Scotiabank.

GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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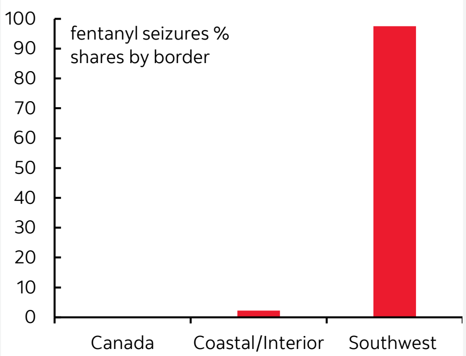
Chart 1

Canada Is a Negligible Share of America's Fentanyl Imports

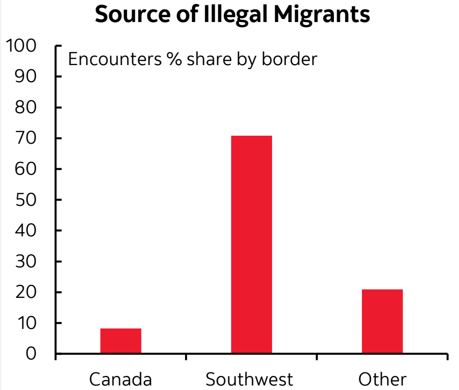


*YTD Share Jan-Oct 2024

Sources: Scotiabank Economics, U.S. Customs and Border Protection.

Chart 2

Canada Isn't the Source of Illegal Migrants



*YTD Share Jan-Oct 2024

Sources: Scotiabank Economics, U.S. Customs and Border Protection.

On Deck for Wednesday, November 27

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	11/27	07:00	MBA Mortgage Applications (w/w)	Nov/22	--	--	6.3
US	11/27	08:30	Durable Goods Orders (m/m)	Oct P	0.5	0.3	-0.7
US	11/27	08:30	Durable Goods Orders ex. Trans. (m/m)	Oct P	0.2	0.2	0.5
US	11/27	08:30	GDP (q/q a.r.)	3Q S	2.9	2.8	2.8
US	11/27	08:30	GDP Deflator (q/q a.r.)	3Q S	--	1.8	1.8
US	11/27	08:30	Wholesale Inventories (m/m)	Oct P	--	--	-0.2
US	11/27	10:00	PCE Deflator (m/m)	Oct	0.2	0.2	0.2
US	11/27	10:00	PCE Deflator (y/y)	Oct	2.3	2.3	2.1
US	11/27	10:00	PCE ex. Food & Energy (m/m)	Oct	0.3	0.3	0.3
US	11/27	10:00	PCE ex. Food & Energy (y/y)	Oct	2.8	2.8	2.7
US	11/27	10:00	Pending Home Sales (m/m)	Oct	--	-1.8	7.4
US	11/27	10:00	Personal Spending (m/m)	Oct	0.3	0.3	0.5
US	11/27	10:00	Personal Income (m/m)	Oct	0.3	0.3	0.3

KEY POINTS:

- **US liquidity begins to dry up for the rest of the week**
- **US tariffs would drive a recession on its northern border…**
- **…with negative repercussions for the US**
- **Model-based tariff effects on US & Canadian GDP, URs, inflation, policy rates and FX**
- **Tariffs on Canada have nothing to do with border security…**
- **…given US data on fentanyl seizures and encounters at the border…**
- **…and everything to do with exploiting a tariff loophole…**
- **…that may ultimately invite retaliation if token border measures don't work**
- **How Canada retaliated in 2018 may be a blueprint going forward**
- **Trump's tariffs could drive the biggest single-month US CPI surge on record**
- **US strong-dollar policies will keep driving a widening trade deficit**
- **The RBNZ wasn't dovish enough for markets**
- **US core PCE expected to be warm**
- **US Q3 GDP revisions expected to continue to signal solid growth**
- **US durables, pending homes, initial claims on tap**
- **US bonds and stocks shut early today for US Thanksgiving**

The US Thanksgiving holiday starts to dry up liquidity via American clients today if it hasn't already done so somewhat already this week. That cautions against reading too much into movements across thinner than usual market activity. With that caution, equities are broadly, but only mildly lower with S&P futures down less than ¼%, TSX futures up a smidge so far, and most European bourses down ½% to 1% except for a small gain in London. This is following a mixed Asian session led by 1.5–2% gains in Chinese equities versus losses in Tokyo and Seoul. Sovereign bond yields are broadly lower by the lower single digits across the US, Canada and most of Europe's curves. The dollar is broadly softer except against MXN that is still depreciating, and CAD that is flat.

