Scotiabank

GLOBAL ECONOMICS

DAILY POINTS

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Contributors

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

On Deck for Friday, January 24

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	01-24	10:00	Existing Home Sales (mn a.r.)	Dec	4.2	4.2	4.2
US	01-24	10:00	Existing Home Sales (m/m)	Dec	1.2	1.2	4.8
US	01-24	10:00	U. of Michigan Consumer Sentiment	Jan F	--	73.2	73.2

KEY POINTS:

- **The yen shook off a dovish sounding BoJ…**
- **…that hiked, raised inflation forecasts, and sounds more emboldened**
- **Gilts, EGBs cheapen as Europe leads stronger global PMIs**
- **US to update PMIs, existing home sales**
- **Chinese equities rally on Trump comments as he prefers to hate Canada**
- **Trump's 5% on defence would mean $1.5 trillion in Canadian tax hikes, or spending cuts, or debt issuance—or some combination thereof over a decade**

The yen largely shook off the BoJ by initially appreciated to the dollar but then slipping back to about the 156 mark while JGBs cheapened by 1–2bps across the curve. Yields on gilts and EGBs are broadly higher in a slight bear flattener move after better than expected PMIs with the obvious question being whether the gains are sustainable into trade tensions or not. Antipodean yields and US Treasury yields are going the other direction. Divergences are reflected in equities as US equity futures are lower along with London's stocks versus Chinese stocks that rallied after Trump said he would 'rather not' hit China with higher tariffs; yet he's ok with beating on Canada with awful logic and a very poor understanding of basic economics.

YEN SHAKES OFF MORE CONFIDENT BOJ

The Bank of Japan hiked its target rate by 25bps as broadly expected and let the numbers do the talking by revising up core inflation forecasts. Core CPI this year was raised by two-tenths (2.7%), next year was raised by half a point (2.4%), and 2027 was raised by a tick (2%).

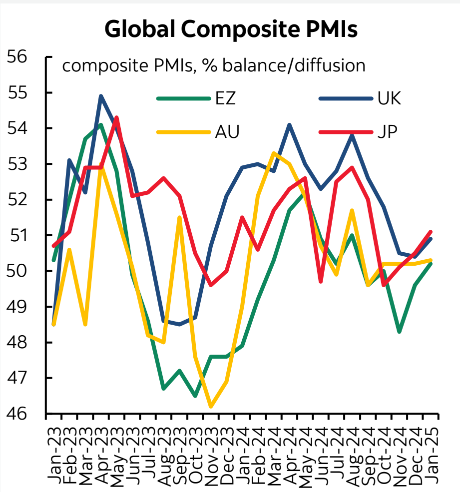
In his press conference, Governor Ueda sounded more confident about realizing policy goals, spoke of a virtuous cycle and how the real policy rate remains very low and the policy rate remains far from neutral, and that if the outlook is realized then it is conducive toward further policy tightening but the path will be informed by data and developments. US policies were cited as a significant source of uncertainty.

EUROPE LED AN IMPROVEMENT IN GLOBAL PURCHASING MANAGERS' INDICES

A wave of global PMIs saw modest improvements in Europe and Japan but not India or Australia (charts 1–3). Manufacturing accelerated everywhere except for Japan.

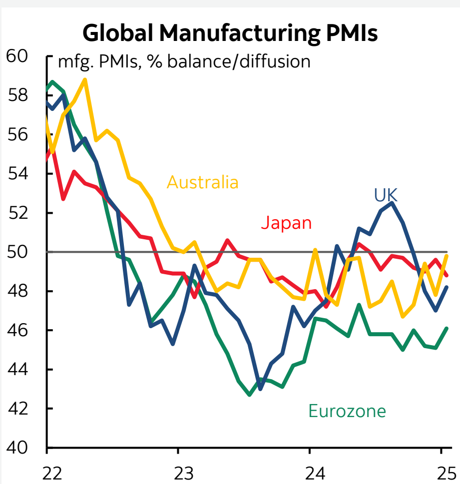
- The eurozone composite PMI increased six-tenths to 50.2 because of a one-point gain in manufacturing that continues to contract (46.1) as the services PMI was little changed (51.4, 51.6 prior). However, new manufacturing orders and new manufacturing export orders continued to decline albeit at a slower pace.

Chart 1



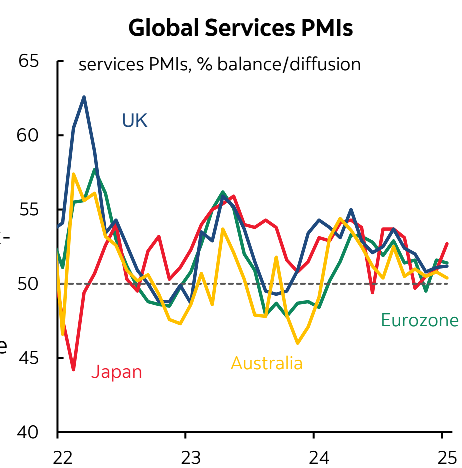
Sources: Scotiabank Economics, S&P Global.

