

Quick Hit – Signs of delayed underperformance in provi credit?

To say we have seen outsized provincial issuance in the last month or so would be an understatement. After all, \$10 billion of new fixed domestic provincial issues came to the market in February alone (more than double Feb-18's \$4.4 billion), exacerbating the usual pattern of increased provincial issuance as borrowers line-up ahead of Budget season. And if you're like us, you'll be quick to associate the notion of *pattern* with that of *seasonality*, the studying of which we gladly undertake from time to time.

As previously hinted, we typically observe a significant tally of provincial new issuance in the lead-up to Budget season. Interestingly, however, this abundance of supply is typically well digested by markets, as evidenced by monthly averages of 10-year Ontario secondary market spread levels between 2012 and 2018. As such, they usually remain mostly stable in February before contracting by some 1 bp in March, supporting the idea that investors are likely eager to take on additional supply as they come out of usually quieter December and January months.

In sharp contrast, 10-year Ontario spreads usually widen by 1.5 bps on average in April. Unsurprisingly, this "Spring time" underperformance is concurrent with provincial borrowers emerging from their respective Budget-related blackout period and effectively kicking into gear the issuance machine for the new year. Simply put, provincial spreads are likely to underperform in that context, perhaps a function of investors anticipating the upcoming stream of issuance to hit the street in the weeks/months ahead.

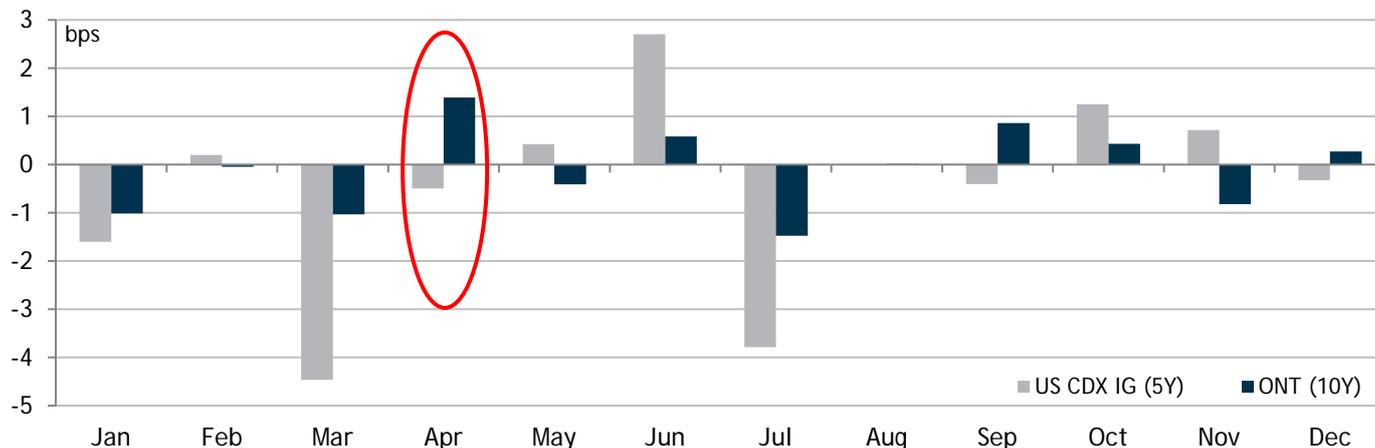
This tends to be corroborated by the fact that provincial spreads tend to underperform relative to other credit indicators in April, including the highly tracked US CDX IG (5Y). In fact, between 2012 and 2018, the 5-year US IG typically tightened by about 0.5 bp in April whereas 10-year Ontario spreads widened by ~1.5 bps. In other words, provincial spreads underperformed on average in April since 2012, *despite* the overall risk-on sentiment. Likewise, we would direct you to our colleague's earlier work on [seasonality](#) back in January (using average monthly constant maturity spread levels since 2010), which presents the same overall idea of April underperformance in provincial spreads, both relative to other months of the year as well as to the US IG and generic deposit notes.

Some technical factors could however hint to a different outcome this year. For one, Ontario's Budget is set to be released on April 11th, which could be qualified of a "late" budget by the province's standards. To that point, half of Ontario's budgets since 2010-11—inclusive of Budget 2019—has been released in either February (1x) or March (4x). That said, the province is unlikely to produce as much supply in April as has been the case in some prior years, which could in turn moderate the usual drift wider seen on spreads. Secondly, Alberta's Premier just called a provincial election on April 16th, with the associated blackout period—pre- and possibly post-election in the event of a change in government—potentially refraining spreads' widening shift in April.

With two out of our three largest provincial borrowers possibly on the sidelines—or issuing less—for some time in April and/or May, we could consequently see the typical issuance parade being delayed. In turn, this could impact the seasonality patterns we have grown accustomed to. Could this be a sign that provincial underperformance could be delayed into some later months this year? We think so. And suffice to say that if the interest rate environment remains as favorable for borrowers as it is now—~75 bps rally in 10-year Ontario yields since November—provincial borrowers will have all the more reasons to resume tapping the markets in full force once Budget releases and election are behind us.

Chart 1: Ontario spreads typically underperformed in April since 2012...relative to credit as well

10Y Ontario and 5Y US CDX IG spreads based on monthly averages since 2012



Source: NBF, Bloomberg

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