FNBO TRANSPORTATION UPDATE

ECONOMIC UPDATE Q2 2023

In Q2 of 2023, the gap between Nominal and Real Gross Domestic Product (GDP) was the smallest since 2020, which means inflation as a percentage of Nominal GDP is decreasing. Real GDP growth was driven by services including housing, health care and insurance and in goods from recreational products, vehicles and gasoline. Government spending rose due to higher compensation of employees. Offsetting this growth were decreases in residential investments and exports, according to the U.S. Bureau of Economic Analysis. The data shows that the cost of goods and services are beginning to decline.

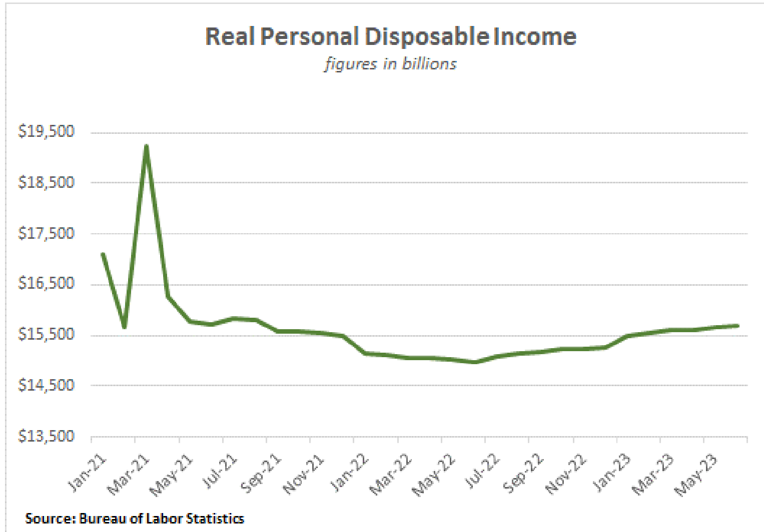
REAL GROSS DOMESTIC PRODUCT

Quarterly Percent Change from Preceding Period

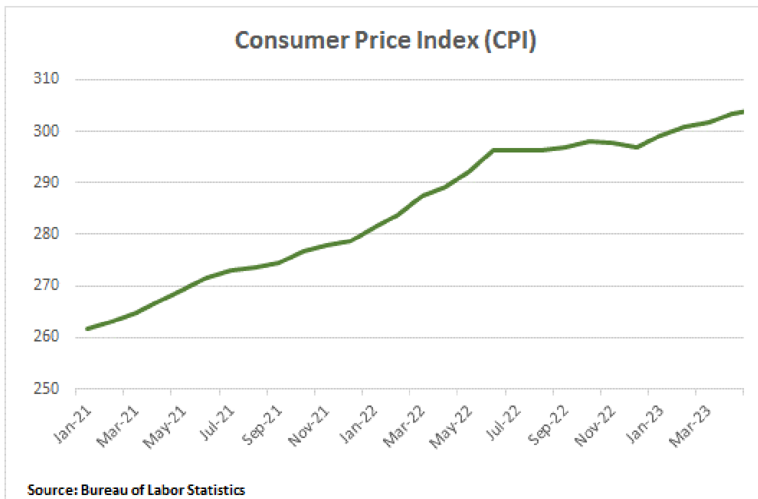
	Q2 2023	Q1 2023	Q4 2022
Nominal GDP	4.7%	6.1%	6.6%
Real GDP	2.4%	2.0%	2.6%
Personal consumption expenditures	1.6%	4.2%	1.0%
Goods	0.7%	6.0%	-0.1%
Durable goods	0.4%	16.3%	-1.3%
Nondurable goods	0.9%	0.5%	0.6%
Services	2.1%	3.2%	1.6%
Gross private domestic investment	5.7%	-11.9%	4.5%

Source: U.S. Bureau of Economic Analysis

Real disposable personal income, as shown on the right, improved 0.61% on average quarter over quarter from $15.5B to $15.6B. The improvement was driven by increased compensation and lower inflation. Personal savings rates were flat over the past quarter, fluctuating between 4.3% and 4.6%, per the Bureau of Economic Analysis. Total consumer debt was up just under 3% for Q2, according to the Board of Governors of the Federal Reserve System. This shows that the financial health of the consumer is improving with real income exceeding inflation and positive savings trends.

