Q1- Q2 2022 ECONOMIC FORECAST

2/16/22

2022: A TIME TO RECOVER AND REBUILD

In 2020, the COVID-19 pandemic shattered our country's sense of invincibility.

In 2021, supply chain struggles and labor shortages shattered our sense of abundance. The driver shortages that have long-plagued trucking became more than an industry concern. Over the past year, the driver shortage, in concert with supply chain bottlenecks, captured the interest of journalists, politicians, and consumers alike. For better or for worse, the American public became fascinated with supply chains at a cultural level. They saw the fundamental challenges and complexity inherent in keeping goods moving and shelves stocked.

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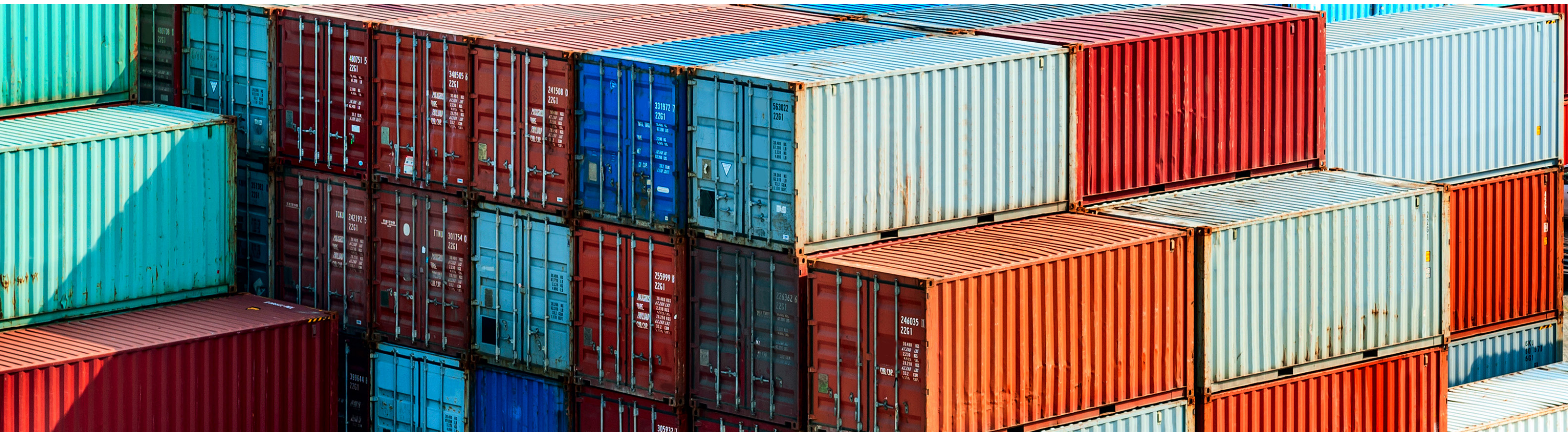
CEOs have become especially attuned to supply chain challenges. A recent survey by Alix Partners, a management consulting firm, revealed that 72% of CEOs in North America, Europe, the Middle East, and Asia are worried about losing their jobs due to business disruptions — a dramatic surge from the 52% reported in the 2020 survey. In the most recent survey, 94% of CEOs agreed their corporate models need to evolve over a three-year horizon in pursuit of fortified supply chains.

Our Q4 2021 economic forecast update, released last November, observed that the "recent supply chain disruptions have reminded us how even the most frictionless digital transactions still rely on physical labor. Every retail purchase relies on real people who work diligently to move goods from Point A to Point B. Regrettably, their hard work and contributions often go unacknowledged and underappreciated until things no longer work. At the end of the day, e-commerce is still driven by human efforts meeting human needs."

People will always be indispensable ingredients in supply chains, even in a digital world. While 2021 was the year of congested container ports and heightened freight volumes, we believe 2022 will be the year of the truck driver, the forklift operator, and the other essential workers who hustle to sustain this country's health and wealth. Our quality of life, quite literally, is in their hands.



