SONAR

MONTHLY MARKET UPDATE

January
2025

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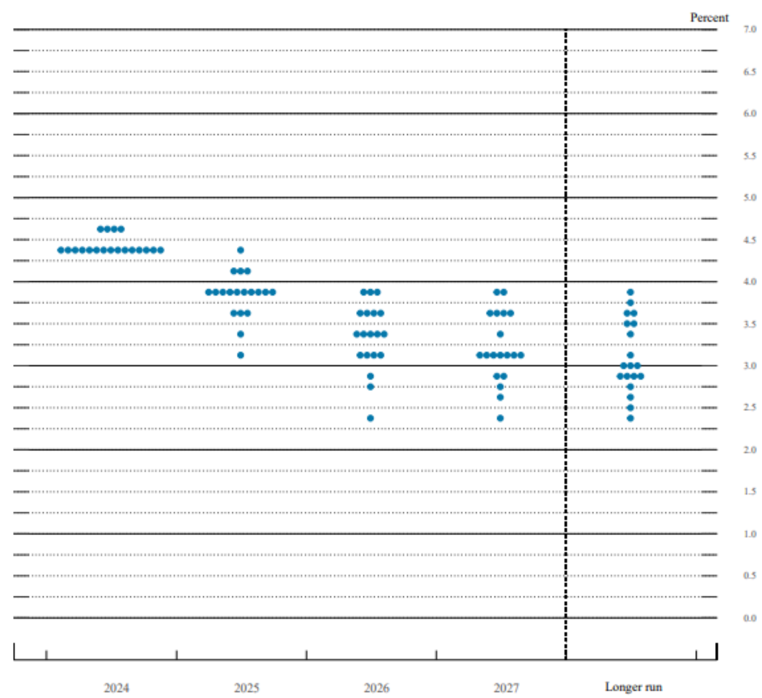
Economic Outlook

With the Federal Open Market Committee remaining aggressive with rate cuts to close out 2024, it might appear that the FOMC has become more dovish based on recent data. But that may not actually be the case, and it isn't out of the question for the FOMC to turn hawkish at some point in 2025. The first meeting of the year is scheduled for Jan. 28-29. Expectations are for the FOMC to pause interest rate reductions at the meeting.

The reason for the pause is likely that the FOMC wants to wait for new data to continue to roll in, giving the economy time to catch its breath after three consecutive cuts. The FOMC has stated its main two objectives in determining monetary policy: Achieve maximum employment and have inflation remain near a long-term target of 2%.

The employment situation closed out 2024 stronger than expected, and the inflation metrics were better than expectations, but that doesn't mean the FOMC is going to just continue cutting rates when there is still uncertainty surrounding inflation and labor.

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



As it does once per quarter, the FOMC releases the expectations for future policy decisions in multiple forms, but the one most widely talked about is the dot plot. The dot plot is effectively a measure of what each FOMC participant expects as the midpoint of the target range for the federal funds rate at the end of each year.

In the September dot plot, the median projection was for the target range of the federal funds rate to end between 3.25% and 3.5%, with a true median of 3.4%, implying 100 basis points worth of cuts during 2025.

Source: Federal Open Market Committee's Summary of Economic Projections

In December's publication, the median projection moved 50 basis points higher, to a median range between 3.75% and 4%, with a true median of 3.9%. This implies that FOMC officials now expect just 50 basis points worth of cuts throughout the entirety of 2025 based on recent economic data.

What will be interesting is how much political influence the new administration has over the Federal Reserve, which is supposed to be apolitical and make policy decisions based on data. In the first Trump administration, there was pressure on the Federal Reserve to hold interest rates as low as possible to compete globally with countries where interest rates in some cases were negative. The question would be, if there were more cuts than initially expected in 2025, does that derail the progress on the inflation front, and what impacts do the potential tariffs being floated by the incoming administration have on inflation.

On the employment front, the labor market continues to be relatively strong, with the jobs report besting analysts expectations once again. Total nonfarm payrolls increased by 256,000 in December, compared to the expectations of 155,000 added jobs during the month. The unemployment rate ticked slightly lower during the month, falling by a tenth of a percentage point to 4.1%. While the unemployment rate is certainly higher than it has been for much of the past three years, it is still historically low relative to pre-pandemic levels.

The growth in December continued to be led by the segments of the economy that have been pushing forward: leisure and hospitality, health care, and government. The leisure and hospitality sector added 43,000 jobs in December, up 1.9% year over year. Much of that increase was from increased hiring at food service and drinking places, better known as bars and restaurants, which added 29,800 jobs during the month. The health care sector added 46,100 jobs in December.

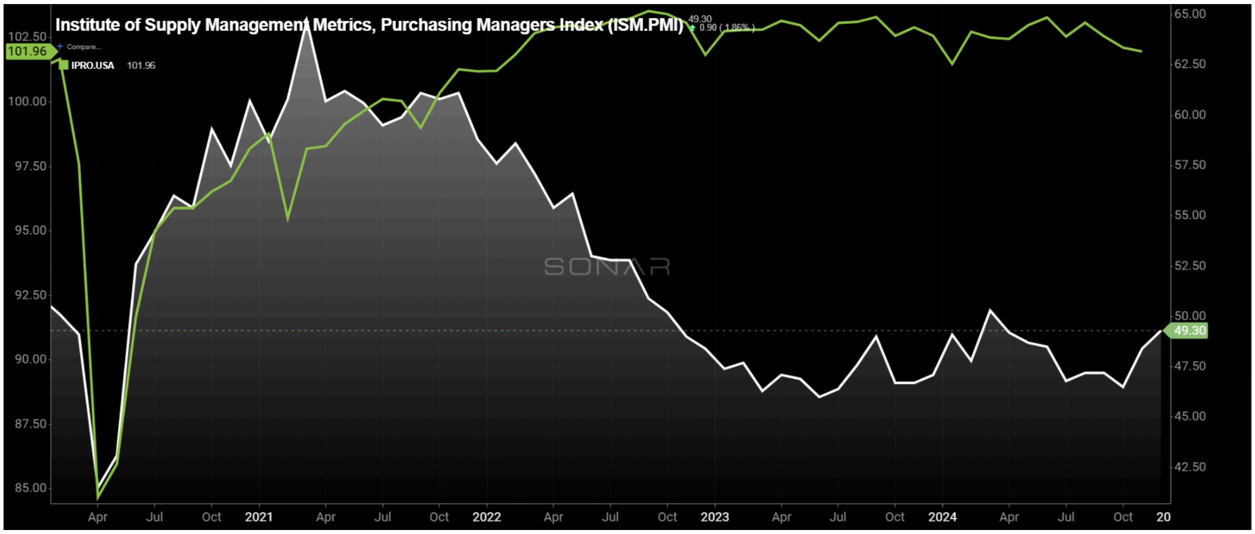
Government payrolls expanded by 33,000 in December, but there is nuance to that figure, as it captures hiring at all levels: local, state and federal. The growth in December was largely at the local and state levels, adding 17,000 and 10,000 jobs, respectively.

