Spring 2024

Industry Update

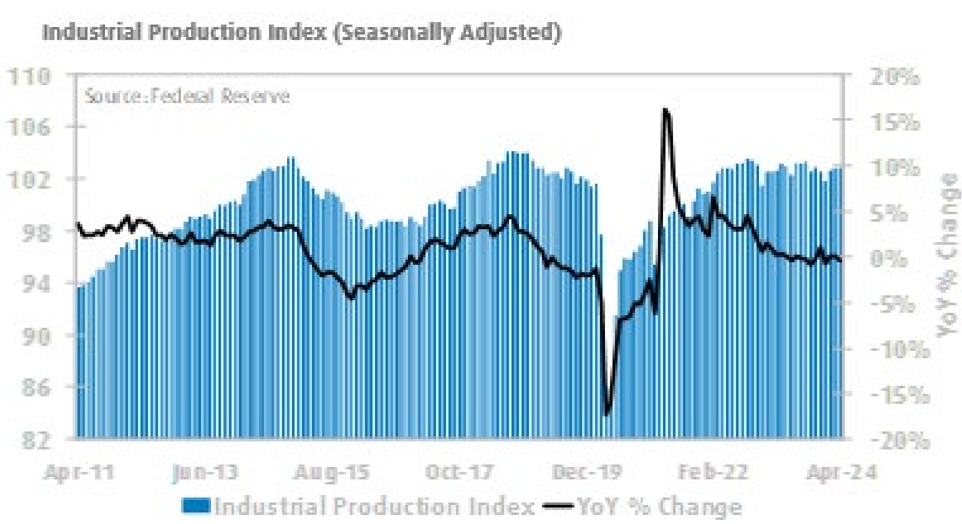
Truck Transportation

Key Developments

- Nebraska Attorney General Mike Hilgers is leading a group of 24 GOP attorneys general who filed a lawsuit to overturn the **EPA rule limiting truck emissions**. A separate lawsuit by a smaller group of AGs against California claims a phased-in ban on internal combustion trucks is unconstitutional and will hurt the U.S. economy.
- According to **FTR**, data from **The Federal Motor Carrier Safety Administration (FMCSA)** shows that 13,720 new authorities were more than offset by almost 18,000 revocations for a net decrease of 4,200 operating carriers during the 1st quarter of 2024, slightly less than a decrease of 4,400 carriers in the year-earlier quarter.
- According to a recent study by **ATRI**, transitioning the long-haul trucking fleet to battery electric vehicles will cost over $1 trillion in electric infrastructure and vehicle purchase costs over 15 years, approximately 5x the cost of transitioning to renewable diesel for similar or greater carbon reduction benefits.
- Be sure to check out the latest perspectives from BMO economists on the U.S. macro outlook (page 8).

Industry Fundamentals

Beyond the unofficial 2nd anniversary of the current freight and profit downcycle, signs of an imminent more than seasonal upturn are few and far between, although it stands to reason that this cycle would be deeper and last longer than usual after the mother-of-all upcycles. Like all worse-than-normal hangovers, this downturn was caused by combining excess amounts of different things – an unprecedented amount of new capacity overshooting a reversal in available freight. One of those alone would be enough to trigger an industry profit recession. As such, the way out of the fog will require improvements in both the freight cycle and the capacity situation. Any sustainable turnaround in freight growth will have to wait for the Fed, where BMO economists have lowered their call for cuts now totaling 50 basis points this year, starting with 25 in September and another 25 penciled in for December. In the meantime, some of the larger for-hire carriers have shifted excess capacity to the spot market, which could accelerate the forced exit of capacity held by weaker operators.

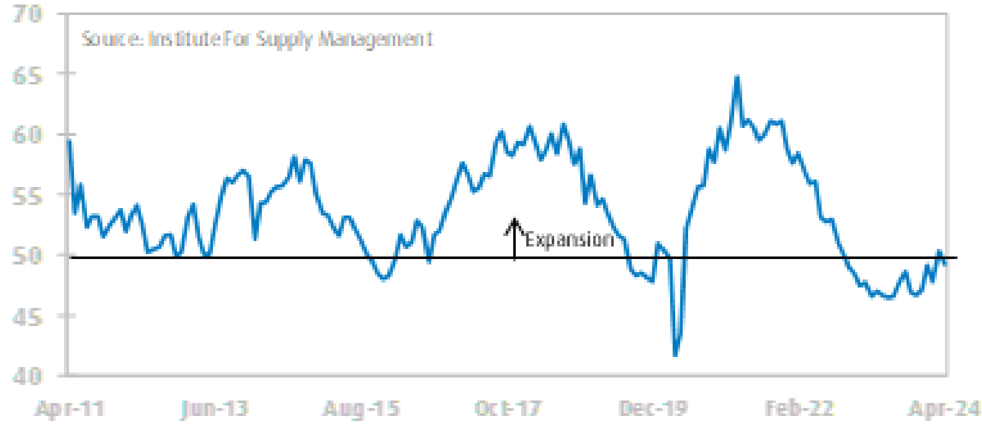


Industrial production was flat in April after March's reported sharp gain (0.4%) was revised to virtually nothing (0.1%). Manufacturing (the largest share of industrial production) tumbled 0.3% in the month after a downwardly revised 0.2% advance and is also below year-ago levels (-0.5%). Across other major sectors, consumer goods production rose only slightly, business equipment and construction supplies fell materially, and all three were down year over year.

The decrease in manufacturing output pushed **capacity utilization** lower by 0.3 percentage points to 76.9%, 1.5 percentage points below a year earlier, and 1.3 percentage points lower than the long-run average.

