BMO

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Winter 2024

Industry Update

Truck Transportation

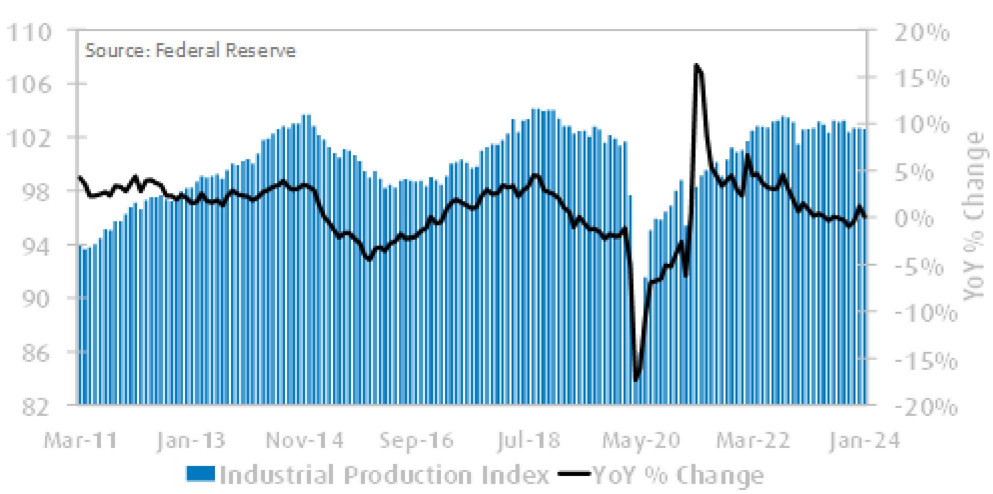
Key Developments

- According to the Census Bureau, **truck transportation industry revenue** during 2023 declined 8.5% to $408 billion, still the 2nd best year on record.
- According to **FTR**, data from **The Federal Motor Carrier Safety Administration (FMCSA)** shows that following net carrier additions of more than 122,000 during 2020-2022, nearly 66,000 new authorities were more than offset by almost 87,000 revocations for a net decrease of 21,000 operating carriers during 2023.
- **Mexico surpassed China to become the largest source of U.S. imports during 2023,** according to the Census Bureau. In 2023, the value of imports from Mexico increased by 4.6% to $475.6 billion, while imports from China declined by 20.3% to $427.3 billion, and imports from Canada declined by 3.5% to $421.1 billion. Further, Department of Transportation data shows that incoming truck crossings from Mexico during 2023 increased by 1.4% to a new high of 7.4 million, while truck crossings from Canada also increased by 0.6% to 5.5 million.
- Be sure to check out the latest perspectives from BMO economists on the implications of the latest Fed decision for the U.S. macro outlook (page 8).

Industry Fundamentals

With a few notable exceptions for retail sales, industrial production, and housing starts, recent US macro data, particularly payrolls, wages, headline real GDP and CPI/PPI, has run hotter than expected. As a result, the futures markets are moving toward an out-of-consensus view by BMO economists that March and even May were too early for the Fed to cut rates. Regardless of the timing, any reduction in interest rates as a by-product of sustainably low inflation rather than poor economic conditions will create a positive setup for improving demand-side trucking fundamentals, particularly in significant truck freight-generating sectors such as retail, housing, and manufacturing. From the supply side, although relatively low fuel prices have kept many poorly positioned carriers in the market for longer than expected, other operating costs (insurance, maintenance, etc..) remain high enough and freight rates low enough that net carrier exits should remain a theme for months to come.

Industrial Production Index (Seasonally Adjusted)



In January, **U.S. industrial production** unexpectedly fell 0.1%, while December was revised lower to a flat reading. Manufacturing output (the biggest share of industrial production) dropped for the first time in three months, down 0.5%, amid a sag in nondurable goods production. In the meantime, durable goods manufacturing held up, with computer and electronic products extending record highs, even as motor vehicles & parts and machinery fell.

The decrease in manufacturing output pushed **capacity utilization** lower by 0.5 percentage points to 76.6%, 1.7 percentage points below a year earlier, and 1.6 percentage points lower than the long-run average.

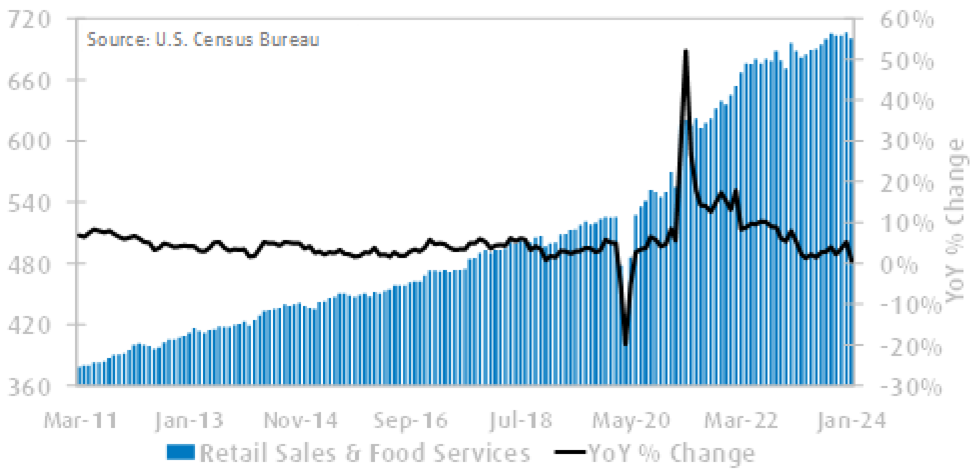
Macroeconomic Indicators

ISM Purchasing Managers Index

The **Purchasing Managers' Index (PMI)** is a sentiment measure of near-term business conditions in the manufacturing sector. During January, the index surprisingly climbed 2.0 pts to 49.1. Although that's still in contraction territory, the gauge is now at a 15-month high. New orders expanded for the first time in nearly 1½ years, jumping 5.5 pts to 52.5. That's the highest level since May 2022 and suggests demand is increasing. In the meantime, production also clawed back into expansionary terrain, up 0.5 pts to 50.4, while inventories climbed and order backlogs stayed below the 50 mark.

