Market View
Economics and Strategy

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Provincial credit: Trading on trade? *[plus fresh oil royalty update]*

By Warren Lovely

On Tuesday, StatCan revealed that Canada's merchandise trade balance had reached a four-year high, as May's $4.2 billion surplus easily topped consensus expectations. See our detailed coverage **here**.

Though down a touch in May, Canada's energy trade surplus still looked quite handsome, particularly vs. the sizeable shortfall in non-energy trade. Given concentrated resource wealth, it follows that provincial trade fortunes can be highly divergent. Witness the large(r) combined international trade surplus for the three most oil-levered provinces vs. international trade shortfalls in some other parts of the country.

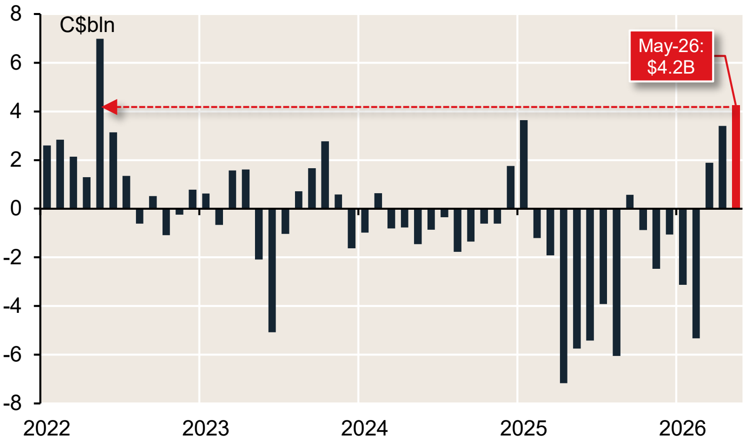
In absolute or relative terms, the biggest international trade balance gap exists between oil-rich Alberta and more factory intensive Ontario. Despite widely divergent trade fortunes, these two provinces notionally trade near to each other in the domestic bond market. More broadly, there appears to be little to no statistical connection/correlation between a province's relative trade balance and its indicative bond spread. This gives the impression that regional trade patterns/prospects (and the underlying commodity prices that often dictate marginal provincial performance) have little bearing on relative value. Think again.

Trade is an important fiscal proxy. In some cases, provincial exports do a better job explaining total provincial revenue than labour income. We're not advocating shunning labour market/personal income metrics but bond investors might benefit from eying provincial trade developments closely.

Of course, for the most oil-exposed provinces, official sensitivities can be used to guesstimate the scale of potential fiscal windfalls. Despite a still-fluid geopolitical backdrop, we offer an updated look at where oil royalties may be headed vs. plan, with the first fiscal updates still some time off.

Chart 1: Canada's trade balance hit four-year high in May

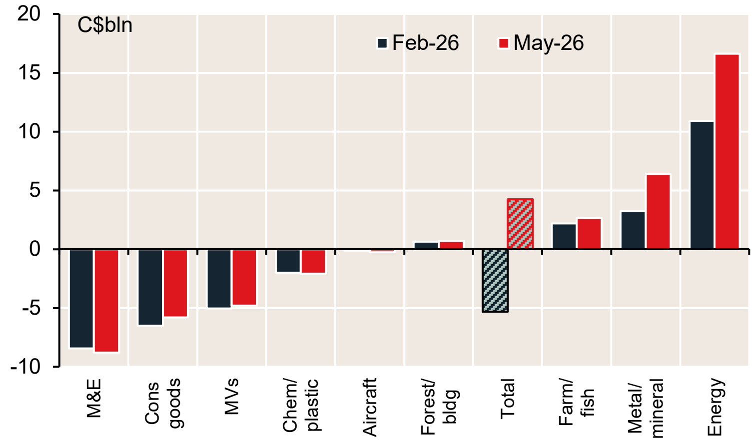
Canada international merchandise trade balance