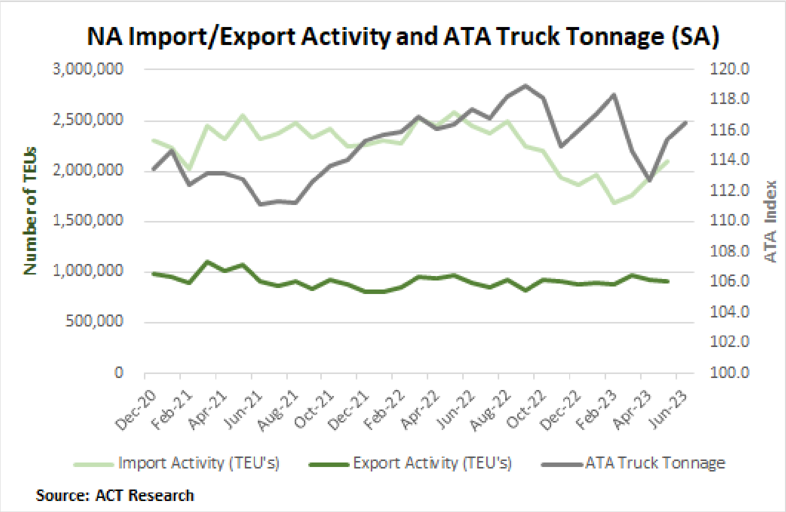


Inflation, measured by the Consumer Price Index (CPI), continued to decline at 3% for June compared to 5% in March. Per the U.S. Bureau of Labor Statistics, the increase in CPI is mainly driven by shelter, with motor vehicle insurance also contributing. The index for all items excluding food and shelter showed growth of 5.3% in May, which was the lowest increase since November of 2021, per the U.S. Bureau of Labor Statistics.

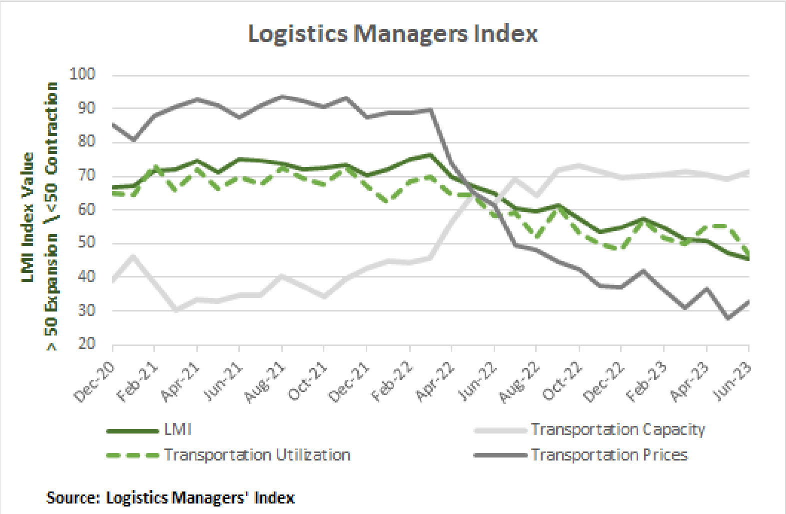


The labor market reported modest growth but with hiring becoming more targeted and selective. There are reports of increased labor availability and high turnover rates returning to pre-pandemic levels, according to the Federal Reserve BeigeBook.

