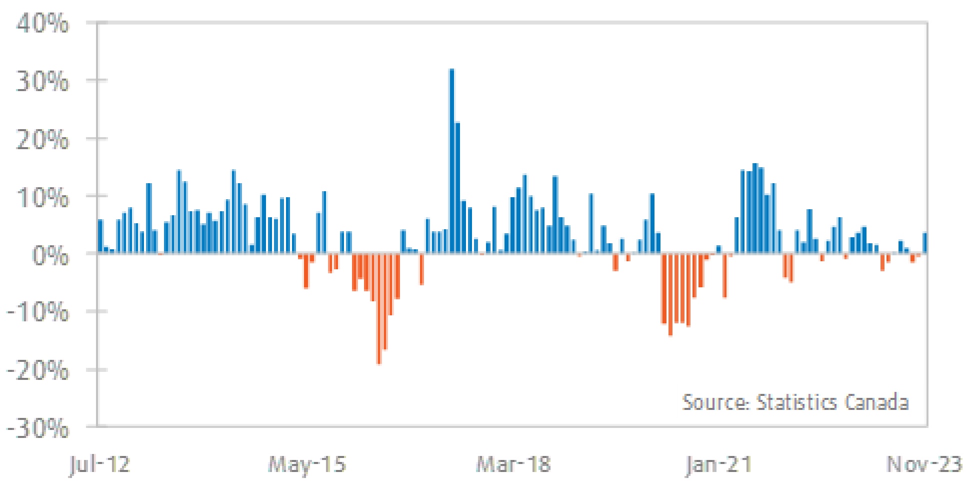
Canada Weekly Diesel Fuel Retail Price (Cents/Litre)



Since the invasion of Ukraine and, more recently, the conflict in the Middle East, **Diesel fuel prices** have been on a high-altitude roller-coaster. Over the past few months, mirroring a slump in WTI prices before a bump higher in February, the national average Diesel price of $1.77/litre in mid-February had decreased $0.18 (-9%) from a September peak. However, Diesel prices were still up 17% from a multi-year low last summer.

Given record North American production, crude prices have declined since the fall despite better than expected global growth, increased geopolitical threats, disrupted Suez access and OPEC+ production cuts. Nonetheless, the current BMO outlook for WTI suggests that crude prices will maintain a slight upward bias while drifting toward an average of $80 per barrel in 2024, up from an average of $77.6 in 2023.

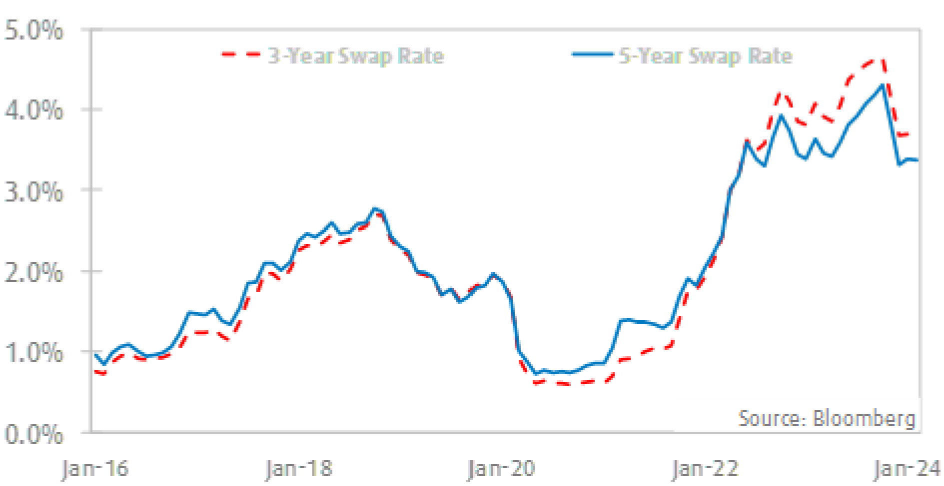
Canada Crude Oil Production Y/Y % Change



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.