Sustained, heightened freight volumes, a stimulus bill, and worsening inflation are late-breaking themes from 2021 that likely will spill over into 2022. While robust consumer spending gave the economy a good deal of momentum heading into the new year, dwindling savings rates will have to contend with inflationary pressures over the first half of 2022. Consumer spending certainly will wane, but to what degree? Moreover, will freight volumes taper off accordingly? To what extent will infrastructure spending dip into an already depleted pool of blue-collar workers? Most importantly, will COVID-19 finally lessen from a pandemic into an endemic?

The answer to those questions will very well determine not just the trajectory of freight markets, but the overall state of the American economy in 2022.

GROWTH ISN'T ALWAYS GUARANTEED

Almost two years have elapsed since the coronavirus pandemic became a full-blown public health crisis. As governments took extraordinary measures to stop the spread and limit the human toll of the pandemic, the country also realized an economic cost. The mitigating steps of lockdowns and social distancing unleashed a ripple effect of not only mass unemployment in the service sectors of the U.S. economy, but also an anxious wave of panic buying and online purchases from retailers. Businesses, particularly in the service sector, were shuttered to prevent health care systems from being overwhelmed. Consumption habits evolved accordingly.

The post-pandemic recovery may take a bit longer to shake out than initially anticipated.

In the early days of the pandemic, our economic forecasts sought to inform logistics and supply chain professionals tasked with making big decisions in the face of uncertainty. After 24 grueling months of courage and poise in the face of an unprecedented public health and economic crisis, it seems the dust is finally beginning to settle. The volatility in the economic indicators will attenuate in a way that will clarify which changes in behaviors and priorities will remain intact. We'll also learn which of the pre-pandemic rules will still apply. Supply chains have adapted considerably to accommodate rapid changes in consumer preferences. Soon, we'll know the difference between the new practices that will persist and those that will revert to the old ways of doing things.

The most recent numbers suggest the post-pandemic recovery may take a bit longer to shake out than initially anticipated. As we said in our prior economic forecast update,

> **"Growth can't be taken for granted. If businesses must raise wages to motivate people to return to work, that could very well fan the flames of long-term inflation. If inflation becomes a serious issue, the Federal Reserve may be forced to move aggressively by raising interest rates to tamp down economic growth."**

With an eye toward discussing what lies ahead in 2022, let's dig into some of the recent economic data.

WHAT'S HAPPENED RECENTLY?

Throughout the coronavirus pandemic, two common themes have characterized our outlook on the freight market. The first is that **the pandemic accelerated many of the dynamics already in play in the early days of 2020.** Carrier exits in 2019 foretold an inflationary environment in 2020. The pandemic economy intensified those underlying factors, and freight rates surged accordingly to record levels. It also defied the typical conventions around annual seasonality in freight movements. In many respects, 2020's "peak season" comprised most of Q3 and Q4. We raised the possibility that we'd see much of the same in 2021 — and that prediction did indeed play out as we expected.

The second key theme in our outlook is this: **The lockdowns have motivated sweeping changes in consumer behavior that are greatly contributing to this heightened rate environment.** A broad shift to e-commerce has left many retailers and manufacturers scrambling to keep up. Supply chain integrity has become every bit as critical to success as marketing.

With those two themes in mind, here are some numbers that have piqued our interest since the release of our Q4 2021 Economic Outlook.

Gross Domestic Product

• On Jan. 27, 2022, the Bureau of Economic Analysis released its initial estimate of Q4 GDP, which yielded 6.9% growth coming on the heels of 2.3% growth in Q3. In our earlier update, we discussed the impact that inflation, in concert with declining disposable income, would have on economic growth for the remainder of 2021. High rates of inflation did stifle growth to an extent in 2021, but the recovery continued amidst the throes of the pandemic. The BEA estimates real GDP growth of 5.7% in 2021.