One bright spot outside of the three segments mentioned above that have arguably carried the labor market forward throughout the past year was the growth in retail trade payrolls. While December tends to be a month when retailers do hire seasonally, the seasonally adjusted payrolls increased by 43,400 during the month. Much of that growth was in general merchandise, which added 12,700, and clothing, which added 22,600.

Manufacturing

The manufacturing sector remains asleep at the wheel as there hasn't been much positive news on that front. A less aggressive Federal Reserve could certainly limit large capital-intensive projects by manufacturers, but there is the potential for tax breaks to help stimulate the industrial side of the economy.

Those will be trends to monitor in 2025 and beyond. At present, the manufacturing sector remains in contraction.



For the ninth consecutive month and the 25th of the past 26 months, the Manufacturing Purchasing Managers' Index produced by the Institute for Supply Management was in contraction. The PMI came in at 49.3 in December, up 0.9 points m/m. A positive sign despite the manufacturing sector's remaining in contraction is that the overall economy continues to expand, as evident by the PMI's remaining above 42.5.

New orders continue to be a bright spot overall as they have now been in expansionary territory for two consecutive months. The New Orders Index increased by 2.1 points m/m to 52.5, though just 21% of respondents reported higher levels of new orders.

Another positive trend is that manufacturers' customers appear to be running leaner inventory levels at the moment. The Customers' Inventories Index fell by 1.7 points m/m in December to 46.7, bringing it into "too low" territory. 18.2% of respondents stated that customer inventory levels were too low, compared with 13.9% in November.

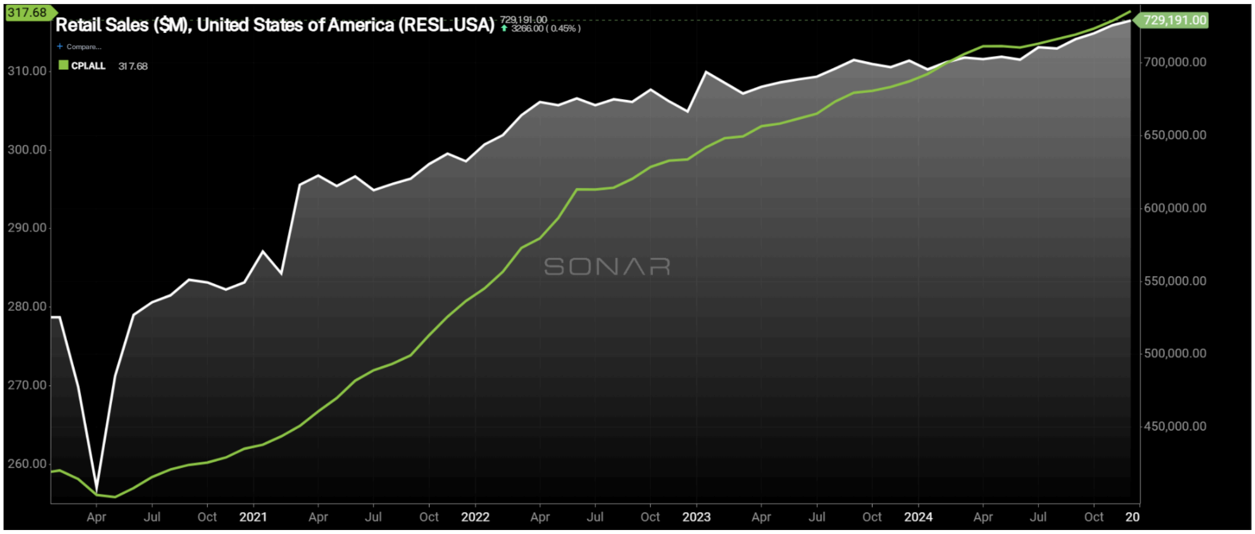
Something that has been interesting within the PMI is the downward trend in the Employment Index. For seven consecutive months, the Employment Index has been in contraction, falling by 2.8 points m/m in December to 45.3. This slowdown in employment suggests continued layoffs hitting the manufacturing sector, where the theme going forward appears to be: doing more with less.

While the PMI suggests a slowdown in manufacturing, industrial production grew during December. Overall industrial production grew by 0.9% m/m in December, the fastest monthly growth figure in more than two years. Industrial production was up 0.5% y/y in December.

Manufacturing increased production by 0.6% m/m but was unchanged from December 2023. Industrial production of business equipment experienced the largest monthly increase, rising by 1.4% m/m, though it was still down 4.3% y/y.

Consumer Conditions and Retail

Inflation has been a hot topic – and rightly so as it isn't retreating as quickly as many would like. Even though inflation readings were better than expectations to close out 2024, it is still a prevalent challenge for consumers moving into 2025.



The Consumer Price Index increased by 0.4% in December, accelerating from the 0.3% increase in November. The increase in December was the largest monthly increase since April. The 12-month running total for the headline CPI was 2.9%, approaching the Fed's long-term target of 2% for inflation, though the CPI is not the Fed's preferred method of inflation. Both the monthly and 12-month totals for the CPI were in line with analysts' expectations.

The challenge for consumers is that inflation has accelerated for two consecutive months, indicating that it is still very much present in everyday life. Now if there was some semblance of good news from the CPI report, it is that much of the inflation was driven by energy prices, which were still down y/y. Overall energy prices increased by 2.6% m/m in December, the largest increase in more than six months. Why is that good? Energy closed out the year down

0.5% y/y, so even with the volatility, the long-term trend is that energy prices are falling. Gasoline prices increased by 4.4% in December but were still down 3.4% y/y.

