

## Industry Update

# Canada Truck Transportation



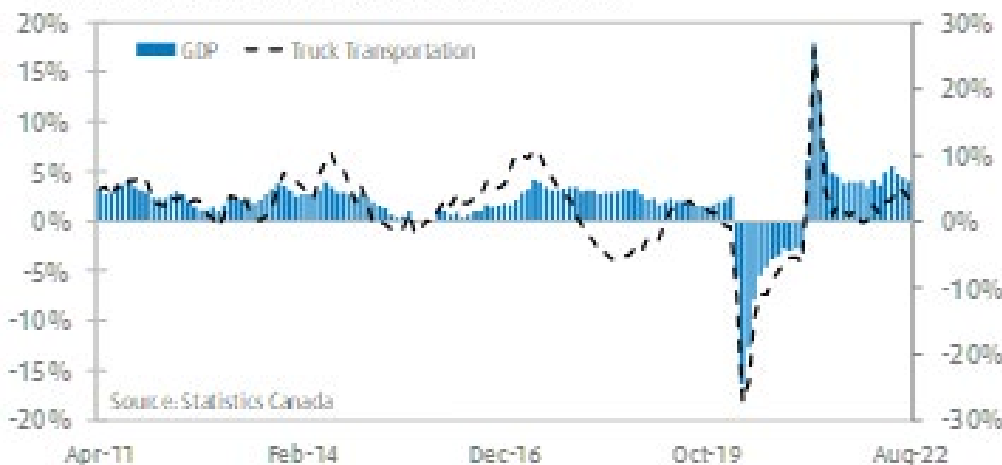
## Key Developments

- According to the most recent **Trucking HR Canada (THRC)** Labour Market Snapshot, employment among truck drivers increased by 11.8% in the third quarter of 2022, with 33,000 additional drivers actively employed compared to the previous quarter. At the same time, the number of unemployed drivers fell by half, and the unemployment rate among drivers stands at 2.1% compared to 5.3% in the overall Canadian labour force.
- The federal government announced that truck driving is one of 16 new NOC (National Occupational Classification) occupations in the **Express Entry** program. The new NOC categories are eligible for expanded pathways to permanent residency and will make it easier to bring in global talent in high-demand sectors such as transportation, health care, and construction.
- Federally regulated carriers – as well as carriers that work exclusively within the borders of Newfoundland, New Brunswick, Ontario, Manitoba, and Yukon – will have to use **electronic logging devices (ELDs)** as of Jan 1. B.C. and Quebec plan enforcement for provincial carriers but have not confirmed timelines, while Nova Scotia will require carriers that operate solely in that province to have ELDs on Jan 1., 2024.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

## Industry Fundamentals

Macro and freight activity has increasingly felt the weight of retreating commodity prices, a slowing global economy, and the Bank of Canada's aggressive rate hike campaign. The Canadian spot market has paralleled slackening conditions in the U.S., with available freight steadily declining and capacity gradually increasing. Relief from the headwinds, none more significant than the retreating housing market, is unlikely to arrive soon as BMO economists don't expect positive GDP growth to re-emerge until the 4th quarter of 2023. That said, low unemployment, sticky wage growth, improving supply chains (most notably in the vital auto sector), healthy consumer and corporate balance sheets, and pent-up demand should blunt some of the initial downside pressures.

Canada Monthly GDP Y/Y Growth (Seasonally Adjusted)



Canadian real GDP edged up 0.1% in August, a bit firmer than the initial flat estimate and extending a lengthy period of modest growth. StatsCan also provided a preliminary estimate for September, where they believe GDP edged up by 0.1% again. The flash estimate for all of Q3 points to overall growth of 0.4%, or roughly 1.6% at an annual rate, in line with the BoC's latest estimate of 1.5% and a tad better than BMO's estimate of 1.0%.

Except for a brief Omicron air pocket at the outset of 2022, **truck transportation** has shown year-over-year growth for most of the past 18 months. Nonetheless, sector activity remains 3.3% below where it was just before the pandemic in February 2020.

