

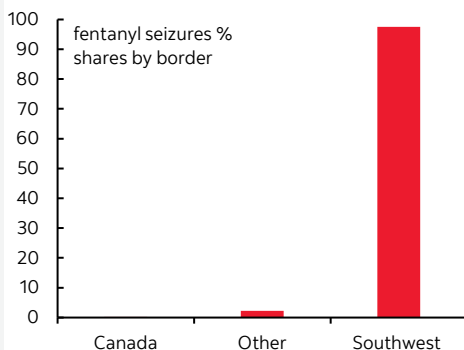
#### Contributors

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Chart 1

#### Canada Is a Negligible Share of America's Fentanyl Imports

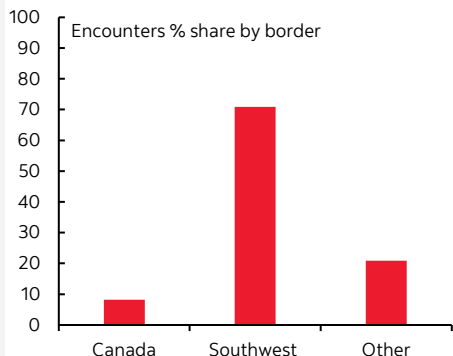


\*YTD Share Jan-Oct 2024

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 Tuesday, January 21

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	01-21	08:30	Core CPI - Median (y/y)	Dec	--	2.4	2.6
CA	01-21	08:30	Core CPI - Trim (y/y)	Dec	--	2.5	2.7
CA	01-21	08:30	CPI, All items (m/m)	Dec	-1.0	-0.4	0.0
CA	01-21	08:30	CPI, All items (y/y)	Dec	1.2	1.9	1.9
CA	01-21	08:30	CPI, All items (index)	Dec	--	161.1	161.8
CA	01-21	08:30	Core CPI - Common (y/y)	Dec	--	--	2.0
CA	01-21	08:30	CPI SA, All items (m/m)	Dec	--	--	0.1

#### KEY POINTS:

- **Trump's protectionism drives stronger USD**
- **Erratic Trump singles out Canada and Mexico for tariffs on February 1st...**
- **...by wrongly accusing Canada of being a material source of fentanyl and migrants...**
- **...while holding off universal tariffs for now**
- **The pacifists who say don't retaliate offer useless alternative approaches...**
- **...as the costs of US isolationism must be made clear to US consumers and businesses**
- **Canadian CPI: Down, but Up?**
- **Will Canadian core inflation soar as it did following past sales tax cuts?**
- **Soft UK jobs put a lock on a BoE cut**

It seems that FX markets are the most clued into tariffs. The dollar is broadly stronger as the initial relief that Trump's Day One didn't include tariffs gave way to last evening's tape bomb that he would impose them on Canada and the US once all the pomp and circumstance fit for an 18<sup>th</sup> century European monarch had subsided. The dollar immediately took off as a broad basket of crosses depreciated, led by, of course, CAD and MSN that are both about 1% softer this morning. The US curve is slightly richer in bull flattener terms. Canada's bond yield curve is slightly outperforming with yields down by about 3–5bps across the curve this morning. TSX equity futures are little changed, US futures are gently higher, and European cash markets range from flat to small losses across the bourses.

Gilts mostly shook off another set of soft UK employment readings while February 6<sup>th</sup> is a lock for a BoE cut. Canadian CPI is on tap as the last major piece of data before next week's BoC meeting that may roughly coincide with tariffs and Canadian retaliation.

#### VOLATILE TRUMP REINTRODUCES TARIFF THREAT

Betrayed. Incensed. Outraged. Downright PO'ed! These are among the cleaner words I'd use to describe my reaction to Trump's announcement last night. Our ally. Our longstanding economic partner. Turning against Canadians.

With the caution that it did not appear in one of his [Executive Orders](#) and therefore it is not yet fact, President Trump said he would impose a 25% tariff on Canada and Mexico on February 1<sup>st</sup>. This was in response to a reporter's question in the oval office and his response seemed impromptu, perhaps as well thought out as his insistence while speaking with a reporter that Spain is a member of the BRICs!! Trump's erratic behaviour and willingness to butt heads with at least some of his key advisors require taking his words with a grain of salt at all times. He also alleged that the reason is because of fentanyl and migrant workers which is strongly refuted by the facts in Canada's case (charts 1, 2). Not that the facts have ever really mattered much to Trump.

