

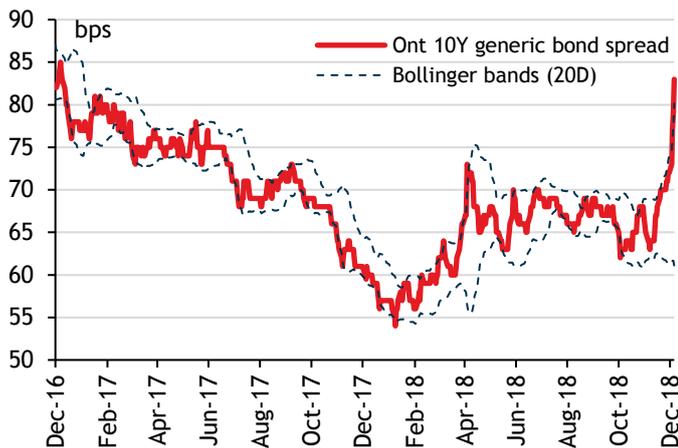
Quick Hit – A near-4 std dev move in provi bonds... violent in the extreme

Disclosure: We offer this note from the relative tranquility/safety of a Strategy desk. There's a generalized and wholly unflattering tendency amongst economists and strategists (in Canada and elsewhere) to pound the table, making bold pronouncements and recommendations without having to actually put their view on the line, at least in terms of direct P&L. So what we offer here is submitted humbly. We can certainly understand the reluctance to stick one's neck out in such an overtly volatile market. But...

The absolute and relative cheapening of provincial credit has been beyond extreme. The spread on Ontario's 10-year benchmark bond—one of the more liquid instruments in Canadian debt capital markets—has blown out 20 basis points in 20 days (Chart 1). We've shaken so far out of the earlier tight trading range that 50-day Z-scores on provincial spreads are near 4! In other words, there's been a roughly 4 standard deviation cheapening of provincial credit spreads based on the last 50 days of trading, which would take us back to early October and the onset of financial market volatility. Let's just say that moves of this magnitude are rare. Looking back over the ~2,500 days of post-crisis trading history, you'll find just 6 instances (0.24% of total observations) where Ontario 10s registered a relatively larger deterioration (on the basis of 50-day Z-score at least) (Chart 2). Again, we get it, things are U-G-L-Y out there. But the relative widening of provincial credit has been at least as significant... in fact more extreme... that what we've witnessed in other bond market sectors or in other asset classes (Chart 3). For those with sufficient verve then, the balance sheet return on provis just got a whole lot more compelling.

Chart 1: 20 bps in 20 days... seriously extreme!

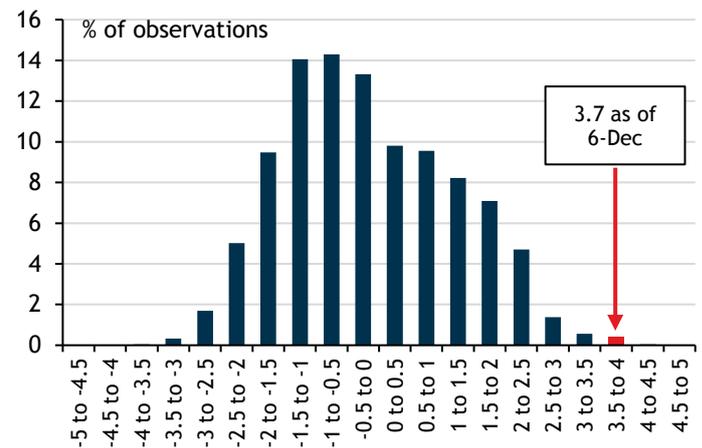
Ontario 10Y generic benchmark bond spread vs GoC



Source: NBF, Bloomberg

Chart 2: We don't see moves like this often

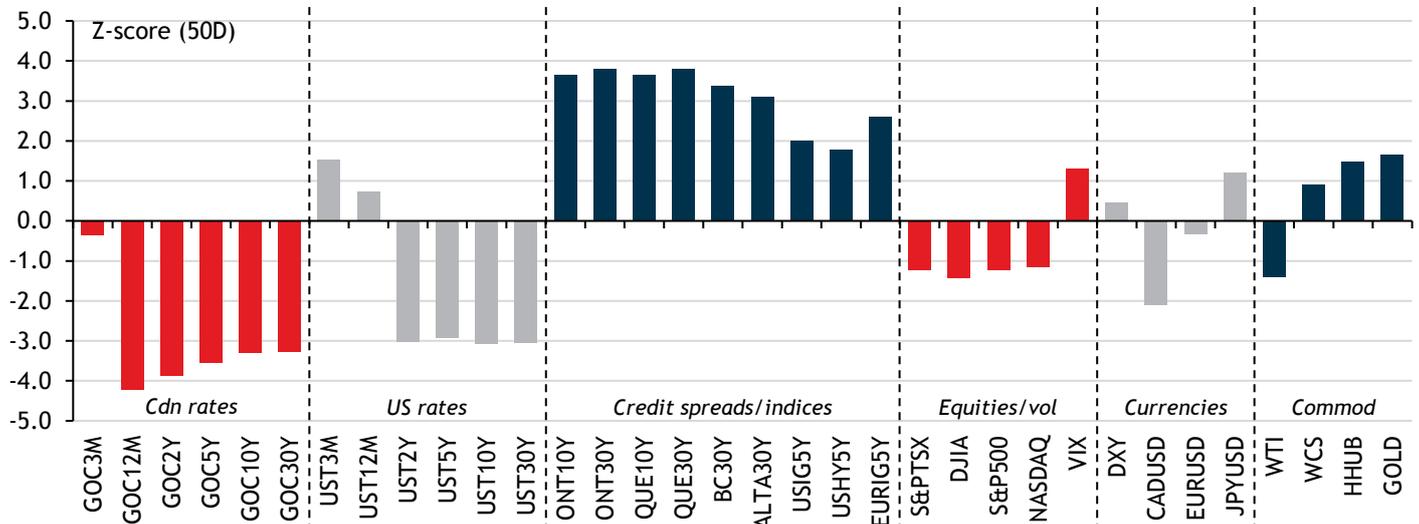
Distribution of 50-day Z scores on Ontario 10Y benchmark spreads



Source: NBF, Bloomberg | Note: Based on daily Z-scores for post-crisis period

Chart 3: Re-pricing of provincial credit even more extreme than other assets/sectors

50-day Z-scores for selected assets/securities (as at 6-Dec, 11:00 EST)



Source: NBF, Bloomberg

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