Given relatively flat crude oil prices compared to a year earlier, **crude oil production** also grew modestly at just shy of 1% year-to-date through November. Still, production during November reached an all-time monthly high and was 3.5% higher than a year earlier.

Interest Rates: 3 & 5 Year Interest Rate Swap Pricing

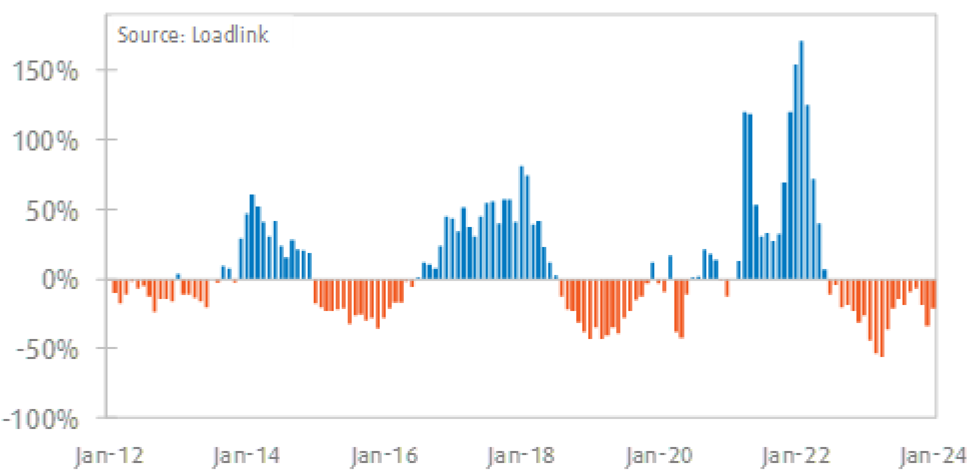


Interest rate swaps are derivative instruments commonly used by financial institutions to mitigate interest rate risk on a loan portfolio. The pricing of interest rate swaps (swap rates) mirrors expectations of interest rates' future direction.

After a peaking last October, rates have reversed course and shifted lower primarily in response to flattening macro data and growing anticipation of a more stimulative posture of policy rates. Although the BOC has been in a holding pattern since last July, as of mid-February, BMO's economists forecast that a rate cut will probably not materialize until June.

Freight Indicators

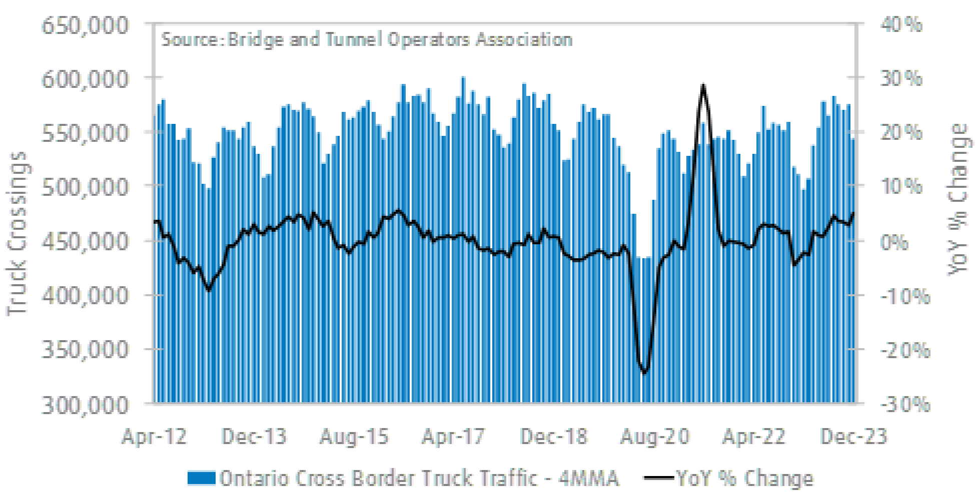
Canadian Truckload Spot Freight Volume Index Y/Y % Change



Since peaking in early 2022, **truckload spot freight volume** has weakened considerably and reached a low point last July. That said, although spot freight volume declined year-over-year for nineteen consecutive months, the number of loads during January increased 47% from December, mainly on inbound cross-border strength, and reached its highest level in ten months.