US equities shut at 1pmET and bonds will close at 2pmET.

US Data Crunch

The US will pack in several releases ahead of the Thanksgiving holiday and early close. Since there is a ridiculous number of releases being crammed in I'll just rattle them off.

- Q3 GDP (8:30amET) is expected to be little changed around the prior 2.8% q/q SAAR estimate (Scotia 2.9%).
- Core PCE inflation (10:00amET) is expected to land at 0.3% m/m SA and 2.8% y/y; that was also the estimate from Fed economists provided in Chair Powell's recent remarks. Any possible revisions to Q3 core PCE (8:30amET) are unexpected but a risk.
- Durable goods orders (8:30amET) are expected to rise largely on transportation sector gains.
- Weekly initial jobless claims (8:30amET) are expected to be stable around still very low levels.
- Monthly consumer data is expected to post another modest gain in spending and incomes (10:00amET).
- Pending home sales (10amET) are expected to give back some of the prior month's large gain.

Estimating the Impact of Trump's Tariffs on the US and Canada

If the US imposed a 25% tariff on all goods imported from Canada with or without Canadian retaliation, then the result would be a swift and severe recession on America's northern doorstep that would crush demand for US imports. That's the conclusion of modelling work around various tariff scenarios by our modellers René Lalonde—probably the best in the country in my opinion and who was one of the original architects of the BoC's workhorse macroeconometric models—and Farah Omran. See the accompanying table for model-based estimates of the effects of tariffs imposed by the US in five percentage point increments up to 25% in order to provide an idea of the sensitivities at different tariff thresholds.

Under Trump's threatened 25% tariffs and assuming at first that Canada did not retaliate, the result would be that Canada's economy would contract by a peak 3.8% q/q SAAR and lose 2.7% of GDP in the long-run. The BoC's policy rate would go down 275bps, the UR would rise 2.2 ppts, core inflation would fall -0.9% and the exchange rate would depreciate by about 20%.

With full retaliation by Canada, Canada's economy would contract by 5.6% at peak, lose 4.5% of long-run GDP, the policy rate would go UP 275bps, the exchange rate would fall by about 21%, the UR would rise 3ppts and core inflation would rise by over 4 ppts.

The US wouldn't be hit as hard as it imposes tariffs with only mild Canadian retaliation, but would still feel the effects. Trump's 25% tariff would raise the US unemployment rate by 0.4 ppts, knock a peak 0.9ppts off GDP growth and 0.5% off long-run US growth, raise US core PCE inflation and add a half percentage point to the Federal Reserve's policy rate relative to the scenario absent tariffs. Greater retaliation by Canada and Mexico and perhaps China would obviously impose significantly further damage upon the US economy.

Blaming Border Security for Tariffs Against Canada is a Ruse

Trump says imposing tariffs on Canada is about demanding greater border security. Fentanyl imports and illegal immigration are the top worries. Let's check some facts along the lines of what I shared with clients and staff yesterday and previously alluded to in other notes this week.

Estimating the Impact of 25% US Tariffs on All Goods Imported from Canada

	US							Canada (without retaliation)						
Tariff	GDP, %	GDP, long-run, %	Core PCE, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps	GDP, %	GDP, long-run, %	Core Inflation, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps
5%	-0.2	-0.1	0.2	11	1.7	0.8	0.1	-0.8	-0.5	-0.2	-55	3.9	2.1	0.4
timing	2026Q2	2028Q4	2025Q2	2025Q3	2025Q1	2025q4	2026Q4	2026Q4	2028Q4	2026Q3	2026Q4	2025Q1	2025q4	2025Q3
10%	-0.3	-0.2	0.4	22	3.4	1.6	0.1	-1.5	-1.1	-0.4	-110	7.8	4.2	0.9
15%	-0.5	-0.3	0.6	32	5.1	2.5	0.2	-2.3	-1.6	-0.5	-164	11.6	6.3	1.3
20%	-0.7	-0.4	0.7	43	6.7	3.3	0.3	-3.1	-2.2	-0.7	-219	15.5	8.4	1.7
25%	-0.9	-0.5	0.9	54	8.4	4.1	0.4	-3.8	-2.7	-0.9	-274	19.4	10.5	2.2

