PROVINCIAL ISSUERS UPDATE
Budget Season Q&A

Summary

Nine Canadian provincial governments have released their 2025 budgets. They generally incorporated a prudent baseline fiscal outlook and possible altered paths driven by U.S. trade policies and consequent harmful global trade war.

There are two big missing pieces to the budget season. Market participants expect Ontario to release its budget in upcoming weeks following Premier Ford's re-election last February. At the federal level, electoral promises and tariff-driven financial support point to an increase in Government of Canada's bond issuance contrasting with similar borrowing requirements for provinces in FY2025–26 relative to a year prior.

Enhanced by abrupt changes in erratic U.S. tariff policies, the budget season led to a variety of questions during our most recent conversations held with market participants. As such, Laurentian Bank Securities covers in this edition of the *Provincial Issuer Update* key questions and answers tied to the provincial bond market.

- To what extent the recent escalation of the global trade war alters the fiscal path of Canadian provinces?
- To what extent the higher risk premium for U.S. Treasuries may change the provincial debt management strategy?
- What to make of the Quebec rating downgrade by S&P?
- Does the latest BC rating downgrade from S&P and Moody's materially change something?
- Does the Canadian energy exemption from U.S tariffs favor oil-producing provinces?
- Auto shutdowns and big spending promises: What to expect from the Ontario budget?
- How big the FY2025–26 federal deficit and GoCs issuance could look like?

To what extent does the recent escalation of the global trade war alter the fiscal path of Canadian provinces?

The main takeaway should reassure market participants: Canadian provincial governments generally exposed resilient fiscal outlooks over the medium-term. There is no presence of a fundamental, material financial deterioration beyond FY2025–26 relative to previous expectations. This matters more than the short-term, inevitable tariff-induced hiccup of FY2025–26 in our view. In most provinces, the assumed base line scenario is very prudent. It generally includes a moderate degree of U.S. tariffs, on Canadian exports and the rest of the world, typically lasting beyond 2025. As of mid-April, and despite the multiple swift turnarounds from the U.S. administration that may lie ahead, the global trade shock appears less severe than assumed in most provincial baseline fiscal outlooks.

Another feature of the 2025 budget season will give some piece of mind for investors: governments buffed up annual reserves in FY2025–26 relative to the year prior, totaling $11.7B excluding Ontario. The degree of prudence varies from coast to coast. Alberta and British Columbia have the largest annual buffer at $4B each, or around 5% of revenues. However, B.C. is one of the rare provinces not incorporating U.S. tariffs in the baseline scenario. Saskatchewan is alone at the other end of the spectrum, with no specific buffer. Instead, the Saskatchewan government decided to maintain spending flat this year relative to FY2024–25. The prudence built in Quebec's fiscal outlook is sizeable without being excessive, including 10% U.S. tariffs over two years on most Canadian exports in addition to a $2B annual reserve. The Manitoba budget includes a $200M reserve on top of the existing $585M stabilization fund, making together a reasonable cushion.

Given the unknown end game of the global trade war, some provincial governments provided alternative scenarios. Under the positive scenario of a rapid tariff rollback, the above-cited buffers would end up not being utilized, reducing FY2025–26 total provincial debt issuance below the baseline scenario of $93B, excluding Ontario. This could materialize if U.S. President Trump's 90-days pause on several of the global tariffs lasts. Under the severe and long-lasting downside scenario, bond issuance would be modestly higher according to estimates provided by Quebec. B.C.'s and Alberta's downside scenarios point to a moderate deterioration in revenues, and thus most likely a moderate increase in borrowing requirements.

Our economic team tracks for the time being a flash downside blip lasting two months, in March and April, at a minimum. It started with U.S. trade policy uncertainty weighing down confidence and hindering decisions, followed by the implementation of tariffs on the aluminum-steel-auto sectors and non-compliant USMCA products.

To what extent does the higher risk premium for U.S. Treasuries change the provincial debt management strategy?

