Industry Update

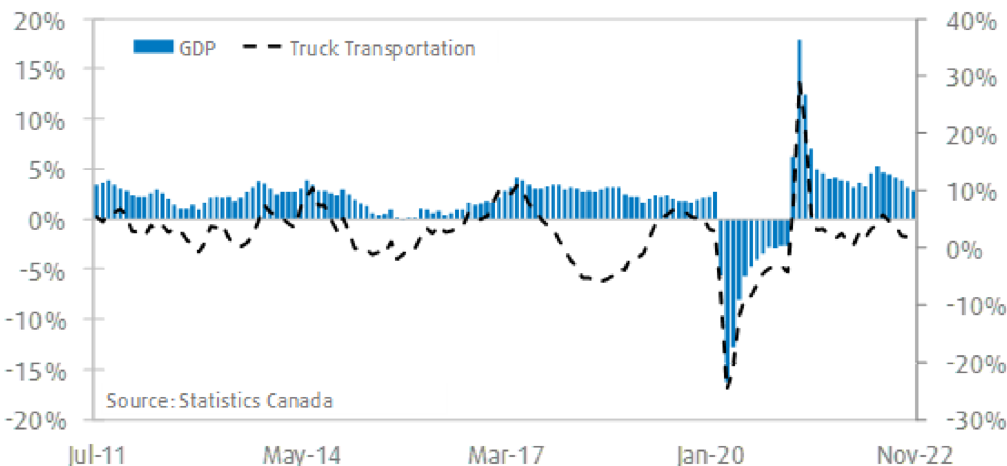
Canada Truck Transportation

Key Developments

- As part of Canada's $9.1 billion **Emissions Reduction Plan**, the Federal Government released **Canada's Action Plan for Clean On-Road Transportation**, outlining the strategy for the switch to zero-emission vehicles and achieving net-zero emissions by 2050. The plan will set annually increasing requirements towards attaining 100% light-duty zero-emission vehicle sales by 2035. The roadmap also aims to reach 35% of total new medium and heavy-duty vehicle sales being zero-emission vehicles by 2030 and 100% by 2040, depending on the feasibility of available products.
- Winners of the 2023 **Truckload Carriers Association's Best Fleets to Drive For** have been announced, with six of the top 20 from Canada. Canadian winners were C.A.T.; Challenger Motor Freight; Erb Transport; Fortigo Freight Services; Kriska Holdings; and Wellington Group of Companies. Bison Transport was the sole Canadian company to repeat as a Hall of Fame winner and was joined in the Hall of Fame by TransPro Freight Systems.
- Lagging behind other jurisdictions that adopted and enforced the **ELD mandate** at the beginning of the year, Quebec announced that the province would mandate electronic logging devices (ELDs) beginning April 30th.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

Freight volumes continue to bear the brunt of retreating commodity prices that dampen production, a consumer shift toward services, and tighter financial conditions manifested in slowing manufacturing, construction, and trade activity. While the spot freight market saw a seasonal upturn at the tail end of 2022, the longer-term trend reflects slackening conditions. On the bright side, decelerating inflation, a surprisingly robust labor market, improving supply chains, and a pause in rate hikes by the Bank of Canada should mitigate some downside pressure. Indeed, the tailwinds entering 2023 have been strong enough for BMO economists to nudge their GDP growth outlook higher for the current 1st quarter and delay the onset of a base-case shallow and brief macro contraction until mid-year.



Canadian real GDP edged up 0.1% in November, and the preliminary estimate for December points to a flat read. As such, the economy grew roughly 1.6% annualized during Q4, a touch higher than the BoC's latest estimate (1.3%) and slightly above BMO's call (1.5%). Note that 1.6% growth is below the economy's 10-year trend (1.8%) and last year's population growth.

Following a peak in June, growth in the **truck transportation sector** has decelerated. Still, the industry has recorded 21 consecutive months of positive year-over-year growth through November. Nonetheless, industry activity remains slightly below where it was just before the pandemic's start in February 2020.

