Fall 2023

Industry Update

# Truck Transportation

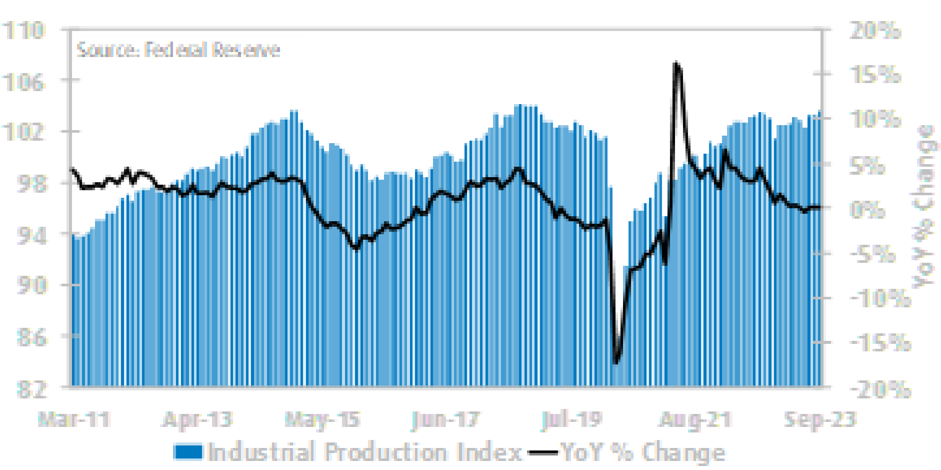
## Key Developments

- The **National Retail Federation** forecast that holiday spending is expected to reach record levels during November and December and will grow between 3% and 4% over 2022 to between $957.3 billion and $966.6 billion. Albeit below the average of the past few years, this year's growth in holiday spending will be in line with the average annual holiday increase of 3.6% from 2010 to 2019.
- According to an analysis by **Freightwaves**, an estimated 35,000 trucking companies were shuttered in the fiscal year ending Sept. 30. For the ten years prior, the average number of annual out-of-service orders was 15,585.
- **Nations Capital (NCI) and Ritchie Bros. Auctioneers** have received bankruptcy court approval to be the agent and liquidator of Yellow Corporation's transportation assets. The assets include a total of approximately 60,000 units of trucks, trailers, and miscellaneous LTL support equipment located across the United States and Canada at more than 300 terminal locations.
- 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

Following the best quarterly GDP growth since the 4th quarter of 2021, a growing collection of more recent data points confirms the overall macro slowing that BMO economists forecast over the next year. Nonetheless, BMO's call for a soft landing with no recession is intact, and most importantly, the increasing likelihood that the Fed Funds rate tightening cycle is over. That said, BMO is also holding to the expectation that any explicit easing by the Fed will have to wait until the 3rd quarter of next year. At the industry level, truck freight rates and, likewise, active truck capacity utilization have stabilized at low levels and are expected to improve very gradually throughout 2024. However, beyond seasonal tightening, any enduring improvement over the next several quarters will not necessarily come from a surge in freight tonnage but rather the rebalancing of freight-carrying capacity from the ongoing exit of marginally viable carriers that poorly timed their entry into the market during the peak freight cycle of the pandemic era.

**Industrial Production Index (Seasonally Adjusted)**



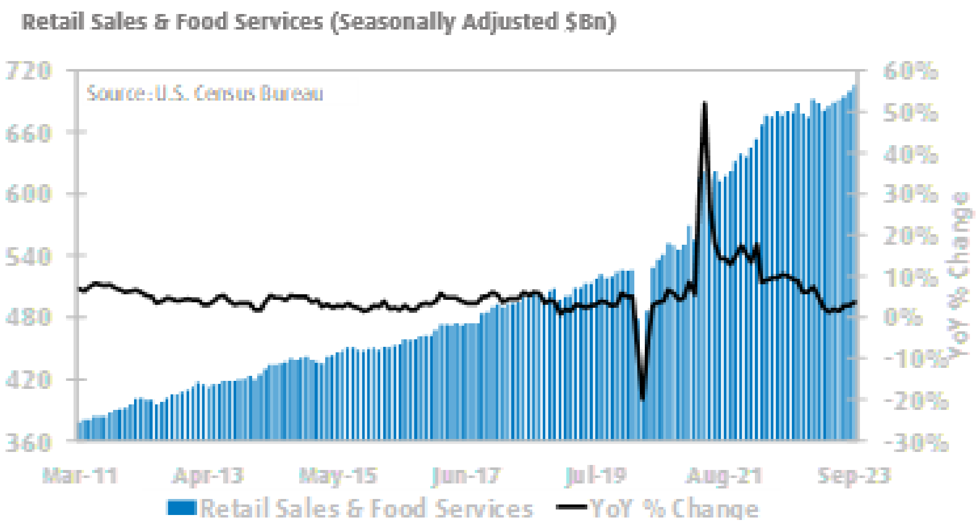

**U.S. industrial production** jumped 0.3% in September, confounding expectations for a decline. Although the prior month's gain was revised to flat, the index now stands at its highest since the end of 2018. Manufacturing output (the biggest component of industrial production) rose 0.4% after August's gain was revised to show a 0.1% decline. Notably, motor vehicles and parts climbed 0.3% despite the autoworker's strike.

The increase in manufacturing output pushed **capacity utilization** higher by 0.1 percentage points to 77.8%, which is still 1.7 percentage points below a year earlier and 0.4 percentage points lower than the long-run average.