• On Jan. 14, 2022, the Census Bureau released its advanced estimates of U.S. retail sales for December 2021. The data puts a damper on the end of the holiday shopping season, with retail and restaurant sales dropping by 1.9%. In an interview with The Wall Street Journal, the chief economist at Pantheon Macroeconomics commented on the recent retail data, “The overall numbers are terrible, but … we expect a strong rebound in sales once the omicron wave subsides.”

• The Federal Reserve recently reported U.S. industrial production fell for the first time since September. Manufacturing output dropped 0.3% as supply-chain issues continue to affect output.

• The Atlanta Branch of the Federal Reserve Bank’s “GDP Now” tracker suggests growth will be very hard to come by in the initial months of 2022. As of Feb. 1, 2022, the “GDP Now” tracker predicts a stagnant 0.1% growth in Q1 2022.

• After the latest round of stimulus legislation failed to pass the U.S. Senate, economists at Goldman Sachs revised their GDP growth forecasts for Q1 2022 from 3% to 2%.

800,000+
new jobs in December

650,000+
fewer food service jobs than pre-pandemic

Employment

• On Jan. 5, 2022, ADP released the results of its monthly payroll survey. December saw an encouraging uptick in private sector employment to the tune of 807,000 jobs. That's great progress, especially coming on the heels of an additional 534,000 new private sector jobs in November. The manufacturing and construction sectors saw modest gains. Each added approximately 50,000 new jobs headed into the holiday season.

• However, the Bureau of Labor Statistics reported total nonfarm payroll employment increased by a much more modest 199,000 jobs in December as the unemployment rate declined from 4.2% to 3.9%. Moreover, October and November's monthly employment data was revised upward due to survey participants taking longer than usual to report their hiring trends to the BLS. In 2022, the employment market will continue to navigate chronic worker shortages. While the labor force is indeed increasing gradually, it is still down by more than 2 million workers from before the pandemic.

• Further, the BLS report indicated the leisure and hospitality sector added a modest 53,000 jobs in December. While that's certainly a decline over the hiring pace of 200,000 seen in October of 2021, the leisure and hospitality industries added 2.6 million jobs altogether in 2021. That's still down by about 1.2 million jobs compared to the beginning of the pandemic. There are still 653,000 fewer jobs in the restaurants, bars and food services sectors compared to employment levels in February 2020.

• Earlier in December, Michael Feroli, the chief economist at J.P. Morgan, predicated the unemployment rate could trend as low as 3% by the end of 2022. "It's stunning to see how much the rate has fallen in the last five months. We expect that pace of decline to slow, but it doesn't take much to get below 4%, even with a tick up in the labor participation rate, which has been depressed over the last year and a half." Concurrently, Feroli expects 3% GDP growth in 2022 and an increase in the federal funds rate in September.

Consumer Sentiment

• Consumers' opinions of the economy were worsening heading into the new year. The most recent data from the University of Michigan's consumer sentiment survey shows a drop from 70.6 in December to 67.2 in January. In addition, expectations for inflation over the next five years rose to 3.1%, up from the 2.9% increase reported in December.

• On Jan. 25, 2022, the Conference Board released its latest monthly Consumer Confidence survey results. The findings reveal consumer confidence flagged in January after three months of gains to end 2021. Consumer Confidence in January reads out at 113.8, down from 115.2 in December while the Expectations Index — a measure of consumers' short-term outlook for income, business, and labor market conditions — declined to 90.8 in January from 95.4 in December.

Logistics Managers' Index

The Logistic Managers' Index is a survey of leading logistics executives that calculates a score based on an array of industry components ranging from warehousing capacity, utilization, and prices to transportation capacity, utilization, and prices. Any reading above 50 indicates expansion while readings below 50 indicate contraction.

• The December 2021 index (released Jan. 4, 2022) gestures toward a logistics industry that was gaining momentum headed into the holiday shopping season but has leveled off in the new year. The most recent LMI reading of 70.1 increases growth at a decreasing rate, and is also a slight decline from the readout of 73.4 in November. It's also the first declining readout after 10 consecutive months of sequential LMI increases.