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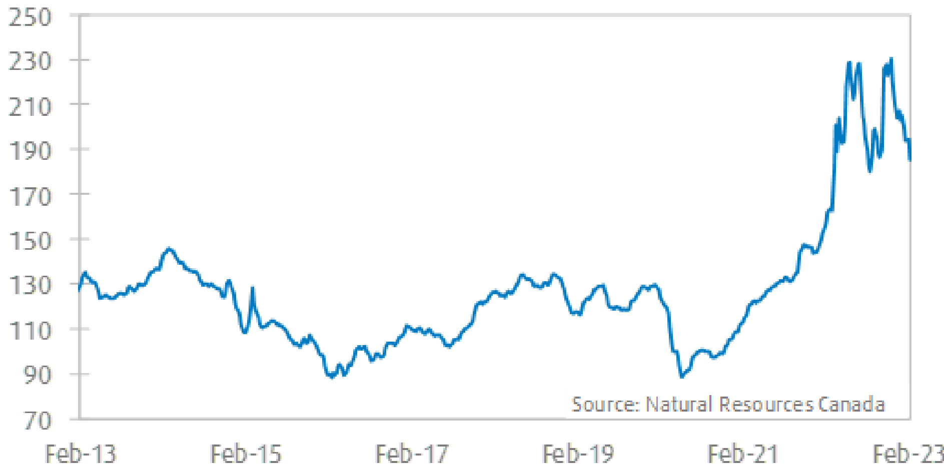
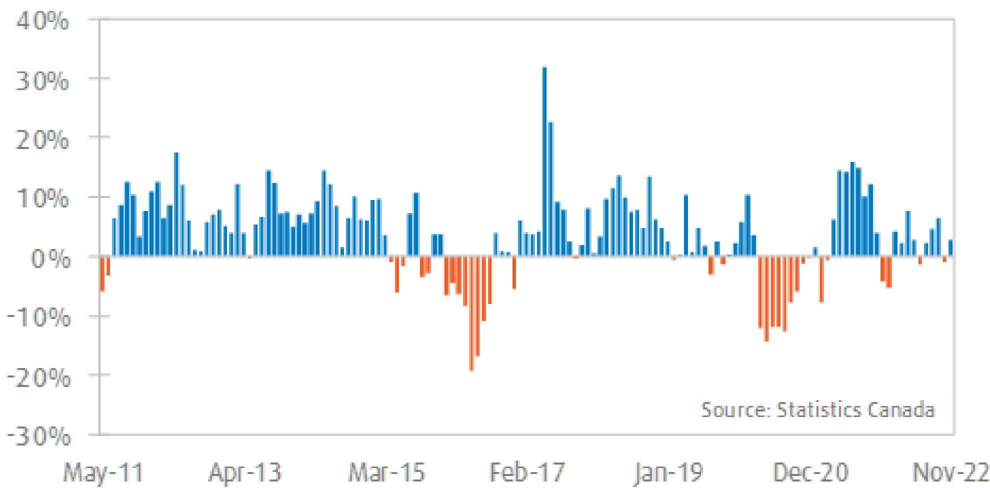
Trucking Business Influencers



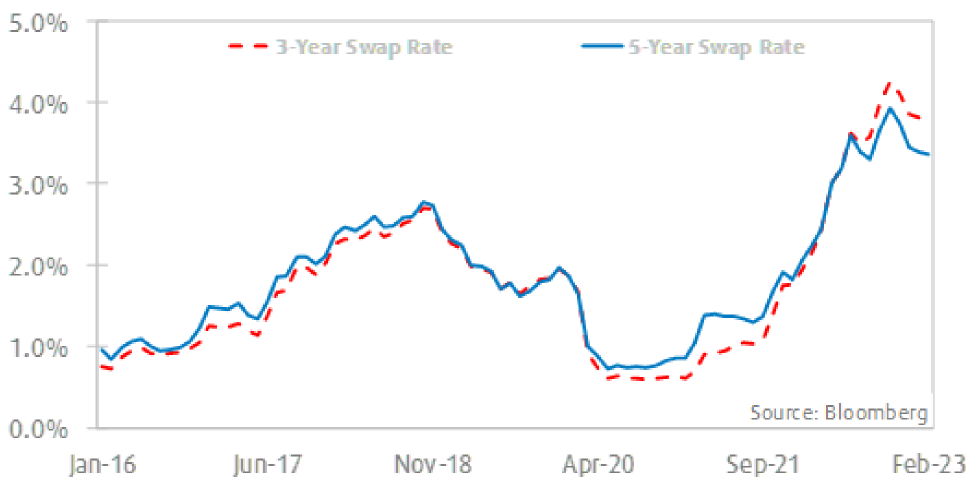
Since the invasion of Ukraine, **Retail Diesel fuel prices** across Canada have been on a high-altitude roller-coaster. More recently, however, mirroring a decline in global crude prices, the average weekly Diesel price of 185 cents/liter during early February had declined 45 cents (-20%) from an all-time high in November.

