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## May I have the envelope, please?

By Warren Lovely

Watched any good movies or shows lately? If so, you may be gearing up for the annual awards season, the highlight of which tends to be the Oscars. But you don't have to wait around for the 94<sup>th</sup> Academy Awards on March 27<sup>th</sup> to get your awards fix. Indeed, for observers of and/or participants in Canada's domestic debt capital markets, it's time to present our annual Fixed Income Trading Awards. I'm your host, Warren Lovely, and may I have the envelope, please?

### National Bank's 2021 Fixed Income Trading Awards

[Based on IIROC's MTRS 2.0 bond & money market trading statistics | Limited edition trophies are on their way]

**Same, same award** ➤ **Total C\$ bond trading volumes, 2021 vs. 2020** – All told, the equivalent of C\$13.839 trillion of Canadian bonds changed hands in 2021. That was remarkably similar to the C\$13.836 trillion of total bond volume recorded in 2020. We're talking year-over-year growth of just 0.03% to be precise. Yes, you have to squint to really see a difference. But don't let the near-identical tally in total bond volume fool you; last year produced some notable trading developments, including those worthy of the following awards.

**Hyperactive award** ➤ **GoC bonds, 3-10 years** – Busiest overall was once again the belly of the GoC curve (i.e., 3-10 years). There was over C\$5.7 trillion of trading in this sector, up ever so slightly from 2020 and accounting for >40% of total domestic bond trading. There continues to be disproportionate turnover in GoC 3- to 10-year bonds relative to the share of outstandings, hedging activity heavily concentrated here.

**Major momentum award** ➤ **GoC bonds, under 3 years** – Not to be outdone, there was ample trade in shorter-dated Canadas. There's presumably more to come in 2022, as BoC policy normalization hints at elevated vol for front-end rates. Indeed, judging from year-over-year growth as of December (+17%) or Q4 (+25%), trading of short Canada bonds has perked up appreciably. Inter-dealer flow has surged of late, while volumes linked to Canadian banks and other domestic institutional clients have also stepped up notably. [Aside: As per our latest [Fixed Income Monitor](#), we see five BoC hikes in 2022. We favour trading the front-end from the short side, 2s-10s looking to flatten ~40bps this year.]

**You're so special award** ➤ **GoC 2-year bonds** – Domestic bond repo volumes shot up 12% in 2021, landing just shy of C\$40 trillion. Without trivializing volumes for provincial, crowns or MBS, it was in GoC bonds where repo activity really expanded. You're likely aware of some serious tightness in GoC 2s, a story we explored [here](#) and an issue that's come back to the fore early in the year. A quick fix may prove elusive, although some tweaks to the federal debt management strategy in Budget 2022 could help. Stay tuned. In the meantime, be mindful of dislocations.

**What term out award** ➤ **GoC bonds, over 10 years** – Ottawa continues to steer plenty of paper into the long end. Some C\$33 billion of nominal longs were auctioned last year, up from C\$23 billion in calendar 2020 and standing miles above pre-COVID levels. Ultras returned too. Still, total trade in GoC >10-year bonds declined 15% last year, with liquidity in the long end of the Canada curve not exactly oceans deep.

**I need protection award** ➤ **GoC real return bonds** – RRBs may account for less than 1% of total GoC bond volume, but runaway inflation has spurred some investors to seek protection here. That keyed a near-40% increase in RRB trading last year. With Canadian inflation likely to average almost 4% in 2022, even more accounts could seek a hedge in the coming months and quarters, even if available product is limited.

**Long & liquid award** ➤ **Provincial bonds, over 10 years** – Provincials heavily influence the narrative in longer tenors. As these issuers stepped back out the curve, the volume of trade in >10-year provincial bonds surged almost 40% in 2021. Whereas longs account for less than 10% of GoC trading, the long end is home to ~40% of total provi volume. Provi bonds: Long? Yes. Liquid? You bet. Go ahead and test us.

