July 10, 2020 - (Vol. IV, No. 44)

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

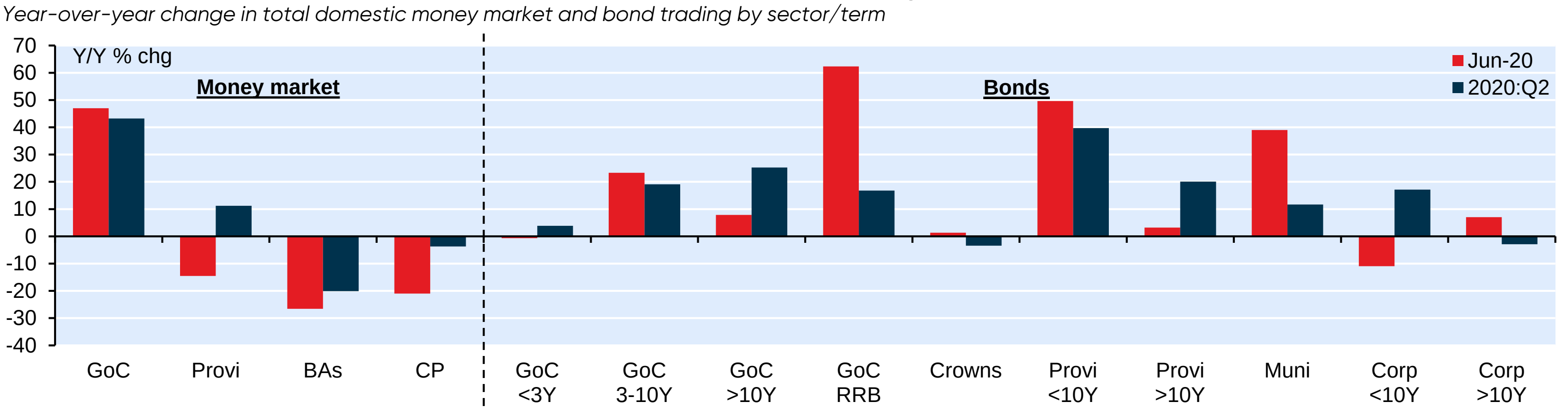
By Warren Lovely

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

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Paul-André Pinsonnault
Senior Economist
paulandre.pinsonnault@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rate Strategist, Economics and Strategy
warren.lovely@nbc.ca

Taylor Schleich
VP, Rates Strategist, Economics and Strategy
taylor.schleich@nbc.ca

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA")which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.