## Macroeconomic Indicators

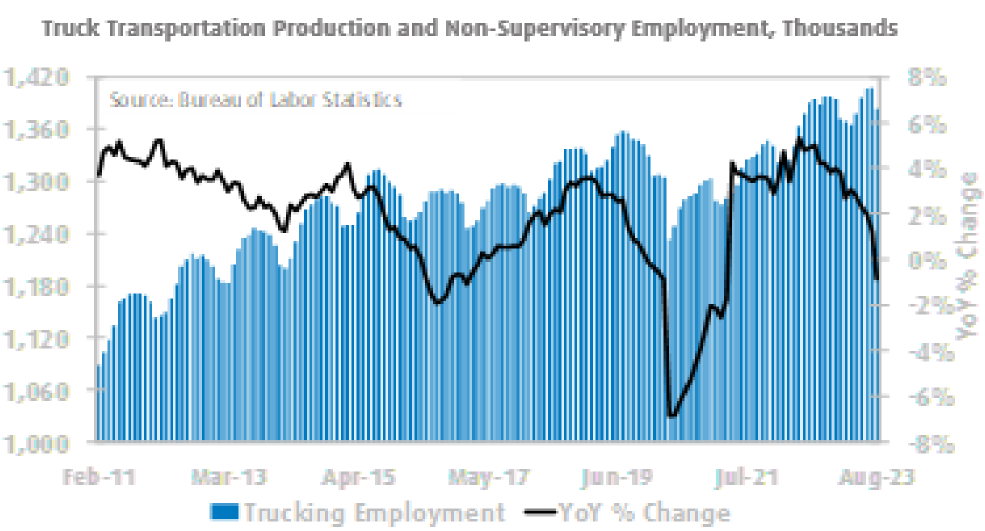

The **Purchasing Managers' Index (PMI)** is a sentiment measure of near-term business conditions in the manufacturing sector. During October, the index dropped by a more-than-expected 2.3 points to 46.7. Overall, the index has held below the 50-mark, indicating shrinking activity, for twelve straight months – longer than during the financial crisis. The silver lining is that the UAW strike was likely a drag during October, so the recent settlement with the Big 3 is one less headwind in the future.

The past relationship between the PMI and GDP suggests that the October PMI corresponds to an annualized GDP growth rate of -0.7%, well below BMO Economists' current estimate of +0.9% for the fourth quarter.




**U.S. retail sales** climbed 0.7% in September, down slightly from an upwardly revised 0.8% rate in August but more than double consensus expectations for a 0.3% advance. Solid job growth, sturdy wage gains, and possible excess (though declining) savings continue to fuel the impressive spending. Sales rose in eight of 13 categories, including motor vehicles and parts (+1.0%), restaurants and bars (+0.9%), gasoline stations (+0.9%) and personal care stores (+0.8%).

While the strong labor market will enable consumers to keep spending, growth will be challenged by the resumption of student loan payments, dwindling excess savings, and slowing wage growth. For now, though, it would be premature to underestimate the U.S. consumers' willingness to spend.



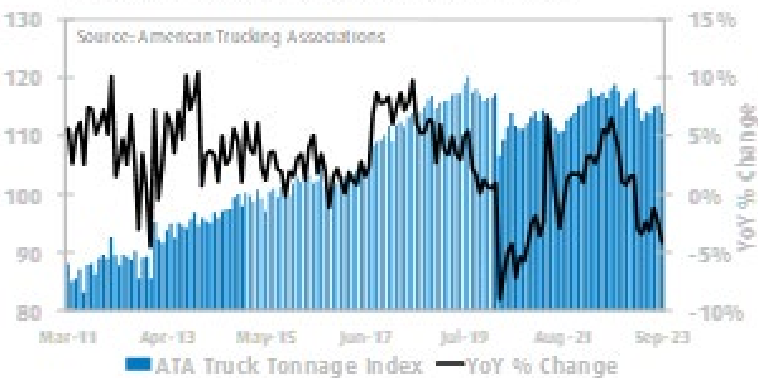

Employment in the truck transportation industry during August retreated from an all-time high reached in July. **Production and non-supervisory employment** during August declined for the first time since March and was down 1.7% (~24,600) from the record high of 1.4 million in July and down 0.8% (~11,600) year-over-year.

Despite recently reaching an all-time absolute high, the growth rate of employment has notably decelerated over the past 18 months (and turned negative for the first time in more than two years) as lower equipment utilization from a sluggish freight environment has decreased the urgency for carriers to add driver capacity.

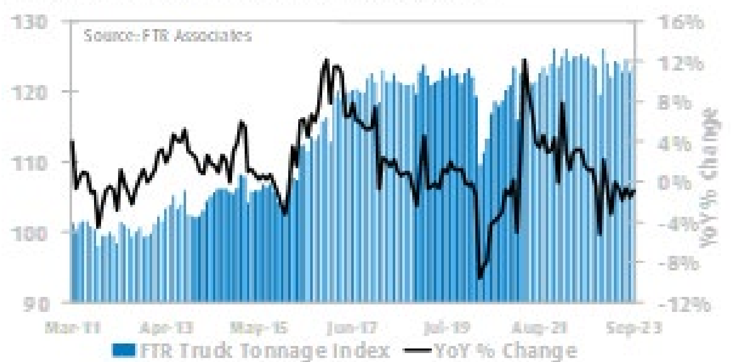
## Freight Indicators

Pressure on interest rate-sensitive freight-generating sectors will likely keep truck freight stuck in neutral for several quarters. Beyond the upcoming holidays, consumer consumption will increasingly feel the cumulative effects of elevated inflation, depleted savings, the restart of student loan payments, and high interest rates on record revolving credit balances. Further, with home affordability near 4-decade lows, homebuilders will remain cautious about starting new builds. More positively, there remains a long tail of freight destined for the still near-record number of new homes not yet completed. Additionally, the accumulated backlog of durable goods remains at record levels, while the near and on-shoring trend in manufacturing is a welcome secular tailwind that could partially offset any end-market weakness. Lastly, already healthy infrastructure spending should finally see a boost next year from funds released by pandemic-era stimulus initiatives.

