

Provincial credit quality on the defensive?

By Warren Lovely

The 2026 provincial budget season hasn't even started, yet the first rating downgrade has landed. Specifically, S&P downgraded Nova Scotia a single notch from 'AA-' to 'A+', maintaining a 'negative' outlook. Rather than unpacking this specific downgrade, we put provincial rating trends in

perspective. As to whether credit ratings even matter to investors, statistical analysis answers in the affirmative... at least when it comes to where provinces trade one vs. the other. Granted, relative liquidity counts for much, while political risk is a growing consideration for some.

Chart 1: Evolution of average provincial credit quality... from COVID pandemic through recovery to a 'new world order'

Weighted average provincial long-term credit rating score (CRS)

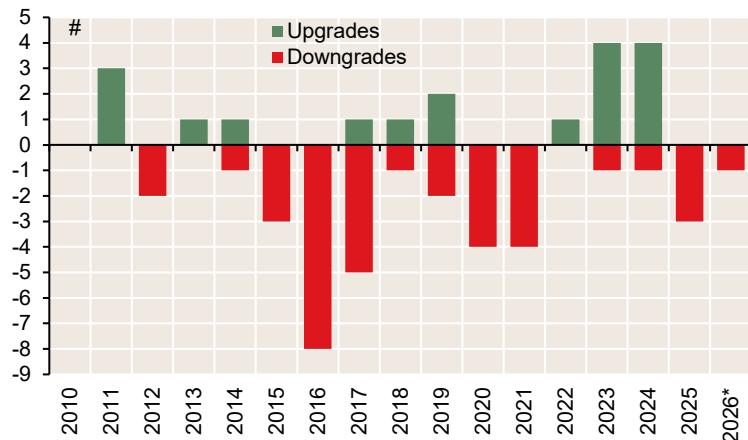


Source: NBC, S&P, Moody's, DBRS, Fitch, StatCan | Note: CRS is linear transformation of rating, controlling for outlook; re-weighted monthly using working age population; up to 27-Jan-26

On January 26th, S&P downgraded the Province of Nova Scotia a single notch from 'AA-' to 'A+', maintaining a 'negative' outlook. As per S&P, the downgrade reflected a "weaker budgetary position". Mind you, fiscal pressure is hardly unique to Nova Scotia, helping to explain why the weighted average provincial credit score has mostly given up the ground won during a post-COVID recovery. There will be much to digest in the upcoming budget season, but we expect provincial finances to remain under some strain. So this may not be the only negative rating adjustment delivered in 2026.

Chart 2: Counting upgrades & (more recently) downgrades

Count of provincial long-term credit rating upgrades & downgrades

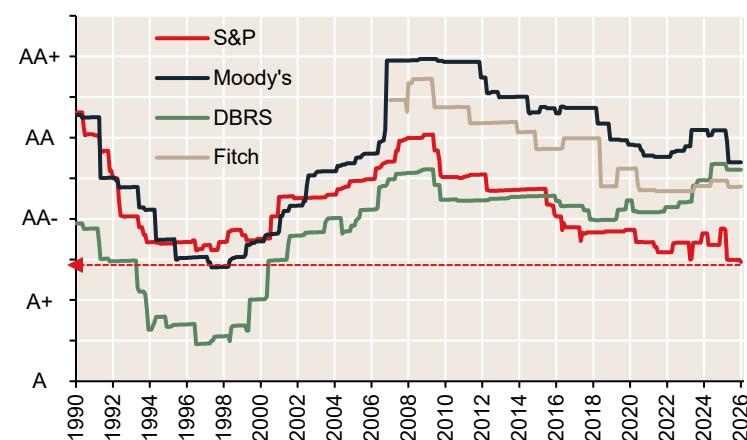


Source: NBC, S&P, Moody's, DBRS, Fitch | Note: 2026 is up to 27-Jan; simple count of number of rating notch upgrades and downgrades each calendar year

Building on three 2025 downgrades, the N.S. move highlights a deteriorating balance of provincial rating adjustments. At present, five of 35 provincial ratings are on 'negative' outlook, implying some risk of further ratings pressure after 2026 budgets are presented. Stay tuned. Of the major rating agencies, S&P has been more decisive (some might say proactive or bearish) when it comes to the provinces. Indeed, the weighted average rating S&P assigns to the provincial sector is now lower than at any time since 1990. At Moody's, by contrast, ratings pressure has much more contained.

