

Muni musings

By Warren Lovely/Alpa Atha

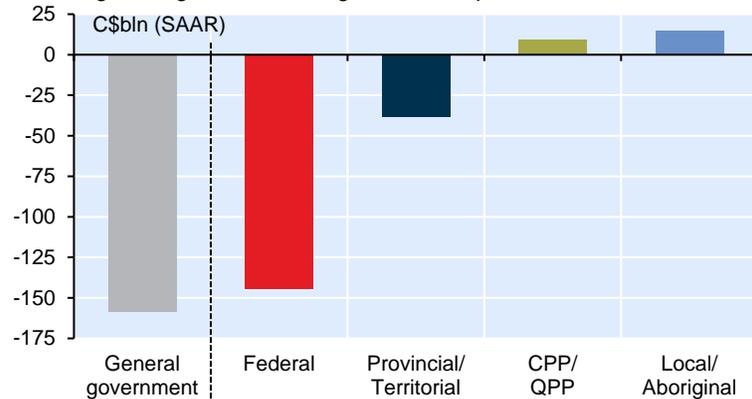
National Bank's *10th Annual Municipal Borrowers Conference* goes off (virtually) next week: September 14th & 15th. If you haven't already, contact NBF to register for any/all of the nine issuer presentations that are lined up. At the risk of prejudging the message and/or lumping unique borrowers together, here's a narrative you're likely to hear next week: local economies are recovering (notwithstanding ongoing virus worries); jobs are returning (although some sectors remain fragile); populations are growing (despite immigration having been disrupted by border closures); housing markets are robust (in some cases red hot); municipal operating budgets remain balanced, as required by law (which has nonetheless required effort given pandemic-related revenue/spending pressures); extraordinary support from other levels of government has helped (with a more permanent fix for transit authorities nonetheless a priority); municipal tax rates, notably on real property, remain relatively low/competitive (implying fiscal capacity if ultimately needed); municipal credit ratings are strong and stable (in some cases, as with the Region of York, actually improving); capital investments continue apace (although only a fraction requires fresh debt). Sound familiar? Well, certain elements should, as one of the more compelling aspects of the muni credit story is its sheer year-over-year consistency.

Qualitative assessments are all well and good, but why pass up an opportunity to test theories with fresh, hard data. Enter August's Labour Force Survey and Q2 reports on Canadian government finances/credit market activity. We could dedicate a whole separate note to municipal labour market conditions. But for now, let's just say that nearly half of all CMAs have seen employment levels return to (if not surpass) where things stood before COVID hit. That's progress. As for quarterly finances, the story remains a compelling one. Canada's local governments collectively ran a budget surplus in Q2, contrasting mightily with still-sizeable deficits being run federally and provincially (Chart 1). If you can believe it, the local government sector's combined surplus is now larger, not smaller, than where things stood pre-COVID (Chart 2), which speaks to the lower-beta nature of key municipal revenue streams and the fact that more virus-spending is happening federally/provincially.

The real test is whether these reported fiscal developments get reflected in the bond market. And believe us, they do. Whereas the feds and provinces continue to push plenty of net new bonds into the market, net issuance is non-existent in the local government sector (Chart 3). That continues a relatively constructive technical trend, with municipal leverage relatively modest in absolute and relative terms. The total stock of outstanding municipal government bonds is equivalent to just 3% of GDP, an increasingly tiny fraction vs. the expanding pool of GoC and provi securities. Munis aren't wholly immune to the pandemic, but the story remains a relatively healthy one. Tune in next week to hear for yourself.

Chart 1: Not all government ink is coloured red in Canada

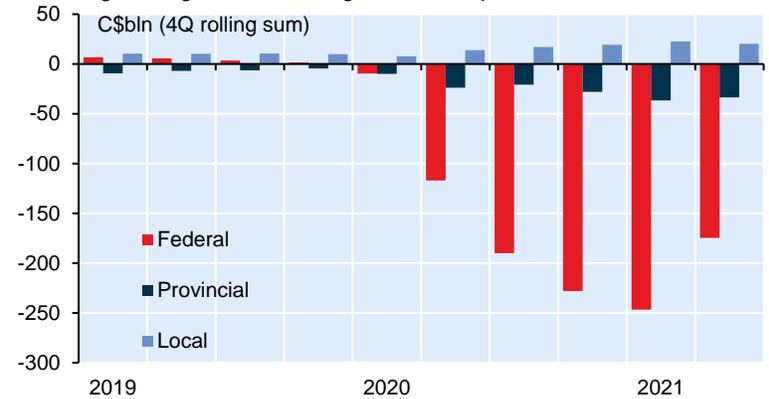
Canada general government budget balance by sector: 2020:Q2



Source: NBF, StatCan (National Accounts)

Chart 2: Three levels of gov't, three different trajectories

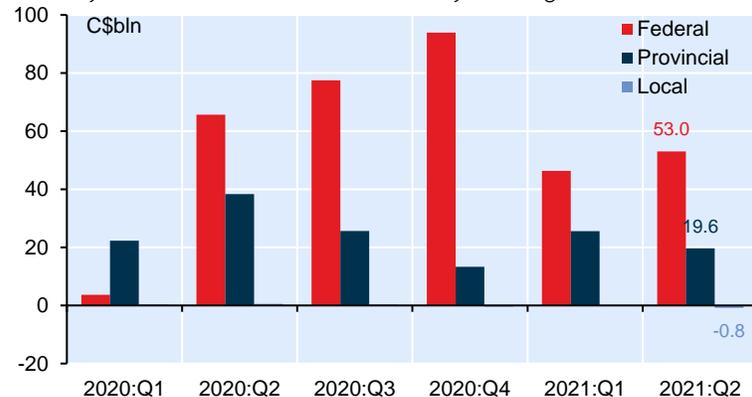
Canada general government budget balance by sector: Pre-virus to current



Source: NBF, StatCan (National Accounts)

Chart 3: No net borrowing at local government level

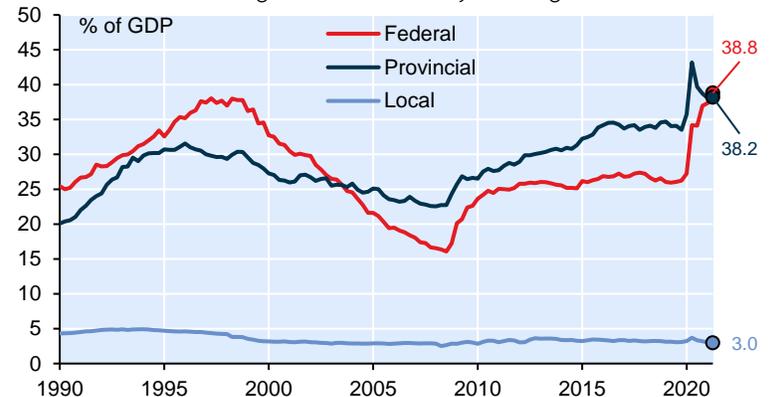
Quarterly net new Canadian bond issuance by level of government



Source: NBF, StatCan | Note: Bonds only; excludes net purchases by BoC

Chart 4: Municipal balance sheets strong(er)/protected

Book value of outstanding Canadian bonds by level of government



Source: NBF, StatCan | Note: Value of bonds placed with all investors, including BoC



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