

## Provi bonds pose for their end-of-year non-resident close-up

By Warren Lovely

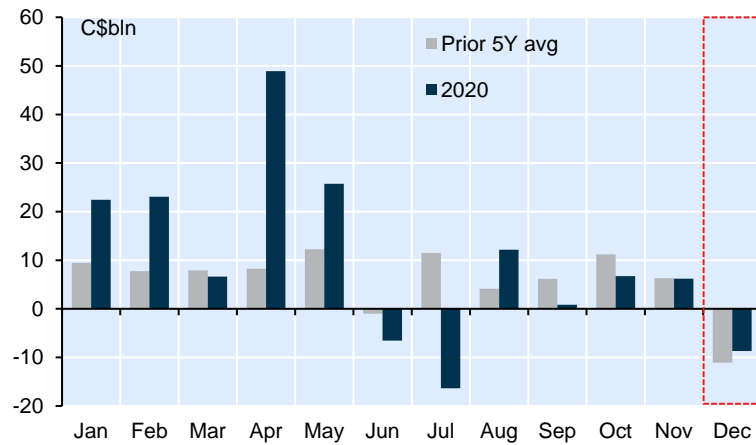
Today's international securities transactions data close the book on non-residents flows in Canadian portfolio securities for 2020. On the surface, it seems like 2020 went out with a whimper, given C\$8.7 billion in net foreign *divestment* of Canadian bonds in December. But as we always caution, December is hardly a typical month in Canada's fixed income market. There's a particularly heavy concentration of maturities, and the passive divestment that happens when these securities retire often makes December look like a weak month for foreign investor interest. Look past this seasonal head fake and you will see that 2020 was a truly exceptional year. Over C\$120 billion (net) of Canadian bonds were placed with non-residents. Add the C\$20 billion (net) of Canadian money market paper that non-residents acquired and 2020 goes down as a record year for foreign engagement in Canadian fixed income assets. Just when we needed them the most, non-residents were ready and willing to swallow our paper.

Beyond the headline figures, this note provides a close-up on non-resident flows in Canadian provincial bonds. We're watching the provi sector closely, with the Bank of Canada's Provincial Bond Purchase Program due to expire in early May. To be clear, we feel it appropriate to let this program die. **To us, it should be RIP PBPP—a catchy title for a topic we'll be exploring in greater detail this week.** As this note makes clear, however, non-residents are one potential avenue to pick up needed slack in provincial bond markets as the central bank backs away.

Non-resident purchases/holdings of Canadian portfolio securities... with a focus on Canadian provincial bonds

**Chart 1: December's net divestment a seasonal story**

Net foreign purchases of Cdn bonds by month of year

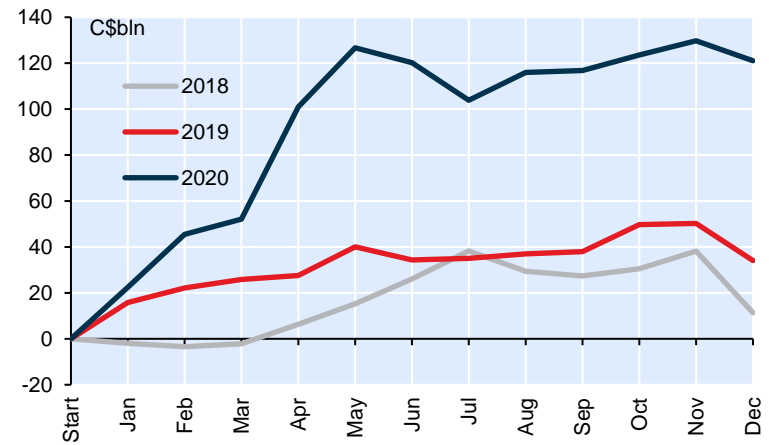


Source: NBF, StatCan | Note: All sectors & currencies

There was C\$8.7bln of net foreign divestment in Canadian bonds in December. But that's a seasonal story, reflecting concentrated maturities. December has produced 'net selling' of Canadian bonds every year since 2013.