Chart 3: S&P relatively more bearish (and/or proactive)

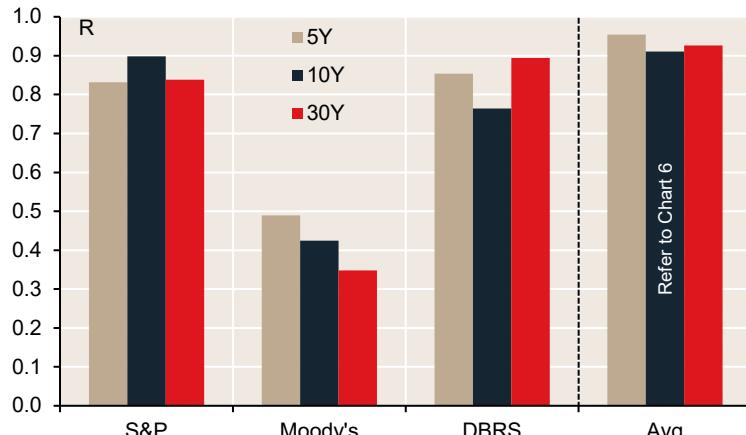
Weighted average provincial long-term credit rating by agency



Source: NBC, S&P, Moody's, DBRS, Fitch, StatCan | Note: 2026 is up to 27-Jan; re-weighted monthly based on working age population; Fitch avg starts 2007 & currently covers 5 provis

**Chart 4: Which set of ratings fits best with provi spreads?**

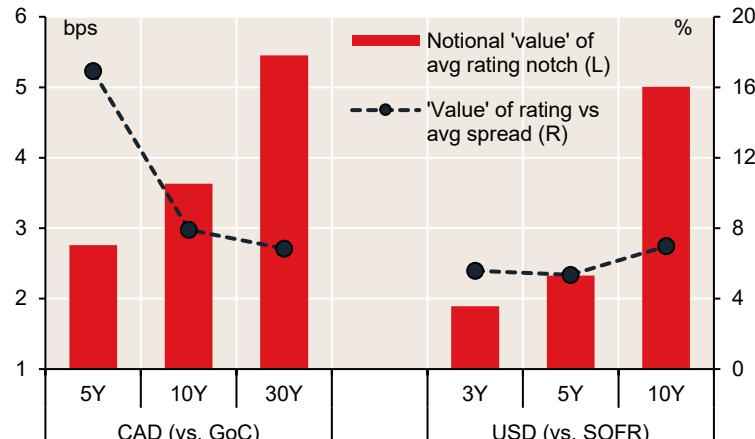
Correlation btw provincial long-term credit ratings & CAD spreads vs. GoC



Source: NBC, S&P, Moody's, DBRS | Note: Correlation between current ratings (controlling for non-stable outlooks) & CAD spread indications by tenor; as of 27-Jan-26

Chart 5: How much is a rating 'worth'? [Interpret with caution]

Estimated value of average credit rating notch, based on OLS regression analysis



Source: NBC, S&P, Moody's, DBRS, BBG | Note: OLS regression of current spread indications on average credit rating score, relative liquidity & political risk dummy; as of 27-Jan-26