FREIGHT DEMAND

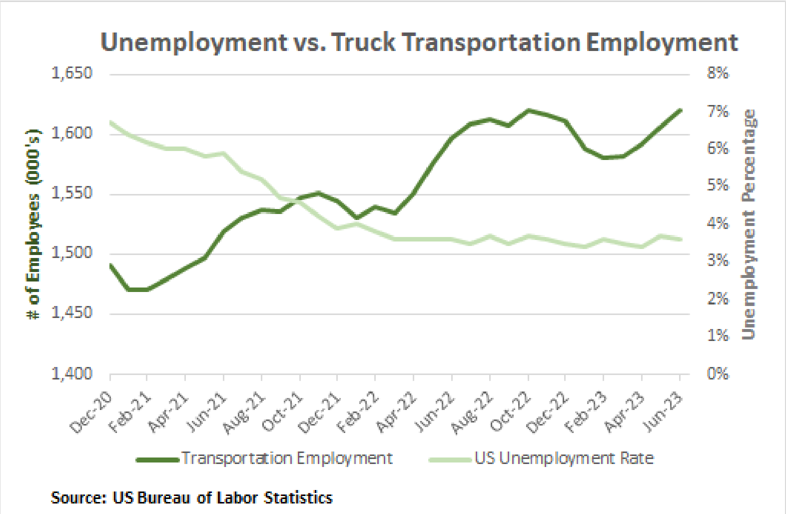


Trucking demand rebounded in second quarter after a steep decline at the beginning of the year. However, according to ATA Chief Economist Bob Costello the index continues to be in recession territory given the declines year over year with softer retail sales, manufacturing and housing starts. On the spot market side, per DAT, posting of loads were down 65% year over year during the first half of the year. While import activity showed an increase in April and May, import levels are down 19% year over year due to declining U.S. retail sales and destocking. Export container volumes decreased slightly during the first two months of 2023 and remain down 5% year over year. Given the decrease in the U.S. dollar, ACT Research indicates export trends will stabilize after four years of significant declines.

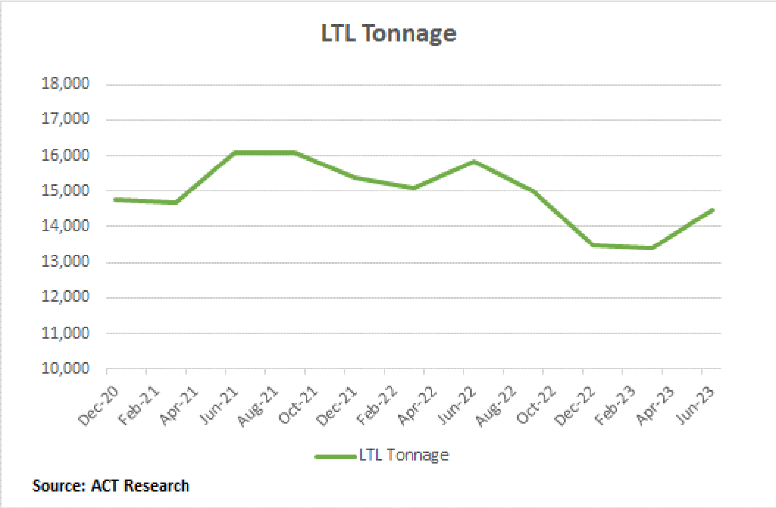


The Logistics Managers Index (LMI) highlights the inverse correlation between transportation capacity and prices with readings above 50 representing expansion in the industry. For June, the LMI was at 45.6, which is the second consecutive month of contraction. Increased capacity and reduced transportation prices driven by lower inventory levels are the primary contributor.

Truck employment, in the bottom-left chart, is up from Q1 due to increased employment in general freight local trucking and specialized freight. General freight LTL reported declines over the quarter, per the U.S. Bureau of Labor Statistics. The national unemployment rate was up slightly at 3.60% for June.



LTL Tonnage improved in Q2 but continues to be down year over year as shippers consolidate loads into full truckloads.