**Chart 2: Non-res scoop up C\$121bln of Cdn bonds in 2020**

Net foreign purchases of Cdn bonds: Cumulative total by month

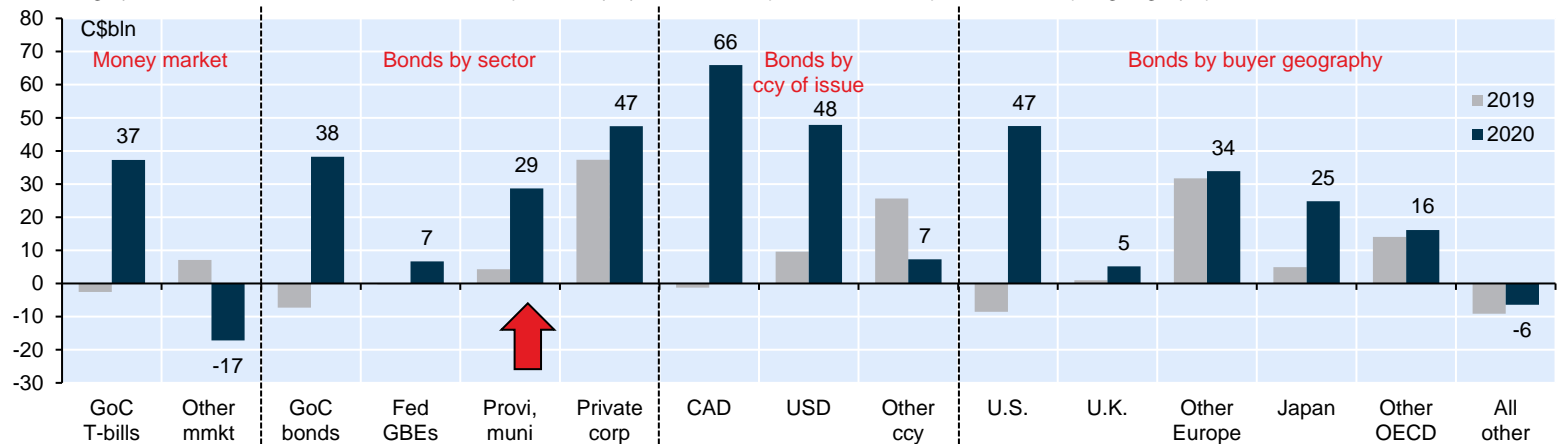


Source: NBF, StatCan | Note: All sectors & currencies

Notwithstanding December's divestment, non-residents accumulated a net C\$121bln of Canadian bonds in 2020. They also scooped up C\$20bln of Canadian short-term paper, making 2020 a year for the record books.

**Chart 3: What Canadian bonds were non-residents buying last year? More like, what weren't they buying**

Net foreign purchases of Cdn debt securities: Money market paper & bonds by sector, currency of issue & buyer geography

