



A bond supply-valuation dance in 3 acts

By Warren Lovely, Piper Kerr & Ethan Currie

With a remarkable first half of the calendar year still relatively fresh in our minds, it remains a natural time to reflect on supply developments and resulting valuations across the domestic bond market. To us, Canada's supply-valuation dance remains an intriguing/beguiling one, so we offer an interpretation in three acts. This first note (i.e., Act 1), can be thought of as a contextual warm up, detailing various supply developments. Acts 2 and 3, to follow, will examine the influence on absolute and relative valuations, while outlining a near-term trading bias.

Act 1 ~ Setting the stage with supply

Canada's domestic market was served up roughly C\$45 billion of gross bond issuance in June. Last month's aggregate supply was remarkably similar to May, but don't let that fool you; some very material compositional shifts are happening below the surface. Of note, the first-half lift moderated materially relative to the corresponding year-earlier period (Chart 1). Year-to-date supply relief was unquestionably driven by federal and provincial governments, where heretofore-explosive revenue gains (one positive aspect of elevated prices and surging nominal output) leave more cash on hand and translate into appreciably lighter borrowing requirements. Call this Canadian fiscal repair on a grand scale, even if (i) much of the revenue surge is cyclical in nature and (ii) expenditure pressures are accumulating (not least of which will be cost-of-living adjustments/wage increases for public sector employees and assorted affordability initiatives).

Bond volume details further illustrate the fiscal recovery theme. Gross GoC bond supply is off some 30% on a year-to-date basis, as the federal deficit contracts and lighter cash requirements simply mean less sovereign product. While the GoC's ultra-long program has already been axed, don't misinterpret that as a wholesale abandonment of a term-out strategy. A fresh QBS (covering July to September) implies a 7½-year weighted average bond term (i.e., still notably longer than the pre-COVID trend). Meanwhile, outstandings in the shortest-of-all GoC funding tranches (i.e., T-bills) are running well shy of budgeted levels. Vitally, Ottawa's reduced GoC funding requirements, and thus low(er) levels of net GoC bond issuance, have dovetailed nicely with the onset of BoC QT. All else equal, that eases the ask of end investors, who by definition have replaced the central bank as the market clearing force. See related notes [here](#) and [here](#).

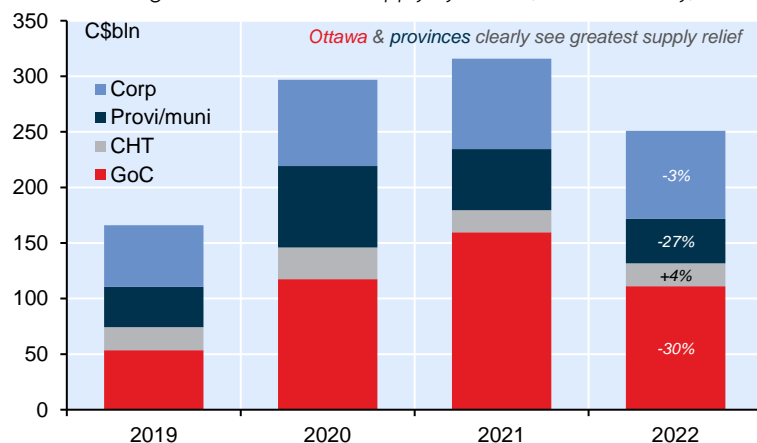
Collectively, Canada's provinces pushed C\$9.3 billion into the domestic bond market in June. As with the feds, YTD supply is off nearly 30% in provi land vs. the year-earlier period, testifying to buoyant revenue growth and budgetary consolidation. Meanwhile, on a fiscal year basis (i.e., since April 1st), the aggregate provincial borrowing program for 2022-23 appears to be more-or-less on track (Table 1). That's despite a relatively slow(ish) start in April and Ontario's early June election. We'd emphasize that the 'official' funding requirements set down in 2022 budgets are subject to (big-time?) adjustment. Public accounts suggest extra cash was on hand to start the year. Leaning the other way, pre-funding isn't generally built into official requirements. All that to say, underlying cash needs are likely to shift notably for more than a few.