## Trucking Business Influencers

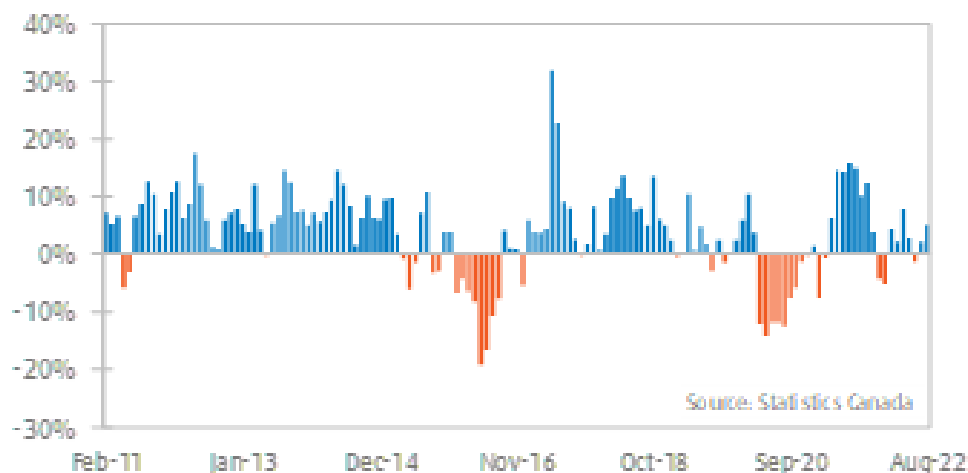
Canada Weekly Diesel Fuel Retail Price (Cents/Liter)



Since peaking at an all-time high in May, **Retail Diesel fuel prices** across Canada have been on a high-altitude roller-coaster. As of mid-November, the average weekly Diesel price of 230 cents/liter had recovered 50 cents (+28%) from a plunge in August and exceeded the prior peak (by 2 cents).

The current BMO outlook suggests that crude prices will remain elevated given low inventories and the possibility that OPEC+ would likely cut output further in response to a weakening global economy, with WTI averaging \$96.50 US\$/bbl in 2022 and \$90 in 2023.

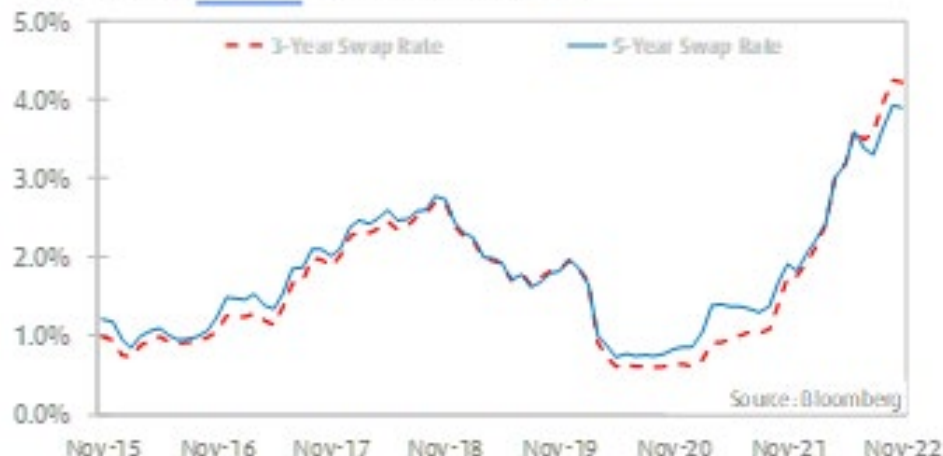
Canada Crude Oil Production Y/Y % Change



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. That said, a +5.0% increase in crude oil production during August represented the highest monthly output since December 2020 and the sixth out of the past seven months of year-over-year gains.

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-driven fossil fuel divestments.