**Front-end loaded award** ➤ **Municipal bonds** – Once again, Canada's municipal governments emerged from an economic recession with their intrinsic credit quality intact. That means we haven't seen the same type of increase in funding activity. While full-year muni volumes were 4% higher year-on-year, a lot of that trade was loaded into the first half of the year. We see roughly C\$6 billion of gross muni issuance in 2022. While issuance/secondary trading is often concentrated in the spring and fall, a few candidates can be expected to test the market soon enough. As for a value proposition, shorter-dated muni spreads are relatively tight, but there's residual value in the longer end of the curve.

**Credit where credit is due award** ➤ **Corporate bonds** – Total corporate bond trading was down 5% in 2021, volumes flagging somewhat in the final quarter of the year. Interestingly, while domestic investors were less active last year, non-residents stepped up their trading, accounting for a growing share of corporate bond volumes. [Note: See 'foreign affiliation award' for more non-res colour.]

**Green means go award** ➤ **Green bond issuers** – You won't find a detailed breakout of green bond trading in IIROC's stats, but it's hard to miss the growing appeal and relevance of these securities. We're not picking favourites among an expanding pool of issuers. But consider that Ontario cleared the single largest domestic green bond last year, a C\$2.75 billion 8-year deal met with hearty demand. There's more to come in 2022, from provis, munis, corps, PSEs/SSAs and the sovereign itself. Sustainable finance: It's a growth industry if there ever was one.

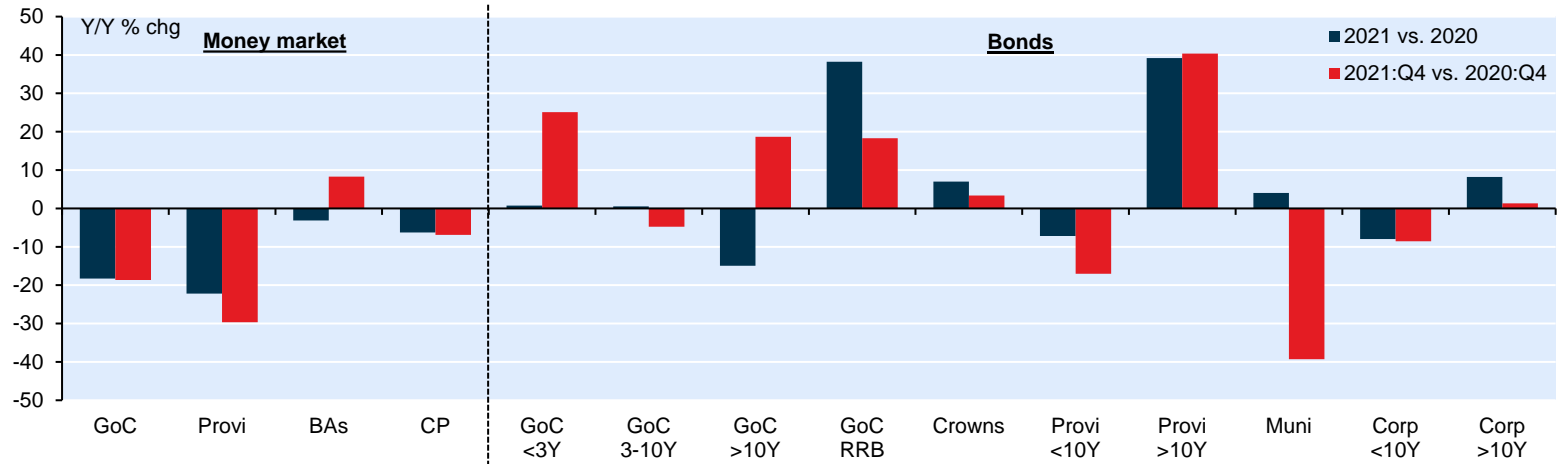
**Foreign affiliation award** ➤ **Federal Crown bonds** – Technically, the highest non-resident share of trading is observed in the GoC market. Non-residents could be called on to clear some non-trivial net GoC issuance in 2022, particularly once BoC balance sheet run-off gets rolling. Ex-GoC, the largest non-resident share of trading is found in federal Crowns, where overall liquidity remains healthy. Dear foreign investor: Have we mentioned that 5Y CMBs are attractive here, trading more or less in line with the tightest provis? Other PSEs, like CPPIB Capital and PSP Capital, are likewise enticing, where rating enhancement doesn't require much of a spread sacrifice and where liquidity is building.

