Industry Update

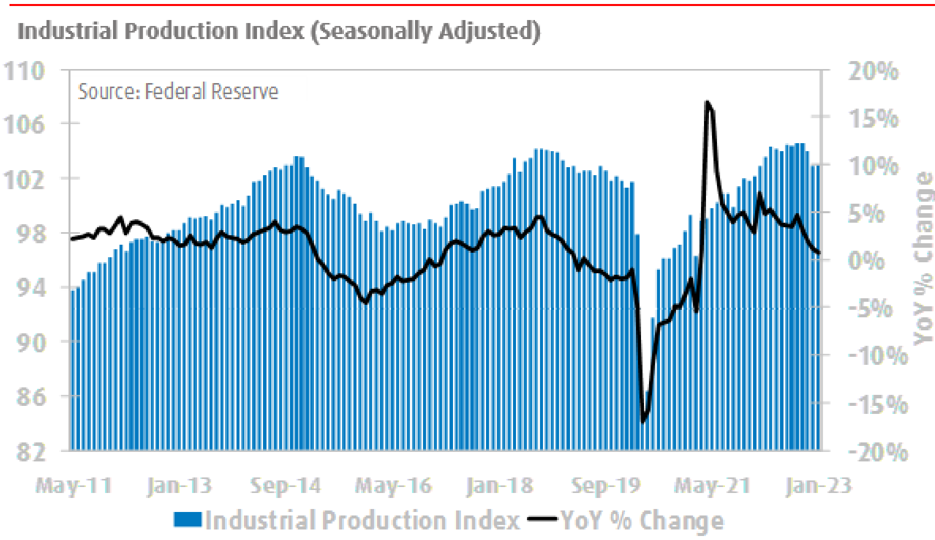
# Truck Transportation

## Key Developments

- According to the **National Retail Federation (NRF),** 2022 holiday sales are expected to increase between 6% to 8%, which is slower than the record 14% increase last year but well above the 10-year average growth of 4.9%. Online sales continue to increase at double-digit, year-over-year levels, with the NRF forecasting online and other non-store sales to increase by 10% to 12%.
- A recent study of highway charging requirements conducted by **National Grid Plc** found that by 2030, electrifying a typical highway gas station will require as much power just for electrified passenger vehicles as a professional sports stadium. As more electric trucks hit the road, the projected power needs for a big truck stop by 2035 will equal that of a small town.
- Data from the **FMCSA Drug and Alcohol Clearinghouse** show that as of November 1st, 73% of 156,510 drivers with at least one violation remain in "prohibited status." Further, 76% of those in prohibited status (86,501) still need to start the return-to-duty (RTD) process.
- Be sure to check out the latest perspectives from BMO economists on the influence of inflation and Fed rate increases on the U.S. macro outlook (page 8).

## Industry Fundamentals

Although the pullback in fuel prices has benefitted all carriers, small-medium fleets, in particular, that primarily live in the spot market and purchase Diesel at retail, have been thrown a desperately needed lifeline. However, that lifeline has also allowed the capacity of marginally viable operators to remain in the game longer and has yet to be balanced with any freight tailwinds. Likewise, unless there are notable changes to capacity and/or freight growth, the supply/demand equation will continue to be in the shippers' favor well into the year. On a more positive note, despite a recent shift in bond market expectations of higher interest rates for longer, the consensus macro view has migrated from a hard landing to a soft landing (slow or no growth but no recession) or, at worst, a "shallow/rolling sector" recession. BMO's economists are in that group and have all but taken the potential for a hard landing (15% chance, down from a prior expectation of 25%) off the table. Still, as of late February, a shallow recession (50% chance) sometime this year remains the base case.

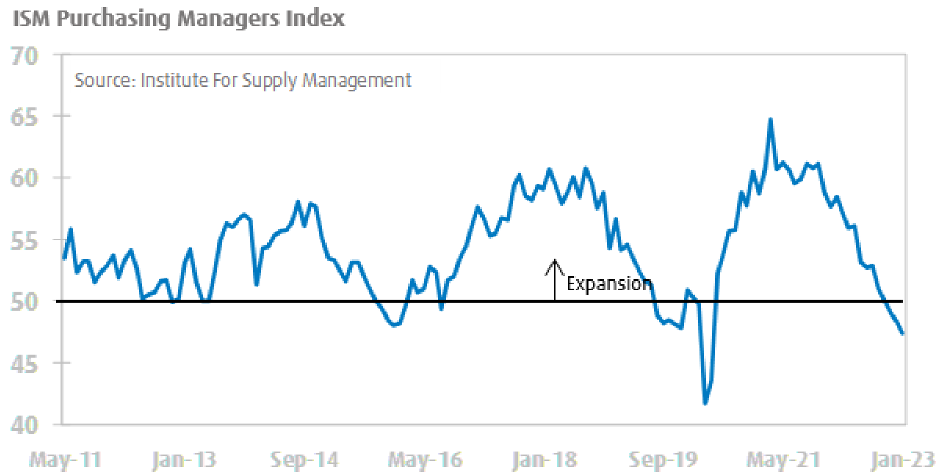



**U.S. industrial production** was unchanged in January, which fell short of expectations. However, a closer look reveals the miss was entirely attributable to warm weather and a -9.9% drop in utilities. Excluding utilities, output was up by just over 1.0%.