The rate of increase in food prices slowed slightly in December, rising by 0.3% m/m, down from the 0.4% m/m increase in November. Food prices, which typically are volatile in nature similar to energy prices, were surprisingly stable throughout 2024, with steady increases on a monthly basis. The 12-month running total for food prices was up 2.5% during the year. Both food-at-home and food-away-from-home prices increased by 0.3% m/m in December, though food-at-home prices had a less severe increase throughout the entirety of 2024. Food-at-home prices increased by 1.8% during the 12 months ending Dec. 2024, while food-away-from-home prices rose by 3.6%.

Core inflation, or the CPI excluding food and energy prices due to their volatile nature, remains elevated, though December's figures bested expectations. Core inflation increased by 0.2% m/m in December, a tenth of a percentage point better than what analysts projected. The increase in December was also the slowest rate of price increases since July. The 12-month total for inflation came in at 3.2%, also a tenth of a percentage point below analysts' expectations.

Shelter prices continue to be the main driver of inflation, representing more than 30% of the overall CPI. Shelter prices increased by 0.3% m/m for the third consecutive month. Shelter prices are up 4.4% y/y.

While inflation's impact on consumers remains, it hasn't stopped them from spending. December's retail sales continued to show that consumers are willing to spend, though sales growth slowed in December. Total retail sales released by the U.S. Census Bureau grew by 0.4% m/m in December, down from the 0.8% m/m growth in November. Some of the slower growth is likely a result of a later-than-normal Thanksgiving holiday, which created a shorter timeline for the retail holiday season. December's growth in retail sales fell short of analysts' expectations of 0.6% m/m growth, but again some of the spending was likely pulled forward into November. Even with the slower growth, retail sales were up 3.9% y/y, continuing to outpace the rate of inflation.

There were several bright spots in the retail sales report, including an uptick at: furniture stores, sporting goods, hobby, musical instrument and bookstores, and clothing stores. All three of the categories saw sales grow by over 1.5% m/m in December. In essence, more discretionary purchases were made in December than in previous months, which isn't necessarily a surprise given the holidays during the month.

Gasoline station sales also accelerated by 1.5% m/m in December, likely a result of the aforementioned inflation in gasoline prices.

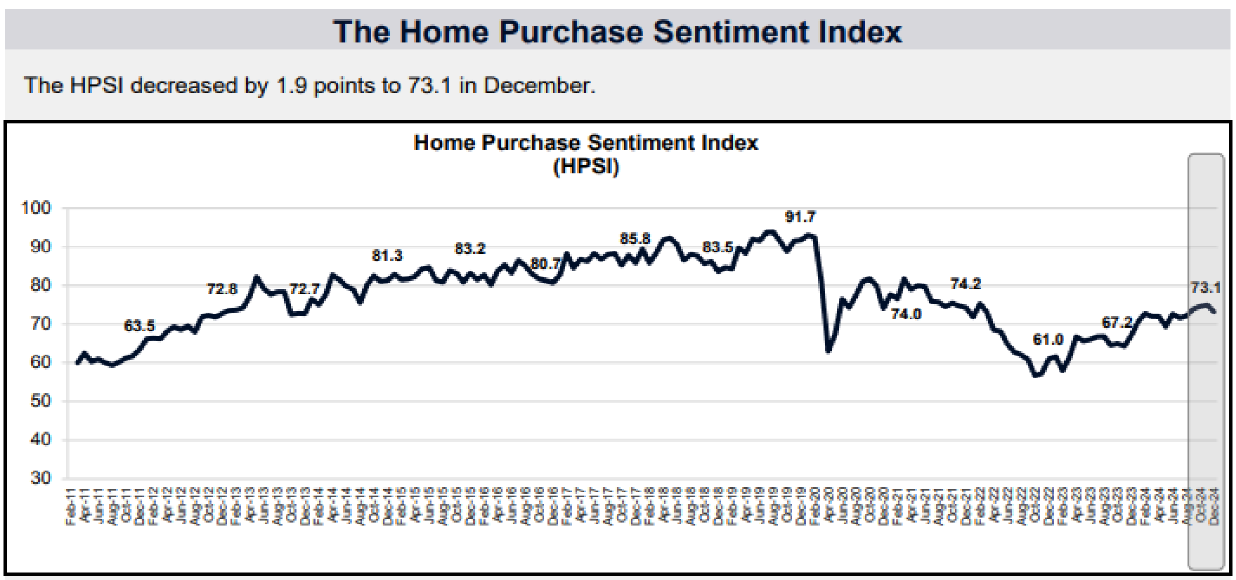
As expected during the winter months, sales of building materials and dealer sales of garden equipment and supplies were muted in December, falling by 2% m/m. This decline was the largest of the categories tracked within the retail sales report. Sales at these stores were down 1.2% y/y. In the months ahead, this will be an area to pay attention to see if consumers continue to spend on discretionary purchases or if they retreat following the holiday season.

Housing and Construction

The housing market continues to face pressures, especially from higher mortgage rates. While the Federal Reserve has been cutting rates, mortgage rates have actually been rising. This has more to do with the fact that mortgage rates are closely tied to long-term treasury yields, namely the 10-year treasury.

The average 30-year fixed rate mortgage has once again eclipsed 7% according to Freddie Mac. The current 30-year fixed mortgage rate sits at 7.04%, 32 basis points higher than it was this time last month and 44 basis points higher than it was this time last year. It also marks the highest the rate has been since the week ending May 9.

With mortgage rates on the rise, home purchase sentiment is starting to suffer after improving over the course of the past two years. The Home Purchase Sentiment Index (HPSI) produced by Fannie Mae fell by 1.9 points m/m in December to 73.1. Compared to this time last year, the HPSI is up 5.7 points, signaling that home purchase sentiment is still vastly improved over the course of the past year.

