Industry Update

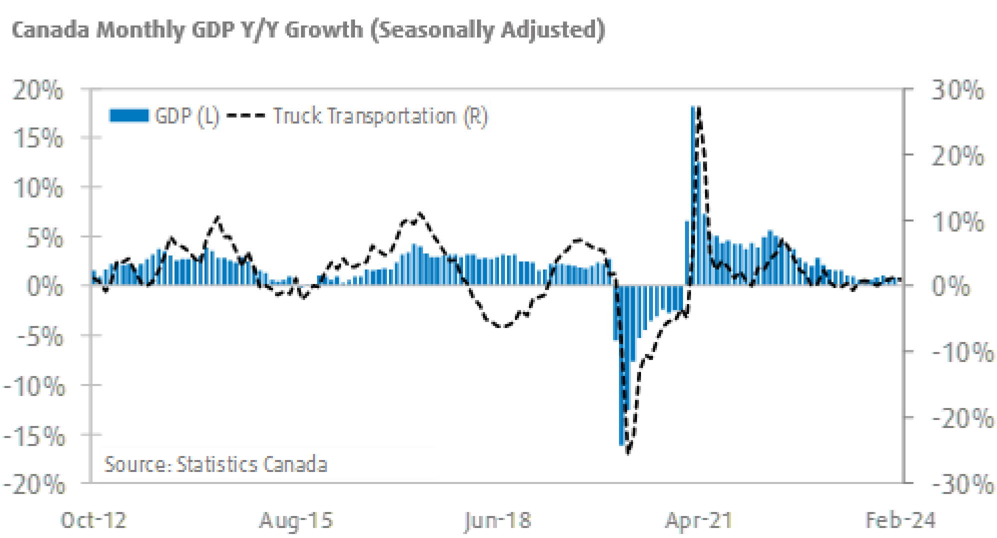
Canada Truck Transportation

Key Developments

- According to **Geotab**, while EVs remain a small minority of the overall commercial fleet, EV units among Canadian commercial fleets increased 67% during 2023. Further, Geotab estimates that EVs are range capable for 50% of Canada's current commercial fleet, particularly in rural areas.
- The **Teamsters Canada Rail Conference** (TCRC) announced that nearly 10,000 workers at CN and CPKC have voted to authorize strikes at both companies. A work stoppage can occur as early as May 22 without an agreement.
- **CarriersEdge** named Challenger Motor Freight of Cambridge, Ont. the Best Overall Fleet in the large carrier category during the Best Fleets to Drive For Education & Awards Conference in Charlotte, N.C. Challenger Motor Freight was also named North America's overall Best Fleet to Drive For in 2022. Canadian fleets have been on a winning streak in the large carrier category. C.A.T., based in Coteau-du-Lac, Quebec, a rookie finalist, was the Overall Winner of the 2023 Best Fleets to Drive For.
- According to the **U.S. Department of Transportation**, truck crossings from Canada (all ports) into the U.S. during the first quarter were down 0.3% compared to a year earlier, following a full-year increase of 0.6% during 2023.
- Be sure to check out the latest perspectives from BMO economists on the Canadian macro outlook (page 6).

Industry Fundamentals

Trucking activity has improved since last fall, with sector GDP growth keeping pace with overall GDP, while spot freight volumes in March were 35% higher than the cycle low point last July, although still more than 20% lower than a year earlier. Nonetheless, any lasting resolution to the freight recession will largely hinge on the timing and pace of any central bank policy rate easing cycle. With inflation heading in the right (lower) direction and rising unemployment, expectations are coalescing around an initial BoC rate cut, possibly by June, if not July. While that will be a welcome start for borrowers of all types, what happens after that will largely depend on how fast (or not) the Federal Reserve follows suit, where the BoC will surely not want to step too far out ahead of the Fed for fear of weakening the currency and re-igniting inflation.



The Canadian economy grew by 0.2% in February, slightly below expectations. Adding to the softness, January's gain was revised down a tick to +0.5%. February growth was led by mining/oil/gas, transportation/warehousing, hospitality and finance. However, eight sectors contracted in the month, and seven saw activity below year-ago levels, highlighting the economy's headwinds.

Similar to the broader economy, growth in the trucking sector has nudged slightly higher since bottoming last fall. Although year-over-year growth has improved from zero last October to 1% in February, sector activity is still slightly (-0.6%) lower than in February 2020, just before the start of the pandemic.