Macroeconomic Indicators

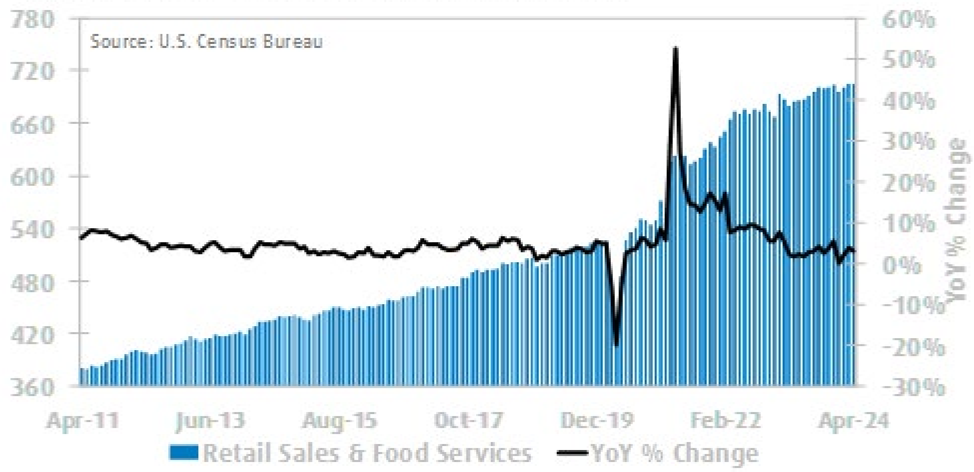
ISM Purchasing Managers Index



The **Purchasing Managers' Index (PMI)** is a sentiment measure of near-term business conditions in the manufacturing sector. The index pulled back more than expected to 49.2 in April, indicating a resumed (slight) decline in the sector. This followed a one-month growth spurt after 16 consecutive months of contraction. The ISM sub-indexes suggest that new orders reversed lower in the month, while employment fell, albeit less than the prior month. Although suppliers sped up deliveries, costs are on the rise again. The prices paid index shot up to the highest level since June 2022.

The past relationship between the PMI and GDP suggests that the April PMI corresponds to an annualized GDP growth rate of +1.9%, slightly better than BMO Economists' current estimate of +1.7% annualized for the second quarter.

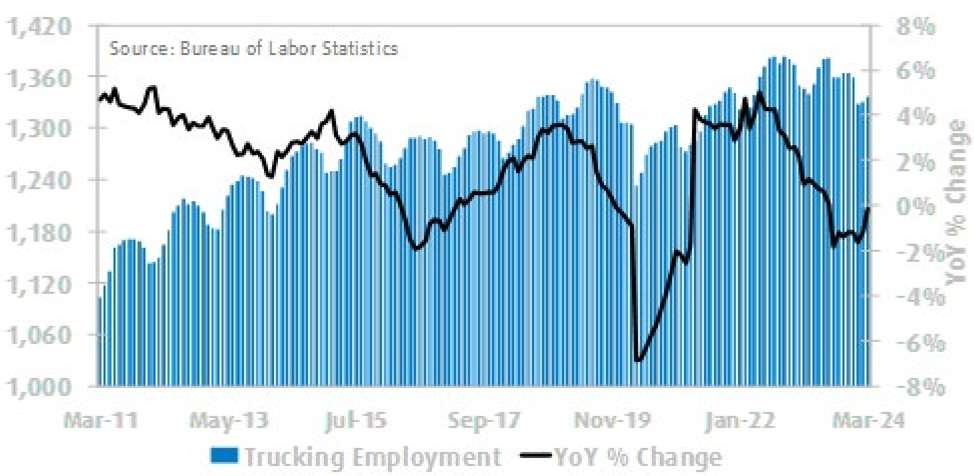
Retail Sales & Food Services (Seasonally Adjusted $Bn)



The long-anticipated slowdown in consumer spending might be underway. **U.S. retail sales** were unchanged in April, well below consensus expectations for a 0.4% gain and down sharply from the 0.6% (downwardly revised) advance in March. Depleted excess savings, record household debt, and a significant slowdown in job growth caused consumers to throttle back their spending.

A majority of the categories saw declines, most notably in non-store retailers (-1.2%), sporting goods (-0.9%), motor vehicles and parts (-0.8%), and health and personal care (-0.6%). Due to higher prices, sales at gasoline stations popped 3.1%, while clothing and electronic stores jumped 1.6% and 1.5%, respectively. Spending at restaurants and bars edged up 0.2%, more than offsetting the 0.1% dip in March.

Truck Transportation Production and Non-Supervisory Employment, Thousands



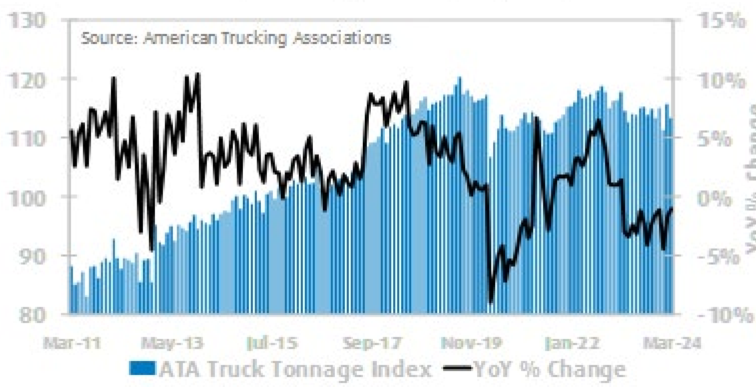
Although the decline was modest in March, employment in the truck transportation industry fell year-over-year for the eighth consecutive month. **Production and non-supervisory employment** (not seasonally adjusted) during March was down 3.2% (~44,900) from a recent peak of 1.38 million last July but down only 0.2% (~2,200) year-over-year.

Industry employment continues to contract as lower equipment utilization from a sluggish freight environment has decreased the urgency for larger private and for-hire carriers to add driver capacity.