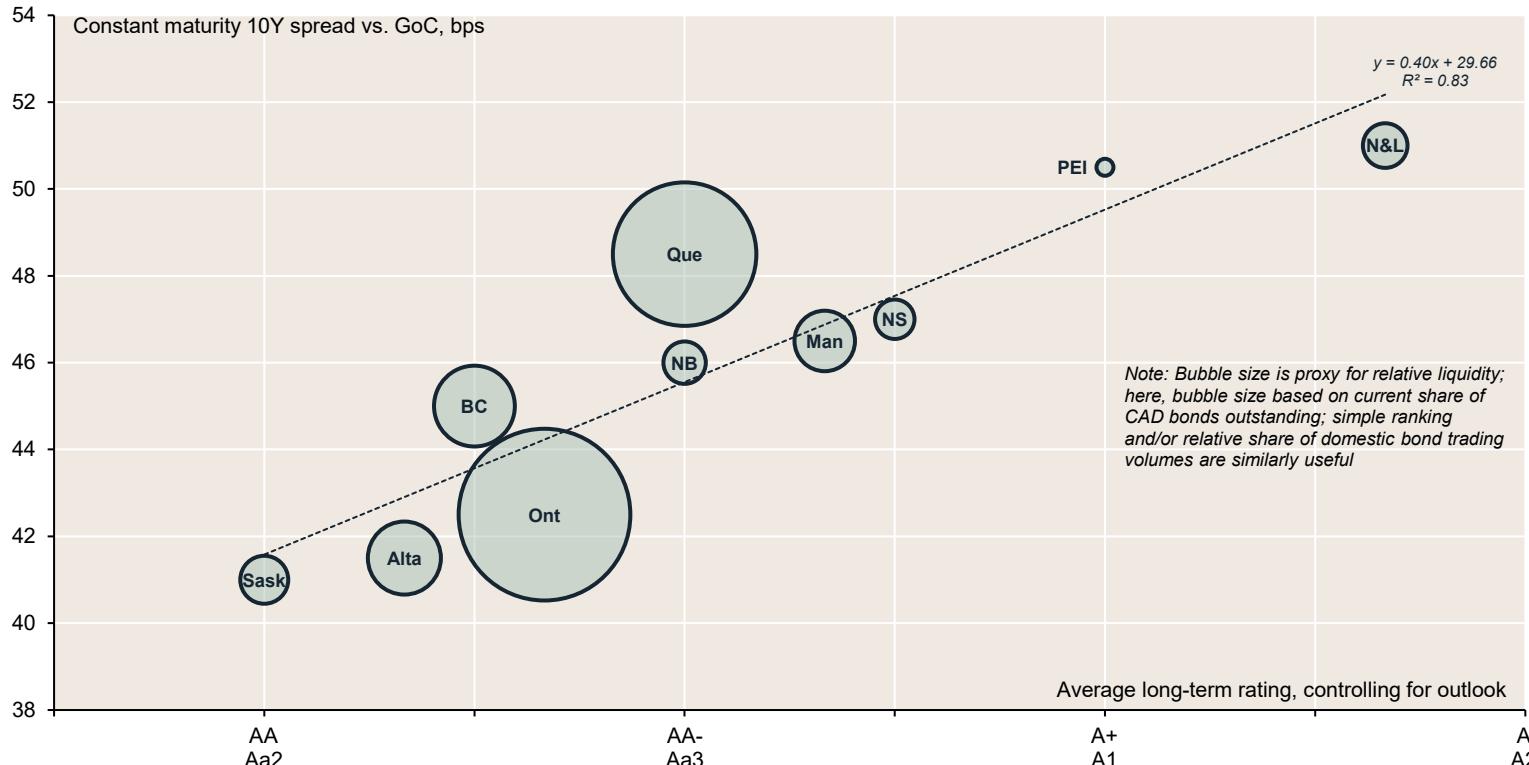
Time to ask the question: Do credit ratings even matter to provincial spreads? Not surprisingly, the answer is nuanced. Notwithstanding weaker budgetary performance and accumulating debt at the provincial level, Canada's federal government is leveraging up at an even faster rate. From a fundamental and technical perspective then, relative budget balances, debt trajectories and net bond supply dynamics support today's tight provincial spreads vs. the GoC curve. (To say nothing of the apparent wall of cash actively seeking marginal yield/carry across credit markets globally.)

Where ratings are arguably most useful is when valuing one province vs. another. It's still the case that ratings alone explain much of the dispersion in provincial spreads. Granted, some sets of ratings appear more useful than others. For example, provincial spreads are currently far more correlated with S&P rating scores than with the equivalent set of ratings assigned by Moody's.

As for how much a single rating notch might be 'worth', OLS regressions incorporating (among other things) ratings, liquidity and (if so inclined) political risk provide a rough guide. In the domestic bond market, each notch on an average rating might be worth ~5 basis points in the 30Y sector. Note that the ratings coefficient can be expected to expand/compress with the overall level of spreads. Given this, an average rating notch may be worth 7-8% of the underlying spread in CAD 10s or 30s (a higher ratio in 5s given tight underlying spreads). That is NOT to say a given rating change elicits that magnitude of re-pricing. Alas, markets are efficient and investor attitudes adjust more swiftly than credit ratings. But do credit ratings matter? Statistically speaking, they absolutely do.