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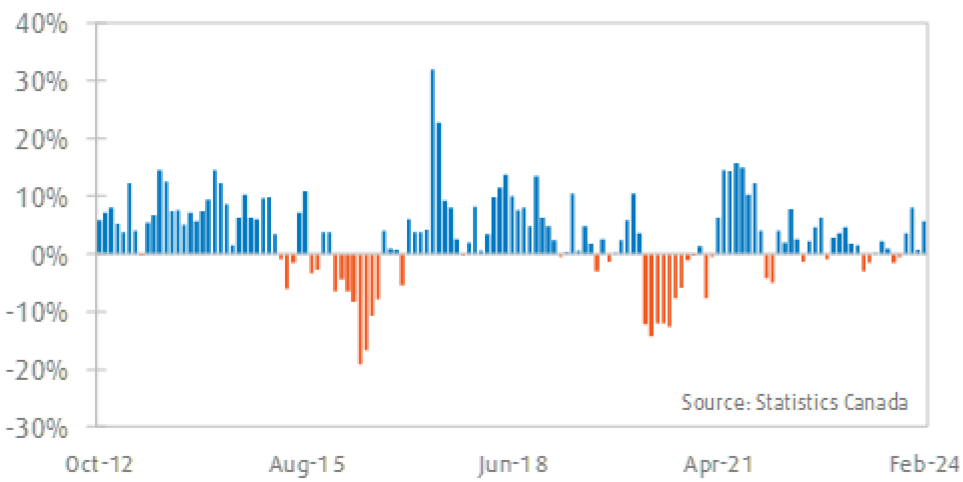
Trucking Business Influencers

Canada Weekly Diesel Fuel Retail Price (Cents/Litre)

Over the past few months, mirroring a relatively tight range in crude prices, the **national average Diesel price** of $1.68/litre in mid-May was flat year-to-date. However, diesel prices were still down 14% from the previous high in September.

Given record North American production and a still pending replenishment of the U.S. strategic petroleum reserve, and despite better-than-expected global growth, increased geopolitical threats, disrupted Suez access, and a cap on OPEC+ production, crude prices have been confined to a relatively narrow two-year range. As such, the current BMO outlook for WTI suggests that oil prices will remain relatively stable, with an average of $80 per barrel in 2024 and 2025, up from an average of $77.6 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.

With crude oil prices up about 5% compared to a year earlier, **crude oil production** during February increased year-over-year by almost precisely the same percentage. Further, total output over the trailing 12 months increased by 1.4% to a record for any 12-month period.

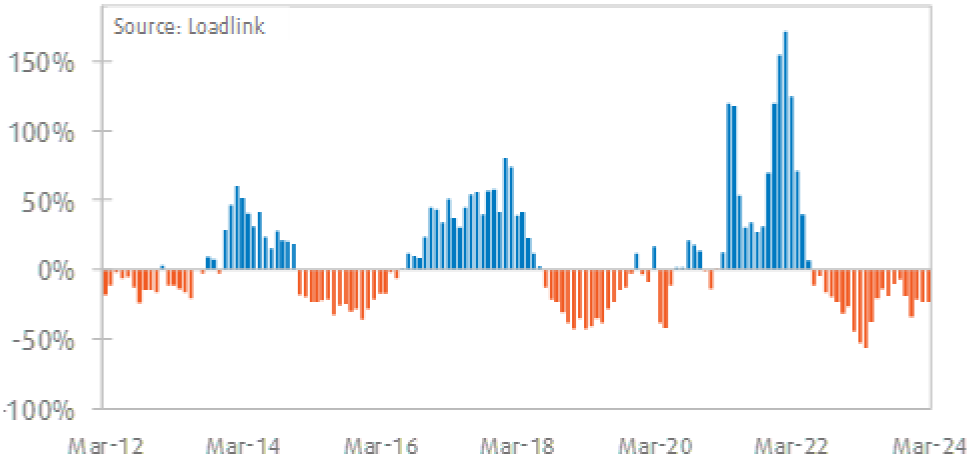
Interest Rates: 3 & 5 Year Interest Rate Swap Pricing

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 finding a recent bottom in December, rates have reversed course and drifted higher primarily in response to a slightly improved macro outlook, largely due to strong government spending. That said, given expectations for further inflation cooling on both sides of the border, BMO's economists forecast an initial 25bp rate cut in June with additional single cuts during both the third and fourth quarters.