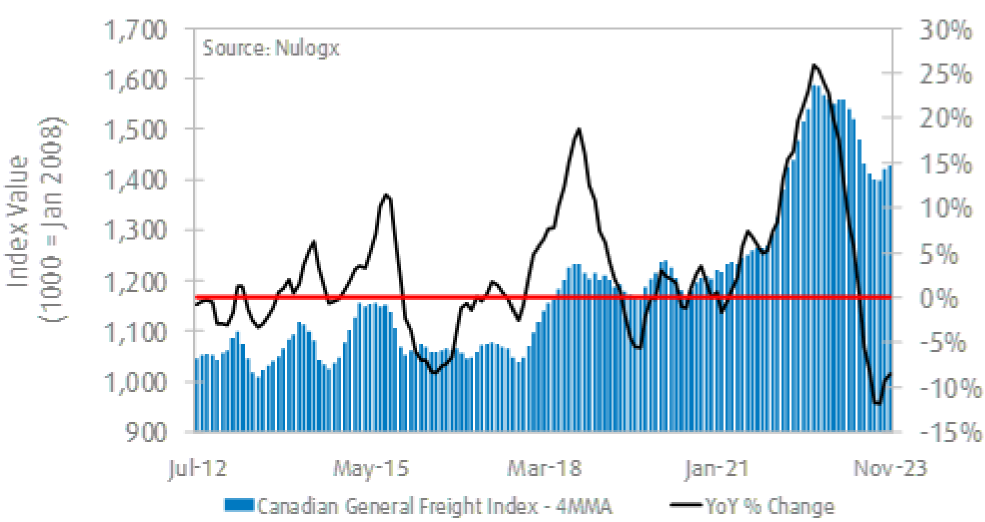
Given typical seasonal weather impacts, available capacity (trucks on the road) did not keep pace with the surge in available spot volume to start the year. The truck-to-load ratio in January of 2.61 was 29 percent lower (tighter) than the 3.67 trucks for every load posted in December but 48 percent higher (looser) than the 1.76 posted a year earlier.

Ontario Cross Border Truck Traffic



Despite volatility caused by the UAW strikes, the 4-month moving average of **truck border crossings** accelerated as the year progressed and has shown positive year-over-year growth since last April. For the full year, truck crossings in 2023 increased by 3.7%, reaching the largest total since 2019.

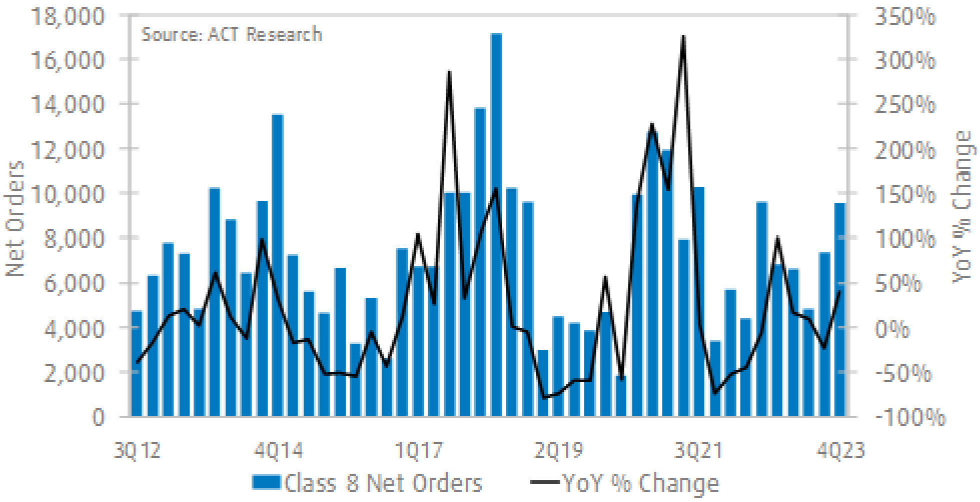
Canadian General Freight Pricing Index



Since reaching an all-time high during the summer of 2022, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers has steadily declined. That said, although base rates drifted lower through the fall, an increase in the fuel component of the index starting in the summer and into the fall resulted in the 4-month moving average increasing during November for the 2nd consecutive month.