He also said they are “not ready for that yet” in reference to universal tariffs. And so Trump is singling out Canada and Mexico as targets for a trade war.

Through no fault of her own, the single mom trying to put her kids through school may be thrown out of work thanks to Trump’s tariffs. The household already dealing with mortgage resets faces unemployment. There is no intelligent justification for this. If there is one thing that unites Canadians time and again, then I fear it will be a wave of anti-American sentiment notwithstanding the many cross border ties with families, friends and businesses. That would be a shame, but wait until the effects hit families and the numbers.

If broadly applied with no carve-outs and over a meaningful period of time, then the effects of a 25% tariff on Canada’s economy would be devastating. Ruinous, in fact. See the end of this note for the scenarios for everything from GDP to the unemployment rate, inflation, USDCAD, the BoC, and the consequences to the US including Fed hikes.

US tariffs would be sure to invite swift and severe retaliation if for no other reason than the politics of looking useless and weak. Obviously, no one wins trade wars, but the kid who never stands up for himself always loses and for a long time. Making it clear there is at least a cost to the US by disrupting their supply chains and causing damage into US mid-term elections is the best chance to get Trump to stand down and for the sake of the longer run outlook even with the well understood higher shorter run costs and fresh from the crisis experience that invoked unprecedented tools. Don’t stand up now, and he’ll do it over and over throughout his four years. Four years of getting your lunch stolen, Canada, as one assault leads to another. That is my firm belief in assessing what kind of US administration this is. Through whatever means necessary you have to make it clear that US jobs, paycheques, prices and supply chains will be vulnerable into the mid-term elections and gone is the myth that Trump won the election because he would be a better steward of the economy.

Besides, the alternatives are unappealing. Negotiate? Yeah, how’s that working for you?? Or how about just taking your lumps and moving on in meek, bootlicking fashion? Oh please, you’ll be taking your lumps over and over into the long-term poor house as the US administration’s philosophy is to crush foreign economies somehow believing that would be good for investment in America. Wish that Canada had diversified trade partners decades ago? Yeah, thanks, that’s really helpful now. Demand that Canada diversify trade partners going forward? Ok, precisely how when that’s never really happened, and on what reasonable timeframe—20 years from now?! The camp that says don’t retaliate would have Canada getting its lunch stolen over and over throughout the next four years and they have no good alternatives to how to deal with a man who responds to force. The application of countervailing force got him to go out with a whimper during NAFTA 2.0 negotiations and so there is precedent.

Reading America under Trump correctly is key to determining the next steps. America is turning more isolationist, more protectionist, and more insular toward the rest of the world. This is true whether it is trade or withdrawing from the WHO (good luck in the next pandemic...) or other global agreements. Making it clear to US consumers and businesses what the costs to such an approach will be like is key to asking them point blank via their pocket books if this is really what they want on the path to the mid-terms. As a case in point, note that major US networks are barely—if at all—noting the tariff issue.

Chart 3

**CANADIAN CPI: DOWN, BUT UP?**

December headline CPI will be distorted by the GST/HST cut, but the BoC’s preferred core measures could be warm again (8:30amET).

I went with -1.0% m/m NSA for headline CPI dipping down to 1.2% y/y from 1.9%. A literal translation of the tax cut’s effects combined with average seasonal downward pressures would reveal an even weaker reading. The math on the tax cuts effects is in my Global Week Ahead article and see chart 3.

Offsetting this somewhat is that underlying prices could have firmed and may add to the recent trend (chart 4). Key is that retailers may have crowded-in the space left by tax cuts by either offering less discounting and/or outright higher prices.