Manufacturing was behind most of the strength with the biggest monthly gain (+1.0%) since February 2022 and was broad-based, with non-durables (+1.1%), durables (+0.8%), and other manufacturing (+2.2%) all recording gains. Further, manufacturing **capacity utilization** jumped 0.6 percentage points to 77.7%, the first increase since October, which could stall the deflationary trend in goods prices.

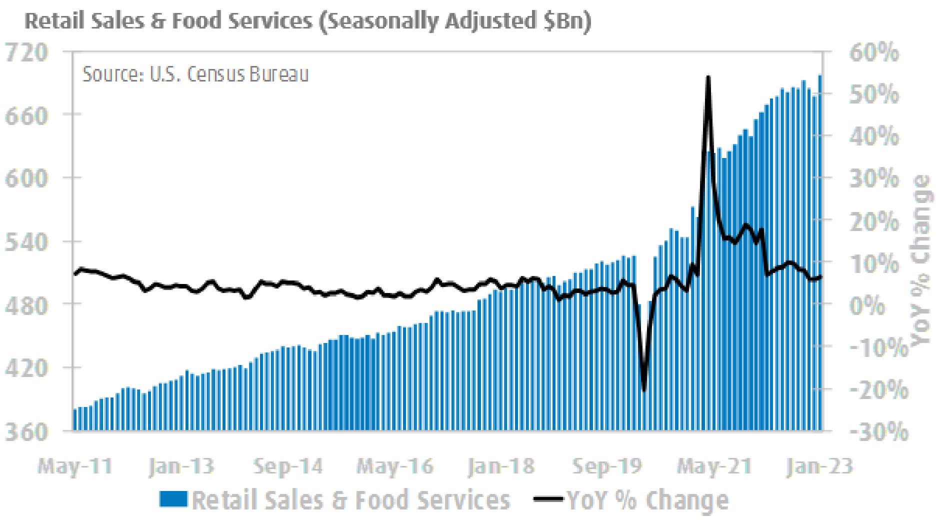
BMO Transportation Finance

## Macroeconomic Indicators



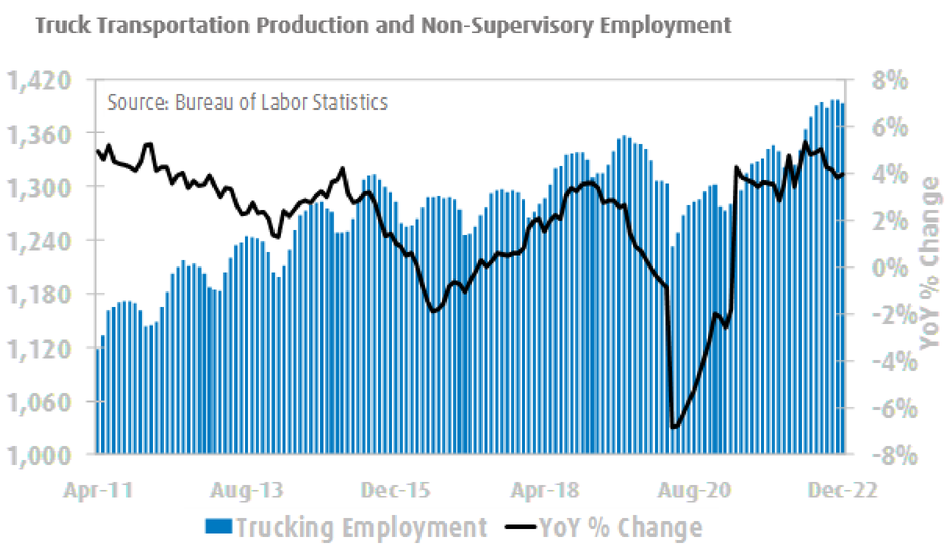

The **Purchasing Managers' Index (PMI)** is a sentiment measure of near-term business conditions in the manufacturing sector. In January, the index fell yet again, down one point to 47.4. That marks the 7th drop in the past eight months as higher borrowing costs continue to undercut demand for goods. Aside from the sharp drop at the onset of the pandemic in 2020, the index currently sits at the lowest level since 2009. New orders (-2.6 pts to 42.5) and production (-0.6 pts to 48.0) continued to descend sharply as they pulled away from the above-60 readings seen through much of 2021.

The past relationship between the PMI and GDP suggests that the January PMI corresponds to an annualized GDP growth rate of -0.5%, well below BMO Economists' current estimate of +0.5% for the first quarter.




Consumers—the biggest engine of the U.S. economy—are still holding up. Solid job and wage growth are shoring up households, despite still-high inflation, tightening financial conditions, and overall decelerating macro trends.

The 3.0% jump in **U.S. retail sales** during January was the largest monthly increase since March 2021, or since 2001 when excluding the pandemic. (Note that sales declined 16.2% on a not seasonally adjusted basis, but that is the smallest January decline in at least 30 years, outside the pandemic era.) The gains were broad-based, with motor vehicles and parts +5.9%, furniture +4.4%, and electronics +3.5%. As another sign of resilient consumer confidence, dining out surged +7.2% after a flat December and a 0.2% dip in November.

