



# Draining Canada's bond market holding tank (a quick progress report)

By Warren Lovely

*Holding tank [noun]: A place in which someone or something is temporarily kept or confined*

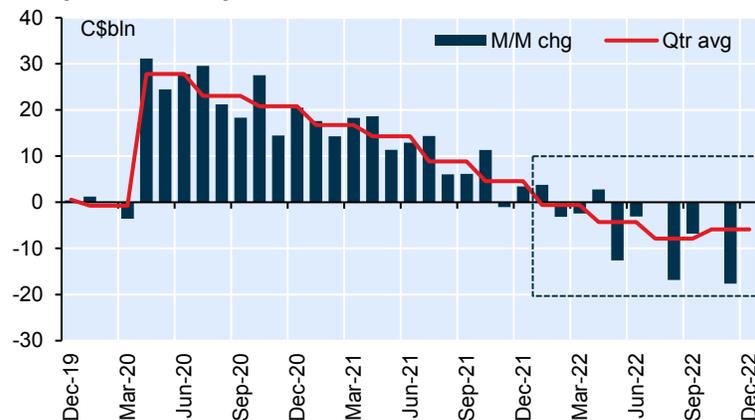
In a bond market context, central bank balance sheets were transformed into massive holding tanks as part of the policy response to the pandemic. But consistent with an equally extraordinary tightening exercise in 2022, central banks have started to drain off these vessels. So far, this QT process has been passive, gradual and generally less-than-disruptive. With the release of Canada's Q3 national balance sheet accounts this week, we've an ability to assess how this drainage system is working and where bonds formerly held at the BoC are ending up.

The Bank of Canada's holdings of domestic GoC bonds will end 2022 ~C\$55 billion lower than the prior year-end (Chart 1). The corresponding ownership share will be 35.6% vs. a peak of 43.5% set in fall 2021 (Chart 2). Strictly speaking, running bonds off the Bank's balance sheet adds a non-trivial dimension to Canada's net bond supply dynamics. Simply put, it requires finding homes for more bonds. But so far, so good. In the first three quarters of 2022, we succeeded in placing more Canadas with a variety of domestic investor types, ownership shares moving up most notably at mutual funds, chartered banks and insurance companies. Non-residents have also helped balance the market, the par value of their holdings up almost C\$20 billion on a year-to-date basis and their ownership share hovering around a non-trivial 30%.

Make no mistake, Canada's initial QT phase has been made more manageable by rapidly declining net borrowing needs (Chart 3). As per the latest credit market summary, Q3 ushered in negative net issuance of federal government bonds for the first time since 2018. Adding in the provinces, Canadian governments tapped credit markets, in all forms, for barely C\$10 billion (net) in Q3. In first three quarters of the year, annualized government borrowing was <2% of GDP—nicely below the pre-COVID trend. In relative terms, governments have also accounted for a declining and below-average share of total credit market activity (Chart 4). In the past year, we trace less than 15% of net borrowing to Canadian governments—one of those technical factors that presumably colours one's RV assessment. All this speaks to the meaningful (albeit cyclically assisted) fiscal recovery that has been reported in Ottawa and across most provinces. No question, QT works a lot easier when government cash needs are low and falling. Notwithstanding this initial progress, there's a notionally tougher road ahead in 2023. (Much) slower economic growth risks complicating fiscal consolidation efforts; it surely won't be raining cash the way it was in 2021 and 2022. Meanwhile, the volume of bonds rolling off the Bank's balance sheet will reach almost C\$90 billion in calendar 2023, which is clearly a bigger nut to crack.

**Chart 1: BoC holdings of Canadas down \$56bln in 2022**

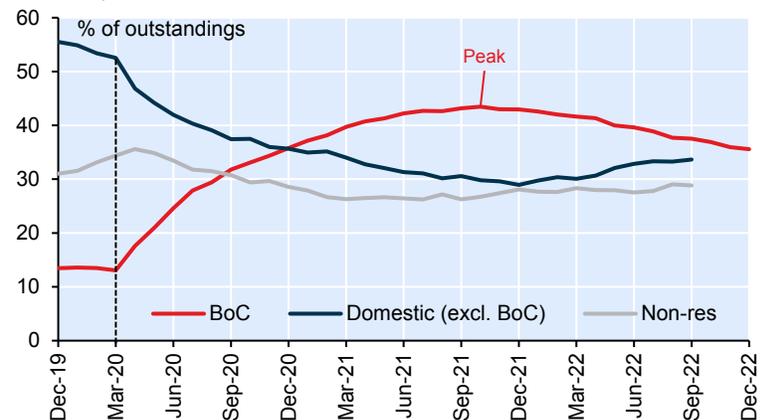
Change in BoC holdings of domestic GoC bonds