The past relationship between the PMI and GDP suggests that the January PMI corresponds to an annualized GDP growth rate of +1.9%, essentially in line with BMO Economists' current estimate of +2.0% for the first quarter.

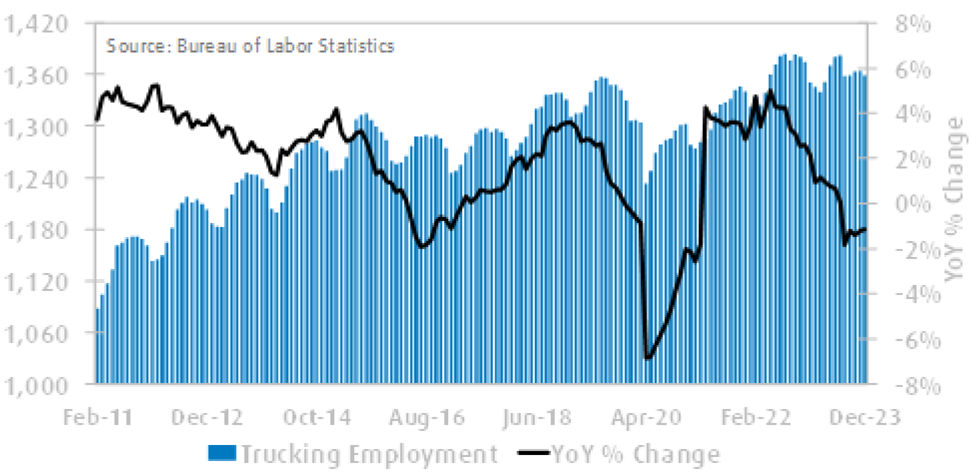
Retail Sales & Food Services (Seasonally Adjusted $Bn)



U.S. retail sales declined 0.8% in January after climbing 0.4% in December. This was considerably shy of the consensus forecast of -0.2% and follows a solid, but not spectacular, holiday shopping season. The largest monthly decline since March 2023 questions the ability and willingness of the consumer to continue propelling economic growth.

Receipts declined in nine of 13 categories, led by building materials (-4.1%), gasoline stations (-1.7% with gas prices down almost 2.0%), and motor vehicles and parts (-1.7%). However, furniture sales rose 1.5%, while restaurant and bar receipts climbed 0.7%, the eleventh consecutive monthly increase.

Truck Transportation Production and Non-Supervisory Employment, Thousands



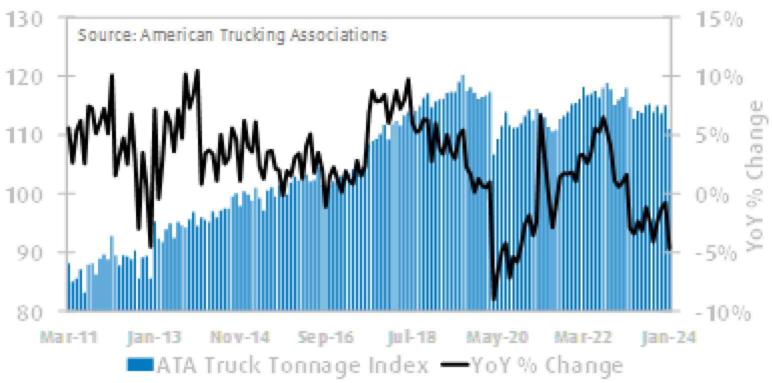
In December, employment in the truck transportation industry fell year-over-year for the 5th consecutive month. **Production and non-supervisory employment** during December was down 1.7% (~23,300) from a recent peak of 1.38 million in August and down 1.1% (~15,700) year-over-year.

Despite absolute levels of employment remaining close to the all-time high set in May 2022, employment growth has turned negative as lower equipment utilization from a sluggish freight environment has decreased the urgency for larger private and for-hire carriers to add driver capacity.

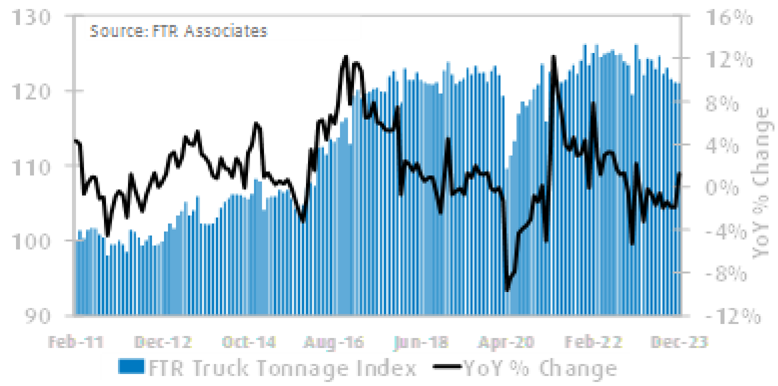
Freight Indicators

While the freight environment has started the year on typically soft post-holiday seasonal footing, there is little expectation that a cliff event is on the horizon. On the contrary, there's a solid case to be made that the freight cycle, with some help from the Fed, could improve as the year progresses. A few of the more significant potential tailwinds include the approach of more constructive seasonality (produce, summer, back-to-school, holidays), healthy inventory levels that will need replenishing, a resurgence in near-onshore manufacturing and infrastructure spending, a record backlog of durable goods, near-record number of new homes not yet completed, the prospect of lower mortgage rates to fuel new homebuilding, and virtually non-existent goods inflation that should gradually shift consumer marginal dollars away from stubbornly expensive experiences.