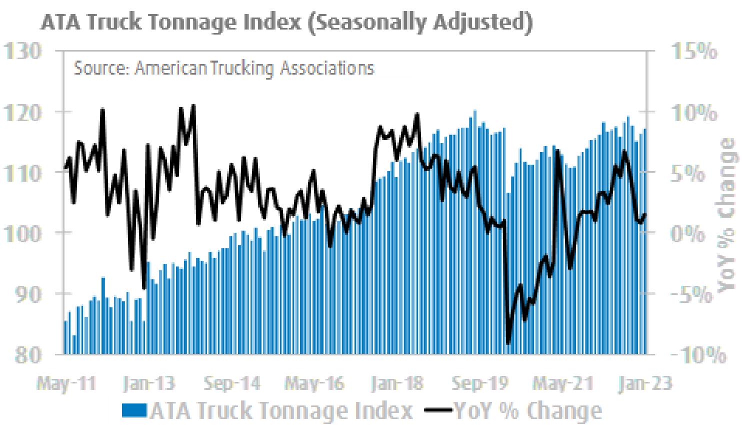


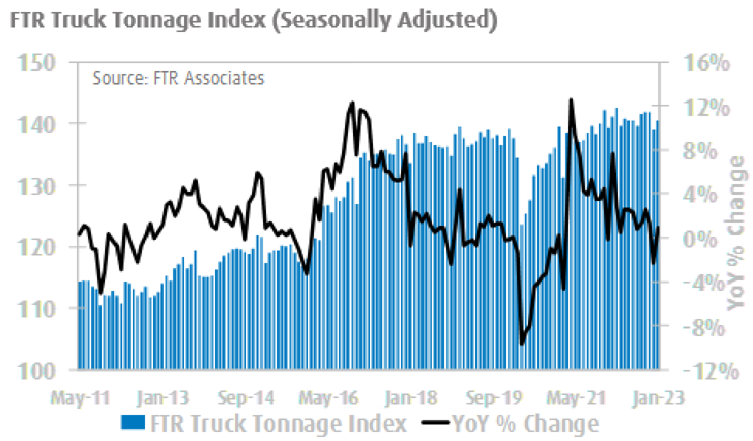

Employment in the truck transportation industry has plateaued after reaching an all-time high in November. **Production and non-supervisory employment** during December dipped slightly from the record high by -0.3% (~4,300 jobs) month-over-month but was up 4.0% (~53,300 jobs) year-over-year.

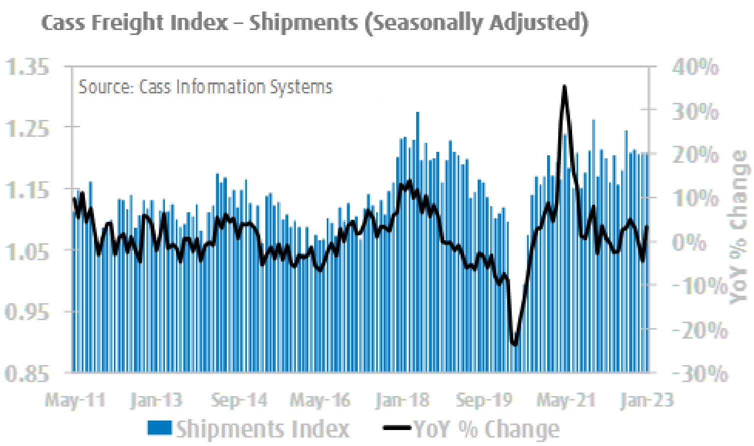
The growth of the driver pool over the past couple of years has likely slowed as the incentive of solid earnings potential has dissipated with slowing freight growth and the decline in freight rates.

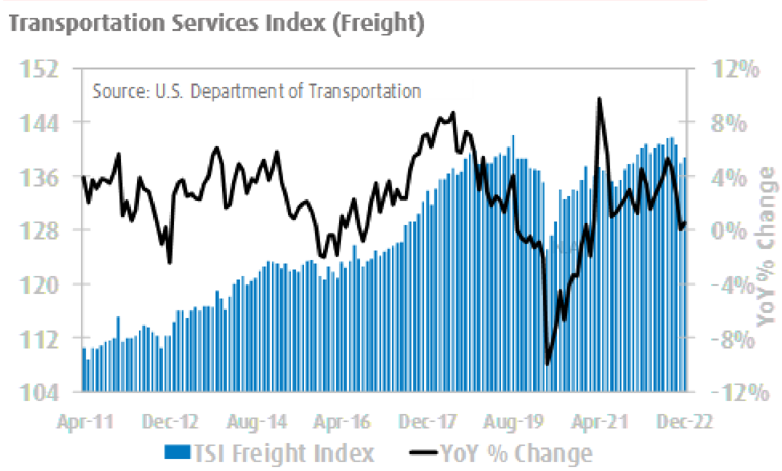
## Freight Indicators

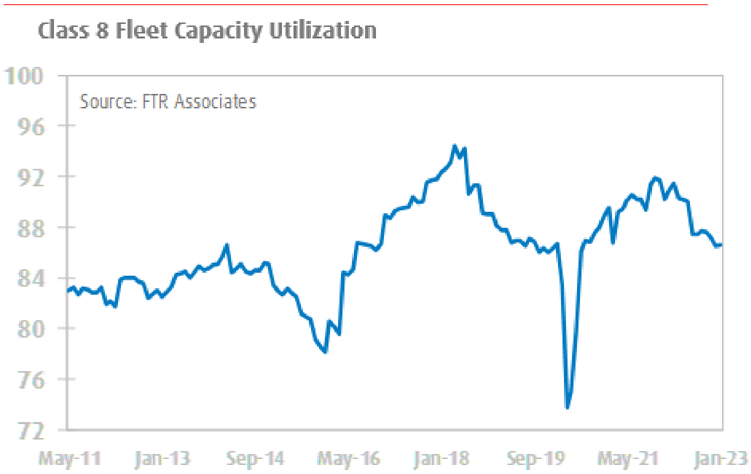
The year-long and nearly relentless compression in spot rates (and contract rates to a lesser degree) clearly reflects an environment of decelerating freight growth, gradually increasing capacity, and deteriorating fleet utilization. The near-term outlook for freight is mixed at best if for no better reasons than typical early calendar year pauses in consumer retail and corporate capital spending, bad weather, etc. Tightening monetary policy also weighs on freight-heavy sectors such as global trade, consumer spending on durable goods, residential construction starts, and manufacturing activity. More positively, medium-term offsets to freight headwinds include improving seasonality, normalizing inventories, a resilient employment landscape, healthy consumer and corporate balance sheets, improving consumer and homebuilder sentiment, robust energy production, a near-peak number of homes under construction, and a still incomplete replenishment of auto inventories.



