Industry Update

Canada Truck Transportation

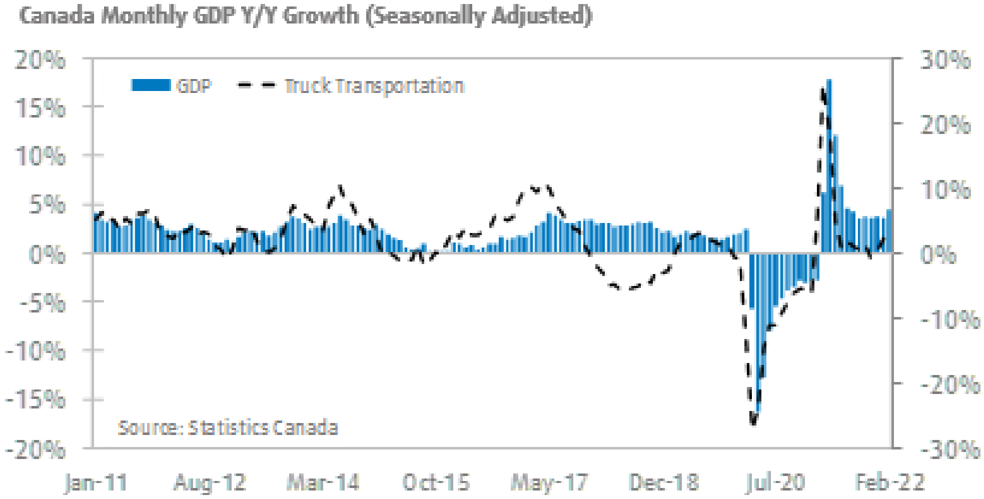
Key Developments

- Recent data from **Trucking HR Canada** and **Statistics Canada** show that the driver shortage improved modestly during the 1st quarter but remains a persistent problem for the industry. Unemployment among truck drivers in Q1 2022 was 4.2%, up slightly from 3.2% in Q4 2021, but well below the average unemployment rate of 6.1% in the Canadian economy. Driver employment in Q1 2022 was down 8% from Q4 but up 2% from the year-ago quarter.
- According to a recent **study by NACFE**, approximately half of all Canadian and U.S. Class 8 diesel trucks used for regional hauls (up to a 100-mile radius) could be replaced by currently available battery-electric models with minimal or no impact on operations, efficiency, or productivity.
- A recent **study by ATRI** concludes that Hydrogen fuel cell trucks are the most environmentally friendly zero-emission vehicle option for long haul trucks. The report showed that while battery-electric trucks have no direct tailpipe emissions, CO_2 production associated with vehicle, battery, and electricity production would only result in a 30% decrease in CO_2 emissions compared to a standard diesel truck.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

Canada's resource-rich economy has shown remarkable resilience despite 30-year high inflation, protracted Covid restrictions, supply constraints in the auto sector, and an expectation for the BoC to push interest rates much higher. Further, with pent-up demand for services coupled with commodity prices expected to remain elevated for several quarters, BMO's economists recently raised their 2022 GDP growth forecast to +4.1%, which puts Canada at the top of the G7. And unlike deteriorating conditions in the U.S. spot freight market, the Canadian spot freight market remained tight through the 1st quarter, with capacity trailing available freight by a wide margin. Still, as the year unfolds, nobody should be surprised by a supply-induced freight air pocket and some degree of demand destruction as collateral damage in the inflation fight.

Canada Monthly GDP Y/Y Growth (Seasonally Adjusted)



February GDP powered ahead by 1.1%, well above an initial estimate of +0.8%. Combined with a slight gain in January, estimated growth for Q1 sits at an impressive annualized pace of 5.5%, despite border blockades and Omicron restrictions in much of the country during January and February. The February gain was broad-based, as 16 of 20 industries were in the green, and was led by strong gains among the reopening sectors, including hotels & restaurants (15.1%), arts & entertainment (8.4%), and air travel (7.7%).

While well off the pandemic bottom and slightly above year-earlier levels, **truck transportation** sector activity remains 4.1% below where it was just before the pandemic in February 2020.

