BMO

Fall 2023

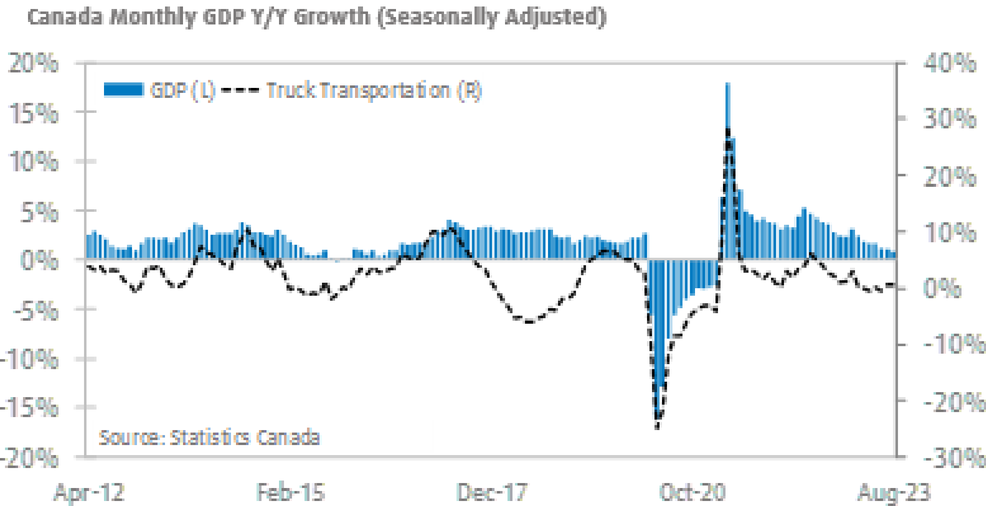
Industry Update
Canada Truck Transportation

Key Developments

- **Trucking HR Canada's (THRC)** quarterly Labour Market snapshot shows truck drivers' unemployment rates have dropped sharply. The unemployment rate among drivers settled at 3.4% during September, down from a peak of 6.5% in April.
- The **Ontario government** is looking to extend gasoline and fuel tax rate cuts to June 30, 2024. Since July 1, 2022, Ontario has lowered the gasoline tax by 5.7 cents per liter and the diesel tax by 5.3 cents per liter. The government is proposing to extend the rate cuts so the gasoline and diesel tax rate would remain at nine cents per liter.
- **Ontario** is also moving toward allowing 60-foot trailers, which have been operating under a pilot project. While participating carriers have been limited to eight permits, proposed changes would allow unlimited permits after five years of operation if safety conditions are met.
- According to the **U.S. Department of Transportation**, trucks moved $38 billion (all numbers in USD) of freight across the Canada-U.S. border in August, more than $2 billion more than in August 2022.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

The Canadian economy continues to struggle under the weight of past BoC rate hikes, resulting in a flat GDP over the past seven months. Worse for the trucking sector is that goods-producing sectors have underperformed the services sector significantly, with truck freight bouncing along the bottom since April and well below year-earlier levels. As such, capacity will remain loose, and rates will remain under pressure until any combination of resurgent freight volumes and fleet rationalization. The silver lining to the no-growth macro picture and the increasing threat of recession is that policy rates have likely already peaked. Nonetheless, given inflation remaining uncomfortably above the BoC's 2% target, BMO economists believe any policy rate relief will have to wait until at least mid-2024.



GDP has been flat since February, with year-over-year growth fading steadily. That said, the headline for August was padded by gains in mining/oil/gas, which have now fully reversed the wildfire-driven declines. However, decreases in manufacturing, utilities, and agriculture pulled goods-producing sectors down 0.2% month-over-month. Services sectors saw a modest 0.1% increase, but 9 of 15 sub-sectors were flat or lower.

Growth in the truck transportation sector has also been decelerating for more than a year. Although the industry has treaded water recently, nominal activity during August was essentially the same as in February 2020, just before the pandemic started.

