Market View
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Some perspective on record foreign buying of 'Canadian' securities

By Warren Lovely

When it comes to Canadian data releases, the monthly international transactions in securities release remains one of the more arcane and misunderstood. As a result, reported headline figures have demonstrated a tendency to raise eyebrows and prompt questions. Today's release, for the reference month of March 2022, is no different.

First, the latest catchy headline from Statistics Canada: "international transactions in securities generated an unprecedented net inflow of funds [in March and Q1]". Canada's extraordinary/record net portfolio capital inflow—some $70 billion in March alone and nearly $120 billion for Q1 as a whole—reflects sizeable foreign investment in Canadian securities combined with net selling of foreign assets by Canadian investors.

We don't wish to minimize non-resident interest in Canadian stocks, but when it comes to big-time foreign buying of Canadian securities, the real story is in the bond market. For March, bonds accounted for $30.3 billion or roughly two-thirds of total foreign investment in Canadian securities. For Q1 as a whole, bonds were overwhelmingly the story, comprising 96% of net foreign investment during the quarter.

You might get the impression that non-residents were coming over the gunnels in the first few months of 2022, pouring into Canada's domestic bond market and soaking up product wherever and whenever it was found. But that's simply not the case. And that brings us to one of the more misunderstood elements of these data. StatCan records foreign buying of 'Canadian' assets even if the securities in question are issued and traded not in Canada but in international markets. That's a not-so-subtle distinction, particularly for many large/frequent Canadian bond issuers, who have a long history of steering sizeable chunks of supply to international debt capital markets.

So yes, non-residents technically purchased over $30 billion of 'Canadian' bonds in March, but barely $500 million (less than 2%) took the form of CAD-denominated paper. The real foreign bond buying was happening in the U.S. dollar market ($17.5 billion net purchases of Canadian product in March) and other foreign bond markets ($12.3 billion net in March).

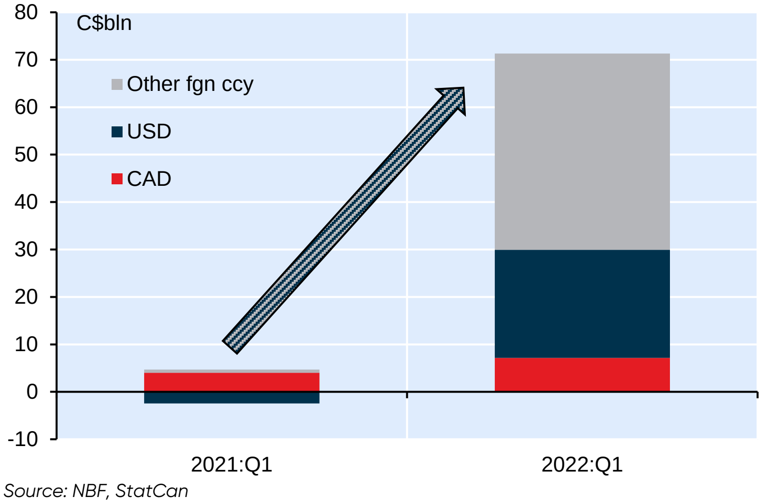
More specifically, what non-residents were really buying in March (and over the past number of months) was Canadian bank paper issued abroad. Adding in March's hefty tally, Canada's private corporations—notably banks—have raised nearly $150 billion from foreign investors in the latest 12-month period. That both dwarfs the prior record and is effectively triple the net foreign funding secured by all other Canadian issuers combined (including federal-provincial governments where deficits and capital spending needs make net financing needs non-trivial).

We're not situated in the Treasury department, but if you're looking for some colour on why Canadian banks have so aggressively funded themselves consider the following. Through March, banks were still seeing strong loan growth. At the same time, deposit growth was moderating, leaving capital market financing to make up the difference. In some cases, there were U.S. acquisitions and/or share buybacks to finance. Meanwhile, it's not inconceivable that some banks took the opportunity to secure extra funding ahead of Bank of Canada QT—an unconventional monetary tightening exercise that got rolling in April and will gradually drain liquidity and deposits from the system.

So there are a number of reasons why Canadian banks were eagerly tapping foreign currency markets in March. The good news? The funding got done, even if investor enthusiasm varied with underlying financial conditions/risk sentiment. Simple arithmetic means the ability to source funding from international markets limits the amount of bonds hitting the domestic bond market. It's a diversionary tactic that helps to insulate domestic spreads and one pursued not only by our banks but by Canada's provincial governments too.

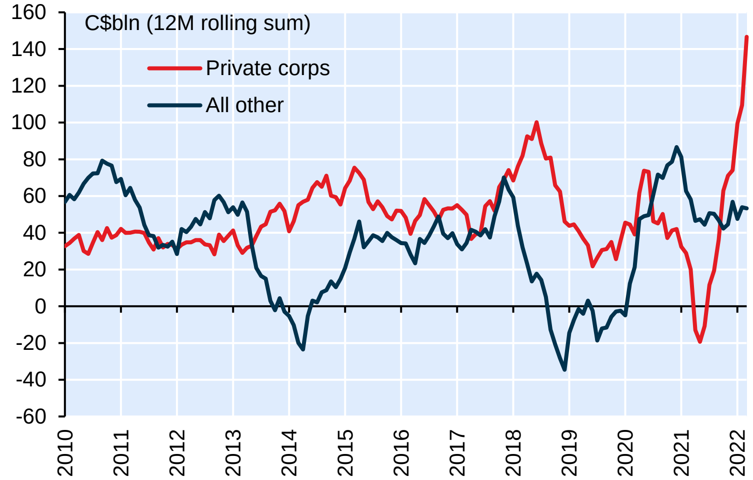
So even if headlines are a bit misleading and most of the foreign buying was happening south of the border and/or across the pond, there's nonetheless an indirect benefit to domestic bonds from what has been a truly extraordinary amount of foreign engagement in Canada.

Chart 1: Bond buying surge really seen in foreign currencies…
Net foreign investment in "Canadian" bonds by currency of issue



Source: NBF, StatCan

Chart 2: … and largely an international corporate bond story
Net foreign investment in Canadian bonds (all ccys): Private corps vs. all other



Source: NBF, StatCan | Note: 'All other' comprised of federal, provincial, municipal governments & government business enterprises; net bond flows in all currencies

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

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@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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