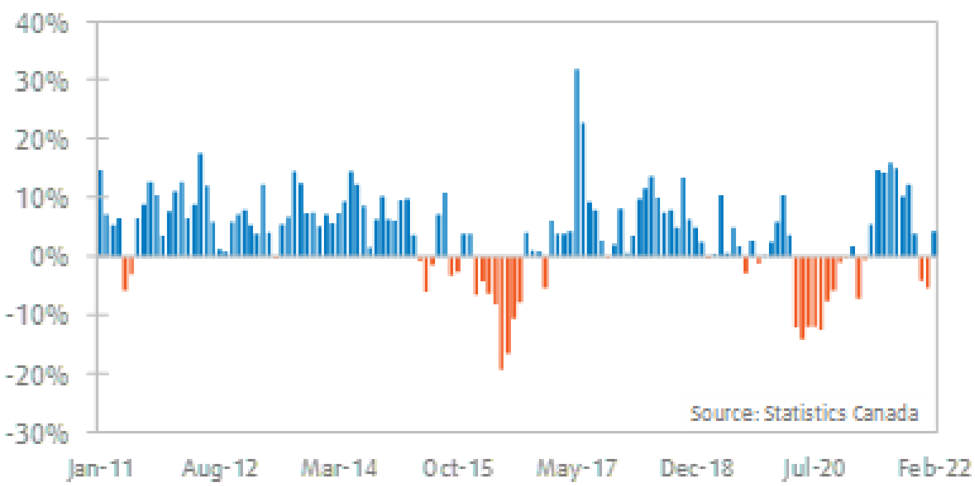
Trucking Business Influencers

Canada Weekly Diesel Fuel Retail Price (Cents/Liter)

Retail Diesel fuel prices across Canada have been on an unrelenting uptrend and recently reached a record high. As of early May, the average weekly Diesel price of 227 cents/liter was up 64 cents (+39%) since the invasion of Ukraine and 101 cents (+81%) since a year earlier.

The current BMO outlook suggests that crude prices will remain elevated (WTI averaging $101 US$/bbl in 2022 and $85 in 2023) for the foreseeable future as increasing demand for non-Russia crude is only partially offset by slowing global macro growth and new supply creeping into the market.

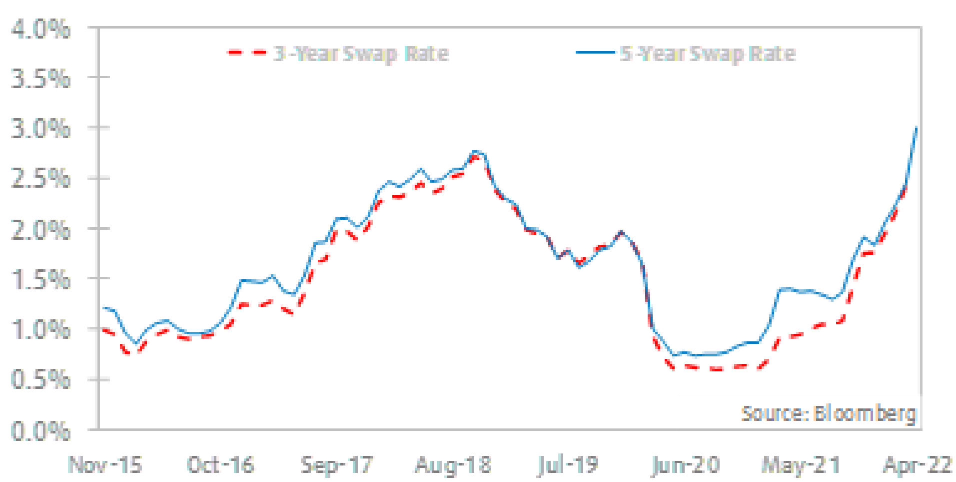
Canada Crude Oil Production Y/Y % Change



Just as the invasion of Ukraine was unfolding and the price of crude was about to skyrocket, **crude oil production** across Canada was at the outset of a typical seasonal downturn. 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 for heavy equipment difficult. In an average year, the rig count will fall 85-90% from its peak in the winter to its minimum in April and May.

Longer-term, beyond the current global supply constraints, the big questions for crude oil production will be how the demand curve evolves due to climate change policies and the trend toward ESG-based investment evaluation and fossil fuel divestments.