Freight Indicators

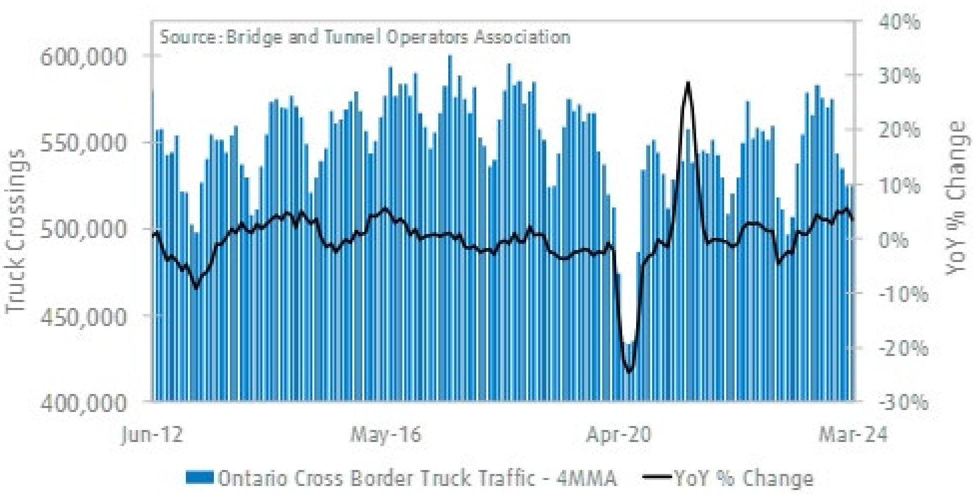
Canadian Truckload Spot Freight Volume Index Y/Y % Change



Since peaking in early 2022, **truckload spot freight volume** has weakened considerably and reached a low point last summer. However, although spot freight volume has declined year-over-year for twenty-one consecutive months, the number of loads during March was 35% more than the cycle-low last July.

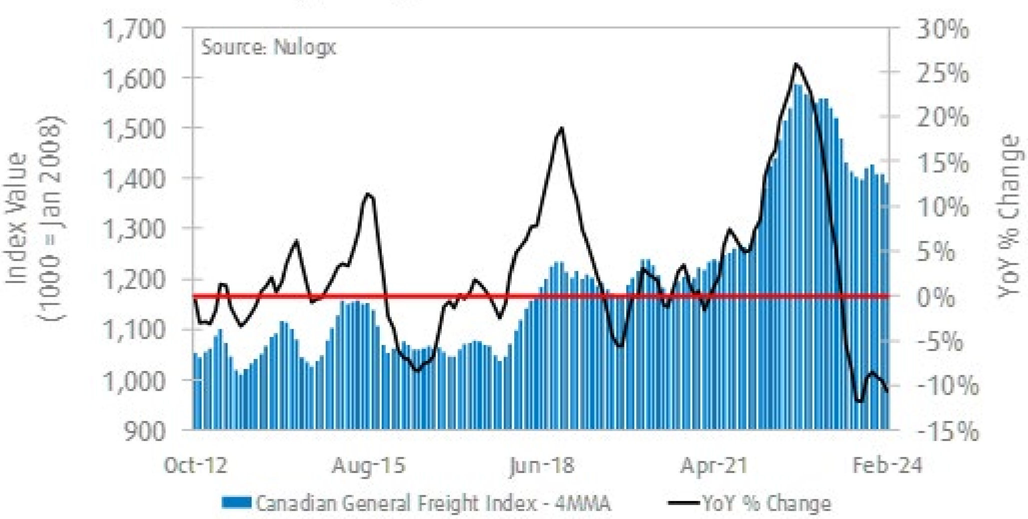
That said, available spot freight volume has not kept pace with available capacity (trucks on the road). The truck-to-load ratio in March of 3.21 was 10 percent higher (looser) than the 2.93 trucks for every load posted in February and 28 percent higher (looser) than the 2.51 posted a year earlier.

