Market View

Economics and Strategy

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Provincial funding able to gear down from here

By Warren Lovely

Well that was truly special. In the past three months (i.e., April to June), Canada's provinces collectively secured the equivalent of C$62 billion from debt capital markets—a remarkable tally, eclipsing the extraordinary fireworks of 2020:Q2. When added to the ~C$43 billion issued in calendar Q1, year-to-date provincial bond supply (across all currencies) is snick shy of C$105 billion. As far as mid-year issuance tallies go, that's 3½ standard deviations above the post-GFC trend.

While perhaps not yet fully appreciated, provincial bond issuers will be in a position to slow things down (at a time of their choosing). On a fiscal year basis, more than half of the total 2024-25 borrowing requirement was completed in the first quarter of the fiscal year—a tremendous head start, which in some cases reflects a concerted effort to advance funding programs given the political calendar.

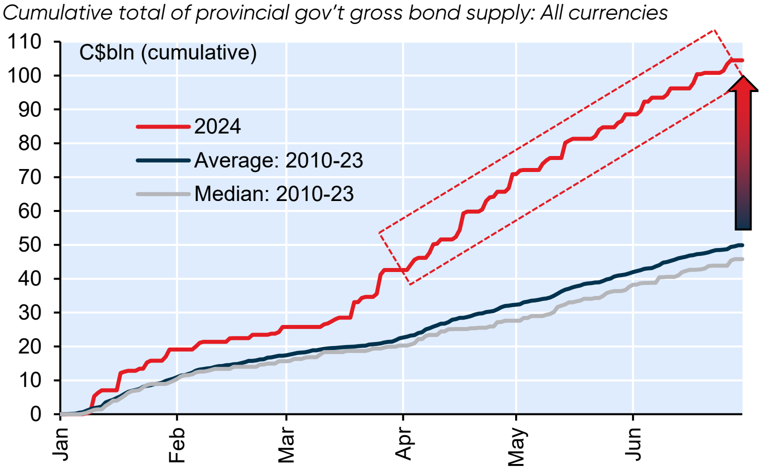
International markets have contributed mightily to record YTD supply, a trend that remained in evidence in June (where five foreign currency trades netted the equivalent of C$6.6 billion). Notwithstanding the benefits of international supply (including supply diversion, investor diversification, sheer depth of demand), we'd expect a material moderation in the second half of the calendar year, a development that could see xccy basis swap spreads moving to the left.

Domestically, a supply moderation already looks to be taking shape. After C$15.4 billion in April and another C$12.2 billion in May, domestic (i.e., CAD-denominated) bond issuance 'slowed' to C$9.3 billion in June. Based on our read of remaining funding needs and a likely currency split, the pace of domestic provi supply should downshift hard in the second half, to as little as one-half of the Q2 tempo.

As for valuations, it's perhaps impressive that spreads vs. govis have held in so well in the face of such a supply onslaught. Credit a heretofore-healthy risk appetite. On that score, we're mindful of a gathering slowdown in the US, which could mount a challenge to credit more generally. No question, provi valuations are most exceptional on an asset swap basis, Ontario 10s cheaper vs. OIS today than at any time in the risk-free reference rate era. If, like us, you felt 10-year swap spread were biased higher, a less forceful bond supply impulse could translate into potential ASW performance, even allowing for some suffering in overall investor risk sentiment.

Chart 1: A remarkable quarter comes to an end...