Interest Rates: 3 & 5 Year Interest Rate Swap Pricing

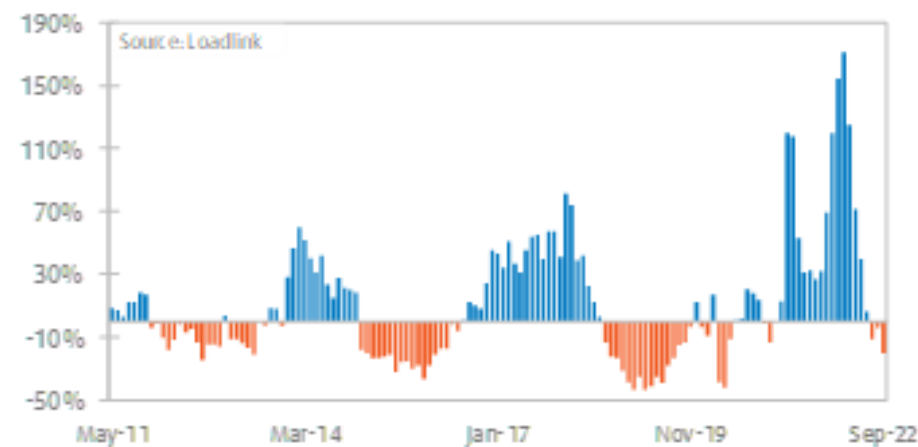


**Interest rate swaps** are derivative instruments commonly used by financial institutions to mitigate interest rate risk on a loan portfolio. The pricing of interest rate swaps (swap rates) mirrors expectations of interest rates' future direction.

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. Although the pace is expected to slow, BMO's economists forecast the BoC to raise the target overnight rate to 4.5% (from 3.75%) by early next year. Nonetheless, a recent slight rollback of swap rates reflects a potential peak in year-over-year inflation and likewise increasing odds that central banks are moving closer to pivoting toward a less hawkish stance.

## Freight Indicators

Canadian Truckload Spot Freight Volume Index Y/Y % Change



Balance in the Canadian spot market has shifted, with capacity expanding and demand softening. Since reaching an all-time high in March, **truckload spot freight volume** has decreased rapidly in the subsequent six months through September. Compared to the March peak, the index during September had contracted 69% but remained modestly higher than at the same point during 2018-2020.

Capacity continued to loosen, with the truck-to-load ratio climbing from the record-setting lows seen during the pandemic. The ratio for September of 3.65 available trucks for every load posted was significantly higher than 0.63 as recently as February and also 38 percent higher compared to 2.64 a year earlier.

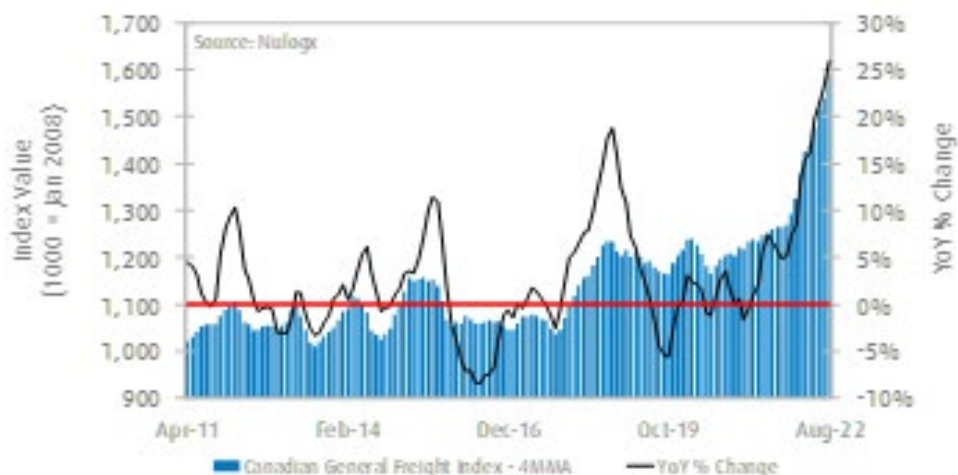
Despite the headwind of a relatively strong US dollar, slowly improving auto manufacturing supply chains and the elimination of mandatory vaccines have helped monthly **truck border crossings** show modest year-over-year growth averaging 2.2% since March.