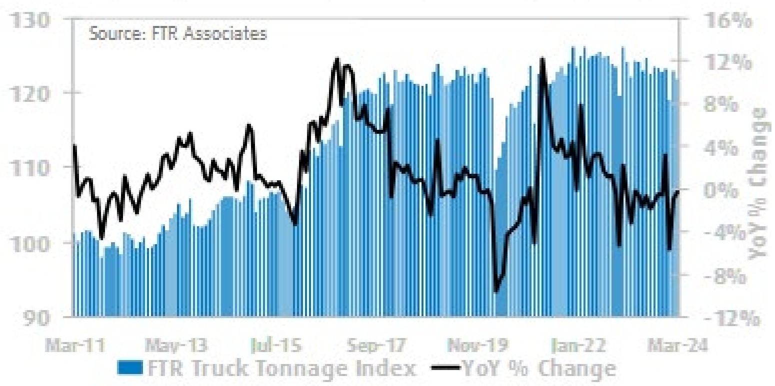
Freight Indicators

Most freight signals are generally sluggish, showing no growth or modest declines but not collapsing. However, any lasting resolution to the freight recession and a sustainable increase in freight volumes will hinge on the timing and pace of any Federal Reserve easing cycle. Although lower interest rates would provide a more durable and robust tailwind for the overall freight environment, there's a solid case to be made that the freight market could see at least modest improvements regardless of the Fed. A few of the more significant potential tailwinds include the approach of more constructive seasonality (produce, summer, back-to-school, holidays), healthy inventory levels that will need replenishing, a resurgence in near-onshore manufacturing and infrastructure spending, a record backlog of durable goods, large number of new homes not yet completed, and deflating prices on goods that should gradually attract consumer marginal dollars away from stubbornly expensive experiences.

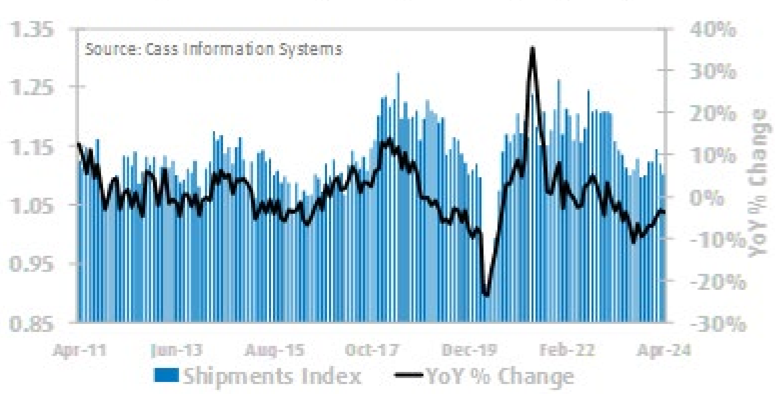
ATA Truck Tonnage Index (Seasonally Adjusted)



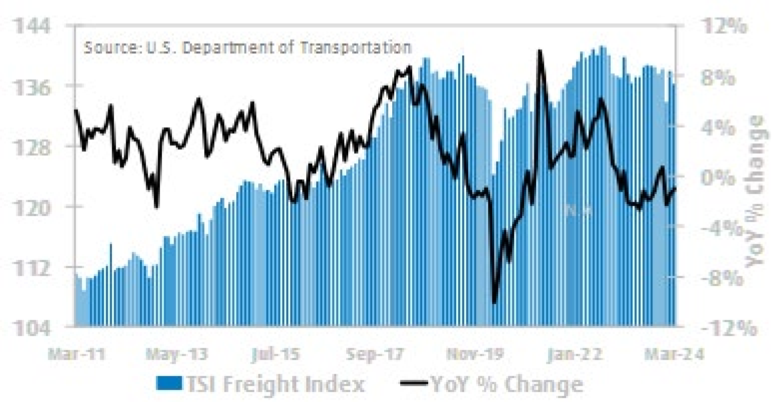
FTR Heavy Duty Truck Tonnage Index (Seasonally Adjusted)



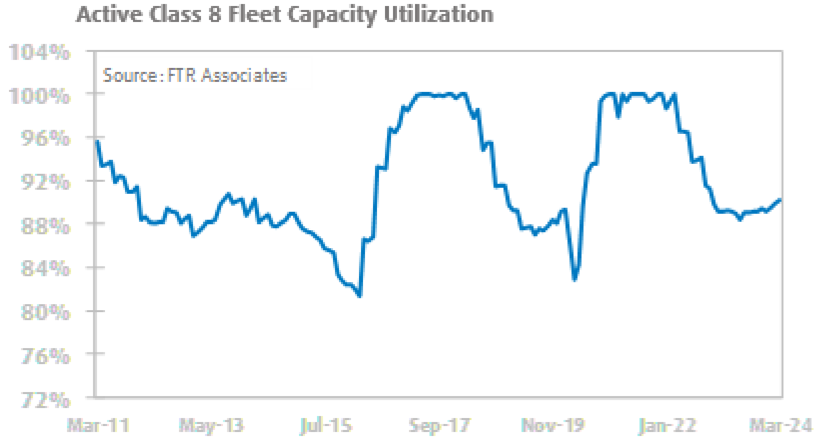
Cass Freight Index – Shipments (Seasonally Adjusted)



Transportation Services Index (Freight)