Source: NBC, StatCan | Note: SA balance to May-26

Chart 2: Energy trade surplus up big time vs. pre-war level

Canada international merchandise trade balance by commodity: May vs. Feb

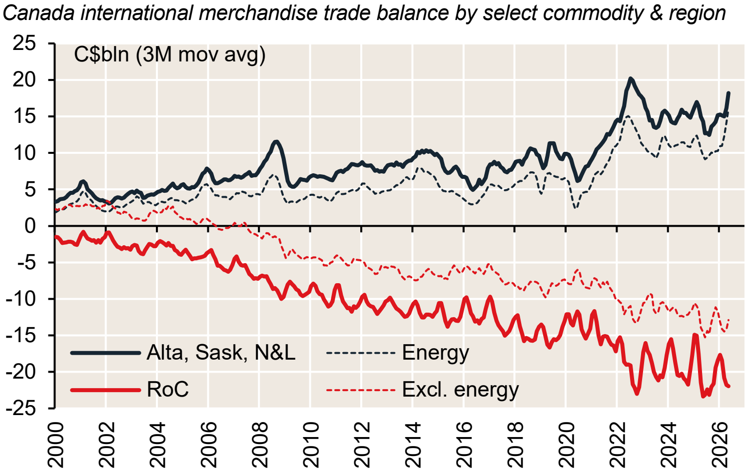


Source: NBC, StatCan | Note: SA balance by commodity group

Canada's trade surplus hit a four-year high in May. Though the energy trade surplus receded a touch in May (vs. the prior month), it's well above where things stood prior to the outbreak of the Middle East conflict. Things were meant to de-escalate, but work towards a lasting peace has recently stalled, with President Trump threatening a renewed blockade of the Strait. Stay tuned.

Chart 3: Clear commodity-province connection

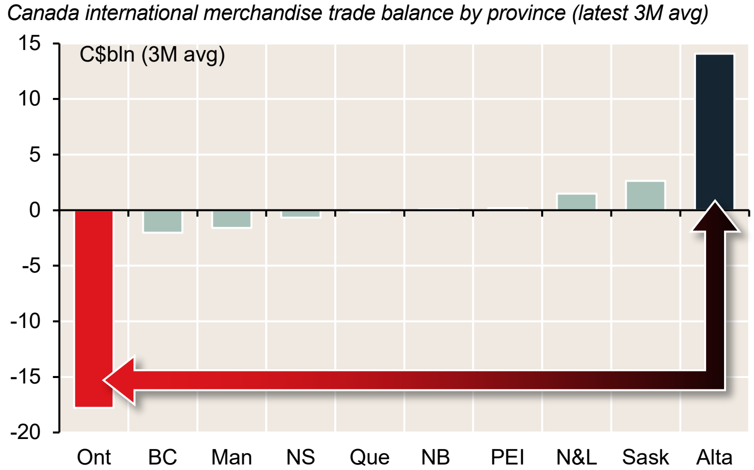
Canada international merchandise trade balance by select commodity & region



Source: NBC, StatCan | Note: Monthly to May-26; SA by commodity; NSA by province

Chart 4: Provincial trade balances can be highly divergent

Canada international merchandise trade balance by province (latest 3M avg)

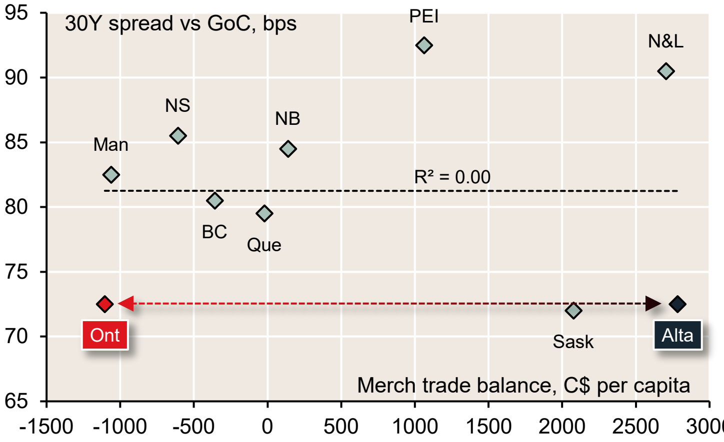


Source: NBC, StatCan | Note: NSA balance for 3M ending May-26

Canada's widening gap between energy and non-energy trade—so apparent through May—has a direct regional/provincial parallel. In Canada's three most oil-levered provinces, surging nominal exports have pushed trade balances further into surplus over the latest three-month period. Ontario continued to run the largest international trade deficit of all the provinces through May.

Chart 5: Trade balance no help on provincial spreads?