Interest Rates: 3 & 5 Year Interest Rate Swap Pricing

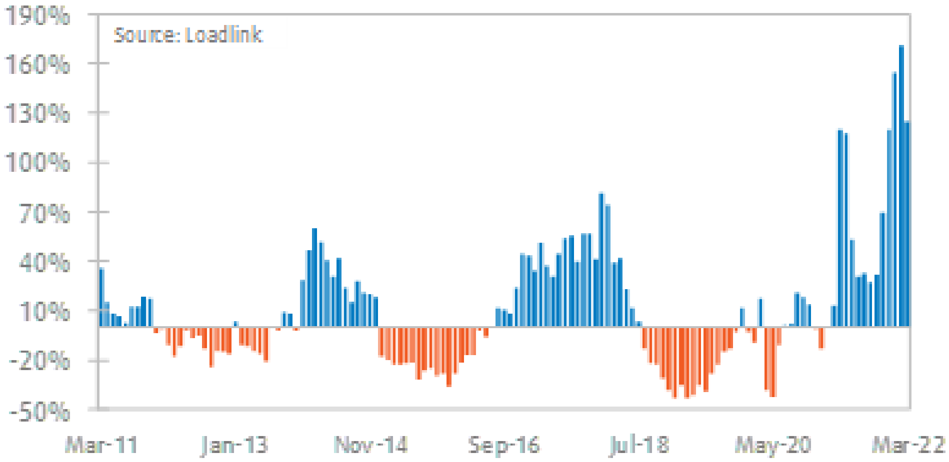


Interest rate swaps are derivative instruments commonly used by financial institutions to mitigate interest rate risk on a loan portfolio. The pricing of interest rate swaps (swap rates) mirrors expectations of interest rates' future direction.

Short-term bond yields have bolted higher as the Bank of Canada and the Fed have embarked on an unequivocally hawkish path in response to multi-decade high inflation. As such, BMO's economists recently raised their expectations for the BoC to raise the target overnight rate to 2.75% (from 1.0% currently) by next Spring.

Freight Indicators

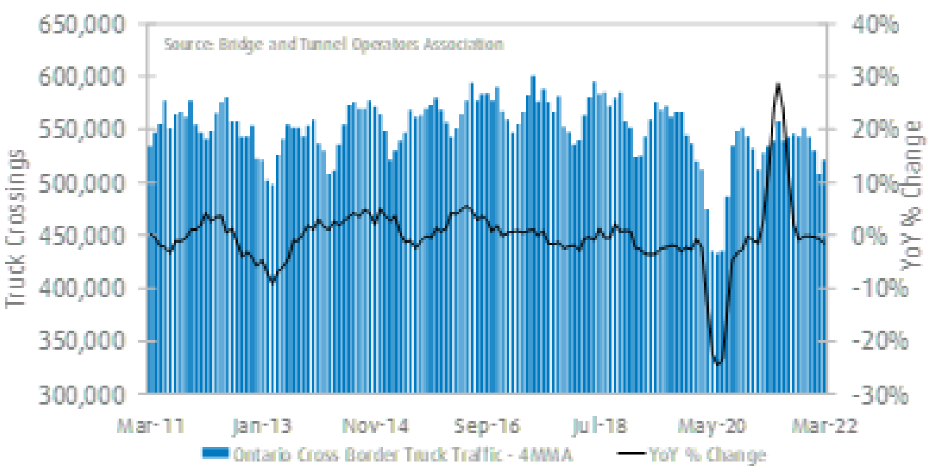
Canadian Truckload Spot Freight Volume Index Y/Y % Change



Despite supply chain issues and aided by a clearing of backlogs accumulated during the border blockades and vaccine protests, monthly **truckload freight spot volume** increased for eight consecutive months, with March being the best month ever. Compared to last March, volumes increased by 125 percent while surpassing February's record month by 11 percent.

