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Provincial funding in overdrive

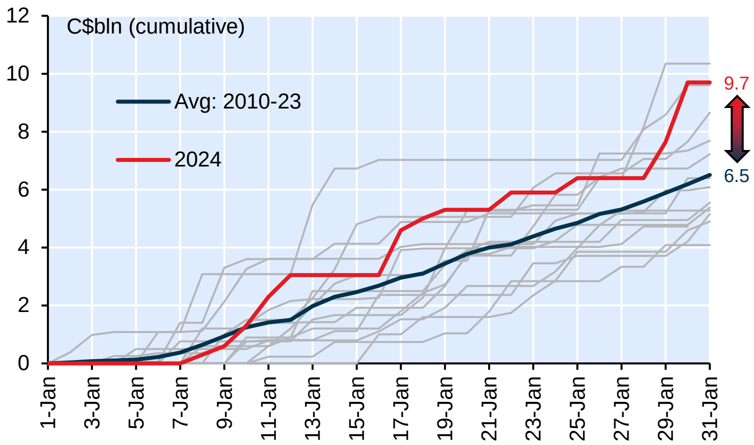
By Warren Lovely, with assistance from Marc-Olivier Archambault

It's not every month that Canada's provinces succeed in lifting nearly $20 billion from debt capital markets. In a so-called 'normal' month, more like 7 yards of gross provincial bond supply might be expected. So what we just bore witness to (in January) is both extraordinary and quite beneficial for a provincial government sector where the annual budget season is approaching.

Breaking down provincial supply

In the domestic (i.e., CAD) market, the provinces secured just under $10 billion in new term funding in January. While that wasn't technically a record for the first month of the year, it was nearly 2 standard deviations above the post-GFC mean (Chart 1). (If you're really keeping score, January 2024 ranks as the 10th largest month of domestic provincial supply in the post-GFC era.)

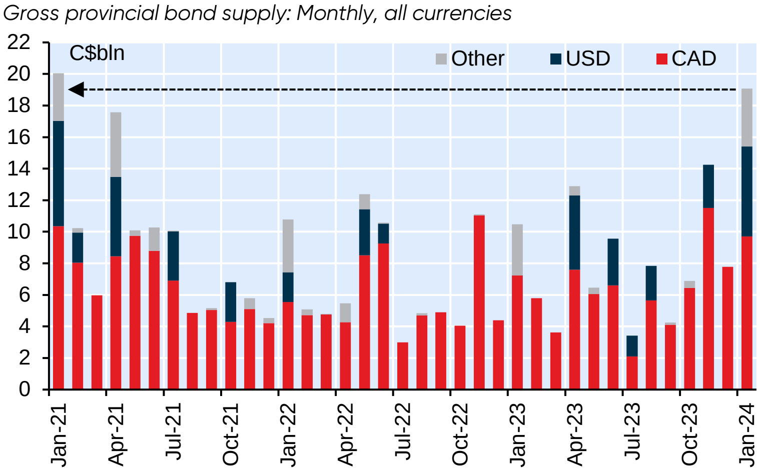
Chart 1: A *very* productive month for provi bond issuers…
Evolution of provincial gross domestic bond supply: Month of January



Source: NBF, BBG | Note: Grey lines represent past Januarys, from 2010-23

To this already sizeable domestic issuance tally, a further $9 billion (CAD equivalent) in international bond proceeds was added. It took just four international trades—two apiece in USD and EUR—to secure all that foreign currency liquidity, the average international trade netting ~4X vs. the representative domestic deal.

Chart 2: … raising ample cash at home and abroad…
Gross provincial bond supply: Monthly, all currencies



Source: NBF, BBG | Note: International issues converted to CAD at prevailing FX rates

Across all currencies then, January's grand total surpassed $19 billion (CAD equivalent). That's the single busiest month of gross provincial bond supply in three years (Chart 2) and ranks as the third-largest all-currency tally ever. Moreover, it comes just two months removed from another meaningful lift (in November 2023), highlighting the determination on the part of provincial governments when it comes to securing needed financing. More on that in a moment.