	Canada (with retaliation)							Canada (half retaliation)						
Tariff	GDP, %	GDP, long-run, %	Core Inflation, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps	GDP, %	GDP, long-run, %	Core Inflation, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps
5%	-1.1	-0.9	0.8	56	4.2	2.2	0.6	-0.9	-0.7	0.4	16	4.0	2.1	0.5
timing	2027Q1	2028Q4	2025Q3	2025Q3	2025Q1	2025q4	2025Q4	2026Q4	2028Q4	2025Q2	2025Q3	2025Q1	2025q4	2025Q4
10%	-2.3	-1.8	1.7	112	8.4	4.4	1.2	-1.9	-1.4	0.8	33	8.1	4.3	1.0
15%	-3.4	-2.7	2.5	168	12.6	6.5	1.8	-2.8	-2.2	1.2	49	12.1	6.4	1.5
20%	-4.5	-3.6	3.3	224	16.8	8.7	2.4	-3.8	-2.9	1.6	65	16.1	8.6	2.0
25%	-5.6	-4.5	4.1	280	20.9	10.9	3.0	-4.7	-3.6	2.0	82	20.2	10.7	2.5

First, the US Customs and Border Protection agency breaks down fentanyl seizures by air, land, sea and 'other' (vehicles?) **here**. 2024ytd figures show that the northern border (aka Canada) accounted for 0.08% of all fentanyl seizures by value in the US. That rounding error pales in comparison to the southern border that accounts for 84.2% while central/coastal/other points account for the remaining 15.8% (chart 1).

Second, the same US Customs and Border Protection Agency data breaks down figures on encounters at the border broken down by border which serves as evidence on illegal migration into the US (**here**). The 'northern border' accounts for 7–8% of all CBPA encounters (chart 2). And if you've ever watched the local border cops show in Canada, then it's not a tough sell that note that a large number of those are probably not illegal migrants. Canada's numbers also show a much lower share are in the 'individuals within a family unit' than on the southwest border (ie: singles, not bringing the whole caravan across).

Clearly Canada is this raging source of drugs and migrants pouring into the United States....NOT!

Canada is an ally. A friend. An important economic partner of the United States. Potential tariffs applied by the incoming US administration would cause a lot of outrage in Canada imo. My country doesn't deserve this treatment. It bothers me to no end that innocent people going about their daily lives working hard to make a living and meet their commitments during challenging times risk losing their jobs, their incomes, their businesses, their very livelihoods because of the arbitrary, divisive actions of another country.

As previously argued throughout this week, this is not about border security. Trump just says so because that way he can exploit Section 232 of the Trade Expansion Act of 1962 that gives broad ability to impose tariffs in response to a perceived national security risk. That way he thinks he gets around trade agreements.

I'm worried that Trump's thinking has evolved and not in a good way. I think he genuinely thinks tariffs are good. He can't impose them without declaring a national security issue, so he uses section 232 of the Trade Expansion Act of 1962 to hike tariffs while fabricating one. Trump thinks tariffs a) are good because they substitute purchases from US companies from foreign firms and encourage domestic investment, and b) because they can fund other tax cuts. Both views are almost entirely without merit.

With that, it's unclear what Canada can do going forward. Maybe token gestures at the border to address an issue that doesn't materially exist will assuage Trump's concerns and give him a small political victory before his base and perhaps avoid tariffs. That should be 'plan A'. But that view rests on the assumption that he really is pursuing tariffs because of border security issues and will indeed bend if he can point to some mild efforts, and I'm not sure at all that this is the case. I still think that he is pursuing tariffs because he fundamentally believes in them against what economists believe.

Thus, if token measures don't work, if there is no material security issue on the northern border that comes anywhere close to justifying such harmful measures, and if Canada faces tariffs no matter how much it begs and grovels, then ultimately Canada may feel it does not have any choice left than to retaliate and we need to be prepared for such a risk.

That would raise risks and is not something I'm advocating at this stage, but it may well be where things wind up. Pure theory would say that if the US imposes tariffs on Canada, then Canada should not retaliate. But if retaliation makes it clear to the US that there would be disruptive pain the other way, then it may be an effective way of ensuring the US tariffs—if imposed—would be short lived versus permanent. Retaliation would have to be done in a strategic way that creates maximum harm to Trump's base by one of America's two biggest trading partners.

What Canada Did in 2018

So what would be the playbook? I fear Canada may retaliate in the end if Trump really does go ahead with tariffs. Recall what FinMin Freeland (now Deputy PM) said in 2018:

"Canada has no choice but to retaliate with a measured, perfectly reciprocal dollar-for-dollar response."

Here is the list of items Canada imposed retaliatory tariffs upon when the US imposed tariffs on May 31st 2018. Canada implemented the moves on Canada Day (July 1st) 2018 and they stayed in place until May 17th 2019, thus leaning against the optimistic narrative at the time that tariffs would be very short-lived. The tariffs were narrower in scope in response to the narrower US tariffs than what is being proposed now, but they were aimed in a strategic manner right at Trump's base, right down to Kentucky bourbon. The Canadian government's proven inclination is to retaliate and I'm not sure it will be different this time albeit with far greater stakes.

