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Heat wave breaking in provincial credit?

By Warren Lovely

Hot enough for you? For much of the summer, swathes of Canada have been subjected to unseasonably warm temperatures. While the heat wave has yet to fully break, temperatures (in some parts at least) have receded a touch of late. And so it is in one of the more liquid corners of Canada's credit market: provincial bonds.

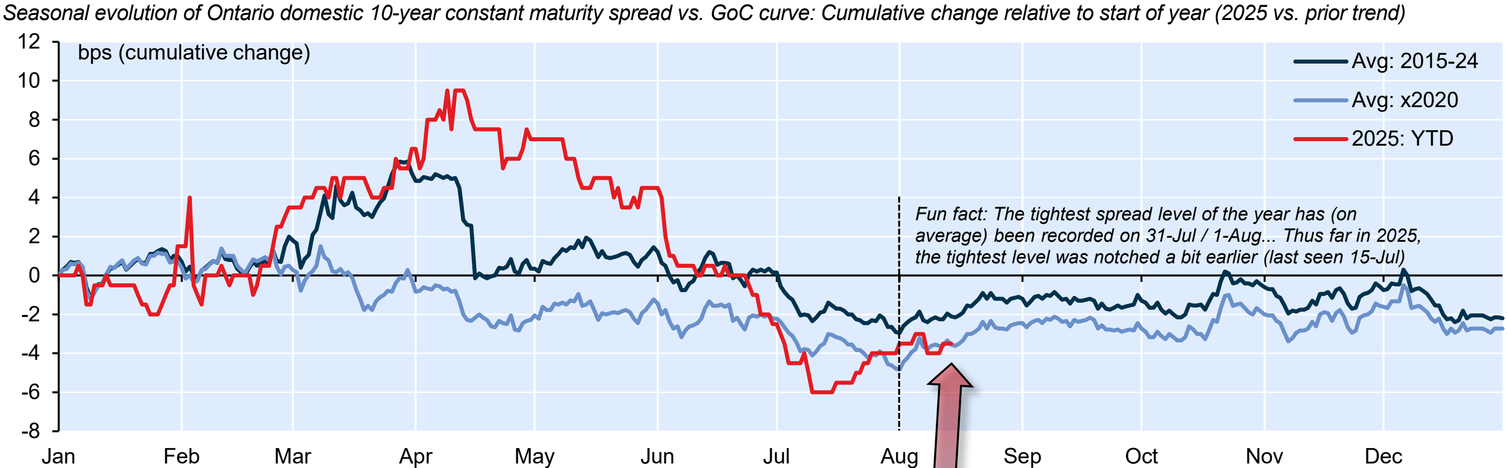
The bellwether provincial G-spread—Ontario 10-year—has been plenty hot (i.e., tight) this summer. On an indicative, constant maturity basis, the mid-50s level vs. the GoC curve registered in mid-July represented the tights of the year. Indeed, spreads weren't much removed from the snuggest levels notched in the 15-year post-GFC period. So yes, the notional 'credit market humidex' had been popping!

Relative to July's hottest levels, spreads have cooled a bit. Indicatively, we currently put Ontario's constant maturity 10-year spread at ~59 bps vs. the curve. Call that 2½ bps removed from the tights in what is admittedly a thinner market, summer trading volumes always relatively sluggish. It's not uncommon for spreads to cool at this juncture, August saddled with the poorest performance record of any month when parsing the last decade of daily data. (Only once in the prior ten years did 10s net tighten in August, with spreads widening 8 of 10 times.)

Looking ahead, ambient temperatures are surely meant to recede as we head into fall. But a still-extraordinary geopolitical backdrop, and attendant economic/financial uncertainty, hints that seasonal tendencies may be less reliable from a bond valuation perspective (both in cash markets and swaps). One thing we can say, we will soon have more active provincial bond market to test conviction, with primary supply and secondary volumes poised to pick up. Finally, even if spreads were to suffer a bit of seasonal indirection, it's hard to argue with the carry afforded of provincial credit (out to 10-years at least).