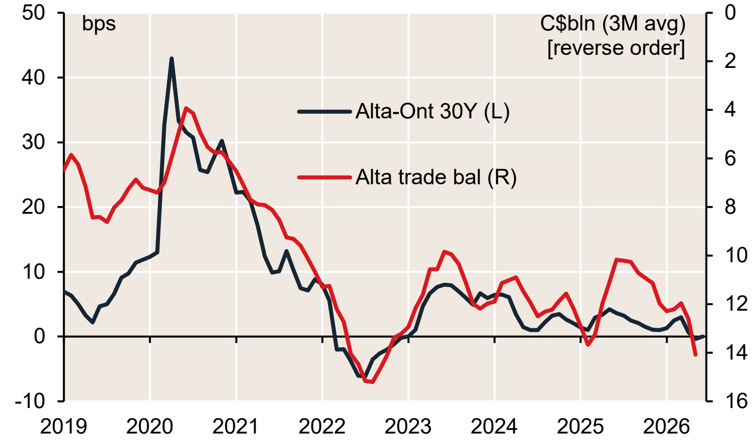
International merchandise trade balance & 30Y bond spread by province (latest)



Source: NBC, StatCan | Note: NSA trade bal is 3M avg to May-26; spreads as of 8-Jul-26

Chart 6: Tracking Alberta's trade balance & relative spread

Alberta international merchandise trade balance & 30Y bond basis to Ontario

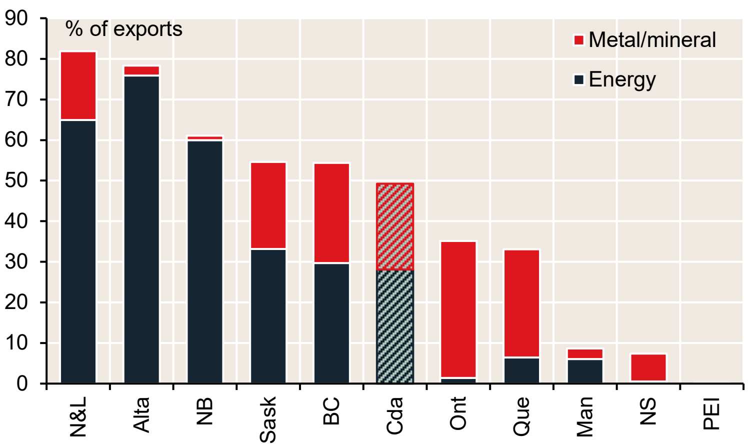


Source: NBC, StatCan | Note: 30Y basis monthly avg to Jun-26; NSA trade bal to May-26

Relative trade balances (vs. population or GDP) don't appear to hold much sway on domestic bond spreads. In one extreme case—Alberta vs. Ontario—trade balances are kilometers apart and yet the two province's 30-year domestic bonds trade near to each other. But over time, it's clear Alberta spreads are very much evolving in line with trade fortunes, which are in turn driven by oil.

Chart 7: Inter-provincial export picture (Take 1)

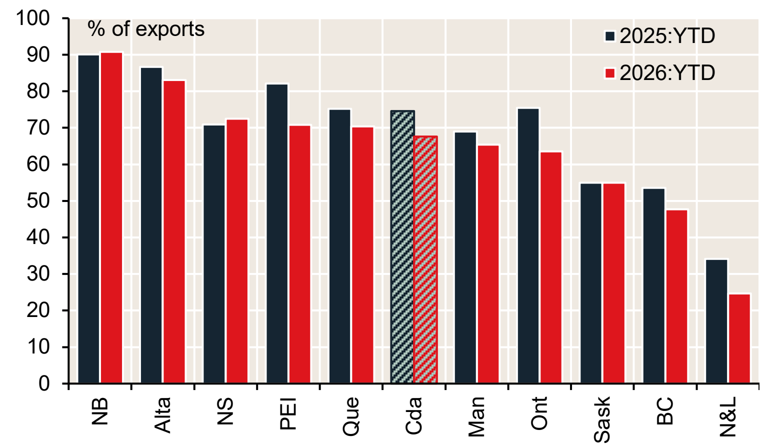
Share of provincial international merchandise exports by select commodity



Source: NBC, StatCan | Note: NSA exports for Jan-May 2026

Chart 8: Inter-provincial export picture (Take 2)