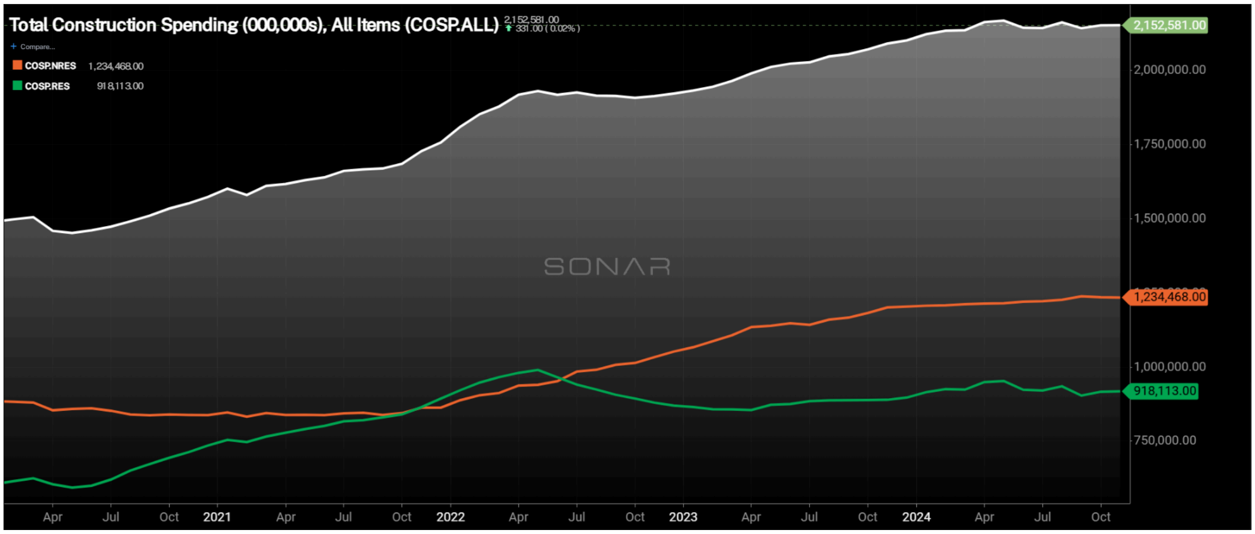


"Even though the HPSI fell to end the year, consumer sentiment toward the housing market finished 2024 substantially above year-ago levels, attributable in part to respondents' ongoing expectations that mortgage rates will decline," said Mark Palim, Fannie Mae senior vice president and chief economist, in the Jan. 7 release.

Of the respondents to the HPSI survey, 78% stated that they believe it is a bad time to purchase a home, compared to just 22% who believe it is a good time. The percentage who believe it is a bad time to buy has been trending slightly lower since May 2024, when 81% of respondents believed it was a bad time to buy.

Even with consumers feeling like it's a bad time to buy, mortgage applications were on the rise to start 2025. Mortgage applications increased by 33.3% week over week for the week ending Jan. 10, against a figure that was adjusted to offset the New Year's holiday, according to the Mortgage Bankers Association.

In addition to increased mortgage applications, existing home sales have been improving. In November, the most recent month for which data is available, existing home sales increased by 4.8% m/m and were 6.1% higher than last year, according to the National Association of Realtors. The median existing home price also increased, rising by 4.7% y/y to $406,100.



While the housing market is in a state of "think one thing, do another," the construction industry as a whole has continued to outperform year-ago levels. In November, the most recent month for which data is available, total construction spending was flat m/m. Total construction spending came to a seasonally adjusted annual rate (SAAR) of $2.153 trillion, up 3% y/y.

Residential construction spending was a source of growth in November, rising 0.1% m/m to a SAAR of $918.1 billion. Residential construction spending was up 3.2% y/y during the month.

Nonresidential construction spending offset the growth in residential construction spending, falling by 0.1% m/m to a SAAR of $1.234 trillion. Nonresidential construction spending was still 2.8% higher y/y even with the slight slowdown in the month. The manufacturing sector, the largest sector of nonresidential construction spending, fell by 0.2% m/m to a SAAR of $235.9 billion, up 11.3% y/y.

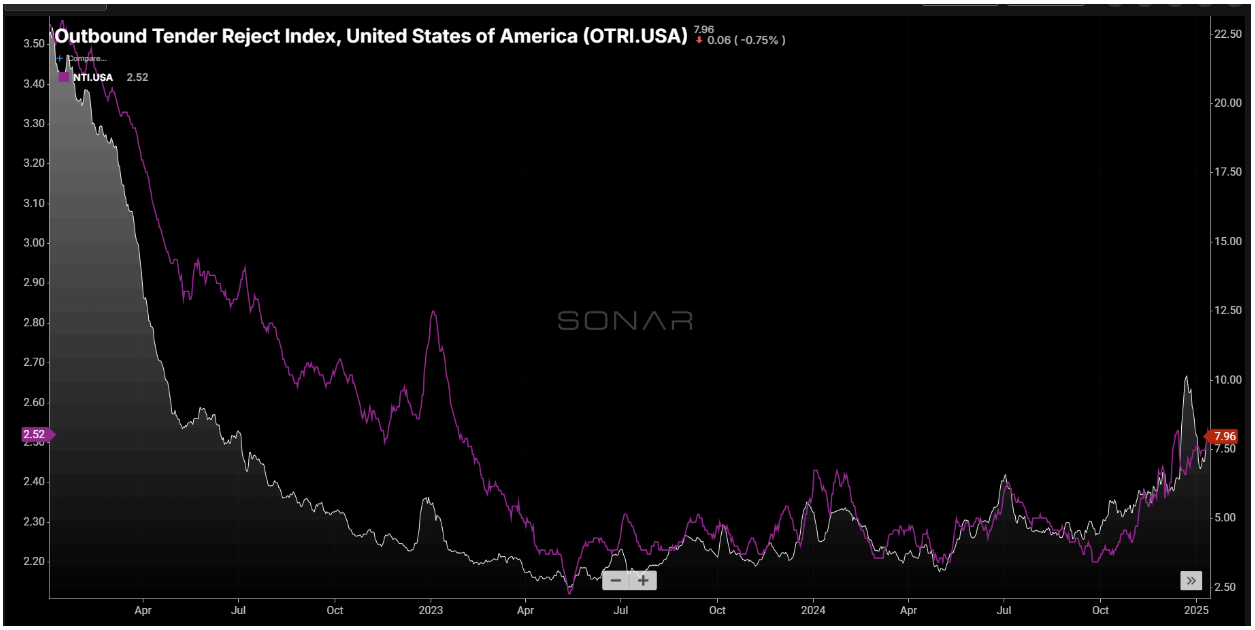
Freight Market Overview

National Summary

Truckload seasonality was much more evident this holiday period than in either of the previous two years. Spot and tender rejection rates rose to annual highs as demand slid into what was a very slow two-week period from a shipping and operating perspective. That is not to say it wasn't challenging for the few that were left manning the ship with limited staff. Intermodal did not lose steam like it typically does in November and December, as demand appeared to grow leading into Christmas. This late-season increase in loaded container shipping occurred during the pandemic years of 2020-21 but has not been a consistent trend in other years. December import demand was the strongest it has been since 2020, according to the bookings data, but fell into near-perfect alignment with 2024 in January. Weather events were once again strong disruptors to the Eastern half of the U.S., but the longer-term trend for a tightening market is still strongly in play for the rest of the year.