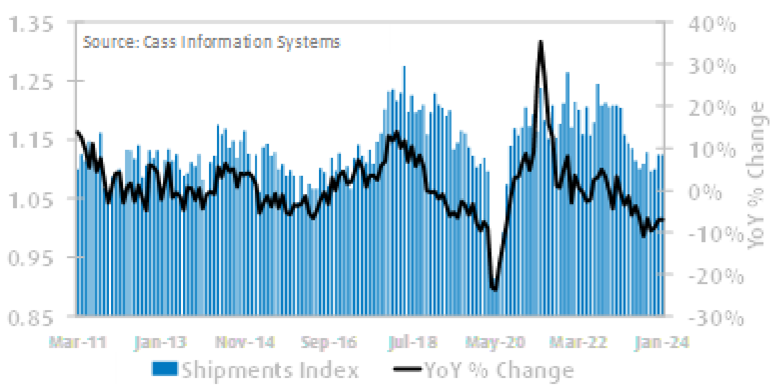
ATA Truck Tonnage Index (Seasonally Adjusted)



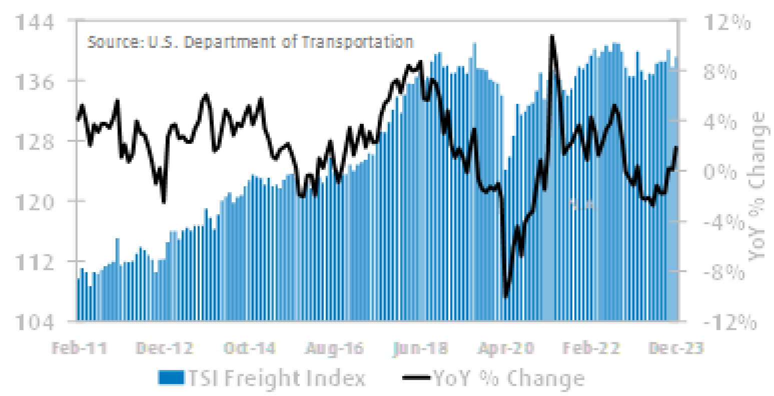
FTR Heavy Duty Truck Tonnage Index (Seasonally Adjusted)



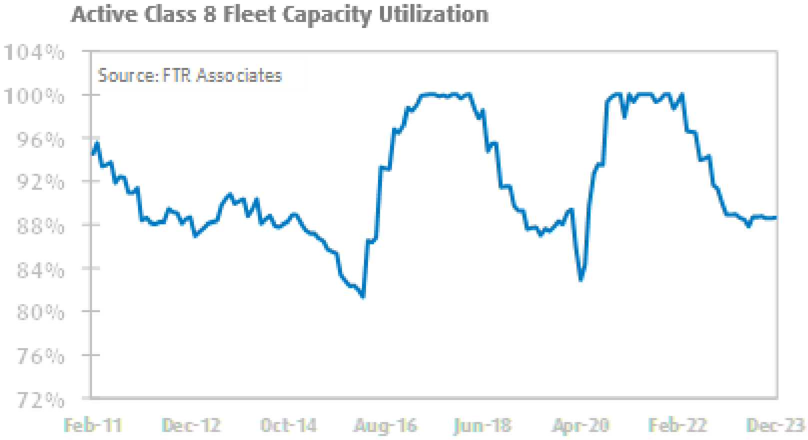
Cass Freight Index – Shipments (Seasonally Adjusted)



Transportation Services Index (Freight)



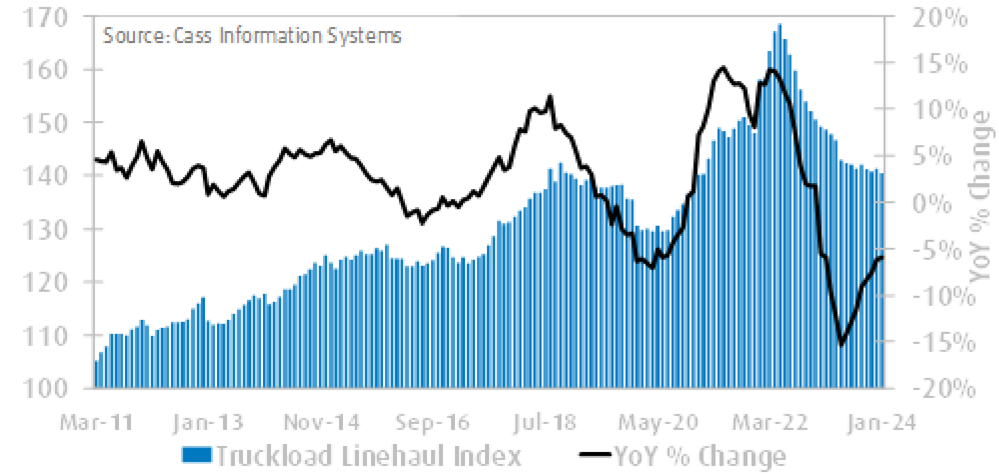
Active Class 8 Fleet Capacity Utilization



- The **ATA For-Hire Truck Tonnage Index** (primarily contract freight) fell 3.5% (month-over-month) during January and was 4.7% lower than a year earlier.
- The **FTR Truck Tonnage Index** has been in a downtrend for the past year with December breaking a string of ten consecutive months of year-over-year declines.
- The **Cass Freight Shipment Index** (all modes) has declined year-over-year for twelve consecutive months through January.
- The **TSI Freight Index** finished 2023 on a high note with three consecutive positive year-over-year readings through December.
- The **FTR Class 8 Capacity Utilization Index** has been steady near a 3-year low and several percentage points below its long-term average.