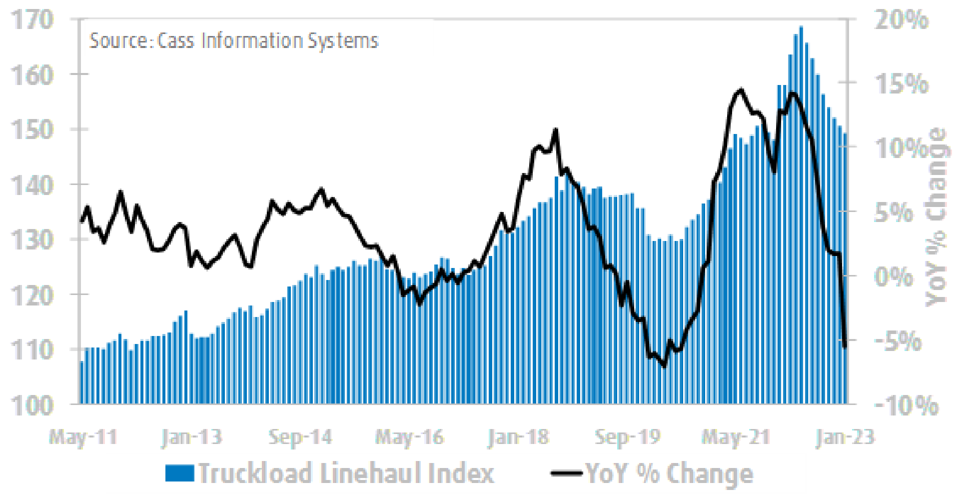




- The **ATA For-Hire Truck Tonnage Index** (primarily contract freight) increased 1.4% (month-over-month) during January after rising 1.2% in December. Still, the index remains 2.1% below the January 2020 pre-Pandemic level.
- The **FTR Truck Tonnage Index** has been mostly flat throughout the past year but remains near an all-time high.
- The **Cass Freight Shipment Index** (all modes) has been relatively flat at high levels over the past six months through January.
- The **TSI Freight Index** reached a post-pandemic high in September but weakened for the remainder of the year.
- The **FTR Class 8 Capacity Utilization Index** has retreated to a nearly 2-year low but is essentially in line with its long-term average.

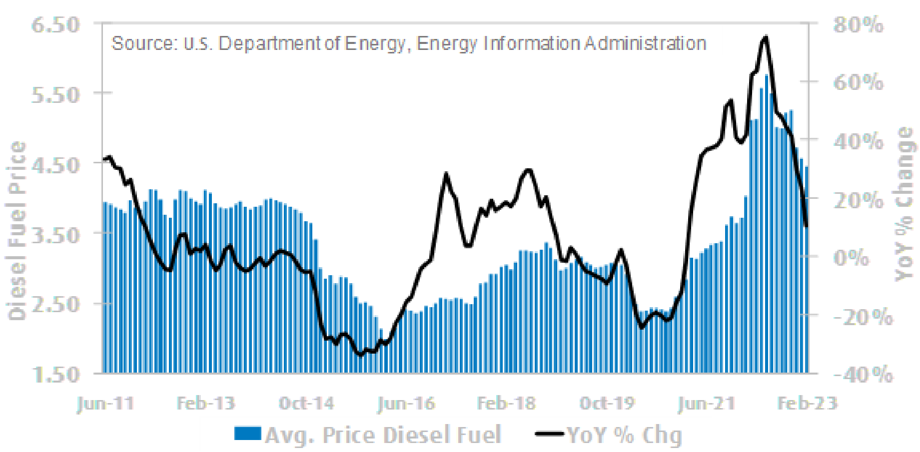
## Revenue And Expense Indicators

### Cass Truckload Linehaul Index




The **Cass Truckload Linehaul Index,** which reached an all-time high last May, reflects a mix of base rate pricing (excluding fuel and other surcharges) in the dry van contract and spot freight markets. Due to the periodic nature of the contract pricing cycle, there is typically a five or six-month lag from when the contract market reflects earlier trends in spot freight pricing. With spot rates having seen nearly relentless pressure since March of last year, a softening of contract rates is also well underway but still has some catching up.

### On-Highway Diesel Fuel Price (Monthly Average $/Gallon)




Since the invasion of Ukraine, **Diesel** fuel prices have been on a high-altitude roller-coaster. More recently, however, mirroring a decline in WTI crude prices, the average weekly Diesel price of $4.38/gallon in late-February had declined $1.37 (-25%) from an all-time high last June.