Trucking

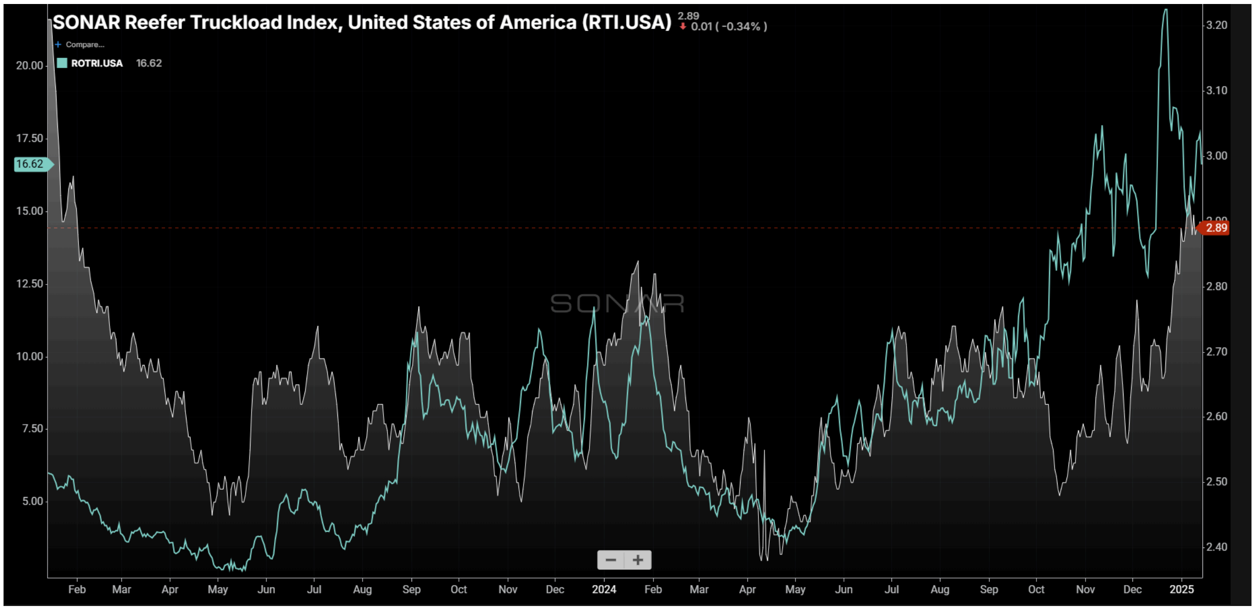
As mentioned, truckload spot rates hit their highest levels of 2024 in December. Rates do tend to peak around the Christmas holiday, but some of this is not necessarily due to volume, but to shrinking availability of capacity and shorter average length of haul. Simultaneously tender rejection rates pushed above 10% for the first time since 2022. The 10.16% value that hit on Dec. 22 was well above the 5.58% Christmas peak value of 2023.



The increasing spot and rejection rate trends corroborate the notion that the U.S. truckload market has tightened noticeably the past two years. While neither data point is anywhere close to where it was during the pandemic, the trend is for a slow tightening that really may only be noticeable to market participants during seasonal peaks.

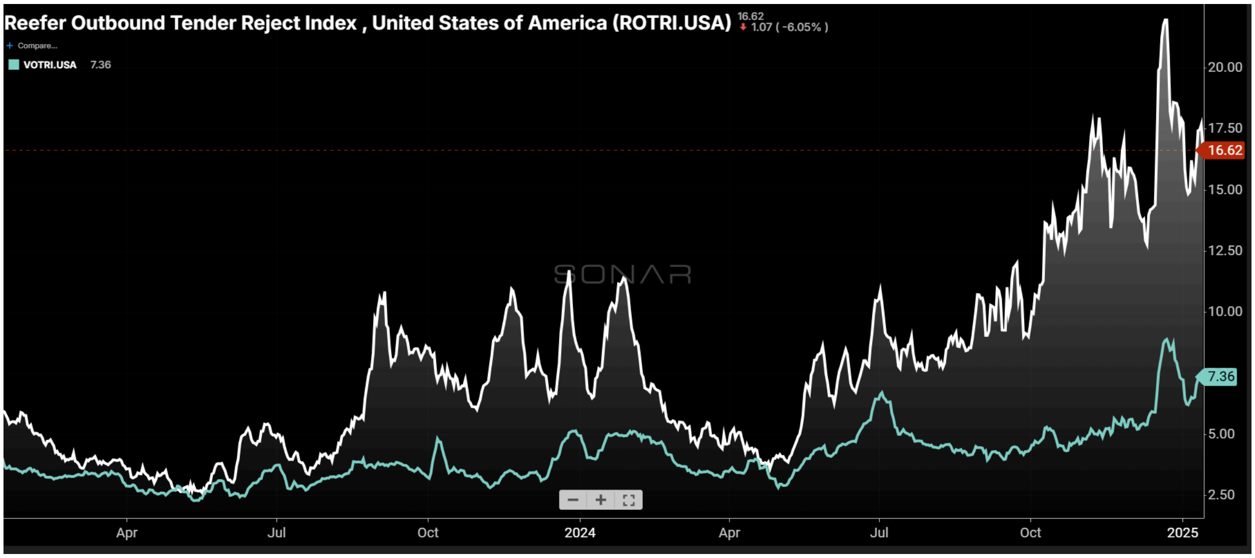
As of mid-January, national rejection rates were still hovering around 8%. This higher-than-expected value is the result of two strong winter weather events hitting portions of the Midwest and Southeast during the first full week of the year.

Winter weather was a big factor last January, when colder-than-typical weather struck the central U.S. Refrigerated truckload demand got a strong boost due to its ability to protect freight from potentially damaging temperatures.