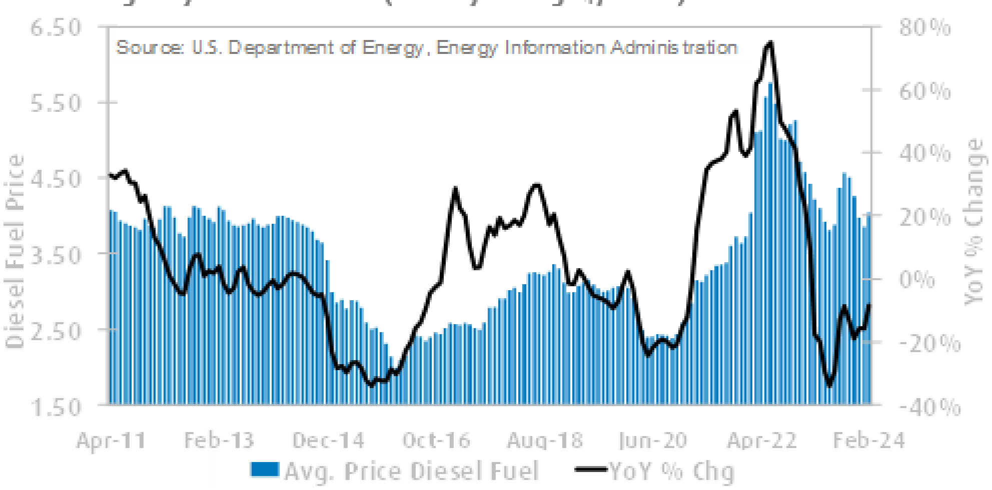
Revenue And Expense Indicators

Cass Truckload Linehaul Index



The **Cass Truckload Linehaul Index** 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 dry van spot rates flat since last April, the worst of the downward pressure on contract rates is also likely in the rearview. That said, even with a flattening trend, the year-over-year comparisons may not turn positive until the 3rd quarter of this year.

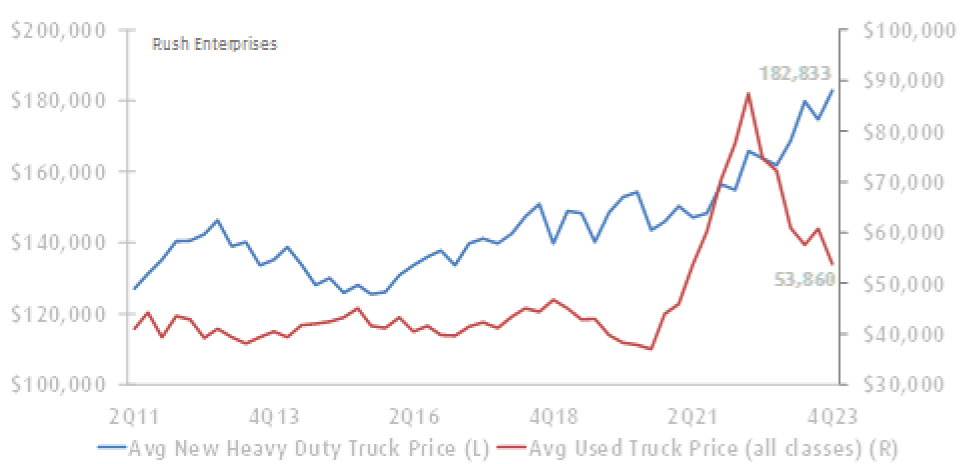
On-Highway Diesel Fuel Price (Monthly Average $/Gallon)



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. However, over the past six months, mirroring a slump in WTI prices before a recent bump higher in February, the national monthly average Diesel price of $4/gallon in mid-February had decreased $0.56 (-12%) from a September peak.

According to the most recent forecast from the U.S. Energy Information Administration (EIA), WTI crude and Diesel prices are expected to peak during the 2nd quarter, followed by gradual price declines through the fall. However, the EIA also acknowledges the risk of further upside to their forecasts depending on the persistence and effectiveness of the Houthi Red Sea attacks.