According to the most recent forecast from the U.S. Energy Information Administration (EIA), WTI crude and Diesel prices will continue to drift lower throughout the remainder of 2023 and through at least the first half of 2024.

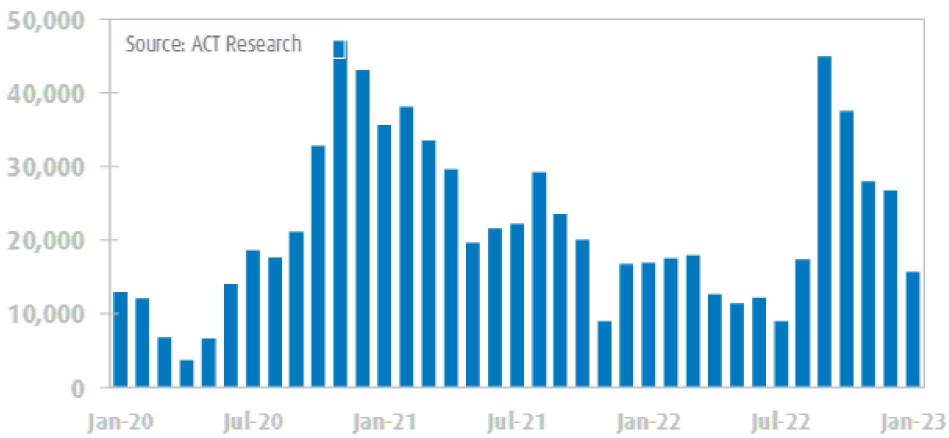
### Average New Heavy Duty and Used Truck (All Types) Prices ($)


With an improved but still somewhat constrained supply chain, the **average price of new heavy-duty trucks** sold by Rush Enterprises during the 4th quarter saw a second consecutive albeit relatively modest decline. Heavy-duty ASPs decreased by $2,134 (-1.3%) from the 3rd quarter but were still up $5,253 (+3.4%) from the year-earlier quarter.

The record imbalance of supply and demand in the used truck market is well along the process of normalizing. The **average price of all used trucks** sold by Rush Enterprises during the 4th quarter declined -3% from the 3rd quarter and -17% from the peak 2nd quarter but remained slightly above the year-earlier quarter (+3% y/y). That said, Rush has taken a strategically defensive position by holding below-average used truck inventories, which may be masking more severe depreciation rates in the broader used market.

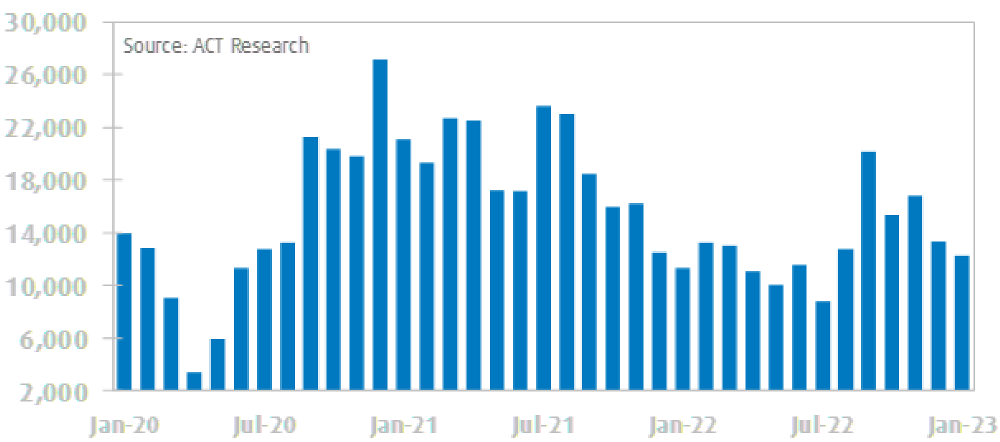
## Truck and Trailer Orders

### U.S. Class 8 Net Truck Orders



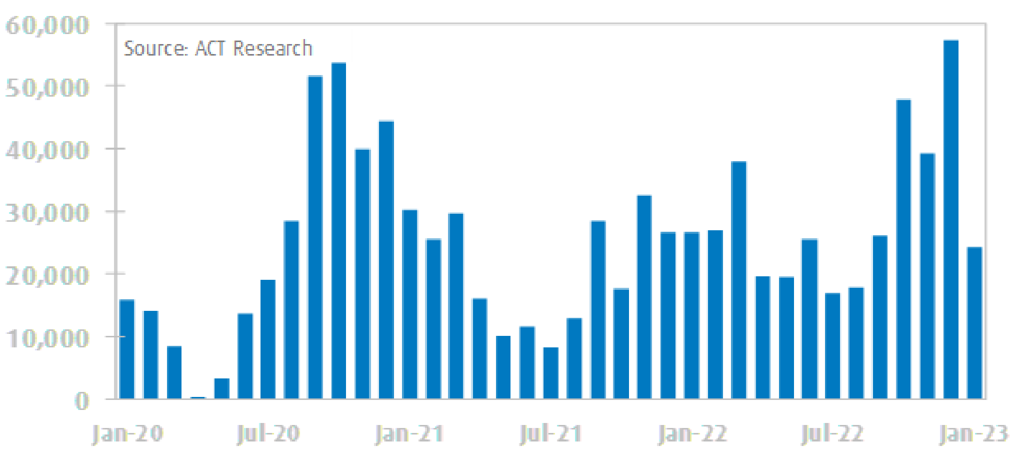

As expected, the surge in **U.S. Class 8 net truck orders** during the 2nd half of last year has dissipated, with pent-up demand for 2023 build slots now booked and allocated for delivery as far out as the 4th quarter. During January, net truck orders declined for the 4th consecutive month and were approximately 1/3 of the most recent monthly peak during September and 8% lower than a year earlier. Based on prior seasonal trends and the ferocity of the most recent surge, the near-term order pattern will likely remain at or below replacement into mid-year.

