BMO | Transportation Finance

Winter 2022

Industry Update

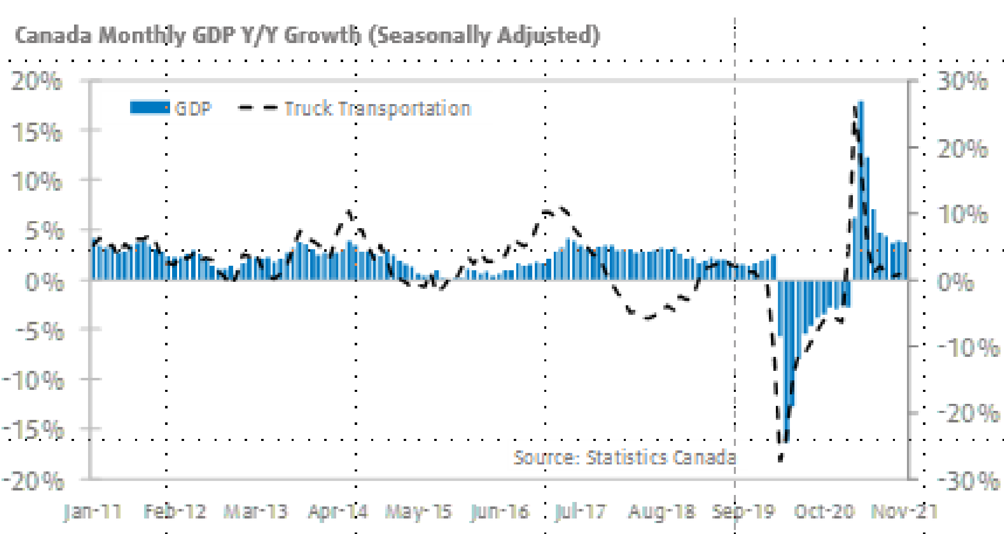
Canada Truck Transportation

Key Developments

- Recent data from **Trucking HR Canada** and **Statistics Canada** show that the trucking industry's jobs vacancy rate hit new record highs, even before the impact of domestic and border vaccine mandates. The vacancy rate in truck transportation hit 8 percent in the third quarter of 2021, which was the second-highest industry vacancy rate behind accommodations and food services. The number of openings for truck drivers increased to a record 22,990, representing a 20-percent surge over the second quarter of 2021.
- Following a recent federal supply chain summit, the **Canadian Trucking Alliance (CTA)** called for increased government program support to alleviate the growing truck driver shortage. The proposals call for "known employers" to tap into immigration channels, increased funding for training, and a streamlined application process for Labor Market Impact Assessments needed to access the Temporary Foreign Worker Program.
- According to Loadlink Technologies, **Canada's spot market** closed 2021 on a record high note, with December load volumes soaring 120% year over year and up 20% from a record November.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

Despite the expectation of an Omicron "cold snap" during the first quarter, GDP growth should rebound as the year progresses, with 2022 in its entirety finishing comfortably above long-term potential at +4.0%. While BMO economists are now forecasting rate hikes totaling 125bps by the BoC this year (up from a prior forecast of 100bp), the "glass half full" outlook is underpinned by easing virus restrictions, supply-chain networks gradually improving, and inflation beginning to roll over in the Spring. The vaccine requirement (and protests) for cross-border truck drivers will be a short-to-medium term cost and freight headwind. However, cooling yet still robust demand for housing, positive employment and income trends, and sustained strength in commodity prices should offer much-needed freight tailwinds as 2022 unfolds.



Despite flooding in British Columbia, **real GDP** posted better than expected gains late in 2021, rising 0.6% month-on-month in November. However, given the onset of Omicron, the early read on December was roughly flat. Nonetheless, monthly overall economic output during November recovered for the first time to its pre-pandemic (February 2020) level. In part, the underlying strength reflected another stage of reopening, with hotels & restaurants jumping 3.4% and arts, entertainment & recreation surging 5.4%.

While well off the pandemic bottom and slightly above year-earlier levels, **truck transportation** sector activity remains 5.4% below where it was in the same month in 2019.