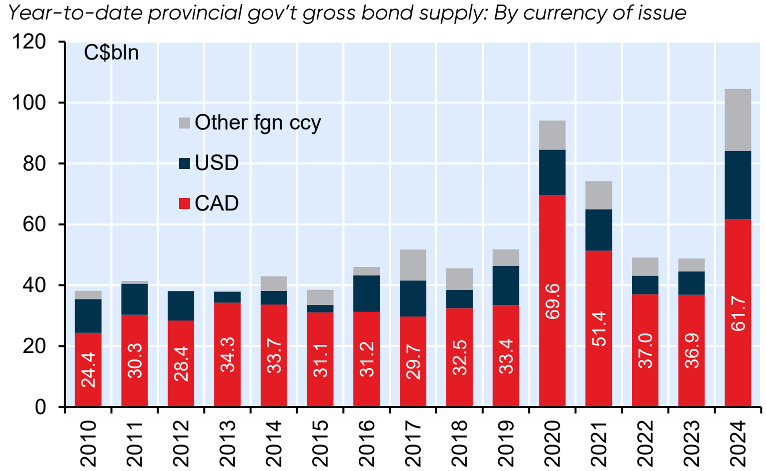
Cumulative total of provincial gov't gross bond supply: All currencies



Source: NBF, BBG | Note: Cumulative total of all-currency daily issuance

Chart 2: ... as provi bond supply pace breaks records

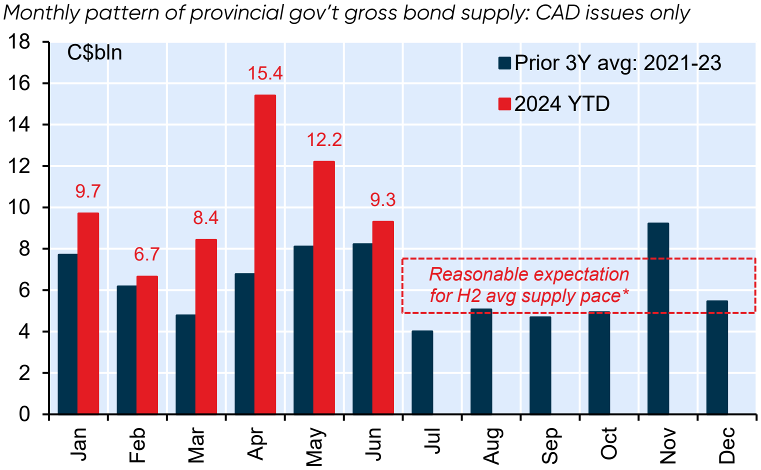
Year-to-date provincial gov't gross bond supply: By currency of issue



Source: NBF, BBG | Note: Year-to-date refers to Jan-Jun

Chart 3: Domestic issuance pace can/will slow

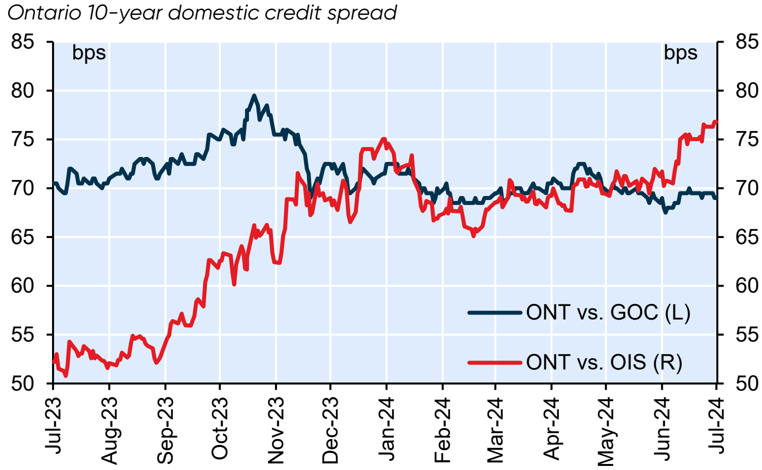
Monthly pattern of provincial gov't gross bond supply: CAD issues only



Source: NBF, BBG | Note: H2 range is illustrative based on assumed borrowing needs & ccy split; range denotes monthly avg; individual months could exceed top end of range

Chart 4: Credit spread exceptionalism? In a sense, yes!

Ontario 10-year domestic credit spread



Source: NBF | Note: Based on NBF's daily constant maturity spread indications

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

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