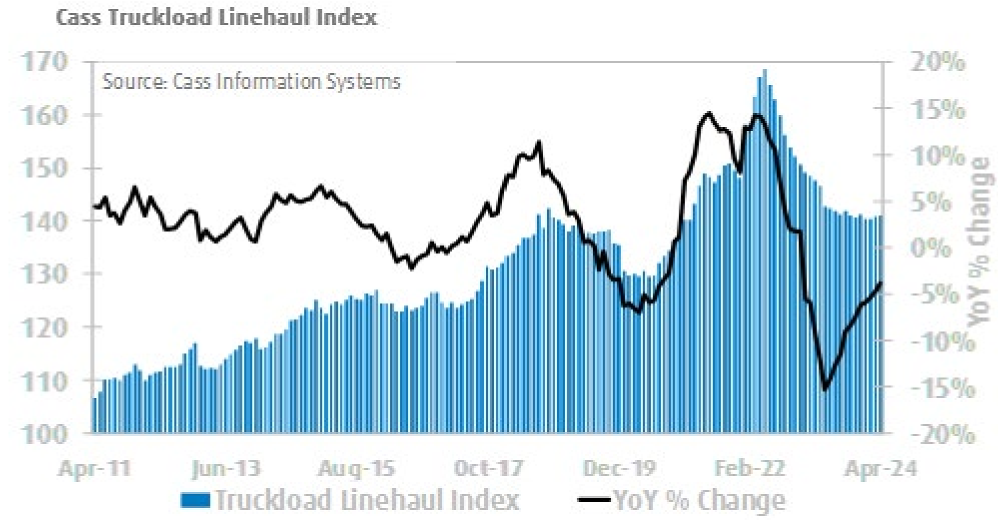


Active Class 8 Fleet Capacity Utilization

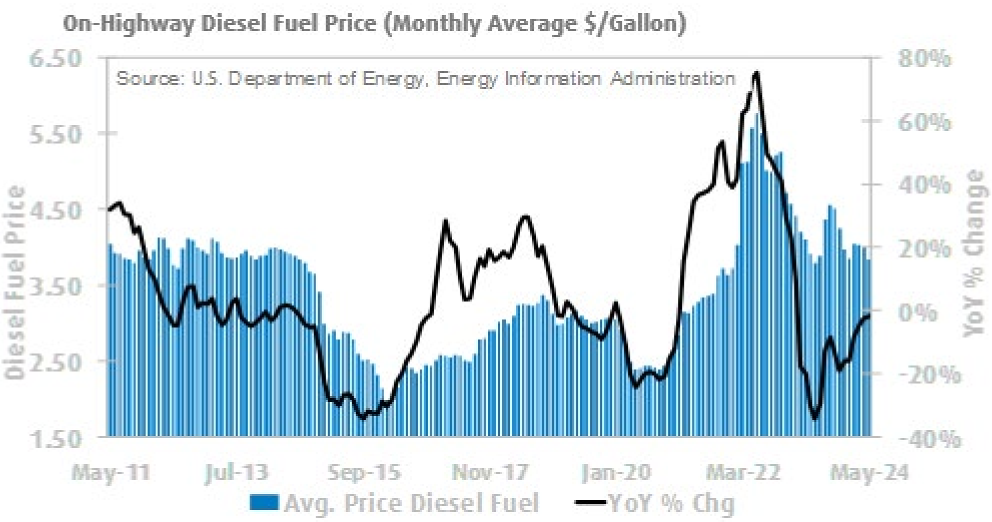


- The **ATA For-Hire Truck Tonnage Index** (primarily contract freight) fell 2.0% (month-over-month) during March and was 1.0% lower than a year earlier.
- The **FTR Truck Tonnage Index** has been in a downtrend with single-digit year-over-year declines in 13 of 14 months through March.
- The **Cass Freight Shipment Index** (all modes) has declined year-over-year for fifteen consecutive months through April.
- The **TSI Freight Index** resumed a downtrend at the start of 2024, with year-over-year declines in 12 of the past 15 months.
- The **FTR Class 8 Capacity Utilization** Index has gradually drifted higher but remains not far from a 3-year low.

Revenue And Expense Indicators

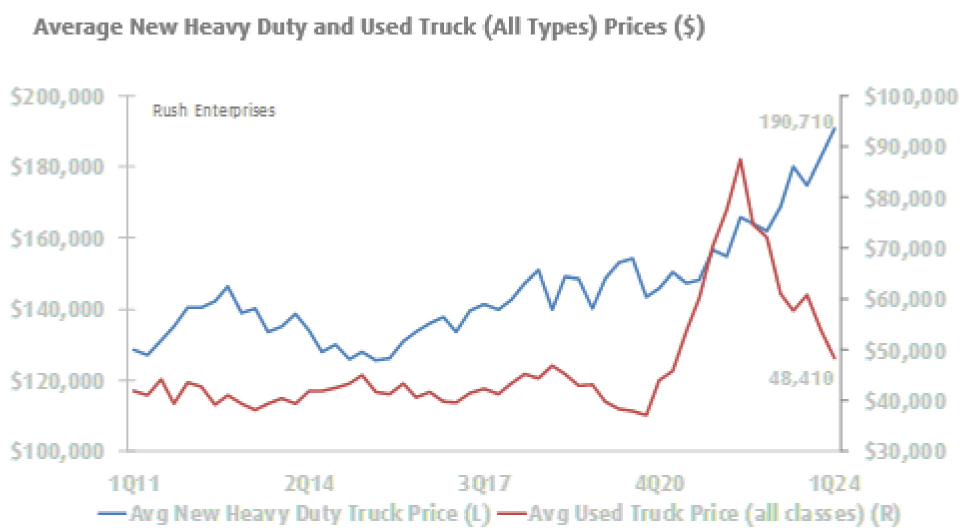


The **Cass Truckload Linehaul Index** reflects a mix of base rate pricing (excluding fuel and other surcharges) in the dry van contract and spot freight markets. Due to the periodic nature of the contract pricing cycle, there is typically a five or six-month lag from when the contract market reflects earlier trends in spot freight pricing. With dry van spot rates relatively flat for over a year, the worst downward pressure on contract rates is also evidently in the rearview. That said, even with a flattening trend, the year-over-year comparisons may not turn positive until the 3rd quarter of this year.



Mirroring a relatively tight range in crude prices, the national average **Diesel price** of $3.79/gal in mid-May was down only 2% (-$.09) year-to-date. That said, diesel prices were down 18% from last September's most recent high mark.

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 modestly from an average of $77.6 in 2023.