Ontario Cross Border Truck Traffic



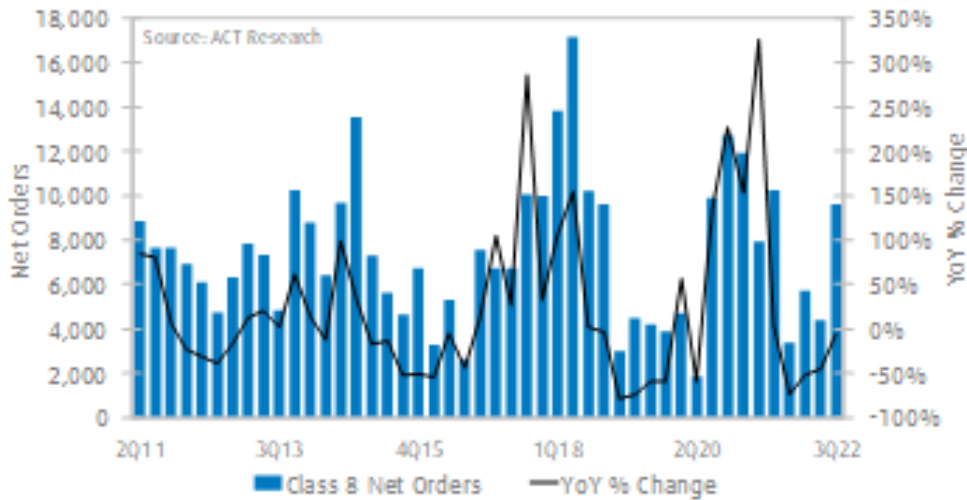
In August, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers reached a new all-time high. Although base rates are significantly higher than pre-pandemic levels, most of the overall surge in total freight costs is attributable to rapidly increasing fuel surcharges. That said, the fuel component of the index during August fell slightly from its peak in July. Fuel was 31.59% of base rates in August versus 32.77% in July and 17.69% a year earlier. Overall, year-over-year shipping costs during August were up 25.9%, more than triple Canada's overall inflation rate of 7.0% and well above the full-year 2022 CPI estimate by BMO economists of 6.8%.

Canadian General Freight Pricing Index



## Truck Orders

Canada Class 8 Net Orders



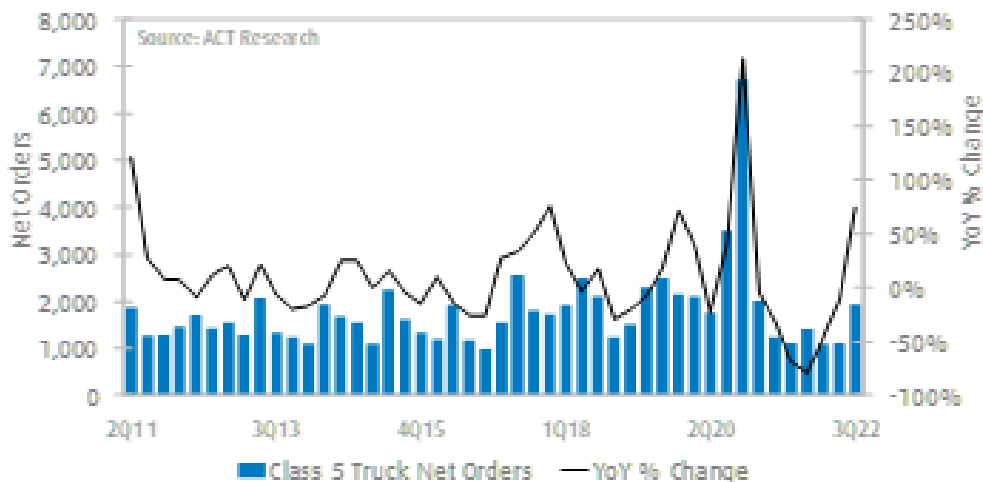
**Net new Class 8 orders** awoke from a lackluster 2nd quarter and saw a strong surge during the 3rd quarter as OEMs gained incremental visibility into the supply chain and opened more build slots for 2023 production. Further, well below average (0.4%) cancellations as a percentage of the backlog confirm 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 supply chain factors afflicting the Class 8 market also caused a steep contraction in **Class 6-7 truck net orders**. Similarly, this class has experienced a sawtooth pattern throughout the year and, most recently, a sequential rebound during the 3rd quarter, albeit less impressive than the Class 8 surge. In the near-to-intermediate term, the severe-duty segment of this class will be in a tug-of-war between positive momentum in the energy sector and contracting activity in the construction sector.