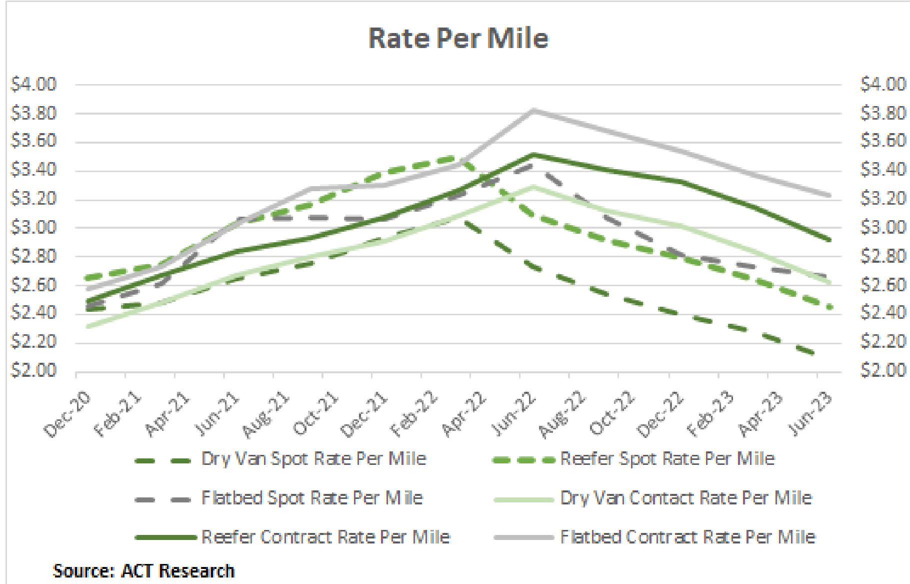
TRUCK RATES

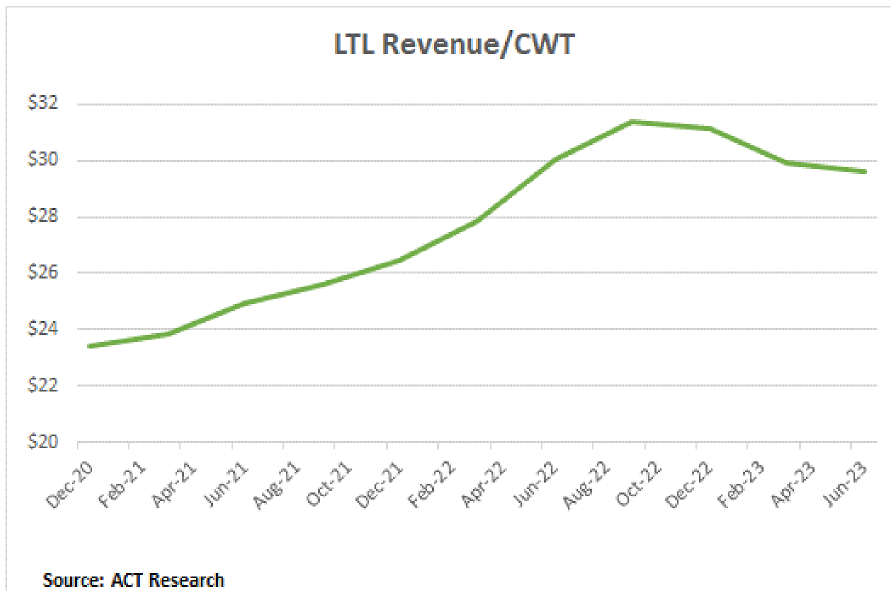
Shown on the right are contract and spot rates for dry van, reefer and flatbed. The decline continues to be driven by excess capacity and lower freight demands. Contract rates dropped 6% for dry van, 5.4% for reefer and 4.8% for flatbed. When netting fuel, those decreases dropped 3% on average.

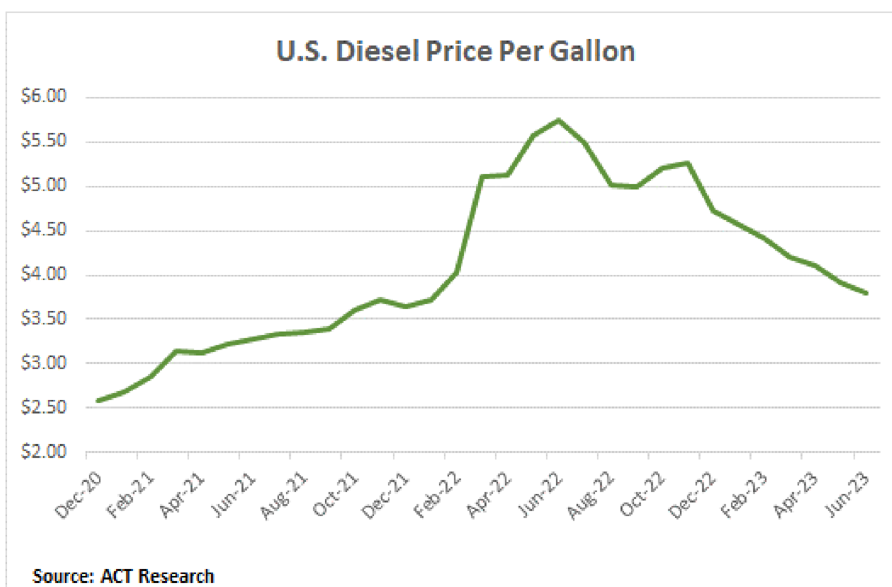
Spot rates continues to decline as import levels decreased and shippers optimized their freight. Dry van spot rates were down 8.3% with reefer spot rates down 7.2% and flatbed spot rates down 2.6%. When netting fuel, those decreases were about 3% lower, however, flatbed spot rates increased by 1.4% quarter over quarter.