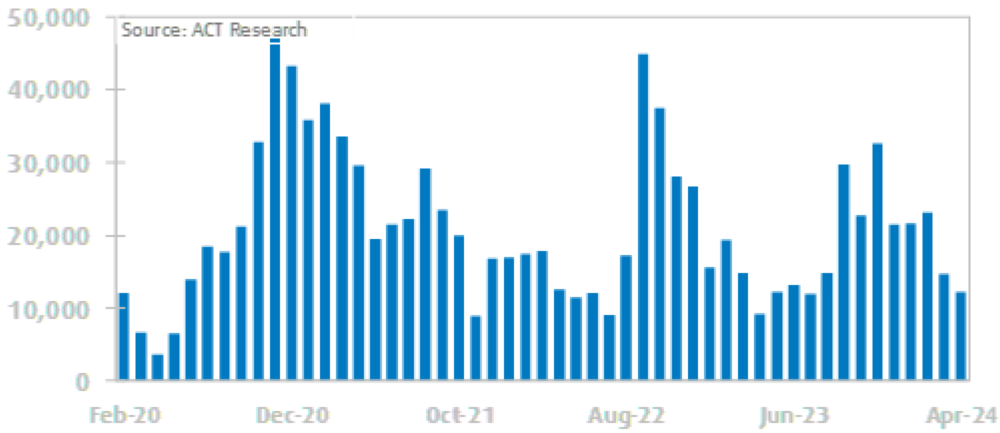


With over-the-road for-hire carriers sitting on the sidelines yet strong demand from large private fleets and vocational buyers (Refuse/Construction), Rush Enterprises' **average price of new heavy-duty trucks** reached a new high during the first quarter. Heavy-duty ASPs increased by $7,877 (+4.3%) from the 4th quarter and $21,933 (+13.0%) from the year-earlier quarter.

After a brief reprieve during the 3rd quarter of last year, used truck pricing continues to search for a bottom while reaching a new 3-year low during the 1st quarter. The **average price of all used trucks** sold by Rush Enterprises during the 1st quarter decreased 10.1% from the 4th quarter and 20.6% from the year-earlier quarter. Rush expects used prices to continue to decline, albeit at a decelerating pace.

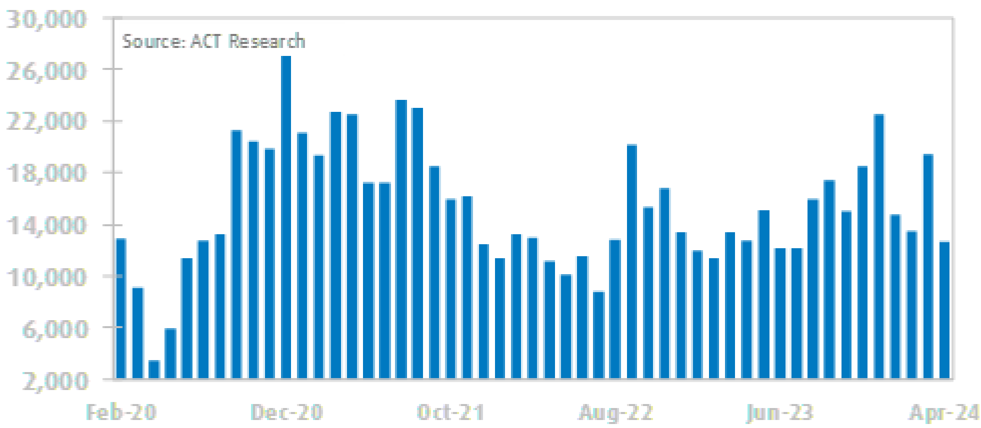
Truck and Trailer Orders

U.S. Class 8 Net Truck Orders



Given that pent-up demand was in the latter stages of fulfillment, year-over-year comparisons of **U.S. Class 8 net truck orders** mainly remained negative during the second half of last year and into the first two months of this year. Nonetheless, monthly orders exceeded 20k for six consecutive months through February before finally running out of steam in March and April. Although up 32% from a year earlier, April orders met subdued expectations and were the lowest since last July. With pent-up demand largely satisfied and expectations for an equipment cycle reset coming to fruition, full-year orders will likely finish below 2023.

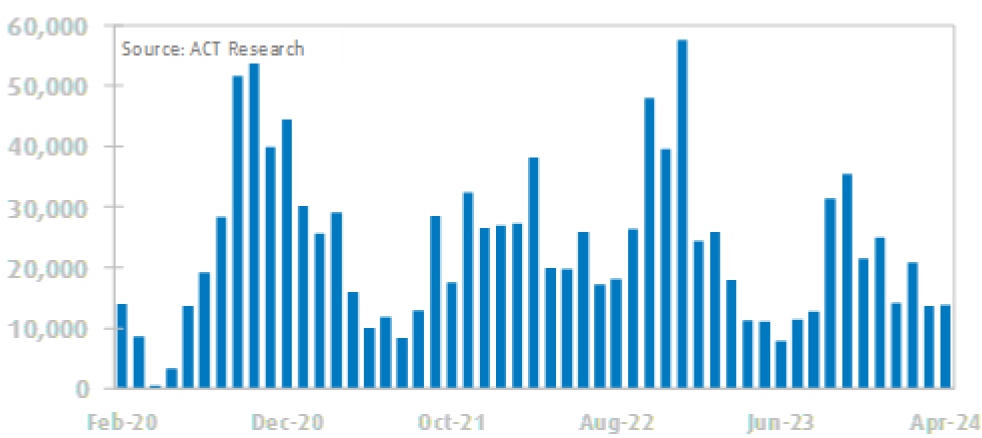
U.S. Class 5-7 Net Truck Orders



Since peaking at the end of last year, **medium-duty truck orders** have returned to normal levels, with the exception of a single-month burst during March. Fundamentals for typical end-markets continue to be mixed, with vocational and infrastructure providing tailwinds while homebuilding and retail goods have been underwhelming.

The longer-term view remains stable, featuring the usual support of diverse end markets, a secular trend toward shorter hauls, and the durable tailwinds of e-commerce and last-mile delivery.

