

Quick Hit – Trading Ontario and Québec in and around elections

Ontario elections are just around the corner and the last few months have provided us with their fair share of unexpected surprises, disturbing the usual steady state to say the least. Whereas Québec has historically been the driver behind pre-election spread jitters, things could be—and up until now are—very much different this time around.

For starters, it will be the first time that an election in Ontario will be held before the one in Québec since 1989-90—aside from the timing interference in 2011-12 related to Québec's 2008 snap election. This subtlety has generally led the Québec vs Ontario relationship to hover around the tightest levels in and around an Ontario election, with the relationship likely having had time to rebound from the peaks brought about by uncertainties surrounding the Québec vote.

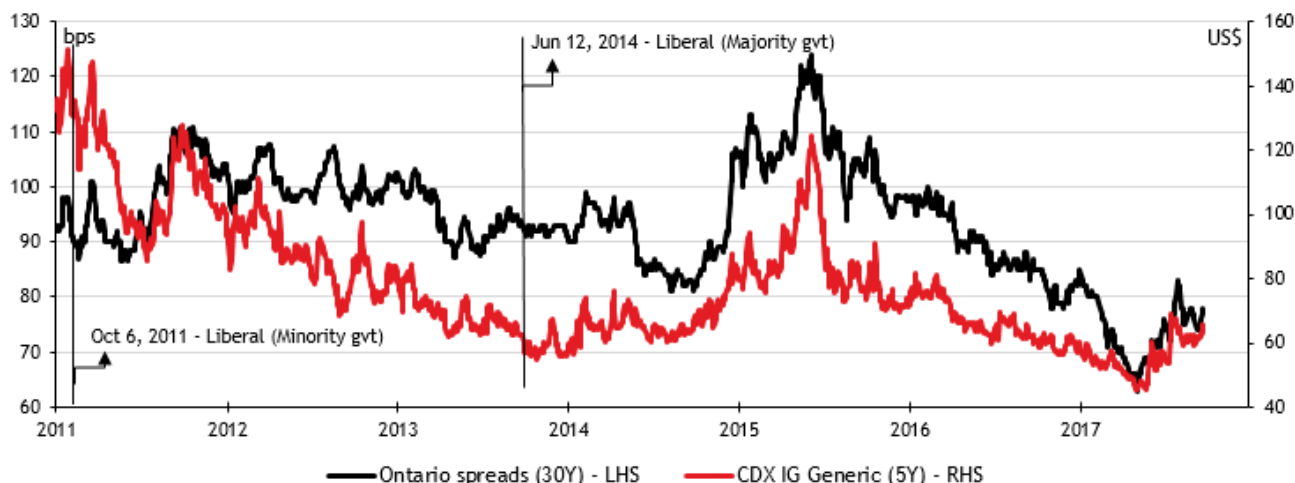
To that point, Québec spreads have never been as tight relative to Ontario's as they currently are. This reinforces the fact that Ontario spreads are cheapest to Québec's prior to an Ontario election (and Québec spreads cheapest to Ontario's before a Québec election), but currently for different reasons than we usually encounter. As such, Ontario has been plagued with some negative headlines of late, from a chosen return to deficit to public accounting debates surrounding pensions and Fair Hydro relief, having in turn resulted in corresponding credit noise that generated some attention.

Looking back at historical data, Ontario's absolute and relative spreads have usually not proven very volatile in the early stages preceding an election, controlling for the broader corporate credit environment as illustrated by the IG index—excluding the 2011 campaign that took place in a raging European debt crisis (Chart 1). This is in sharp contrast to the disturbance to which Ontario spreads were subject this year, now trading around their widest levels to Québec's and even giving rise to an appreciation in other provincial credits. As such, the aforementioned rationale led some of the Maritime provinces' spreads to outperform vs Ontario's, aided by investors' appetite for non-Ontario product. An improved price for crude oil further brought about oil-levered provinces' spreads to appreciate relative to Ontario's, with 10-year Alberta spreads for instance now standing 1bp through Ontario vs 5bps over back in early April only. As an aside, while we have typically not observed volatility in either of Alberta's or British Columbia's spread differentials to Ontario around previous elections, it will be interesting to observe the political landscape as we approach Alberta's May 2019 vote. In the same way, we will also be monitoring a minority government situation in British Columbia.