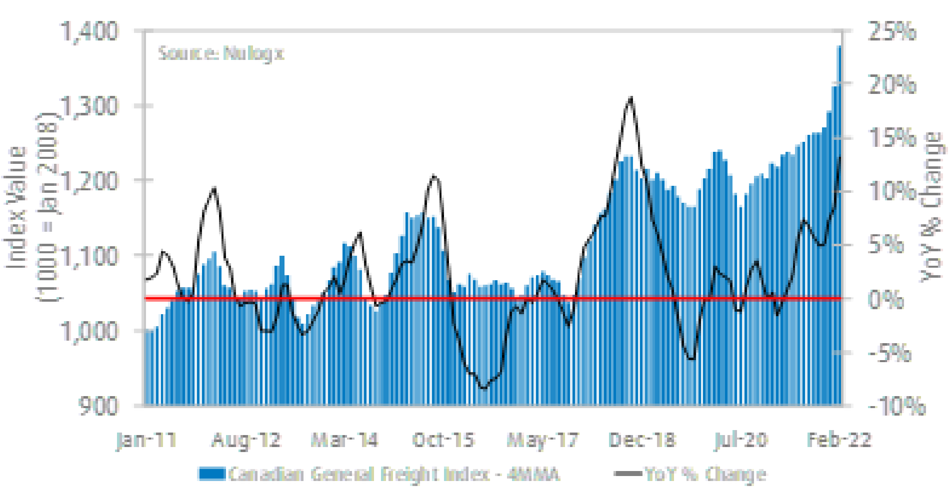
Capacity remained exceptionally tight through March, with the truck-to-load ratio (0.68) up slightly from February (0.63) but still 53% lower than a year earlier.

Ontario Cross Border Truck Traffic



Although the introduction of vaccine mandates followed by protests and border blockades were a headwind to start the year, monthly **truck border crossings** during March exhibited resilience. Crossings during March were 0.3% higher than a year earlier and 5.5% higher than the pre-pandemic level recorded in March 2019. During the 1st quarter, crossings declined 4% from the 4th quarter and 3.1% compared to the pre-pandemic 1st quarter of 2019.

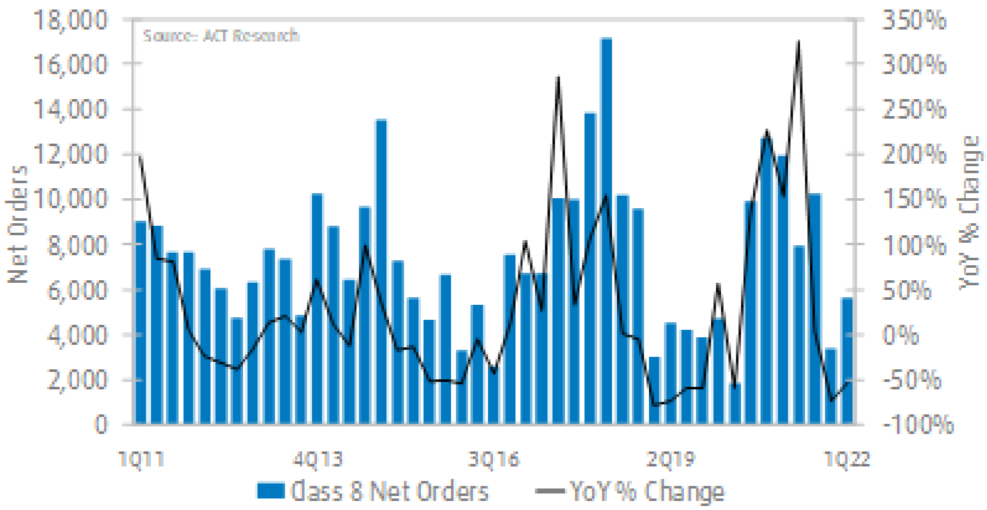
Canadian General Freight Pricing Index



In February, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers reached a decade-plus high. Although base rates are moderately higher than pre-pandemic levels, most of the increase since the pandemic is attributable to rapidly increasing fuel surcharges. Overall, year-over-year shipping costs during February were up 13.2%, more than double Canada's overall inflation rate of 5.8% during the 1st quarter and easily above the full-year 2022 CPI estimate by BMO economists of 6.5%.