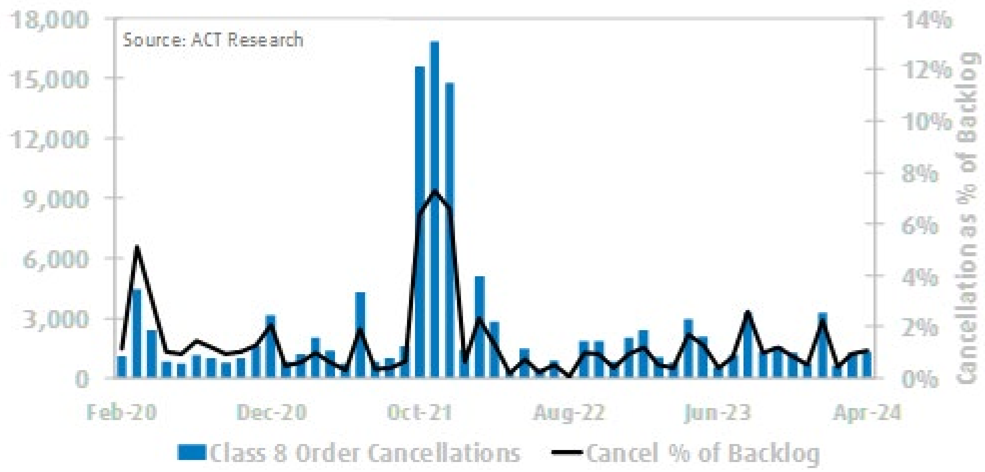
U.S. Net Trailer Orders



Except for a short and muted order season late last year, **trailer orders** have generally been in a tailspin since peaking at the end of 2022. April was the first month since last September and only the second month over the prior sixteen, where orders increased year-over-year, although attributable to easy comparisons rather than a firming in demand. Throughout last year and into this year, the market made a stark transition from strong demand limited by supply chain constraints to a normalized supply chain met with lackluster demand expected to endure throughout 2024.

Other Equipment Indicators

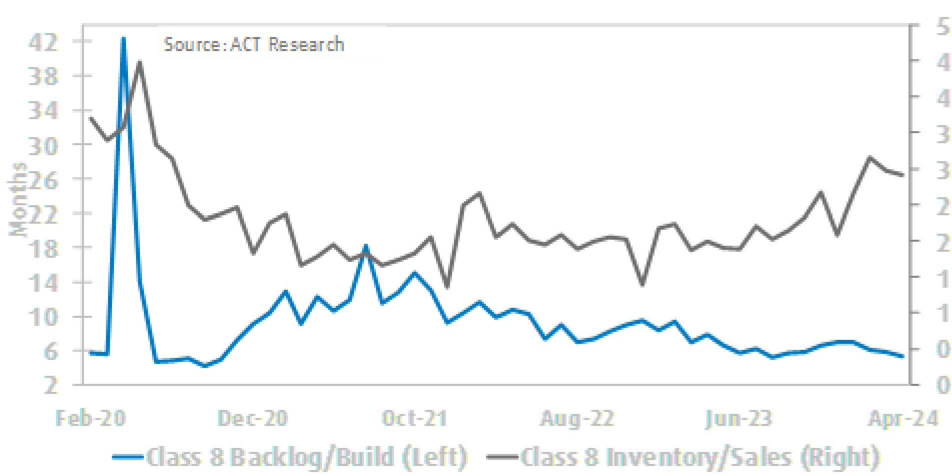
U.S. Class 8 Order Cancellations



Including a one-month bump-up outlier in January, most likely due to rescheduling or periodic housecleaning, the trailing 6-month average monthly cancelation rate (as % of backlog) of 1.0% compares favorably to the pre-pandemic long-run average of 1.8%.

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 should not be expected to remain so far below the long-run average. Still, except for the occasional cleanup and re-shuffling of orders, with several years of limited availability still fresh, the looming prospect of an EPA pre-buy, and barring any unforeseen macro fallout, most fleets should remain reluctant to cancel their orders.

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



A significant drop in orders during March and April, combined with a surprisingly steady pace of builds, has reduced the wait time for new Class 8 trucks to a multi-year low. Specifically, the **heavy-duty backlog-to-build** ratio has decreased from seven months in December to approximately five months in April and below the long-run pre-pandemic average of six months.

The combination of steady production and a notable deceleration in unit sales has put upward pressure on inventories. As a result, the **heavy-duty inventory-to-sales** ratio has doubled from below 1 ½ months at the end of 2022 to nearly three months at the end of April and is uncomfortably above the high end of the long-term average range of 2-2 ½ months.

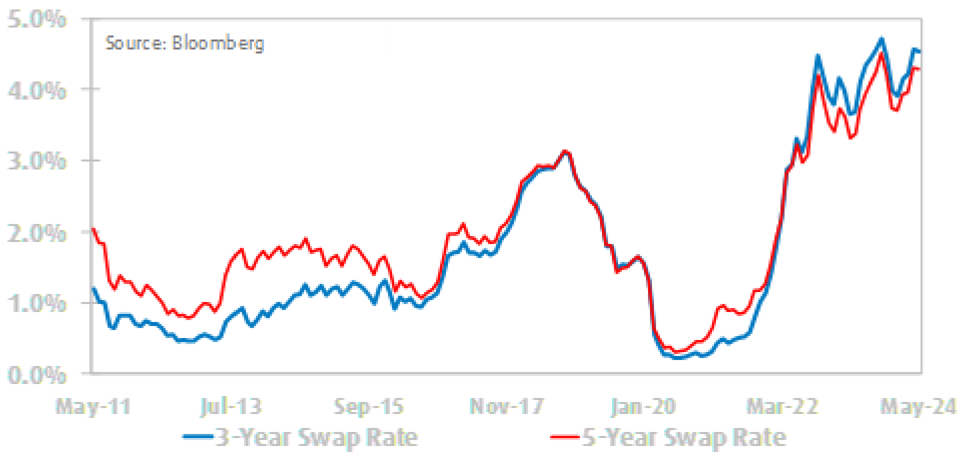
U.S. Class 8 Retail Sales vs Builds

Since peaking just below 30k monthly units at the end of 2022, **U.S. Class 8 unit sales** have been choppy but predominantly downward trending throughout 2023 and early 2024. With pent-up demand satisfied and carriers enduring the industry's worst profit recession since the global financial crisis, further weakening of unit sales through at least mid-year should not be surprising.

Despite the expectation of declining sales, **Class 8 production** through April had yet to respond in kind but is expected to do so as the year progresses. In the meantime, the result is a multi-year low backlog.

