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## Quick Hit – Reflections on a half years' worth of trading volumes

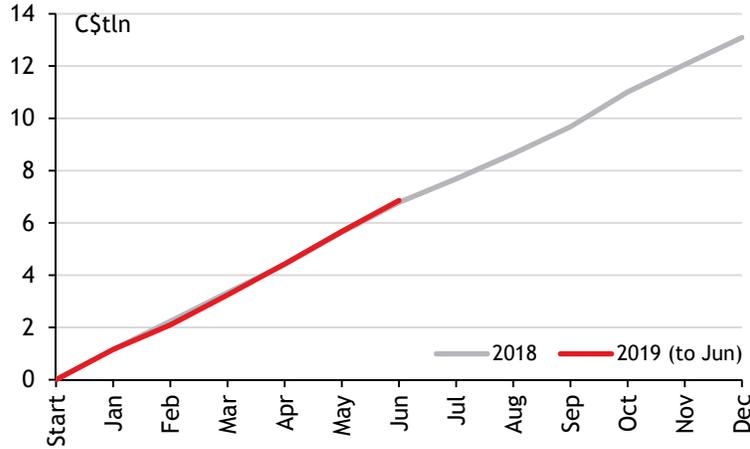
By Warren Lovely

If you're not familiar with Canada's *Bond and Money Market Secondary Trading Statistics*, we're talking about IROC's new-and-improved monthly dataset that breaks down, with relatively limited delay, secondary market activity in Canadian debt capital markets (by sector, tenor and investor type). As the single best publically available source of information quantifying market-wide shifts in liquidity/turnover, we regularly sift through these data. And with June figures in the books, it's appropriate to highlight a few broad trends from the first half of 2019. To be clear, the following analysis is based on flows aggregated across the entire dealer universe (i.e., not limited to National Bank Financial):

- On the face of it, total secondary trading volumes in Canada's bond and money markets during the first half of 2019 were little changed vs the prior year-to-date (Chart 1). Some C\$6.86 trillion of Canadian bonds changed hands in the first six months of 2019, just 1% above the corresponding 2018:H1 tally. It was a similar story in the money market, where total YTD trading was ever so slightly below last year's first half pace. But don't let that mislead you. Below the surface, there have been notable shifts in the composition of secondary market trading in both short- and longer-term markets (Charts 2-3);
- In Canada's bond market, roughly 80% of total volume gets traced back to Government of Canada bonds, so let's start there. While total GoC bond trading during the first half was virtually identical to the prior YTD (+0.3%), activity has more recently picked up, establishing a new peak in Q2. Note: A methodology/reporting change means we only have directly comparable data going back to the start of 2018;
- So far this year, GoC bond flows have migrated a touch from the belly (3-10 years) down the curve (to bonds maturing in under 3 years), as a fundamentally revised monetary policy outlook has required a lot of portfolio tweaking in the front end. Canada volumes tend to be proportionately much lighter out the curve—not that surprising given the greater risk and much more infrequent nature of GoC 10- and 30-year auctions (vs 2s, 3s and 5s). If anything, however, 2019 has actually brought more active trading in the longer end of our sovereign bond market (Chart 4). That's included a greater than 25% jump in RRB volumes, although linkers still account for less than 1% of total GoC volumes, so let's keep this in perspective;
- Elsewhere in the bond market (i.e., the 20% of secondary trading that's non-GoC as per Chart 5), first half volumes were in most cases on the rise. That seems generally consistent with an observed migration in client activity towards higher-yielding credit products, as sovereign yields have plumbed fresh lows. There's been a nice pop in Canada Mortgage Bond/federal crown bond volumes. And the hunt for incremental yield/carry might also help explain a near-30% jump in strip bond trading, with institutional client flows in provi strips having picked up nicely. Mind you, strips are hardly uber-liquid product;
- Here's one exception to the trend towards more active trading in credit markets: mortgage backed securities (MBS). First half MBS trading volumes slumped ~17% as mortgage credit growth and the origination of related securities moderated notably... a development that likewise distorted the traditional spring-time tendency towards wider swap spreads. Falling MBS trading/origination volumes and tighter swap spreads are a by-product of a cooler residential housing market, which in turn was brought on by tougher rules and (at least temporarily) higher rates/narrower margins. Now, it's worth noting that we've more recently seen a heartbeat return to some key housing markets as mortgage rates have followed underlying yields lower and as positive demand fundamentals have re-exerted themselves. Closing the loop on securitized product, note that ABS volumes picked up nicely vs the prior YTD, but trading of ABS product is still a fraction (just one-quarter) of what we see in MBS;
- We could pen a whole separate note on what specific counterparties are doing, volume wise. But for now, we'll train our attention on non-residents... that closely watched segment of the investor universe, which allows us to gauge (partially and somewhat imperfectly) international attitudes towards Canada. And what have we seen in 2019? A re-engaged foreign bond investor, that's what. All across Canada's debt capital markets, two-way trade with non-residents has picked up noticeably and disproportionately. In other words, the non-res share of trading, if not in all cases overwhelming, is everywhere on the rise (Chart 6). You see this in GoC T-bills and in all key facets of the bond market: Canadas, Canada Mortgage Bonds and other federal crowns, provincials, municipals, corporates, MBS, ABS and even strips. Now, increasing volumes don't necessarily equate to net buying, but our related analysis of Canada's international transactions in securities data reveal foreign investors have been net acquirers of C\$ bonds so far this year (at least through May). That's been a non-trivial source of demand for a Canadian dollar fixed income universe that simply isn't growing all that fast these days, a theme we explored the other day;
- Taking a closer look at money market volumes, you'll see year-to-date trading of GoC T-bills is up roughly 8% vs the year-earlier period. As noted above, you can give an assist to a more active non-resident investor base. The trend towards higher T-bill volumes could well continue, given that Ottawa is focused on supporting/enhancing liquidity via an enlarged bill stock (refer to Budget 2019's *Debt Management Strategy* for details). The trading of provincial bills has likewise stepped up in 2019, with related tenders having met with consistently solid demand. Again, you might link that to an underlying hunt for yield, as Canadian 3-month T-bills today yield a scant 1.65%. Meanwhile, YTD trade in BAs has increased by almost 20%. For the uninitiated, BAs tend to account for a significant share of total money market trading (almost one half in 2019), owing to their relatively shorter duration vs bills. But this year's more active trading of BAs also reflects a larger stock of outstandings.