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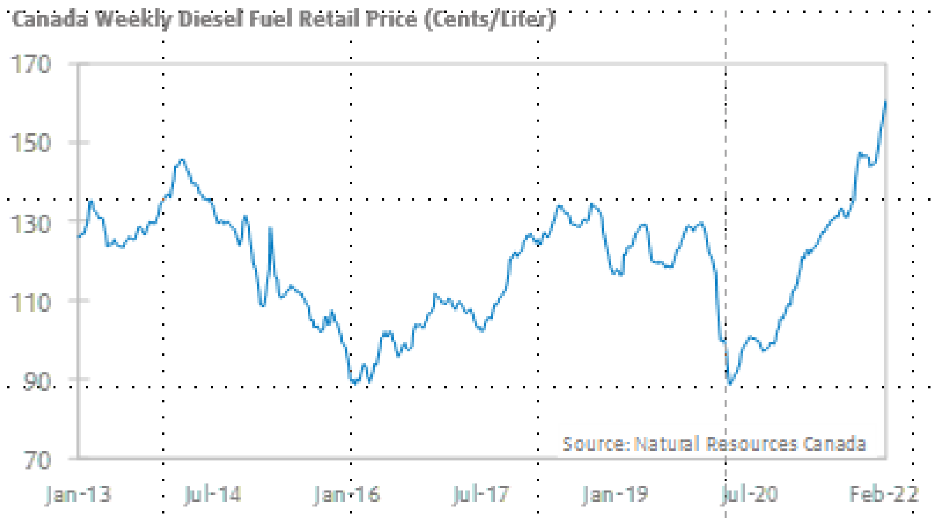
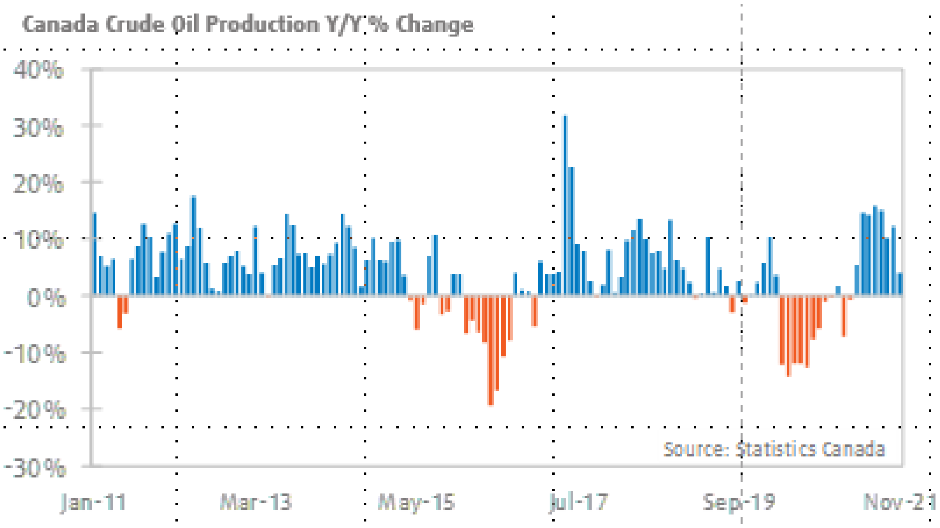
Trucking Business Influencers



