Market View
Economics and Strategy

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Searching for a seasonal supply outlet

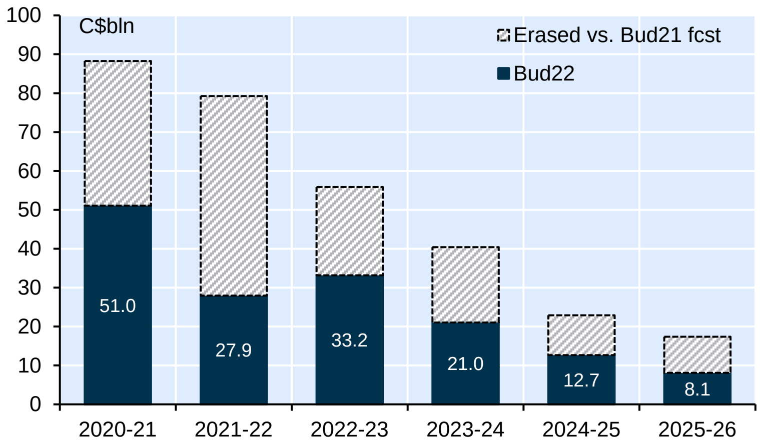
By Warren Lovely

Mid-May tends to be an interesting seasonal period. In Canada, the outsized cashflows set to arrive in a couple weeks' time tend to reverberate across domestic debt capital markets, both in the lead up to and immediate aftermath of the cash deluge. Refer to our detailed thoughts here. It's perhaps less-than-surprising that issuers react to this excess cash by steering marginal product into the market. Again, our earlier piece explored supply seasonals in the domestic provincial bond market. But what of supply seasonals for international issuance?

Notwithstanding all that Canadian cash, mid-May has historically been of one of the busiest times of the year for non-CAD provincial bond issuance as spring budgets and due dili efforts generally fall away. Only mid-January tends to bring more international issuance by our provis. We're reluctant to place blind faith in empirical tendencies since supply drivers are hardly static year to year. And as our New York trading colleagues would no doubt caution, investor demand for dollar-denominated provincial debt might not be exceptionally deep at this particular moment—a by-product of monetary policy/inflation anxiety and tighter financial conditions. Less-than-lean dealer inventories suggest prospective deals could be met by at least some selling in switch, rather than the ultra-clean burns that encourage fast followers. Still, there's presumably an incentive for provincial issuers to tap international markets when/where they can. There's a non-trivial amount of borrowing to do in fiscal 2022-23 and perhaps a desire for catch-up given a collective slow start in April. Indicatively, cross-currency arbs are compelling (or at least tolerable). Plus, the diversionary nature of international funding can be a salve for more important domestic spreads. That's a non-trivial consideration, given provinces haven't exactly been spared wider domestic spreads despite compelling fiscal news.

Chart 1: Material fiscal improvement in provi land...

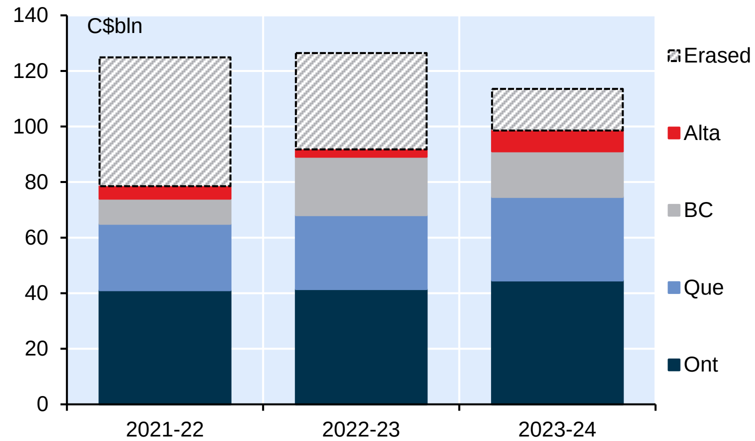
Aggregate provincial budget deficit outlook: Budget 2022 vs. Budget 2021



Source: NBF, prov gov'ts | Note: "Erased" represents cumulative budgetary improvement from Budget 2021 to Budget 2022