**Significant shrinkage award** ➤ **Treasury bills (GoC & provincial)** – Fewer GoC T-bills and less provi money market activity meant reduced volumes. The BoC has all but erased its holdings of GoC T-bills, non-residents likely to remain a key market clearing flow in a choppy 2022.

**It's a mystery award** ➤ **'Other' domestic money market securities** – We'll end on a suspenseful note. Nearly C\$2 trillion of money market trading was unallocated in 2021. We're talking ~35% of total volume. Here's hoping IIROC gets a better handle on these flows post haste.

**Chart 1: Assessing growth in trading volumes across Canada's fixed income market**

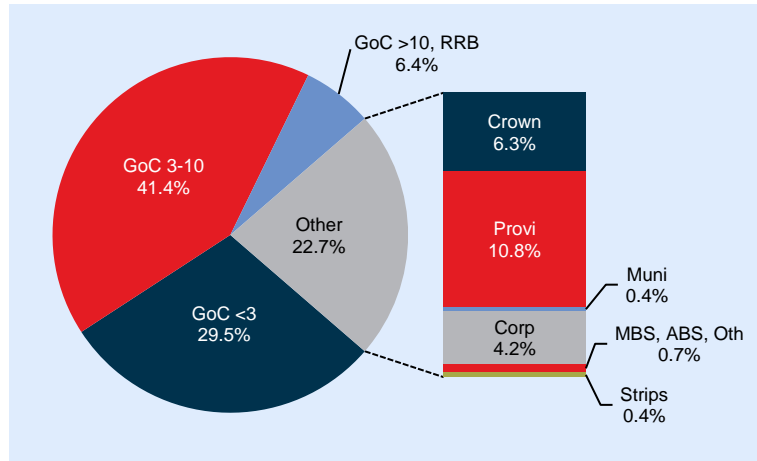
Year-over-year growth in total Canadian secondary bond & money market trading by major sector/tenor: 2021 (full-year & latest quarter)



Source: NBF, IIROC | Note: Change in total trading, based on all counterparties

**Chart 2: Bond volume dissection shows 77% of trade in GoC**

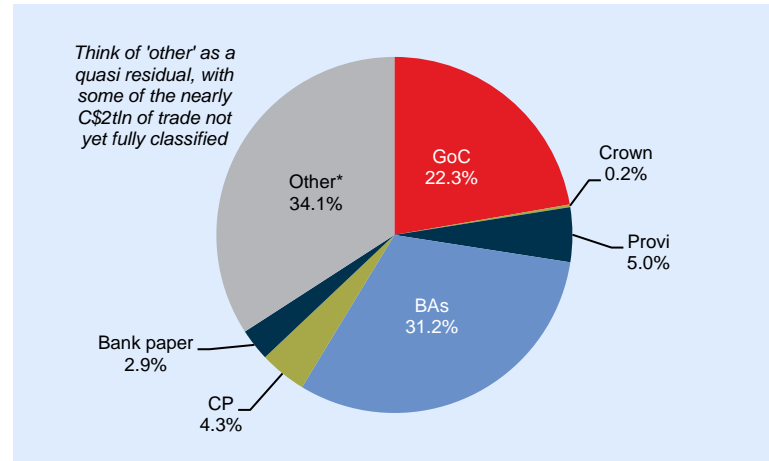
Share of Canada secondary bond trading by major sector/term: 2021



