

Quick Hit – Sovereign bond scarcity: A Canadian perspective

It was a slow month for GoC issuance in May, with only \$7 billion coming to market, spread across the 2-year, 5-year and 30-year sectors. This figure, down a non-trivial \$5.9 billion from May 2017, represents the smallest amount of nominal bonds auctioned in the month of May in ten years—consistent with the 2018 federal budget signaling lower funding needs for the fiscal year. On a calendar year-to-date basis, GoC issuance is down \$9.7 billion (-17%) versus the same period in 2017. (See Table 1, page 2 for a complete breakdown of monthly issuance for Canada’s sovereign and sub-sovereign issuers).

Diving into May’s GoC auctions, the story of the month was the long bond supply, or what little there was of it. The \$1 billion auction size marked the smallest nominal 30-year offering in the 20 years for which the Bank of Canada offers data. With a smaller-than-average tail (the auction’s high yield bid minus the average yield bid) and the 2nd highest coverage ratio for a long-bond auction on record, it’s becoming increasingly clear that investors’ thirst for longer-dated maturities is not being quenched—at least at the sovereign level. Compounded with the fact that Canada is one of only a few top-rated sovereigns to offer 30-year bonds with any type of yield, it appears that a demand-side imbalance is contributing to the flatter 10s-30s Canada curve we’ve been observing over the past year or so (Chart 1). Our colleague in Economics, Paul-André Pinsonnault, has explored this issue thoroughly in the past. To be clear, the drop off in long-dated supply shouldn’t come as a shock. [We’d been expecting](#) a step down in long bond auction sizes, consistent with prior DMS guidance.

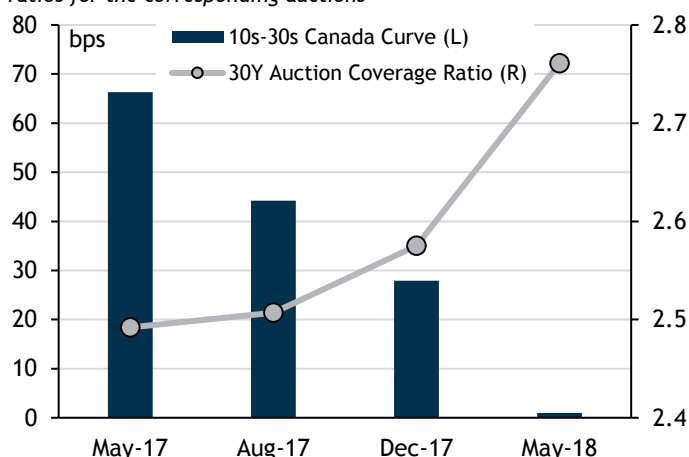
Looking now to June, we should see supply pick up, with four auctions scheduled. Our projections indicate that we should expect roughly \$9 billion in issuance over the next 30 days, with two-thirds of that coming in the 2-year sector. Based on historic issuance patterns, we’re also looking for a \$2.3 billion 10-year offering and a \$700 million single-price RRB auction. While \$9 billion is a step up from May, it’s a far cry from the monthly record of \$14.1 billion issued in June of last year which should result in the difference between 2018 and 2017 YTD totals growing even wider at the mid-year mark.

All told, the April-June quarter of nominal sovereign issuance should end up tallying roughly \$26 billion, marking the fourth straight quarter of declining supply. In contrast, borrowing requirements south of the border have been stepping up. The latest quarterly refunding statement from the US Department of the Treasury pointed to US\$73 billion of issuance over the same 3-month period, up US\$7 billion over the prior quarter and up US\$11 billion from only two quarters ago. Given the current US fiscal path, borrowing needs are only going to rise and on an annual basis are forecasted to surpass US\$1 trillion by 2020. These supply-side developments, along with a robust American economy, suggest that US rates will continue heading higher. And given the opposing direction that Canadian bond supply seems to be moving, the Canada-US interest rate differentials look to remain at wide (perhaps even wider?) levels.

Now we don’t want to give the impression that long bond issuance is down across the board. In fact, it’s quite the opposite in the provi universe. Provincial long bonds (>10Y maturities) totaled \$5.1 billion in May, up \$3 billion from April and more than 5 times the new monthly supply of sovereign 30-years. Over the calendar year-to-date, provincial issuance in longer-dated maturities has outpaced long Canadas by nearly a 10 to 1 rate, and is also up nearly \$2 billion versus the same period in 2017. That is to say, if long bonds are what you seek, there a more than a couple motivated provincial issuers happy to fill your boots, even if longs are all but a scarce commodity in Canada’s sovereign bond market.

Chart 1: Demand driving Canada curve flatter

10s-30s Canada curve on last four 30Y auction dates vs. coverage ratios for the corresponding auctions



Source: NBF, Bank of Canada, Bloomberg

Chart 2: Canada-US differential staying wider

Canada-US 10Y interest rate differential since September 2017 (i.e. (Canada 10Y - US 10Y) * 100)



Source: NBF, Bloomberg

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Table 1: A deep dive into May's domestic bond supply