Impact of GST/HST Break on Headline CPI						
	NB	NL	NS	ON	PE	Canada
HST	15	15	15	13	15	
GST	5	5	5	5	5	5
<u>Prov. Component to HST</u>	10	10	10	8	10	
<b>Distribution to Canada</b>	<b>1.9</b>	<b>1.3</b>	<b>2.5</b>	<b>40.8</b>	<b>0.4</b>	
<u>CPI Weights on Affected Items</u>						
Bakery & cereal products (ex. Baby food)	1.7	1.6	1.6	1.3	2.0	1.5
Vegetables & vegetable preparations	1.2	1.0	1.2	1.2	1.1	1.3
Non-alcoholic beverages	0.8	0.9	0.6	0.5	0.6	0.6
Confectionary	0.6	0.6	0.6	0.4	0.5	0.3
Potato chips & other snack products	-	-	-	-	-	0.3
Food Purchased from restaurants	5.1	6.0	5.6	5.9	7.3	6.0
Children's clothing	-	0.6	0.5	0.4	0.6	0.5
Children's footwear	-	-	-	-	-	0.1
Toy, games (ex. Video games) & hobby	-	-	-	-	-	0.8
School textbooks & supplies	-	0.1	0.1	0.1	0.1	0.1
Books & reading material (ex. Textbooks)	-	0.2	0.3	0.2	0.2	0.1
Newspapers	-	-	-	-	-	0.0
Alcoholic beverages	-	4.0	3.3	2.3	3.0	2.7
<b>Total:</b>	<b>9.3</b>	<b>15.1</b>	<b>13.7</b>	<b>12.2</b>	<b>15.4</b>	<b>14.8</b>
Impact on Provincial CPI	0.93	1.51	1.37	0.98	1.54	-
Impact on National CPI	0.02	0.02	0.03	0.40	0.01	0.74
<b>Total Impact on National CPI (m/m NSA, in ppt)</b>						<b>1.21</b>

Sources: Scotiabank Economics, Statistics Canada.

That has happened before. For example, when the GST was cut by 1 ppt in each of July 2006 and January 2008, the BoC's preferred trimmed mean and weighted median measures immediately jumped higher (chart 5). In July 2006, WM jumped to 3.5% m/m SAAR (0.9% prior) and trimmed mean soared from 0.87% to 4.35% m/m SAAR. In January 2008, TM and WM both landed on 4.2% m/m SAAR from much cooler readings the prior month.

Trimmed mean CPI could put the hottest prices where crowding-in occurred into the upper 20% of the distribution that gets eliminated, but that may have also bumped what else would have been in that 20% tail into the middle 60% and thus lift the measure overall. Weighted median would also be expected to rise in a crowding-in scenario as it's the 50<sup>th</sup> percentile price in the weighted basket.

Also note that the GST/HST cut is bigger overall than it was on those two prior occasions. It's not an across the board GST cut on the roughly 60% of the basket that is taxable as before, but this time it's a bigger decline in the rate and includes HST cuts by Ontario and the four eastern provinces.

A repeat of what happened to core measures in past GST cuts is not assured today, but if this does happen, then it might dent BoC pricing for the January 29<sup>th</sup> meeting. They would add to a string of warm readings throughout Q4.

On the heels of the massive strength in jobs including the 91k created in December and the trend before that, plus decent tracking for Q4 economic growth, another warm set of core gauges could question the rush to ease.

And then enter tariffs. If the US imposes tariffs and if Canada retaliates in kind, then the path forward for the BoC is unclear. Gravelle and Macklem have made that abundantly clear.

**WEAKENING UK JOB MARKET REINFORCES BOE CUT PRICING**

Soft employment reports added a couple of points to BoE rate cut expectations for the February 6<sup>th</sup> meeting but had little overall effect on UK markets (charts 6–9). Payrolls fell by about 47k m/m in December after losing 32k the prior month and on a protracted downward trend. Total employment growth has basically stalled, with just 13k added in November and a 35k in total over the past three months. Wage growth ebbed to 5.3% m/m SAAR in November after a pair of readings around the 7½% range. Jobless claims were little change in December.