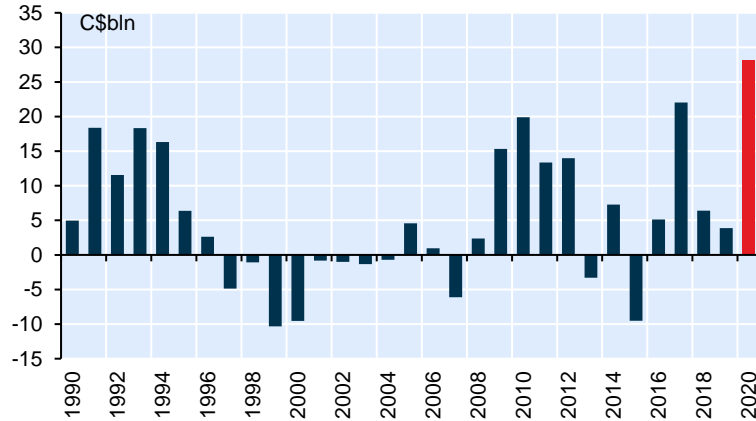


Source: NBF, StatCan

Between money market paper and bonds, non-residents purchased a net C\$141bln of Canadian debt instruments in 2020—a record amount and more than C\$100bln higher than 2019. Sovereign paper was much sought after (both T-bills and bonds), which when overlaid with BoC buying kept markets tight in absolute and relative terms. Big-time buying of CAD-denominated bonds supported the currency. U.S. and Japanese investors really drove last year's marginal buying.

**Chart 4: Record foreign buying of provincial bonds**

Net foreign purchases of Cdn provincial bonds

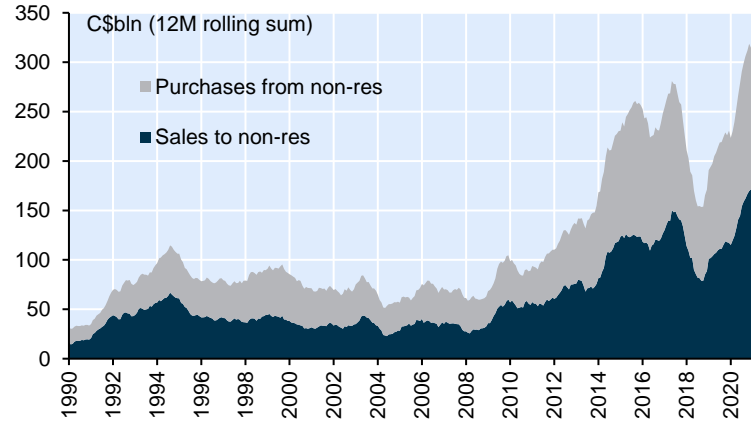


Source: NBF, StatCan | Note: Includes GBEs; all currencies

Keying on provincial bonds, 2020 saw a net C\$28bln placed with non-residents—a record tally. Solid foreign demand (in conjunction with extreme policy accommodation) helped clear an unprecedented amount of supply.

**Chart 5: Two-way flow in provincials with non-res surges**

Net foreign sales/purchases of Cdn provincial bonds

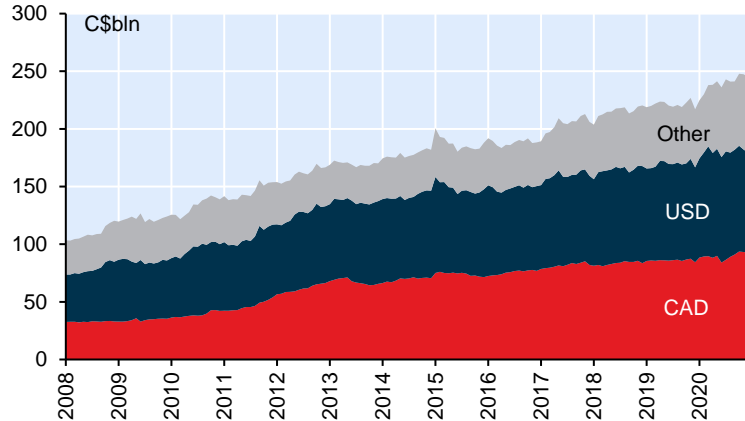


Source: NBF, StatCan | Note: Includes GBEs; all currencies

Two-way flow in provincial bonds with non-resident investors has surged, having been clearly biased to net buying of late. This includes foreign currency issues but increasing non-res activity has also been observed domestically.

