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Provi spread solver: Less simple, still satisfying

By Warren Lovely

Almost exactly one year ago, we penned a *Market View* note on provincial credit, which we titled *"Simple yet satisfying spread solver"*. That note (accessible **here**) explored the (significant) statistical link between long-term credit ratings and domestic bond spreads. With the provincial ratings backdrop continuing to evolve (weakening on average), we thought it appropriate to update, and extend, our analysis.

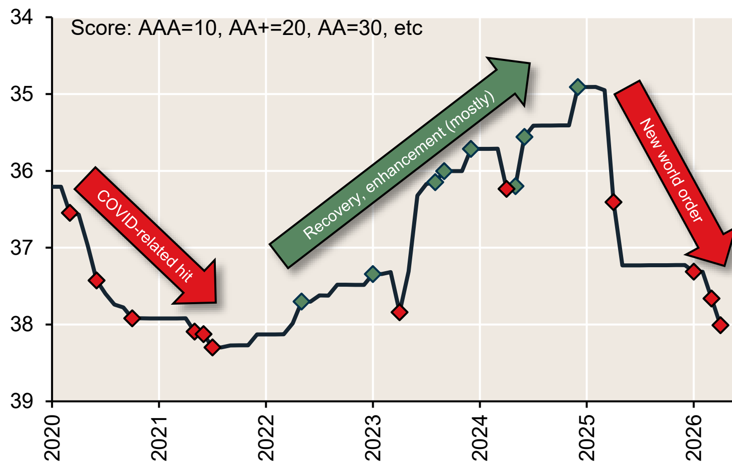
Not surprisingly, credit ratings still do a respectable job in explaining deviations in provincial bond spreads. It likewise remains the case that liquidity counts for much, as the ability to move efficiently in/out of a bond position is a comfort to many (particularly in volatile markets).

One year ago, we found that these two variables—average rating and relative liquidity—were about all you needed to explain provincial spread dispersion. But it may come as no surprise that RV analysis, in provincials and other credit markets, is a bit more nuanced these days.

In a nod to recent Middle East turbulence, we tested the significance (and value) of a province's relative energy sector exposure. Notwithstanding a sharp re-pricing of crude oil on an 11th hour ceasefire, provincial bond valuations hint at an oil exposure premium. That's sensible enough, given the amount of above-plan resource revenue we've been estimating. We likewise find targeted evidence of political risk in the longer end of the provincial credit curve. Read on…

Chart 1: On average, provincial credit quality has weakened

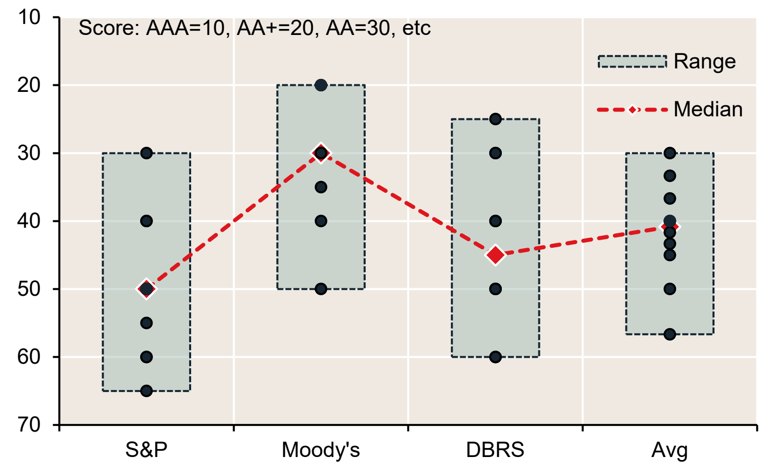
Weighted average provincial long-term credit rating score since COVID



Source: NBC, S&P, Mdy, DBRS, Fitch, StatCan | Note: Monthly to Apr-26; controls for non-stable outlooks; weighted by working age population; markers denote upgrades/downgrades