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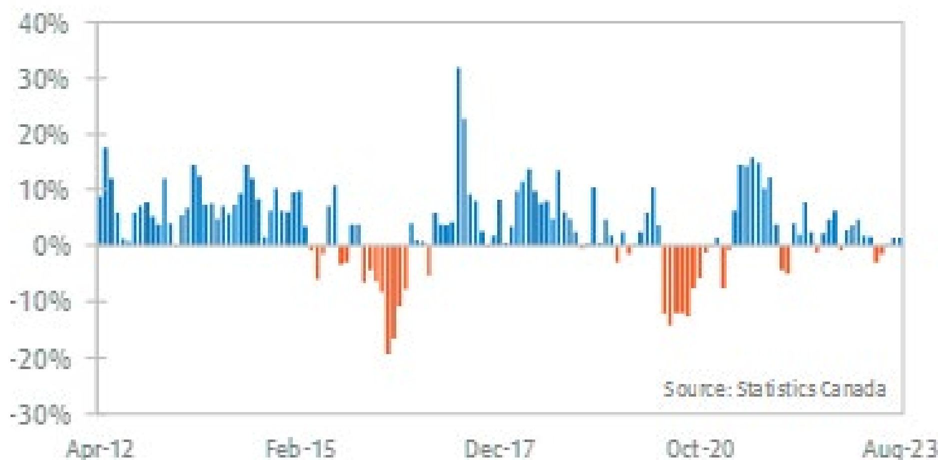
Trucking Business Influencers

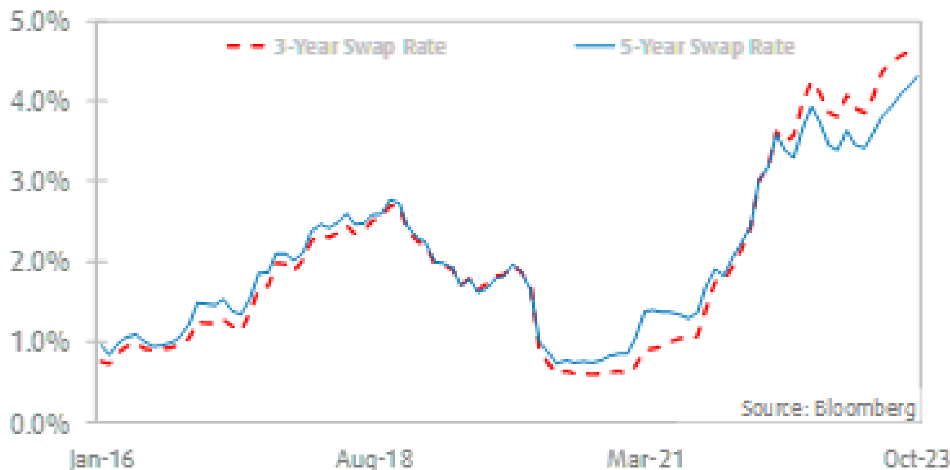
Since the invasion of Ukraine and, more recently, the conflict in the Middle East, **Diesel fuel prices** have been on a high-altitude roller-coaster. Over the past few months, mirroring a runup in WTI crude prices since mid-summer, the national monthly average Diesel price of $1.89/litre in early November had increased $0.38 (+25%) from June but was still down 18% from a year earlier.

The crude price increase since summer reflects increasing odds of avoiding a hard landing, increased geopolitical threats, and OPEC+ production cuts. The current BMO outlook for WTI suggests that crude prices will continue to drift higher toward an average of $82.50 per barrel in 2024, up from an average of $79 in 2023.



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.

Nonetheless, despite double percentage declines in the price of crude oil compared to a year earlier, **crude oil production** was up slightly year-over-year from June through August while also showing a gain of 1% year-to-date.



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 have reversed course and shifted higher primarily in response to the most recent policy rate increases. However, as elevated short-term rates continue to weigh on the macro picture, the current steep inversion will likely flatten as policy rates eventually revert to a more stimulative posture. Although the BOC has been in a holding pattern since July, as of mid-November, BMO's economists forecast that a rate cut will probably not materialize until mid-2024.