• Transportation capacity contracted for the 19th consecutive month in December, registering at 42.6 (+2.9). The survey narrative observed "Transportation continues to be constrained by both equipment and labor availability."

• The December LMI report also further elaborated on the state of transportation prices: "While the rate of expansion for transportation prices has dipped below 90.0 for the first time in five months, it continues to grow at significant rate of 87.6. This is a continuation of the trend we saw throughout 2021. Domestic rail and road shipping rates were up 23% from 2020, and are likely to increase throughout 2022, with some industry experts predicting (or at least hoping for) some relief in price by 2023."

Freight Market Dynamics

• November 2021 was the weakest month for Class 8 truck orders in more than 25 years. Much of that can be attributed to production issues, of course. How dire are production issues? According to ACT Research, an order for a Class 8 power unit placed in early December wouldn't be delivered until February 2023. In the same vein, FTR Research data indicates November Class 8 orders dropped by 41% from October and 82% year over year. OEM production issues likely will constrain truckload capacity for the foreseeable future, even though carriers are holding on to equipment longer than they otherwise would in normal times.

• On Jan. 18, 2022, the American Trucking Associations reported its Truck Tonnage Index increased 1% in December after rising 0.5% in November (the index's baseline of 100 is pegged to 2015 volumes). The tonnage index is far from the lofty peaks it saw in April 2021. But new housing starts and reinvigorated factory outputs are driving five consecutive months of increasing freight tonnage rates.

• Spot rates have flown well above cruising altitude for the duration of the pandemic, and the observer consensus is this circumstance will persist for several months more. The holiday rush in December pushed spot rates for dry vans to just shy of $3.00 and refrigerated units to $3.45, while flatbed rates held tight at $3.04. Since then (as of Jan. 21, 2022) rates have climbed even higher, with **average van and flatbed rates at $3.13 and refrigerated at $3.60.**

• Diesel fuel has reached its highest cost in seven years. According to the U.S. Energy Information Administration, the U.S. on-highway diesel fuel prices increased to $3.780 per gallon as of Jan. 24, 2022, from $3.657 two weeks before (a $1.064 increase year over year).

OUR 2022 OUTLOOK

By and large, 2021 unfolded much as we predicted in our preceding annual economic outlook. As we expected, 2021 was characterized by ramped-up government spending, elevated freight volumes, and inflationary truckload rates despite attenuated economic growth in the second half of the year. We did expect truckload demand and spot rates to ease off in the second half of 2021. To the contrary, volumes and rates defied gravity for the bulk of 2021. Each of these dynamics unfolded in the face of prolonged driver shortages.

We believe many of these circumstances will carry over into the first half of 2022. Even if dwindling consumer spending is in the cards for 2022, inventories will have to be replenished after a year and a half of unprecedented scarcity. Consequently, we expect freight volumes to run at a fever pitch for at least two more quarters and remain strong for the balance of the year.

If the economy can maintain a recovery trajectory while staving off inflation, then expect another year of robust freight volumes and heightened truckload rates. However, if consumption does buckle under the weight of inflation and lackluster consumer sentiment, then supply chains will have to devote several months to rebuilding inventories before anyone will have the chance to catch their breath.

Accordingly, we'll pay particular attention to these four key themes as 2022 unfolds:

1) Incremental Growth in Truckload Capacity: Slowly, but surely, drivers are returning to trucking. The allure of an inflationary rate environment and robust freight volumes is hard to resist for entrepreneurial drivers who want to reap the benefits by running under their own operating authority. Indeed, 92,000 new DOT numbers were issued before the end of 2021, which is a considerable increase over the 59,500 issued in 2020. As that trend continues in 2022, a driver's desire to become an owner-operator or independent carrier will contend with recruiting efforts at midsize and larger fleets. As truckload capacity is distributed further along the trail in a way that bolsters the numbers of one-, two-, and three-truck fleets, asset-based carriers will have to rely more on their brokerage divisions to corral the trucks they need to serve their contract commitments.