Again based on our analysis of past spread movements, the largest shifts in relative spreads have usually occurred in the three to four month period preceding an election (Chart 2), especially for Québec—but note that the PQ now trailing far behind in voters' intentions could generate less turmoil in and around the next election, set for October 1st. If history is any guide, it would be around this time of year, i.e. in the three to four month period preceding a Québec election, that we would start to see underperformance of Québec spreads *vis-à-vis* Ontario. While we can't rule out political noise in Québec, there's at least as much noise pertaining to Ontario now. At the end of the day, if a cheapening in Québec to Ontario spreads was nonetheless to happen, they remain two provinces with highly distinct economic risk profiles, on path to very different fiscal and rating trajectories, all in all leaving us more constructive on Québec spreads from here onward.

Chart 1: Global credit backdrop through recent years

Ontario 30Y spreads in light of the 5Y Generic CDX IG index

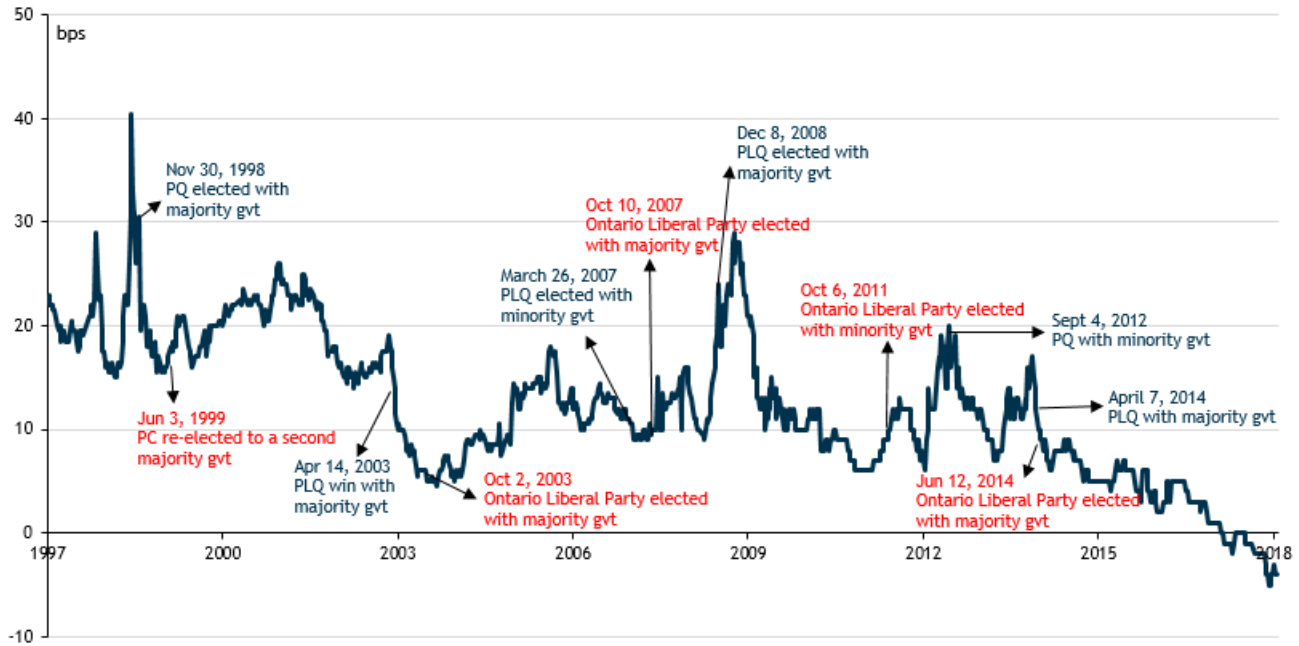


Source: Bloomberg, NBF

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Chart 2: Historical election outcomes in Québec and Ontario

Québec vs Ontario 30Y indicative issuance spread relationship



Source: Provinces of Ontario and Québec, NBF

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