When it comes to terming out, provinces continue to take the cake. The clear majority of June's provincial supply (\$5½ billion) was priced in the long end. That was the largest amount of long bond issuance on record, save for April 2020 of course—the most extraordinary of months, when a move to secure exceptional liquidity saw issuance records smashed. With a 23½-year weighted average term, June goes down as the only month in the post-GFC era where total supply *and* average duration both exceeded trend by at least one standard error. Expressed another way, the total dollar duration of domestic provincial supply exceeded C\$215 billion (i.e., total issuance x weighted average term). Remarkable stuff, and certainly worthy of technically inspired valuation analysis (of credit spreads, curves and basis).

Before moving to Acts 2/3 and select ins/outs of technically driven valuation analysis, a word on corporate bond supply. After a monumental lift in Q1, corporate issuance has settled into a C\$9-10 billion monthly run-rate of late. Fair to say that some issuers got a bit nervous in June, as new issue windows proved more fleeting than we'd like. Of note, YTD corporate supply is more than 2X what we've seen at the provincial level, a relative supply disparity that contributes, at the margin, to re-pricing select domestic credit relationships. First Intermission...

Chart 1: Governments lead issuance lower in 2022

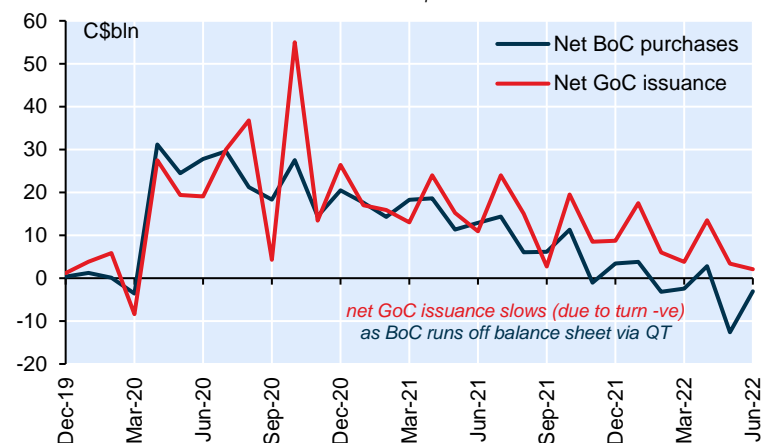
Year-to-date gross domestic bond supply by sector (CAD issues only)



Source: NBF, Bloomberg, BoC | Note: YTD refers to Jan-Jun; % chg is vs. 2021:YTD

Chart 2: Less GoC net supply as BoC backs away (pheff)

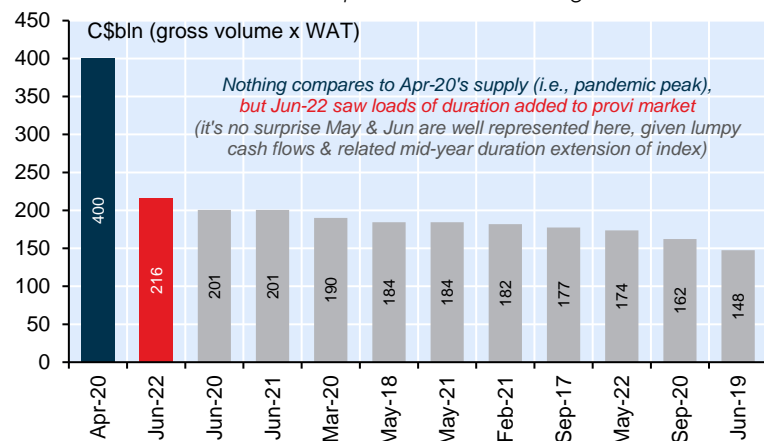
Net GoC bond issuance vs. net BoC bond purchases



Source: NBF, BoC | Note: We estimate net GoC issuance will be negative in Jul-Sep qtr