Chart 2



Sources: Scotiabank Economics, S&P Global.

Chart 3



Sources: Scotiabank Economics, Markit, Bloomberg, ISM.

- Within the eurozone composite, Germany's composite climbed (50.1, 48.0 prior) as both services and manufacturing improved. France's composite PMI edged higher entirely on manufacturing as services slipped a touch.
- The UK composite PMI increased half a point to 50.9 due to manufacturing (48.2, 47.0 prior) as the services PMI was stable (51.2, 51.1 prior).
- Japan's composite PMI increased (51.1, 50.5 prior) entirely due to services (52.7, 50.9 prior) as manufacturing slipped (48.8, 49.6 prior).
- Australia's composite PMI was basically flat (50.3, 50.2 prior) as manufacturing's weakness subsided (49.8, 47.8 prior) and services softened a touch (50.4, 50.8 prior).
- India's composite PMI fell 1.3 points to a still healthy 57.9, entirely due to services (56.8, 59.3 prior) vs manufacturing (58.0, 56.4 prior).

The US S&P PMI arrives later this morning (9:45amET) along with existing home sales (10amET).

THE CANADIAN BUDGETARY IMPACT OF HITTING TRUMP'S 5% DEFENCE TARGET

Canada spends too little on defence. It should increase its defence spending to its NATO obligation. You're in, or you're out, and we have to live up to our international commitments while securing our own country.

But 5% of nominal GDP as per Trump's oft-repeated insistence of all NATO countries? That's pretty darn unlikely but it's important for folks in Canada who loosely advocate such a step to understand the choices that would have to be made to hit the target. Let's do the math.

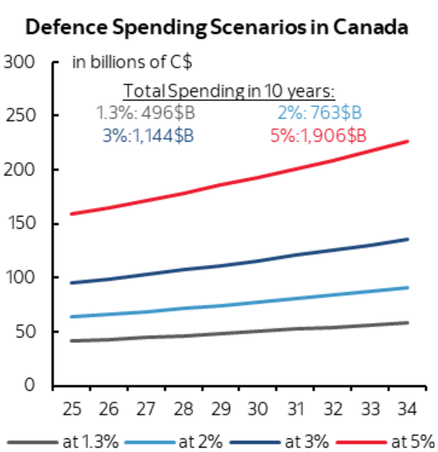
Chart 4 shows defence spending projected over the next decade at various shares of nominal GDP including the current share if maintained, 2%, 3% and 5%. In all cases the hikes start immediately and for NGDP I've used our nearer-term projections and then grown nominal GDP by about 4% per year. The 10-year tallies would range from about half a billion cumulative nominal dollars spent on defence at the current share of NGDP, all the way up to nearly $2 trillion for a four-fold increase.

Chart 5 shows what would happen to federal government spending under base line program spending projections and if defence spending was raised to 5% of NGDP relative to a baseline 1.3%. Program spending projections are drawn from the Fall Economic Statement for the first five years and then grown by about 4% per year thereafter.

Chart 6 shows what would have to happen to program spending and taxes if total spending were kept constant while raising defence spending to 5% of NGDP.

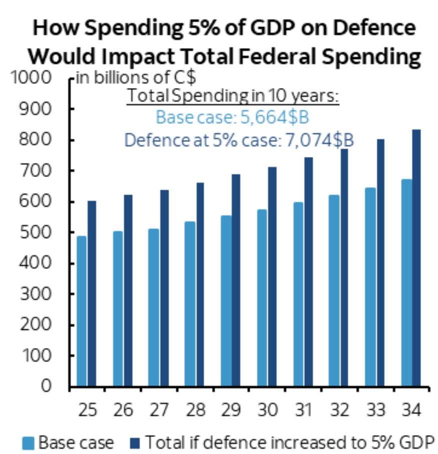
Now for the punchlines. To fund a four-fold increase in defence spending that would hit Trump's demand, Canadians would have to accept about C$1½ trillion of either program spending cuts or tax hikes—or some combination thereof—over the next decade if the goal were to avoid blowing out the deficit. That would mean a cumulative 25% cut to program spending over the full next decade that would require eliminating core programs as the amounts are wildly in excess of anything that could be achieved through efficiency reviews or scaling back civil servants that would probably have to rise with a bigger defence ministry.

Chart 4



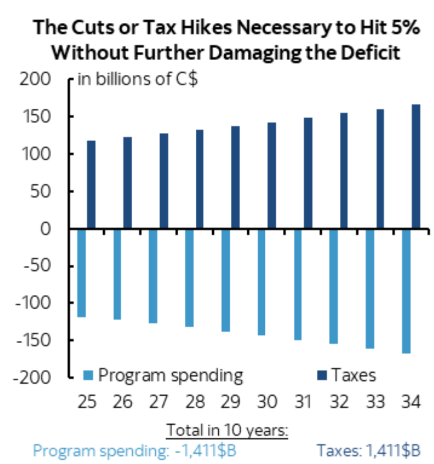
Source: Scotiabank Economics.