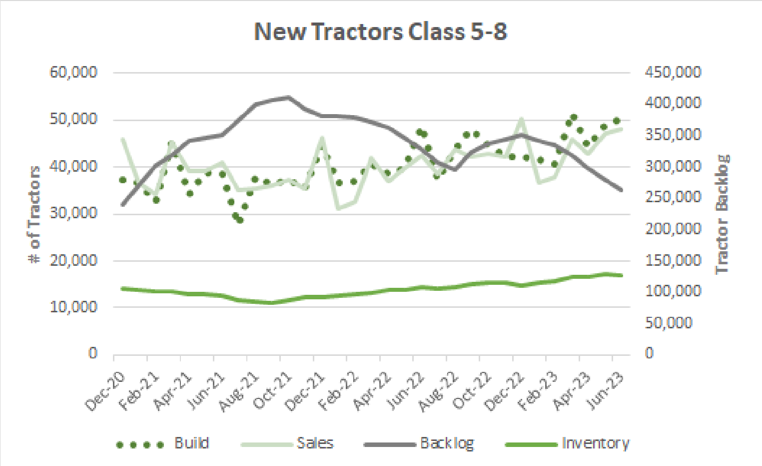
LTL costs were down 4%, as shown on the right, when netting fuel rates were flat. This is due to the high barriers to entry that allow LTL providers to hold prices as they invest in real estate, technology and equipment. Per ACT, LTL rates are expected to remain positive as LTL rate increases over the past 18 months were modest in comparison to TL rates.

Diesel prices dropped 10% in the second quarter and 28% when compared to Q2 of 2022. The decline in diesel prices is a result of lower demand domestically and internationally because of a slowing economy. Diesel may rise in the second half of 2023 as OPEC, Russia and Saudi Arabi have all announced reductions in oil exports totaling 2.5 million barrels per day.

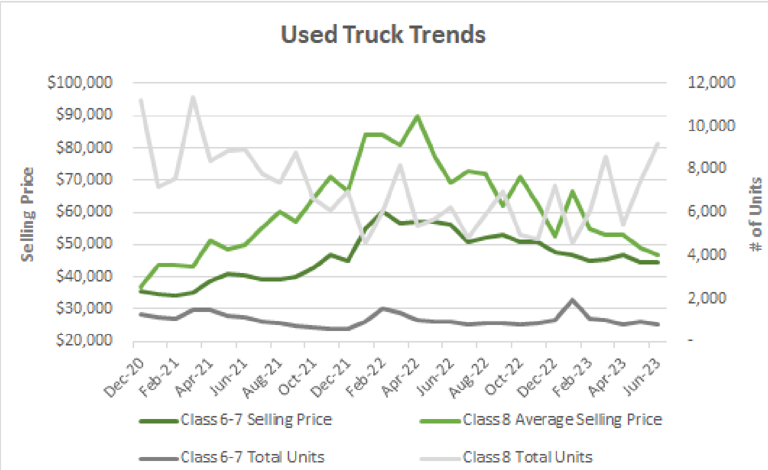








Source: ACT Research



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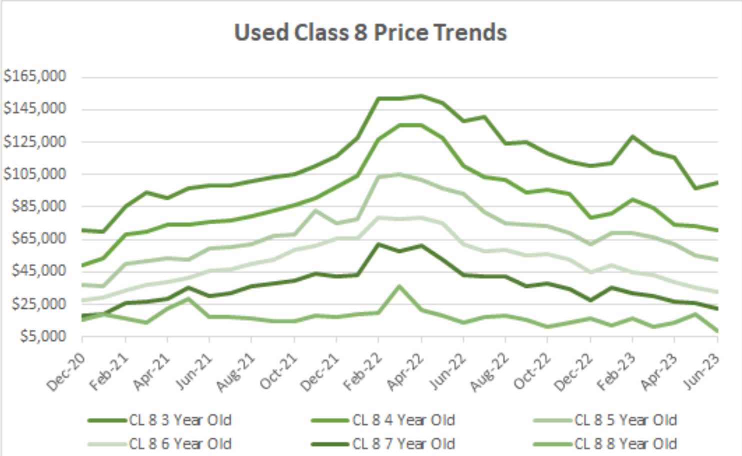


Source: ACT Research

TRACTOR TRENDS

Demand for new trucks is still strong, while backlog is down, which is seasonal until 2024 build slots open up, per ACT Research. Build levels on average were up 7% quarter over quarter and 12% year over year. While class 8 trucks were up 1% quarter over quarter and 11% year over year, class 5-7 experienced 18% growth quarter over quarter and 16% year over year. Sales continue to follow build levels as there is little stock inventory being allocated.