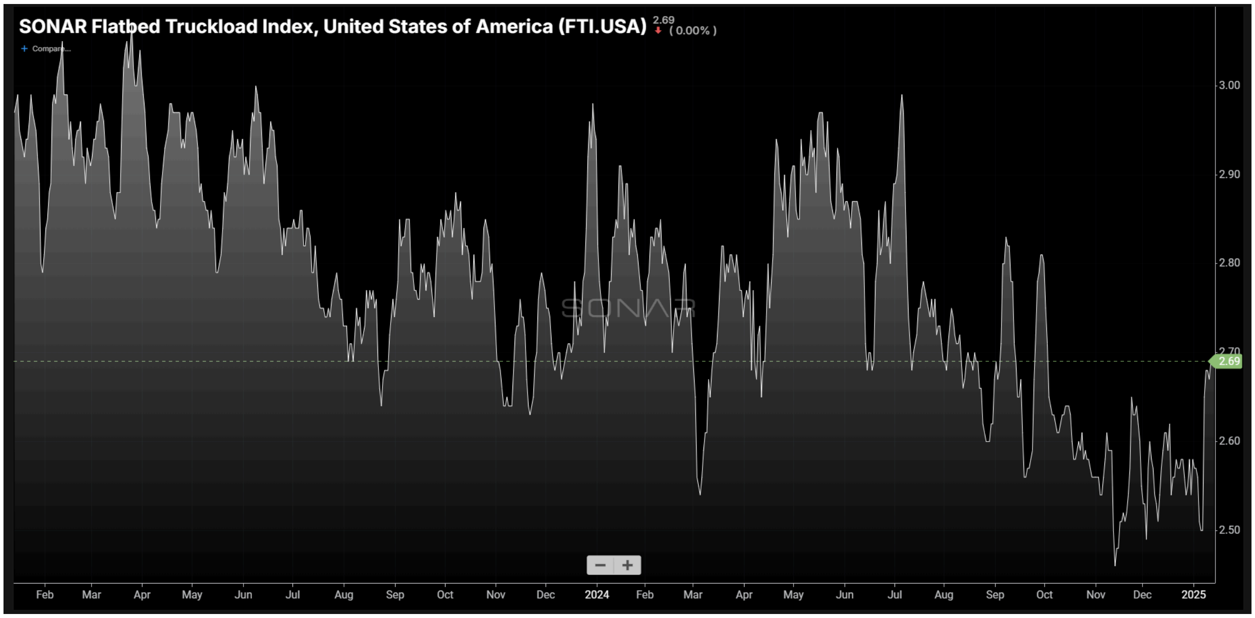
This year, the Reefer Truckload Index (RTI), which measures the average spot rate for refrigerated truckloads, hit its seasonal peak after the new year and remained elevated into the middle of January. Reefer rejection rates (ROTRI) peaked before Christmas but remained above 14% in the weeks following.

The refrigerated truckload market appears to be much more sensitive to disruptions than its dry van counterpart, probably due to the fact it represents less than 20% of the total for-hire truckload market. Protect-from-freeze season is also benefiting from cold weather, which has been relatively consistent in portions of the Eastern half of the country.

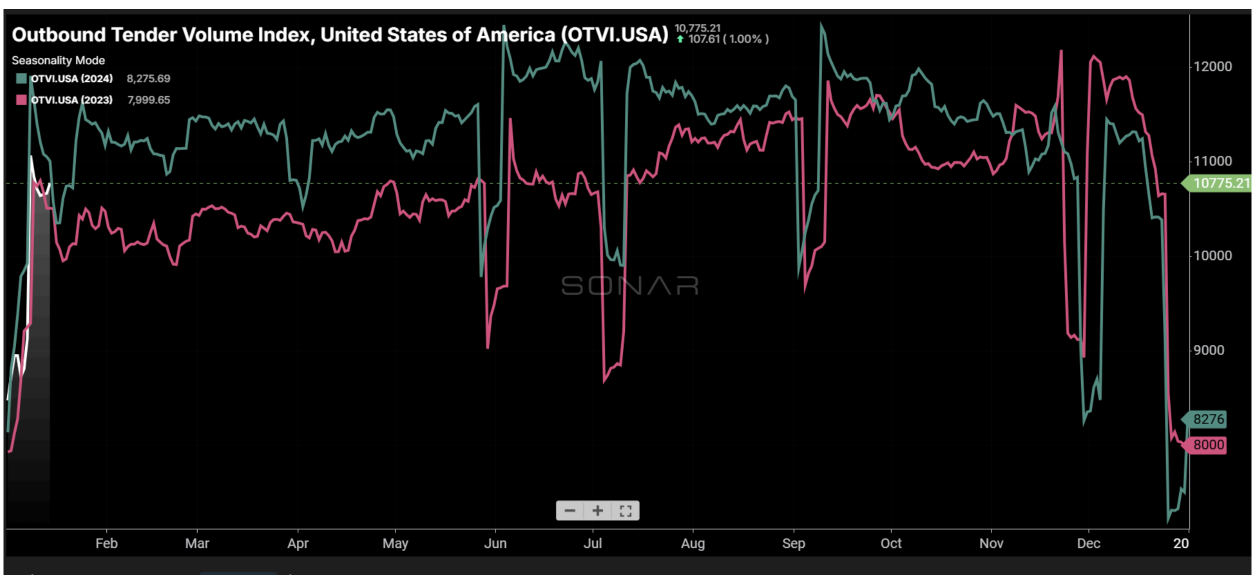


Comparing van rejection rates (VOTRI) to reefer (ROTRI) the refrigerated market appears to be further along in its journey toward supply and demand equilibrium, with rejection rates sustaining above 10% throughout the fourth quarter of 2024. They are also markedly higher than they were in 2023 and '24 to this point, when they were averaging around 8.4%. If weather permits, this sector could be poised for a strong breakout.

Van rejection rates are still trending higher but do not support the current level of tightness persisting in the refrigerated sector as temperatures rise. This type of tightening occurred last year, which produced a bit of a snapback in the refrigerated truckload market in February and March. This level of recovery is not anticipated, but some stabilization is expected unless the van sector breaks loose in a more nonseasonal manner.



The flatbed market appears to have gone dormant, as spot rates spent most of the second half of 2024 in decline. An active winter weather pattern does not support any recovery in this space until the spring. The current slowness could support a sharp transitional market once the temperatures rise, as many carriers may be taken by surprise. The housing market is not expected to turn sharply, but many home improvement retailers are cautiously optimistic about a return to home refurbishment after a few slow years.



The national Outbound Tender Volume Index (OTVI) fell below previous-year levels throughout December and remained in negative growth territory into mid-January. The annual comps got tougher for demand throughout the fourth quarter, as December 2023 was one of the strongest months of the year, removing the impact of the holiday season. From that perspective, this past December was a return to a more typical pattern, though the drop does appear somewhat exaggerated.