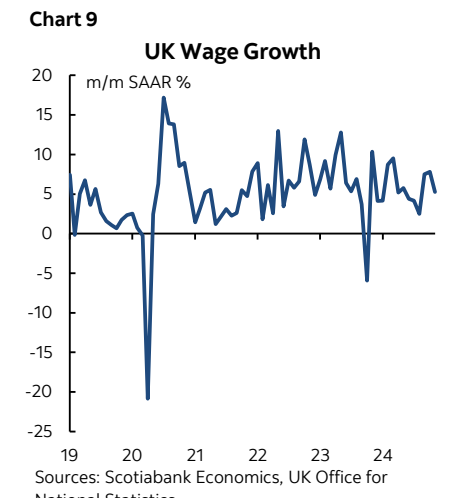
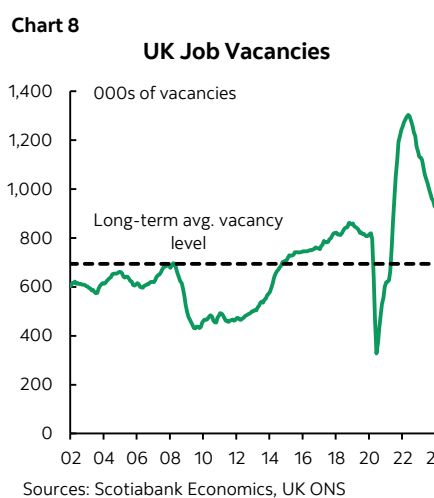
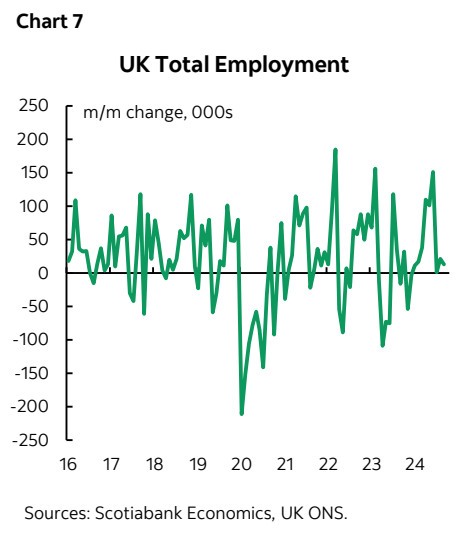
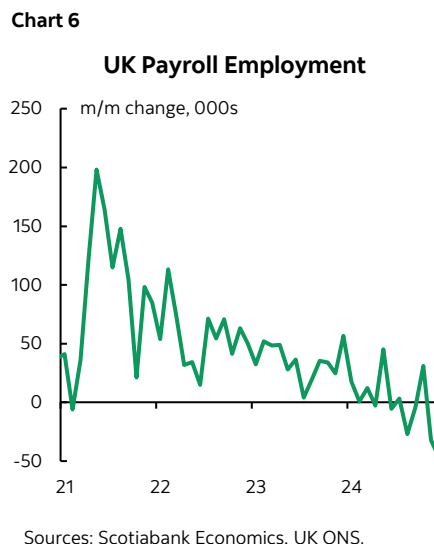
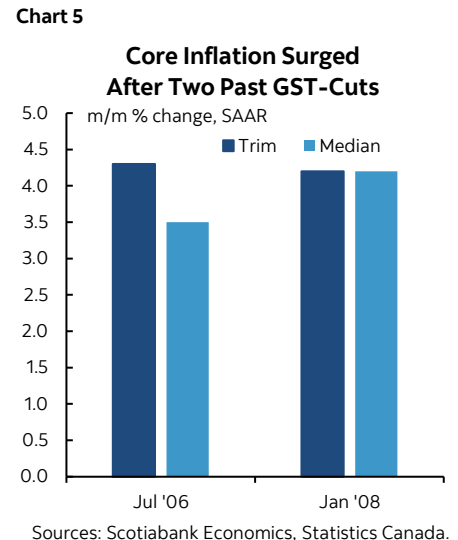
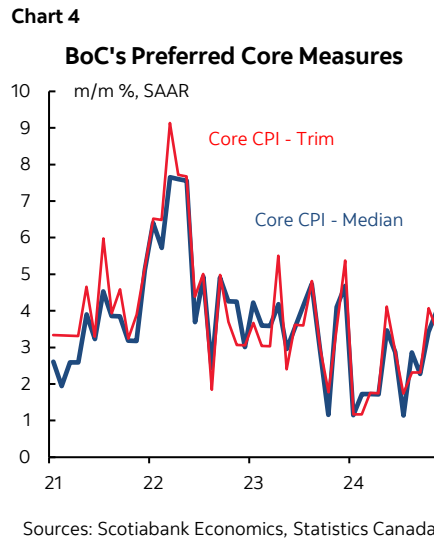
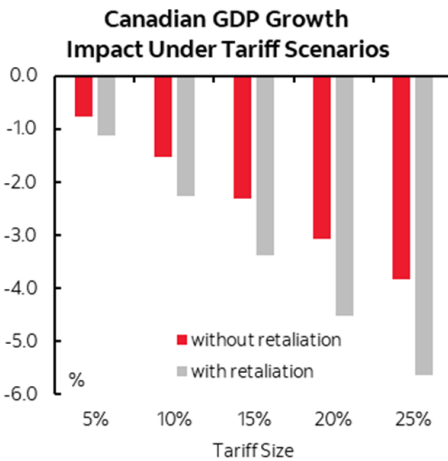