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 demand at the end of 2020. Nonetheless, the Class 5 market followed the trend of the larger classes and saw a sequential uplift in net orders during the 3rd quarter. Further, the long-term demand outlook 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



As rate hikes continue, BMO Economists expect real GDP growth to grind to a halt next year in Canada and the US (0% average growth for each), with net contractions in the first half of the year amounting to around ½% (not annualized). These would be considered short and shallow recessions. The net risk is that both economies succumb further to these rate hikes, or even more tightening ensures they do, thus triggering a deeper recession and rate cuts next year.

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



**Canadian housing starts** during October fell 11% from the highest pace of the year in September to a worse-than-expected seasonally adjusted annualized rate of 267,055 units. Urban single-family starts fell 4% to 57,045 in the month, while multi-units decreased 13% to 188,189. Altogether, BMO economists expect starts to decline another 15-20% during 2023.

Assuming a continuing normalization of the supply chain, the pent-up demand of well-capitalized consumers should propel the **auto sector** to a resumption of modest unit sales growth during 2023.

U.S. Dollar per 1 Canadian Dollar



Amid the U.S. dollar's strengthening trend, the **Canadian dollar** has been weakening, averaging C\$1.370 (US\$0.730) in October. In the past 18 years, the currency has only been this weak (or weaker) on two occasions, March-May 2020 at the onset of the pandemic and December 2015-February 2016 owing to the collapse in oil prices. With the Bank of Canada likely no longer keeping pace with Fed rate hikes and stopping sooner (January vs. March), BMO Economists look for the Canadian dollar to weaken further despite stable prospects for oil prices.

After declining to around C\$1.38 (US\$0.725) in December, the Canadian dollar is expected to appreciate more than 4% against the US dollar (to C\$1.325 or US\$0.755) by the end of next year on broad weakness in the US dollar.



## “Voice of the BMO Economics Team”

With the post-pandemic economy challenged by volatile commodity and energy prices, moderating but still unacceptably high inflation, 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 Canadian economy. For more: <https://economics.bmo.com/en/>

### Whither The Economy Now? (Nov 18<sup>th</sup> 2022) - Douglas Porter, BMO Chief Economist and Managing Director

A steady stream of Fed speakers rained on the market parade this week, drumming home the message that **policy will need to tighten further and remain there for longer**. The head rainmaker was St. Louis Fed President Bullard, who sealed his reputation as lead hawk by warning that the appropriate terminal funds rate should be above 5%, at a minimum. The hawk talk landed just as oil prices spent the week careening lower to under \$80, taking the commodity complex further below its pre-Ukraine invasion levels. In a week that saw most major markets largely moving sideways, this combination of tough Fed speak and sagging oil prices inverted the Treasury yield curve even more deeply. Ten-year yields dipped below the mid-point of the Fed’s target range (3.875%), and the **2s10s spread was at -70 bps** by Friday morning, the deepest inversion in 40 years.

While various points on the Treasury curve have been inverted for months, the fact that **long-term yields have fallen even below the overnight rate** is a much more important marker and **signals pronounced economic weakness ahead**. Meantime, Canadian 10-year yields also dipped this week, and are nearly 70 bps south of like-dated U.S. yields, taking Canada-US spreads close to all-time wide differentials. (The record negative spread of -92 bps was hit in late 2015 when oil prices had been crushed.) And Canada’s overnight rate of 3.75% is far above the 10-year yield of barely 3.1%, with the inversion first arriving in early September. If anything, this paints an even **more challenging picture for Canada’s 2023 growth outlook**. And, like the U.S., we are expecting zero GDP growth next year.