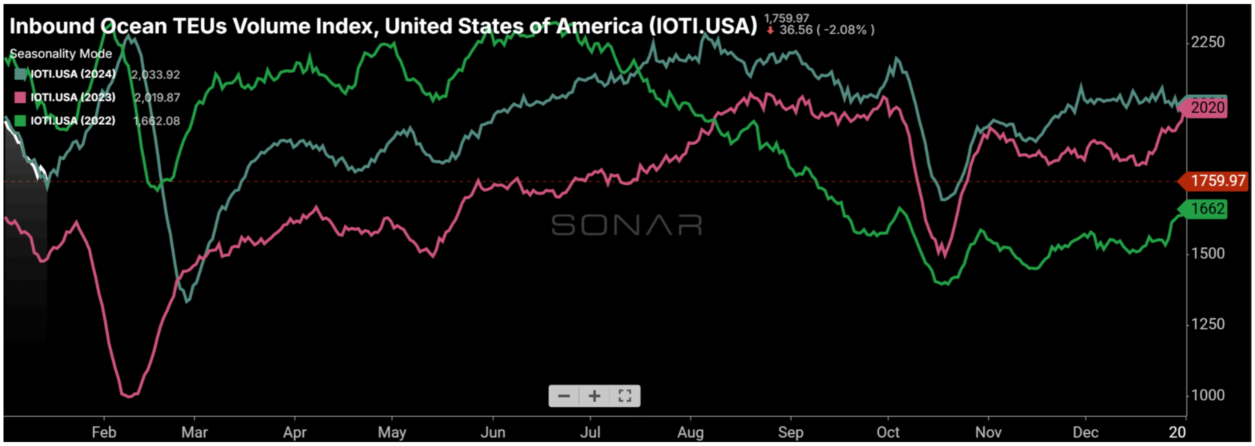
Loss of share to intermodal is a big factor in weakening truckload demand beyond a returning seasonality. Intermodal container shipping increased 6%-7% y/y in December, while tender volumes were down over 6%. From an economic perspective, total demand was relatively flat, but there was a strong shift in mode utilization.

The winter months favor continued use of intermodal for long-haul freight by shippers. Weather conditions, a lower sense of urgency and lower cost all favor using the rails this time of the year. There are questions around its continued use as providers increase rates and urgency returns to shippers for moving goods in the warmer months.

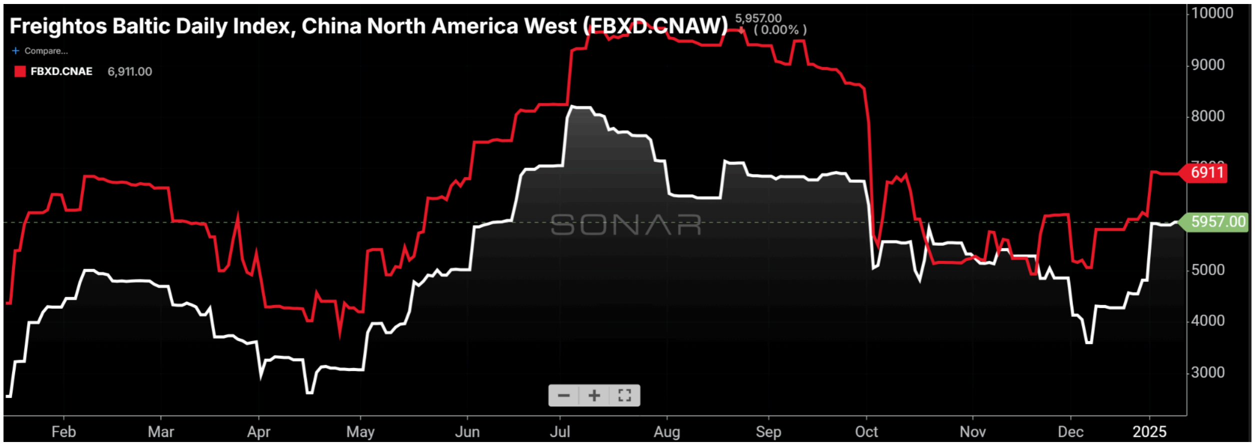
Local or city freight demand was elevated throughout the past month as shippers leaned on trucks to serve the far upstream and far downstream moves more than they have in years past. Demand for loads moving less than 100 miles was up over 7% in December. Long-haul demand saw a near 10% reduction in load requests. This makes sense in the context of shippers utilizing rail more for the transcontinental moves.

Maritime

To start the year, ocean container bookings for U.S. imports have trended roughly in line with the elevated levels of early last year. That comes after the U.S. West Coast ports recorded numerous records months late last year as import volumes remained about 15% above the five-year average. Gene Seroka, executive director at the Port of Los Angeles, recently cited a high volume of empty containers departing on export vessels as an indicator that ocean carriers need those containers back to Asia quickly because they expect high import volumes to continue.



Meanwhile, maritime spot rates in the trans-Pacific eastbound lanes shot up to their highest levels since early fall. Currently, maritime rates are being supported by carriers implementing general rate increases and continued strong demand ahead of both Lunar New Year and additional tariffs on goods manufactured in China. Going forward, rates will likely decline seasonally in late February and March. In addition, most industry players believe that U.S. imports were pulled forward ahead of tariffs and a possible ILA strike, which didn't materialize. That may result in a steeper-than-normal decline in volumes and ocean spot rates after tariffs go into effect.

