

Provincial bond markets looking past u-rate?

By Warren Lovely

In explaining relative provincial government bond spreads, few economic variables tend to be more useful than the unemployment rate.

To clarify: For much of the past decade, there's typically been a reasonably good fit between all ten provincial bond spreads and each province's corresponding unemployment rate. The longer-run correlation has been in/around +0.8 and you'd be hard pressed to find another high frequency economic data series with more consistent explanatory power. But as we absorbed the latest *Labour Force Survey* (see our detailed analysis [here](#)), it struck us that the utility of the u-rate has seemingly broken down (Chart 1).

As it stands, individual provincial unemployment rates (as of May-25) explain barely one-third of today's 30-year domestic provincial bond spreads. Outside of a brief and ultra-extreme COVID period, that's the weakest connection you'll find. Compare the seemingly limited utility of provincial jobless rates to each province's relative liquidity ranking or average long-term credit rating. Its currently no comparison, with the

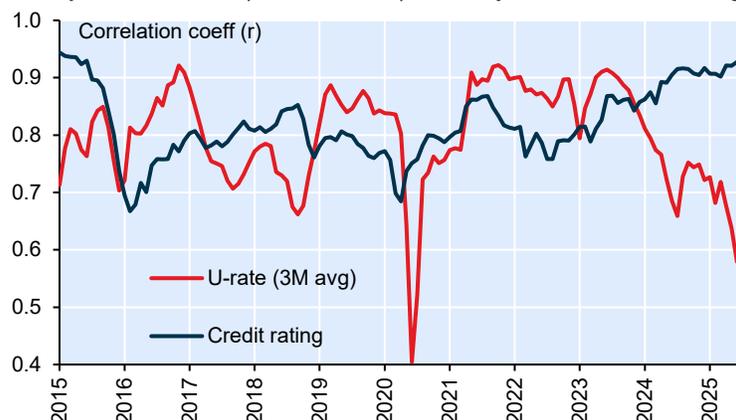
latter two variables (liquidity and outlook-adjusted rating) continuing to hold much greater sway on provincial bond investors (Chart 2).

So just what kind of regional labour market conditions are provincial bond investors looking through? We've no intention of 'picking' on any jurisdiction, but Ontario's trade- and housing-sensitive economy has come under some pressure (Chart 3), the province's unemployment rate rising faster than in most if not all other regions. Confirmation of a renewed Canada-U.S. trade pact can't come soon enough... for Ontario and really the country as a whole. Meanwhile, some marginal BoC interest rate relief (where it to arrive) could help resuscitate Ontario's moribund housing market. Stay tuned.

Even for those willing to look past relative labour market weakness, it may be that a bit of relative re-pricing is still in order. A simple OLS model incorporating average credit ratings and liquidity scores hints that a few names may be relatively 'cheap' to Ontario (Chart 4).

Chart 1: Provincial spreads de-link from jobless rate?

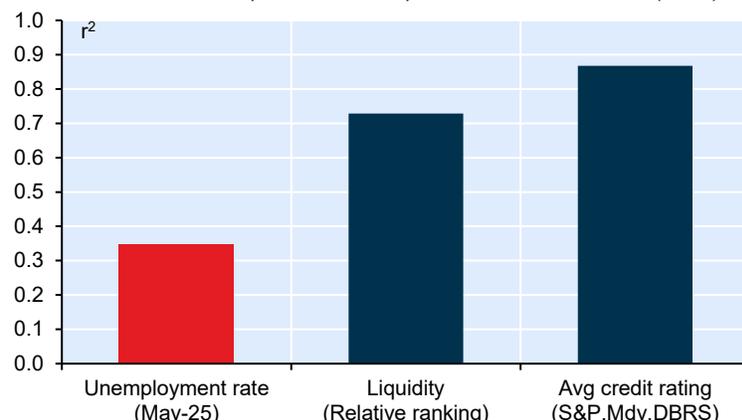
Monthly correlation of 30Y provincial bond spreads vs. jobless rates & credit ratings



Source: NBC, StatCan, S&P, Moody's, DBRS | Note: Monthly correlation of 30Y spreads with (i) unemployment rates (3M avg, 1M lag) and (ii) avg ratings controlling for outlooks

Chart 2: Ratings & liquidity hold much sway (as they should)

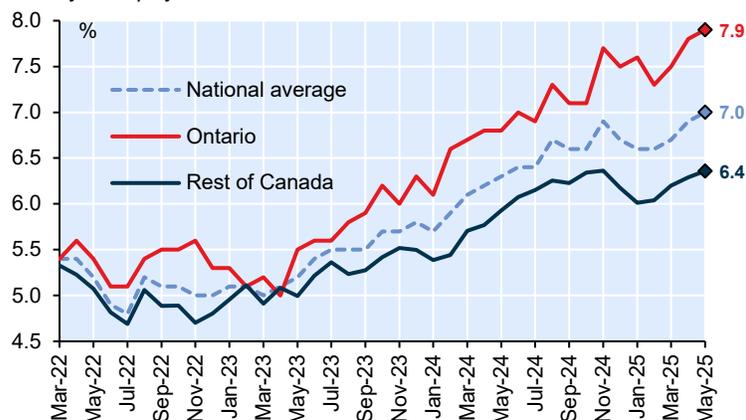
Current correlation of 30Y provincial bond spreads vs. select variables (9-Jun)



Source: NBC, StatCan, S&P, Moody's, DBRS | Note: Compares constant maturity indications as of 9-Jun-25 to latest unemployment rates, liquidity rankings & long-term credit ratings

Chart 3: Ontario's labour market pressured

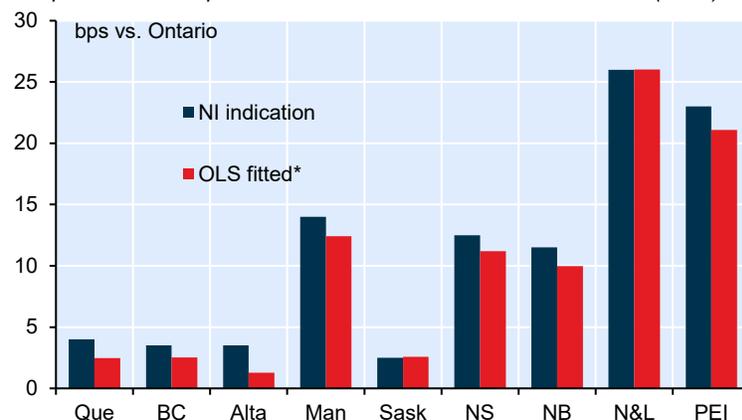
Monthly unemployment rate: Ontario vs. rest of Canada



Source: NBC, StatCan | Note: Monthly seasonally adjusted data

Chart 4: A simplified look at inter-provincial RV

30Y provincial bond spreads: Current indications vs. OLS fitted values (9-Jun)



Source: NBC | Note: New issue indications are constant maturity vs. GoC curve as of 9-Jun-25; OLS fitted values based on model incorporating average credit rating & liquidity rank



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