Ontario Cross Border Truck Traffic



After hitting a low point during December, Ontario truck border crossings have accelerated while the 4-month moving average has shown positive year-over-year growth since April of last year. Year-to-date through April, truck crossings increased by 1.8% and 3.7% for the trailing 12 months.

Canadian General Freight Pricing Index

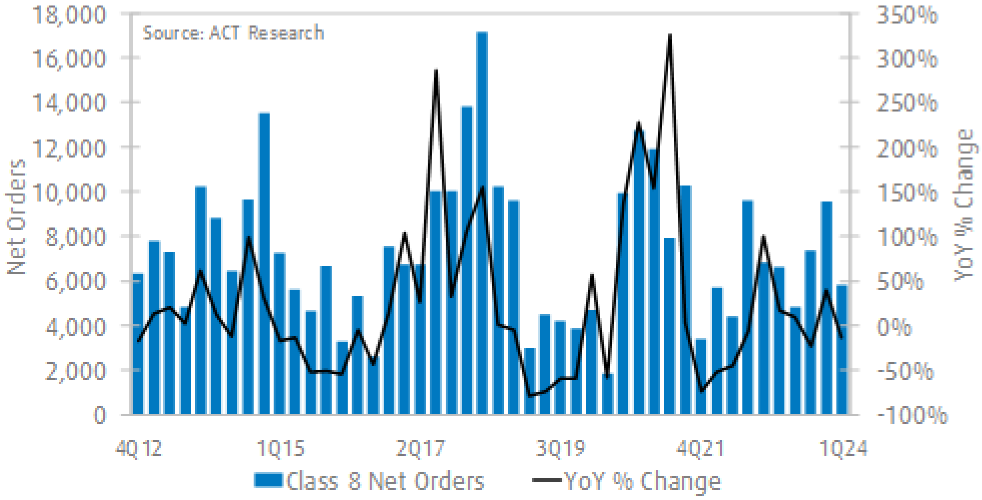


Since reaching an all-time high during the summer of 2022, an index representing the **total cost** (fuel surcharges + base rates) of over-the-road freight transportation for Canadian shippers has declined to a multi-year low but remains well above pre-COVID levels. That said, the rate of decline has slowed, given that stubbornly elevated fuel surcharges have mitigated the steady drift lower of base rates.

Beneath the surface, total domestic LTL remains above last year's cost levels. In contrast, total costs for domestic truckload, cross-border truckload, and cross-border LTL segments remain below those of a year ago.

Truck Orders

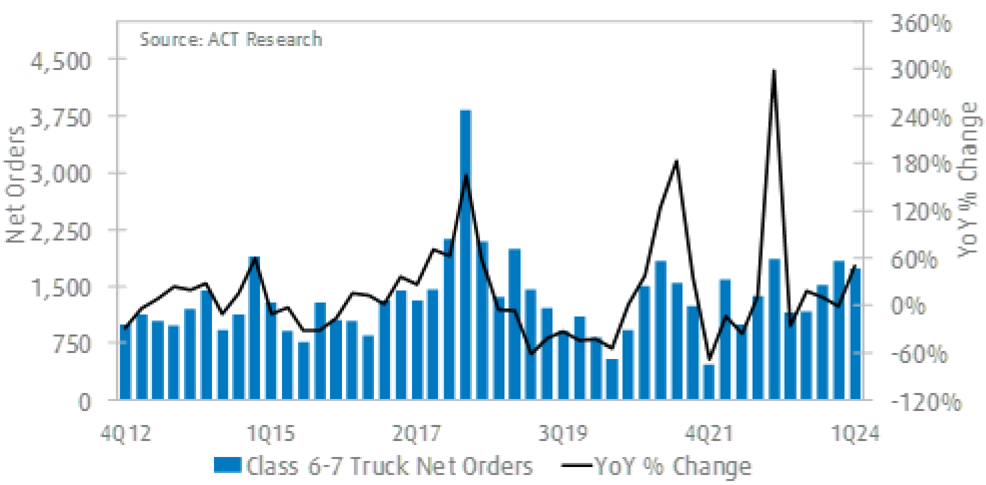
Canada Class 8 Net Orders



Year-over-year and quarter-over-quarter comparisons turned negative during the year's first quarter as **Class 8 net truck orders** took a hiatus from a strong finish last year when build slots opened completely for 2024 deliveries.