The main driver of the loss of confidence in U.S. economic policy appears to be the tariff-induced inflation it generates, rather than the concern of a sudden Chinese fire sale of U.S. Treasuries. The negative market sentiment shock has been observable through the absence of a major decline in U.S. short-term rates, in part due to the inability of the U.S. Federal Reserve to cut its policy rate in a slower real GDP growth / higher CPI inflation environment. This same sour market sentiment has been perceived in the unusually large jump of the 30-year bond yield during the second week of April. Overall, the U.S. bond market is volatile but there is no major stress, or panic. Boston Fed President, Susan Collins, said mid-April that the U.S. Federal Reserve would absolutely be prepared to deploy its various tools to help stabilize the financial markets if the need arose. As such, this spring's U.S. bond market stress should not completely block the pipeline for Canadian issuers looking to tap the domestic and international markets. At the same time, we cannot go as far as predicting Canadian provinces will match in FY2025–26 the record-high foreign issuance activity reached during FY2024–25 ($53B).

Excluding Ontario, the nine other provinces have revealed a combined $93B in bond issuance in FY2025–26, just a notch under the $97B tally of FY2024–25. Given the absence of a meaningful difference from the year prior, and despite enhanced volatility of the U.S. and Canadian yield curves, we do not foresee a pressing motive for issuers to materially move away from the guidance provided in the debt management sections of provincial budget documents. Several provinces have been able to gradually extend the maturity of their debt structure in recent years to an apparent optimal zone, sometimes slightly north of 10 years. As such, there could be an implicit preference of sticking to the usual 10-year and 30-year benchmarks, increasing these sizes if required under a severe tariff scenario. Issuers opting to reach markets with a relatively shorter 5-year term may resonate to market participants as a minor mixing twist rather than a consistent fundamental change. On the domestic side, the market openness allowed Ontario to issue three times in three consecutive weeks in March prior to April 2nd, issuing a mix of bonds in the 5-year, 10-year and 30-year sectors. Saskatchewan and B.C. both issued June 2035 benchmarks. Ontario was able to tap the bond market post "Liberation Day", issuing 10-year and 30-year deals.

Despite the enhanced volatility of U.S. interest rates including agitation of U.S. swap spreads, the U.S. dollar recent erosion appears to signal a leaning for non-U.S. assets, a small positive for Canadian issuers. One positive sign of liability robustness observed lately relates to the offshore market access capability of the three provincial governments located in the Canadian Prairies. Indeed, Alberta, Saskatchewan, and Manitoba have tapped the European bond market despite long-term EUR swaps volatility tied to Germany's intention to ramp up issuance of bunds. Alberta issued a EUR 1.25B, 10-year bond, at mid swap +71 basis points mid-March. Saskatchewan was able to carry with its strategy to expand international issuance activity, tapping the market late March in both EUR and CHF. Manitoba previously issued in February a 35M EUR deal maturing in 2037.

What to make of the Quebec rating downgrade by S&P?

S&P agency's downgraded the Province of Quebec long-term outlook from AA- to A+ with a stable outlook on April 16th . At the same time, it lowered Hydro-Québec's rating of senior unsecured debt from AA- to A+ stable. S&P's decision reflects the lack of progress relative to a few metrics previously exposed in June 2024. S&P had expected "*a solid policy response to expeditiously address fiscal slippage in next year's budget … leading to modest operating deficits*". Unfortunately, Budget 2025 revealed a $13.6 billion deficit for FY2025–26, which is 1.8% of GDP. This deficit decreases to 1.3% before the deposit to the Generations Fund, indicating a negative trend.

S&P particularly points out the elevated deficits for the next three years, leading to the title of the report "*persistent operating deficits*". The rating agency was not pleased by the 2025 Budget plan showing the bulk of the effort to get back to a balanced budget in the later part of the 5-year outlook, namely after the general elections of 2026. S&P cites after-capital deficits of more than 10% of total revenues in the next three years. Our number crunching points toward a 14% figure.