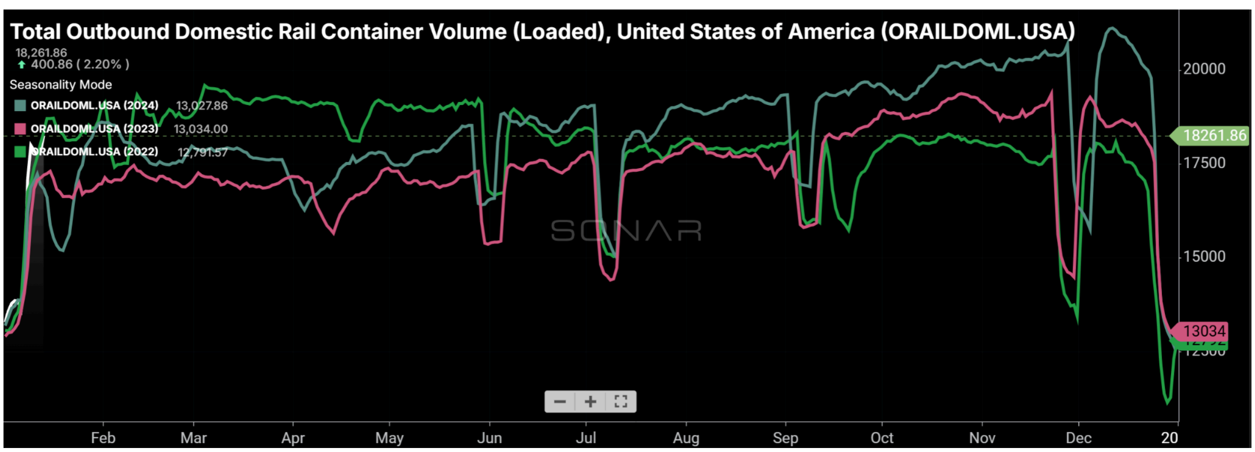


The Red Sea remains an area of uncertainty – carriers have multiple routing plans in place for whether the Red Sea is or is not open. While the Houthi rebels appear to be moving on to different targets, ocean carriers are not in a rush to return to the Red Sea. The longer routings around the Cape of Good Hope have led to an estimated 8%-10% reduction in effective ocean capacity. That in turn led to tremendous results for carriers. In 2024, China-owned Cosco reported a 95% increase in earnings before interest and taxes, with only modest growth in volume. Operational disruptions are another factor to watch. While a strike by the ILA appears to have been averted, strikes in Europe are disrupting port throughput. In addition, port congestion, particularly at the Port of Singapore, was a major event last year and could repeat in 2025.

Intermodal/Rail

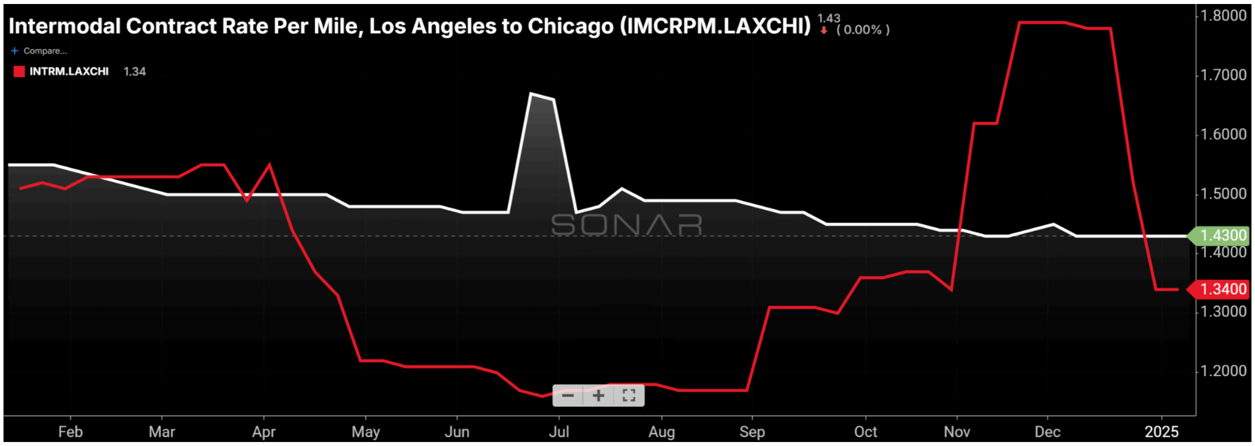
Intermodal volume continues to be supported by healthy consumer spending, which remains backed by a still-strong job market. According to the Association of American Railroads, 2024 was the third-strongest year ever for total intermodal volume, and December 2024 was a record for that month. While intermodal volume has been strong in recent months for both segments, domestic intermodal volume showed a notable pickup in the final few months of last year, with loaded volume up 6.5% year over year in Q4 and up 13.1% on a two-year stack.

The seasonal pattern of the fourth quarter's domestic intermodal volume was unusual with December as the peak month; an October peak is more normal. In addition to record import volumes last year at the U.S. West Coast ports, transloading activity picked up midway through the year (a result of oceangoing container scarcity and some disruption in the international intermodal network), which contributed to domestic intermodal volume growth. In addition, domestic intermodal volume growth handily outpaced domestic truckload volume growth. That was driven by import-heavy freight demand in intermodal-compatible lanes, meaningful spreads in contract rates between the two modes and rail service that avoided meltdowns seen in recent years.



Certain domestic intermodal carriers have alluded to increases in contract rates this year, after two years of decline, but the magnitude of those increases remain unclear. We expect carriers to make the argument that rates should rise because they were able to provide strong service in the past year, even during peak season, in a year with near-record volumes. Plus, a tightening truckload market should make that mode less competitive.

Most intermodal contracts renew at some point in the first quarter, and those changes in contract rates will be visible for 67 lanes via the IMCRPM tickers in SONAR. The white line in the chart below is one example. It shows the contract rate of $1.43 a mile, including fuel surcharges, in the LA to Chicago lane. One use case is to compare the intermodal spot (INTRM tickers) and contract rate for the same lane to see if carriers are willing to take incremental loads at reasonable rates or whether they are instead protecting capacity for their contractual shippers. For instance, from LA to Chicago, intermodal spot rates have come down to below contract rates, from about 35 cents a mile above during peak season, suggesting carriers should not have trouble sourcing intermodal capacity in the lane.



Outlook

Weather will significantly impact the domestic freight market over the next month. While truckload capacity typically loosens seasonally, persistent cold air in the Eastern half of the country will continue causing disruptions. This will likely keep rejection rates higher than they would be during a milder winter. However, capacity should remain relatively accessible between weather systems, as demand is not expected to surge in the coming month.

The spring outlook remains uncertain, but a return to seasonal volume in March could be more disruptive than in previous years. Additionally, the ongoing decline in active market participants is becoming increasingly noticeable each month. Over the past seven months, intermodal transport has helped stabilize the surface transportation market, a trend that is expected to continue into spring. This will contribute to ongoing negative growth in truckload capacity.

Economic uncertainty will continue to suppress demand until a clearer outlook emerges. Barring significant weather events, the long-term trend of gradual tightening should persist, with March serving as the next key checkpoint for assessing market tightness.