Scotiabank.

GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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On Deck for Monday, June 9							
Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	06-09	10:00	Wholesale Inventories (m/m)	Apr F	--	--	0.0
US	06-09	11:00	NY Fed 1-Yr Inflation Expectations (%)	May	--	--	3.6

KEY POINTS:

- **Markets shake off the nonfarm high**
- **Canada's curve is mildly underperforming US Ts on strong jobs, defence spending**
- **The explosive math behind Canada's defence spending surge**
- **Canada needs a budget now to explain how to fund defence spending plans**
- **Chinese trade softens as tariffs kick in**
- **Chinese inflation remains weak**
- **Mexico to refresh CPI in an otherwise quiet N.A. session**
- **Global Week Ahead—It'll Come in Waves (reminder here)**

Markets are starting a fresh week with mixed performances across asset classes. Canada's curve may be vulnerable to underperformance as the defence spending math sinks in (see below). Global equity benchmarks are flat to slightly lower across most of N.A. and Europe as Asia-Pacific markets rallied while catching up to Friday's solid payrolls report especially considering a large estimated dent from weather. Sovereign bond yields are a few points lower across US and EGB curves with the UK front-end slightly underperforming. The dollar is broadly softer.

THE MATH BEHIND CANADA'S DEFENCE SPENDING SURGE

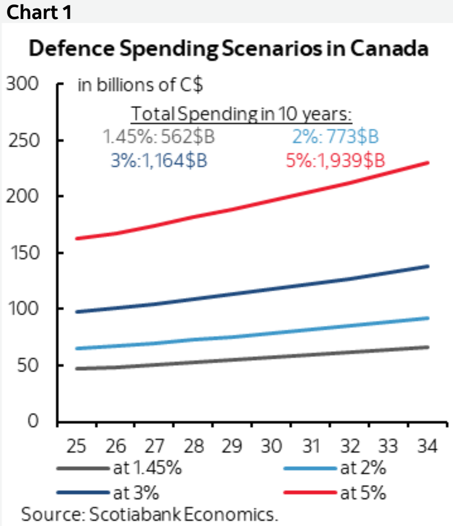
Canada is set to announce a major increase in defence spending today and key will be how it is funded and the likely amount of debt issuance. PM Carney will make the formal announcement at 10amET, then tour a military facility at noon, and then hold a press conference at 1pmET. The Globe and Mail is reporting that Canada will rapidly expedite its plan to increase defence spending by hitting 2% this fiscal year instead of 5+ years from now and then target further subsequent increases. This is ahead of a NATO summit on June 24–25th when Secretary-General Mark Rutte has said he expects members to raise military spending to 3½% of GDP plus 1½% on related security measures for a total of 5%.

Chart 1 shows projections for annual spending in nominal dollars under various targets for defence spending as a share of projected nominal GDP. They update what was here.

Canada spent 1.45% of NGDP on defence last year, or about C$45 billion las year. 2% this year would mean raising that to about $65B for an increase of $20. Over ten years, a 2% of NGDP target that includes economic growth using our current forecasts for 2025–26 and then trend growth thereafter would amount to spending about C$775B, versus $560B at a steady 1.45% of NGDP for a cumulative ten-year rise of about $210B.

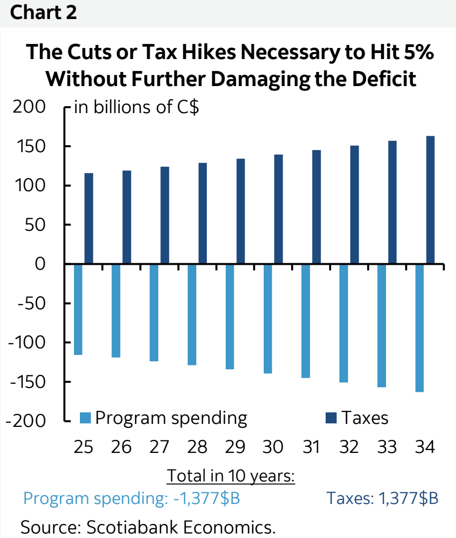
At 3% of NGDP, Canada would be spending about $1.16 trillion on defence and related security measures over a ten-year period for

Chart 1



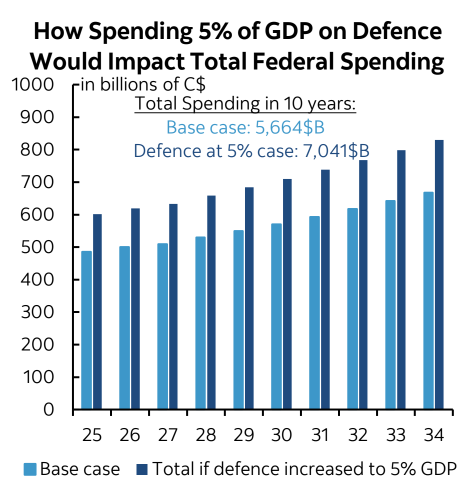
Source: Scotiabank Economics.