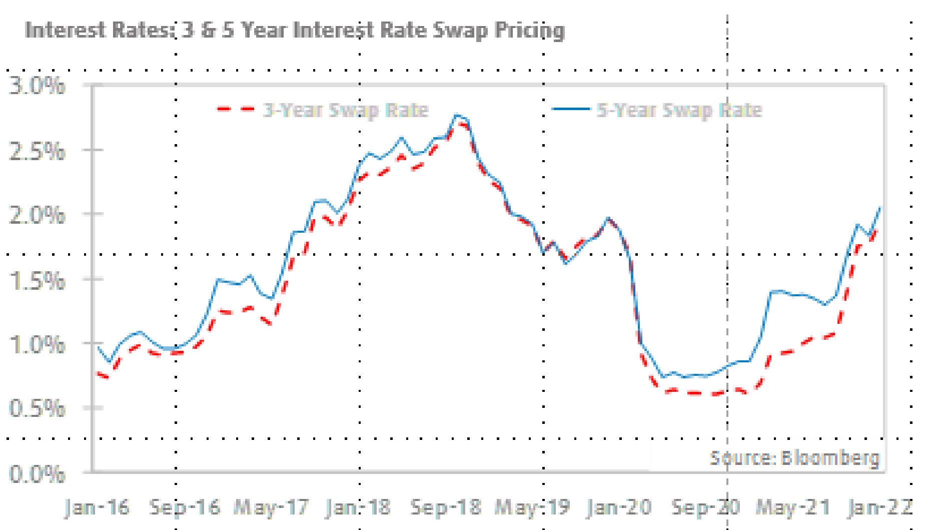
Retail Diesel fuel prices across Canada have been on an unrelenting uptrend and recently reached a record high. As of early February, the average weekly Diesel price of 160 cents/liter was up 46 cents (+40.0%) since a year earlier and nearly double from the early-pandemic bottom.

The current BMO outlook suggests that crude prices will remain elevated (WTI averaging $76.00 in 2022 and $77.50 in 2023) for the foreseeable future as increasing demand is somewhat offset by new supply creeping into the market.



Crude oil production across Canada saw year-over-year growth throughout the Autumn as maintenance completed in September enabled operators to increase production to the highest level since December 2020. Further, given the recent increase in crude prices, data from Baker Hughes shows the active oil rig count in Canada continued to accelerate through January and is nearing the pre-pandemic peak.

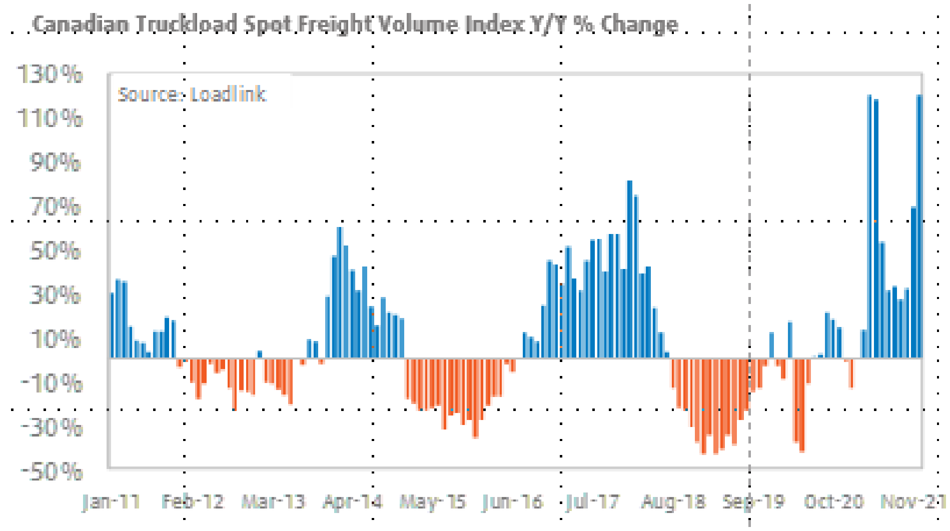
Longer-term, the big questions for crude oil production will be how the demand curve evolves due to climate change policies and the trend towards ESG-based investment evaluation and, likewise, fossil fuel divestments.



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.