Used class 6-7 units were down on average 37% in the second quarter with prices flat and down less than 1% despite increased age and mileage. Part of the decline in Q2 was seasonal as year over year units were down only 11%. However, prices are down 20% year over year with units having lower mileage but higher age.

Used class 8 trucks for sale increased 15% from Q1 with the average price down 15%, mileage flat and age up 3%. Year over year units were up 28% with a 37% reduction in price. This reflects the number of trucks being turned in as operators exit the industry.

Used values of class 8 trucks decreased across all ages. While 3-year-old trucks had an uptick in value, when averaging values over the quarter it was still down. The decrease in values can be attributed to lower demand for used trucks as fewer entrants are coming into the market. Year over year values were down 44% on average.

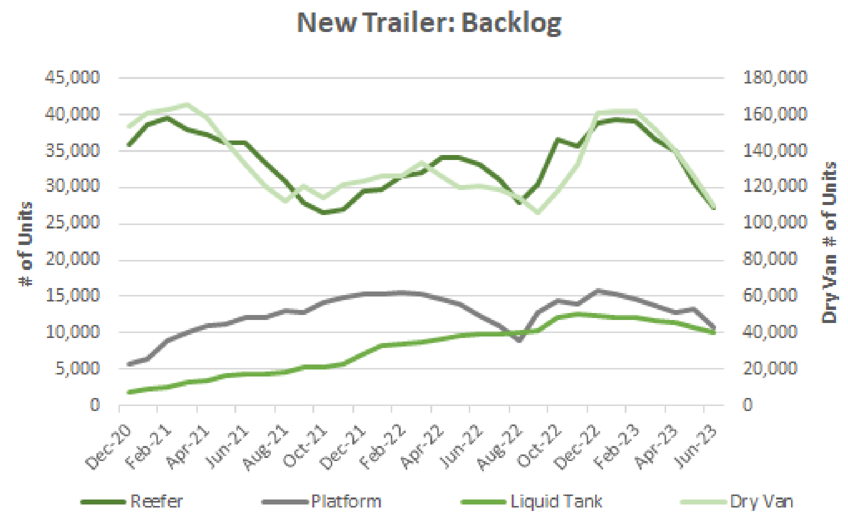
TRAILER TRENDS

Trailer backlogs were down 19% in Q2 driven by build levels exceeding orders. Dry vans and reefers experienced the greatest decline with marginal decreases in platform and liquid tank. According to ACT Research, cancellations were up 112% quarter over quarter and up 210% year over year.

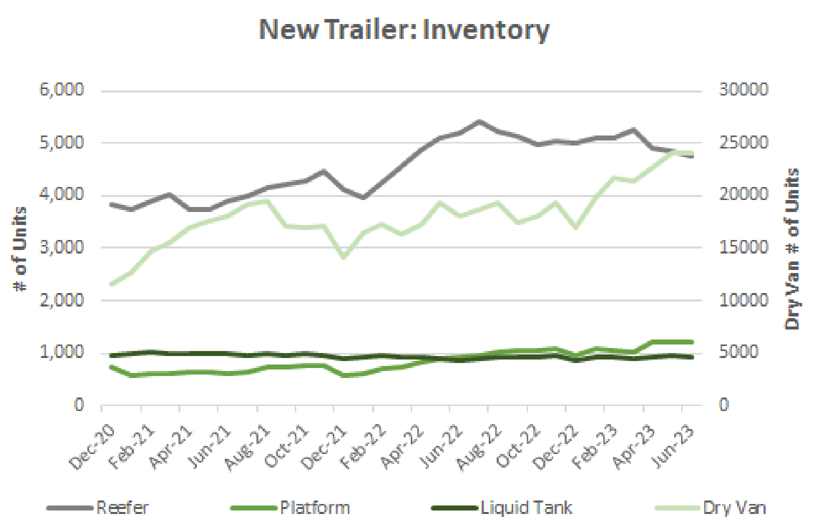
Inventory numbers were up 9% quarter over quarter and up 12% year over year for Q2, according to ACT Research. Dry van and platform inventories reported the largest increases, up 12% and 14% respectively.