Chart 2



Source: Scotiabank Economics.

Chart 3



Source: Scotiabank Economics.

a cumulative $600B increase. At 5% of NGDP, Canada would be spending C$1.94 trillion for a cumulative $1.38T increase. Yes, 'T' as in trillions.

These amounts are obviously large and quite possibly very large for what is at present about a C$3.1T economy in terms of annual nominal GDP. A key question is how the defence spending surge will be funded. Will core program spending outside of defence be gutted? If the defence surge comes entirely from this source then chart 2 shows the annual reductions in program spending ex-defence that would be necessary to hit 5% of NGDP spent on the military. That's unlikely, and unclear how it would be achieved given some parts that cannot be reduced (interest payments) or are very difficult to do, but Carney has said he will target operating spending increases at about 2% which is below the likely NGDP growth rates and would incrementally increase some room in the budget. Will taxes go sharply higher and, if so, then who pays? Chart 2 also shows the massive increase in tax revenues that would be needed if this is entirely relied upon. If higher taxes, then will it be a soak-the-corporations plan? Will the middle class and upper income households be soaked? All of the above? If so, then that could sterilize some of the economic impact but come at a cost to private sector growth. Will it all come from higher deficits and debt issuance? Chart 3 shows how much federal spending would increase over time if there were no other spending cuts and hence this amount would have to be funded by debt. That could compound risks to the bond market and term borrowing costs.

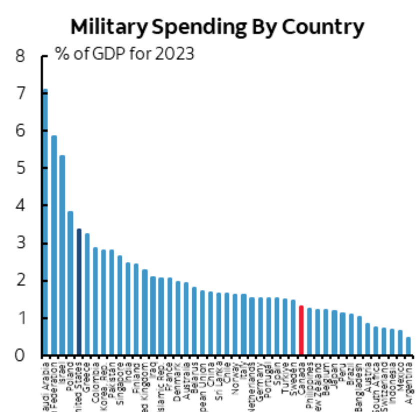
That's why we need a budget! Now. Not in the fall which could stretch to days before Christmas. Now. You cannot go throwing around such massive spending targets with glamorous photo ops without a plan for how to fund it relative to everything else.

There are also implications for the Bank of Canada. An extra half percent of GDP spent on defence and related security measures is a material boost to nearer-term growth. How much so depends upon details behind the numbers that would inform how much of this boost leaks out through imports from foreign military equipment providers, versus how much is spent on domestic military equipment providers and how much is spent on transfers such as what appear to be plans to boost pay and benefits for the military. If Canada rapidly acts to increase spending beyond this fiscal year, then that—and the composition of spending—would have to figure into revised projections for the economy.

At this point, I would tentatively say that the spending surge is a modest additional argument for the BoC to stay on hold.

Then the politics enters the equation. Canada should be spending at 2% and thus meeting its NATO commitment. It has been an international laggard as shown in chart 4 that ranks military spending as a share of NGDP using World Bank comparable numbers from 2023; Canada would vault up the list at 2% and even more so at wherever it ultimately lands, but so would other NATO members. Yet Carney targeted 2% of NGDP on defence five years from now during the election campaign and so massively increasing this amount and the knock-on effects such as how to fund it are not what voters chose on April 28th.

Chart 4



Sources: Scotiabank Economics, World Bank.

Another issue is whether this is Canada's ransom payment for getting out of US tariffs. If so, then the higher scenarios are one heck of a ransom payment for releasing the Canadian economy from the grips of Donald Trump's protectionism and a massive departure from standing the country's ground against US belligerence.

The question of value for money is also critically important. Canada faces no immediate threats to its borders. To what purpose would spending more on defence go toward? More peacekeeping missions? More active involvement in the world's hot spots? Putting out forest fires raging across the country? Or sitting idly by and being another source of Canada's productivity issues?

Perhaps the biggest question of all is whether all of this sudden love affair with military toys will make the world a safer place, or a more dangerous one. One argument is that it's necessary because of Russian aggression, and to counter China's build-up. A counter is that the world has rarely been a safer place when everyone is surrounded by the temptation to use their toys.