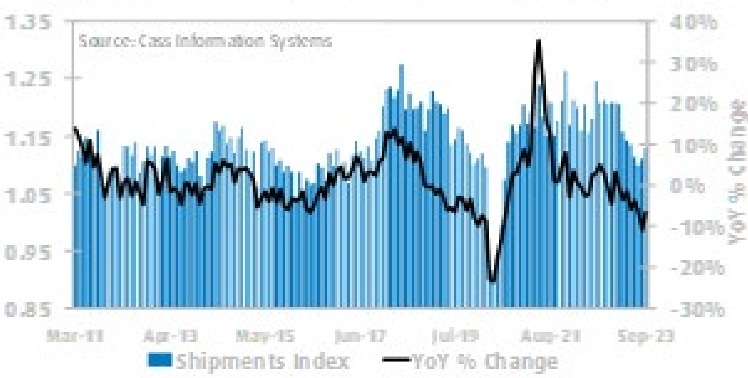
**ATA Truck Tonnage Index (Seasonally Adjusted)**



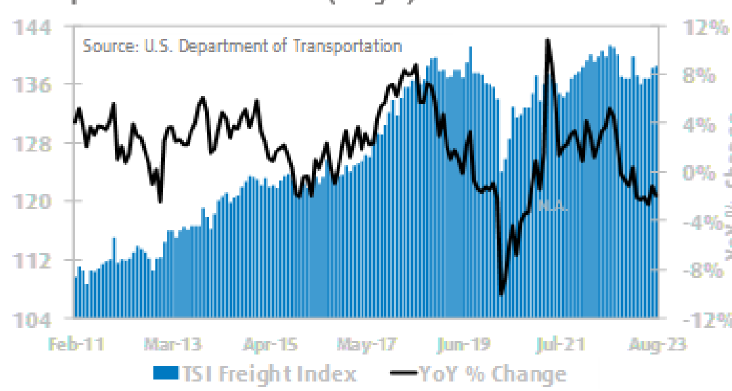

**FTR Truck Tonnage Index (Seasonally Adjusted)**




**Cass Freight Index – Shipments (Seasonally Adjusted)**




**Transportation Services Index (Freight)**

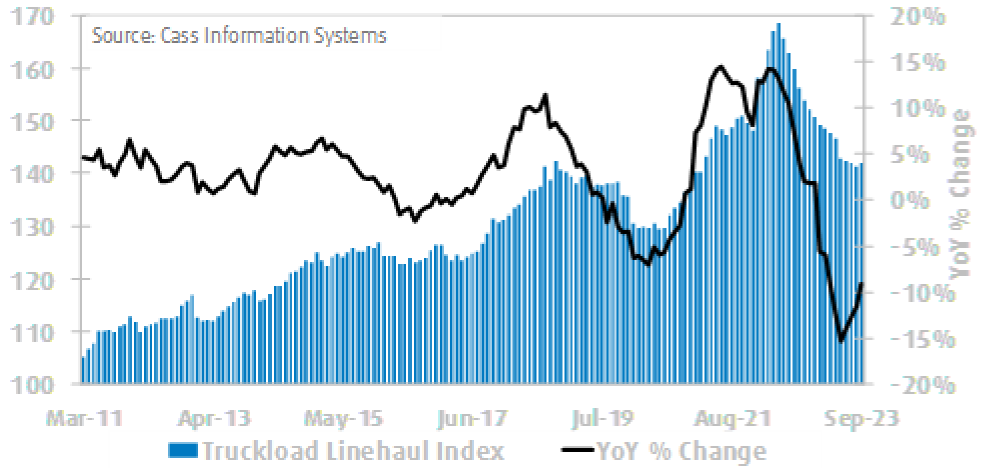



**Class 8 Fleet Capacity Utilization**


- The **ATA For-Hire Truck Tonnage Index** (primarily contract freight) fell 1.1% (month-over-month) during September and was 4.1% lower than a year earlier.
- The **FTR Truck Tonnage Index** has been choppy at a high level while contracting year-over-year in ten of eleven months through September.
- The **Cass Freight Shipment Index** (all modes) has declined year-over-year for eight consecutive months through September.
- The **TSI Freight Index** has contracted year-over-year during nine of the prior ten months through August.
- The **FTR Class 8 Capacity Utilization Index** has bounced from a 3-year low and is essentially in line with its long-term average.