Chart 10

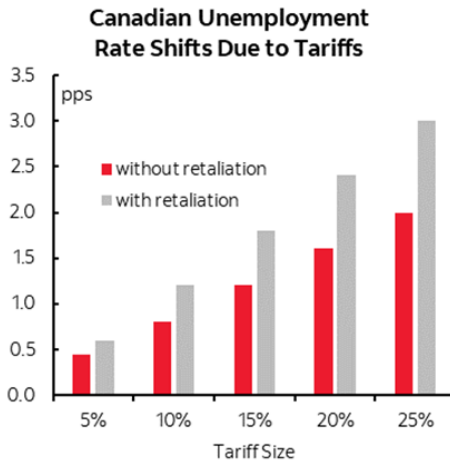
Estimating the Impact of 25% US Tariffs on All Goods Imported from Canada																
Tariff	US								Canada (without retaliation)							
	GDP, %	GDP, long-run, %	Core PCE, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps		GDP, %	GDP, long-run, %	Core Inflation, pps	Policy Rate, bps	Exchange Rate, %	FX impact by 25q4	Unemployment, pps	
5% timing	-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	
	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	
Tariff	Canada (with retaliation)								Canada (half retaliation)							
	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% timing	-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	
	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	

Chart 11



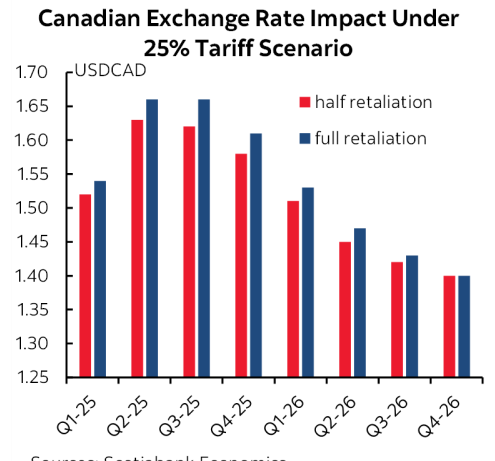
Sources: Scotiabank Economics.

Chart 12



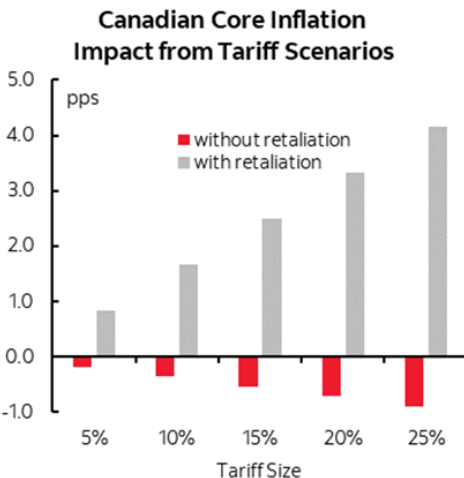
Sources: Scotiabank Economics.

Chart 13



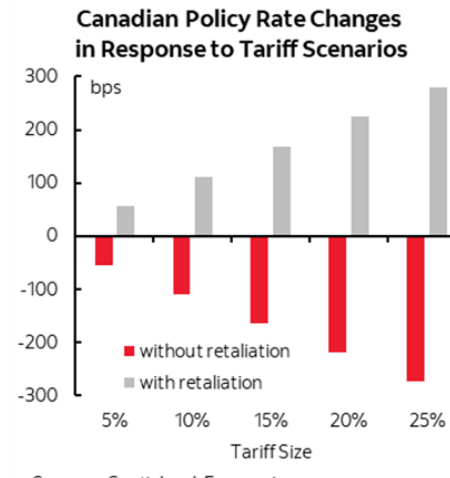
Sources: Scotiabank Economics.