New trailer builds were up 3% in Q2 and up 6% year over year. Dry van, reefer, platform and liquid tank all reported increased quarter over quarter build levels. However, year over year reefer and platform reported decreased build levels. ACT Research reported build plans for the remainder of 2023 have been lowered due to lower demand and increased inventory levels. Supply chain issues appear to have normalized with only minor, manageable disruptions.

Per ACT Research, "Conversations with industry stakeholders the past few weeks revealed that while they remain relatively optimistic about 2024, there was an acknowledgement of increasingly challenging conditions for customers and dealers."



Source: ACT Research



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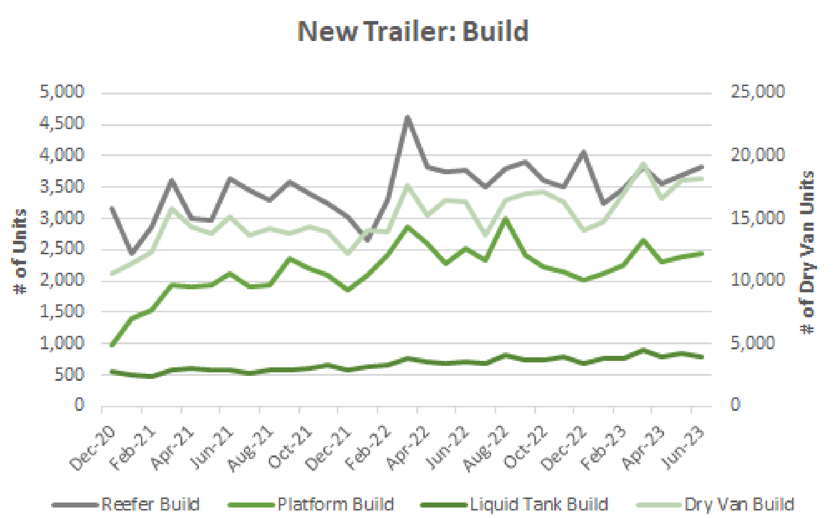