Assessing the spread reaction

In what some may feel is at odds with conventional wisdom, January's abundant bond supply coincided with *tighter*, not *wider* provincial credit spreads.

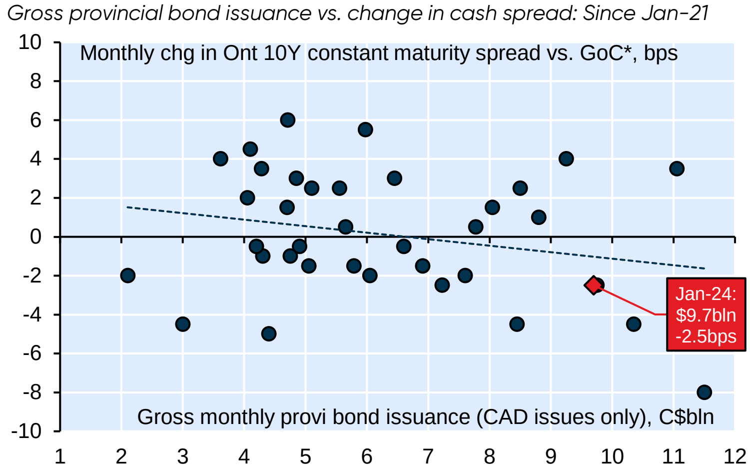
We don't entirely discount supply as a long-run valuation driver, and we tend to view the supply impulse as a (partial) determinant of inter-credit relationships (e.g., provis vs. crowns/PSEs/corps, or one province vs. another).

Still, as we've routinely argued, provincial issuers are sophisticated enough and nimble enough to leverage positive market tone. In the simplest of terms, that regularly means issuing into strength, when and where investor demand exists.

To us, it's hardly surprising that, as often as not, big-time supply months are associated with firm(er) spreads (Chart 3). That was the case in January, as provinces unearthed broad and deep demand for their paper. If anything, 10-year provincial credit outperformed key credit/risk proxies in January (e.g., US IG CDX).

Nor did the provinces need to sacrifice significantly on preferred term to get meaningful supply in the door. The weighted average term of new CAD issues hovered at 16 years in January, more or less in line with the prior 12-month trend.

Chart 3: … with little evidence of supply indigestion…
Gross provincial bond issuance vs. change in cash spread: Since Jan-21



Source: NBF, BBG | Note: Sprd chg based on EOM levels; monthly data Jan-21 to Jan-24

Who was issuing (and who was not)

Last month's super-sized issuance tally is made even more impressive by the fact that Canada's second-largest province—Quebec—remained on the sidelines. Having essentially attained fully funded status for the 2023-24 fiscal year, Quebec brought no supply in neither December nor January. Pop quiz: When was the last time Quebec went back-to-back months without tapping the domestic bond market? By our count, that was back in late 2015-early 2016. As it stands, Quebec's $21.9 billion gross requirement for fiscal 2023-24 is 97% funded with still two months to go (or a bit less if you control for a prospective budget blackout period).

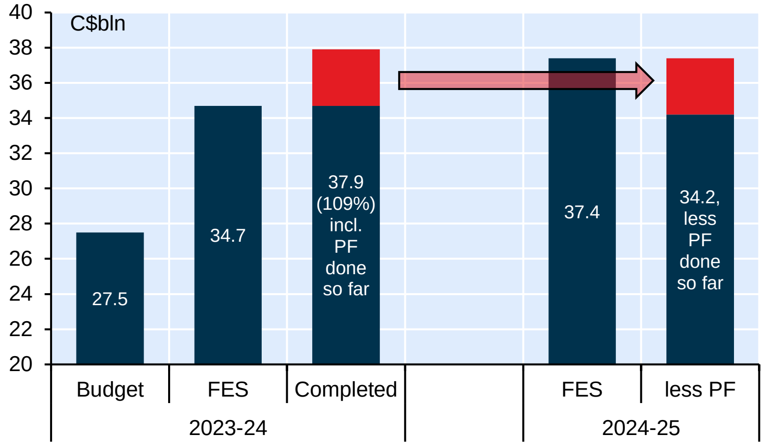
Making up for Quebec's absence (or perhaps taking advantage of it), every other province (i.e., 9 of 10) tapped debt capital markets in January… be it in fixed or floating format, either at home or abroad.