Source: NBF, IIROC | Note: Share of C\$13.8 trillion in total bond trading in 2021

**Chart 3: Money market volumes carry big asterisk for 2021**

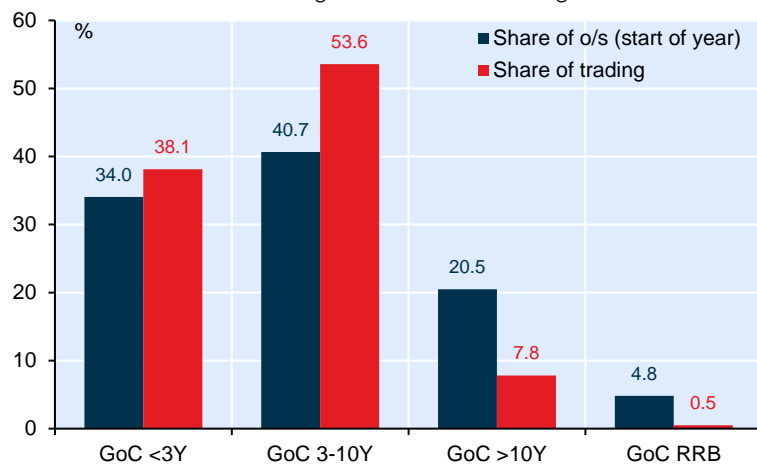
Share of Canada secondary money market trading by major sector: 2021



Source: NBF, IIROC | Note: Share of C\$5.7 trillion in total money market trading in 2021

**Chart 4: Relatively brisk turnover in 'mid' Canadas**

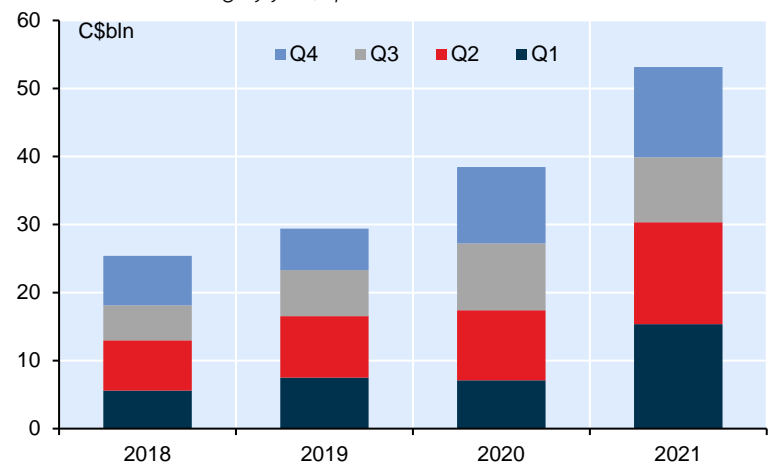
Share of total GoC bond trading vs. share of outstanding bonds: 2021



Source: NBF, IIROC, Bank of Canada | Note: GoC outstanding bonds as at 1-Jan-2021; share of GoC trading based on full-year total