Chart 2: Credit rating agencies can see risks differently

Range of provincial long-term credit rating scores per rating agency: Current

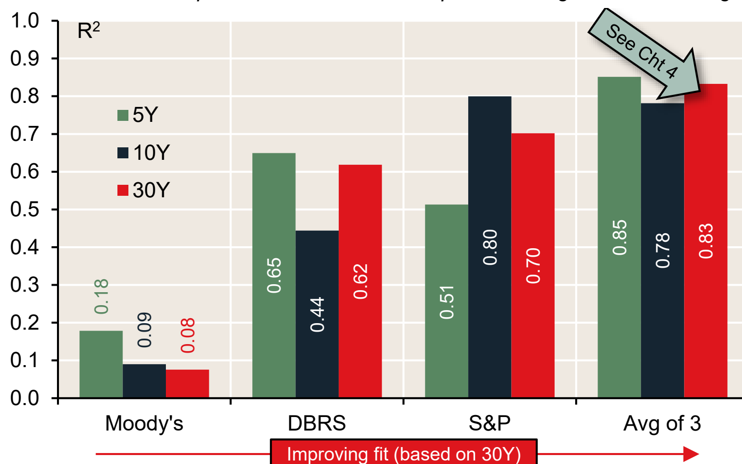


Source: NBC, S&P, Mdy, DBRS | Note: Markers are individual provinces; some scores overlap; controls for non-stable outlooks; excludes Fitch (which rates only 5 provinces); as at 8-Apr

While negative actions remain somewhat concentrated, the average provincial long-term rating has deteriorated. A collection of downgrades and/or outlook changes since 2025 have fully erased the improvement in average credit quality secured during the initial, super-charged COVID recovery period. Note that individual credit rating agencies can (and do) view provincial risks differently, significantly so in some cases. S&P has been more aggressive, accounting for the bulk of recent rating adjustments. The median rating assigned by S&P is currently two full notches below Moody's.

Chart 3: Spreads still fit best with average rating score

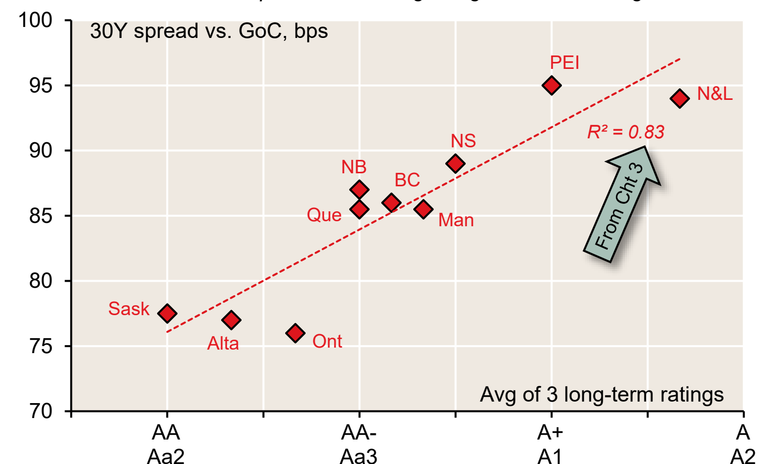
Correlation between provincial domestic bond spreads & long-term credit ratings



Source: NBC, S&P, Mdy, DBRS | Note: Ratings control for non-stable outlooks; as at 8-Apr

Chart 4: Ratings are a useful though imperfect valuation tool

Provincial domestic bond spreads vs. average long-term credit ratings

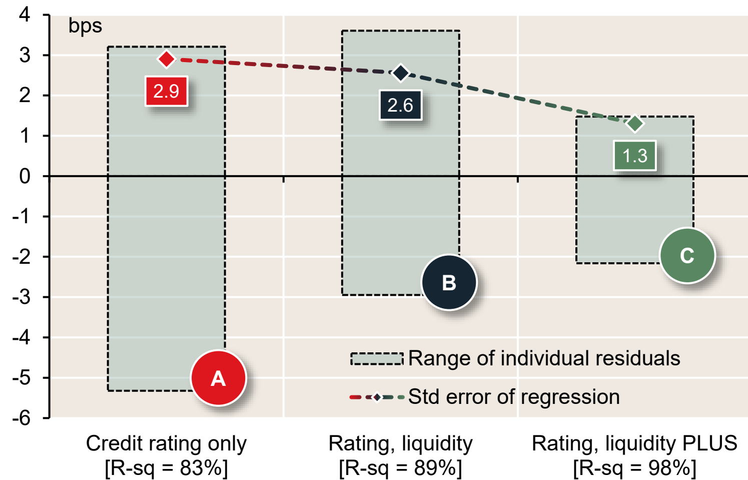


Source: NBC, S&P, Mdy, DBRS | Note: Ratings control for non-stable outlooks; as at 8-Apr

It's no contest when it comes to which set of ratings fit best with provincial spreads. At present, a linear conversion of Moody's ratings has little bearing on valuations. While S&P rating scores work better, the best statistical fit is currently achieved by using average credit rating scores. In the long end, ratings alone explain 83% of domestic spread variation. Not bad, but we can do better…