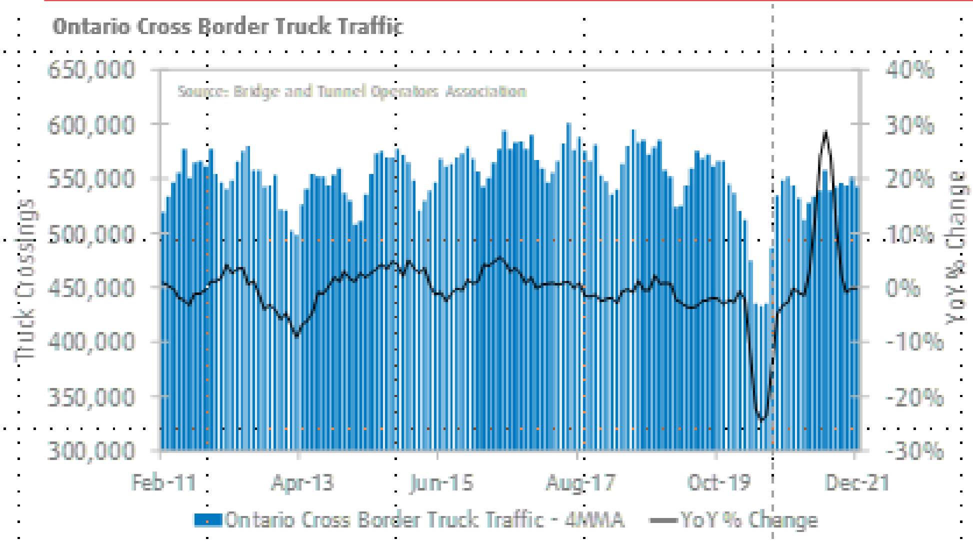
Short-term bond yields have bolted higher as the Bank of Canada and the Fed have signaled a decidedly more hawkish stance in response to multi-decade high inflation. As such, BMO's economists recently raised their expectations for rate increases by the BoC from a total of 100 basis points to 125 during 2022.

Freight Indicators

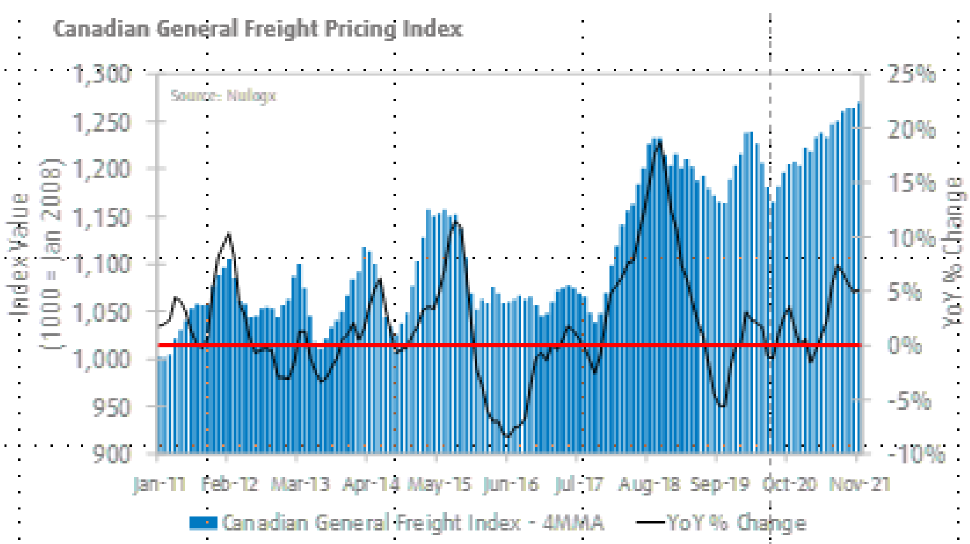


Despite supply chain issues and possibly aided by pre-emptive measures before cross-border driver vaccine mandates, monthly **truckload spot freight volume** increased for six consecutive months in the second half of the year, with December being the best month ever. Compared to last December, volumes increased by a staggering 120 percent while surpassing November's record month by 20 percent.

Capacity remained exceptionally tight during December, with the truck-to-load ratio below two for the second consecutive month. The ratio for December was 1.21 available trucks for every load posted, down 32 percent from 1.79 in November and 56 percent lower compared to a ratio of 2.75 in December 2020.



Although the January vaccine mandates for truck drivers on both sides of the border will undoubtedly be a headwind for near-to-medium term crossings data, monthly **truck border crossings** through December had begun to exhibit resilience. Crossings during December were 1.6% higher than a year earlier and 6.6% higher than the pre-pandemic level recorded in December 2019. During the 4th quarter, crossings grew 1% from the 3rd quarter and 0.8% compared to the pre-pandemic 4th quarter of 2019. Despite supply chain issues, particularly related to the auto industry, truck crossings during 2021 increased 7.6% compared to 2020 but were 2.6% lower than in 2019.



