

# Provincial Credit Watch: May 2021

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

- **Mixed returns; long-end underperforms**
- **PBPP set to end and BoC tilts more hawkish**
- **Budget season winding down**

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## Provincial Returns

Provincial bond returns were mixed in April, with the middle of the curve outperforming the long end. The Bank of Canada left interest rates unchanged and tapered its QE program to \$3 bln per week, as widely expected. But, the Bank also took a more hawkish stance, suggesting that the stage could be set for rate hikes in the second half of 2022 —we're now expecting an initial move in January 2023. Long provincial spreads narrowed in the month, and now sit at the tightest level since February 2020, just before the pandemic broke open. From a year ago, the long provincial index was down 7.8%, outperforming GoCs by a wide margin.

Total Returns (%)												
Sector	1-month				6-month				12-month			
	Broad	Short	Mid	Long	Broad	Short	Mid	Long	Broad	Short	Mid	Long
Universe	0.06	0.18	0.55	-0.50	-3.65	0.06	-2.95	-8.70	-2.03	1.61	-1.00	-7.27
All Government	0.07	0.16	0.53	-0.38	-4.55	-0.24	-3.78	-9.84	-3.72	0.42	-2.86	-9.00
Canada	-0.01	0.13	0.38	-1.34	-3.45	-0.28	-4.68	-13.15	-3.26	0.20	-4.52	-13.86
Agencies	0.28	0.22	0.51	-0.34	-1.77	-0.29	-3.97	-8.07	-0.92	0.50	-3.07	-7.35
Provincials	0.15	0.22	0.66	-0.14	-5.53	-0.16	-3.05	-9.00	-4.22	0.88	-1.52	-7.77
Municipals	0.06	0.24	0.50	-0.34	-4.56	-0.20	-2.95	-7.59	-2.13	1.19	-0.43	-4.79
All Corporates	0.01	0.25	0.61	-0.88	-1.15	0.77	-0.39	-4.84	2.74	4.21	5.10	-1.30
Corporate AA	0.21	0.19	0.60	-1.35	-0.38	0.24	-2.34	-7.40	1.89	2.43	0.68	-5.61
Corporate BBB	0.16	0.27	0.64	-0.58	-0.31	1.41	0.47	-3.46	4.83	5.76	6.90	1.38

Source: PC Bond, a business unit of FTSE TMX Global Debt Capital Markets Inc.

As of April 30, 2021

### Short Provincial Bond Yield Spread (DEX Index)

vs. Canada (bps)



### Long Provincial Bond Yield Spread (DEX Index)

vs. Canada (bps)



## Relative Performance

All provinces saw spreads tighten over the past month, with Quebec and Ontario underperforming at the long end of the curve. Budget season is almost complete (Newfoundland & Labrador is still pending). There were few major surprises, with many provinces tabling documents based on conservative assumptions.

The BoC's **Provincial Bond Purchase Program** is about to wind down, on the initial 1-year schedule. The BoC has already tapered the program to one tender per week (two previously) along with a reduced maximum size. As the program ends, the spread impact from here could be relatively small (and contained to 10-yr and under, where the buying has been). If anything, there could be some curve flattening in the absence of BoC purchases, and some relative weakness in smaller names.

### Spread Performance vs. Canadas (bps : chng)

Province	5-year spread			10-year spread			30-year spread		
	1-mo.	6-mo.	12-mo.	1-mo.	6-mo.	12-mo.	1-mo.	6-mo.	12-mo.
British Columbia	-5.0	-6.5	-28.0	-7.0	-14.0	-27.0	-4.5	-14.5	-24.5
Alberta	-4.5	-9.0	-42.0	-9.5	-24.0	-45.5	-11.5	-27.5	-44.5
Saskatchewan	-5.0	-9.5	-35.0	-8.0	-21.0	-39.0	-14.0	-27.0	-47.0
Manitoba	-4.0	-8.5	-30.0	-10.0	-19.0	-36.0	-11.5	-23.5	-39.0
Ontario	-4.0	-6.0	-25.0	-6.0	-13.0	-25.0	-3.5	-11.0	-21.0
Quebec	-4.5	-8.5	-27.5	-7.0	-16.5	-27.5	-5.5	-14.0	-22.0
New Brunswick	-5.0	-10.0	-35.0	-6.0	-25.0	-39.0	-10.5	-26.5	-36.5
Nova Scotia	-4.0	-9.0	-30.0	-6.0	-22.5	-33.5	-6.5	-22.5	-32.0
Prince Edward Island	-5.0	-10.0	-35.0	-6.0	-25.0	-39.0	-10.5	-25.5	-35.5
Newfoundland & Labrador	-4.0	-21.0	-55.0	-6.0	-36.0	-62.0	-6.5	-42.0	-55.0
Average	-4.5	-9.8	-34.3	-7.2	-21.6	-37.4	-8.5	-23.4	-35.7