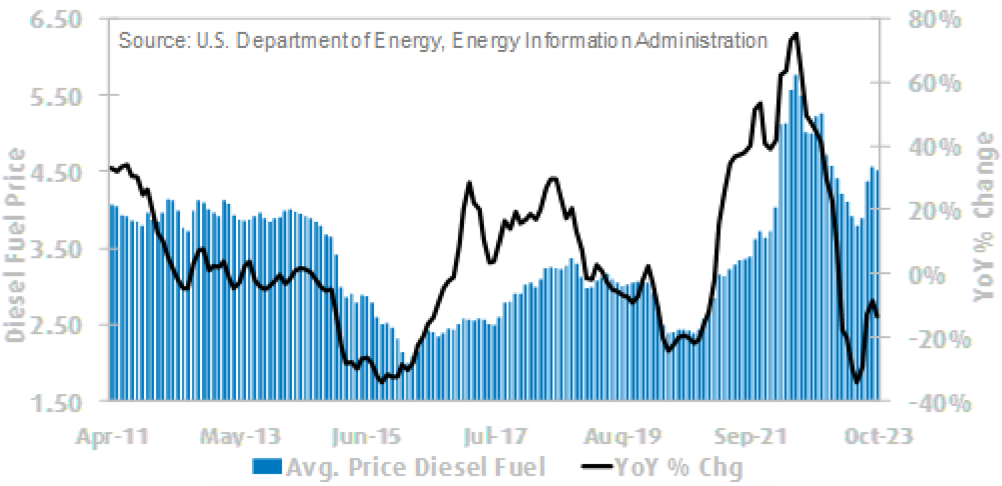
## Revenue And Expense Indicators

### 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 April, the worst of the nearly relentless downward pressure on contract rates may be in the rearview. That said, even with a flattening trend, the year-over-year comparisons will likely remain negative into the 2nd quarter of next year.

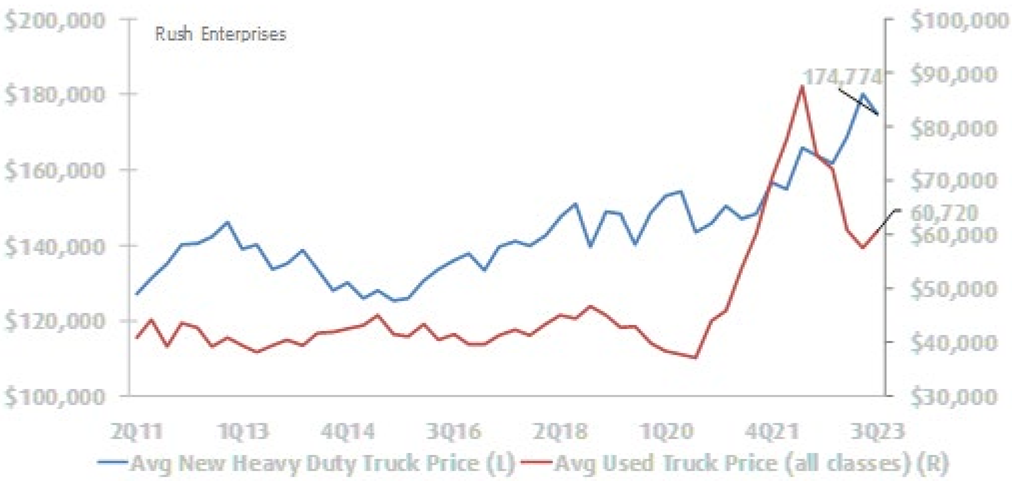
### On-Highway Diesel Fuel Price (Monthly Average $/Gallon)




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. Over the past few months, mirroring a runup in WTI crude prices since mid-summer, the national monthly average Diesel price of $4.51/gallon during October had increased $0.71 (+19%) from June but was still down nearly 14% from a year earlier.

According to the most recent forecast from the U.S. Energy Information Administration (EIA), WTI crude and Diesel prices will experience modest volatility in both directions through the remainder of the fall before finishing the year near current levels, followed by gradual price declines through mid-summer of 2024.

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

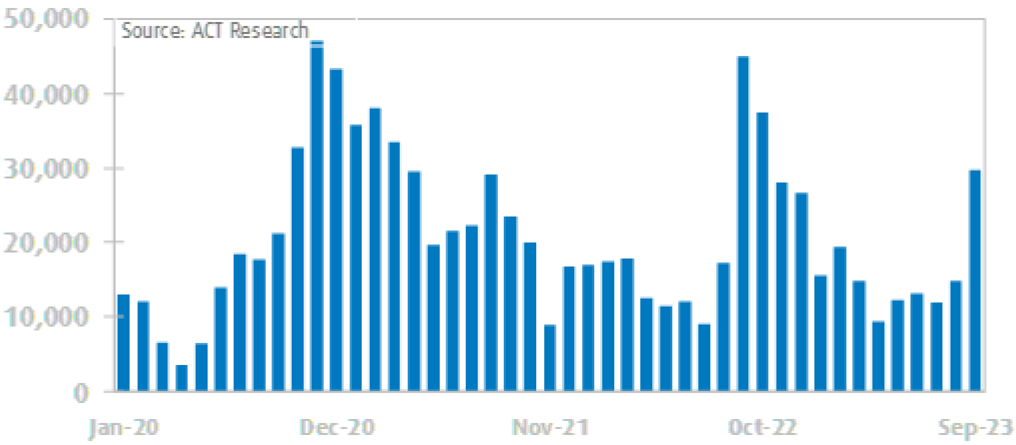



With a substantially improved supply chain coupled with ongoing strong demand from large fleets, the **average price of new heavy-duty trucks** sold by Rush Enterprises during the 3rd quarter remained just shy of the record reached during the 2nd quarter. Heavy-duty ASPs decreased by $5,187 (-2.9%) from the high watermark of the 2nd quarter but were still up $10,895 (+6.6%) from the year-earlier quarter.