In November, 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 during 2021 was attributable to rapidly increasing fuel surcharges. Overall, year-over-year shipping costs during November were up 5.1%, outpacing Canada's overall inflation rate of 4.7%, and well above the full-year 2021 CPI of 3.4%.

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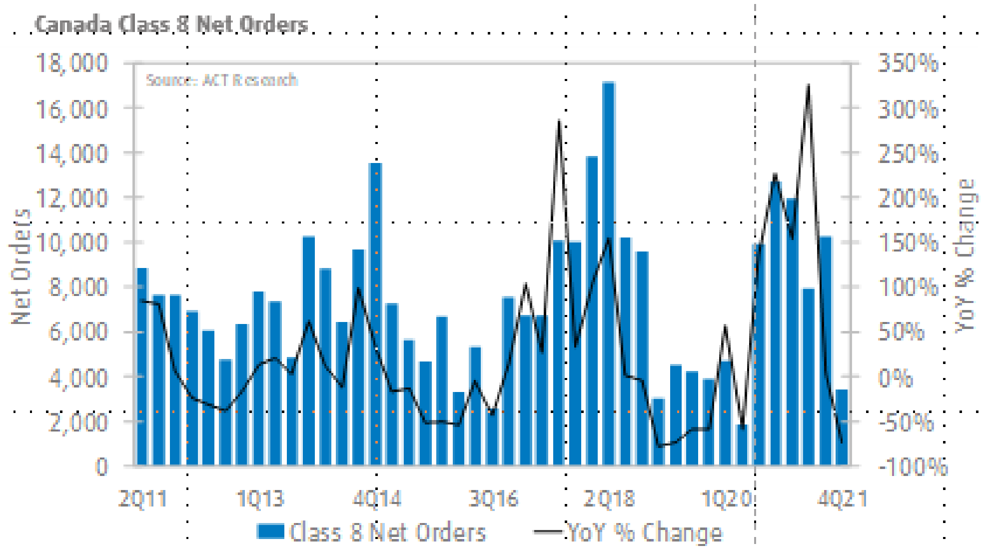
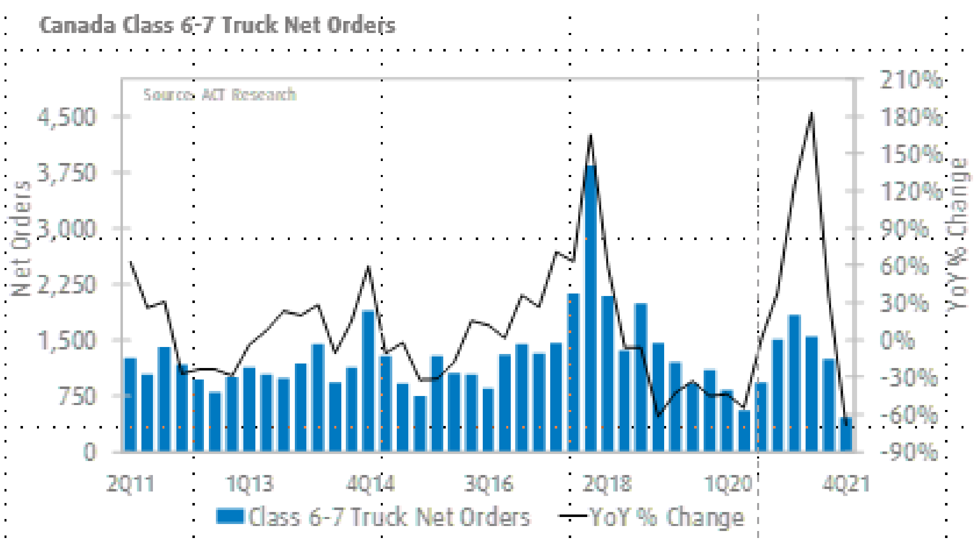
Truck Orders