Chart 6: Snapshot of provincial credit spreads suggests ratings matter (a lot)... as does liquidity and political risk too!

Average provincial credit rating (horizontal) & constant maturity 10-year CAD spread vs. GoC (vertical), with bubble size a proxy for relative liquidity: 27-Jan-26



Source: NBC, S&P, Moody's, DBRS | Note: Snapshot based on current spreads & ratings/outlooks; for each province, three ratings are averaged (with outlooks controlled for)

The above chart focuses on 10-year provincial spreads in the domestic (CAD) market. Vertically, we plot constant maturity indications vs. the GoC curve as of January 27th. A given province's average credit rating is expressed horizontally. Here, we use the simple average of the three ratings assigned by each of S&P, Moody's and DBRS, controlling for non-stable outlooks. (We exclude Fitch since they rate only half the provinces.) At present, average credit rating scores explain 83% of the differentiation in 10Y G-spreads. You can improve fit by controlling for relative liquidity (using simple rankings, outstanding bond stocks or secondary trading volumes). While not always relevant, political risk is an increasing consideration for some and may help explain current Quebec bond valuations. Putting it all together, average rating scores plus relative liquidity plus a political risk dummy can yield a R-squared as high as 97%. Relatively simple, yet arguably quite effective.



Excerpt: NBC's Provincial Ratings Snapshot as of 27-Jan-26 | Refer to our comprehensive Government Fact Sheet set for detailed notes