**Chart 6: Don't lose sight of foreign currency factor**

Non-resident holdings of Cdn provincial bonds by currency of issue

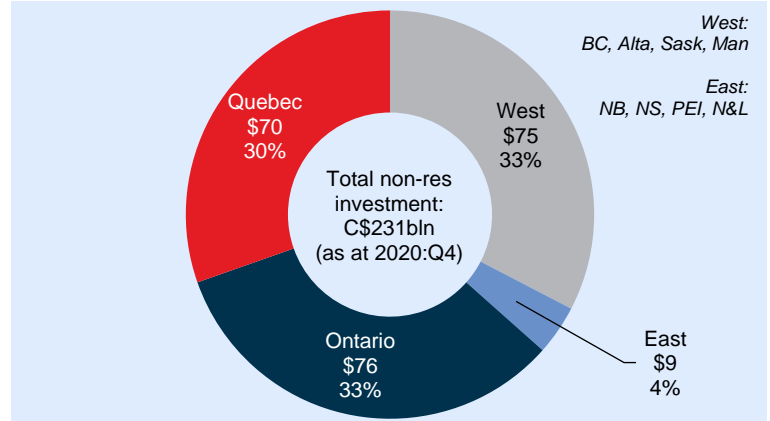


Source: NBF, StatCan | Note: Book value; includes GBEs

When it comes to provincials (and corps for that matter), be mindful of the currency split. The majority of provi bonds non-residents own are denominated in foreign currencies. Mind you, holdings of CAD paper have ground higher.

**Chart 7: Snapshot of non-res holdings of provi bonds**

Distribution of non-resident holdings of Cdn provincial bonds by issuer

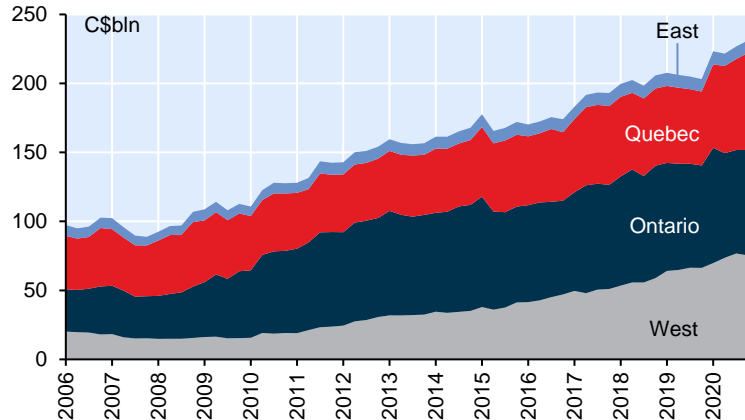


Source: NBF, StatCan | Note: Book value; excludes GBEs; all currencies

At the end of 2020, non-residents owned just over C\$230bln of provincial government bonds (excl. provi GBEs). Ontario bonds accounted for the largest share, followed closely by the 'West' (inclusive of BC, Alta, Sask, Man).

**Chart 8: Which provinces are non-res investors holding?**

Non-resident holdings of Cdn provincial bonds by issuer

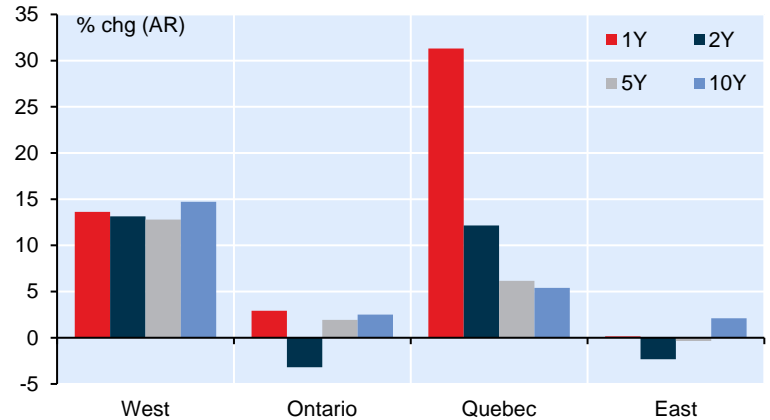


Source: NBF, StatCan | Note: Book value; excludes GBEs; all currencies

A decade ago, Western provinces accounted for 15% of non-res provi holdings. At that time, Ontario's share was closer to one-half. But foreign holdings of Western bonds have since increased four-fold, vaulting their share higher.