Share of provincial international merchandise exports to United States

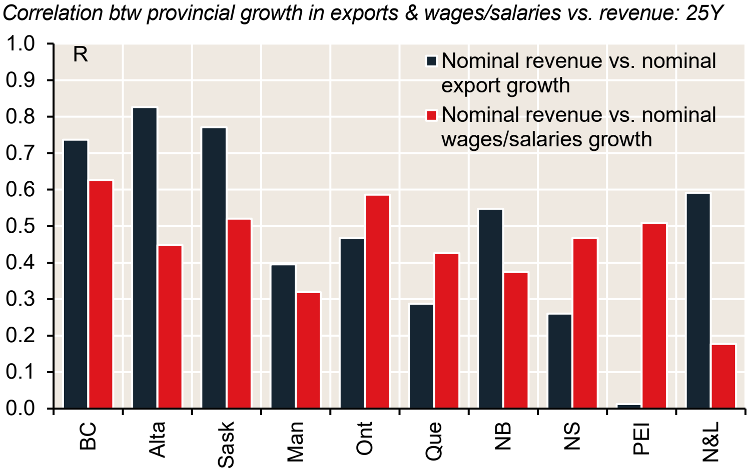


Source: NBC, StatCan | Note: NSA exports for Jan-May

Turning to individual provincial exports (as opposed to trade balances), it's clear that recent performance and future prospects are uneven. Direct provincial exposure to high-profile commodities (e.g., energy, minerals) can be quite concentrated. Reliance on the U.S. economy also varies notably, with the future of CUSMA remaining one of the biggest question marks on Canada's outlook.

Chart 9: Export growth helps explain revenue growth

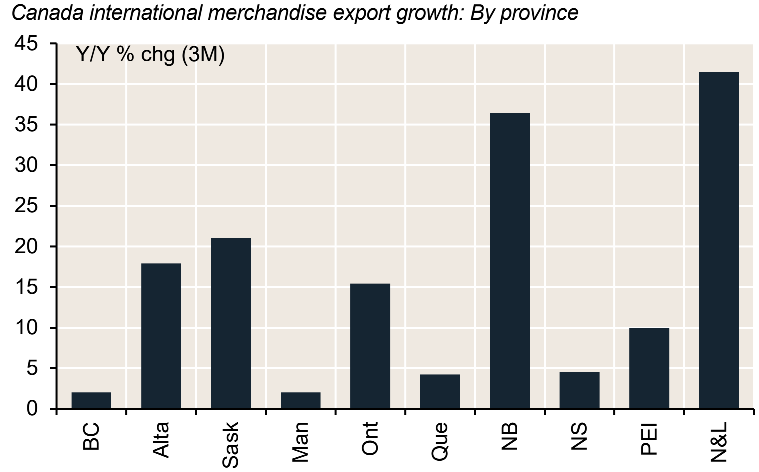
Correlation btw provincial growth in exports & wages/salaries vs. revenue: 25Y



Source: NBC, StatCan, prov gov'ts | Note: Based on FY growth rates; 25Y to 2025-26

Chart 10: Current export growth in some cases striking

Canada international merchandise export growth: By province

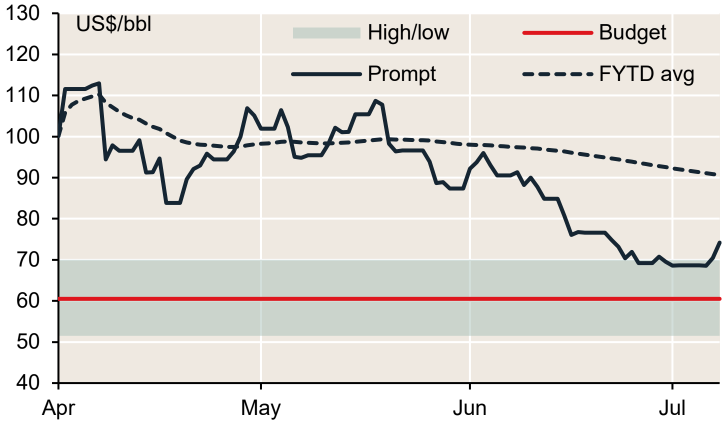


Source: NBC, StatCan | Note: NSA export growth based latest 3M vs. year-earlier period

Bond holders take note: Nominal exports in some cases do a better job explaining total provincial revenue than wages and salaries, based on our study of fiscal year growth rates for the past quarter-century. Labour market conditions (and related personal incomes) obviously bear close scrutiny but spare some time for provincial trade tallies, where relative export fortunes can shift significantly.