Truck Orders

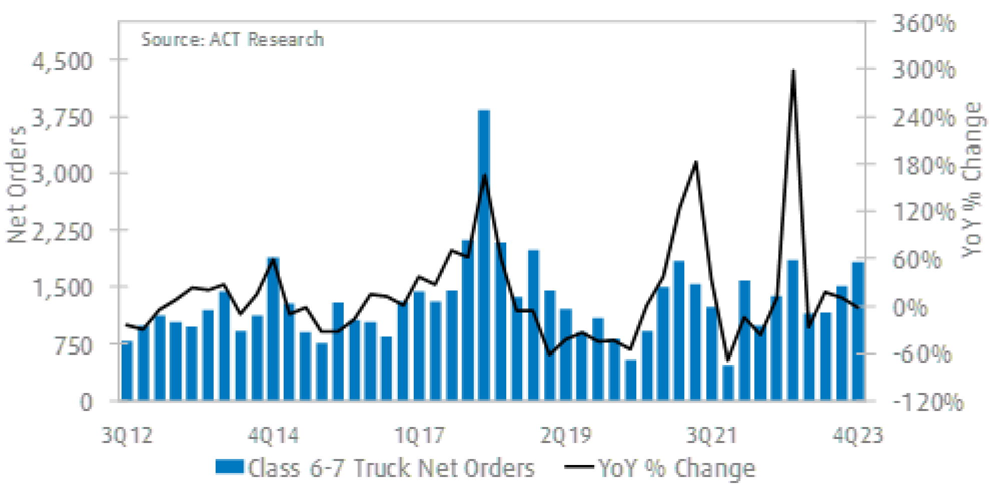
Canada Class 8 Net Orders



Year-over-year and quarter-over-quarter comparisons turned positive during the year's final quarter as **Class 8 net truck orders** awoke from a typical Summer slumber and build slots opened completely for 2024 deliveries.

Net truck orders bottomed in April and surged to a peak in October before drifting lower toward the end of the year. Altogether, orders during the fourth quarter were the most for a fourth quarter since 2020, up nearly 30% from the third quarter and an impressive 40% higher than the year-earlier quarter. Based on prior seasonal trends and given expectations of an equipment cycle reset toward replacement levels this year, decelerating order trends through the Spring would not be surprising.

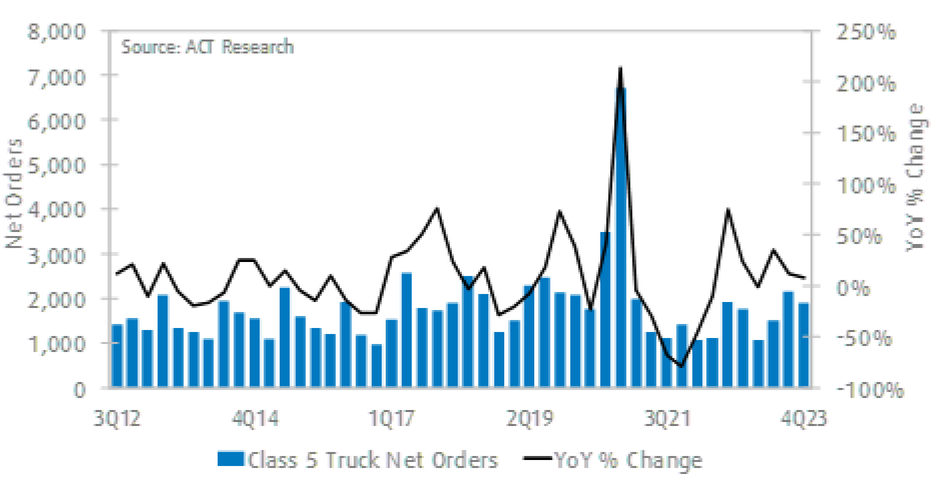
Canada Class 6-7 Truck Net Orders



Class 6-7 net orders decelerated early during the final quarter but finished on a high note with the best December and 4th best month on record. Overall orders during the 4th quarter were up 21% from the 3rd quarter but were essentially flat from a year ago. That said, after a challenging comparison early in the year, orders for the entire year were down nearly 3%. On a positive note, trailing 6-month cancellations remain relatively benign, averaging 0.6% of backlog and well below the 1.8% 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