Chart 2: ... yet more gross borrowing in 22-23

Gross borrowing requirements for four largest provinces: 2022 budgets

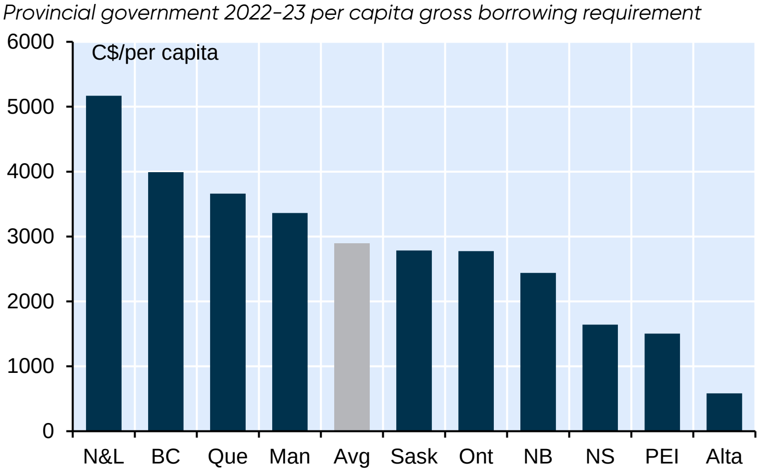


Source: NBF, prov gov'ts | Note: "Erased" reflects combined reduction in gross long-term borrowing requirements from Budget 2021 to Budget 2022

As we've detailed repeatedly, provincial finances have enjoyed a massive improvement in the past year. For fiscal 2022-23, the combined deficit is nearly C$25 billion better than prior guidance. That means a lot less issuance than once feared. Nonetheless, the provincial sector has collectively telegraphed a larger gross borrowing requirement for 2022-23 relative to what was secured in 2021-22.

Chart 3: Relative funding needs vary notably

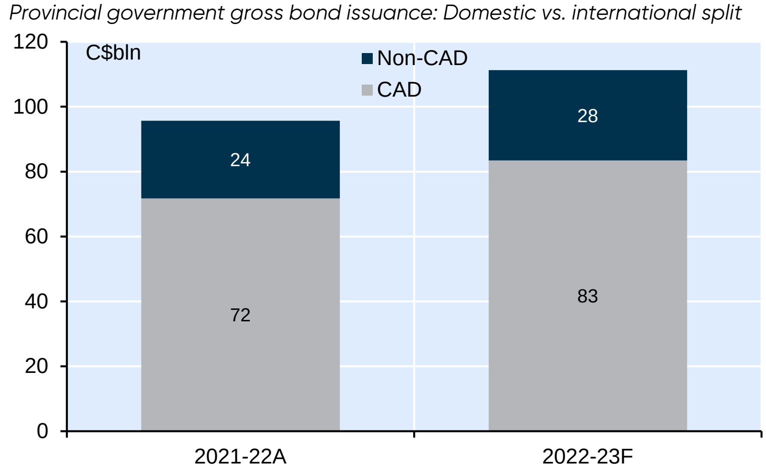
Provincial government 2022-23 per capita gross borrowing requirement



Source: NBF, prov gov'ts, StatCan | Note: Official long-term borrowing requirements scaled to 2022:Q1 population estimates; based on Budget 2022 projections

Chart 4: 75/25 funding split implies non-trivial non-CAD paper

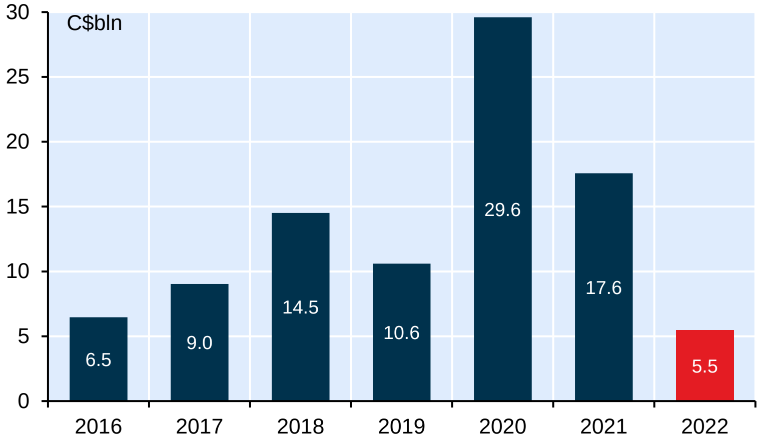
Provincial government gross bond issuance: Domestic vs. international split