Chart 11: Still a 'high price' scenario for Alberta

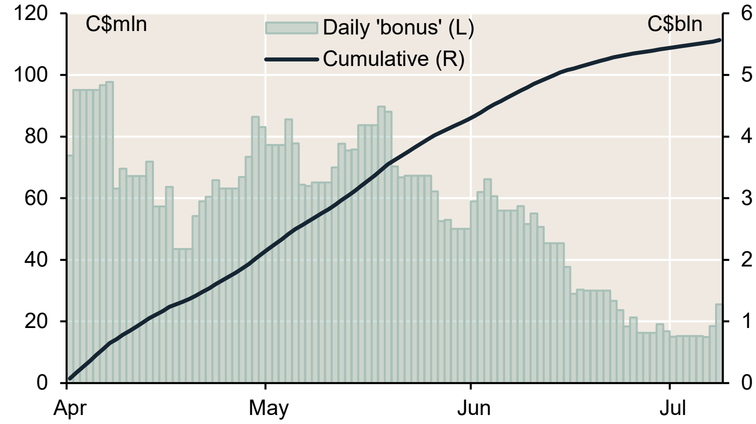
Crude oil (WTI) price vs. Alberta budget planning assumption/scenarios: 2026-27



Source: NBC, Alta, BBG | Note: Daily prompt contract to 8-Jul-26

Chart 12: Gauging bonus royalties already in the door

Estimate of Alberta 'bonus' crude oil royalties vs. plan: 2026-27 FYTD (WTI only)

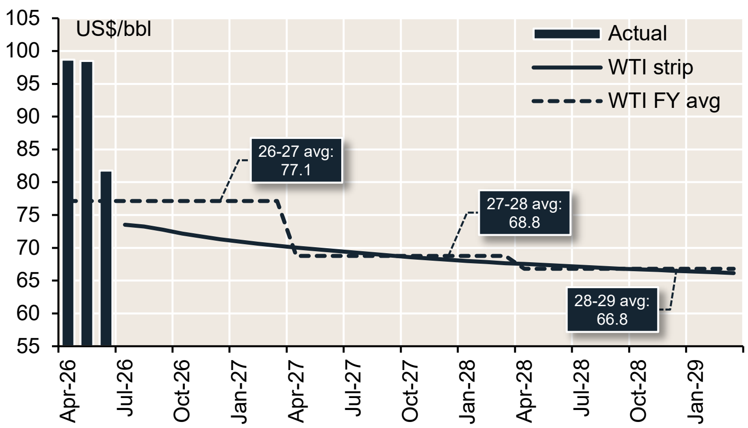


Source: NBC, Alta, BBG | Note: Illustration only; WTI effect only; daily 'bonuses' to 8-Jul-26

In the meantime, official fiscal sensitivities (where available) can be used to ballpark potential revenue 'surprises'. Given Alberta's budget was based on US$60.5/bbl WTI, we very much remain in a 'high price' scenario. Indeed, comparing actual vs. planned WTI prices, it's possible that Alberta has already clipped ~$5.5bln in bonus crude royalties just 100 days into fiscal 2026-27.

Chart 13: Much depends on how crude oil pricing evolves

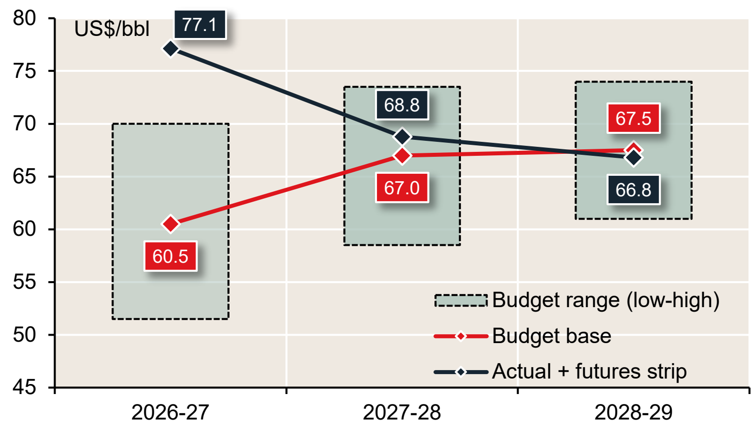
Crude oil (WTI) actual & futures contract pricing: As of 8-Jul-26