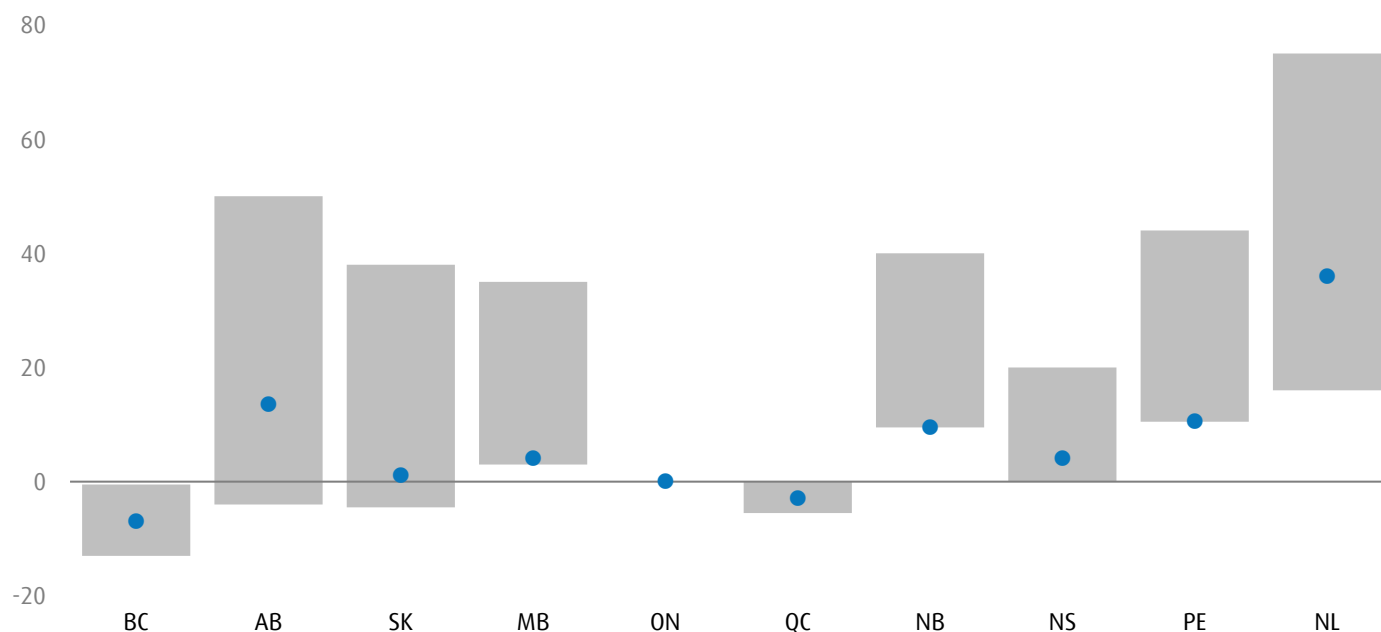
Source: PC Bond, a business unit of FTSE TMX Global Debt Capital Markets Inc.

Implied new issue spreads; as of April 30, 2021

### Provincial 30-year Spread Ranges vs. Ontario

(bps : 3-year period ending April 30, 2021)

● = current



## Fundamentals

### Budget Season Winding Down

The FY21/22 budget season is almost complete, with Newfoundland & Labrador the last province with a plan pending. After a tumultuous year, provincial governments look to re-set longer-term fiscal plans now that there is more certainty on the economic outlook and vaccination program. We recently published a report covering some of the **key themes to watch**: [Report available here](#).

