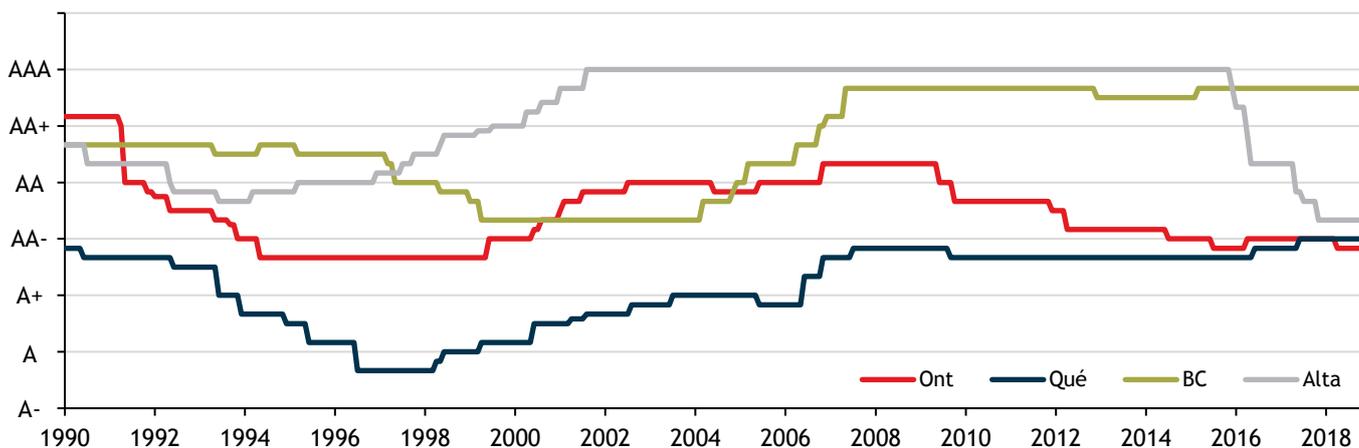


Quick Hit – Ontario suffers another credit rating downgrade

Yesterday afternoon, Moody’s downgraded the long-term rating of the Province of Ontario from Aa2 to Aa3. The outlook on the rating was changed from “Negative” to “Stable”. As per Moody’s, the downgrade “reflects the fiscal challenges facing the province over the medium-term... with further deficits to follow which Moody’s forecasts will result in a deterioration of key financial metrics over the next 3-5 years.” The downgrade wasn’t all that surprising, and is hardly the first for Ontario. It’s the second knock by Moody’s, with S&P having likewise erased two notches from Ontario’s rating since the global financial crisis. Meanwhile, DBRS and Fitch have each downgraded the province once. And this might not be the last ratings hiccup either. Recall that Fitch placed Ontario on “negative” outlook back in June and as recently as September warned that a revised accounting approach (brought about by a change of government) had “swelled” the deficit. Fitch, like us and virtually every provincial bondholder out there, is still waiting on a detailed fiscal plan from the new Progressive Conservative government, including the mechanics of and timeline for deficit reduction. Regardless of where you place the blame politically, the Moody’s downgrade of Ontario is a reminder that running a hefty deficit at a mature stage of the economic cycle, and carrying a near-record debt burden when interest rates are normalizing, puts your credit ratings and bond spreads in jeopardy. Indeed, Ontario’s steady deterioration in its average credit rating (Chart 1) speaks to a structural erosion in Canada’s largest province. Add in downgrades in Alberta and some other jurisdictions and the weighted average provincial credit rating is now the weakest it’s been since a methodology change was enacted a dozen years ago. To be fair, some provinces are doing well. Nonetheless, a heavily indebted and less fiscally sustainable provincial government sector remains something of a weak link here in Canada. As it happens, that message was reinforced by today’s Q3 national balance sheet accounts, which extended a record gap in gross debt burdens between Ottawa and the lower levels of government (Chart 2).

Chart 1: Ontario’s credit rating takes another step down

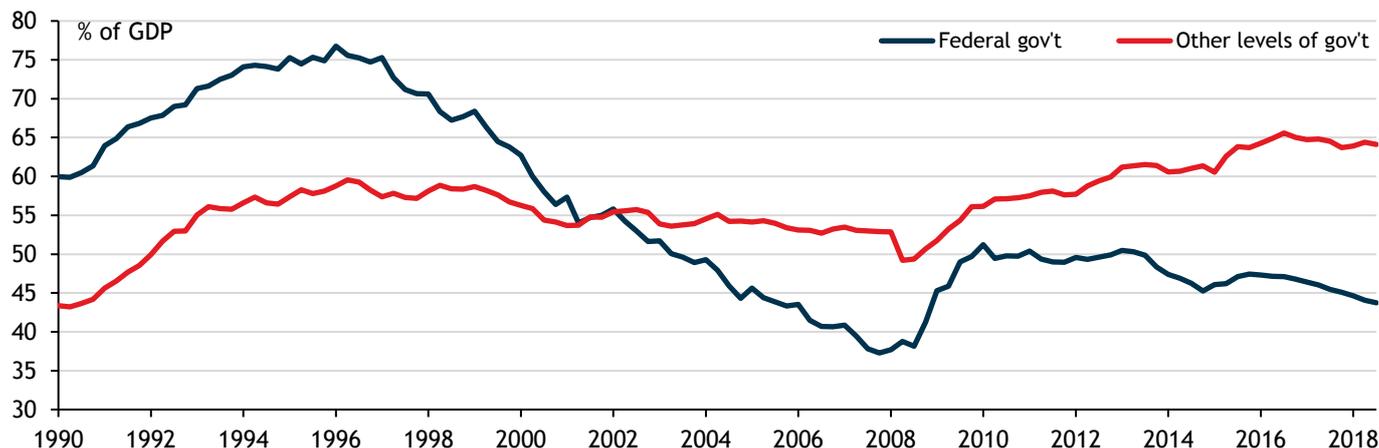
Average long-term provincial credit rating (S&P, Moody’s, DBRS)



Source: NBF, S&P, Moody’s, DBRS | Note: Incorporates “positive” and “negative” outlooks where applicable

Chart 2: Gross debt burdens growing apart in Canada’s government sector

Gross debt burden (book value): Federal government vs other levels of government



Source: NBF, Statistics Canada

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