### U.S. Class 5-7 Net Truck Orders




**Medium-duty 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 residential construction activity takes a toll. More positively, cancellations remain relatively benign at 1.3% of backlog, well below the 2.5% pre-pandemic average. The longer-term view remains stable, featuring the usual support of diverse end markets, the secular trend toward shorter hauls, and the durable tailwinds of e-commerce and last-mile delivery.

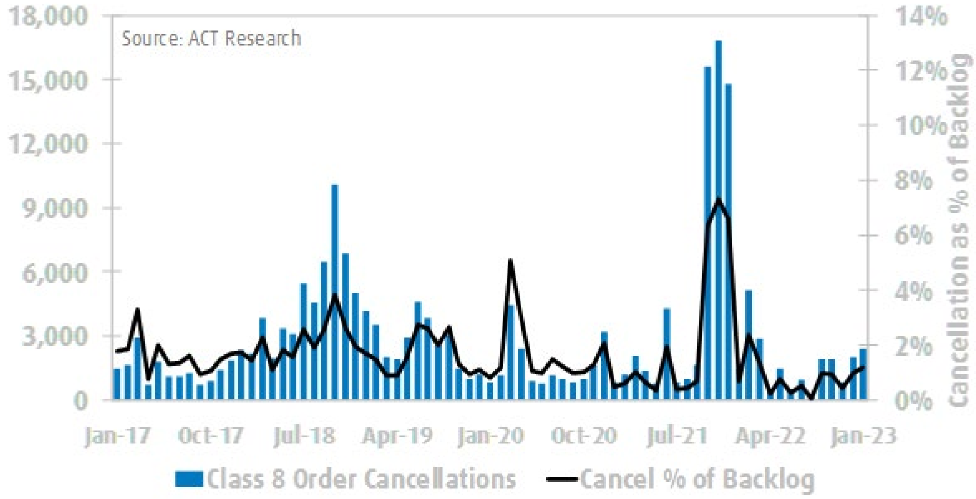
### U.S. Net Trailer Orders




Similar to the heavy and medium-duty OEMs, trailer manufacturers only recently had been willing to open build slots and book orders for the remainder of 2023. And given the combination of improving supply chain visibility, pent-up demand, and typical seasonal fall/winter order strength, **net trailer orders** during the 4th quarter surged to the highest totals in recent memory. That said, orders during January saw a significant seasonal correction while retracing 58% from December, although the monthly cancelation rate of 1.8% remains slightly below the long-run average of 2%.

## Other Equipment Indicators

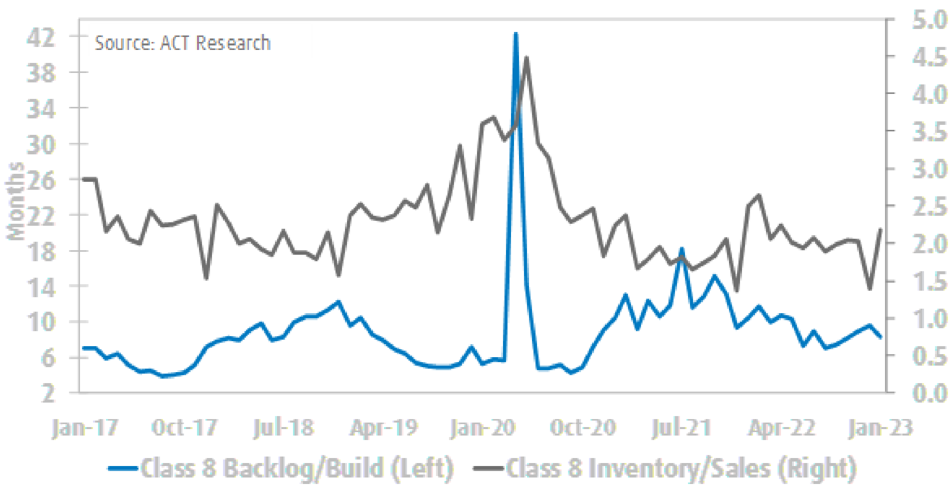
**U.S. Class 8 Order Cancellations**




Carrier appetite for capacity appears intact given the recent surge in orders and a trailing 6-month average monthly cancelation rate (as % of backlog) of 0.8% compared to the pre-pandemic long-run average of 2.3%.

That said, given sustained stress on cash flows in the spot market and growing concerns about the durability of the freight market, the pace of cancellations is likely to trend higher. Still, following two years of limited availability, and despite a two-month modest uptrend in cancellations from below-average levels, most fleets are not expected to give up their place in line easily.

**U.S. Class 8 Backlog/Build vs. Inventory/Sales**




OEMs have been managing the intake of orders with the intent of gradually reducing the Class 8 manufacturing backlog, which had steadily declined for nearly a year until the order surge late last year. Further, the monthly build rate has significantly improved since last year (see below). As a result, the **heavy-duty backlog-to-build** ratio has been more than halved over the past 18-months. But at eight months in January, the backlog is still above the long-run pre-pandemic average of six months.