Chart 5: Adding liquidity (PLUS other factors) improves fit

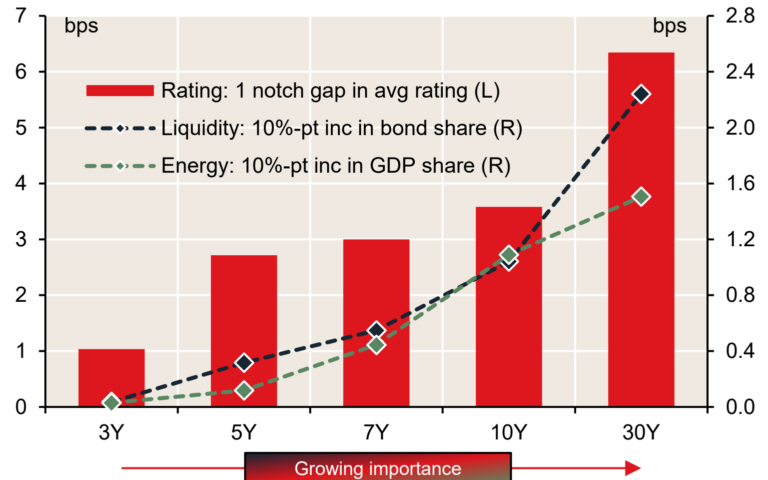
Relative fit (residual spread, standard error) of OLS models of domestic spreads



Source: NBC, S&P, Mdy, DBRS, BBG, StatCan | Note: Select OLS models of domestic spreads; "PLUS" specification adds energy sector weight & political risk dummy; as at 8-Apr

Chart 6: Estimating value of ratings, liquidity & oil exposure

OLS coefficients on average rating, relative liquidity & energy sector importance



Source: NBC, S&P, Moody's, DBRS, BBG, StatCan | Note: Based on 4-variable OLS model of domestic spreads; coefficient on political risk dummy not shown; as at 8-Apr

As noted, ratings alone explain 83% of provincial spread variations in the long end (Model A). Put ratings together with a measure of relative bond market liquidity and the R-squared on a 30-year spread equation improves to 89% (Model B). Guided by our intuition (and encouraged by the size/sign of Model A-B residuals), we tested the importance of energy sector exposure and political risk too. An enhanced specification (Model C) improves fit and reduces standard error. Based on this 'rating, liquidity PLUS' model, we estimate the following for the 30-year sector (all else equal): each one-notch gap in the average credit rating might be worth 6.3 bps; each 10%-pt gap in the share of domestic bonds outstanding might be worth 2.2 bps; each 10%-pt gap in the energy sector's share of provincial GDP might be worth 1.5 bps. These estimated effects/coefficients are as of April 8th and would generally be expected to expand/compress with the underlying spread environment.

Chart 7: A closer look at domestic bond spreads in the long end… actual vs. fitted

Provincial 30-year bond spread vs. GoC curve: Current NBC indication vs. select OLS model specifications

bps

NBC indication (8-Apr-26 AM)
Fitted (A): Credit rating only
Fitted (B): Rating, liquidity
Fitted (C): Rating, liquidity PLUS

Provinces ordered by NBC spread indications: Tightest to widest →

	Rating Score *AAA=10*	Liquidity Bonds O/S *% total*	Energy Weight *% of GDP*
Ont	36.7	40.5	2.5
Alta	33.3	7.2	30.1
Sask	30.0	3.1	21.5
Que	40.0	27.6	3.1
Man	43.3	4.9	5.3
BC	41.7	9.1	6.1
NB	40.0	2.4	4.3
NS	45.0	2.1	1.7
N&L	56.7	2.6	22.7
PEI	50.0	0.4	1.2

Ont, Alta, Sask, Que, Man, BC, NB, NS, N&L, PEI (y-axis: 75–100 bps)

Source: NBC, S&P, Mdy, DBRS, BBG, StatCan | Note: Select OLS models of domestic spreads; "PLUS" specification adds energy sector weight & political risk dummy; as at 8-Apr

Our 'ratings, liquidity PLUS' specification secures a very tight fit with current domestic spreads, as evidenced by a 98% R-squared and 1.3 bp standard error. Beyond the obvious benefit/uplift from superior credit ratings, investors clearly value relative liquidity (no surprise there). While the situation in the Middle East remains fluid, with crude oil prices having retreated Wednesday, we still expect Canada's oil-levered provinces to book above-plan resource revenue… something investors also appear to be discounting. Political uncertainty arguably influences Quebec pricing out the curve.

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