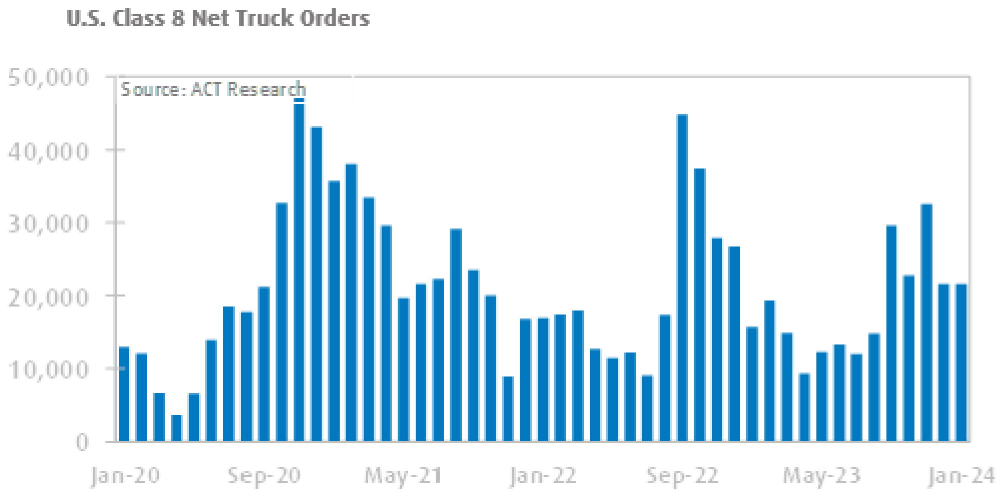
Average New Heavy Duty and Used Truck (All Types) Prices ($)



With strong demand from large private fleets and vocational buyers (Refuse/Construction), the **average price of new heavy-duty trucks** sold by Rush Enterprises during the 4th quarter rebounded from the 3rd quarter and reached a new high watermark. Heavy-duty ASPs increased by $8,059 (+4.6%) from the 3rd quarter and $21,088 (+13.0%) from the year-earlier quarter.

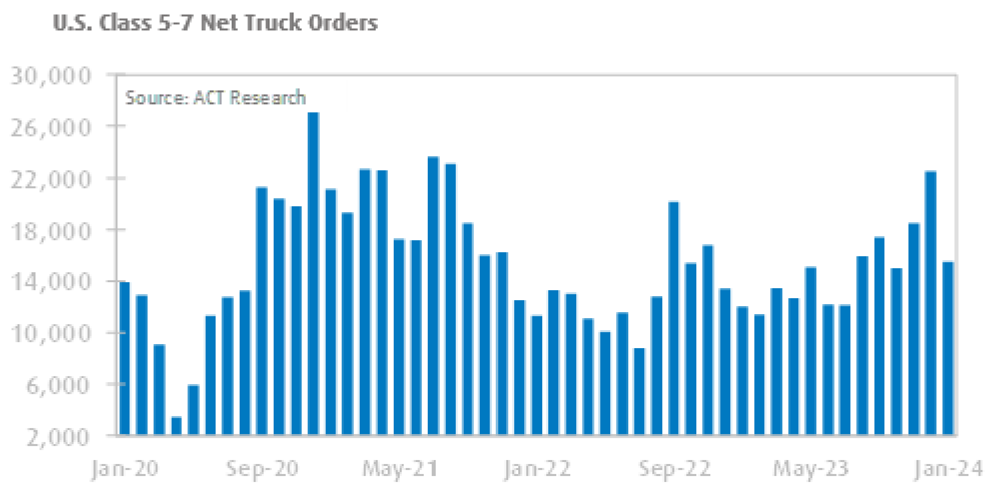
After a brief reprieve during the 3rd quarter, used truck pricing resumed a six-quarter downtrend during the 4th quarter. The **average price of all used trucks** sold by Rush Enterprises during the 4th quarter decreased 11.3% from the 3rd quarter and 25.4% from the year-earlier quarter. Rush expects the rate of price depreciation to decrease with a bottom in pricing sometime later this year.

Truck and Trailer Orders



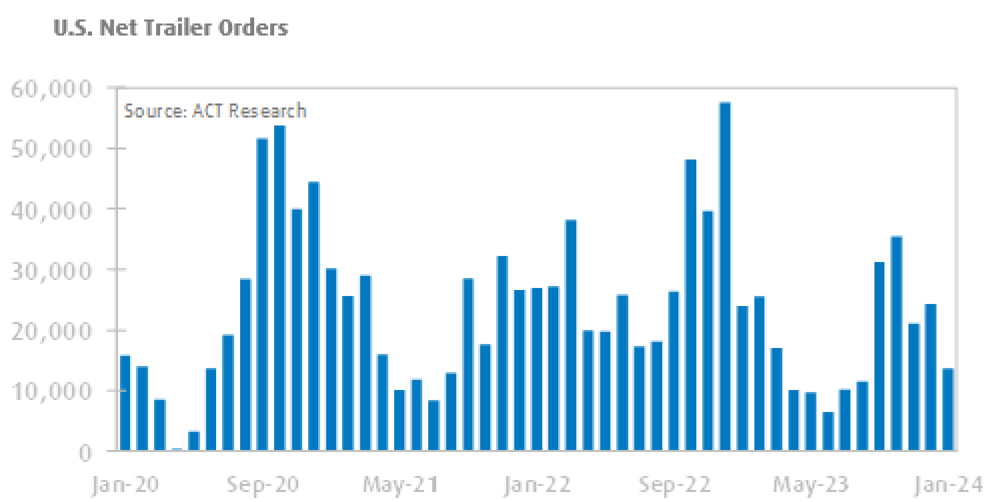
Given that pent-up demand was in the latter stages of fulfillment, year-over-year comparisons of **U.S. Class 8 net truck orders** mainly remained negative during the 2nd half of last year. That said, monthly orders exceeded 20k for five consecutive months through January while averaging 25.6k or more than 307k annualized.

Orders in January exceeded subdued expectations and were 38% higher than a year earlier, with upcoming year-over-year comparisons remaining relatively easy through mid-year. However, with pent-up demand largely satisfied and expectations for an equipment cycle reset this year, full-year orders will likely finish below 2023.



