

Market View – Pump up the [Canadian bond market] volume

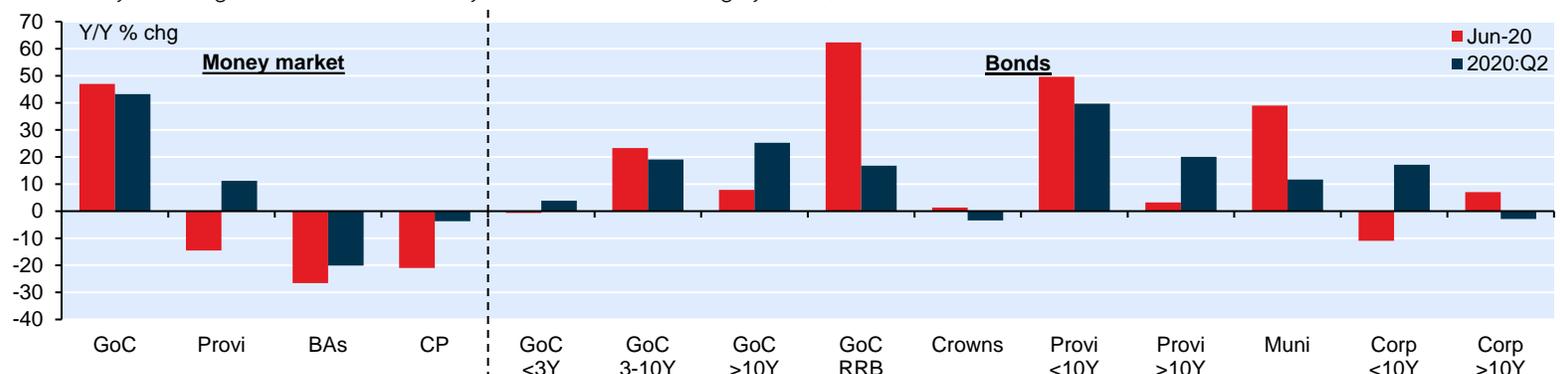
By Warren Lovely

Friday afternoon on another sweltering hot summer day, what better way to pass the time than by boning up on Canada’s fixed income trade volumes. This note focuses on fresh stats for June, which cap a pretty extraordinary quarter for market participants:

- The data set in question is IIROC’s monthly MTRS 2.0 domestic trade vol compilation, which provides a relatively timely and quite detailed breakdown of what is being traded around (and by whom) in Canada’s fixed income market. These data are not seasonally adjusted. As if we needed reminding, there’s some serious seasonality in issuance and trading activity, invalidating month-over-month comparisons. Focusing instead on year-over-year comps, the latest monthly tally saw total bond trading volumes up 13% vs. Jun-2019 and even farther above Jun-2018 (+18%). Note: The MTRS 2.0 regime started in 2018, so comparisons to 2017 or earlier periods aren’t meaningful.
- Looking at quarterly results, which by definition smooth out monthly noise, you’ll find domestic bond trading volumes in 2020:Q2 were 15% larger than 2019:Q2. Quarterly money market volumes, by the way, were up 10% year-on-year, as a surge in T-bill trading (capturing an explosive increase in bills outstandings, as Ottawa rapidly financed its virus action plan) more than offset a drop-off in BA activity.
- There were interesting developments in Government of Canada bonds, which accounted for ~80% of total bond volumes in Q2. Total GoC volumes were up 14% vs. the prior year, implying a higher rate of turnover when you consider total outstandings (excl. BoC holdings) were little changed. Of note, GoC trading (excl. BoC QE) migrated out the curve. Total volumes for 0-3 year Canadas were up just 4% year-on-year. It’s here where the majority of BoC QE has been concentrated and there are fewer bonds leftover to trade. Total trading in the 3-10 year sector surged closer to 20%, where there’s been more net supply. But the biggest increase of all was registered in the over 10-year category of the GoC bond market, as Q2 volumes stood more than 25% higher than the prior year. If anything, the shift in action to longer tenors could be exacerbated by Ottawa’s freshly announced strategy of terming out its debt—a topic we explored in our coverage of the recent [federal fiscal snapshot](#) and in a [related note by Taylor Schleich](#). As for who was trading all those Canada bonds, details reveal a big-time increase in volumes amongst domestic institutional investors, alongside a notable increase in inter-dealer trade. Non-residents remained well engaged, where a double-digit year-over-year increase in volumes kept their share of total GoC trading north of 20%.
- As for the remaining 20% of domestic bond volumes not accounted for by the GoC, results were uneven across sectors. CMB issuance may be stepping up, consistent with an increase in mortgage insurance in force at CMHC. But in Q2, the volume of federal crown paper trading hands moved *lower*, not *higher*. That included less activity (vs. the prior year) among domestic institutional accounts and non-residents.
- It was a totally different story in provi land, however, where bond volumes have absolutely surged. Total trading in the second quarter was fully one-third higher than a year ago, reflecting in part, an unprecedented amount of issuance as provincial governments moved aggressively to secure liquidity. The Q2 spike in provi volumes owes an assist to April’s outsized dose of supply. But provi volumes were pretty impressive in June too, which coincided with a continuing improvement in financial conditions and investor eagerness to take on risk (in both credit and equity markets). The counterparty breakdown shows broad-based gains in provincial bond volumes: Canadian banks were more active; so too were other domestic institutional investors; there was also more trade via anonymous systems. Particularly noteworthy was the increase in trading of provincial bonds by non-residents. For Q2 as a whole, non-resident trade in provincial bonds was almost 75% higher than a year earlier. June’s non-res tally was essentially double the prior monthly average. As international investors loaded up on what now looks like very attractively priced paper, they drove their share of total provincial bond trading to ~10% in Q2.
- Interestingly, non-residents weren’t nearly as active in municipal government bonds during Q2, where non-res trading volumes slumped more than 35% year-on-year. Domestic institutional investors also reduced their activity in munis. Really then, the ~12% reported increase in Q2 muni volumes (vs. the prior year) was due to dealers trading bonds amongst themselves and/or via anonymous systems. To be fair, we’ve seen nothing like the increase in primary muni issuance that we’ve observed in provincials. And while we don’t want to overplay muni credit risks, the reduced level of activity might partly reflect certain high-profile warnings of a liquidity crunch. Moreover, the curious decision to bar/exclude municipal bonds from Bank of Canada purchase facilities may also be a factor here. To us, the central bank’s decision on muni bonds is worth re-visiting. Why not level the QE playing field across the entire general government sector? It’s a thought.

Chart: Compositional shift... with total Canadian bond trading volumes up 15% in Q2 vs. the prior year

Year-over-year change in total domestic money market and bond trading by sector/term



Source: NBF, IIROC



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