#### Economic and Fiscal Fundamentals

Province	Real GDP (y/y % chng)		Jobless Rate (%)		Budget Balance				Net Debt (% of GDP)	
	2020	2021f	2020	2021f	(\$ mlns)		(% of GDP)		20/21	21/22e
British Columbia	-3.8	6.3	9.0	6.5	-8,144	-9,698	-2.8	-3.1	18.8	22.9
Alberta	-8.2	7.2	11.6	8.7	-20,192	-18,221	-6.6	-5.4	20.3	24.6
Saskatchewan	-5.2	5.3	8.4	7.0	-1,865	-2,611	-2.4	-3.2	19.0	21.7
Manitoba	-4.8	5.4	8.1	6.6	-2,080	-1,597	-2.9	-2.1	38.8	39.9
Ontario	-5.0	5.5	9.6	8.0	-38,500	-33,100	-4.5	-3.7	47.1	48.8
Quebec	-5.3	5.9	8.9	6.5	-12,000	-9,200	-2.7	-2.0	45.0	45.5
New Brunswick	-3.7	3.8	10.1	9.0	-13	-245	0.0	-0.6	37.3	36.4
Nova Scotia	-3.2	4.4	9.8	8.2	-706	-585	-1.6	-1.2	37.4	37.9
Prince Edward Island	-3.0	3.5	10.7	8.4	-120	-112	-1.7	-1.5	34.5	35.4
Newfoundland & Labrador	-5.3	4.5	14.2	13.7	-1,838	-1,430	-6.0	-4.5	53.8	55.0
Canada*	-5.4	6.0	9.6	7.5	-85,458	-76,799	-3.9	-3.2	36.7	37.6

Sources: BMO Capital Markets, Fiscal Updates.

\* NL budget pending. Budget balance and net debt are provincial totals

The following provinces tabled their 2021 budgets in April:

The **Province of British Columbia is projecting a \$9.7 billion deficit** in FY21/22, which weighs in at 3.1% of GDP or about middle-of-the-road among the provinces. The good news is that FY20/21 is tracking meaningfully better than last expected, with the deficit last fiscal year now estimated at \$8.1 billion, down from \$13.6 billion expected in the fall fiscal update. As we suspected, revenues have come in much stronger than the province thought (they tend to run with conservative forecasts anyway). Additionally, this budget continues to build in prudence on three fronts: A conservative economic outlook; a \$1 billion forecast allowance; and \$3.25 billion in pandemic and recovery contingencies that are roughly allocated, but might not necessarily all get used.

That said, this year's wider deficit and still-heavy capital spending program will lift **net debt** to \$72 billion, or just under 23% of GDP (up 4.1 ppts). There is **no plan to balance the books**, but the deficit should fall to \$5.5 billion next fiscal year and \$4.3 billion by FY23/24, or a manageable 1.3% of GDP. Net debt, however, will continue to climb to 27.3% of GDP by FY23/24, with no sign of turning lower, driven by capital-plan borrowing.

A full analysis is [posted here](#).

The **Province of Manitoba is projecting a \$1.6 billion summary budget deficit in FY21/22**, slightly improved from the \$2.1 billion now expected for FY20/21. That weighs in at a modest 2.0% of GDP, and sits at the lower end of the provincial pack. Looking ahead, the Province expects the deficit to decline sharply next fiscal year, to just \$374 million (or 0.4% of GDP), as revenues continue to rebound and spending fades as pandemic-related measures wind down. This budget largely builds on past efforts, rolling out more COVID-related funding and a few other modest measures. Net tax changes in this budget amount to small relief of \$198 million for FY21/22.

A full analysis is [posted here](#).

The **Province of Saskatchewan is projecting a \$2.6 billion deficit in FY21/22**, notably deeper than the \$1.9 billion shortfall now expected in FY20/21. The deterioration comes as spending ramps up sharply this fiscal year in response to COVID, offset partly by improved revenues. That marks a record high deficit for the Province, but it's still manageable at roughly 3.2% of GDP. As a reminder, deficits pushed 7% of GDP in the early 1990s, when the fiscal situation was severely stressed, and neighboring Alberta is currently facing a shortfall that weighs in at 5.4% of GDP. The longer-term fiscal outlook has deteriorated significantly versus last year's plan, with a \$770 million deficit persisting by FY24/25 and a return to a balanced budgets by FY26/27.

A full analysis is [posted here](#).