Source: NBF, prov gov'ts | Note: 2021-22 represents completed funding; 2022-23 is prospective split assuming 75% of official borrowing needs are sourced domestically

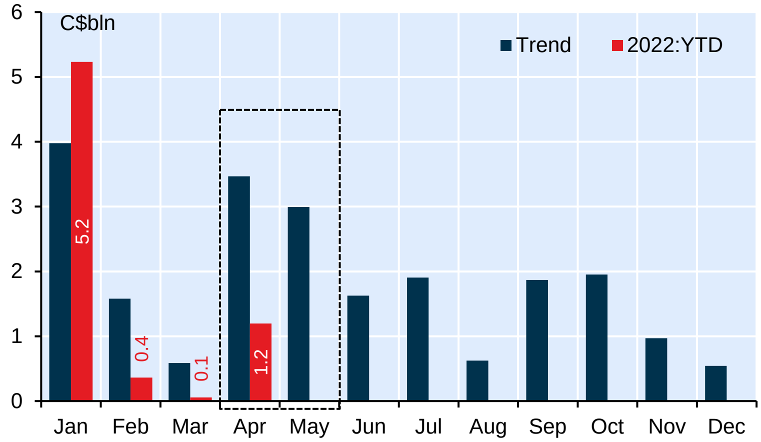
Economic and fiscal performance remains uneven/unbalanced. That's partly reflected in relative borrowing needs, which have collapsed most materially in Alberta (where significant revenue upside remains). All told, provinces project C$111 billion of gross borrowing for 2022-23. Assuming 25% is sourced internationally, we'd could see ~C$28 billion of non-CAD paper (all else equal).

Chart 5: Not the quickest start to FY funding in 2022-23
Provincial bond issuance (all markets): Month of April (i.e., first month of FY)



Source: NBF, Bloomberg

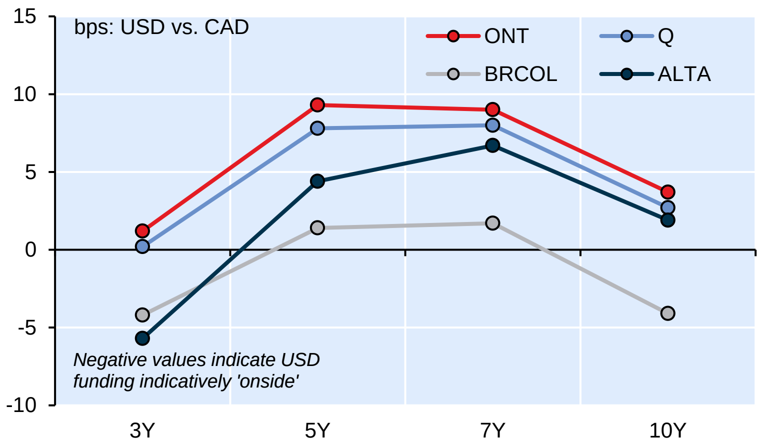
Chart 6: International funding activity muted of late
Provincial bond issuance (international markets): 2022:YTD vs. prior trend



Source: NBF, Bloomberg

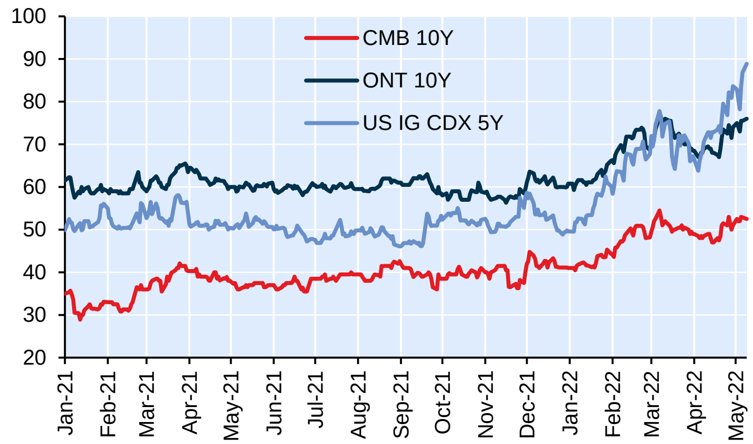
Unlike the past couple of years, the aggregate provincial borrowing program hasn't gotten off to the quickest start in 2022-23. Just C$5.5 billion was secured in April across all markets. International funding activity has been somewhat muted for the past few months in fact. But spring 2022 may not be a total write-off when it comes to non-CAD supply…