With the tailwinds of better-than-expected residential construction, consumer spending, and pent-up demand, **medium-duty truck orders** accelerated last fall as OEMs opened more build slots for early this year.

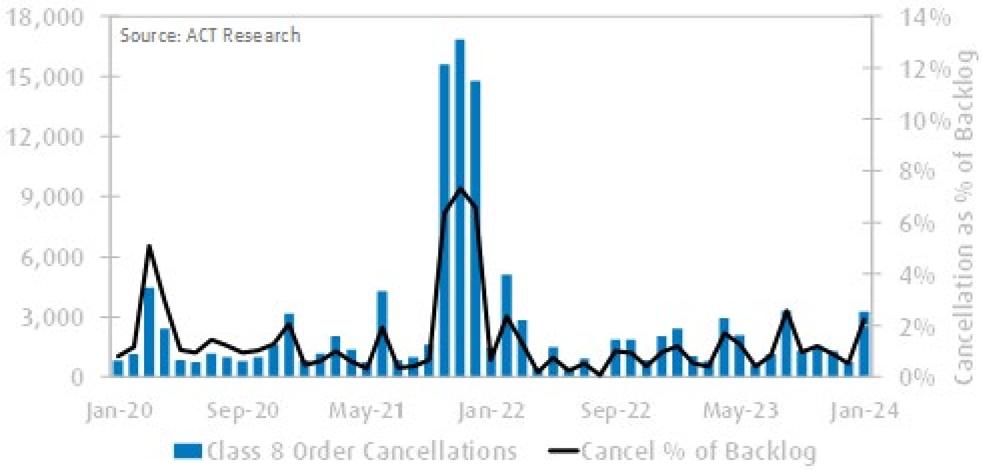
Orders accelerated throughout last year and finished with the highest monthly total since August 2021 and the best December since 2020. Further, 2024 has started on solid footing, with January orders up 29% year-over-year despite a larger-than-typical seasonal drop from December. The longer-term view 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.



Despite the usual recovery from the Summer lull, **orders for trailers** have been in a tailspin since peaking at the end of 2022 with year-over-year declines (most of them double digits) during twelve of the prior thirteen months through January. During that time, the market transitioned from strong demand limited by supply chain constraints to a normalized supply chain met with lackluster demand expected to endure throughout 2024.

Other Equipment Indicators

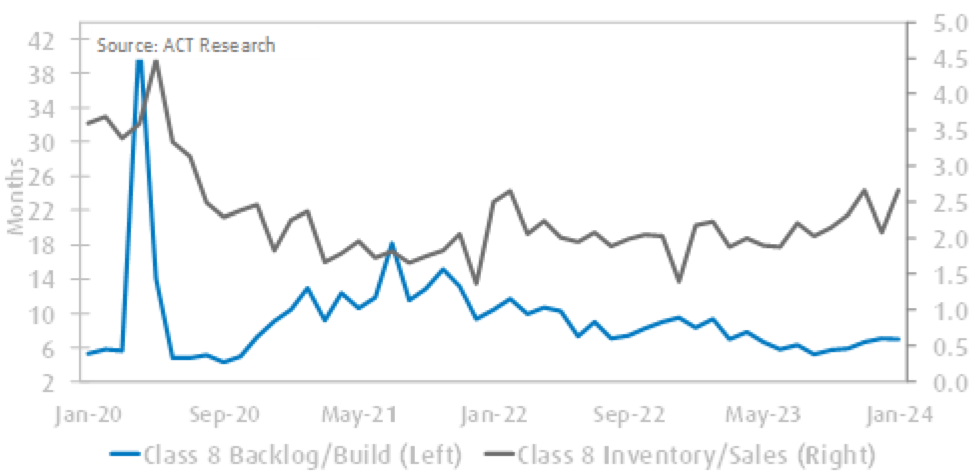
U.S. Class 8 Order Cancellations



While the trailing 6-month average monthly cancelation rate (as % of backlog) of 1.4% compares favorably to the pre-pandemic long-run average of 2.3%, a bump up during January to 2.2% bears watching.

That said, given stress on cash flows in the spot market, sustained pressure on contract rates, and a sluggish freight market, the rate of cancellations should not be expected to remain so far below the long-run average. Still, except for the occasional cleanup and re-shuffling of orders, with several years of limited availability still fresh, the looming prospect of an EPA pre-buy, and barring any unforeseen macro fallout, most fleets should remain reluctant to cancel their orders.

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



A relatively steady flow of orders, combined with a reduction in production, has lifted the wait time for new class 8 trucks over the past six months. Specifically, the **heavy-duty backlog-to-build** ratio has increased from just over five months in August to seven months in January, modestly above the long-run pre-pandemic average of six months.

Despite reduced production, a sharper decline in unit retail sales has put upward pressure on inventories. As a result, the **heavy-duty inventory-to-sales** ratio has increased from below 1 ½ months at the end of 2022 to the high end of the long-term average range of 2-2 ½ months.