**Chart 9: Growth in non-res positions partly issuance story**

Growth in non-resident holdings of Cdn provincial bonds by issuer

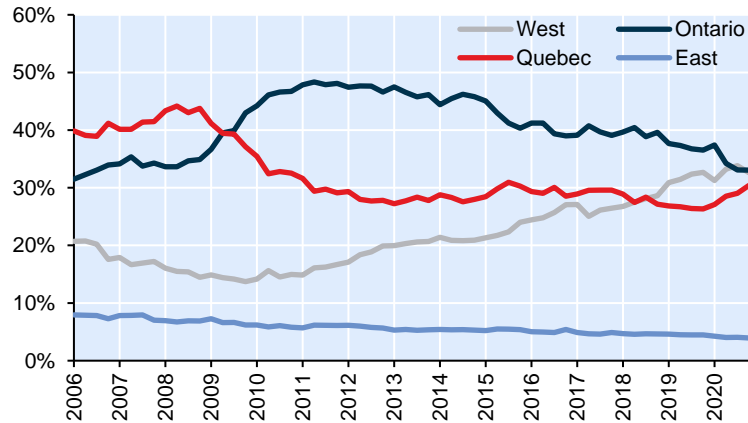


Source: NBF, StatCan | Note: Based on book value; excludes GBEs; all currencies

Rapid growth in non-res holdings of Western bonds is partly a function of outsized borrowing needs (incl. Alta). Non-residents boosted their holdings of Quebec bonds by C\$17bln last year, facilitating a virus-driven surge in issuance.

### Chart 10: Provincial bond portfolios adjusted

Share of non-resident holdings of Cdn provincial bonds by issuer

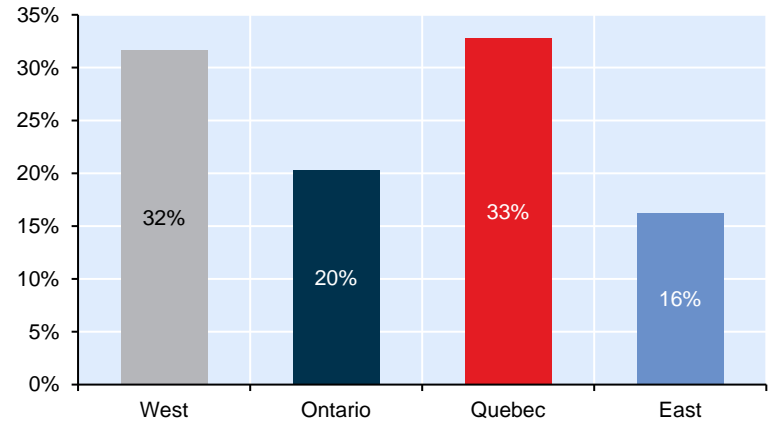


Source: NBF, StatCan | Note: Book value; excludes GBEs; all currencies

2020 saw something of a convergence in non-resident holdings of provincial bonds, with the book value of investments in Ontario, Quebec and Western provinces in the same ballpark. But...