**Chart 5: RRB volumes up as inflation protection sought**

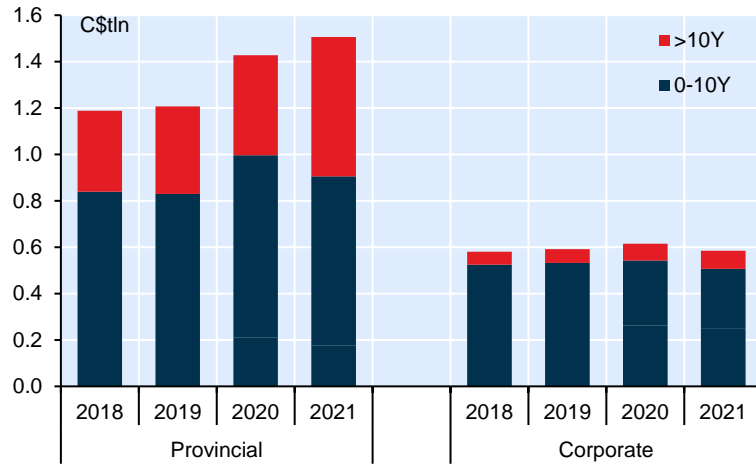
Total GoC RRB trading by year/quarter



Source: NBF, IIROC | Note: Total GoC RRB trading volume up 38.2% in 2021

**Chart 6: Substantial/growing trading of long provincials**

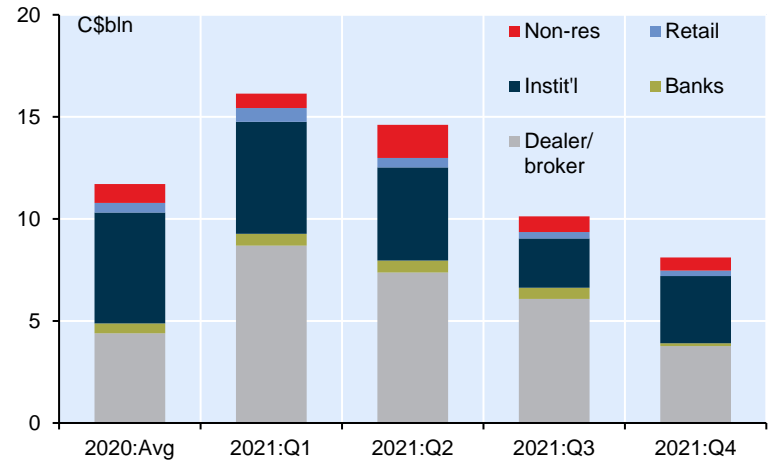
Total annual provincial & corporate bond trading by term



Source: NBF, IIROC | Note: Total 2021 provincial bond trading +5.5% vs. prior year; total corporate bond trading -4.9% vs. prior year; >10Y accounts for 40% of total provi trading

**Chart 7: Muni trading moderated in H2, but due to pick up**

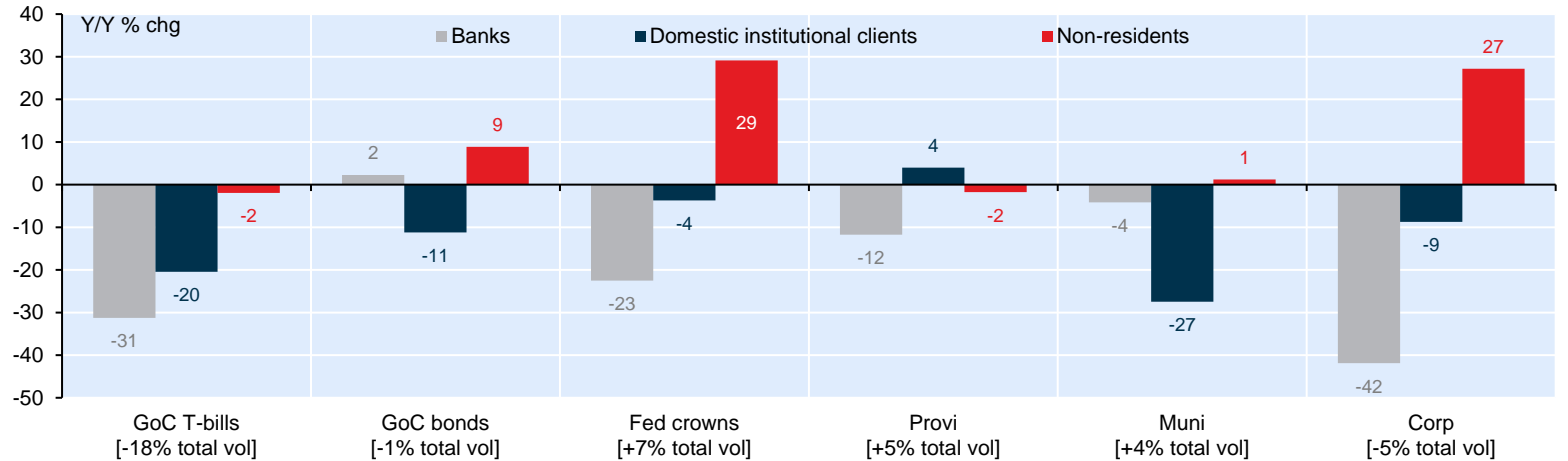
Total quarterly municipal bond trading by counterparty: 2021 vs. 2020 average