CHINA DEVELOPMENTS

The US and China restart trade negotiations in London today so keep an eye on any headline risk going forward.

China's trade figures slowed a bit more than consensus expected for the month of May. In USD terms, export growth was 4.8% y/y (6% consensus, 8.1% prior) while import's contracted by -3.4% y/y (-0.8% consensus, -0.2% prior). Some of that was a currency effect as yuan-denominated exports were up 6.3% y/y (9.3% prior) and imports fell -2.1% y/y (+0.8% prior).

China's inflation stats offered little surprise. CPI was unchanged but still soft (-0.1% y/y, -0.2% consensus). Producer prices fell a little more rapidly (-3.3% y/y, -3.2% consensus, -2.7% prior) partly as oil prices fell.

QUIET N.A. CALENDAR

There is little on tap into the N.A. session. Mexican CPI for May is due out, but monthly tallies rarely offer material surprises since the figures are released on a bi-weekly basis (8amET). Consensus expects 0.2% m/m with core up 0.3%. The NY Fed's 1-year inflation expectations measure is also due for the month of May (11amET).

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.	4.02	4.04	3.94	4.11	4.12	4.01	4.50	4.51	4.44	4.97	4.97	4.97
CANADA	2.70	2.70	2.58	2.96	2.96	2.83	3.35	3.34	3.22	3.60	3.58	3.50
GERMANY	1.87	1.88	1.79	2.16	2.18	2.08	2.57	2.58	2.52	3.02	3.01	3.01
JAPAN	0.78	0.76	0.77	1.03	1.01	1.04	1.47	1.46	1.51	2.92	2.89	2.95
U.K.	4.03	4.01	4.03	4.16	4.16	4.16	4.66	4.64	4.67	5.35	5.34	5.41
	Spreads vs. U.S. (bps):											
CANADA	-132	-134	-135	-115	-117	-118	-115	-117	-122	-138	-139	-147
GERMANY	-215	-216	-215	-195	-195	-192	-193	-193	-192	-195	-196	-195
JAPAN	-324	-327	-316	-308	-311	-297	-304	-305	-293	-206	-208	-202
U.K.	2	-2	9	5	3	16	15	14	23	38	37	44

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	26429	86.8	0.3	1.0	4.2	20.1
Dow 30	42763	443.1	1.0	1.2	3.7	10.2
S&P 500	6000	61.1	1.0	1.5	6.0	12.2
Nasdaq	19530	231.5	1.2	2.2	8.9	14.0
DAX	24166	-138.1	-0.6	1.0	2.8	30.2
FTSE	8824	-14.3	-0.2	0.6	3.1	7.0
Nikkei	38089	347.0	0.9	1.6	1.6	-2.4
Hang Seng	24181	388.9	1.6	4.4	5.7	31.7
CAC	7793	-11.8	-0.2	0.7	0.6	-2.6
Commodities	Level		% change:			
WTI Crude	64.90	0.32	0.5	3.8	6.4	-14.1
Natural Gas	3.69	-0.09	-2.4	-0.1	-2.7	26.5
Gold	3320.49	10.07	0.3	-0.9	48.9	44.8
Silver	36.19	0.39	1.1	9.4	9.6	19.4
CRB Index	300.89	2.27	0.8	3.6	2.0	3.8
Currencies	Level		% change:			
USDCAD	1.3687	-0.0009	-0.1	-0.2	-1.8	-0.5
EURUSD	1.1409	0.0012	0.1	-0.3	1.4	6.0
USDJPY	144.46	-0.3900	-0.3	1.2	-0.6	-8.0
AUDUSD	0.6518	0.0028	0.4	0.4	1.6	-1.4
GBPUSD	1.3558	0.0030	0.2	0.1	1.9	6.5
USDCHF	0.8215	-0.0008	-0.1	0.5	-1.2	-8.4

Central Banks	
Current Rate	
Canada - BoC	2.75
US - Fed	4.50
England - BoE	4.25
Euro zone - ECB	2.15
Japan - BoJ	0.50
Mexico - Banxico	8.50
Australia - RBA	3.85
New Zealand - RBNZ	3.25
Next Meeting Date	
Canada - BoC	Jul 30, 2025
US - Fed	Jun 18, 2025
England - BoE	Jun 19, 2025
Euro zone - ECB	Jul 24, 2025
Japan - BoJ	Jun 17, 2025
Mexico - Banxico	Jun 26, 2025
Australia - RBA	Jul 08, 2025
New Zealand - RBNZ	Jul 08, 2025