Used truck prices experienced a surprising reprieve from relentless depreciation since peaking during the 2nd quarter of 2022. The **average price of all used trucks** sold by Rush Enterprises during the 3rd quarter increased 5.3% from the 2nd quarter but was still down 18.6% from the year-earlier quarter. Rush has taken a strategically defensive position by holding below-average used truck inventories and expects demand and values for used equipment to remain low through year-end.

## Truck and Trailer Orders

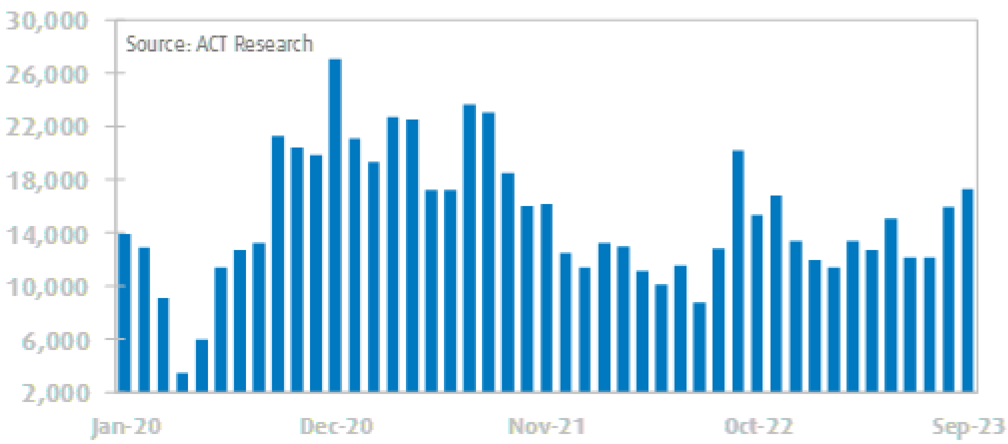
U.S. Class 8 Net Truck Orders




Although year-over-year comparisons remain negative, **U.S. Class 8 net truck orders** awoke from a typical Summer slumber as the Fall order season approached and build slots opened for 2024 deliveries.

Net truck orders bottomed in April and had since drifted higher through August before the surge in September. Altogether orders during the 3rd quarter were up 62% from the 2nd quarter but 21% lower than the year-earlier quarter. Based on prior seasonal trends and next year's build slots fully opening over the next couple of months, the near-term order pace will likely remain elevated through the end of the year. That said, given expectations of an equipment cycle reset to replacement levels next year and difficult comparisons, declines in year-over-year orders through the Spring would not be surprising.

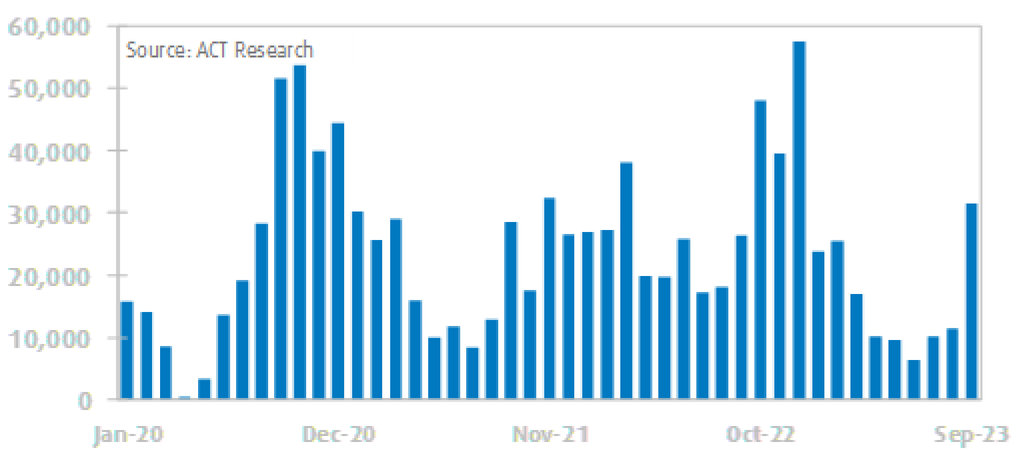
U.S. Class 5-7 Net Truck Orders




Despite the headwind of slowing residential construction, **medium-duty truck orders** accelerated entering the fall as OEMs opened more build slots available for early next year.

Overall orders during the 3rd quarter were up 13% from the 2nd quarter and nearly 9% from a year ago. Similarly, year-to-date through September, orders are up 9%. Importantly, trailing 6-month cancellations remain relatively benign, averaging 1.4% of backlog and well below the 2.6% 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 pattern for heavy-duty power equipment, albeit with signature pronounced volatility, **orders for trailers** saw a significant surge entering the Fall following a usual seasonal lull during the Summer. And given typical fall/winter seasonality, orders will likely remain elevated, although most likely lower year-over-year, through year-end.

During the 3rd quarter, orders increased 103% from the 2nd quarter but were down 14% from the year-ago quarter. Meanwhile, the monthly cancelation rate of 2.6% during the 3rd quarter, although an improvement from 3.2% during the 2nd quarter, was still notably above the long-run pre-Covid average of 1.9%.