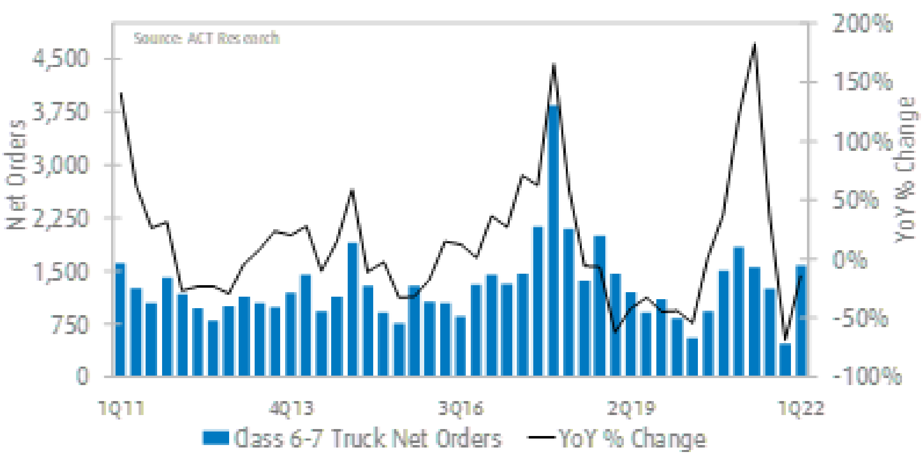
Truck Orders

Canada Class 8 Net Orders



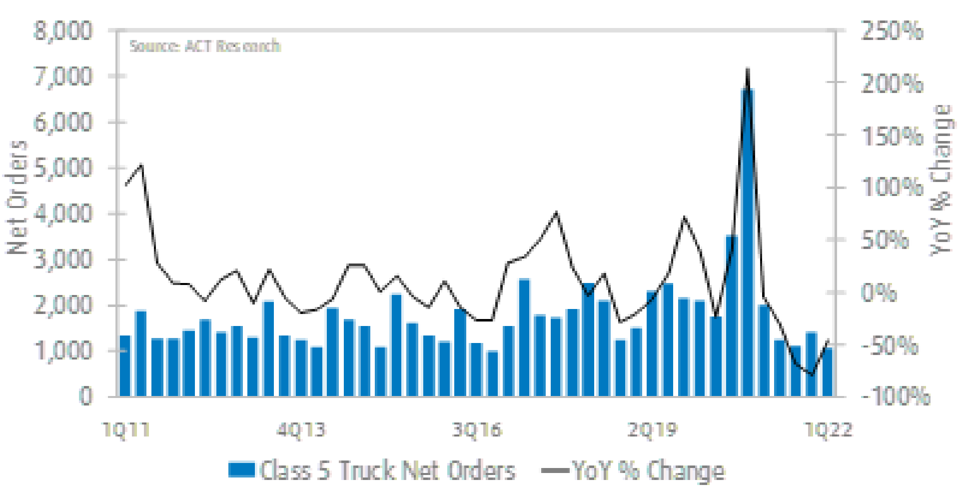
Net new Class 8 orders saw an atypical and welcome uptick during the 1st quarter of 2022. That said, orders remain profoundly negative on a year-over-year basis as OEMs attempt to keep backlog at a manageable level and in line with supply constrained manufacturing capacity. Normalized cancellations as a percentage of the backlog confirm that carrier appetite for capacity remained steady throughout the quarter.

Canada Class 6-7 Truck Net Orders



At the end of last year, the same factors afflicting the Class 8 market also caused a steep contraction in **Class 6-7 truck net orders**. Similarly, this class saw a strong sequential order uptick during the 1st quarter but still fell 14% short of the year-earlier quarter. In the near-to-intermediate term, increased activity in the energy sector should be a tailwind for the severe-duty segment of this class.

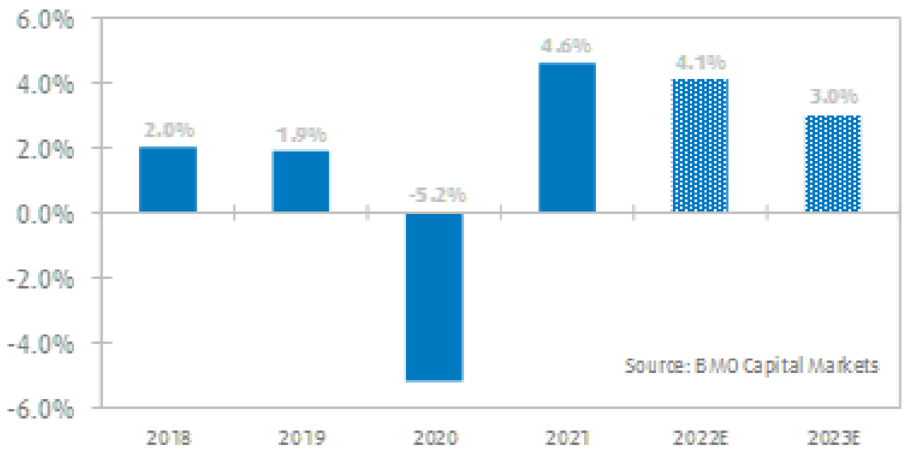
Canada Class 5 Truck Net Orders



In addition to factory supply chain issues that limit available build slots, the **Class 5 truck market** continues to digest record orders at the end of 2020. As such, the Class 5 market bucked the trend of the larger classes and saw a slight downtick in net orders during the 1st quarter. However, the long-term demand outlook remains positive with the usual support of diverse end markets, consistency in vocational sectors, and the durable tailwinds of e-commerce and last-mile delivery.