Chart 5



Source: Scotiabank Economics.

Chart 6



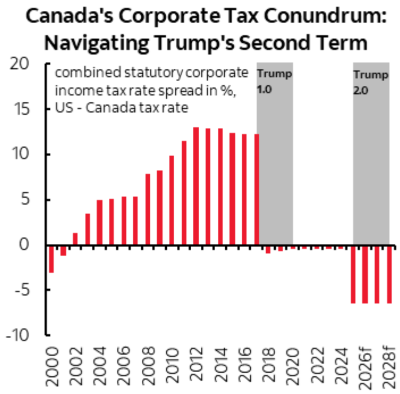
Source: Scotiabank Economics.

If instead the deficit was blown out then debt issuance would have to rise by the same amount and this would risk Canada's AAA sovereign rating while putting upward pressure upon borrowing costs for households, businesses and governments.

Or Canadians would have to accept an equivalent massive increase in taxes either on households or corporations or small businesses or likely some combination thereof in a country with an already high tax burden. In fact, Canada already faces a deterioration in its corporate tax competitiveness to the US especially under Trump's plan to cut US corporate taxes further (chart 7).

So think about your priorities, Canada. Spending trillions on defence goodies comes at the expense of other goals like tax reform. I understand the mixed motives to the request since Canada should at least meet its NATO pledge, but what Trump is after is to militarize the rest of the world just like his own country, and to get the world to buy more defence equipment from the US military-industrial complex that is a key part of his base. Perhaps any increases in Canadian defence spending should go elsewhere if Canada wishes to use this as leverage in trade negotiations.

Chart 7



*Note: Forecast assumes no change to Canadian corporate tax rate while Trump slashes tax rate to 15%.
Sources: Scotiabank Economics, OECD.

In any event, the math and the choices that raising defence spending to Trump's target would entail make it extraordinarily unlikely to ever happen barring a calamity caused by itchy trigger fingers.

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.	4.28	4.29	4.28	4.44	4.45	4.43	4.64	4.64	4.63	4.87	4.87	4.86
CANADA	2.96	2.95	2.93	3.03	3.03	3.00	3.32	3.32	3.30	3.46	3.46	3.42
GERMANY	2.29	2.25	2.23	2.39	2.35	2.34	2.58	2.55	2.54	2.79	2.78	2.76
JAPAN	0.72	0.70	0.69	0.91	0.88	0.87	1.23	1.21	1.20	2.28	2.27	2.29
U.K.	4.36	4.33	4.38	4.37	4.34	4.39	4.66	4.64	4.66	5.22	5.19	5.21
	Spreads vs. U.S. (bps):											
CANADA	-132	-134	-136	-141	-142	-143	-132	-132	-133	-141	-141	-144
GERMANY	-198	-205	-206	-205	-210	-209	-206	-209	-209	-208	-209	-209
JAPAN	-356	-359	-360	-353	-357	-357	-341	-344	-343	-259	-260	-257
U.K.	8	3	9	-8	-12	-5	2	-1	3	35	32	36

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	25434	122.6	0.5	2.4	2.4	21.0
Dow 30	44565	408.3	0.9	3.1	2.9	17.9
S&P 500	6119	32.3	0.5	2.8	1.3	25.7
Nasdaq	20054	44.3	0.2	2.8	0.1	29.5
DAX	21452	40.0	0.2	2.6	8.1	27.0
FTSE	8536	-28.9	-0.3	0.4	4.9	13.4
Nikkei	39932	-26.9	-0.1	3.9	-0.9	11.7
Hang Seng	20066	365.6	1.9	2.5	-0.1	25.8
CAC	7950	57.4	0.7	3.1	9.2	6.6
Commodities	Level		% change:			
WTI Crude	75.08	0.46	0.6	-4.6	7.1	-0.0
Natural Gas	3.83	-0.12	-3.0	-10.1	-3.0	44.9
Gold	2782.61	27.74	1.0	2.9	24.8	38.2
Silver	30.48	-0.32	-1.0	-0.7	2.9	36.9
CRB Index	309.36	-0.02	-0.0	-0.9	5.3	14.2
Currencies	Level		% change:			
USDCAD	1.4330	-0.0053	-0.4	-1.0	-0.2	6.0
EURUSD	1.0474	0.0059	0.6	2.0	0.7	-3.8
USDJPY	156.45	0.4000	0.3	0.1	-0.5	6.1
AUDUSD	0.6311	0.0026	0.4	1.9	1.2	-4.0
GBPUSD	1.2409	0.0056	0.5	2.0	-1.0	-2.5
USDCHF	0.9063	-0.0011	-0.1	-1.0	0.7	5.0

Central Banks	
Current Rate	
Canada - BoC	3.25
US - Fed	4.50
England - BoE	4.75
Euro zone - ECB	3.15
Japan - BoJ	-0.10
Mexico - Banxico	10.00
Australia - RBA	4.35
New Zealand - RBNZ	4.25
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