## Chart 1: Bond volumes tracing out a similar path?

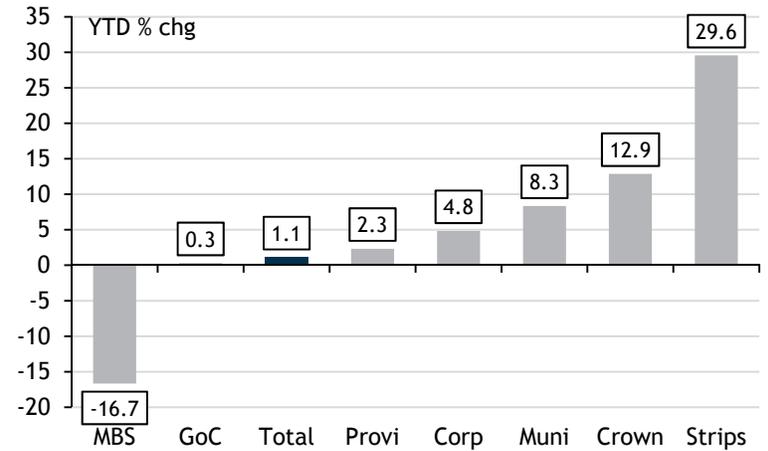
Cumulative Canadian bond trading volumes (all sectors): 2019 vs 2018



Source: NBF, IIROC

## Chart 2: Composition of bond trading shifts...

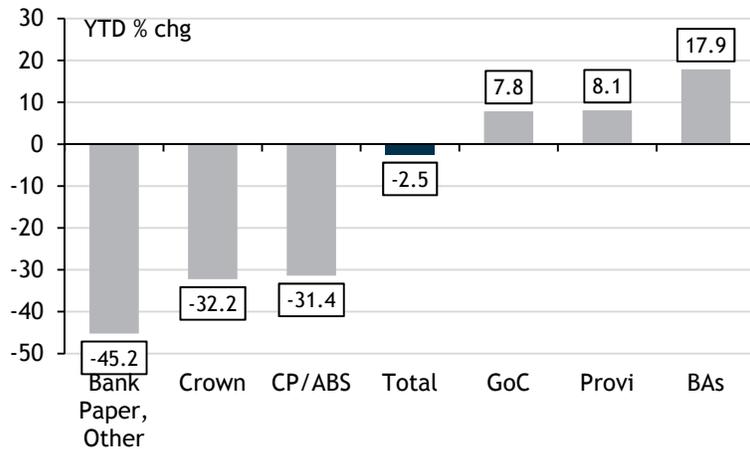
Change in Canadian bond trading by sector: 2019YTD vs 2018YTD