Chart 1: Visual representation of provincial credit spread seasonality, with 2025 (at times) on somewhat unique ride

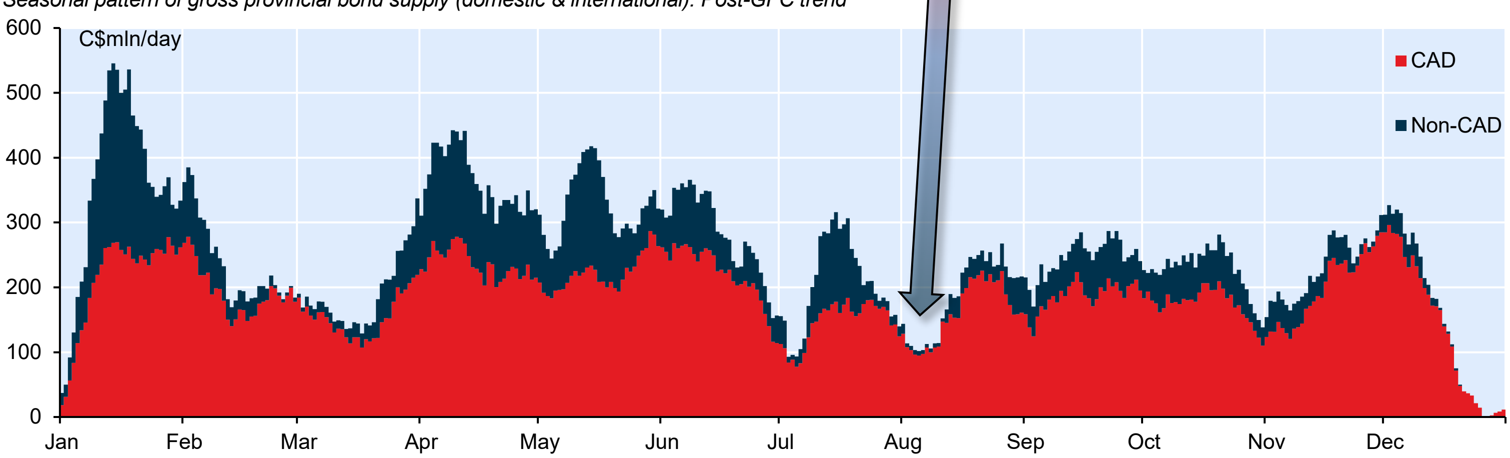
Seasonal evolution of Ontario domestic 10-year constant maturity spread vs. GoC curve: Cumulative change relative to start of year (2025 vs. prior trend)



Source: NBC

Chart 2: Spreads informed, to a degree, by seasonal issuance patterns

Seasonal pattern of gross provincial bond supply (domestic & international): Post-GFC trend

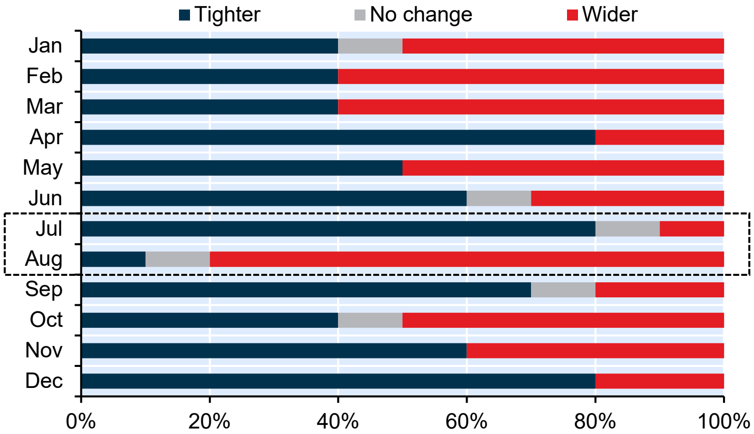


Source: NBC, BBG | Note: Daily pattern smoothed +/-5D; covers 15Y post-GFC period (2010-24); all marketable bonds deals; FX conversion as of issue date

There's some evidence of established seasonal patterns in domestic spreads, mirrored (driven?) to some extent by seasonal surges and lulls in primary market issuance (which in turn influences secondary trading volumes and turnover). For the closely watched Ontario 10-year G-spread, the tights of the year tend to be registered in/around end of July, which is often one of the slowest periods of the year in primary. Spreads routinely leak wider in August, the market becoming increasingly well-supplied as fall approaches. So even if 2025 has been anything but a 'normal' year (politically, economically, fiscally), the recent direction for spreads isn't all that unusual. YTD tights were set in mid July, spreads have softened up a touch since (call it +2½ bps in cash and swaps).