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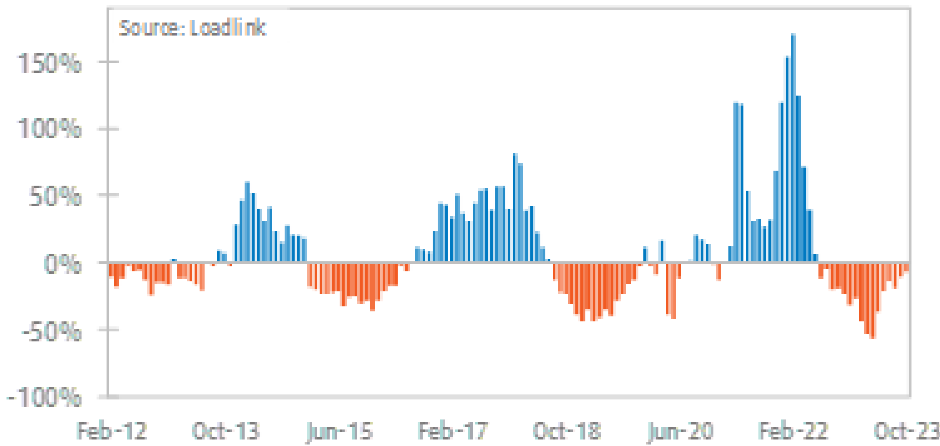
Freight Indicators

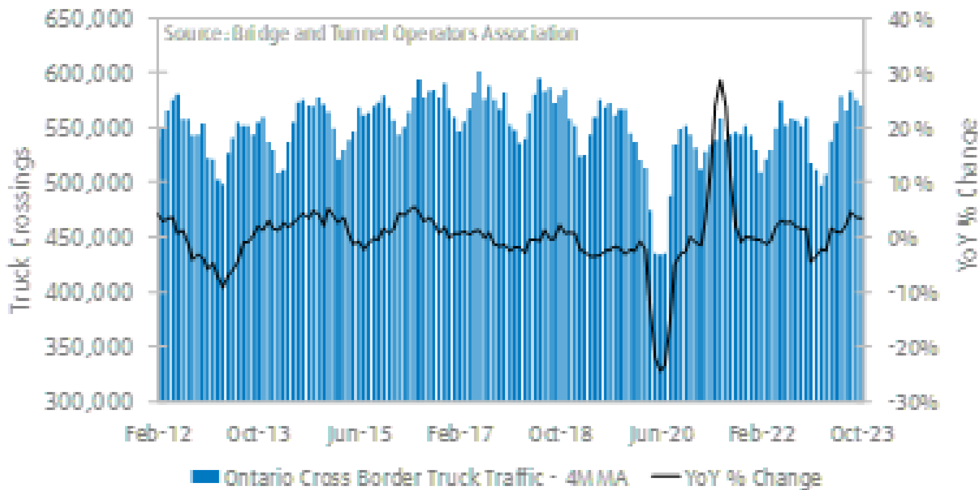
Canadian Truckload Spot Freight Volume Index Y/Y % Change



Truckload spot freight volume has been choppy through most of the year, with a strong start in January followed by generally weak seasonal trends that reached a low point in July. Although spot freight volume declined year-over-year for sixteen consecutive months through October, the rate of decline has shown significant improvement.