Net truck orders peaked in October, drifting toward a 20-month low in March. Altogether, orders during the first quarter were down nearly 40% from the robust fourth quarter and 13% lower than the year-earlier quarter. Based on prior seasonal trends and given expectations of an equipment cycle reset toward replacement levels this year, lackluster order trends through the summer would not be surprising.

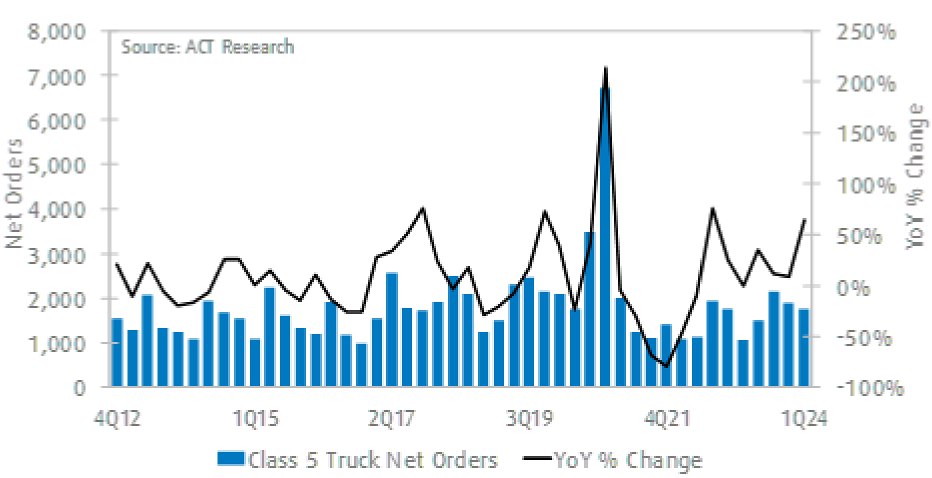
Canada Class 6-7 Truck Net Orders



Class 6-7 net orders decelerated early during the first quarter but finished on a high note with the 2nd-best March and 7th-best month on record. Overall orders during the 1st quarter were down 6% from the 4th quarter but were up 50% from a weak year-earlier quarter.

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

Canada Class 5 Truck Net Orders

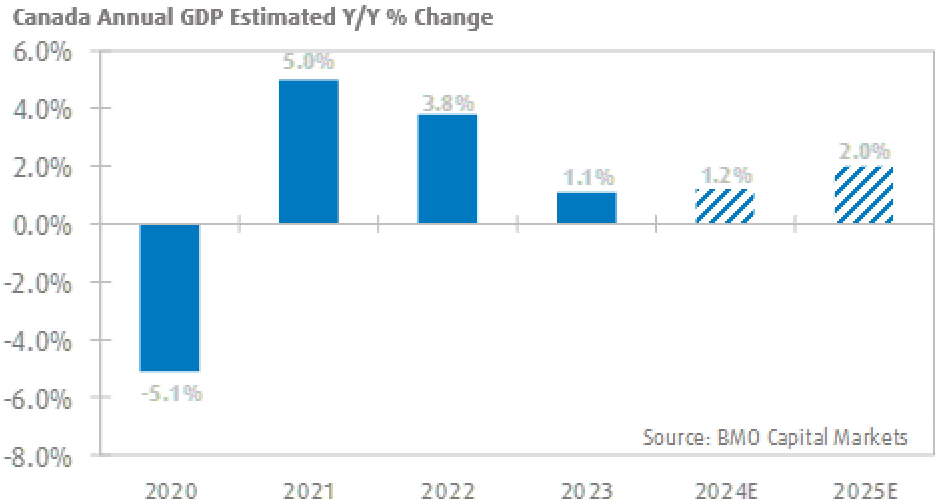


Like the U.S., residential construction has so far outperformed the worst fears that typically accompany an elevated interest rate environment. Likewise, medium-duty truck orders were sturdy during the second half of last year and early this year as supply chains improved and OEMs opened more available build slots.