Chart 14



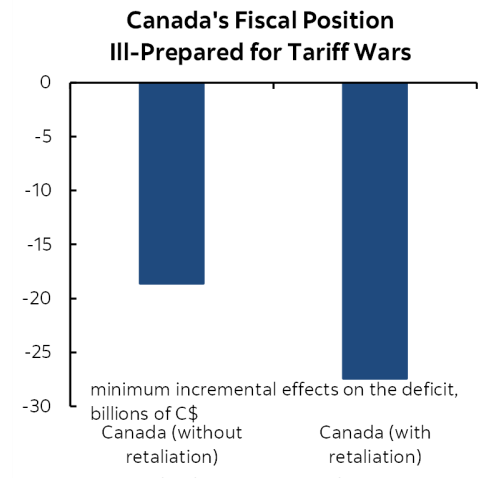
Sources: Scotiabank Economics.

Chart 15



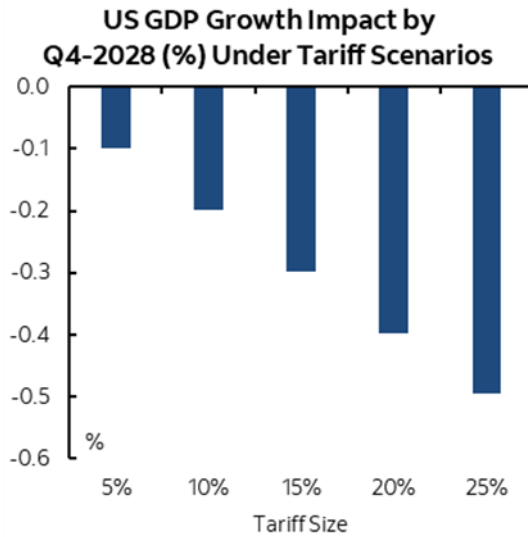
Sources: Scotiabank Economics.

Chart 16



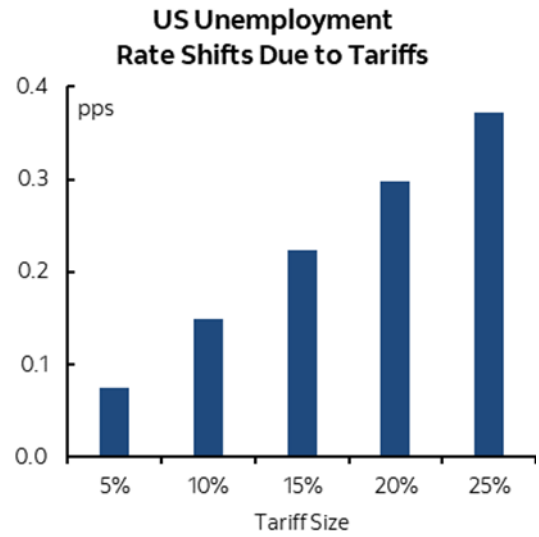
Sources: Scotiabank Economics, Budget 2024.

Chart 17



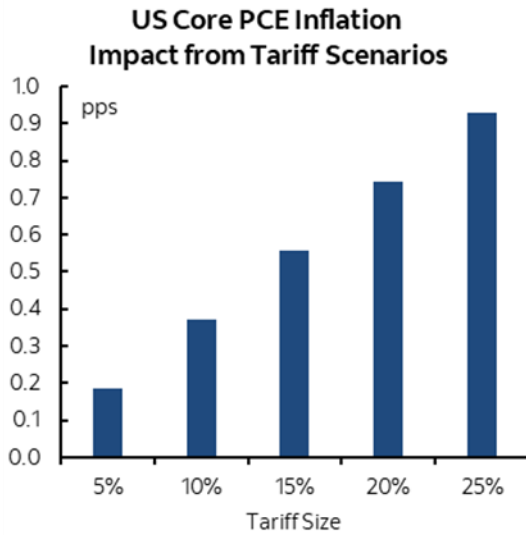
Sources: ScotiabankEconomics.

Chart 18



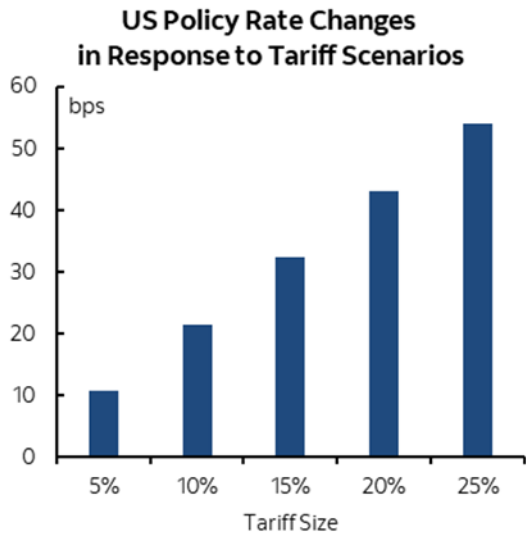
Sources: ScotiabankEconomics.