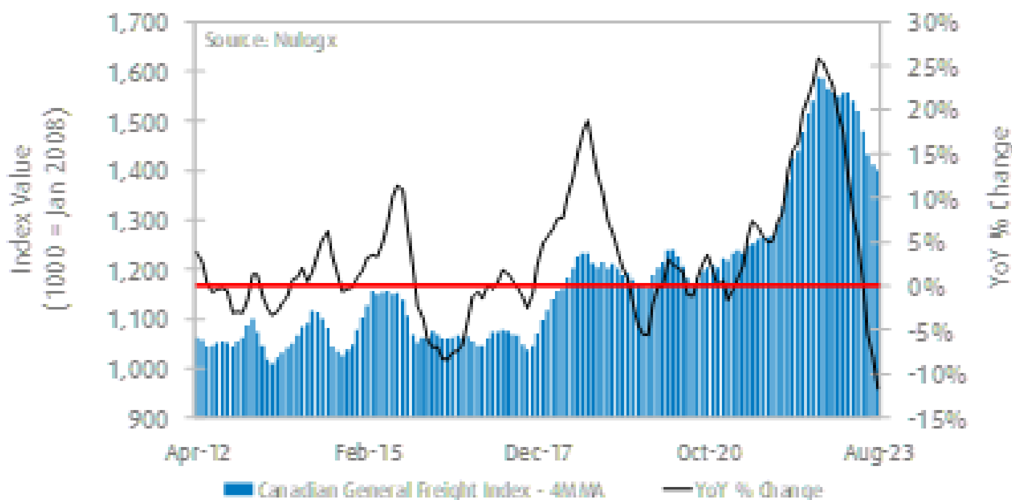
Despite the weak trends in volume, available capacity has been increasing. The truck-to-load ratio in October of 4.34 was 14 percent lower (tighter) than the 5.05 trucks for every load posted in September but 19 percent higher (looser) than the 3.64 posted a year earlier. As expected, the increase in capacity during a sluggish freight environment has kept downward pressure on freight rates (see below).

Ontario Cross Border Truck Traffic



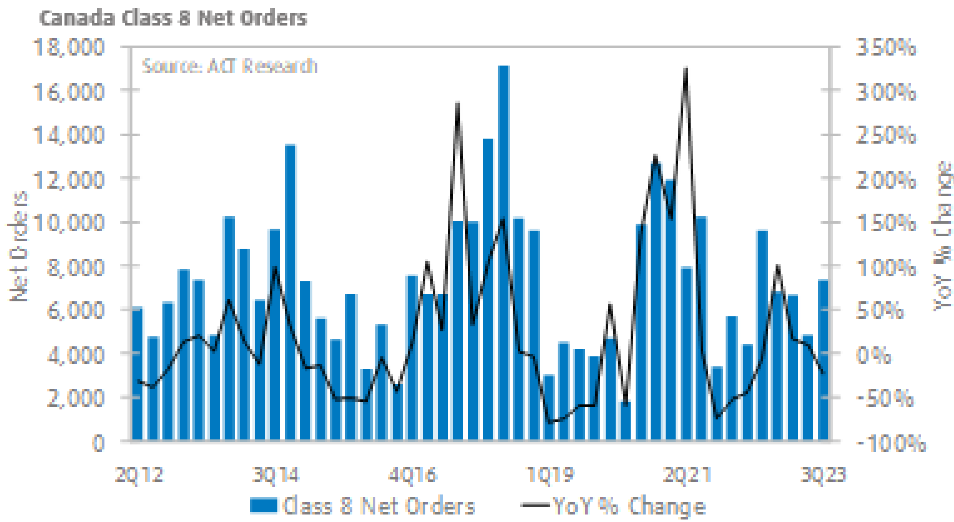
Despite the UAW strikes, the 4-month moving average of **truck border crossings** has shown positive year-over-year growth since April. Further, since bottoming at -21% year-over-year in December last year, truck crossings year-to-date through October are up a healthy 2.9%.