Macroeconomic Indicators

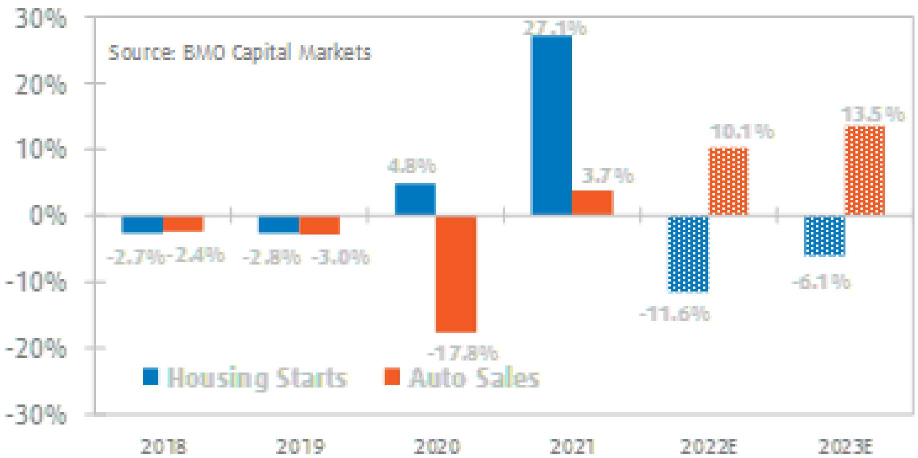
Canada Annual GDP Estimated Y/Y % Change



Canada weathered the latest round of restrictions remarkably well, with **real GDP** likely growing 5.5% annualized in Q1. Relative to the U.S., Canada has two things going for it: more pent-up demand for services given its later easing of COVID restrictions; and high commodity prices, leading to the strongest merchandise trade surplus in 14 years. Growth will also get a modest bump from new spending announced in the federal budget.

BMO's economists estimate Canada's economy will expand 4.1% this year, which would be the best in the G7, before slowing to 3.0% next year as interest rates rise. Oil-rich Alberta should lead the country with 5.6% growth in 2022, as gushing fiscal revenues open the door for tax cuts to help blunt the inflation pain.

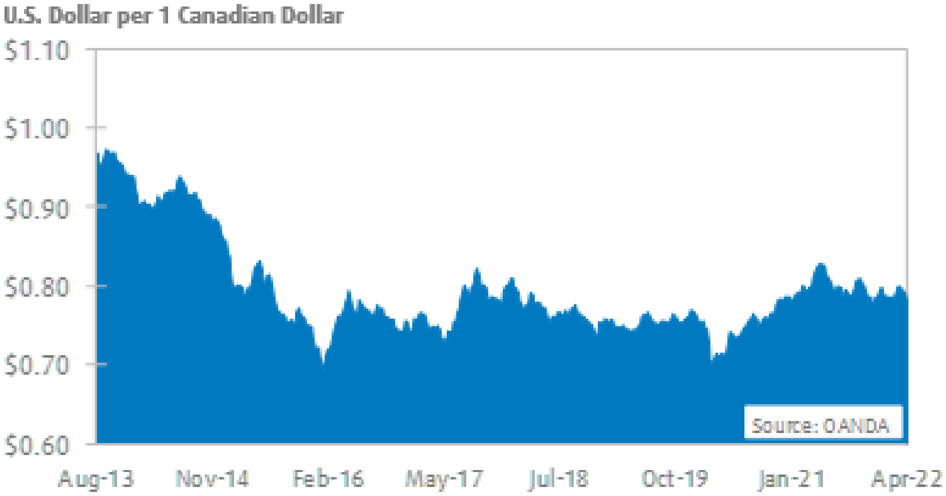
Canadian Annual Housing Starts and Auto Sales Estimated Y/Y % Change



Canadian housing starts held at a robust 246,200 annualized units in March. While down from a year ago, the three- and six-month averages (244k and 252k) are still historically strong. Still, fast-rising mortgage rates are dialing down the heat in housing markets, with the most recent data showing declining sales due to ebbing affordability. BMO Economists expect sales to weaken and eventually fall below pre-pandemic levels while shifting pricing power away from sellers.