Chart 3: August's performance record has been the worst…

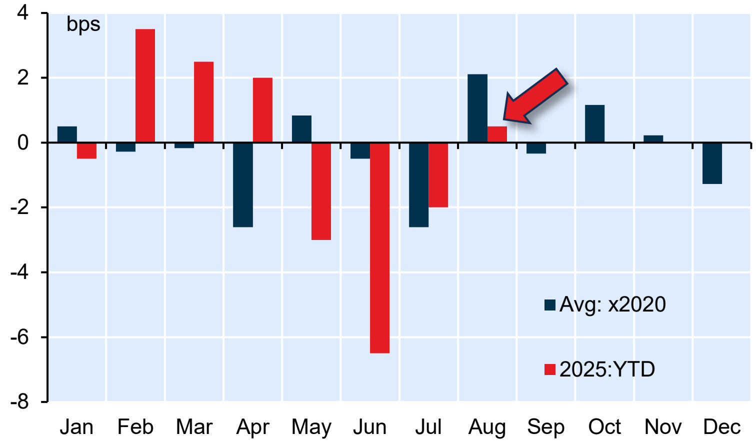
Distribution of net change in Ontario 10Y spread vs. GoC curve by month



Source: NBC | Note: Based on constant maturity indications from 2015-24

Chart 4: … with this month's net widening hardly alarming

Net change in Ontario 10Y spread vs. GoC curve by month: 2025 vs. prior trend

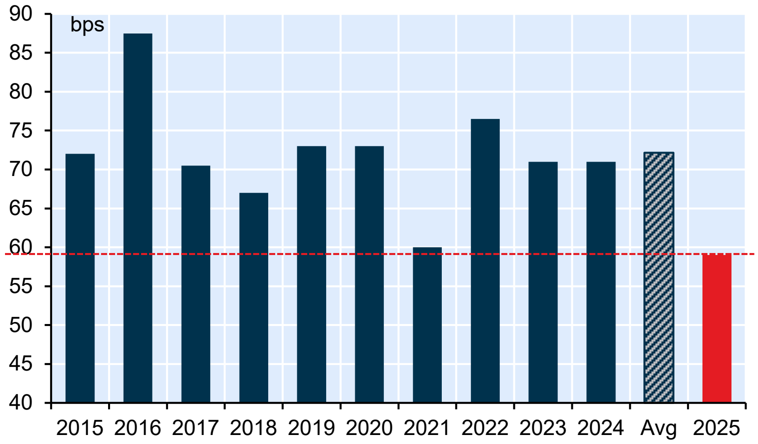


Source: NBC | Note: Based on constant maturity indications; Aug-25 net change as of 14th

When it comes to the net change in provincial G-spreads, no month has a poorer performance record than August. Keying on Ontario 10s, August has delivered a net tightening just once in the past decade, whereas constant maturity cash spreads ended that month wider 8 of 10 times. In a sense, we're sticking to the script then. There's typically less pronounced seasonal direction in the fall.

Chart 5: Putting today's G-spread in a seasonal context

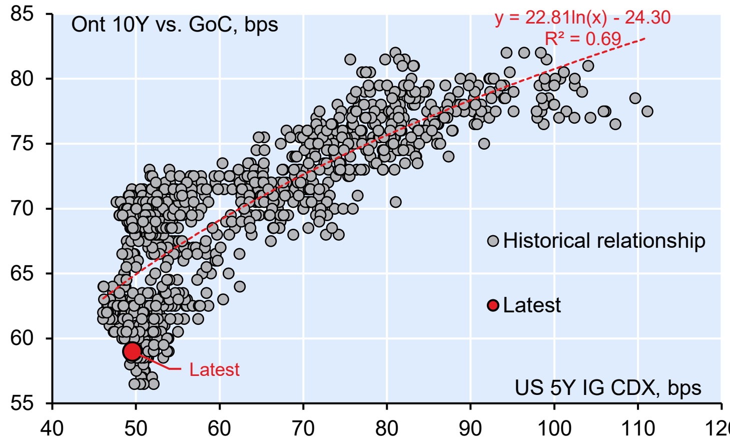
Ontario 10Y spread vs. GoC curve as of August 14th each year