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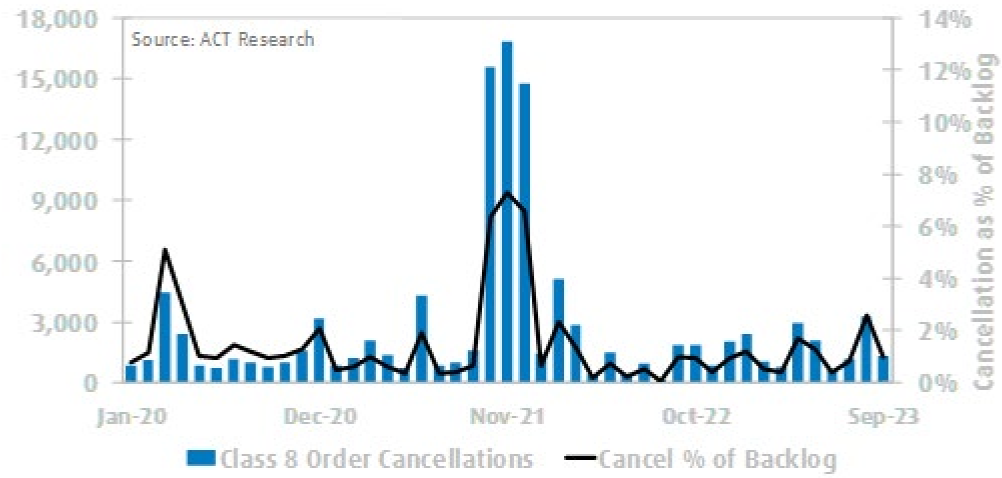
## Other Equipment Indicators

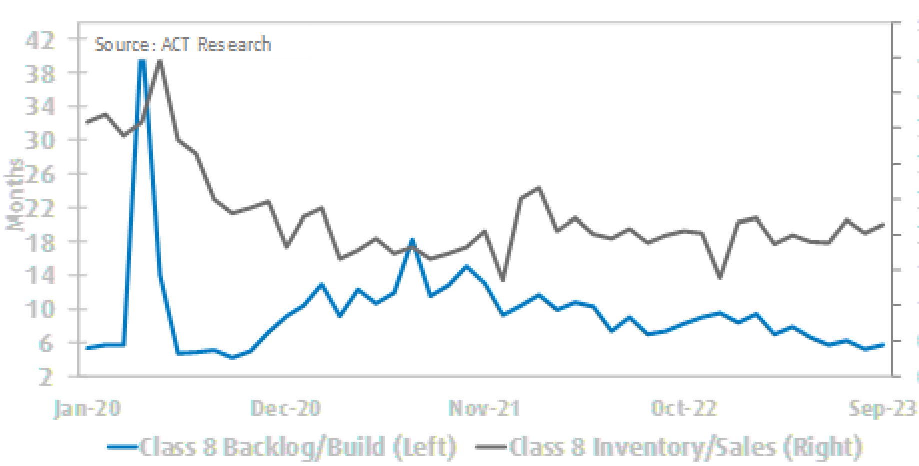
U.S. Class 8 Order Cancellations




Despite the steady downtrend in new orders and backlog throughout the year, the appetite of carriers in the current backlog appears intact, given a trailing 6-month average monthly cancelation rate (as % of backlog) of 1.3% compared to the pre-pandemic 2.3% long-run average.

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 is not likely to remain so far below the long-run average. Still, following several years of limited availability, most fleets remain reluctant to relinquish their place in line.

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




A deceleration in orders throughout the year, combined with a dramatic increase in production, has put significant downward pressure on wait times for new class 8 trucks. Specifically, the **heavy-duty backlog-to-build** ratio has been driven to the lowest level since October 2020 and, at the end of September, was slightly below the long-run pre-pandemic average of six months.

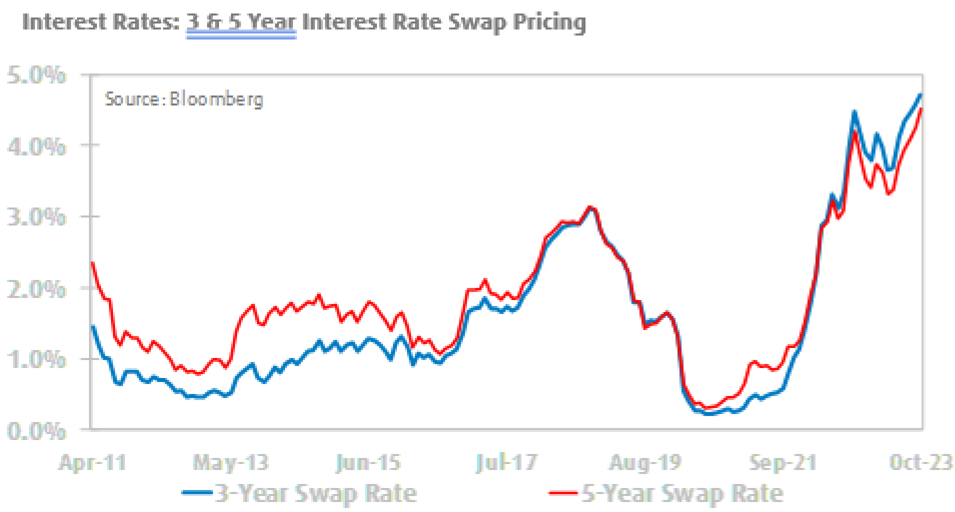
With the improvement in builds met with decelerating demand, the **heavy-duty inventory-to-sales** ratio has increased from below 1 ½ months at the end of last year to the middle of the long-term average range of 2-2 ½ months.