Source: NBC, BBG | Note: Based on latest/indicative pricing for specific futures contracts

Chart 14: What current strip implies vs. budget plan

Crude oil (WTI) price: Alberta budget vs. implied average of futures contracts

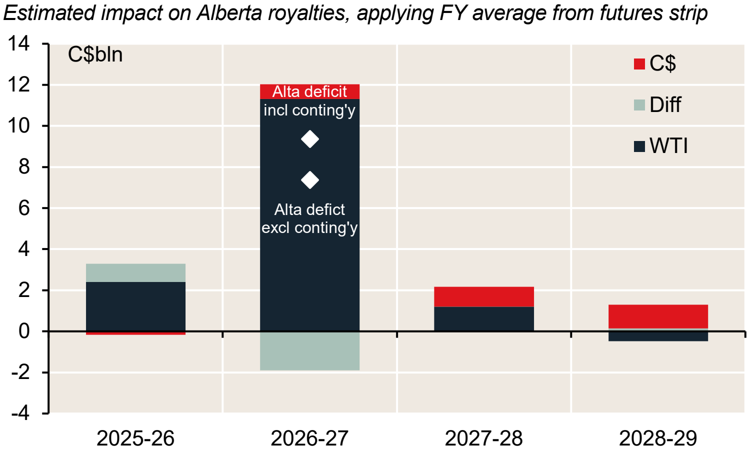


Source: NBC, Alta, BBG | Note: Budget base/range from Bud26; futures strip as of 8-Jul-26

Clearly, the full extent of the royalty revenue surprise in Alberta (or Saskatchewan or Newfoundland and Labrador) hinges on how far (and for how long) prices deviate from plan. Using the current futures strip, WTI might average ~US$77/bbl for 2026-27, with futures implying a sub-70 levels for fiscal 2027-28 and beyond. Caution: As we've seen time and again, things can change fast.

Chart 15: Estimating full-year royalty 'surprise' for Alberta

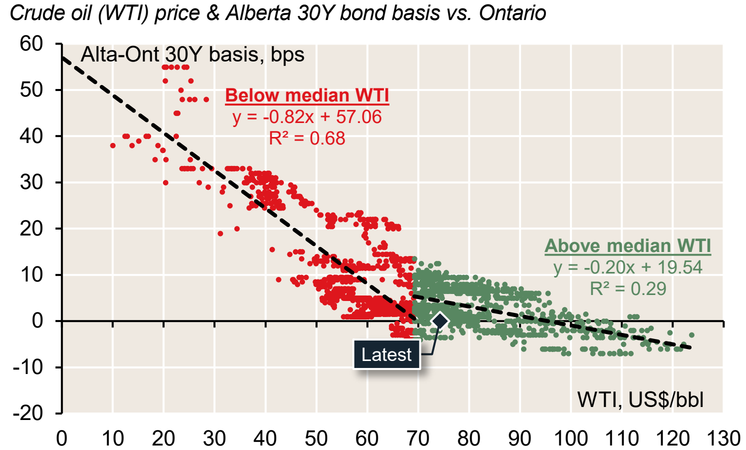
Estimated impact on Alberta royalties, applying FY average from futures strip



Source: NBC, Alta, BBG | Note: Illustration only; averages 8-Jul-26 futures pricing

Chart 16: Important to protect oil price downside!

Crude oil (WTI) price & Alberta 30Y bond basis vs. Ontario



Source: NBC, BBG | Note: 2,000 trading days split into 'above'/'below' median groups

It's still possible that Alberta's 'bonus' or above-plan crude oil royalties could allow the province to largely (if not fully) erase the deficit originally planned for 2026-27. We should also see some residual royalty benefit confirmed in Alberta's 2025-26 public accounts (when released). On balance, we remain bullish on Alberta spreads, seeing current valuations as more than fair for a province with still-considerable fiscal upside and possessed of solid economic/export potential. A final note: Crude oil prices look to exert relatively greater influence on Alberta bond spreads at low(er) levels for WTI. This highlights the importance of protecting against downside resource pricing risks and argues for locking in solidly above-average oil prices when they arrive. Given recent geopolitical turbulence, it may be appropriate for Alberta (and other provinces heavily reliant on natural resources) to implement opportunistic resource hedging programs which could stabilize fiscal results.

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