With an improvement in builds met with steady demand, Class 8 inventories at the end of January were hovering in the middle of a 12-month range. Similarly, the **heavy-duty inventory-to-sales** ratio was squarely in the middle of the long-term average range of 2-2 ½ months.

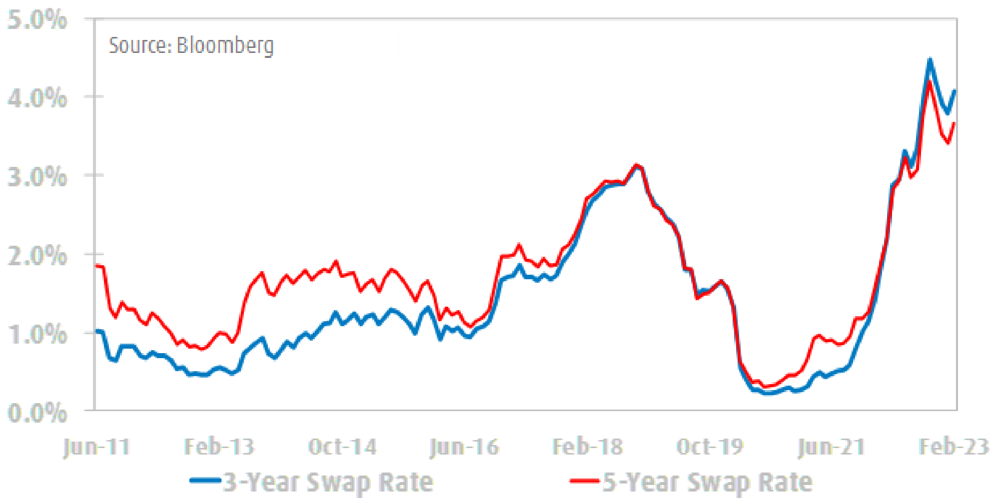
**U.S. Class 8 Retail Sales vs Builds**


Including a typically sharp early calendar downturn during January, the above replacement pace of **U.S. Class 8 unit retail sales** over the past nine months (277k annualized rate from May through January) is a clear sign that OEMs have made significant progress with their supply chains while also demonstrating that plenty of carriers have not lost their appetite for capacity.

**Class 8 production** has improved significantly from a monthly average of 18,000 units in 2021 to 21,000 during the first half of last year and, more recently, an average of nearly 23,300 during the 2nd half through January.

## Other Business Indicators

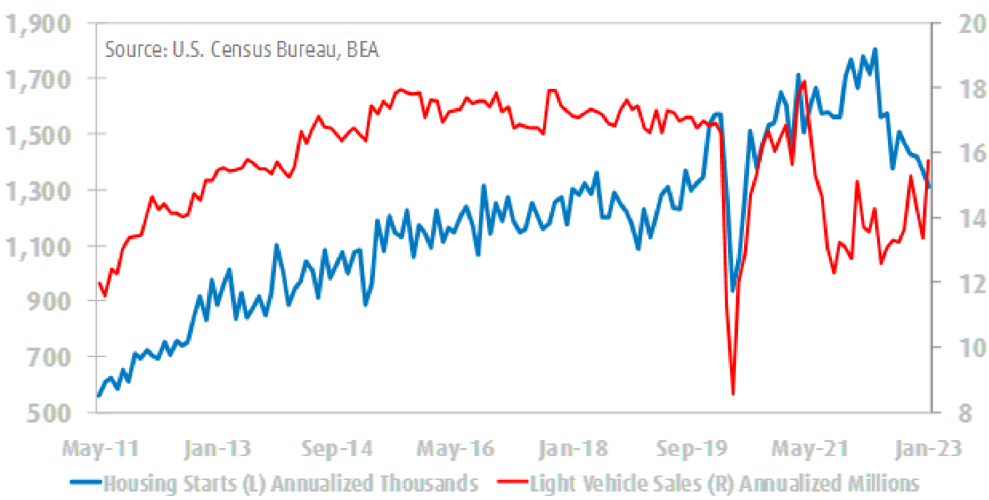
### Interest Rates: 3 & 5 Year Interest Rate Swap Pricing




**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 retreating steadily from the multi-year high hit last fall, the entire yield curve has again reversed course and shifted higher thanks to the most recent employment and inflation data being hotter than expected, which also now has the futures markets expecting a higher terminal Fed Funds rate of 5.25-5.50%. As of late February, BMO's economists had also increased their forecast for the Fed Funds rate to peak at a slightly lower 5-5.25%, but higher than a prior estimate of 4.75-5%.

### U.S. Housing Starts & Light Vehicle Sales (Seasonally Adjusted)




Despite milder weather, **housing starts** in January dropped 4.5% to 1.31 million annually, the fifth straight monthly drop and the lowest level since June 2020. Construction of single-family homes fell 4.3% to a two-month low, while volatile multi-units dropped 4.9%. Starts plunged in the Northeast and the Midwest, while the South and the West rebounded.

Given recent improvements in production and inventory data, supply constraints of components within the auto sector have eased significantly. Importantly, pent-up demand has remained intact. Annualized **U.S. sales of light vehicles** of 15.7 million were the highest since May 2021 but were still down 7% from January 2020, immediately before the pandemic.