Chart 3: Heavy dollar duration in June, as provis go long

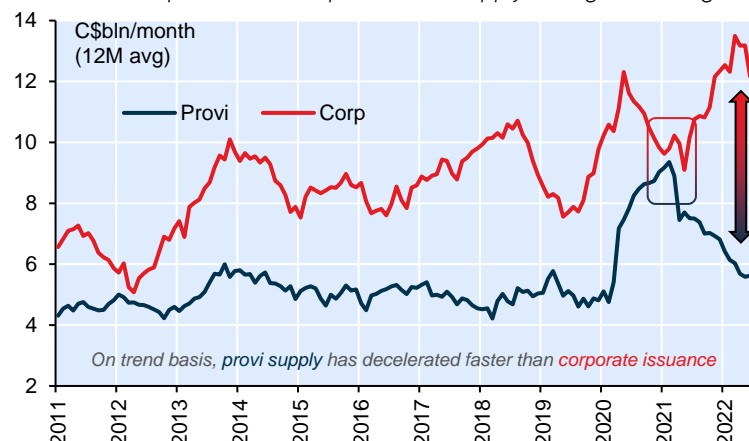
Gross dollar duration of domestic provincial issuance: Largest months



Source: NBF, Bloomberg | Note: 12 largest months of total duration since 2016

Chart 4: Provi-corp dynamic a key technical in credit markets

Gross domestic provincial vs. corporate bond supply: Rolling 12M average



Source: NBF, Bloomberg

Table 1: Gauging province-by-province progress towards 2022-23 official requirements (which are a moving target)

NBF Provincial Borrowing Program Update: 2022-23 fiscal year (i.e., April 2022 to March 2023)

Province / Agency	Ticker	Required ^a C\$bln	Required ^a C\$/per capita ^b	Completed ^c C\$bln	Domestic %	Foreign %	Remaining C\$bln	Funded Status %
British Columbia	BRCOL	21.01	3,991	3.14	96%	4%	17.88	15%
Alberta	ALTA	2.62	584	0.80	100%	0%	1.82	31%
Saskatchewan	SCDA	3.30	2,785	1.86	32%	68%	1.43	57%
Manitoba	MP	4.68	3,363	0.67	90%	10%	4.01	14%
Ontario ^d	ONT	41.50	2,776	11.90	69%	31%	29.60	29%
Québec ^e	Q	26.62	3,660	7.25	83%	17%	19.37	27%
Hydro-Québec ^{f,g}	QHXL	5.00		3.20	100%	0%	1.80	64%
New Brunswick ^h	NBRNS	1.94	2,439	0.50	100%	0%	1.44	26%
Nova Scotia	NS	1.65	1,642	0.30	100%	0%	1.35	18%
Prince Edward Island	PRINCE	0.25	1,503	0.00	--	--	0.25	0%
Newfoundland & Labrador ⁱ	NF	2.70	5,168	0.30	100%	0%	2.40	11%
TOTAL		111.3	2,897	29.9	79%	21%	81.3	27%

% FY elapsed: 27%

Source: NBF, provincial governments, Bloomberg, StatCan | Note: Borrowing update as at 8-Jul-22; (a) Long-term gross funding requirement based on latest available estimates; includes refinancing requirements; excludes prospective pre-funding for coming fiscal year; (b) Per capita needs based on 2022:Q1 population estimates from StatCan; (c) Funds borrowed to date; (d) Includes certain hydro-related financing under province's banner; (e) Includes financing for Financement-Québec; (f) Funds in own name with explicit provincial guarantee; (g) Fiscal year is January - December; (h) Includes requirements for NB Municipal Finance Corp; (i) Includes funding for N&L Hydro

Table 2: The real nitty gritty of supply using NBF's Domestic Bond Tracker (to June 2022)

Gross domestic (i.e., CAD) bond issuance by select sector, issuer, term, structure | Recent monthly results & prior-year comparisons for reference