Despite a 15% pullback since early November, the current BMO outlook suggests that WTI crude prices will rebound given China's recent reopening, new EU sanctions on Russian crude, a recent 5% cut in Russian production, and the possibility that OPEC+ could cut output further in response to a weakening global economy.



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 +3.0% year-over-year increase in crude oil production during November represented the third-highest monthly output since the pandemic and the eighth out of the past ten months of year-over-year gains.

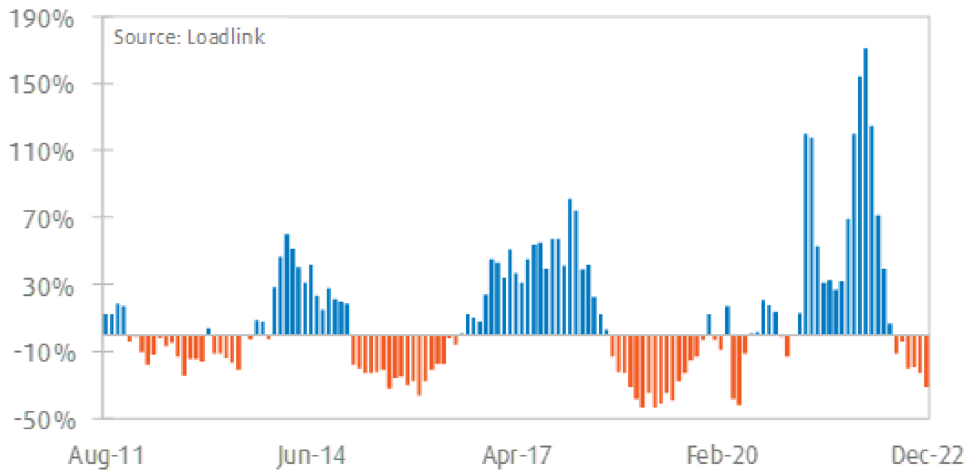
Longer-term, beyond the current global supply constraints, the big questions for crude oil production will be how the demand curve evolves due to climate change policies and the trend toward ESG-driven fossil fuel divestments.



Interest 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.