U.S. Class 8 Retail Sales vs Builds


Including a sharp early calendar downturn in January, the well above replacement pace of **U.S. Class 8 unit retail sales** (275.1k annualized year-to-date and 282.2k over the past twelve months through September) is a clear sign that OEMs have made significant progress with their supply chains while also demonstrating that plenty of carriers, mostly large for-hire and private fleets, have not lost their appetite for capacity. That said, the pace of sales over the most recent three months has decelerated to a still healthy annualized rate of 272.1k.

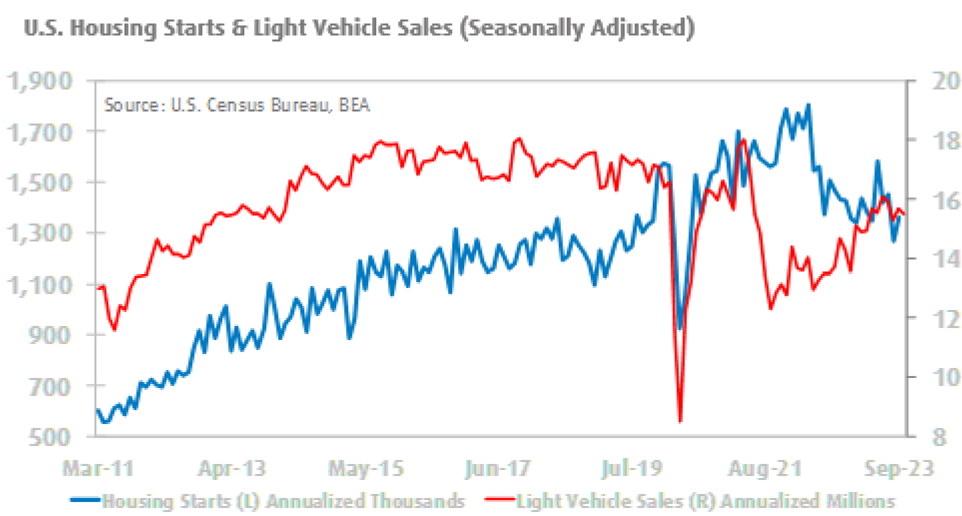
**Class 8 production** has improved significantly from a monthly average of 18,000 units in 2021 to 22,000 during 2022 and, more recently, a year-to-date average of 23,900.

## Other Business Indicators



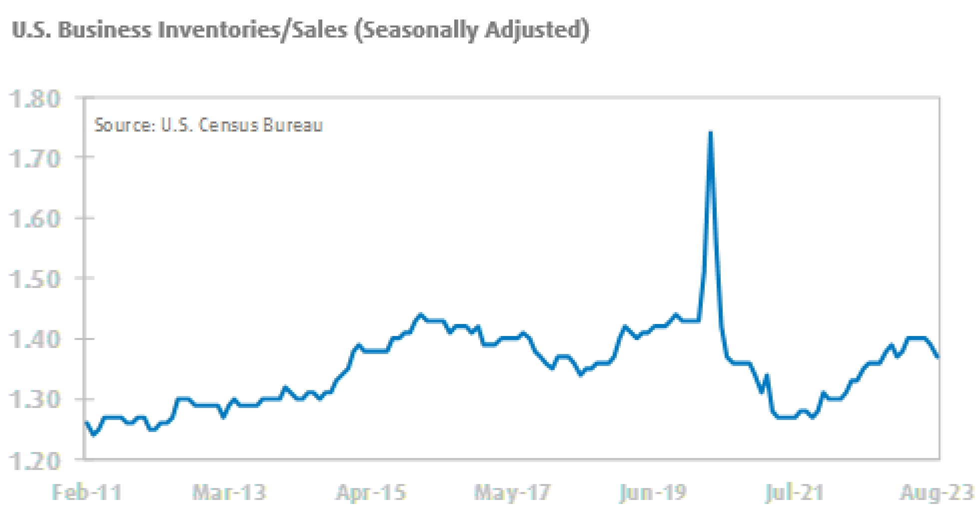

**Interest rate swaps** are derivative instruments commonly used by financial institutions to mitigate interest rate risk on a loan portfolio. The pricing of interest rate swaps (swap rates) mirrors expectations of interest rates' future direction.

After a brief shift lower early in the year, rates across the yield curve at the end of October had again reversed course and shifted to multi-decade highs. The surge higher is primarily due to an improving macro outlook, stubborn services inflation, Fed posturing of "higher for longer," and unprecedented issuance of treasury securities necessary to fund record budget deficits.




Despite a surprising +7.0% month-over-month uptick in September, **U.S. housing starts** have been in a two-year downtrend. High mortgage rates and stubbornly high prices have reduced affordability to the lowest level in nearly four decades. As of early November, BMO economists estimated U.S. housing starts will follow a 10.3% decline in 2023 with another modest decline of 1.4% in 2024.

While the auto sector avoided major roadblocks from the UAW strike, the outlook for future new vehicle sales will remain underwhelming if interest rates don't begin to ease in 2024. As of early November, BMO economists estimated **U.S. auto sales** in 2024 will fall 3.2% from 15.5 million to 15.0 million.