Source: NBF, IIROC | Note: At C\$49.2bln, total 2021 municipal bond trading +4.1% vs. prior year, but by 2021:Q4 trading was down almost 40% vs. 2020:Q4; 2020 refers to qtrly avg

**Chart 8: A closer look at what some key investor types were trading**

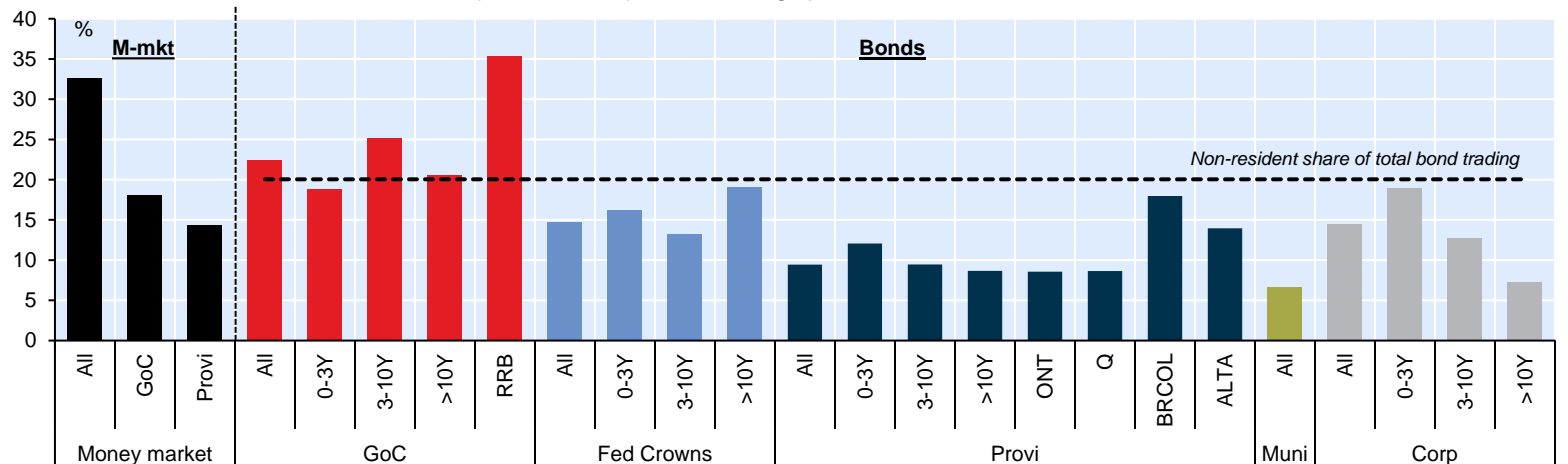
Year-over-year growth in Canadian secondary bond & money market trading by select investor type & sector: 2021



Source: NBF, IIROC | Note: 2021 vs. 2020; figures in [ ] under each sector label refer to year-over-year change in secondary trading across all counterparties

**Chart 9: What share of trading did non-residents accounted for last year?**

Non-resident share of total Canadian secondary bond & money market trading by select sector: 2021



Source: NBF, IIROC | Note: Shares for individual provinces reflect total for all tenors; four largest provinces listed by BBG ticker



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