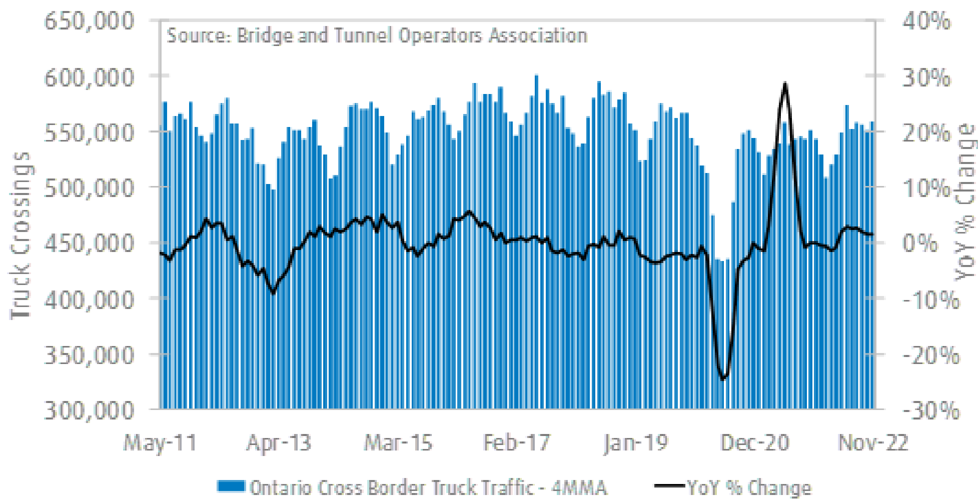
Short-term yields bolted higher throughout 2022 as central banks embarked on a hawkish path of aggressive policy rate hikes in response to multi-decade-high inflation. That said, following a 25 basis point increase in January, the BoC has indicated it will pause to assess the impact of a cumulative 425 basis points of tightening over the past eleven months. Further, a recent rollback of swap rates reflects a decline in year-over-year inflation and, likewise, increasing odds that the next move for central banks could be to reverse course over the next year or two.

Freight Indicators

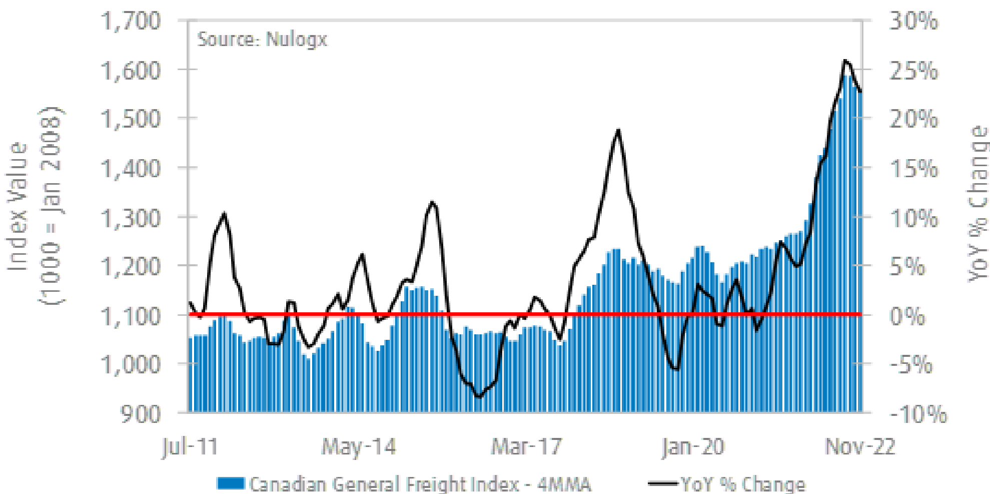


Since reaching an all-time high last March, **truckload spot freight volume** had declined throughout the summer and fall before rallying in November and December. Still, despite the late-year push, spot freight volume declined year-over-year for six consecutive months through December. Altogether, by the end of December, the index had contracted 55% from the March peak but remained higher than at the same point during 2018-2020.

While capacity tightened at the end of the year as freight volumes turned higher, capacity loosened overall during 2022. The ratio for December of 2.13 available trucks for every load posted was lower (tighter) than 2.86 during November but significantly higher (looser) than the cycle low of 0.63 in February and also 76 percent higher compared to 1.21 a year earlier.