		Ontario	Quebec	British Columbia	Alberta	Manitoba	Saskatchewan	Nova Scotia	New Brunswick	Newfoundland & Labrador	Prince Edward Island
Ticker	Bloomberg bond ticker	Govt	ONT	Q	BRCOL	ALTA	MP	SCDA	NS	NBRNS	NF
	Bloomberg T-bill ticker	Govt	OHYD ONTB	QHEL FINQUE QTB	ALBCAP ALTATB	MPTB		NSMFC NVSCTB	NBMFC NWBRBTB	NFLAB NFMF NFTB	PRINCE
Long-term rating	AA-	A+	A+	AA-	A+	AA	A+	A+	A	A	A
Outlook	Stable	Stable	Negative	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable
Short-term rating	A-1+	A-1	A-1	A-1+	A-1	A-1	A-1+	A-1	A-1	A-1	A-1
Stand-alone credit profile (SACP)	aa-	a+	a+	aa-	a+	aa	a+	a+	a	a	a
Institutional framework				Very predictable & well-balanced — Applies to all provinces equally							
Economy	20%	V Strong	V Strong	V Strong	Strong	V Strong	Average	Average	Average	Strong	Strong
Financial management	20%	Strong	Strong	Strong	Strong	Strong	Strong	Strong	Strong	Strong	Strong
Budgetary performance	20%	Weak	V Weak	V Weak	Average	Average	Weak	V Weak	Average	Average	V Weak
Liquidity	20%	Exceptional	Exceptional	Adequate	Exceptional	Strong	Exceptional	Adequate	Exceptional	< Adequate	Adequate
Debt burden	20%	High	V High	High	High	High	Moderate	High	High	V High	High
Date of rating report	19-Jun-25	16-Apr-25	2-Apr-25	8-May-25	26-May-25	5-Jun-25	26-Jan-26	8-Apr-25	21-Jul-25	1-May-25	
S&P	Long-term rating	Aa3	Aa2	Aa1	Aa2	Aa2	Aa1	Aa2	Aa1	A1	Aa2
	Outlook	Stable	Stable	Negative	Stable	Stable	Stable	Stable	Stable	Stable	Stable
	Short-term rating	P-1	P-1	P-1	P-1	-	-	-	-	-	-
	Systemic risk assessment			Aaa — Applies to all provinces equally, based on Government of Canada rating							
	Baseline Credit Assessment: Indicated assign	a1 a1	a1 aa3	aa3 aa2	aa3 aa3	a2 aa3	aa2 aa2	aa3 aa3	a2 aa2	a2 a3	a1 a1
	F1: Economy	25%	3.64	4.22	3.56	3.31	4.10	2.96	5.23	5.87	3.86
	Regional income	15%	2.06	3.04	1.94	0.51	3.83	0.93	4.71	4.78	1.43
	Economic growth	5%	9.00	9.00	9.00	6.00	6.00	6.00	9.00	9.00	6.00
	Economic diversification	5%	3.00	3.00	3.00	9.00	3.00	6.00	3.00	6.00	6.00
	F2: Instl framework/governance	30%	2.00	1.00	2.00	3.50	3.50	2.00	1.00	1.00	2.00
	Institutional framework	15%	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
	Governance	15%	3.00	1.00	3.00	6.00	6.00	3.00	1.00	1.00	3.00
Moody's	F3: Financial performance	20%	5.00	7.66	9.29	6.03	7.94	6.87	8.10	4.93	7.00
	Operating margin	10%	7.28	9.66	12.20	5.50	12.03	9.91	8.62	6.53	7.02
	Liquidity ratio	5%	4.42	10.33	11.75	12.11	4.69	6.67	12.14	3.65	10.97
	Ease of access to funding	5%	1.00	1.00	1.00	1.00	3.00	1.00	3.00	3.00	3.00
	F4: Leverage	25%	12.75	11.39	8.14	8.85	13.58	9.26	8.05	9.10	14.70
	Debt burden	15%	12.91	10.65	8.49	8.53	14.97	9.74	7.26	9.03	13.53
	Interest burden	10%	12.52	12.51	7.62	9.32	11.50	8.54	9.23	9.20	16.45
	Preliminary BCA scorecard-indicated outcome	5.70 (a2)	5.74 (a2)	5.38 (a1)	5.29 (a1)	7.06 (a3)	5.03 (a1)	5.24 (a1)	5.03 (a1)	6.64 (a3)	5.58 (a2)
	Idiosyncratic notching	-	-	-	-	-	+1	-	+1	-	-
	Operating environment notching	+1	+1	+1	+1	+1	+1	+1	+1	+1	+1
	BCA scorecard-indicated outcome	4.70 (a1)	4.74 (a1)	4.38 (aa3)	4.29 (aa3)	6.06 (a2)	3.03 (aa2)	4.24 (aa3)	3.03 (aa2)	5.64 (a2)	4.58 (a1)
ESG	ESG Credit Impact Score (CIS)	1-5 (Pos-Neg)	CIS-2	CIS-2	CIS-2	CIS-3	CIS-2	CIS-2	CIS-2	CIS-3	CIS-2
	Environmental score (E)	1-5	E-3	E-2	E-3	E-4	E-3	E-3	E-3	E-4	E-3
	Social score (S)	1-5	S-2	S-3	S-2	S-2	S-2	S-3	S-2	S-3	S-2
	Governance score (G)	1-5	G-2	G-1	G-2	G-2	G-1	G-1	G-1	G-2	G-2
	Date of rating report	28-May-25	18-Jun-25	10-Apr-25	16-May-25	21-Aug-25	31-Jul-25	14-May-25	5-May-25	26-Aug-25	3-Sep-25
	Long-term rating	AA	AA(Low)	AA(High)	AA	A(High)	AA(Low)	A(High)	A(High)	A	A
	Outlook	Stable	Stable	Negative	Stable	Stable	Stable	Stable	Stable	Stable	Stable
	Short-term rating	R-1(High)	R-1(Mid)	R-1(High)	R-1(High)	R-1(Mid)	R-1(Mid)	R-1(Mid)	R-1(Mid)	R-1(Low)	R-1(Low)
Morningstar DBRS	Strengths	Large, diversified economy	Large, diversified economy	Diversified economy	Competitive tax regime	Diversified & resilient economy	Responsible fiscal policy commitment	Economic stability	Political commitment to fiscal discipline	Significant energy resources	Relatively stable economy