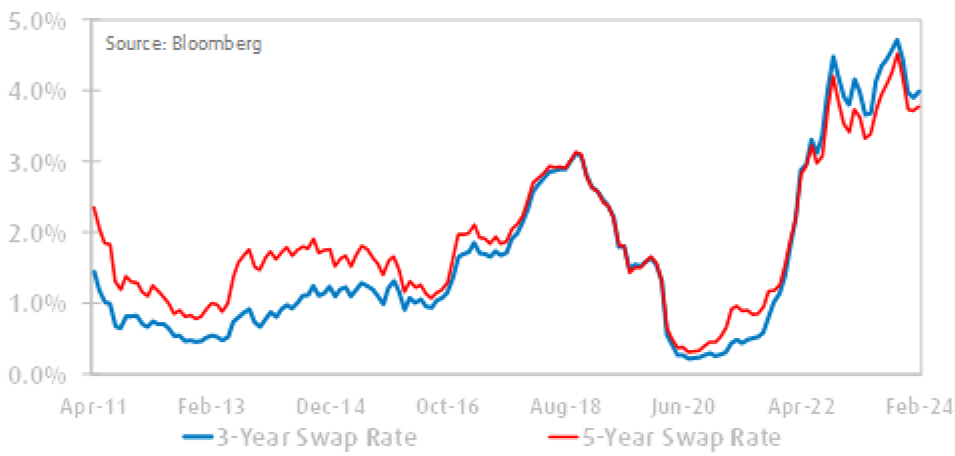
U.S. Class 8 Retail Sales vs Builds

Since peaking just below 30k monthly units at the end of 2022, **U.S. Class 8 unit sales** have been choppy but predominantly downward trending throughout 2023 and early 2024. With pent-up demand satisfied and carriers enduring a profit recession that doesn't seem to have hit bottom, further weakening of unit sales through at least the 1st half of the year should not be surprising.

With the expectation of declining sales, **Class 8 production** has also been cut significantly from a monthly average of nearly 24,000 units through the first nine months of 2023 to a monthly average of 21,000 units during the three months ending in January.

Other Business Indicators

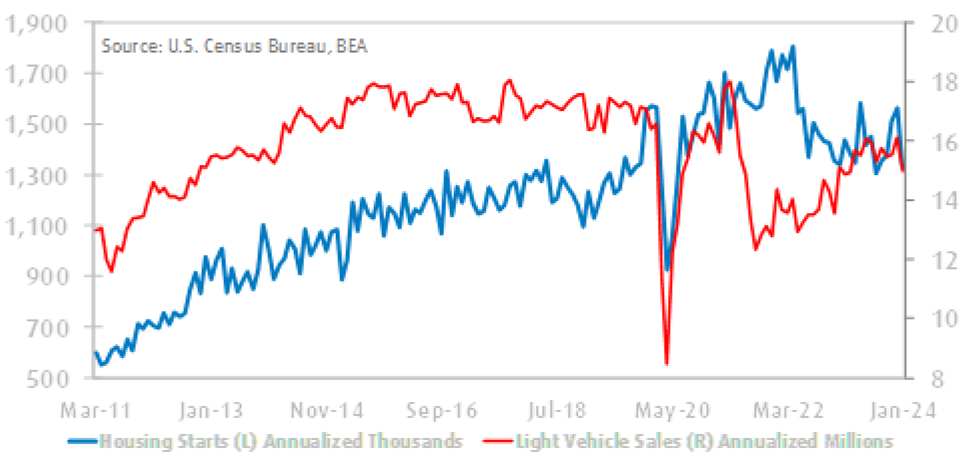
Interest Rates: 3 & 5 Year Interest Rate Swap Pricing



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 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 Fed 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 July.

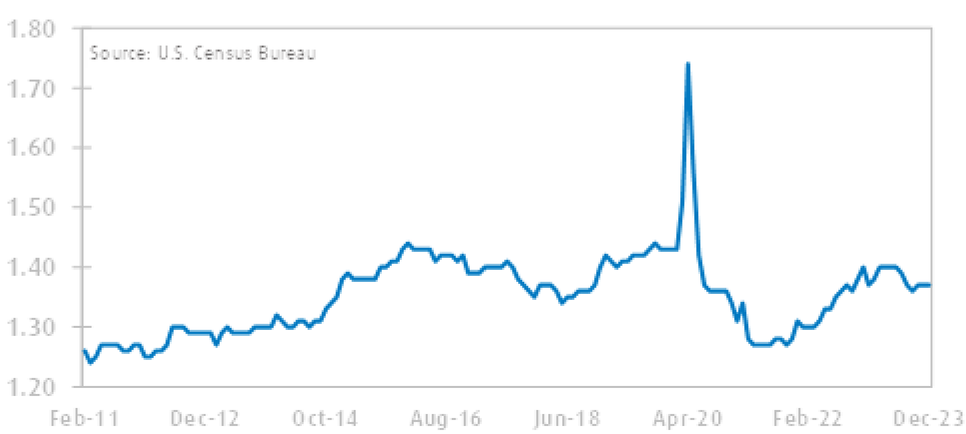
U.S. Housing Starts & Light Vehicle Sales (Seasonally Adjusted)



After a couple of surprisingly strong months to finish 2023, **U.S. housing starts** resumed a 2-year downtrend while plunging 14.8% month-over-month in January. High mortgage rates and stubbornly high prices have reduced affordability to a four-decade low. As of mid-February, BMO economists estimated U.S. housing starts will follow an 8.5% decline in 2023 with another albeit more modest decline of 1.4% in 2024.

Although supply-side issues (semiconductors, UAW strike) have faded into the rearview, the growth outlook for new vehicle sales will remain underwhelming until interest rates begin to ease. As of mid-February, BMO economists estimated **U.S. auto sales** in 2024 will increase only slightly from 15.6 million to 15.7 million units.

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



The **total business Inventories-to-sales ratio** bottomed at an all-time low at the end of 2021 but has since recovered to the pre-pandemic long-term average. A closer look reveals that manufacturing (higher) and general merchandise inventories (lower) have progressed toward normalization. Inventories of motor vehicles and parts have also made progress toward replenishment but are still at the low end of long-term historical norms.