Chart 19



Sources: ScotiabankEconomics.

Chart 20



Sources: ScotiabankEconomics.

Fixed Income	Government Yield Curves (%):												Central Banks		
	2-YEAR			5-YEAR			10-YEAR			30-YEAR			Current Rate		
	Last	1-day	1-WK	Last	1-day	1-WK	Last	1-day	1-WK	Last	1-day	1-WK			
U.S.	4.26	4.28	4.37	4.39	4.43	4.60	4.58	4.63	4.79	4.80	4.86	4.98	Canada - BoC	3.25	
CANADA	2.89	2.92	3.15	2.95	2.99	3.28	3.23	3.28	3.54	3.36	3.40	3.62	US - Fed	4.50	
GERMANY	2.23	2.22	2.32	2.33	2.33	2.46	2.52	2.53	2.65	2.75	2.76	2.86	England - BoE	4.75	
JAPAN	0.68	0.68	0.69	0.86	0.86	0.86	1.19	1.20	1.25	2.27	2.28	2.34			
U.K.	4.37	4.38	4.61	4.38	4.39	4.61	4.64	4.66	4.89	5.19	5.21	5.45			
	Spreads vs. U.S. (bps):														
CANADA	-137	-136	-122	-144	-144	-132	-134	-135	-125	-144	-146	-136	Euro zone - ECB	3.15	
GERMANY	-204	-206	-205	-206	-211	-213	-205	-210	-214	-206	-210	-212	Japan - BoJ	-0.10	
JAPAN	-358	-360	-368	-353	-358	-374	-338	-343	-355	-253	-258	-264			
U.K.	10	9	24	-1	-5	2	7	3	10	39	35	47	Mexico - Banxico	10.00	
Equities	Level			Change			1 Day			1-wk			1-yr		
S&P/TSX	25172			103.7			0.4			2.6			2.3		20.4
Dow 30	43488			334.7			0.8			3.7			1.5		14.9
S&P 500	5997			59.3			1.0			2.9			1.1		23.9
Nasdaq	19630			291.9			1.5			2.4			0.3		28.2
DAX	20976			-14.3			-0.1			3.5			5.5		26.7
FTSE	8519			-1.7			-0.0			3.9			5.4		14.2
Nikkei	39028			125.5			0.3			1.4			0.8		6.8
Hang Seng	20107			180.7			0.9			4.6			2.0		34.4
CAC	7743			9.6			0.1			4.3			6.4		5.0
Commodities	Level			Change			1 Day			1-wk			1-yr		
WTI Crude	76.13			-1.75			-2.2			-3.4			9.6		3.7
Natural Gas	3.88			-0.07			-1.7			-1.3			3.5		54.1
Gold	2726.15			17.94			0.7			1.8			22.3		34.3
Silver	30.26			-0.38			-1.2			1.3			5.1		32.7
CRB Index	311.08			-0.27			-0.1			1.7			6.5		17.2
Currencies	Level			Change			1 Day			1-wk			1-yr		
USDCAD	1.4447			0.0137			1.0			0.7			0.5		7.2
EURUSD	1.0352			-0.0064			-0.6			0.4			-0.5		-4.9
USDJPY	155.85			0.2300			0.1			-1.3			-0.8		5.2
AUDUSD	0.6222			-0.0053			-0.8			0.4			-0.4		-5.3
GBPUSD	1.2246			-0.0082			-0.7			0.3			-2.3		-3.6
USDCHF	0.9107			0.0040			0.4			-0.2			1.3		4.8
													Next Meeting Date		
													Canada - BoC	Jan 29, 2025	
													US - Fed	Jan 29, 2025	
													England - BoE	Feb 06, 2025	
													Euro zone - ECB	Jan 30, 2025	
													Japan - BoJ	Dec 19, 2024	
													Mexico - Banxico	Feb 06, 2025	
													Australia - RBA	Feb 17, 2025	
													New Zealand - RBNZ	Feb 18, 2025	

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