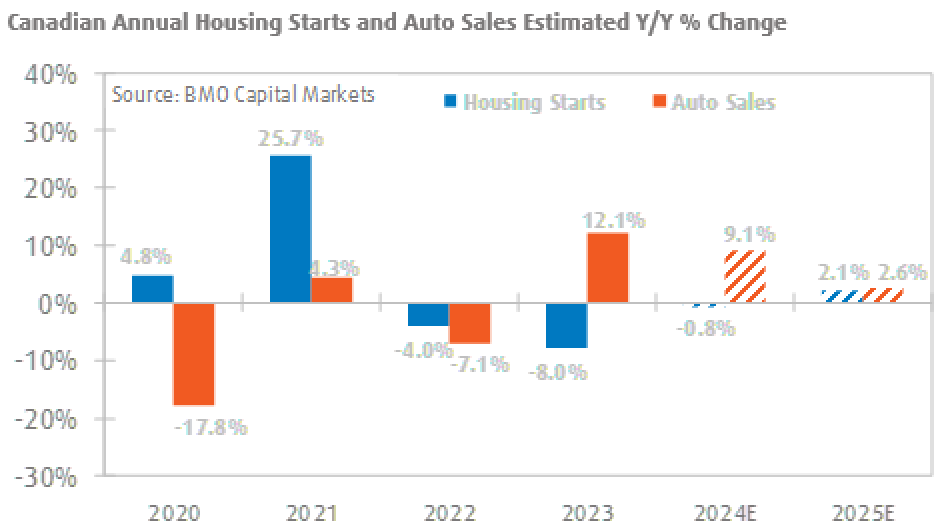
Overall orders during the 1st quarter were down 8% from a solid 4th quarter but up 64% from a frail year-earlier quarter.

Despite the modest near-term macro growth outlook, the long-term demand outlook for medium-duty remains positive, supported by diverse end markets, consistency in vocational sectors, and the durable tailwinds of e-commerce and last-mile delivery.

Macroeconomic Indicators



Real GDP grew 2.3% annualized in Q1, the most in a year, primarily due to strong government spending. However, momentum faded in March amid a flat preliminary GDP result, a slight decline in employment, and a renewed deficit in goods trade. Despite perkier auto sales and steadier housing markets, growth looks set to decelerate to around 1.0% in Q2. Still, for all of 2024, growth could nearly double to 1.7% on a Q4/Q4 basis before stepping up to 2.1% in 2025 on the back of easier monetary policy and continued expansionary fiscal policies at the federal and provincial levels.



Despite the full-court press by policymakers to increase housing supply, the reality on the ground is that **housing starts** continue to ebb gradually. After hitting the highest level of starts on record for a two-year period in 2021/22 (at nearly a 270,000 annual pace), starts simmered down to just over 240,000 last year and will struggle to hit that mark in 2024. To put these figures in perspective, the building goals set out in this year's federal budget implied an annual pace of construction of roughly double that rate.

Despite the drag on disposable income from higher interest rates, pent-up demand should continue to propel the **auto sector** toward another year of strong unit sales growth in 2024.

Amid relatively softer economic readings, Canada's stellar relative inflation performance is reinforcing expectations that not only will the Bank of Canada start cutting rates before the Fed, but overnight interest rate spreads could trend more negatively in the months ahead. Although this could weigh on the **Canadian Dollar** even as the Fed begins to cut rates, a broadly weaker U.S. dollar will remain a dominant theme. BMO economists see the Canadian Dollar 2.5% stronger by year-end, with comparable appreciation next year.

"Voice of the BMO Economics Team"

Sticky Inflation, Sticky Rates
Sal Guatieri, Senior Economist – May 17th, 2024

The inflation embers have cooled more in Canada than in the U.S. due to weaker demand and looser labour markets. The Bank of Canada's preferred Median and Trim measures of core inflation decelerated to annual rates just above 2.0% in Q1, the slowest since 2020 and close to the target. Despite a soggy loonie, goods prices fell for a second straight quarter. Services prices are still running fast at 3.5% in the quarter (after seasonal adjustment), largely due to two remaining white coals—rent and mortgage service costs. But this rate is about half the cycle high. Dousing the embers is a steadily rising jobless rate, now at 6.1% in April after sliding to a half-century low of 4.8% in 2022. A further increase to 6.6% later this year should slow unit labour costs that are still running hot (4.6% y/y in Q4). While labour productivity fell 1.8% in 2023, it rose in the final quarter, hopefully turning from foe to friend in the inflation fight.