Assuming a trend toward normalization of the supply chain, the pent-up demand of well-capitalized consumers should propel the **auto sector** to a pre-pandemic sales pace by the 2nd half of 2022.

U.S. Dollar per 1 Canadian Dollar



The current priority of the Fed is to corral inflation, most likely at the expense of economic growth. The Fed also aims to get policy rates to neutral levels (between 2% and 3%) as fast as possible. With that in mind, BMO's economists expect another 50-point increase in the Fed Funds rate in June, with a potential pivot back to quarter-point moves if inflation rolls over as expected.

Nonetheless, with the BoC expected to keep pace with the Fed, BMO economists expect the Canadian dollar to remain steady through 2023. As of early May, the Canadian dollar was estimated to finish the year at US$0.807 (C$1.24) and US$0.801 (C$1.25) at the end of 2023.

"Voice of the BMO Economics Team"

With the economic recovery in a tug-of-war between re-opening tailwinds, high commodity prices, accelerating inflation, rising interest rates, and persistent supply chain constraints, 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/

Canadian Economy: Onward and Upward – Robert Kavcic, BMO Senior Economist and Director Economics

The Canadian economy is growing at a strong pace, with most industries and segments of the job market fully recovered from the pandemic, and the Bank of Canada now tightening policy. Real GDP is likely to expand 4.1% this year, cooling from the 4.6% pace in 2021, but still running well above potential growth. Meantime, with inflation persistent and well above the Bank of Canada's target, look for a further steady stream of interest rate hikes into 2023.

Regionally, all provinces are expanding, and above-potential growth is expected across the country this year. **British Columbia** looks to post above-average 4.4% growth, as post-flood repair and rebuilding add to solid underlying strength. Regardless of any disaster-related swings in reported GDP, the province looks fundamentally strong.

Alberta, Saskatchewan and Newfoundland & Labrador are also benefitting from the surge in oil prices. We look for WTI oil to average $100 this year, before pulling back to around $85 in 2023, which will provide significant income support to these provinces. Alberta real GDP growth will likely lead the country at 5.6% this year, in part thanks to a rebound in oil production, but also because of broadening strength in consumer activity and housing. Longer term, the broader shift away from fossil fuels will force some adjustment in these regions, but the near-term outlook is solid.

Manitoba is traditionally the most stable economy on the provincial landscape, with a diverse industry providing a cushion. While the drought was a difficult challenge last year, stability remains the norm, with growth expected at 4.2% in 2022. For the Prairies as a whole, this year's crop is not just important for the regional outlook, but also for world food prices, after a brutal drought last year and very tight global grain stocks. A return to a more normal crop could provide a windfall for the sector amid record grain prices, with Saskatchewan also benefitting from surging potash prices.

Ontario's economy entered the pandemic with the strongest growth trends in more than 15 years, but with the largest urban centre and some of the more restrictive COVID-related measures in the country, the expansion was somewhat slower to take hold. But the economy is expanding vigorously now, and service-related businesses, especially within the GTA, look to return to higher levels of activity on a more sustainable basis than during earlier pandemic waves, even as housing activity cools. Real GDP should expand 3.8% this year and 3.0% in 2023, both around the national average. Similarly, **Quebec** is on pace to re-establish itself as a driver of the Canadian economy, although real GDP growth should soften to 3.4% in 2022 after a strong 5.6% bounce last year. The province will face headwinds from higher gas prices and mortgage rates, but a relatively subdued Canadian dollar provides some relief for Central Canada compared to past oil price spikes.

Finally, **Atlantic Canada** is faring well, with growth in the region expected to run above potential this year. As travel flows resume more significantly for the summer 2022 season, the region will stand to benefit. Population flows are also a positive story, as migration from other regions of Canada drives consumer demand and housing.

We're here to help.

Look to us for all your commercial truck and trailer financing needs. Whether you're a dealer, for hire fleet, or an end user customer, we have a team of experts that can help.

Finance Inquiries
Paul DeMarchi
paul.demarchi@bmo.com
289-261-6001

Industry Research Inquires
Michael Zimm, CFA
michael.zimm@bmo.com