### Chart 11: Relatively how significant are foreign investors?

Share of outstanding provincial bonds held by non-residents investors

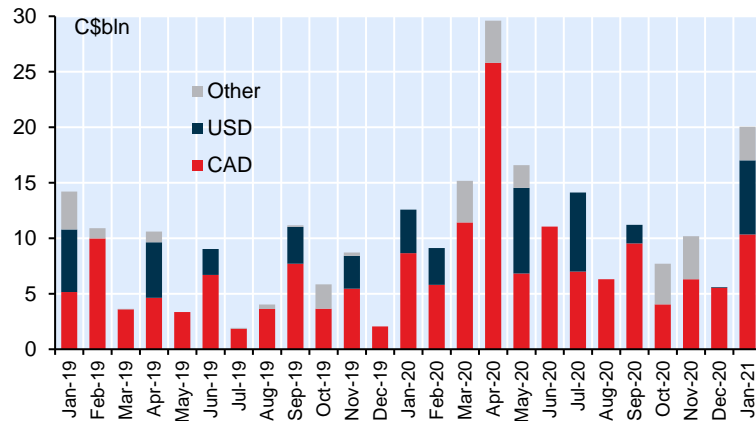


Source: NBF, StatCan, Bloomberg | Note: Book value; excludes GBEs; all currencies; divides non-resident holdings as at Dec-2020 by current provincial outstandings

...when you control for outstandings, non-residents own a notably larger share of Quebec and Western bonds vs. Ontario. The debt of Eastern provinces is the most domesticated, given less foreign supply and relatively lower liquidity.

### Chart 12: Non-res interest in provis continued into 2021

Gross provincial bond issuance by currency of issue

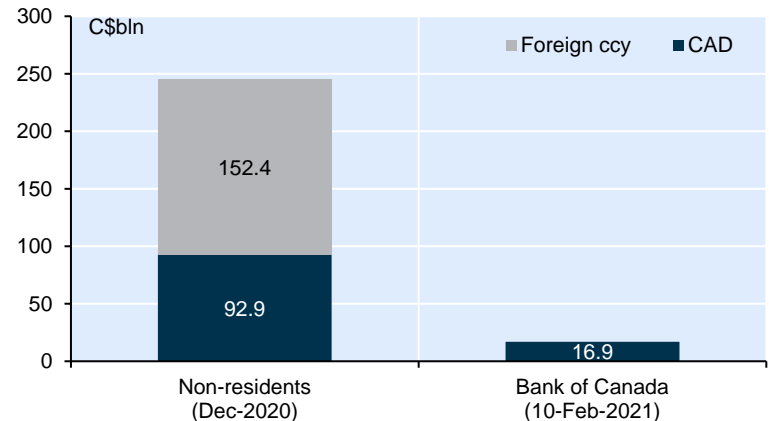


Source: NBF, Bloomberg

Today's data dealt with Dec-2020, but just wait for Jan-2021 figures to roll in. We're sure to see a hefty slug of provincial bonds put into non-resident hands, reflecting last month's outsized borrowing (including foreign currency supply).

### Chart 13: Non-res could be vital outlet as BoC's PBPP ends

Holdings of provincial bonds: Bank of Canada vs. non-residents



Source: NBF, StatCan, Bank of Canada | Note: Non-res holdings are book value, including GBEs; Bank of Canada holdings are market value (as per BoC balance sht)

Non-res interest could be a vital offset as the BoC moves to end its PBPP in May. Foreign interest will be welcome in the domestic market, but provinces retain an ability to fill it internationally too. An opinion piece on PBPP will follow.



## Economics and Strategy

### Montreal Office 514-879-2529

**Stéfane Marion**

*Chief Economist and Strategist*  
stefane.marion@nbc.ca

**Paul-André Pinsonnault**

*Senior Economist*  
paulandre.pinsonnault@nbc.ca

**Daren King**

*Economist*  
daren.king@nbc.ca

**Matthieu Arseneau**

*Deputy Chief Economist*  
matthieu.arseneau@nbc.ca

**Angelo Katsoras**

*Geopolitical Analyst*  
angelo.katsoras@nbc.ca

**Jocelyn Paquet**

*Economist*  
jocelyn.paquet@nbc.ca

**Kyle Dahms**

*Economist*  
kyle.dahms@nbc.ca

**Camille Baillargeon**

*Intern Economist*  
camille.baillargeon@nbc.ca

### Toronto Office 416-869-8598

**Warren Lovely**

*Chief Rates and Public Sector Strategist*  
warren.lovely@nbc.ca

**Taylor Schleich**

*Rates Strategist*  
taylor.schleich@nbc.ca

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