The good news on inflation is magnified by ebbing recession fears. Real GDP likely grew 2.3% annualized in Q1, the most in a year, largely due to strong government spending. However, momentum faded in March amid a flat preliminary GDP result and renewed deficit in goods trade. Despite perkier auto sales, a solid rebound in employment in April, and steadier housing markets, growth looks set to decelerate to around 1.0% in Q2. Still, for all of 2024, growth could nearly double to 1.7% on a Q4/Q4 basis, before stepping up further to 2.1% in 2025 on the back of easier monetary policy and continued expansionary fiscal policies at both the federal and provincial levels.

A return to above-potential growth next year should pull the jobless rate back below 6%. The decline will be greased by a slowdown in the population and labour force. The federal government plans to **notably reduce the number of nonpermanent residents in the next three years.** Torrid growth in this segment drove the population to its largest increase in more than six decades last year (3.2%, or 1.3 million). The planned cutbacks could see a return to more normal expansion of 1%, giving job creators and home builders a realistic chance of keeping up.

The Bank of Canada is moving closer to reducing rates for the first time since March 2020. Another mild CPI release would likely clinch the deal, and we still lean toward June 5 as the date for this milestone. Still, the Bank can't run too far ahead of the Fed or the loonie will tank and fan inflation. Consequently, we no longer expect back-to-back moves, but rather a delayed decline in September. An additional 150 bps of rate cuts are projected by mid-2026, taking policy rates back to a more neutral level of 3.0%. That's still higher than at any time between the financial crisis and mid-2022, but will provide material relief for borrowers.

"Voice of the BMO Economics Team"

Roaring City? No, Not For Housing
Douglas Porter, Chief Economist and Managing Director, May 15th 2024

For a change, the Canadian housing market appears to be having a calm spring. **Existing home sales** dipped 1.7% in seasonally adjusted terms in April from the prior month, even as **new listings rose** a sturdy 2.8%. This combination of solid new supplies and lukewarm demand helped keep **prices down slightly** from year-ago levels. At the same time, **housing starts** slipped slightly last month to an unassuming 240,200 units, just a tad below the past year's average, but right in line with our (mild) expectation for the year.

On the sales data, perhaps the most noteworthy data point was the **6.5% rise in existing listings**, the second largest monthly increase on record, and leaving the supply of properties for sale the highest since pre-COVID days. Put another way, there was the equivalent of 4.2 months of inventory last month, also the highest since early 2020. As CREA notes, most measures suggest the market remains largely balanced, perhaps more so than at any time since prior to the wildness of the pandemic years.

One small surprise in today's results was the reported 10.1% y/y rise in sales activity, especially given soggy results in Toronto and Vancouver. But large bounces in many medium-sized cities, aided by the timing of Easter this year, helped bump up the headline tally. The changing city mix—soft activity in the priciest cities—helps explain why average transactions prices fell 1.8% y/y. None of the nine largest cities reported a price drop in April. Only five of the 26 largest cities reported price drops last month, and four of those were in Southern Ontario. However, the MLS Home Price Index, which adjusts for quality mix, was flat in April from the prior month and still sits 0.9% below year-ago levels. It remains down 14% from the all-time peak reached in early 2022 on a national basis.

While there was a wave of supply in the existing housing market, that wasn't really the case in new building. Despite the full-court press by policymakers to build, build, build, **the reality on the ground is that housing starts continue to gradually ebb.** After hitting the highest level of starts on record for a two-year period in 2021/22 (at nearly a 270,000 pace), starts simmered down to just over 240,000 last year, and will struggle to hit that mark in 2024. To put these figures in perspective, the building goals set out in this year's federal budget implied an annual pace of construction of roughly double that rate—not going to happen. The other key point is that multiples remain, by far, the dominant form of starts, accounting for roughly three-quarters of new building in the past year. Because multiples take much longer to complete, this also suggests that new supply will not come riding to rescue for strained affordability soon.

Bottom Line: Sales activity remains uneventful during the key spring selling season, keeping a tight lid on prices—which is a welcome development, given the extreme unaffordability in the housing market. It's a bit of a mixed message on the supply side, with listings solid, but new building gently cooling. For the Bank of Canada, a calmer housing market will provide a bit more comfort that some small rate trims won't spark a major flare-up in prices. At the margin, cooler home prices and more ample listings slightly increase the chances of rate relief in coming months. When it comes to Canadian housing, calm is good.

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