Other Business Indicators

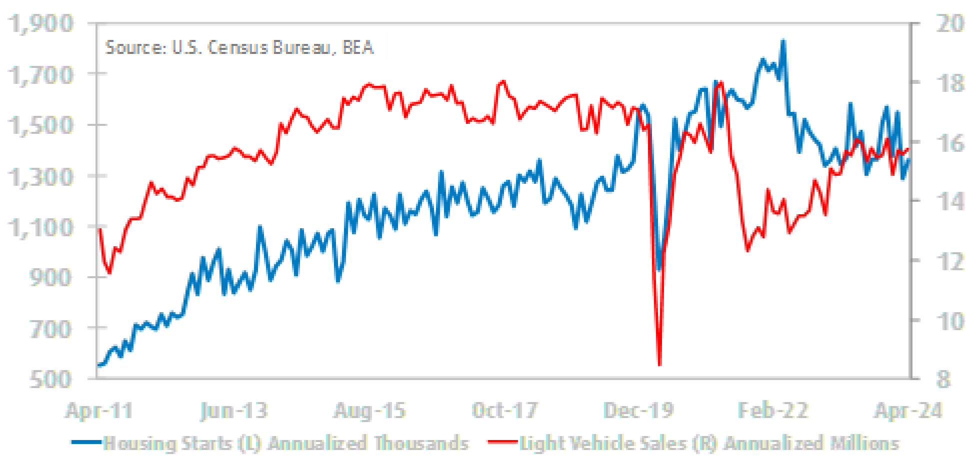
Interest Rates: 3 & 5 Year Interest Rate Swap Pricing



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 January, rates have reversed course and drifted higher primarily in response to a slightly improved macro outlook and hotter-than-anticipated inflation, which has delayed the expected timeframe for the start of a Fed rate-cutting cycle.

U.S. Housing Starts & Light Vehicle Sales (Seasonally Adjusted)



U.S. housing starts during April fell well short of expectations with a modest rebound of just 5.7% to 1.36 million annualized after a downwardly-revised 16.8% slide in March. The entire bounce was in the volatile multi-family segment. Overall, starts are down 0.6% in the past year, so basically in a holding pattern at levels only moderately above those in 2019. As of mid-May, BMO economists estimated housing starts this year will be no better than flat following an 8.5% decline in 2023.

Although supply-side issues (semiconductors, UAW strike) have faded into the rearview, the growth outlook for new vehicle sales will remain underwhelming until interest rates begin to ease. As of mid-May, BMO economists estimated **U.S. auto sales** will increase only slightly from 15.6 million in 2023 to 15.7 million units this year.

U.S. Business Inventories/Sales (Seasonally Adjusted)

The **total business Inventories-to-sales ratio** bottomed at an all-time low at the end of 2021 but has since 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 are still at the low end of long-term historical norms.

“Voice of the BMO Economics Team”

With macro conditions starting to show signs of fatigue, services inflation proving sticky, and market expectations for the Fed to begin cutting rates pushed out to later in the year, 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/

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

Inflation was doing so well, until this year. After rising 2.0% annualized in the second half of 2023, and thus meeting the Fed's definition of price stability, the core PCE deflator bolted 3.7% higher in the first quarter of 2024. The culprit was a 5.4% pop in services prices, in sharp contrast with deflating goods prices. Sturdy gains in necessities such as auto insurance, electricity and natural gas piled onto strength in discretionary items such as recreational services and hotel fees. Rent is also proving a stubborn beast to tame, though recent market measures flag a deceleration. One can draw a straight line all the way from strong wage growth to sturdy services demand and inflation.

This means labor markets likely need to loosen to bring inflation to target. And they have, but only a little. Fewer businesses have job openings, fewer workers are quitting, and fewer consumers think jobs are plentiful. After a blowout quarter, payroll gains decelerated to a normal 175,000 in April. At 3.9%, the unemployment rate is half a percentage point above the cycle low. But it may need to rise further to take the edge off wage gains as employment costs and hourly compensation are still running north of 4% on a yearly basis. It's only because of faster productivity (2.9%) that unit labor costs are held in check (1.8%). But productivity slowed in the first quarter, suggesting this well might be running dry.

For labor markets to loosen further, the economy will need to land at least softly; that is, grow at a sub-potential rate of under 2%. It did take a run at the tarmac in Q1, as real GDP slowed to a 1.6% annualized rate. Faster imports, slower inventory building, and a rare downshift in government spending led to a sharp drop in altitude from 3.4% in Q4 and 4.9% in Q3. However, private domestic demand stayed aloft, cruising at a 3%-plus rate for a third straight quarter. The resiliency of consumer and business spending—85% of the economy—warranted a modest upgrade to our economic outlook. Still, more recent data suggest growth likely stayed below 2% in Q2. Along with slower payrolls, the ISM metrics slipped into contraction territory in April, retail sales and industrial production both stalled in the month, and consumer confidence soured on weaker job prospects and lower equity values. **For all of 2024, GDP growth looks to decelerate to 1.6%** on a Q4/Q4 basis, about half of last year's rate, as elevated interest rates bear down on demand. A moderate pickup to 2.0% is expected in 2025 if the Fed reverses course.

Inflation's wrong turn is likely a speed bump for rate cuts rather than a roadblock. Citing a "lack of further progress" on inflation, the FOMC provided no guidance on rate-cut timing after its May 1 policy meeting. Chair Powell said the committee will need some combination of calmer core prints and weaker labor markets to gain confidence in the inflation outlook. Throwing markets a bone, he at least said increases were "unlikely" as policy is already "sufficiently restrictive". **We pushed out our call for the first reduction to September** (from July) and expect just one follow-up move this year in December. If inflation behaves, though, an additional 175 bps of rate relief could flow by early 2027.

At least the FOMC will be relaxing quantitative tightening soon. Starting June 1, it will reinvest all but $25 billion of maturing Treasury notes per month, down from the current cap of $60 billion. The slower-than-expected run-off of its bond portfolio could ease pressure on Treasury yields, though what's really needed is much calmer inflation data.