Canadian General Freight Pricing Index



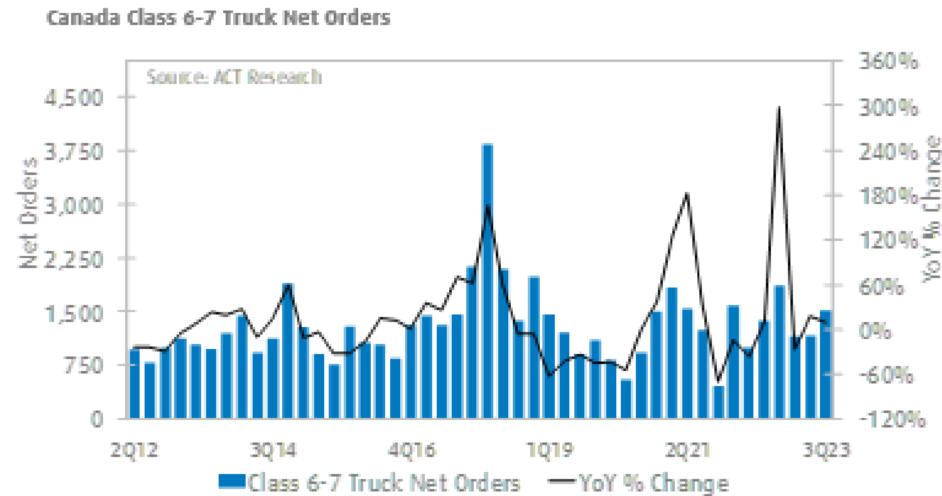
Since reaching an all-time high a year ago, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers has steadily declined. Although base rates remain higher than pre-pandemic levels, most of the overall surge in total freight costs over the past couple of years is attributable to rapidly increasing fuel surcharges. That said, the fuel component of the index declined for six consecutive months through June before rebounding with back-to-back increases in July and August. Fuel was 25.25% of base rates in August compared to 33.50% at last December's peak and 31.59% a year earlier. Overall, the four-month moving average of total shipping costs during August declined nearly 12% year-over-year.

Truck Orders



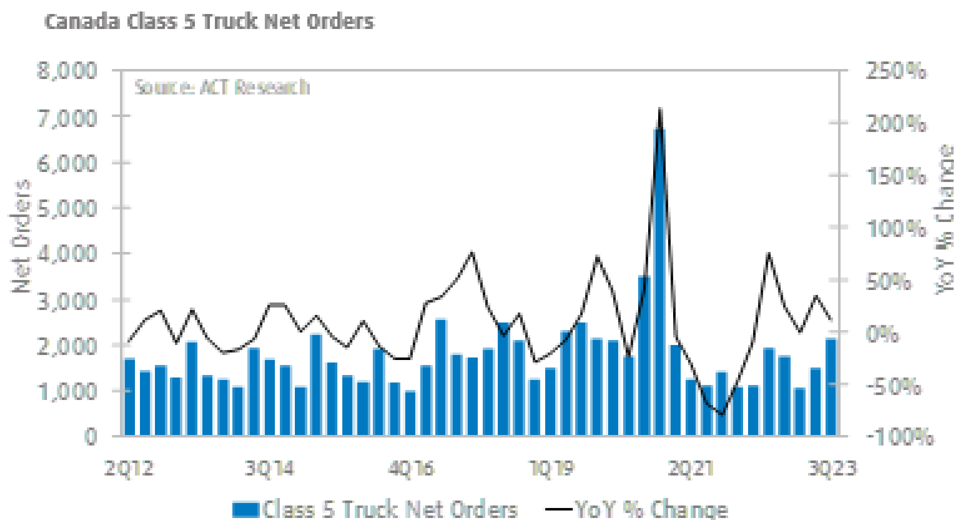
Although year-over-year comparisons have turned negative, **Class 8 net truck orders** awoke from a typical Summer slumber as the Fall order season approached and build slots opened for 2024 deliveries.

Net truck orders bottomed in April and had since drifted higher before a surge in September. Altogether orders during the 3rd quarter were up 52% from the 2nd quarter but 23% lower than the year-earlier quarter. Based on prior seasonal trends and next year's build slots fully opening over the coming 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 toward replacement levels next year, year-over-year declines in orders through the Spring would not be surprising.