### U.S. Business Inventories/Sales (Seasonally Adjusted)


The **total business Inventories-to-sales ratio** bottomed at an all-time low a year ago but has now recovered to the pre-pandemic long-term average. A closer look reveals that manufacturing (up) and general merchandise inventories (down) have progressed toward normalization. Inventories of motor vehicles and parts have also made progress toward replenishment but remain somewhat below historical norms.

## "Voice of the BMO Economics Team"

With macro conditions supported by solid employment & wage growth but challenged by stubbornly sticky high inflation in services, rising interest rates, and cracks in the housing market, we thought it would be helpful to check in on the BMO Economics Team's latest near-term outlook for the U.S. economy.

For more: https://economics.bmo.com/en/

**What Are Americans Still Buying?**
***Sal Guatieri, Senior Economist and Director February 24th, 2023***

Despite rising loan costs and high inflation, U.S. consumers turned on the jets in January, stoked by unusually temperate weather and a spike in after-tax income. The 1.1% sprint in real spending, following declines the prior two months, has consumers on track for a roughly 3% annualized gain in Q1, double the prior pace. Yet, given that special factors (weather, seasonal adjustment) likely played some role, it's hard to take the pulse of underlying demand. A look at what people are still buying (or not) might shed some light on the outlook for both spending and the economy. We tracked spending over the past six months to iron out the September-October gains that were juiced by early holiday discounting, the November-December losses that marked some payback, and the January spike that was partly due to warmer weather. On this basis, real spending looks to have picked up moderately from an earlier downshift. Here is the breakdown by key categories:

*Still going strong:*
- **Services:** notably hotel stays (travel related), personal care, health care (doctor and dentist visits are still going strong amid catch up from the pandemic), air travel, and recreation (such as sports and live entertainment)
- **Public transportation** including taxis and ride-sharing services (reflecting the return to office)

*Rising more modestly:*
- **Goods:** notably furniture and appliances (basically, anything housing-related)
- **Food services:** prior to the January spike, people were cutting back on restaurant visits, which is likely a sign of waning discretionary demand by lower-income groups that have largely exhausted excess savings
- Laundry services and clothing, both supported by the return to office
- **Autos:** seeing through part of the January spike and noting that preliminary data suggest new vehicle sales fell by one million in February

*Stalled:*
- **gasoline**, oddly, despite lower prices and a thirst for travel
- **recreational goods and vehicles**, which were hot in the early days of the pandemic

*Cutting back:*
- **groceries:** notably, egg consumption has plunged due to soaring prices and worsening shortages due to avian flu ravaging the supply of hens
- **household supplies, personal care products**, and (surprisingly) **jewelry** (given that upper-income earners still have substantial excess savings)

What can we take away from this mix of strength in some areas but weakness in others? Three things stand out. **First**, consumers remain keen on buying services, especially anything related to travel or the return to office. And, there is still some "revenge" spending for recreational services. **Second**, there is less pent-up demand for goods, especially the recreational kind. And **third**, households are cutting back on things that have become much more expensive, such as food.

## "Voice of the BMO Economics Team" Continued

**U.S. Economy: What Are Americans Still Buying? (cont.)**

The message is that **American consumers continue to chug along on the back of previously deferred services in the pandemic**. Excess savings and sturdy job markets are taking the sting out of the rising cost of credit and most other items. So long as two-thirds of the economy continues to plod forward, it should remain on course for either a mild downturn or even a soft landing. But its ultimate fate will be decided by the path for inflation and the Fed.

**U.S. Consumer and Prices Ring In The New Year**
***Sal Guatieri, Senior Economist and Director February 24th, 2023***

Wall-to-wall strength in both consumer spending and prices to start the year will pressure the Fed to do more than it really wants to. Personal spending jumped 1.8% in January, more than expected, after slipping in December. Real spending rose 1.1% following back-to-back declines of 0.3% and is now up 1.9% annualized in the past three months. Assuming some payback in February amid a return to more seasonal temperatures, consumer spending should rise around 3% annualized in Q1. This suggests some upside risk to our GDP growth call of 0.5%, though this assumes a hefty inventory drawdown.

The spending gains in January were widespread, with stronger demand for autos and recreational goods complementing a pickup in services. Note, that preliminary data point to a partial pullback in new vehicle sales in February.

Spending was supported by a 0.6% rise in personal income, which was lighter than expected but reflected strength in work hours and wages. The saving rate, which was revised up sharply, climbed further to 4.7% from 4.5% in December (3.4% previously reported). That's up from a near record low of 2.7% last summer, and indicates that households are drawing down excess savings at a slower rate than before, likely due to recession concerns.

The biggest surprise is that prices jumped 0.6%, lifting the yearly rate to 5.4%. And all of that net increase was in core prices, which rose 0.6% after an upwardly-revised 0.4% advance in December. Increases were widespread across goods and services. The sharp rise nudged the yearly core rate up to 4.7%, which is where the 3-month annualized rate is sitting. Powell's 'supercore' metric (services ex energy and housing) also jumped 0.6%. This hoisted the yearly rate to 4.6% from 4.2%, a tick above the past year average. That basically means the Fed has made zero progress in tamping down labor market pressures that are keeping services inflation sticky. Worse still, the 3-month annualized rate for supercore is at 5.4%, suggesting an upward bias to the yearly rate even with favorable comparables.

**Bottom Line:** The economy might avoid a recession for another quarter or longer, but not if the Fed has to move much more aggressively, which, after today's heated report, could well be the case. We'll see if demand and inflation cool off in February...if not, the Fed will come out swinging.

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