"Voice of the BMO Economics Team"

With macro conditions outperforming most economists' expectations, services inflation proving sticky, and market expectations for the Fed to start cutting rates pushed out to later in the year, we thought checking in on the BMO Economics Team's latest perspective on the Fed and the outlook for the U.S. economy would be helpful.

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

Nvigorating

Douglas Porter, Chief Economist and Managing Director - February 23rd, 2024

Stocks rolled to new highs this week, perhaps best highlighted by Japan's Nikkei finally surpassing its end-1989 peak. Putting those 34+ years into perspective, Britain has had eight different Prime Ministers, Canada six, the U.S. has also had six Presidents, and we've lost count of Japan's leaders over that spell. Spurred on by Nvidia's blowout earnings, the S&P 500 and Dow also reached new milestones, albeit with no change in world leaders since the prior records (hit last Thursday). The S&P is now up a cool 27% from a year ago, while the Nasdaq's yearly rise is fast approaching 40%, and the Nikkei has even topped that mighty gain.

The furious rally in equities **makes the Fed's job even more complicated**. Already frustrated by sticky services inflation, and a surprisingly healthy job market early in 2024, the heavy-duty loosening of financial conditions hardly calls out for the need for rate relief—on the contrary. This week's FOMC Minutes noted the "risks of easing too quickly", with some concerned that "progress on inflation could stall". Fixed-income markets have absorbed the message, with Treasury yields backing up even further this week, rising to levels last seen nearly three months ago—or before the Powell Pivot. Market pricing of Fed rate cuts is leaning to fewer and further out, with even the June meeting now in some doubt, and little more than three cuts in total seen for the full year (**we're calling for four cuts, starting in July**).

Aside from the Minutes, it was a particularly uneventful week on the U.S. economic data front. However, the light fare was still generally solid, with jobless claims falling anew to just 201,000—zero sign of stress there—and the S&P PMI showing a pick-up in manufacturing this month to its best reading since the fall of 2022 at 51.5. True, the leading indicator fell for the 23rd month in a row (basically since Fed hikes began), but the Conference Board opined that the index is out of recession range because more than half its underlying components have been on a rising trend over the past six months. We do expect growth to cool this year, and are holding at 2% GDP for Q1, but that's from the piping hot pace of 4% average growth in the second half of 2023.

The stock market sprint may revive broader **consumer confidence**, and could further support growth, in part through the **wealth effect**. **Business capital spending** may also be revved up by the equity rally, with machinery and equipment spending potentially following the strength already seen in factory construction over the past year. Note though that so far, the AI boom has mostly been reflected in stock prices and only a narrow sliver of business outlays; over the past four years, overall business investment is up at a leisurely 2.7% annualized pace, a shadow of the double-digit gains seen in the late 1990s during the internet boom. Still, capital spending is supporting overall activity, and helping steer the economy away from a downturn. And GDP growth of around 2% is hardly cool enough to seriously weigh on underlying inflation, thus keeping Fed officials cautious.

"Voice of the BMO Economics Team" Continued

January FOMC Minutes… Fear of Cutting Too Quickly
Scott Anderson, Chief U.S. Economist – February 23rd, 2024

The Minutes from the January FOMC meeting were **closely aligned with our pre-conceived expectations, and reinforce our baseline forecast for a mid-year start to the rate cutting cycle at the earliest this year.** Right now, the June or July FOMC meetings appear to be the most likely candidates for the first quarter-point rate cut. The minutes clearly illustrate that **most Fed officials remain concerned about moving too quickly to cut interest rates:** it was noted that the **risks of moving too quickly to cut outweigh the risks of keeping borrowing costs elevated for too long.** Some officials noted progress on inflation could stall. In contrast, only a couple of officials pointed to risks to the economy from waiting too long. The economic forecast prepared by the staff for the January meeting was slightly stronger than the December projections. In general, officials said they remained "highly attentive" to inflation risks and noted they did not see it as appropriate to lower rates until gaining "greater confidence" inflation is moving sustainably toward 2%. Officials highlighted the uncertainty in the economic and inflation outlook, as well as uncertainty over how long a restrictive policy stance would be needed.

No detailed plans were mentioned for the winding down of the Fed's quantitative tightening program. However, acknowledging reductions in the overnight reverse repo usage, many officials said it would be appropriate to start in depth balance sheet discussions at the next meeting. A few officials noted balance sheet runoff could continue after rate cuts begin, while some policymakers said a slowing pace of runoff could help smooth the transition to an ample level of reserves and allow the runoff to continue for longer. The staff noted that once the ON RRP facility is either depleted or stabilized at a low level, reserves will decline at a pace comparable with the runoff of the Fed's securities portfolio.

In terms of risks around the outlook, Fed staff placed "some weight" on the chance that further progress on inflation could take longer than expected, while characterizing U.S. financial system vulnerabilities as notable, and saw risks on the economic forecast skewed to the downside.

Bottom Line: The minutes were not much of a market mover today with probabilities of a March or May rate cut holding near recently low levels, and bets still being placed on June or July for the first reduction. The market is pricing in about 3 and a half quarter-point rate cuts before the end of this year. U.S. stocks were trading modestly lower in the wake of the minutes release. Treasury yields rose, mostly holding onto increases seen earlier in the day.

Inquiries About Financing

Travis Ward
(214) 492-4554
travis.e.ward@bmo.com

Industry Research Contact

Michael Zimm, CFA
michael.zimm@bmo.com