A recent analysis by IHS Media revealed the number of drivers at large truckload and LTL carriers hasn't recovered to pre-pandemic levels. BLS data shows the number of long-haul truckers in September 2021 is shy of the number in August 2019 by more than 15,000 drivers. By contrast, there were roughly 14,500 more local drivers in September 2021 than in October 2019. In all likelihood, large carriers will continue to navigate a shortage and a shift, at the same time, for another year.

2) Equipment Production Backlogs: A December study released by ACT Research revealed November ushered in yet another record average retail price for used Class 8 vehicles. November retail prices for used power units not only increased by 11.8% over October's previous record average retail price but have also climbed 67.8% higher on a year-over-year basis. That's about as compelling a data point as one might find in illustrating the scarcity of Class 8 tractor inventories.

In a few circumstances, the ACT Research study observed used tractors fetching higher sale prices at auction compared to retail transactions at dealerships. Moreover, some manufacturers are offering one-year warranties on used equipment.

It's a given that high margins attract new entrants to a marketplace. However, the startup costs of forming a new trucking company have never been higher. The past year saw a slew of new entrants into the carrier market despite record high equipment prices. One working theory currently being researched is that older, more experienced drivers are taking advantage of ballooning real estate values by using the equity in their homes to finance the purchase of used equipment. Obviously, that's not a sustainable proposition in adding capacity to the market. A strong housing market will persist for only so long, particularly with the prospect of rising interest rates on the horizon.

AVERAGE USED CLASS 8 RETAIL PRICE

$48,118	$72,204	$80,769
November 2020	October 2021	November 2021

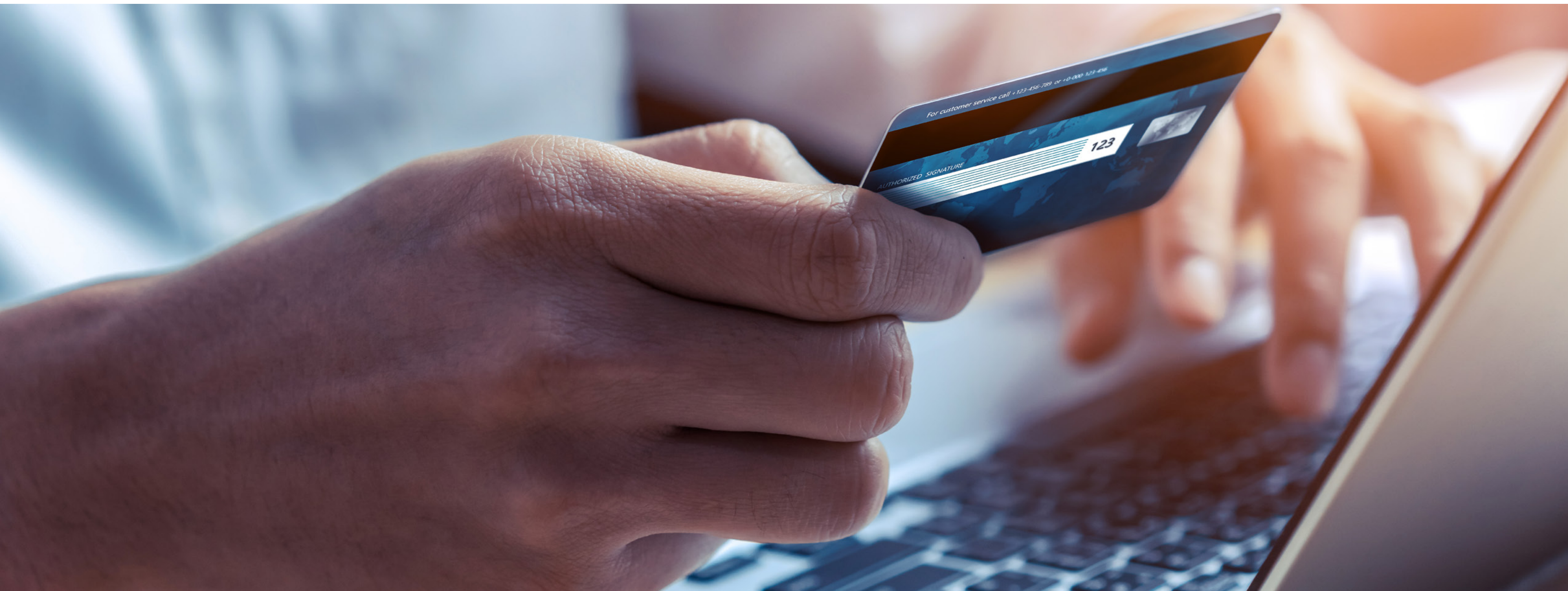
Relief from manufacturing bottlenecks and component shortages can't come soon enough. But when? The answer to that question will determine much of the trajectory of freight markets in 2022.