#### Borrowing (FY20/21). Based on latest official update.

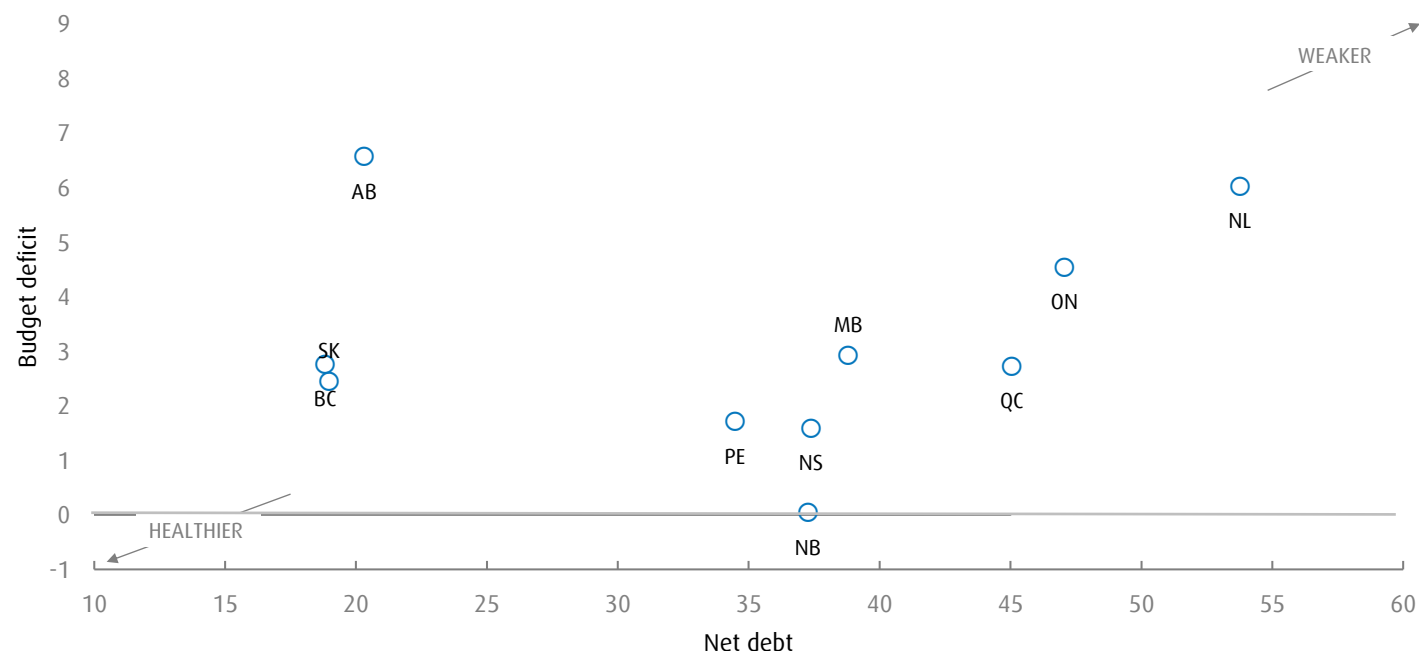
Province	Funding Requirements (\$ mlns)					Credit Ratings		
	Re-financings	Net Borrowing	Total	Remaining	% funded	S&P	Moody's	DBRS
British Columbia	2,866	11,565	14,431	-309	102	AAA**	Aaa	AA (high)
Alberta	4,930	22,899	27,829	-1,324	105	A+**	Aa3	AA (low)**
Saskatchewan	1,440	3,106	4,546	-475	110	AA	Aaa**	AA (low)
Manitoba	3,674	3,255	6,929	-816	112	A+	Aa2	A (high)
Ontario	26,064	41,336	67,400	-6,100	109	A+	Aa3	AA (low)
Quebec <sup>1</sup>	13,320	32,779	46,099	-5,292	111	AA-	Aa2	AA (low)
New Brunswick <sup>2</sup>	1,365	872	2,237	22	99	A+	Aa2	A (high)
Nova Scotia <sup>3</sup>	930	1,220	2,150	-187	109	AA-	Aa2	A (high)
Prince Edward Island	100	150	250	-7	103	A	Aa2	A
Newfoundland & Labrador <sup>4</sup>	692	2,508	3,200	0	100	A**	A1**	A (low)**
All Provinces	55,382	119,690	175,071	-14,490	108			

Including: <sup>1</sup> Financement Quebec and Hydro Quebec (CY); <sup>2</sup> guaranteed NB Electric and NBMFC; <sup>3</sup> NSMFC; <sup>4</sup> NL Hydro

\* Pos. outlook; \*\* Neg. outlook

#### Provincial Fiscal Landscape (based on latest fiscal updates)

% of GDP, FY20/21



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