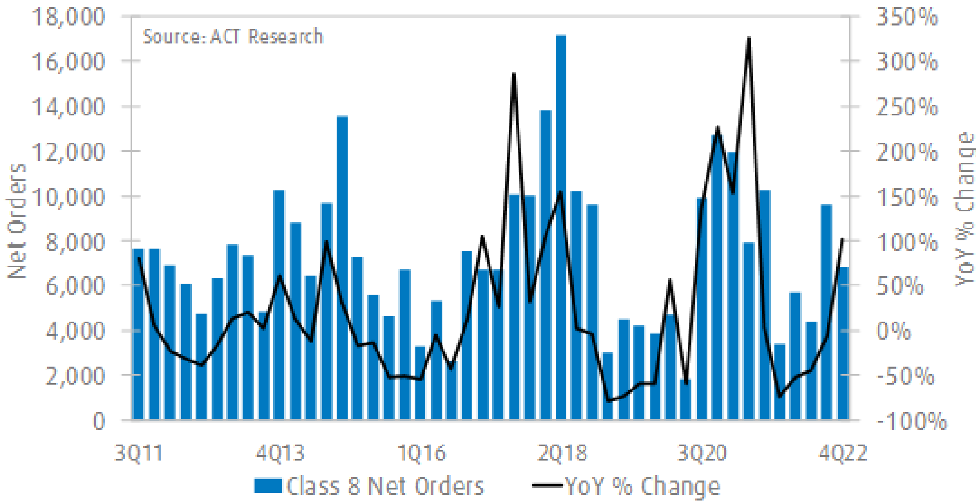


Despite the headwinds of inflation and slowing consumption of goods, improving auto manufacturing supply chains and the elimination of mandatory vaccines have helped the 4-month moving average of **truck border crossings** show modest year-over-year growth averaging 2.2% since May.

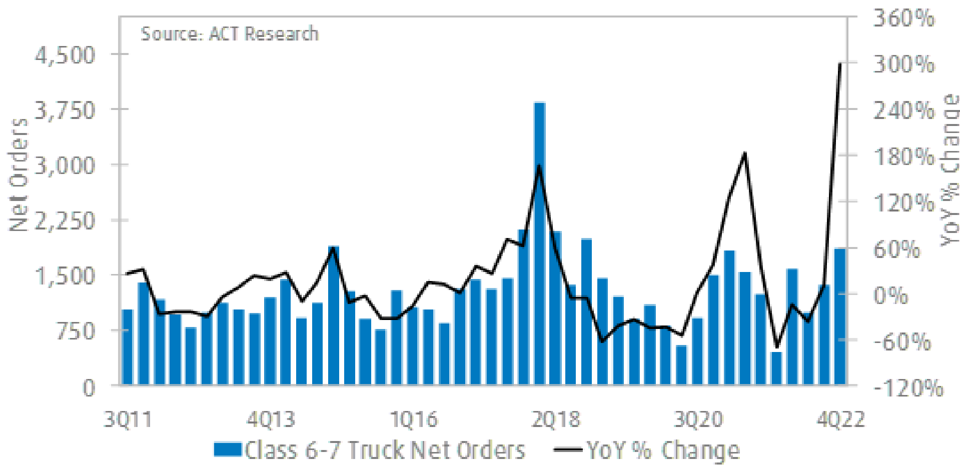


Since reaching an all-time high in August, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers has been gradually declining. Although base rates are significantly higher than pre-pandemic levels, most of the overall surge in total freight costs over the past couple of years is attributable to rapidly increasing fuel surcharges, particularly since the invasion of Ukraine. That said, the fuel component of the index during November reversed a recent downtrend and reached a new all-time peak. Fuel was 32.96% of base rates in November versus 30.54% in October and 21.81% a year earlier. Overall, year-over-year shipping costs during November were up 22.7%, far outpacing Canada's overall inflation rate of 6.8% during November and full-year 2022.