Monthly & YTD gross domestic (C\$) bond supply by major sector

| NBF Domestic Bond Tracker | | | | | | | | |
|--|------------------|-------------|------------|-------------|-----------------------|-------------|-------------------|--------------|
| C\$billion | Monthly issuance | | | Prior yr | Calendar year-to-date | | Calendar year sum | |
| | May-18 | Apr-18 | Mar-18 | May-17 | 2018 | 2017 | 2017 | 2016 |
| Government of Canada | 7.0 | 10.5 | 5.9 | 12.9 | 47.0 | 56.7 | 139.9 | 124.6 |
| 2Y | 3.0 | 3.0 | 3.0 | 3.9 | 19.2 | 23.4 | 61.5 | 61.6 |
| 3Y | - | 2.2 | 2.5 | 3.2 | 7.7 | 9.7 | 25.7 | 13.0 |
| 5Y | 3.0 | 3.0 | - | 3.9 | 13.4 | 15.3 | 30.7 | 29.8 |
| 10Y | - | 2.3 | - | - | 5.3 | 6.0 | 15.0 | 14.5 |
| 30Y Nominal | 1.0 | - | - | 1.2 | 1.0 | 1.2 | 3.5 | 3.5 |
| 30Y RRB | - | - | 0.4 | 0.7 | 0.4 | 1.1 | 2.2 | 2.2 |
| Extra-longs | - | - | - | - | - | - | 1.3 | - |
| Weighted avg term (yrs) | 7.3 | 4.8 | 4.3 | 7.3 | 4.8 | 5.0 | 5.2 | 5.0 |
| Canada Housing Trust | 4.5 | - | 5.0 | 4.8 | 14.0 | 15.5 | 40.0 | 40.0 |
| 5Y Fixed | - | - | 5.0 | - | 5.0 | 5.3 | 21.0 | 20.3 |
| 5Y FRN | 2.3 | - | - | 2.8 | 4.8 | 5.8 | 9.8 | 10.8 |
| 10Y Fixed | 2.3 | - | - | 2.0 | 4.3 | 4.5 | 9.3 | 9.0 |
| Provincial governments | 8.1 | 9.6 | 0.6 | 5.3 | 27.6 | 21.9 | 54.6 | 62.7 |
| Ontario | 3.4 | 5.2 | - | 1.4 | 12.4 | 6.9 | 22.7 | 20.9 |
| Québec | 1.5 | 2.0 | - | 1.6 | 5.5 | 6.1 | 11.6 | 15.4 |
| British Columbia | 0.5 | 0.5 | - | - | 1.5 | 1.0 | 2.5 | 2.0 |
| <i>Big-3 (Ont, Qué, BC)</i> | <i>5.4</i> | <i>7.7</i> | <i>-</i> | <i>3.0</i> | <i>19.4</i> | <i>13.9</i> | <i>36.7</i> | <i>38.3</i> |
| Alberta | 0.9 | 0.6 | - | 1.5 | 2.2 | 3.4 | 8.5 | 10.8 |
| Saskatchewan | 0.7 | 0.3 | - | 0.4 | 1.1 | 1.7 | 3.0 | 2.7 |
| Newfoundland & Lab. | - | - | 0.3 | - | 1.0 | 0.3 | 1.1 | 4.9 |
| <i>Oil-levered (Alta, Sask, N&L)</i> | <i>1.6</i> | <i>0.9</i> | <i>0.3</i> | <i>1.9</i> | <i>4.3</i> | <i>5.4</i> | <i>12.5</i> | <i>18.4</i> |
| Manitoba | 1.2 | 0.7 | - | 0.5 | 2.9 | 1.9 | 3.3 | 4.1 |
| Maritimes (NB, NS, PEI) | - | 0.3 | 0.3 | - | 1.0 | 0.7 | 2.1 | 1.9 |
| Public | 7.7 | 9.6 | 0.6 | 4.0 | 25.8 | 18.5 | 49.2 | 54.5 |
| Private / MTN / Auctions | 0.4 | 0.0 | - | 1.3 | 1.8 | 3.5 | 5.5 | 8.1 |
| Fixed | 7.7 | 9.6 | 0.6 | 4.2 | 26.0 | 19.9 | 50.6 | 55.8 |
| Floating | 0.4 | 0.0 | - | 1.1 | 1.6 | 2.1 | 4.0 | 6.9 |
| 1-5Y | 0.4 | 1.5 | - | 1.1 | 4.9 | 3.9 | 8.8 | 13.0 |
| 6-10Y | 2.6 | 6.0 | 0.3 | 1.1 | 12.4 | 9.5 | 21.8 | 27.2 |
| >10Y (i.e. longs) | 5.1 | 2.1 | 0.3 | 3.2 | 10.3 | 8.6 | 24.0 | 22.5 |
| Weighted avg term (yrs) | 22.8 | 13.9 | 20.0 | 21.7 | 16.9 | 17.4 | 18.5 | 16.3 |
| International issuance | 0.7 | 5.0 | 1.7 | 4.8 | 11.5 | 19.3 | 29.6 | 22.7 |
| Prov'l total (incl non-C\$) | 8.8 | 14.5 | 2.3 | 10.1 | 39.1 | 41.3 | 84.3 | 85.4 |
| Municipal governments | 0.3 | 0.6 | 0.4 | 0.6 | 1.9 | 1.4 | 4.1 | 4.5 |
| Corporate | 10.3 | 8.1 | 8.8 | 14.1 | 39.5 | 43.5 | 105.0 | 83.3 |

* May-2017 also saw C\$2.9bln of federally guaranteed bonds issued in conjunction with Muskrat Falls project in N&L, primarily serials, maturities out to 2057

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; 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 publically syndicated deals only;

corporate issuance as per NBF Corporate Desk Trading and Research and reflects fixed coupon offerings only

Source: NBF, Bank of Canada, provincial governments, Bloomberg

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