The **total business Inventories-to-sales ratio** bottomed at an all-time low at the end of 2021 but has now 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, given some depletion during the UAW strike, remain somewhat below historical norms.

"Voice of the BMO Economics Team"

With macro conditions outperforming most economists' expectations but with the lag of financial tightening not yet fully reckoned with, 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/

**The Global Pause That Refreshes**

***Douglas Porter, Chief Economist and Managing Director - November 3rd, 2023***

When we all look back at this highly unusual and extremely eventful cycle, it may be no exaggeration that **this week will be viewed as a watershed**. A confluence of major events came together in recent days to apparently break the fever in long-term interest rates, the U.S. dollar, and perhaps even bearish sentiment among consumers and businesses. The major spark was Wednesday's FOMC meeting, which helped drive a 40 bp plunge in 10-year Treasury yields over a matter of three sessions. After piercing the 5% level only recently, this week's huge rally took them down below 4.5% before bouncing slightly. Global bonds came along for the ride, with bunds falling 30 bps in little more than a week, and Canada nearly keeping pace with the steep U.S. decline—10-year GoCs fell to barely above 3.7% after pushing above 4.25% just one month ago.

The sharp pullback in long-term interest rates was a profound relief for struggling equity markets, and particularly for dividend-heavy and long-duration stocks. After suffering through a 10% correction in the past three months, the S&P 500 snapped higher by roughly 5% this week, while the lagging TSX was headed for its best week in more than a year with a near-6% advance. At the same time, the U.S. dollar finally relented on its upward march, retreating against a broad basket of currencies. Even the Canadian dollar got into the act, rising 1.5% from last Friday's low tide—i.e., the very day that we penned a piece on the plight of the loonie. Mostly anticipating such a turn, and in our sturdy defense, we did not change our outlook on the Canadian dollar, and continue to expect it to firm over the next year as the greenback fades further.

Yet while this week may mark a watershed, we can forgive future financial historians from wondering precisely **what the trigger was** for such widespread jubilation. After all, **the Fed's decision** to pause was not new—it's the third FOMC meeting this year on hold—nor was it the least bit surprising, as Fed speakers had well-telegraphed the outcome. Some pointed to the mention of tighter financial conditions in the Statement, but many, many Fed officials had noted that in recent weeks. (As well, the furious rally of recent days has gone a long way to reversing said "tighter" conditions.) And Chair Powell's remarks at the press conference were appropriately guarded, with precisely zero promise that the Fed was done. Even so, markets have almost fully priced out any odds of additional hikes and are expecting cuts by the middle of 2024.

This week's heavy onslaught of economic data was not especially shocking either, although the skew was fairly consistently to the soft side of expectations. Friday's **jobs report for October** was arguably the perfect tonic for an ailing market. We will studiously refrain from the tired cliché of calling it a Goldilocks result, even if it was **neither too hot**—hourly earnings cooled to 4.1%—**nor too cold**—job gains were still 150,000—but **just right**: the unemployment rate nudged up a tenth to 3.9%. Papa bear may note that the household survey, which often catches turning points earlier than its payrolls sibling, reported a deep 348,000 job loss. Besides a cooler jobs result, both the **factory and services ISM** came in well light of expectations, reinforcing the view that GDP will decelerate noticeably in Q4 after the 4.9% Q3 blowout. We remain comfortable with our call of just under 1% this quarter; and note that the Atlanta Fed's early read on its GDPNow is 1.2%.

**Treasury's quarterly refunding** was also a key focus this week, and even it helped lighten the mood in the bond market. Make no mistake: Funding requirements remain onerous, with the underlying budget deficit running at nearly $2 trillion. But next week's slate of three major auctions will haul in $112 billion, a bit less than the market was braced for heading into the announcement.

## “Voice of the BMO Economics Team” Continued

**FMOC Announcement – Keeping Policy Cards Close To Chest**

***Michael Gregory, Deputy Chief Economist - November 1st, 2023***

**The FOMC left policy rates unchanged** today, as was broadly expected. The target range for the fed funds rate remains at 5.25%-to-5.50%. In the statement, “strong” replaced “solid” in describing current economic activity, a meaningful upgrade, but this was countered by the mention of both “tighter financial and credit conditions” as weighing on future economic activity. Before, only tighter credit conditions was mentioned, in a new nod to higher bond yields.

Elsewhere, September’s **forward guidance was repeated** (which had been in place for the prior three meetings). It says: “*In determining the extent of additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments*.” As we’ve mentioned before, the “*may be appropriate*” phrase affords the Fed a lot of flexibility. It fit July’s hike, along with September’s and November’s skips and, thus, it can accommodate the possibility of either action at the next meeting.

In the presser, Chair Powell’s opening comments sounded like his remarks made a couple of weeks ago, so no new insights. In the Q&A, in discussing the policy implications of higher bond yields, he said that two things matter. First, whether the move is proving to be persistent and, second, whether the move reflects higher term premiums and not market expectations for ‘higher-for-longer’ policy rates (he judges it is more term premiums).

**Bottom Line:** The Fed served few clues about potential policy actions on December 13 or January 31. In the presser, Powell even avoided saying the Fed had a formal “tightening bias”. In its self-described meeting-by-meeting approach, the Committee will assess whether it has achieved sufficiently restrictive monetary policy. The Fed judges it’s not there yet, but financial conditions are working to steer them in that direction. We'll see where this lands by mid-December, after a couple iterations of key data.



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