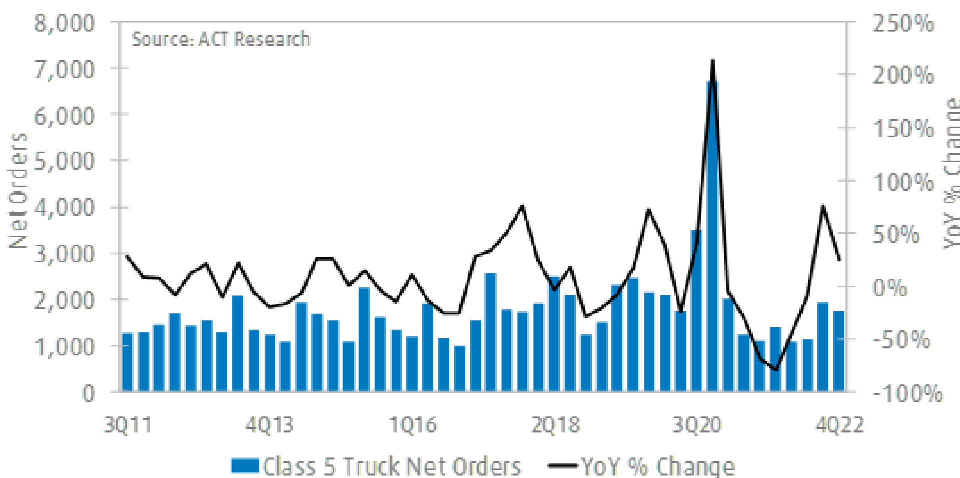
Truck Orders



Net new Class 8 orders were uncharacteristically seasonally weak during the 4th quarter of 2022, albeit against a particularly robust 3rd quarter that saw a strong surge as OEMs gained visibility into the supply chain and opened more build slots for 2023 production. Nonetheless, well below-average cancellations as a percentage of the backlog (1.0% vs. 2.2% long-term average) confirm that carrier appetite for capacity remained steady throughout the quarter.

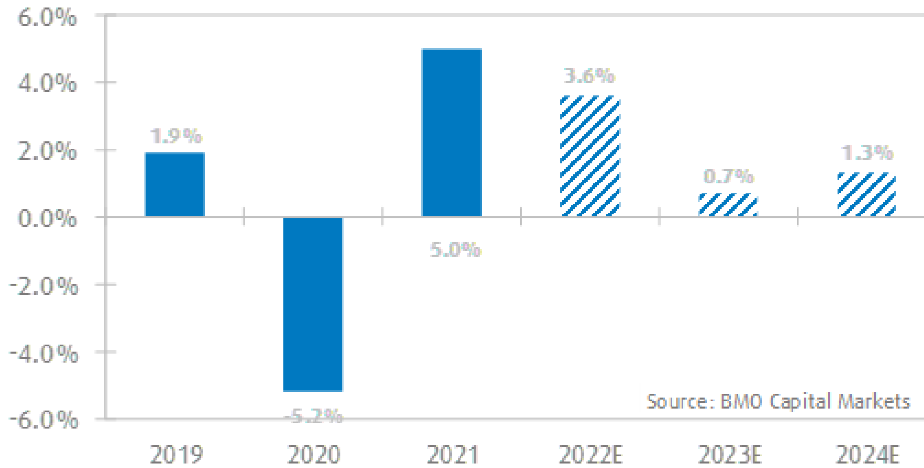


Throughout 2022, **Class 6-7 truck net orders** were vulnerable to the same supply chain factors afflicting the Class 8 market. As such, this class experienced an uneven order pattern during the first half of the year but, more recently, sequential improvements during the 3rd and 4th quarters. In the near-to-intermediate term, the severe-duty segment of this class will continue to be in a tug-of-war between positive momentum in the energy sector and contracting activity in the construction sector.