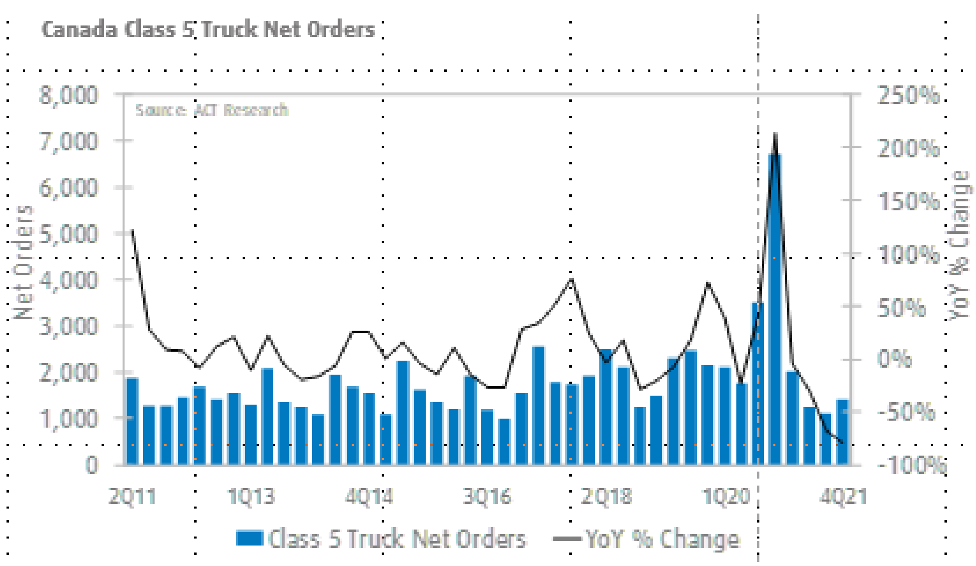


Net new Class 8 orders saw an atypical seasonal collapse during the 4th quarter of 2021. Given the strength in freight rates and a relatively steady gross order intake, the weak net order tally seems not reflective of any end-market weakness. Instead, the weakness reflects factory supply chain issues requiring an OEM reshuffling of the order book by canceling and re-scheduling deliveries initially scheduled for 2021 to later in 2022.



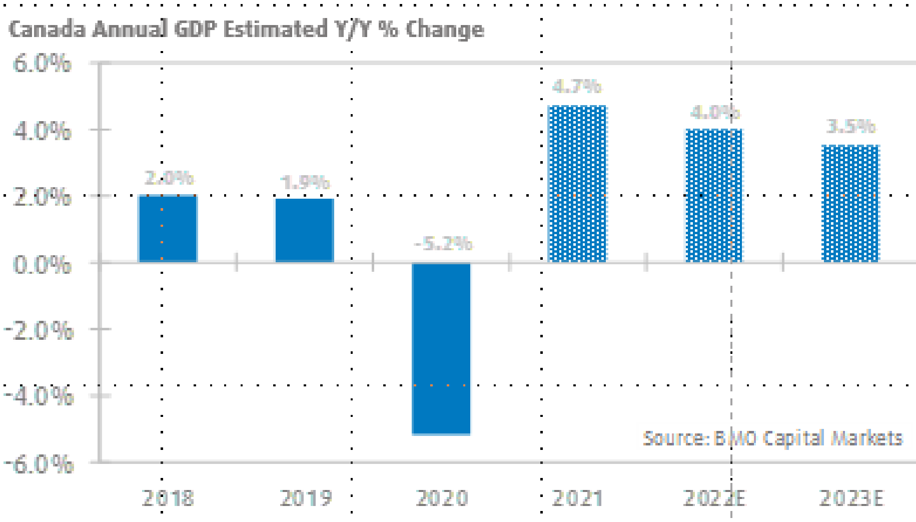
The same factors afflicting the Class 8 market also caused an atypical steep decline in **Class 6-7 truck net orders** during the 4th quarter. Given a lack of supply chain visibility into pricing and availability, OEMs have been reshuffling orders that could not be delivered on time in 2021. OEMs have also been reluctant to book new orders that outpace current manufacturing capacity and expand the current backlog.

Longer-term, the upper end of the medium-duty segment continues to face headwinds, particularly in end-markets such as energy production. Additionally, the segment will continue to be challenged by the ongoing buildout of regional distribution centers and a trend toward shorter hauls favoring smaller trucks.