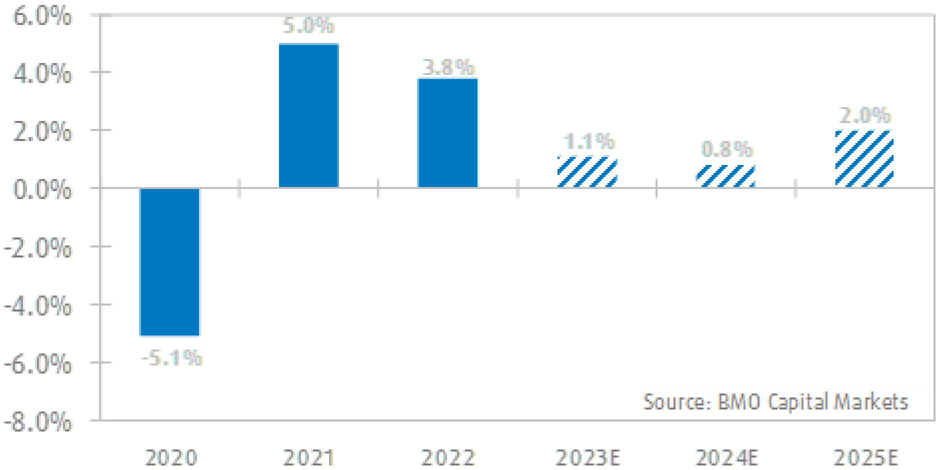
Similar to the U.S., residential construction has so far outperformed the worst fears that typically accompany an elevated interest rate environment. Likewise, medium-duty truck orders were sturdy during the second half of last year as OEMs opened more build slots for early this year.

Overall orders during the 4th quarter were down 12% from a robust 3rd quarter but up 8% from a year ago. Similarly, orders for the entire year were up nearly 13%.

Despite the muted near-term macro outlook, the long-term demand outlook for medium-duty 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

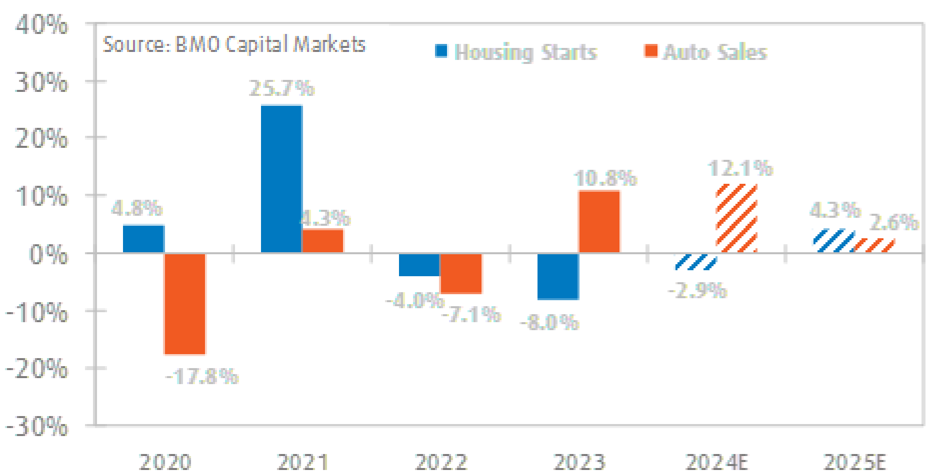
Canada Annual GDP Estimated Y/Y % Change



Canada's growth backdrop at the end of 2023 was firmer than expected, resulting in an upward revision to 2024 estimates. Given the recent upward revisions to U.S. growth, it stands to reason that Canada's pace could also get a lift, with 1% growth entirely within reach this year.