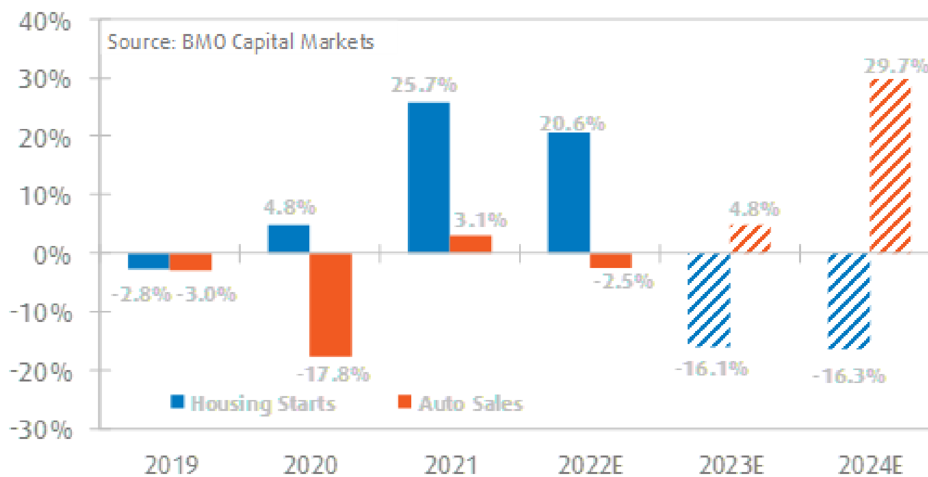


The **Class 5 market** followed the trend of the larger classes and saw an uplift in net orders during the 2nd half of 2022. The long-term demand outlook remains positive with the support of diverse end markets, consistency in vocational sectors, and the durable tailwinds of e-commerce and last-mile delivery.

Macroeconomic Indicators



The macro outlook has brightened over the past few months, with BMO Economists raising their full-year 2023 estimates from no growth (0%) to expecting modest **real GDP growth** in Canada and the US (0.7% average growth for each). That said, the probability of a short and shallow recession, with the most likely timing pushed from early to mid-year, remains the base case with net contractions of -1% (q/q annualized) in both the 2nd and 3rd quarters. The net risk is that both economies are subjected to more rate hikes than currently expected, thus triggering a more profound and possibly more protracted recession.



Canadian housing starts during December declined for the third consecutive month and by 5.5% from November to a seasonally adjusted annualized rate of 248,625 units. Urban single-family starts fell 11% to 44,858, while multi-units decreased 4% to 182,850. Despite the slowing pace toward the end of the year, the overall rate of new construction continued at an elevated pace in 2022, ending the year with actual total urban starts at 240,590 units, down a modest 1.5% from 2021. Nonetheless, BMO economists expect starts to decline another 15-20% during 2023.

Pent-up demand, assuming a continuing normalization of the supply chain, should propel the **auto sector** to a resumption of modest unit sales growth during 2023.

The primary driver of the **Canadian dollar** has been the U.S. dollar, which has overshadowed the fact that the Bank of Canada has been as aggressive as the Fed (up to recently). When the U.S. dollar hit its record high in October, the Canadian dollar averaged C$1.370 (US$0.730). In the past 18 years, the currency has been that weak (or weaker) on only two occasions, March-May 2020 at the onset of the pandemic and December 2015-February 2016 owing to the collapse in oil prices.

As the U.S. dollar has been heading lower recently, the Canadian dollar has been doing the opposite. After averaging around C$1.342 in January (US$0.745), BMO economists look for the Canadian dollar to appreciate a further 3.2% to C$1.300 (US$0.769) by December (total +4.5% y/y).

"Voice of the BMO Economics Team"

With the Bank of Canada signaling a conditional pause and the macro environment still challenged by volatile energy prices, moderating but still unacceptably high inflation, and cracks in the all-important 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/

What Do You Get When You Go On Pause? (Feb 10th 2023) - Douglas Porter, BMO Chief Economist and Managing Director

In a relatively quiet week for economic data, the Canadian jobs report landed with a resounding bang to end proceedings. Even out-doing its rollicking U.S. counterpart, employment zoomed 150,000 in January, which was a larger gain than anything seen in the pre-pandemic years. In percentage terms, the 0.75% surge blasted past those powerhouse gains of 0.33% in U.S. payrolls last month and 0.56% in the U.S. household survey. One way to capture the health of the jobs picture is the employment-to-population ratio. In a word, or ten, **Canada's employment rate of 62.5% matches the strongest reading since the days before the Global Financial Crisis.**

Of course, any Canadian jobs report always comes with a **sea of caveats**, and analysts are well aware of the inherent volatility in the employment series. Plus, the reality is that the economy actually shed 125,000 positions last month in unadjusted terms—but that happens to be the smallest "raw" drop in January jobs on record. Last month didn't so much see a hiring boom as firms holding on tightly to the workers that they already have on payroll.