Yet, despite the dour outlook for 2023, it now looks like Canadian GDP advanced by a solid 3.3% this year. That is well above the nation’s 20-year trend of 1.8% average growth, and would rank it in the upper half of the G7. Strangely, the U.K. will lead the pack with 4.2% growth, as the early-year reopening outweighed the recent tumult. Canada’s gain will also clock in well above the expected U.S. outcome of just under 2%. In retrospect, **Canada had two big relative advantages** this year in the growth sweepstakes:

**The reopening bounce.** Having been locked down much more deeply and longer than the U.S., there was simply more room to rebound this year. Some of the outperformance in 2022 was simply a catch-up for a major underperformance in 2020/21. (Aside: At the start of last year, we were aggressively looking for a 6% snapback in both the U.S. and Canada. Initially, the growth rates were instead reported at 5.7% and 4.5% respectively. Well, presto, now the statistical wizards tell us that the U.S. economy did indeed grow nearly 6% last year, while early indications from the provincial data suggest Canada was north of 5%. Combined, North America grew 5.9% last year. Consider this a small victory lap of vindication.)

**The commodity boost.** The early-year run-up in commodity prices gave Canada a big lift in its terms of trade, raising nominal incomes and swelling government revenues. As well, in contrast to much of the rest of the world, the Prairies had a solid grain crop this year, reversing the terrible drought of 2021, which alone cut overall GDP by roughly half a point last year.

## “Voice of the BMO Economics Team”

### Wither The Economy Now? (Cont.) – Douglas Porter, BMO Chief Economist and Managing Director

Unfortunately, both of these relative advantages are now fading. Either they are a spent force (reopening), or are now actually going into reverse (commodity prices). Meanwhile, there is also one significant relative disadvantage for Canada’s economy, which is moving to the forefront—the outsized share of the housing sector. The combination of new home building, renovation activity, and real estate agent commissions—i.e., the components of residential investment—now totals 7.1% of real GDP in Canada. While that’s well down from the record high of 8.6% in early 2021, it’s more than double the current 3.1% share in the U.S. economy (which itself is down from last year’s nearby high of 3.8%).

Thus, **when housing is going into reverse**, as it now most clearly is, that’s a **much bigger drag on Canada’s economy than the U.S. and most other major economies**. (Even Australia at around 5% of GDP and New Zealand at about 6% aren’t up there with the heft of Canada’s housing sector.) This week brought fresh evidence that housing is retreating fast from the wildness of the past two years, with existing home sales falling 36% y/y, and national prices now down by a precise 10% from their February peak.

Home building typically is the **last shoe to drop** when activity stalls and starts remained sturdy last month at 267,000 units. That’s right in line with the solid average of the past year, which remains 40% above the 30-year trend of closer to 190,000 units. Note also that there are now 328,000 units under construction, easily an all-time record, and suggesting that activity will remain at a high level for some time yet. We would also note that the economy was able to expand almost 5% in the past year even as real residential construction as a whole fell almost 12%.

**Bottom Line:** A housing retreat will cut Canada’s relative growth advantage. Even so, this is likely to just bring Canada closer in line with the U.S. growth trend over the next year. Both are still expected to face a shallow downturn, before stabilizing late in the year. We are officially looking for a moderate drop in GDP in the first half of 2023, but would allow that the resiliency in consumer spending and the relief from lower oil prices may nudge the start date of that downturn a bit later in the year. But we have learned to heed the message of the yield curve, and that message is crystal clear.

**Trivia quiz: In the 40 years since we last experienced real inflation, which North American pro sports team has won the most championships?** Okay, if you guessed the LA Lakers (9 victories), you win a free trial subscription to Focus. But here comes the hard one, and this is for a one-year subscription—**which team has won the second most?** (Cue the Jeopardy! theme tune, as the wheels turn.) The answer is the Toronto Argonauts with 7. With much of the world focused on the start of the World Cup this weekend, spare a moment for the 109th Grey Cup on Sunday, when the Argos will be going for number 8 since 1982. True, they will have to overcome the prohibitive favourites in the Winnipeg Blue Bombers, but the Argos seem to have more than their share of luck despite a reputation akin to a certain other sports franchise in the city.

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