Source: NBF, IIROC | Note: YTD period reflects January to June

## Chart 3: ... same thing in Canada's money market

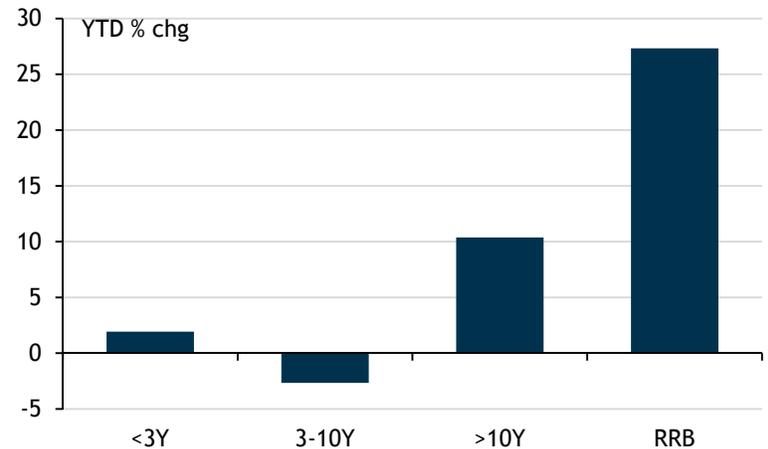
Change in Canadian money market trading by sector: 2019YTD vs 2018YTD



Source: NBF, IIROC | Note: YTD period reflects January to June

## Chart 4: A closer look at GoC bond volumes

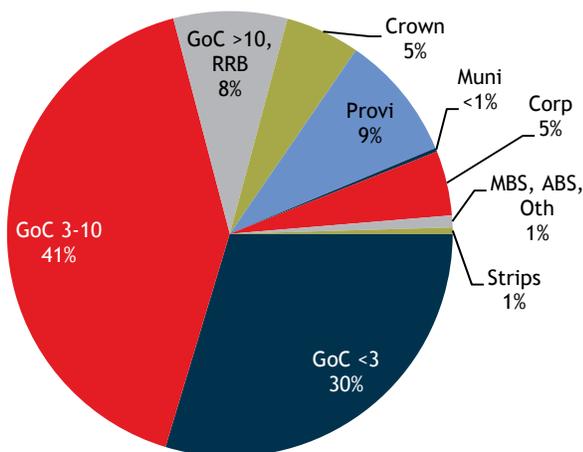
Change in Canadian GoC bond trading by tenor/type: 2019YTD vs 2018YTD



Source: NBF, IIROC | Note: YTD period reflects January to June

## Chart 5: GoCs account for ~80% of bond trading

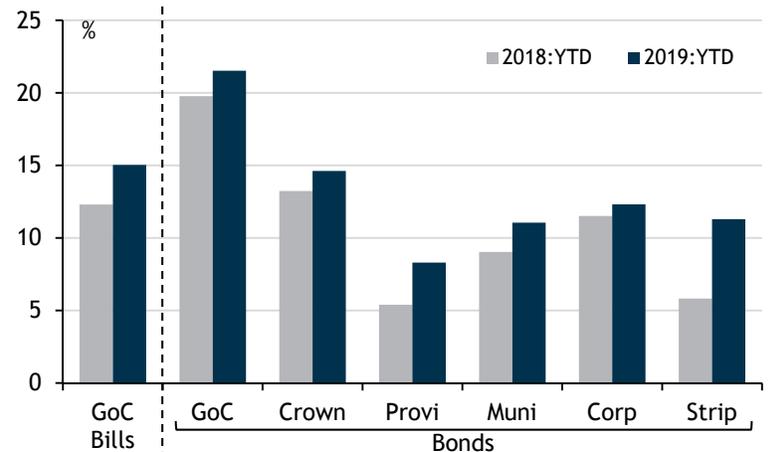
Share of total Canadian bond trading by sector/tenor: 2019YTD



Source: NBF, IIROC | Note: YTD period reflects January to June

## Chart 6: Non-residents more active in Canada

Non-resident share of total Canadian bond trading by sector



Source: NBF, IIROC | Note: YTD period reflects January to June

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