C\$billion	Monthly issuance			Prior yr	Calendar year-to-date		Calendar year sum		
	Jun-22	May-22	Apr-22	Jun-21	2022	2021	2021	2020	2019
Government of Canada	21.0	21.4	13.5	27.4	111.2	159.7	281.4	321.2	114.0
2Y	8.0	9.0	4.5	10.0	35.5	50.0	82.0	117.0	48.0
3Y	3.0	-	3.0	-	12.0	21.0	35.0	49.3	16.4
5Y	4.0	4.0	-	4.0	16.0	28.0	48.0	73.9	30.6
10Y	4.0	8.0	4.0	10.0	36.0	41.0	79.0	56.9	12.6
30Y Nominal	2.0	-	2.0	3.0	10.0	18.0	33.0	23.0	4.2
30Y RRB	-	0.4	-	0.4	0.7	0.7	1.4	1.1	2.2
Extra-long	-	-	-	-	1.0	1.0	3.0	-	-
Weighted avg term (yrs)	6.9	5.5	8.7	8.8	8.2	8.2	8.7	6.4	5.4
Canada Housing Trust	5.0	5.3	-	5.0	20.5	19.8	40.0	53.0	40.0
5Y Fixed	5.0	-	-	5.0	10.5	10.0	20.3	32.0	21.5
5Y FRN	-	1.5	-	-	2.5	2.3	4.3	6.0	9.8
10Y Fixed	-	3.8	-	-	7.5	7.5	15.5	15.0	8.8
Provincial governments	9.3	8.5	4.3	8.8	37.0	51.4	81.8	108.3	57.8
Ontario	4.2	3.7	-	3.9	14.2	20.7	36.0	40.7	25.3
Québec	2.1	3.2	2.8	1.6	12.5	14.1	20.9	24.2	14.4
British Columbia	1.0	1.0	1.0	1.3	4.8	4.3	6.3	10.3	2.9
<i>Most populous (Ont, Qué, BC)</i>	<i>7.3</i>	<i>7.9</i>	<i>3.8</i>	<i>6.8</i>	<i>31.4</i>	<i>39.1</i>	<i>63.2</i>	<i>75.2</i>	<i>42.6</i>
Alberta	0.8	-	-	1.2	1.4	7.2	8.8	15.4	5.7
Saskatchewan	0.3	0.3	-	0.3	1.2	1.6	3.0	4.3	1.9
Newfoundland & Lab.	0.3	-	-	-	0.9	0.5	1.3	3.0	1.6
<i>Oil-levered (Alta, Sask, N&L)</i>	<i>1.4</i>	<i>0.3</i>	<i>-</i>	<i>1.5</i>	<i>3.5</i>	<i>9.2</i>	<i>13.0</i>	<i>22.6</i>	<i>9.2</i>
Manitoba	0.3	-	0.3	0.3	0.9	1.5	3.1	5.8	2.9
Maritimes (NB, NS, PEI)	0.3	0.3	0.2	0.3	1.2	1.6	2.5	4.7	3.2
Public	9.3	8.5	4.0	8.8	36.8	50.8	80.4	102.9	55.7
Private / MTN / Auctions	-	-	0.3	-	0.3	0.6	1.3	5.4	2.0
Fixed	9.3	8.5	4.2	8.8	37.0	51.3	81.7	107.5	57.1
Floating	-	-	0.1	-	0.1	0.0	0.0	0.8	0.6
1-5Y	-	-	0.2	-	0.2	1.7	3.3	23.5	7.0
6-10Y	3.7	4.5	1.7	3.5	19.3	27.2	41.3	49.8	24.9
>10Y (i.e. longs)	5.6	4.0	2.3	5.4	17.5	22.5	37.2	35.1	25.9
Weighted avg term (yrs)	23.4	20.4	21.9	22.8	20.1	19.1	19.5	16.4	19.3
International issuance	1.3	3.9	1.2	1.5	12.1	22.8	29.6	40.9	27.8
Prov'l total (incl non-C\$)	10.6	12.4	5.5	10.3	49.1	74.2	111.4	149.2	85.5
Municipal governments	0.4	0.9	0.4	0.5	2.9	3.7	5.9	5.4	5.3
Corporate	9.2	9.5	10.3	21.4	79.2	81.4	148.1	118.0	117.3

Source: NBF, Bloomberg, BoC, provincial governments | Notes: Figures represent gross bond supply; issuance totals based on par amount; deals recorded as per issue date; unless otherwise noted, figures refer to C\$-denominated issues only; GoC figures exclude Green issuance; provincial figures include issuance by guaranteed entities; provincial international issuance presented for reference purposes, converted to C\$-equivalent amounts at prevailing exchange rates; municipal government issuance refers to publicly syndicated deals only; corporate issuance as per NBF Corporate Desk Trading and Research and reflects fixed coupon offerings only



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