Source: ACT Research

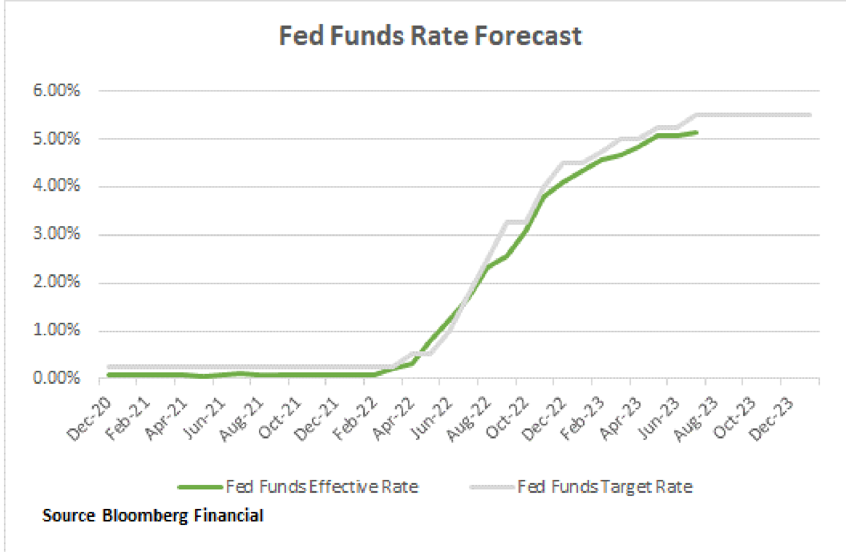
INTEREST RATE OUTLOOK

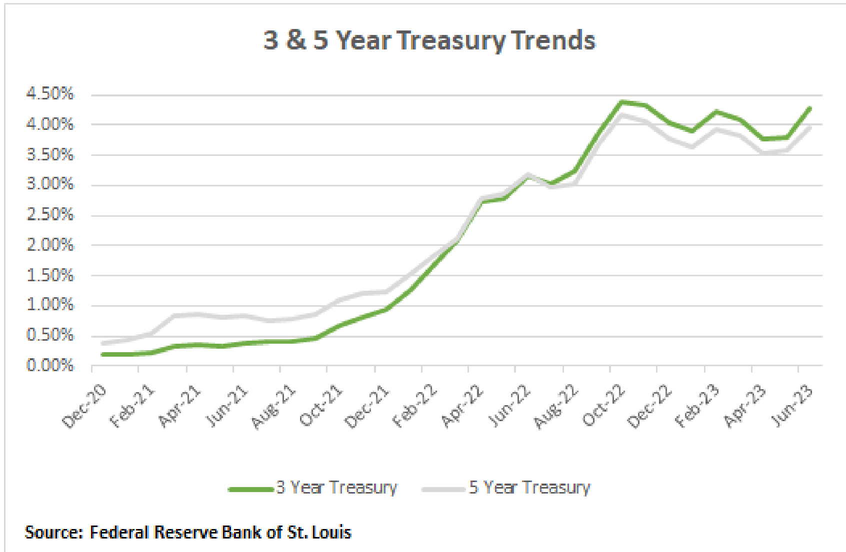
With signs that economic activity has been expanding at a moderate pace, the Fed increased the Fed Funds Rate 25 bps in both May and July, bringing the total increase to 3.75% over the past year.

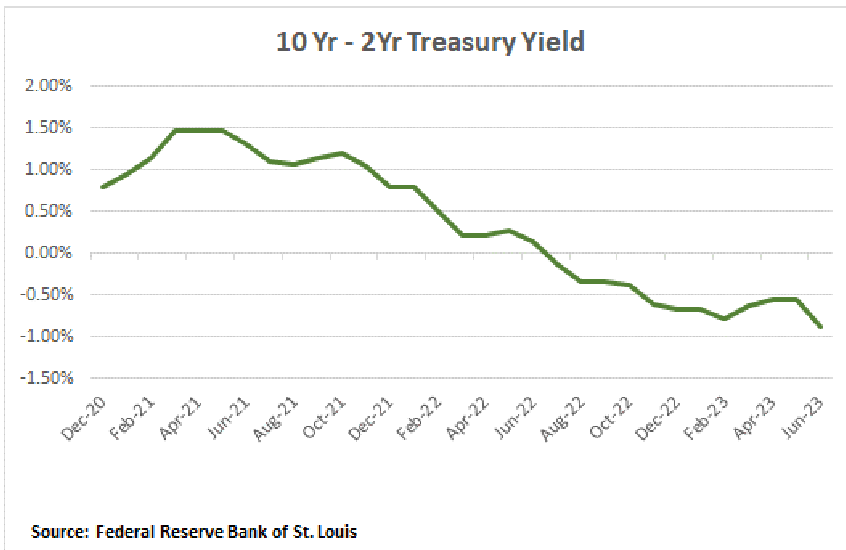
While the central bank's comments indicate a continued commitment to achieving 2% inflation, it stated a potential adjustment to tightening if risks emerge. As such, the market is now anticipating rates to remain flat through the rest of the year, with decreases in the second half of 2024 totaling 1.50% by the year's end. The central bank is expected to continue to shrink its holding of securities, otherwise referred to as quantitative tightening, by reducing Treasury securities and agency debt.

The second chart shows the three- and five-year Treasury yields. Treasuries are a commonly used index for fixed rate loans. This index has been impacted by concern over the financial strength of banks as investors have moved cash to securities, driving yields lower during Q1. That appears to be returning to normal as markets stabilize.

The last chart is the yield curve for Treasuries. Any value above 0% indicates it is more costly to borrow money for a long-term loan than a shorter term. Currently the yield curve is inverted averaging -0.9% for Q2, with the gap between short- and long-term borrowing rates growing. Given the potential for a recession and interest rate decreases in 2024, the yield curve may start to flatten. A yield curve inversion is historically a predictor of recessions.







Connect with the Expert, Aaron Martens

Aaron Martens is the Vice President of Transportation Banking for FNBO. In this role, Aaron supports closely held and family-owned businesses with comprehensive banking services. Aaron has been with the bank for over 15 years, with the majority of his experience in commercial banking. Aaron received a BSBA from the University of Nebraska Lincoln and an MBA from the University of Nebraska Omaha.

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