Regardless of the precise explanation behind the relentless strength in the jobs market, a key takeaway is that **the economy is a long way from recession at the moment**. Accordingly, we are adjusting our economic forecast to reflect that rather loud reality, by pushing out the expected mild contraction by a quarter. **We now look for GDP to post moderate growth in Q1**, and then slip into slight declines in the next two quarters, before growth resumes in Q4. It's a **similar story for the U.S. economy**, in light of a decent start to the year for most indicators. The effect of the firmer start to 2023 means that **full-year GDP growth is now pegged at 0.7% in both countries** (up from 0.5%). Full disclosure: that is exactly in line with the latest Blue Chip Consensus estimate for the U.S., while the Canadian call is a touch below the Bank of Canada's recent estimate of 1.0%.

The robust result on Canada's labour market lands just days after the **Bank of Canada** reinforced its "now on hold" message. In a speech in Quebec City on Tuesday, the Governor was extraordinarily clear that the bar is now very high for any further rate changes in the months ahead. While the rate pause is heavily billed as "conditional", **just by saying the word "pause" makes the bar for any additional move very high**. Adding to the dovish tone, the inaugural Summary of Deliberations from the January meeting revealed that the Bank actively considered a hold at that time (versus the actual 25 bp hike). But while a rate hike at the coming meeting in March is highly unlikely, markets have been busily pricing in significant odds of one more increase later this year. Canadian two-year bond yields reclaimed the 4% mark this week, shooting 25 bps higher.

The sharp back-up in yields was partly an echo of the U.S. move, as 2-year Treasuries rose 20 bps to 4.5%, while 10s climbed almost as much to just above 3.7%. The headline event on the U.S. economic calendar this week was **Fed Chair Powell's remarks to the Economic Club in Washington**. While markets initially seized on his reaffirmation that the disinflation process had begun, and a lack of pushback to easing financial conditions, the weight of his full remarks eventually won the day. As much as investors seem to want to listen only to dovish leans from the Fed, Powell & Co. have been quite consistent in saying that **this is going to be a long battle**. Stern messages from other speakers later in the week—notably from Williams and Waller—pounded home the point that the Fed is not for turning anytime soon.

"Voice of the BMO Economics Team"

What Do You Get When You Go On Pause? (Cont.) – Douglas Porter, BMO Chief Economist and Managing Director

We have long asserted that rate cuts are unlikely this year, and that they are most likely a 2024 story (a theme the Fed is completely on board with). And, the supersized job gains on both sides of the border in January simply solidify that view. Yet, ultimately, **inflation will determine the path of rates in the year ahead**. The one silver lining—from a central bank inflation perspective—in both the U.S. and Canadian jobs reports was that the wage measures eased. Again, aping the U.S. result, Canada's average hourly wages surprisingly slipped to 4.5% y/y (from 4.8%). Some of the dip reflected a change in the composition of jobs—gains in lower wage sectors—but even adjusted for such shifts, wages cooled slightly. It remains to be seen if wages will stay so tame amid the incredibly taught job market, and with the federal public sector union looking for a double-digit increase in current negotiations.

After a relative U.S. data void, **the big gun of CPI arrives on Valentine's Day (Tuesday).** While always a potential major market mover, this month's effort may make fewer waves than normal. That's because **the disinflation story may take a bit of a pause of its own**, as gasoline and used vehicle prices moved back up last month, potentially lifting prices 0.5% m/m. That would be enough to just trim the annual rate by a tenth or two, but it's still likely to be north of 6%. It's a broadly similar picture for core, where underlying prices are expected to rise about 0.4%, just enough to trim the annual rate a few tenths, but to a still-strong 5.5%. We look for a rough repeat in the Canadian data in the following week (Feb. 21).

Beyond that temporary lull in the disinflation story, **headline inflation is expected to melt quickly in the ensuing months.** Calmer energy prices, a more normal supply chain, and very easy comparisons with the huge gains a year ago are expected to drive inflation lower with purpose. But if inflation delivers even a fraction of the high-side surprise that employment has posted, the market won't be talking about rate cuts in the second half of this year—it will be dealing with the possibility of yet further hikes.

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