Class 6-7 net orders accelerated entering the fall as OEMs opened more build slots for early next year. Overall orders during the 3rd quarter were up 30% from the 2nd quarter and 10% from a year ago. That said, after a challenging comparison early in the year, orders year-to-date through September are still down 3%. On a positive note, trailing 6-month cancellations remain relatively benign, averaging 0.5% of backlog and well below the 1.8% pre-pandemic average.

As always, the severe-duty segment of this class will continue to reflect fundamental momentum (or lack thereof) in the energy and construction sectors.



In stark contrast to the U.S., residential construction continues to grind higher despite elevated interest rates. Likewise, medium-duty truck orders accelerated entering the fall as OEMs opened more build slots available for early next year.

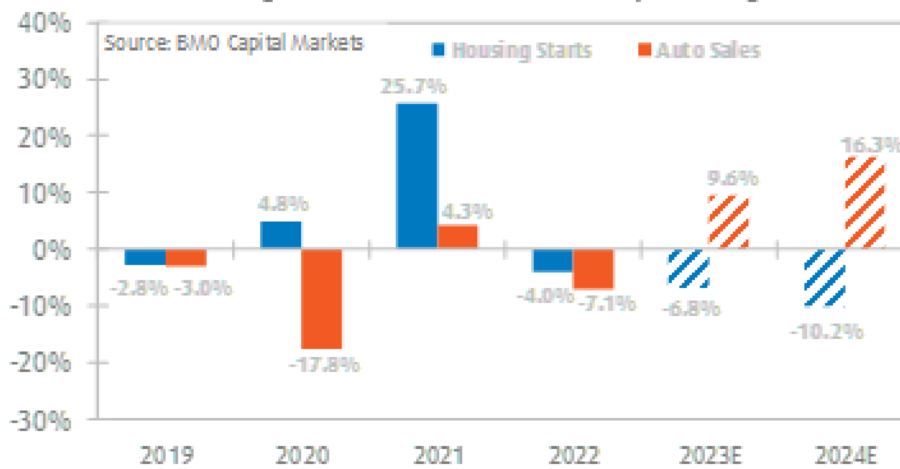
Overall orders during the 3rd quarter were up 43% from the 2nd quarter and 12% from a year ago. Similarly, year-to-date through September, orders are up 15%.

Despite the muted near-term macro outlook, 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

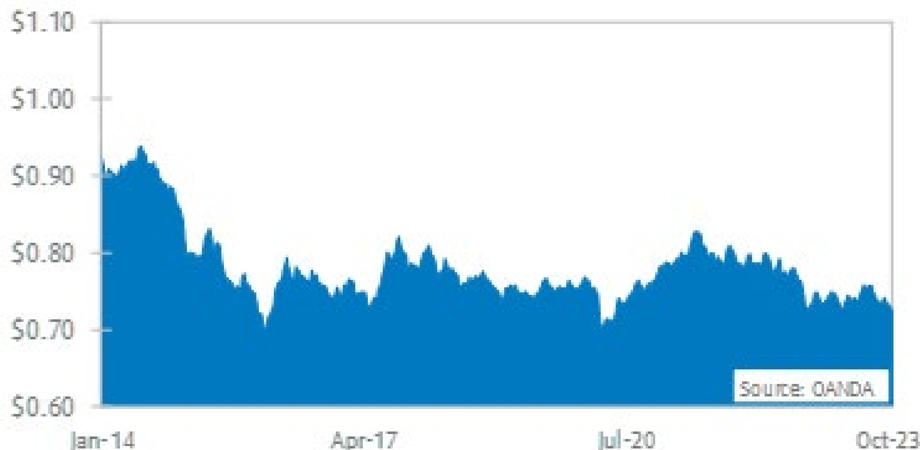
Canada's economy has stalled compared to the U.S., as Canadian households increasingly struggle with larger debts and shorter-term mortgages than U.S. consumers. As such, past rate hikes will increasingly bear down on spending as many mortgages reset at higher rates. Canada's divergence from the U.S. can also be pinned on a more significant reliance on weakening global demand and prices for commodity exports, lower productivity, and much less aggressive fiscal policy.