S&P's downgrade to A+ brings back the Province of Quebec's rating to 2017's level. Back then, structural surpluses were the norm. The net debt-to-GDP ratio had dropped very fast, from above 45% to below 45%. Budget 2025 projects the net debt to GDP to stay far away from this zone again, potentially explaining the stable outlook contrasting with the negative outlook assessed by S&P on both BC (A+ negative) and Nova Scotia (AA- negative). For instance, the alternative downside scenario incorporating 25% U.S. tariffs over two years would lift the net debt-to-GDP ratio to peak of 43% peak by 2028, versus 38.7% today. While a comparison between 2025 and 2017 is imperfect, it indicates that Quebec is unlikely to face another downgrade by S&P or receive a negative outlook.

In fact, the stable outlook attached to the A+ rating merits positive remarks. It expresses commendable efforts from the government intending to maintain long term fiscal sustainability. First, the Quebec government keeps sizeable contributions to the Generations Fund over the next five years, north of $2B per year. Second, Budget 2025 maintains the budgetary law requiring a return to a balanced budget within five years. At the same time, the required efforts to reach a balanced budget are slightly incomplete. Efforts on the spending side to get there have been identified, including tapering off the use of private health care and a hiring freeze in the public sector.

S&P's downgrade came up after the release of Budget 2025 and contrasts with Fitch's AA- stable re-affirmation pre-budget release. Fitch cites in a report released after Budget 2025 "*risks form tariffs and existing fiscal pressure lead to weakest fiscal outcomes since global financial crisis*".

Does the latest BC rating downgrade from S&P and Moody's materially change anything?

Despite the B.C. government's commendable intention to find efficiency savings over the medium-term, Budget 2025 does not incorporate a balanced budget plan and does not consistently put money aside for future debt reduction like Quebec, Alberta and N&L. Altogether, the sizeable deficits penciled in the 3-year fiscal outlook of Budget 2025 ultimately led to the fourth credit rating downgrade of the Province of B.C. in four years.

Moody's dropped the province of B.C. rating from Aa1 negative to Aa2 negative in early April. B.C.'s credit pricing performance did not materially change post-downgrade, revealing no fundamental view alteration from market participants. It is very important to note the absence of an adverse snowball effect: Moody's re-affirmed MFABC's AAA rating with a stable outlook in April, citing "*very limited linkages between MFABC and British Columbia, insulating MFABC from MFABC's borrowing members and the province, rather than MFABC directly*".

Relative to Moody's, the sequence of events was different at the S&P Global Ratings agency. S&P did lower its rating on the province of B.C. from AA- to A+ with a negative outlook early April. One day later, S&P Global Ratings put British Columbia Investment Management Corporation (BCI) on a negative watch. The agency limits its ratings on BCI (AAA) to four notches above those of the related subnational entity, the B.C. government.

Does the Canadian energy exemption from U.S tariffs favour oil-producing provinces?

The all-in, effective tariff rate imposed on Alberta, Saskatchewan and Newfoundland &Labrador is unambiguously lower than other provinces given the exemption of energy from U.S. tariffs. Still, this advantage does not imply a fundamental one in respect to short-term financial performance. First, tariff-induced uncertainty is weighing down on business confidence to the same extent in oil-producing provinces than heavily exposed non-oil producing provinces to the U.S. market, like Ontario and Quebec, according to the Canadian Federation of Independent Businesses. Second, global oil market conditions have been softening. OPEC+ unexpectedly shifted gear by revealing a plan to increase output by more than 400K bbl per day starting in May, bringing down crude oil prices below FY2025–26 assumptions built-in budgets (Alberta: WTI at US$68 per barrel; N&L: Brent at US$73; Saskatchewan: WTI at US$71). In addition, the U.S.-China trade war escalation points to slower global oil demand relative to previous forecasts from the EIA and OPEC. Alberta's budget stands out from the pack in a very positive way because of superior prudence built-in the base line scenario: 15% tariffs on non-energy Canadian exports and 10% tariffs on energy during the entire 3-year outlook. Newfoundland & Labrador went for an annual contingency of $200M representing 1.9% of revenues.