Now, the flaw in the break-it-first "art of the deal" approach is that it assumes in a game theory sense that others won't match it. That didn't work the first time as countries retaliated and ultimately Trump backed down on most of the NAFTA demands that resulted in very little change to Canada and small changes to Mexico. Part of me hopes retaliation does not ensue because the consequences could be quite bad for everyone, but I wouldn't be the least bit surprised to see China, Mexico and Canada punch back.

US CPI Impact of Tariffs

If the US goes ahead with its threatened tariffs on Canada, Mexico and China, then it risks kicking off 2025 with the biggest single month rise in CPI on record.

The biggest single-month changes in US CPI on record were 1.2% m/m in June 2022, 1.4% in September 2005, 1.4% in March 1980, 1.8% m/m in August 1973, and toward 2% m/m in the post-WWII years.

The tariff effect could come close to those readings and may even surpass them.

For starters, at a 3.35% weight on gasoline and 3.5% weight on all energy commodities and assuming all energy prices go up 25% m/m in January or February whether through supply chain effects or arbitrage, US CPI would probably jump by around 1% m/m just on the energy tariff alone. I can almost hear the howls from drivers of gas guzzlers in the US now…

On autos, estimates I've seen of the pass-through effect of tariffs on auto prices would add between 0.2–0.4% m/m to CPI in weighted contribution terms.

And that's just the beginning of the impact on prices paid by Americans in response to higher levies imposed at the US borders. Layer on the impact upon grocery prices, lumber and other construction materials, toys, lots of electronics, business equipment, raw commodities like metals that would ripple through everything, etc etc.

Ironically, Trump campaigned on bringing inflation down, even though his policies add to inflation risk before even getting into tariffs. His proposed tariffs could engineer bigger single-month jumps in US prices than in the depths of the pandemic, the peak of the US housing boom pre-GFC, and maybe even the 1970s oil shocks. Good one, clap clap..

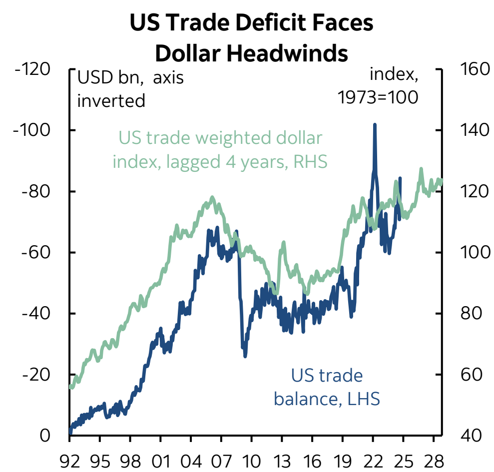
If American consumers view the threat as credible, then it is likely that some demand will be pulled forward affected items in order to get in before the tariffs. That could perversely add to shorter-term US growth before weakening thereafter.

Being in excess demand, the US doesn't have the aggregate capacity to fill this void by cranking up domestic production. It can take years to do so anyway as it's not as simple as just flicking a switch in sectors like energy.

US Policies Driving a Stronger USD Will Continue to Widen the Trade Deficit

The added element to the incoming US administration's policies that bears repeating is that its strong dollar policies will drive a further worsening of the US trade deficit (chart 3). Trump's going to be playing that game everybody loves called Trade Whack-a-Mole as his policies inflame dollar strength, drive a worsened trade account, which angers him toward more protectionism so he lashes out again, worsens things again and so forth.

Chart 3

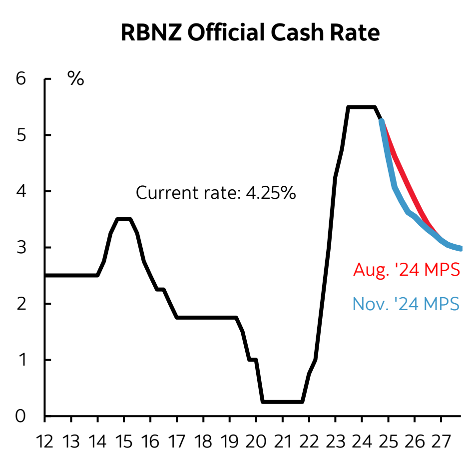


Sources: Scotiabank Economics, Bloomberg.