With these conditions remaining in place, the near-term outlook of BMO economists calls for a relatively short and shallow contraction consisting of -1.0% (q/q annualized) and 0.0% in the 4th and 1st quarters, respectively.



Canadian housing starts increased to 270.5 thousand annualized units in September, the highest level since June, with the six-month average now at its highest since February. Despite the surprisingly sturdy activity, the momentum is expected to face increasing headwinds as elevated interest rates continue to work through the economy. As of mid-November, BMO economists expected housing starts to decline 5-10% during 2023, followed by a slightly deeper contraction next year.

Despite the drag on disposable income from higher interest rates, pent-up demand continues to propel the **auto sector** toward a resumption of strong unit sales growth during 2023 and 2024.



Although the **Canadian dollar** has shown relative weakness since peaking more than two years ago, BMO economists expect a reversal of the trend during 2024 as the U.S. dollar starts to feel the headwinds of market expectations for a Fed rate cut sometime during the 2nd or 3rd quarter of next year. After averaging U.S. $0.746 during the 3rd quarter, BMO economists look for the Canadian dollar to bottom during the 4th quarter at an average of US$0.735 and after that drift higher toward US$0.78 by the end of 2024.

“Voice of the BMO Economics Team”

Given the cross currents of the macro environment so far sidestepping a recession despite multi-decade high interest rates, moderating but still unacceptably high inflation, pressure on commodity prices, and a recent uptick in unemployment, 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 Retail In Therapy

Robert Kavcic, Senior Economist and Director, November 10th 2023

The Canadian consumer is paddling in some very choppy waters right now, and at least one high-profile earnings warning from a large retailer this week has raised some concern about the outlook for spending. Real consumer spending slowed to a crawl (0.2% annualized) in Q2, and our outlook calls for effectively no net growth in spending volumes through the middle of 2024. It’s not all bad from a macro perspective, but it’s not all sunshine and rainbows either, with the challenges outweighing the supports.

The Challenges

Interest rates are biting. Hard: The Bank of Canada is likely done raising rates, but the level of policy rates is well into restrictive territory and likely to stay there for a while, unless the economy really cracks. With underlying core inflation of 3%-to-3.5%, and the overnight rate at 5%, real rates haven’t been this high since the pre-GFC era, and mark a big adjustment after 15 years at or below zero (they were historically negative through late 2022). While that might be a bit of an academic concept, in the real world, mortgage payments are gradually resetting higher and will continue to do so steadily through 2026. The size of the typical payment adjustment will also continue to rise unless mortgage rates fall from current levels (think about those 1.5% mortgages eventually coming to renewal). And, while most Canadians have been stress tested to handle mortgage rates at 5.25% or higher, servicing those borrowing costs could crowd out other spending. CMHC estimated this week that the drain on consumer spending from higher mortgage payments will be roughly $15 billion per year over the upcoming period, which could clip Canadian growth by about half a percentage point.

Housing market correction: We cover this at length in other venues, so the short story is that many markets across Canada, especially Southern Ontario, are seeing weak sales volumes and falling prices. Changes in sales volumes tend to correlate with retail spending a few months down the road—e.g., you buy a house, you need some new furniture. But there’s also a wealth effect that is likely turning negative after a long supportive run. The Bank of Canada has published some estimates of the wealth effect from housing, measuring it as a meaningful driver of consumer spending, and moreso than other factors such as changes in stock prices. Arguably, more widespread use of tools likes HELOCs has tightened that housing wealth-to-spending relationship over time. Needless to say, after a blazing run, this source of consumer spending support has mostly turned the other way.

Inflation hurts: If they don’t have to eat, drive to work, or live somewhere, Canadians are probably doing just fine. Otherwise, sticky inflation and lasting past price increases are still eating into other discretionary spending. Grocery inflation, for example, has cooled to below 6% y/y and is likely headed lower, but that won’t make shopping carts any cheaper. This theme of more spending on essentials at the expense of discretionary goods has been seen in some recent earnings reports.