Ontario, not surprisingly and to its credit, has been particularly active of late. After securing an eye-popping $11+ billion via seven trades in January, Ontario has quickly vaulted itself into pre-funded status. Note: With $37.9 billion raised against 2023-24's $34.7 billion gross long-term borrowing requirement, Ontario would today characterize its bond program as 109% funded (Chart 4). Other provinces have pushed into pre-funded territory too. British Columbia, for example, has utilized international markets (including a benchmark EUR trade in January) to propel the borrowing program forward.

We would note that 'official' provincial borrowing requirements are subject to change. Even this late in the fiscal year, budgetary figures (and a government's resulting cash position) can/will change. In some cases, non-trivial prudence needs to be controlled for, which could be drawn down or released if not needed. Certain non-budgetary items and a province's capital plans (including major project timing) are likewise subject to revision. And while a vital source of financing, long-term debt isn't the sole means of funding available. As is customary then, we will look to upcoming budgets when refining provincial borrowing requirements, the focus quickly shifting to the gross funding needed for the upcoming 2024-25 fiscal year (which commences April 1st).

Chart 4: … leaving some advantageously positioned

Ontario borrowing requirement vs. completed funding: 2023-24



Source: NBF, Ont | Note: Includes pre-funding to 31-Jan-24; req'ts subject to change

We won't minimize revenue risks linked to a slow-growing economy. Nor should spending pressures at the provincial level be overlooked. But as Ontario and some others have nicely demonstrated, being proactive with your borrowing program can create important flexibility for what remains a highly uncertain outlook. We'd look for this debt management philosophy to carry into February, where a healthy supply tempo should be expected.

Table: Provincial borrowing status update, with two months left in fiscal year

NBF provincial borrowing program update: 2023-24 fiscal year (April 2023 to March 2024)

Province / Agency	Ticker	Required [a] C$bln	Required [a] C$/per capita [b]	Completed [c] C$bln	Domestic %	Foreign %	Remaining C$bln	Funded Status %
British Columbia[d]	BRCOL	12.53	2,321	14.67	43%	57%	0.00	117%
Alberta	ALTA	5.40	1,162	3.78	52%	48%	1.62	70%
Saskatchewan	SCDA	1.96	1,616	1.99	100%	0%	0.00	101%
Manitoba	MP	5.20	3,632	4.32	70%	30%	0.89	83%
Ontario[e]	ONT	34.70	2,255	37.91	84%	16%	0.00	109%
Québec[f]	Q	21.92	3,063	21.17	66%	34%	0.75	97%
Hydro-Québec[g,h]	QHEL	5.00		3.80	100%	0%	1.20	76%
New Brunswick[i]	NBRNS	1.96	2,374	1.50	100%	0%	0.46	77%
Nova Scotia	NS	2.03	1,956	2.00	100%	0%	0.03	99%
Prince Edward Island	PRINCE	0.25	1,437	0.20	100%	0%	0.05	80%
Newfoundland & Labrador[j]	NF	2.20	4,136	1.80	100%	0%	0.40	82%
TOTAL		**93.2**	**2,362**	**93.1**	**73%**	**27%**	**5.4**	**100%**
							% FY elapsed:	*84%*

Notes:
a) Long-term gross funding requirement based on latest available estimates; includes refinancing requirements; excludes prospective pre-funding for coming fiscal year
b) Per capita needs based on 2023:Q1 population estimates from StatCan (i.e., population at start of fiscal year)
c) Funds borrowed to date
d) Budget req't refered to gross borrowing from all sources; Q2 provided guidance on long-term borrowing
e) Includes certain hydro-related financing under province's banner
f) Includes financing for Financement-Québec
g) Funds in own name with explicit provincial guarantee
h) Fiscal year is January – December; figures in table refer to calendar 2023; gross long-term requirement for calendar 2024 is again estimated at $5bln
i) Includes requirements for NB Municipal Finance Corp.
j) Includes funding for N&L Hydro
Source: NBF, prov gov'ts, BBG, StatCan

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

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