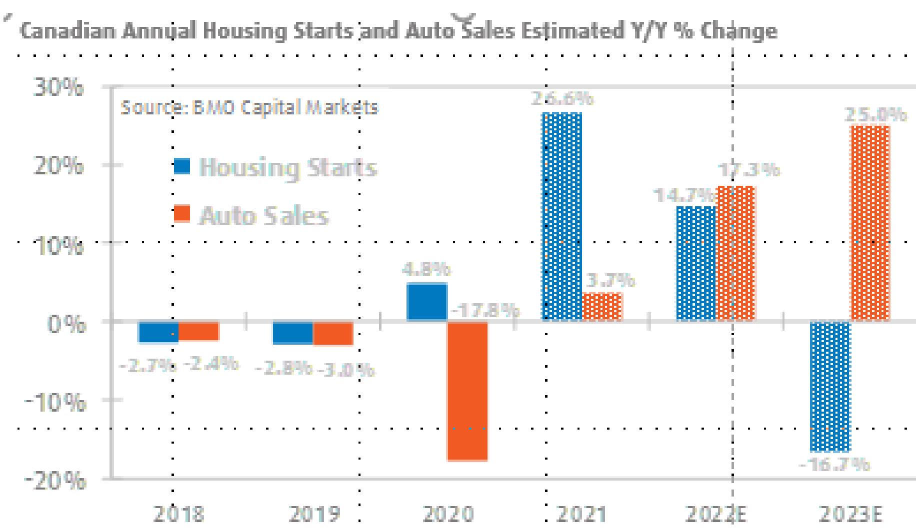
In addition to factory supply chain issues that continue to limit available build slots, the **Class 5 truck** market continues to digest record orders at the end of 2020. That said, the Class 5 market bucked the trend of the larger classes and saw a slight uptick in net orders during the 4th quarter. 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



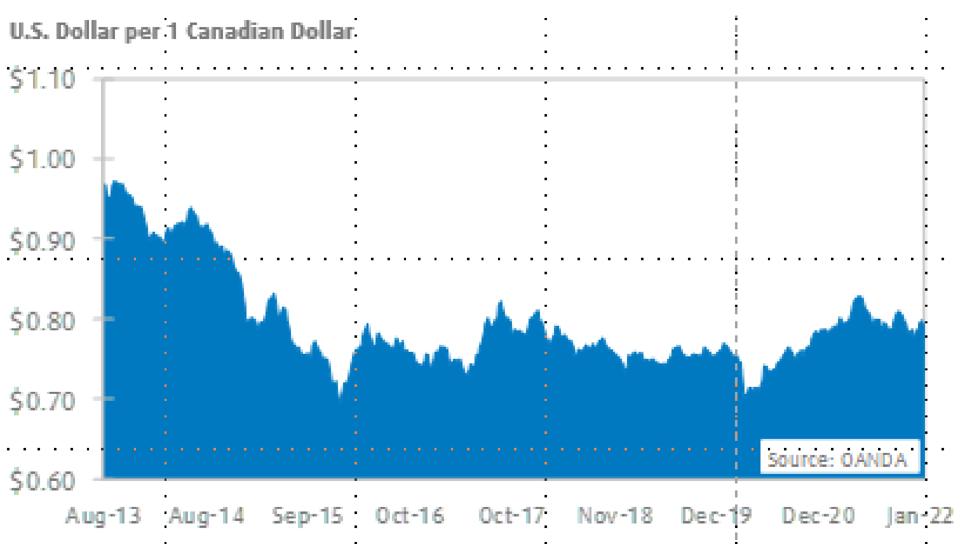
Following a disappointing second quarter (-3.2% annualized), the macroeconomy rebounded impressively during the 2nd half of 2021. In fact, the 4th quarter estimated annualized growth of +6.5% would make the final quarter the strongest quarter of the year. Further, November was the sixth consecutive month of growth and the first month where economic activity exceeded the pre-pandemic level of February 2020.

The early read on 2022 reflects a tough 1st quarter due to Omicron restrictions and, after that, the primary headwind of BoC tightening. Nonetheless, economists at BMO are forecasting above long-term trend full-year **Real GDP** growth of 4.0%, featuring less drag from last year's three big negatives—the virus, supply chain issues, and a brutal drought.