Chart 7: USD funding arbs looking better
Snapshot of provincial cross currency funding levels: USD vs. CAD market



Source: NBF | Note: Indicative levels as at 9-May

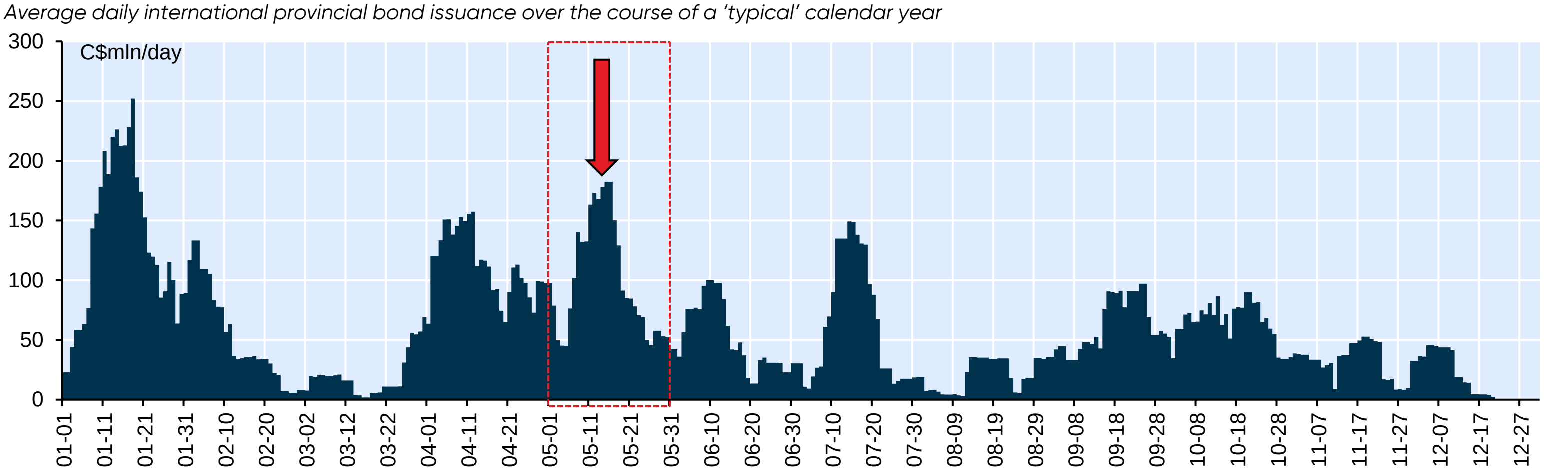
Chart 8: Domestic spreads may need protecting
Secondary credit spreads: CMB, Ontario & U.S. IG CDX



Source: NBF, Bloomberg

Cross-currency funding arbs appear respectable, if not fully onside for all names/tenors. While the 10Y USD arb may look relatively close to domestic levels, a defensive market tone might make 3s to 5s the safer/less risky trade. After all, provinces continue to get term in the domestic market, where investors would presumably welcome news of supply being diverted to international markets.

Chart 9: A finer look at international bond supply seasonals… with mid-May typically one of busiest times of the year
Average daily international provincial bond issuance over the course of a 'typical' calendar year



Source: NBF, Bloomberg | Note: Based on marketable bond issuance over 12Y period (2010-21); levels smoothed +/- 5 days; international trades converted to CAD at prevailing FX rate

Not to make too much of seasonal tendencies, but mid-May has tended to be something of a sweet spot when it comes to international bond supply from provincial governments. Only mid-January has produced more action (on average). One caveat: Ontario has an election upcoming (on June 2nd), which could influence this issuer's approach to debt capital markets both at home and abroad.

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