The Supports

Population explosion: Canada’s population has grown by a massive 3% in the past year, and adding 1.2 million more people means more spending in the aggregate. What’s interesting is that total core retail sales (excluding autos and gas) have grown at about 3% annualized over the past six months; in volume terms, they’ve been flat; and in real per capita terms, they’ve contracted about 3% annualized. In effect, more people are each spending the same amount of money on less stuff. Tightening at the individual level is getting masked by the sheer increase in numbers.

Canadian Retail In Therapy (cont.)

Jobs and wages: The labour market is still tight and we're seeing some fraying around the edges. The unemployment rate is up 0.8 ppts from the cycle low and unfilled job openings have fallen by more than 320k since May 2022, but the market is moving off historically strong levels. The real proof is that wage growth is strong in the 3%-to-5% range, and new contract settlements are coming in hot. In fact, with headline inflation off the boil, real wage gains have turned positive after running deeply negative for the past two years. That will lend important support if it holds.

Key Takeaway

The big takeaway here, and for our economic outlook, is that there is enough resiliency backing households to limit severe outcomes like widespread delinquencies and mortgage defaults. But, that doesn't take away from the likelihood that discretionary spending will continue to struggle in the quarters ahead.

Turning Point

Sal Guatieri, Senior Economist and Director, November 8th 2023

Unlike the U.S., **Canada's economy has stalled, at best**. Real GDP contracted slightly in Q2 and Statistics Canada's initial read is for a slight decline in Q3, meeting one (though not the most accurate) definition of recession. Special factors such as wildfires and strikes by public sector and port workers haven't helped, but there is more behind Canada's underperformance. Households are struggling with larger debts and shorter-term mortgages than U.S. consumers. Past rate hikes will increasingly bear down on spending, as less than half of mortgages have reset at higher rates since early 2022, according to the central bank's Financial System Review. While Canadian households still appear to have substantial excess savings, they are likely to use them to pay down debt and ease the burden of rising loan payments. The divergence with the U.S. also reflects less heated fiscal spending, greater exposure to the weak global economy, and sagging labour productivity. The latter partly explains why the economy isn't growing despite 3% annual population growth, causing living standards to shrink.

We expect **real GDP to contract 1.0% annualized in Q4** and remain flat early next year. Not helping is a **housing market heading south once again** as a result of high mortgage rates and the worst affordability in over three decades. Benchmark prices could sag about 5% by next summer, taking total losses to around 15% since early 2022. Apart from a still-rapidly expanding public sector, Canada's economy is also getting some lift from auto sales, which zoomed 20% y/y in October amid more ample supplies and pent-up demand. Still, **real GDP is expected to grow just 0.5% in 2024** after an estimated 1.0% rate in 2023, a far cry from 3.4% in 2022. At 5.7% in October, the unemployment rate is up 0.8 ppts from its half-century low of mid-2022, and will likely reach 6.5% by next summer. Although employment has risen by one-half million in the past year, with nearly a quarter of the gains landing in the past three months, it can't keep up with torrid labour force growth. And, with job vacancies sliding 26% y/y in August, hiring could weaken soon.

A looser labour market will ease pressure on unit labour costs, which are still running hot due to fast-rising wages and declining productivity. It should also support a **further slowing in consumer inflation**, which has fallen from 8.1% in mid-2022 to 3.8% in September. Most core CPI metrics are now below 4%, though sticky services prices (notably rents) suggest that inflation could still take until late next year to return to the 2% target.

With the economy on the cusp of recession, the **Bank of Canada is likely done raising rates**. It kept the policy rate unchanged at 5.0% in the latest two meetings, but retains a tightening bias given elevated inflation. We suspect the next move in policy rates is a cut, likely beginning in July 2024, and eventually settling at a more neutral level of around 2.75% in 2026. A friendlier rate environment should see 10-year Canada yields ease modestly from current levels of around 3.8%.

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