In turn, there's also less pressure on the Bank of Canada to start cutting any time soon. The solid finish to the year, after a long dry spell for growth, affords policymakers the ability to gently push back on speculation of easing as they wait for underlying inflation to come down further.

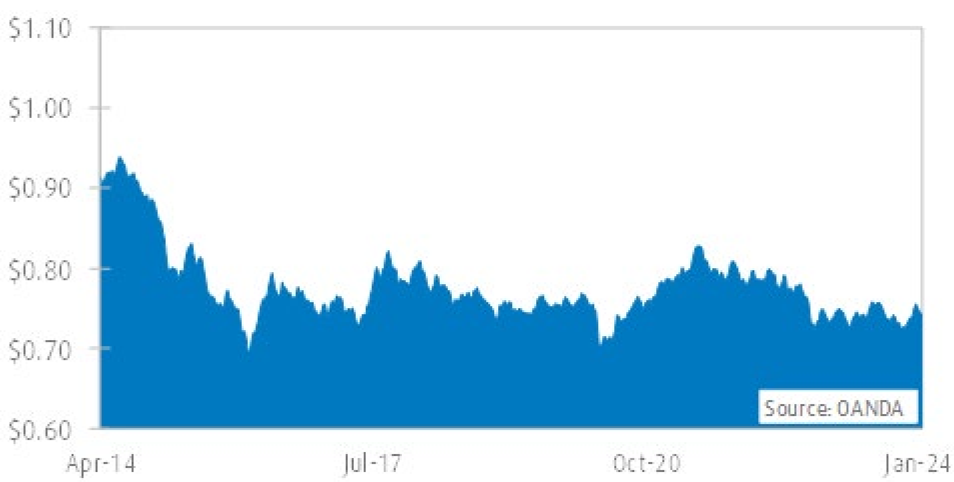
Canadian Annual Housing Starts and Auto Sales Estimated Y/Y % Change



The Canadian housing market should enter a period of overall stability this year, with lower resale prices, easing mortgage rates, and pent-up demand likely helping to set a floor for the market. But a return to the rollicking price gains of recent years and previous highs for some locations is unlikely. Further, housing starts will likely remain flat at around 240k units plus or minus a few thousand, which is still miles below government supply goals.

Despite the drag on disposable income from higher interest rates, pent-up demand should continue to propel the **auto sector** toward another year of strong unit sales growth during 2024.

U.S. Dollar per 1 Canadian Dollar



As the market's Fed policy expectations shifted from its recently most hawkish (during October) to its most dovish (during December), the **Canadian dollar** strengthened alongside a weakening greenback. The Canadian dollar averaged just under US$0.745 in December and January after averaging US$0.729 in October (the latter was the weakest level since the onset of the pandemic and, before that, a few months during the 2015 collapse in oil prices). As those most dovish expectations faded, so did the Canadian dollar's lift, currently trading under US$0.74. Although the Bank of Canada will likely start easing before the Fed (but perhaps only barely), the theme of a broadly weaker greenback should still push Canada's currency higher by nearly 2% by year-end (compared to January's average) and about 3% next year.

“Voice of the BMO Economics Team”

Sal Guatieri, BMO Senior Economist – February 7th, 2024

Unlike the U.S., Canada's economy met expectations of a sharp slowdown last year. Despite support from its major trading partner and a rapidly growing population, real GDP growth likely downshifted to 1.1% in 2023 from 3.8% in 2022. It contracted in Q3 amid stalled consumer spending and a pullback in investment and exports, and, on an industry basis, came to a virtual halt between May and October.

But the economy appears to have taken a step back from the recession edge. Real GDP surprisingly turned up in the final two months of last year. As well, auto sales accelerated 15% y/y in January to the highest level in the post-pandemic period. Home sales are also showing a spark due to a pullback in mortgage rates and expected easier monetary policy this year. Accordingly, we lifted our GDP growth call modestly through the turn of the year from the flat profile previously expected.