Auto shutdowns and big spending promises: What to expect from the Ontario budget?

Unfortunately, the month of April brought some bad news for the Ontario auto industry. Stellantis temporarily paused production at the large SUV assembly plant of Windsor for two weeks, directly affecting 3,500 workers at the plant. GM will partially cease operations at the smaller Ingersoll plant, although the adverse impact on Ontario's real GDP will be relatively more significant due to the longer shutdown tied to the rebalancing of inventory with lower demand. Only a partial rebound in production is expected next fall at the Ingersoll plant relative to the previous level of assembly. This adjustment raises the risk of a slower real GDP growth path for Ontario closer or slightly below 1% in 2025. Budget 2025 should either incorporate this in the base line scenario or in an alternative tariff scenario.

This short-term shock is not only directly tied to U.S. tariffs. The latter could weigh down on U.S. auto sales to a various degree according to experts. According to the Telemetry think-tank, if current tariffs stay in place over the long run, sales of light vehicles in the U.S. and Canada would be more than 20% lower relative to the base case scenario. Meanwhile, Cox Automotive recently revised down its U.S. sales volume forecast of 2025 by a more modest 5%.

This being said, moving some of auto production to the U.S. and away from Ontario would prove to be overly costly for automakers. A recent report from the Canadian Chamber of Commerce cites that shifting auto plants from Canada to the U.S. would require three years of construction. Auto companies would rather lean in favour of absorbing costs than opting for bold, unproductive relocation plans. The same report argues that that U.S. labour costs remain significantly higher, to the tune of 20%, relative to Canada.

Although Ontario's economy finds itself in a relatively disadvantageous position in the short-run because of U.S. tariffs imposed on the non-Canadian content of USMCA compliant assembled vehicles, tinkering with the idea of ballooning bond issuance in FY2025–26 would be the wrong, short-sighted conclusion. History shows an apparent preference for Ontario to smooth annual bond issuance over time, fostering stability from a market perspective. For example, a year ago in Budget 2024, the government reduced cash and cash equivalents by $1B to prevent an equivalent increase of bond borrowings. Then, in the stellar 2024 Fall Update showing a better-than-expected deficit, Ontario resisted the idea of issuing fewer bonds by increasing cash reserves to maintain long-term bond issuance intact at $37.5B in FY2024–25. In our view, it would be surprising to find out the FY2025–26 borrowing program indicates bond issuance north of $42B or south of $35B. It was previously projected at $35B in the last Fall Update.

In addition, market participants should not be concerned by the $11B financial assistance announced by Premier Doug Ford in early April to support businesses affected by U.S. tariffs. $9B is related to a 6-month deferral of several taxes. Taxes will not be collected before October, which does not fundamentally change the accounting of FY2025–26. The remaining $2B relief is a rebate offered during the month of April. This rebate comes from the Workplace Safety and Insurance Board (WSIB). A first $2B tranche was previously distributed in March. The WSIB, collecting deductions from payroll to cover employees in case of a work-related injury, is a trust under administration not included in Ontario's consolidated financial statements. According to the latest available public accounts, WSIB benefits from a net asset balance of $5.1B, implying Ontario likely won't have to issue more bonds.

Another recurrent question from market participants relates to the electoral promises of Premier Ford. The flagship measure is the construction of a tunnel under Highway 401 at a cost exceeding $50B. If the government goes ahead with this project, it will likely take more than a decade to build. Funding initially dedicated for other purposes could be re-allocated to prevent a surge in capital spending and borrowing requirements.