Unfortunately, the Biden administration expects the global semiconductor shortage to persist through at least the second half of this year, so the strain on equipment manufacturing might not be resolved anytime soon.

3) Attenuated Consumer Spending: In prior forecast updates, we talked about how the resilience of the American consumer has a psychological foundation. If Americans feel confident about their future earnings and the overall state of the economy, they'll be inclined to spend generously. Indeed, mindset matters immensely. Many government agencies have reported inflation is at its highest in several decades. Moreover, increasing wage, materials, and transportation costs are still working their way downstream from manufacturers and food suppliers to retailers and consumers. Unfortunately, there's a good possibility that field-to-fork prices will rise even higher in the coming months. High grocery bills compounded by increasing gas prices will affect more than consumers' wallets. If inflation continues to creep into Americans' daily purchasing decisions, it'll erode their sense of confidence in the economy.

Of course, flagging consumer demand will help resolve much of the strain currently placed on supply chains. But that sort of medicine may be worse than the malady.

4) Legislative Agendas in an Election Year: The latter months of 2021 ushered in an infrastructure bill that would have considerable impact on the trucking industry. A slew of construction projects likely will contend for workers who would have otherwise entered the driver pool. However, an apprenticeship program that will lower the age floor for interstate drivers is a welcome development amidst a chronic driver shortage. But what other economic recovery initiatives and government spending packages await the U.S. in a midterm election year? Ongoing supply chain challenges certainly will be front-and-center for policymakers. The same can be said for workforce development programs as well. A pared-back version of the "Build Back Better Act" could also reemerge. Moreover, how will unemployment benefits look in a post-pandemic economy?



BETTER DAYS ARE IN STORE

Although the country is still navigating uncharted waters, there's plenty to look forward to in 2022. Encouraging signs abound, from labor markets to retail sales. However, inflation is certainly a cause for concern. If consumer confidence and consumption tapers off, then there will be clear ripple effects across an array of economic indicators — from unemployment rates to home prices. Yet no matter what lies ahead for the U.S. economy in 2022, the prospect of finally emerging from a global pandemic is alone worth celebrating.

It's also worth celebrating the diligence and ingenuity of logistics and supply chain professionals. We've closed each of our prior economic forecasts by acknowledging the heroes who have kept our shelves stocked and our economy afloat in the face of adversity, and we do so again here. The contributions from truck drivers, warehouse and retail workers, logistics and supply chain practitioners, and a host of other contributors have sustained our country in unprecedented times. We've also expressed how proud we are to collaborate with shippers and peers across the industry to at a time when our collective efforts have mattered the most. Our industry's work has never been more crucial — and our decisions have never been more meaningful — than right now.

Better days are in store because of you.

Thank you, again, for rising to the occasion. It's been a privilege to be on this journey with each and every one of you. Our hope is that the new year brings health and unbridled prosperity to a world in dire need of both.

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