Still, growth is expected to slow to 0.8% in 2024, ranking as the weakest year (apart from the pandemic) since 2015. Slowing U.S. demand, sagging productivity, and rising mortgage payments (even as prevailing rates decline) are likely to hinder activity. Moreover, soaring business bankruptcies—up 41% to 13-year highs in 2023—are likely to slow hiring. Much-needed rate relief later this year, however, should support a return to moderate 2.0% GDP growth in 2025.

The gravitational pull of a weak economy is causing the inflation tide to retreat. Since peaking in mid-2022, CPI inflation has fallen almost five percentage points to 3.4% y/y in December. However, most core metrics are running a little faster due to rising mortgage payments (29% y/y), rents (8%) and wages (in the 4%-to-5% range). Still, with the jobless rate rising nearly one percentage point from cycle lows to 5.8% in December, and expected to reach 6.5% this summer, inflation should slip into the low 2s by year-end.

Similar to the Fed, the Bank of Canada no longer believes rates need to rise further to tame inflation, but is in no hurry to reverse gears. It still needs to be convinced that inflation won't stop falling above the target, and is patiently watching for further declines in core inflation and wage growth. The latter has conspired with sagging productivity to spike unit labour costs 6.1% y/y in Q3, or three times faster than the rate consistent with price stability. We expect the Bank to delay rate cuts until June, before reducing the overnight rate from 5% currently to 4% at year-end and below 3% in early 2026.

The Canadian dollar remains boxed in a narrow, depressed range. Given the country's poor economic and productivity performance, it is unlikely to take flight. However, assuming the trade-weighted greenback continues to retreat from earlier record highs, the loonie could strengthen modestly to C$1.32 by year-end.

“Voice of the BMO Economics Team”

BoC Summary of Deliberations (Jan. 24) — Watching and Waiting
Robert Kavcic, Senior Economist and Director, February 7th 2024

The summary of the Bank of Canada’s deliberations from the January 24th decision was set against the BoC dropping its tightening bias. The Bank believes that policy is tight enough, but hasn’t been so for long enough yet given still-nagging inflation pressure. As such, “it was difficult to foresee when it would be appropriate to begin cutting interest rates”. Rate cuts are not imminent.

On economic growth, the Bank continues to see past rate hikes filtering through to weigh on activity. Recall that the January Monetary Policy Report pegged 2023Q4 growth at zero; and 2024Q1 at 0.5% annualized. We’ve since seen some upside data flow, particularly for real GDP, but our updated outlook is not out of line with what the Bank was seeing in January. For the record, we have 1.0% growth in 2023Q4 and are in-line with the MPR at 0.5% for 2024Q1. In general, the Bank believes the economy is operating in “modest excess supply”.

On inflation, the backdrop gets tougher with core inflation metrics still running too strong to allow for rate cuts. As we read in the January press statement, and have heard various times since then, “Governing Council wants to see further and sustained easing in core inflation”. In other words, cooler inflation and more time. That’s a bit of a different picture than the Fed is painting: it believes inflation over the past six months has been where it wants it, but the central bank also wants more time.

Wage growth was noted as a concern by the BoC, especially when set against weak productivity growth. If wage gains don't slow or productivity doesn’t improve, that could be a source of ongoing upward pressure on inflation that is concerning.

The Governing Council also discussed shelter costs, and the risk that “if the housing market rebounded more than expected in the spring of 2024, shelter inflation could keep CPI inflation materially above the target even while price pressures in other parts of the economy abated”. While mortgage interest costs are the big driver of inflation right now (from past rate hikes), and rents are also a large contributor (where monetary policy doesn’t have a big immediate effect), there’s some acknowledgement that easing too soon and re-igniting the resale market would be a misstep. After all, resale price swings find their way into the CPI relatively quickly, and the current weight of the categories they directly influence is now higher than each of rent and mortgage costs.

Given those moving parts, the BoC is also focusing on the breadth of inflation. It says that “prices for just over half of CPI components were growing at a rate above 3%, indicating that the drivers of too-high inflation continued to be broad-based.”

Bottom Line: The Bank of Canada is not cutting rates yet. It needs to see inflation metrics improve further and show that they can sustain themselves at better levels.

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