Source: NBC | Note: Based on constant maturity indications

Chart 6: … with one traditional RV screen flagging 'rich'

Ontario 10Y spread vs. GoC curve & US 5Y IG CDX (i.e., risk proxy)

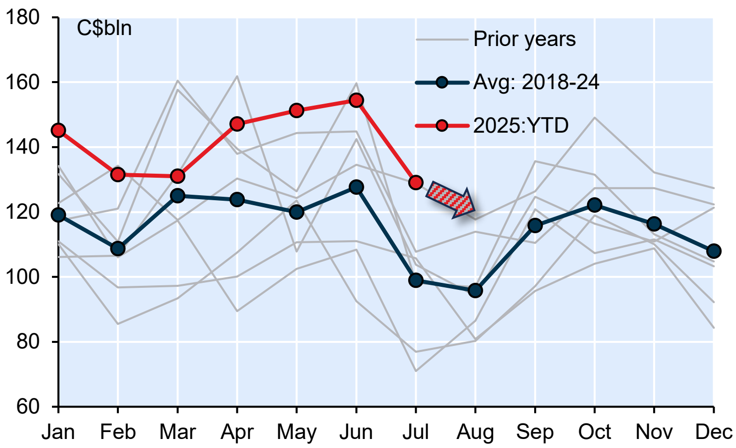


Source: NBC, BBG | Note: Latest 1,000 trading days; Ontario spread is constant maturity

Though spreads have backed up a bit from July's tights, G-spreads still lean towards the 'richer' side of things based on the empirical track record and/or some traditional risk proxies (e.g., US IG CDX). It remains a different story for ASW levels, where Ontario 10s hover in/around OIS+90bps. That's off the wides (briefly in triple digits) sure, but still affords investors ample carry.

Chart 7: Thinner summer markets argue for caution…

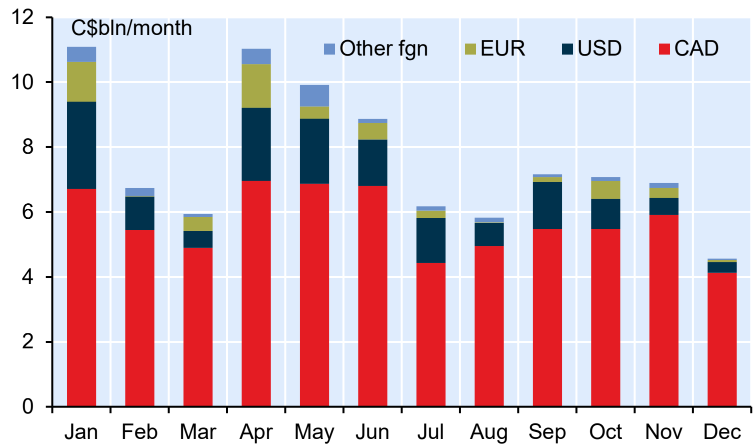
Seasonal pattern of provincial government secondary bond trading volumes



Source: NBC, CIRO | Note: Total trading, all dealers & all counterparties; monthly to Jul-25

Chart 8: … with fall funding allowing for test of conviction

Seasonal pattern of provincial government gross bond supply: 2010-24



Source: NBC, BBG | Note: All marketable bond deals; FX conversion as of issue date

Cautions? There are always a few. Setting aside extreme geopolitical uncertainty, the relative lull in primary market activity and secondary liquidity is a consideration in summertime. Put another way, we'll be able to more fairly test investor conviction and the overall appetite for provincial credit as the new issue supply machine cranks back up this fall. And on supply… don't lose sight of the potential for provincial issuers to divert non-trivial issuance to international markets, where well-placed trades could illicit a sigh of relief from domestics since there's no little ample funding to do.

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