Ultimately, what matters are the long-term indicators of progress on the debt burden reduction strategy targeted by Ontario. The net debt-to-GDP ratio (at 37.8%, below the 40% target), the net debt-to-revenues ratio (202%, targeting below 200%) and debt-servicing ratio (6%, below the 7.5% target) have been solid. These three metrics are poised to fundamentally remain in good shape post-2025 budget release. Furthermore, Ontario appears far from any credit rating concerns, even from S&P that have shifted gears more than other credit agencies lately. S&P upgraded Ontario's long-term rating from A+ to AA- last year.

How big could the FY2025–26 federal deficit and GoCs issuance look?

It is challenging to firmly assess the most plausible path of the credit performance of provincial issuers relative to federal benchmarks without having a clearer view of the GoC debt management strategy for FY2025–26. The 2025 federal budget should provide such clarity. The recent spread resistance of provincial credits relative to Government of Canada bonds (GoCs) indicate the risk of higher debt issuance at the federal level versus provinces.

As mentioned at the beginning of this report, nine provinces excluding Ontario point to a combined bond issuance of $93B in FY2025–26. This amount should reach between $130B and $135B once Ontario releases its budget. Total provincial issuance during FY2024–25 was approximately 10% higher, at $146B, an amount including $18B in pre-financing activity.

While provinces could issue somewhat less in FY2025–26 than the year prior, the federal government will likely gear up GoC issuance. A softer Canadian real GDP profile alone should shave $4B to FY2025–26 annual revenues relative to the Fall Update, according to our calculations. In addition, expensive electoral promises from federal parties and geopolitical pressures fueling spending skew the risk in favour of deeper federal deficits and higher increase in GoCs. For instance, both Liberals and Conservatives plan to reduce personal income tax rates, shaving $6B and $13B in revenues per year, respectively. The Conversative party also pledges a deferral of capital gains taxes costing $5B annually. The Liberal party recently announced $5B in trade infrastructure and even more funding for housing over time. Simultaneously, actions and demands from the Trump administration lean in favour of structurally higher defense spending from Ottawa that has failed to meet the NATO 2% GDP target, primed to add close to $20B in spending over the medium-term.

Considering these developments and the Parliament Budget Officer previous estimates of a $50B deficit in FY2024–25 and $47B in FY2025–26, a revisited $60B-$65B shortfall in FY2025–26 in the upcoming 2025 federal budget does not appear unrealistic. Annual deficits are poised to be revised higher beyond FY2025–26 as well relative to the Fall Update, unless the next federal government finds out new efficiencies.

As for the GoC borrowing offering impact, the other big factor to consider relates to the continuous roll-off of bonds from the Bank of Canada's balance sheet. The federal government previously issued $172B of GoCs during FY2023–24 and $257B during FY2024–25. Under our assumptions including modest real GDP growth of 1.2% in 2025, GoC issuance can be expected to come in close to $310B in FY2025–26. This figure assumes a ramp-up of T-bills issuance tied to the tax payment deferrals on corporate income and GST announced in late March, providing up to $40B in liquidity to businesses coping with U.S. tariffs. In the Fall Update, the increase in issuance was equally split between the 5Y/10Y (+$3B each) and the 2Y (+$6B) sectors. Such strategy could be repeated again, possibly leaving the long 30Y sector with another timid increase (+$1B in the Fall Update).

Key takeaways

In summary, signs of geopolitical-driven cost pressures and compressed revenues point to larger federal deficits and a moderate rise in the federal net debt-to-GDP ratio. Such plausible path raises the question of the capability of Ottawa to raise future transfers to subnational governments to the same extent it had increased in recent years. At the same time, even under a sweeping U.S. tariff scenario, we do not see the federal net debt to GDP ratio soaring to the point of threatening the triple-A rating like the 1990s. As such, the AAA feature of the central government entity should be used more convincingly by the next federal government to better support provincial jurisdictions not benefiting from such a rare rating, notably by increasing its contribution to infrastructure spending.

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