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Market View – Ontario & Quebec: Two (funding) solitudes?

By Warren Lovely

Ontario and Quebec: Canada's two most populous provinces; sharing a lengthy border; home to large and outwardly focused industrial sectors; earlier laid low (like everyone) by COVID; fighting desperately to stay open and contain the virus in the face of resurgent case counts; seeking additional federal support for health care; pledging meaningful support in their own right for hard-hit households and businesses; running sizeable deficits; adding to already elevated debt loads; requiring multiple years (five or more) to get to balance… We could go on. Let's just say you can and will find more than a few commonalities when examining these two provincial jurisdictions. But there are also some key distinctions. And no, we're not talking about language and culture or who happens to be home to the better professional hockey team. (Sorry Sens fans, this really comes down to the Buds vs. Les Habs.) A few quick distinctions drawn from fresh updates:

Budget deficit: Ontario, with a projected deficit of $38.5 billion or 4.5% of GDP, expects to spill relatively more red ink in 2020-21. Quebec puts its budgetary shortfall at $15 billion or 3.4%, prior to the use of a stabilization reserve. Both have incorporated meaningful prudence, owing to elevated economic uncertainty and a worrisome trajectory for the virus. Ontario has a $2.5 billion reserve and residual contingences of $2.6 billion for 2020-21; Quebec has a $4 billion provision for risks and/or additional supports, with four and a half months to go in the fiscal year.

Back to balance & debt targets: Quebec has identified a structural gap of $5.5-7.0 billion, which it aims to tackle over five years. Quebec admits it will be difficult to achieve a legislated debt target of 45% gross debt-to-GDP by 2025-26. The corresponding act will be reviewed near term. Ontario's fresh budget sees the deficit still around 3% of GDP and net debt-to-GDP approaching 50% come 2022-23. Ontario's next budget (due before March 31, 2021) is to offer a timeline on getting to balance. We provided some related scenario analysis the other day.

Size of this year's borrowing program: Ontario has a $52.3 billion long-term borrowing need for 2020-21, which is 6.2% of GDP or roughly $3,500 for every citizen. Despite a relatively smaller deficit, Quebec's long-term funding need is proportionately a bit larger (7.4% of nominal GDP; ~$3,800 per capita). In either case, we're talking about a big-time step up in funding relative to pre-COVID days. Call it a 30% increase for Ontario and a >60% surge for Quebec when stacked up against completed borrowings from 2019-20.

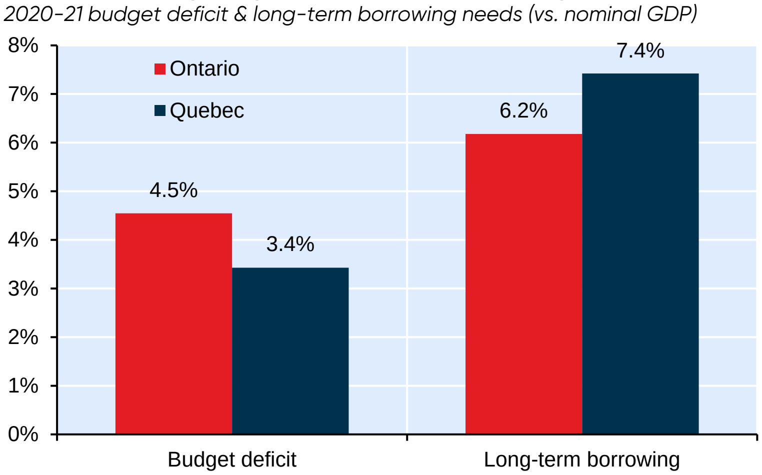
Borrowing status: Both Ontario and Quebec are ahead of schedule at what is the 62% mark of the fiscal year. Quebec, in particular, is way out in front of its program, having completed 90% vs. more like 70% for Ontario. Mind you, both are adept at getting big chunks of change in the door quickly. So don't blink, or else you might miss a green banner and/or international bond trade that vaults funded status ahead.

Use of international markets: There's a not-so-subtle distinction to be made here. Quebec has relied on international markets to a larger extent relative to its pre-COVID tendency and what we're seeing in Ontario. Quebec has so far sourced 42% of its funding from non-CAD markets, secured via large USD and EUR trades (two apiece). Ontario has stuck closer to home (in relative terms), as the domestic share of completed funding sits at the upper end of a loose 70-80% target range. Of course, as Gadi Mayman just reminded us in his fresh CEO's Corner: *"Foreign currency borrowing helps reduce Ontario's overall borrowing costs and ensures the government will continue to have access to capital if domestic market conditions become more challenging. Ontario will also continue to regularly borrow in currencies other than the Canadian dollar to ensure the continued diversification of its investor base."*

Future-year needs: Lastly, we'd note that both Ontario and Quebec have projected *smaller deficits* but *larger borrowing needs* for 2021-22. Ontario puts next year's long-term program at $58.6 billion (+12%), while Quebec tells us there's $35.3 billion to do (+9%). We will obviously need to see what other provinces are thinking in terms of next year's funding needs. But at this point, with the two most populous provinces flagging larger requirements, 2021-22 is destined to be another outsized year of provincial bond issuance. We currently place aggregate long-term needs in the $140-170 billion range or about double the pre-COVID annual issuance pace. With so much to do, you can bet both Ontario and Quebec will be keen to get a jump start via prefinancing. Quebec, it would appear, could be doing just that in no time at all.

Chart 1: Weighing deficits & borrowing needs

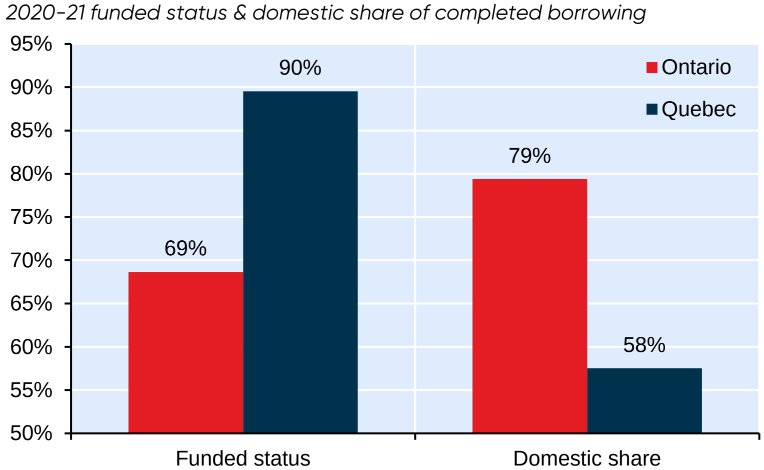
2020-21 budget deficit & long-term borrowing needs (vs. nominal GDP)



Source: NBF, Ontario, Quebec | Note: Deficit includes prudence; Quebec balance before ~$12 billion use of stabilization reserve

Chart 2: Assessing funding progress & strategy

2020-21 funded status & domestic share of completed borrowing



Source: Source: NBF, Ontario, Quebec | Note : As at 12-Nov or 62% market of fiscal year

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