		Capacity to raise revenue	Low-cost hydro power generation	Fiscal capacity	Strong demographics	Demographics	Young & growing population	Prudent debt mgmt & structure	Significant liquidity via sinking funds	Low reliance on federal transfers	Prudent debt & liquidity management
		Effective borrowing platform	Diversified, well-established borrowing		Abundant oil & gas resources	Debt management	Diversified portfolio of GBEs	Strong liquidity position	Low unfunded pension liabilities	Wage certainty	Growing population
		Liquidity to manage risk				Abundant low-cost hydroelectricity					
	Challenges	Relatively high debt burden	High debt burden	Pace of spending growth	Eco concentration & market access	Elevated debt levels	Economic volatility	Collective bargaining adds to pressures	Economic growth uncertainty	Reliance on volatile commodity sector	Small size & eco concentration
		Global economic uncertainty	Aging population	High household indebtedness	Labour negotiations	High taxes & limited fiscal capacity	Revenue volatility	Relatively older population	Highly leveraged provincial utility	Elevated debt burden	Elevated debt burden
		Electricity system policy	Relatively high personal income tax	Affordability challenges		Eco uncertainties may impact deficit	Emissions & environmental policies	Energy transition costs	Moderate reliance on federal transfers	Weak demographics	Limited fiscal capacity
			US trade policy & slowing global demand	Rising debt burden		Increasing reliance on federal transfers			Weak demographics		Reliance on federal transfers
	ESG consolidated impact	Applicable: Y/N	N	N	Y (Relevant)	N	Y (Relevant)	N	N	N	N
	Environment factors	Y/N	N	N	Y (Relevant)	N	Y (Relevant)	N	N	N	N
	Social factors	Y/N	N	N	N	N	N	N	N	N	N
	Governance factors	Y/N	N	N	N	N	N	N	N	N	N
Fitch	Date of rating report	12-Dec-25	10-Jun-25	9-May-25	18-Sep-25	20-Nov-25	21-Jan-26	14-Nov-25	4-Jun-25	18-Jul-25	8-Jul-25
	Long-term rating	AA-	AA-	AA+	AA	-	AA	-	-	-	-
	Outlook	Stable	Stable	F1+	Stable	-	Stable	-	-	-	-
	Short-term rating	R-1	R-1	F1+	F1+	-	F1+	-	-	-	-
	Stand-alone credit profile (SCP)	a+	a+	aa	aa-	+1 notch					
	Support (ad hoc, via federal govt)	+1 notch	+1 notch	+1 notch	+1 notch		+1 notch				
	Risk profile	Stronger	Stronger	Stronger	Stronger	High Midrange		High Midrange			
	Revenue robustness	Stronger	Stronger	Stronger	Stronger	Midrange					
	Revenue adjustability	Stronger	Stronger	Stronger	Stronger	Stronger		Stronger			
	Expenditure sustainability	Midrange	Midrange	Midrange	Midrange	Midrange		Midrange			
	Expenditure adjustability	Stronger	Stronger	Stronger	Stronger	Stronger		Stronger			
	Liability/liquidity robustness	Stronger	Stronger	Stronger	Stronger	Stronger		Stronger			
	Liability/liquidity flexibility	Stronger	Stronger	Stronger	Stronger	Stronger		Stronger			
	Debt sustainability category	'bbb'	'bbb'	'a'	'aa'		'aa'				
	ESG relevance score	1-5 (Low-High)	3 (Neutral)	3 (Neutral)	3 (Neutral)	4 (Negative)		3 (Neutral)			
	Date of rating report	20-Jun-25	20-Jun-25	5-May-25	4-Jun-25		4-Jun-25				



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Subscribe to our publications:
NBC.EconomicsStrategy@nbc.ca

To contact us:
 514-879-2529

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

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

Jocelyn Paquet
 Senior Economist
jocelyn.paquet@nbc.ca

Kyle Dahms
 Senior Economist
kyle.dahms@nbc.ca

Alexandra Ducharme
 Senior Economist
alexandra.ducharme@nbc.ca

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

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

Taylor Schleich
 Rates Strategist
taylor.Schleich@nbc.ca

Ethan Currie
 Strategist
ethan.currie@nbc.ca

Angelo Katsoras
 Geopolitical Analyst
angelo.katsoras@nbc.ca

Nathalie Girard
 Senior Coordinator
n.girard@nbc.ca

Giuseppe Saltarelli
 Desktop Publisher
giuseppe.saltarelli@nbc.ca

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