Canadian housing starts fell 22% to 236,106 annualized units in December, but only after the number of starts in November was revised to a massive 303,813 annualized units. Despite these monthly swings, the level of starts remains above its historical trend. The six-month moving average was 260,567 units, comparable to building booms in the 1970s and 1980s. Vancouver saw an increase among the major cities, while Toronto and Montreal posted declines in December.

Assuming a trend toward normalization of the supply chain and in-person purchasing, 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.



With peak-fear of the Omicron variant in the rearview and inflation at decade highs, the Fed has been emboldened to swap QE for QT and accelerate the timing of a rate lift-off that closes the gap with other G10 banks and the BoC. As such, the US dollar has shown recent relative strength, albeit within a tight range.

Nonetheless, BMO economists expect the Canadian dollar to maintain a slight upward bias throughout 2022 and, after that, hold relatively steady during 2023. As of early-February, the Canadian dollar was estimated to finish 2022 at US$0.808 (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 whack-a-mole Covid variants, roller coaster employment trends, high commodity prices, accelerating inflation, 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: Bracing For Rate Hikes – Sal Guatieri, BMO Senior Economist

Despite flooding in British Columbia, Canada's economy **ended the year on a high note** with estimated growth of 6.5% annualized in the fourth quarter. A strong gain in November pushed GDP slightly above pre-pandemic levels. However, capacity restraints to address Omicron will likely stall the expansion in the first quarter of 2022. Indoor dining dropped 60% on average in January compared with 2019 levels, versus just 10% lower in November. Employment plunged 200,100 in January (or -1.0%), kicking the jobless rate up to 6.5%. Still, there were 32,500 more persons working than before the pandemic.

As in prior waves, **jobs and activity should come storming back soon with most provinces now lifting restrictions.** A rebound in accommodation, food services, and entertainment should help to lift GDP 7.0% in the second quarter and 4.0% for all of 2022, compared with estimated growth of 4.7% in 2021. Households are floating on a cushion of savings, though many are also highly indebted. One area ripe for improvement is business investment. Unlike the U.S., spending on equipment and intellectual property products remains below pre-pandemic levels, while commercial construction is down 17%.

Inflation isn't running as hot in Canada as in the U.S. or Europe, though the CPI rate of 4.8% y/y in December is still the highest in 30 years. The hope is that upward pressure on goods prices (6.8%) will ease as demand shifts toward services (3.4%), though the latter will be pressured higher by rising rent and wages. Inflation will likely stay elevated at 4.1% this year, before moderating to 2.5% next year, still above pre-virus levels and the central bank's mid-point target.

After pledging to keep policy rates at crisis-low levels for most of the past two years, the **Bank of Canada** is now warning loudly that rates "will need" to rise to control inflation. With the economy back at full employment, and fearing that high inflation might become ingrained in expectations, the Bank will begin normalizing policy at the March 2 meeting. Governor Macklem sees a "rising path" for rates, that is, a series of moves. We expect quarter-point rate hikes at the next four meetings, with three additional increases taking the overnight rate to 2.0% by spring 2023. The **10-year Canada yield** will rise less than policy rates, after spiking 75 bps last year and a further 35 bps this year in anticipation of tighter policy. We see the yield rising to 2.1% by year-end from recent levels of 1.85%.

As in 2021, the **Canadian dollar remains range-bound** against a strong greenback. Support from surging oil prices and the first string of current account surpluses in 13 years has been offset by the chance of the Fed outrunning the Bank of Canada to catch up with higher U.S. inflation. We look for the currency to appreciate moderately to US$0.81 (C$1.235) by year-end, supported by elevated commodity prices.

Risks: Although Omicron cases have crested, the possibility of a more lethal variant with the ability to evade vaccines remains a distinct threat. As well, additional waves of the virus could impede global supply chains, though most of Southeast Asia (with the notable exception of China) has shifted away from a "COVID-zero" approach now that vaccination rates are higher. Other threats to the economy stem from persistent high inflation and the need for aggressive monetary tightening, unsustainable house price increases in Canada and the United States, possible conflict between Russia and Ukraine, ongoing trade tensions between the U.S. and China, and a renewed decline in North American equity markets after January's stumble.

We're here to help.

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