The RBNZ Wasn't Dovish Enough for Markets

The NZ$ appreciated and kiwi bonds sold off after the RBNZ's decision last evening. That's because the revised forward guidance pointed to fewer cumulative rate cuts over the coming year than markets were pricing. For instance, the RBNZ says that the OCR will average just over 3½% by 2025Q3 whereas markets were pricing about 3¼% by about the same time frame (chart 4). That's not a big deal, and central banks don't necessarily have any better idea what they'll be doing that far out than markets, but for now the signal is slightly less cutting than was being priced. Otherwise, the RBNZ cut 50bps as expected this time and Governor Orr's comments in the press conference left the door open to another 50bps move way out at the next meeting that only comes on February 19th if the data evolves as expected. A three-month policy meeting gap seems a tad bizarre in this climate.

Chart 4



Sources: Scotiabank Economics, Reserve Bank of New Zealand.

There are a few gems on the US calendar before standing by the door on US trading floors will get you burned by the breeze of folks rushing to the exits. Also watch for any other off-calendar developments like on the trade file.

Fixed Income	Government Yield Curves (%):											
	2-YEAR			5-YEAR			10-YEAR			30-YEAR		
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk
U.S.	4.20	4.26	4.32	4.12	4.19	4.28	4.26	4.31	4.41	4.44	4.48	4.60
CANADA	3.20	3.23	3.27	3.10	3.14	3.22	3.25	3.28	3.38	3.27	3.29	3.43
GERMANY	2.02	2.02	2.13	2.01	2.03	2.18	2.16	2.19	2.35	2.37	2.42	2.55
JAPAN	0.59	0.59	0.56	0.74	0.74	0.72	1.07	1.07	1.08	2.31	2.29	2.29
U.K.	4.31	4.33	4.41	4.18	4.22	4.32	4.30	4.35	4.47	4.79	4.83	4.92
	Spreads vs. U.S. (bps):											
CANADA	-101	-102	-105	-103	-105	-106	-101	-103	-103	-118	-119	-117
GERMANY	-218	-224	-219	-211	-216	-210	-210	-212	-206	-208	-206	-205
JAPAN	-361	-367	-376	-339	-345	-356	-318	-324	-333	-213	-219	-230
U.K.	10	8	9	6	3	4	5	5	6	35	35	32

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	25405	-5.2	-0.0	1.6	3.8	26.8
Dow 30	44860	123.7	0.3	3.7	6.5	27.0
S&P 500	6022	34.3	0.6	1.8	3.7	32.3
Nasdaq	19176	120.7	0.6	1.0	3.5	34.7
DAX	19219	-77.2	-0.4	1.1	-1.3	20.4
FTSE	8264	5.1	0.1	2.2	0.2	10.8
Nikkei	38135	-307.0	-0.8	-0.6	-1.2	14.1
Hang Seng	19603	443.9	2.3	-0.5	-4.8	13.0
CAC	7123	-71.0	-1.0	-1.0	-5.0	-2.0
Commodities	**Level**		**% change:**			
WTI Crude	69.16	0.39	0.6	0.4	-3.7	-7.6
Natural Gas	3.30	-0.17	-4.8	3.4	29.0	18.2
Gold	2652.01	18.86	0.7	0.1	18.9	31.7
Silver	30.54	-0.25	-0.8	-2.4	-7.9	28.8
CRB Index	288.02	0.51	0.2	1.0	1.2	6.5
Currencies	**Level**		**% change:**			
USDCAD	1.4058	0.0004	0.0	0.6	1.2	3.2
EURUSD	1.0533	0.0044	0.4	-0.1	-2.6	-3.8
USDJPY	151.51	-1.5700	-1.0	-2.5	-1.2	1.9
AUDUSD	0.6481	0.0006	0.1	-0.4	-1.5	-1.9
GBPUSD	1.2631	0.0062	0.5	-0.2	-2.6	0.0
USDCHF	0.8832	-0.0033	-0.4	-0.1	2.1	0.3

Central Banks	
Current Rate	
Canada - BoC	**3.75**
US - Fed	**4.75**
England - BoE	**4.75**
Euro zone - ECB	**3.40**
Japan - BoJ	**-0.10**
Mexico - Banxico	**10.25**
Australia - RBA	**4.35**
New Zealand - RBNZ	**4.25**
Next Meeting Date	
Canada - BoC	**Dec 11, 2024**
US - Fed	**Dec 18, 2024**
England - BoE	**Dec 19, 2024**
Euro zone - ECB	**Dec 12, 2024**
Japan - BoJ	**Dec 19, 2024**
Mexico - Banxico	**Dec 19, 2024**
Australia - RBA	**Dec 09, 2024**
New Zealand - RBNZ	**Feb 18, 2025**