"Voice of the BMO Economics Team"

The Path Forward Remains as Clear as Mud
Scott Anderson, Chief U.S. Economist - May 17th, 2024

Economic data, as it has for much of the pandemic and post-pandemic periods, continue to surprise the consensus forecast. This week, the **surprises were resoundingly to the downside**. Meanwhile, sizable data revisions continue to cloud the outlook for economic forecasters and Fed policy makers, making the path forward about as clear as mud. As Chair Jerome Powell is fond of saying at his FOMC press conferences these days, inflation is still too high, further progress in bringing it down is not assured, and the path forward is uncertain. Last week I posed the question: is the second quarter going to show strong real U.S. GDP growth or be more of an inflationary mirage? Our forecast has been closer to the latter than the former, expecting below-consensus real GDP and consumer spending growth of around 1.7% and 2.0%, respectively, with stubbornly resilient CPI inflation of around 3.7% annualized in the second quarter. The median forecast from the Survey of Professional Forecasters published by the Philadelphia Fed on May 10th is looking for second quarter GDP growth of 2.1%. I was hoping this week's data on April retail sales, industrial production, housing starts, and consumer and producer inflation would shed some important light on the question, as the Atlanta Fed and New York Fed GDP trackers for Q2 GDP growth have also been holding well above our estimates in recent weeks.

Well, the April data are in and there was a unanimous miss on all U.S. growth fronts, including retail sales, industrial production, housing starts, and initial jobless claims, so it seems **our somewhat below consensus forecast for Q2 remains just about in the right place for now.** Maybe the mud isn't quite as cloudy for us. In fact, the economic surprises around the U.S. economic data haven't been this consistently negative since 2019 before the pandemic began. Let's start with the retail sales report for April. Not only did headline sales remain unchanged from March, and well below the consensus estimate of 0.4%, but retail sales excluding food service, gasoline, building materials and auto dealers, often referred to as the retail sales control group and used as an input for estimating real consumer spending in the quarterly GDP report, actually declined 3.1% at an annualized pace last month. After subtracting out April's 3.8% annualized CPI inflation rate, core real retail sales dropped at a hefty 6.9% annualized pace to kick-off the second quarter.

In response to the weaker growth to start the second quarter, the GDP tracker from the Atlanta Fed dropped to 3.6% from a peak of 4.2% the week before, while the New York Fed's version slipped to a lower 1.9% this week. Yes, these tracking forecasts remain somewhat above our Q2 growth forecast, but it will only take a few more disappointing reports or downward revisions to past data to move these tracking forecasts down to our level.

Speaking of downward revisions, we are expecting a pretty big one on May 30th with the release of the second estimate of first quarter GDP. Growth was already a bit of a disappointment when it came in well below forecasts at 1.6%. But along with this week's April retail sales report, core retail sales for prior months were revised substantially lower through March, shaving half a percentage point off the initial first quarter BEA estimates for consumer spending and GDP growth. **We expect the latter will get revised down to a measly 1.1%** from the 1.6% initial estimate. The analysts still talking about a strong and resilient consumer and labor market to justify current equity market valuations may soon need to start changing their tune to Fed rate cuts are coming to the rescue. Over the last two weeks, more elevated initial jobless claims also point to a recent softening in the U.S. labor market that merits some closer attention.

Turning to this week's inflation data, we have seen an impressive round of applause in the financial markets with U.S. equity markets surging to new record highs and Treasury bond yields generally dropping as traders solidify around the view that the Fed will be able to start cutting interest rates by our forecasted September date. While the headline and core CPI measures of inflation year-on-year moderated in-line with our and the consensus forecasts, the details looked a bit softer than the past three months and generally moved in the right direction, **keeping the door open for a couple Fed rate cuts this year**. So yes, still sticky inflation, but a bit of light at the end of the tunnel. If only we can get there through all this mud.

“Voice of the BMO Economics Team” Continued

Small Business Not Yet Seasick
Sal Guatieri, Senior Economist – May 17th, 2024

A resilient economy is lifting all ships, but some higher than others. In particular, while large firms appear to be taking the waves in stride, **smaller shops are taking on some water**. Although confidence among corporate executives is healthy and normal, that’s not the case for small business owners. The NFIB small business optimism index, though ticking up last month, is little changed in the past year and about 10% below normal. Plans to increase staff and capital expenditures have ebbed as the same low number of respondents as in the Great Recession think now is a good time to expand. Many small firms are hiking pay to retain workers, but more are getting squeezed when passing the bill to customers.

The divergence in confidence between large and small businesses is reflected in recent hiring. While large and mid-size firms expanded staff by 1.6% and 1.0%, respectively, in the six months to April, **smaller stores (with fewer than 50 employees) have largely held the line** (0.1%), according to ADP. A large percentage of small companies can’t find qualified help to fill positions, as bigger firms usually offer better pay and benefits. Labor quality ranks second only to inflation as their most pressing problem.

Compared with bigger firms, **small shops are struggling more with rising wages** as they have less ability to adopt labor-saving technologies to address worker shortages. They also have less leverage in controlling supply costs. Small firms are especially **challenged with high borrowing costs and access to credit**, as most rely on banks rather than investors for financing, and the former have tightened loan standards in the past year. Many small stores need to repay loans from the Small Business Administration, which provided nearly $400 billion of credit to almost four million businesses during the pandemic. Many have little choice but to pass higher credit, wage and other costs to customers, yet risk losing market share. Small businesses that rely on lower-income households are at greatest risk, as their spending power and savings have been disproportionately impacted by inflation.

To be sure, **most small businesses are making a go of it**, with many even thriving thanks to the robust economy. Business bankruptcies, though turning up, are only at pre-pandemic levels. American households have increased spending at twice the rate of their Canadian peers in the past year, as the latter are much more affected by mortgage resets. But the longer that interest rates stay aloft, the more consumers will feel the need to retrench. While Wall Street is pining for lower rates to keep cruising, it’s Main Street that truly needs relief to avoid going under.

Inquiries About Financing

Travis Ward
(214) 492-4554
travis.e.ward@bmo.com

Industry Research Contact

Michael Zimm, CFA
michael.zimm@bmo.com

bmotf.com