Source: NBF, BoC

**Chart 2: BoC ownership share edging down (though still elevated)**

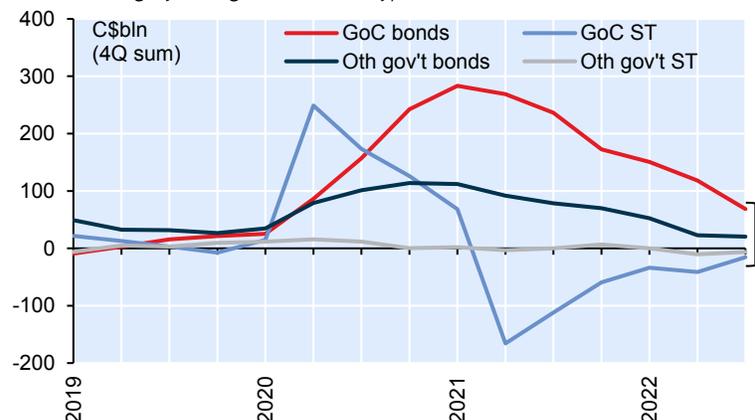
Ownership share of domestic GoC bonds



Source: NBF, BoC

**Chart 3: QT process aided by reduced net gov't borrowing**

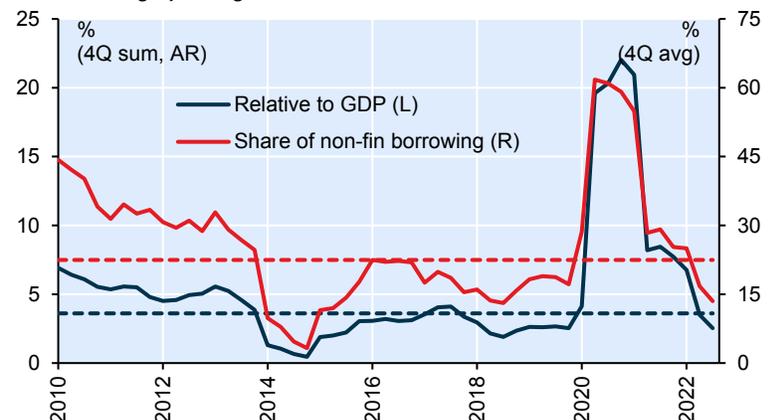
Net borrowing by Cdn gov'ts: Level & type



Source: NBF, StatCan (NBS)

**Chart 4: Striking recovery in broader public sector**

Net borrowing by Cdn gov'ts: Relative to GDP & share of total funds raised



Source: NBF, StatCan (NBS) | Note: Dotted lines refer to pre-COVID avg (2010-19)

**Table 1: Detailing the ownership of C\$4.95 trillion of Canadian debt securities**

Market value & share of total holdings: Canadian debt securities by type of paper & holdings by detailed NBS sector (as at 2022:Q3)

Holdings (C\$bln, market value)	Cdn debt securities	Canadian short-term paper			Canadian bonds				
		All Cdn ST paper	Gov't of Canada	Other sectors	All Cdn bonds	Gov't of Canada	Provincial gov'ts	Local gov'ts	Other sectors*
Total all sectors	4,951.4	680.9	185.1	495.7	4,270.6	1,017.6	874.4	67.1	2,311.5
Domestically held (incl. monetary authority)	3,079.6	460.5	154.4	306.1	2,619.1	728.9	652.8	58.1	1,179.3
Households & non-profit institutions	98.6	8.4	1.1	7.3	90.2	16.5	19.1	17.6	37.0
Corporations	2,611.1	355.1	133.6	221.5	2,256.0	662.8	523.8	34.9	1,034.5
Non-financial corporations	99.9	52.9	13.6	39.3	47.0	6.6	3.5	0.0	36.9
Financial corporations	2,511.2	302.2	120.0	182.2	2,209.0	656.2	520.3	34.9	997.6
<b>Bank of Canada</b>	<b>398.3</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>398.3</b>	<b>377.2</b>	<b>11.8</b>	<b>0.0</b>	<b>9.3</b>
Chartered banks & quasi-banks	451.9	77.5	34.8	42.8	374.4	57.4	127.5	6.3	183.1
Insurance & pension funds	822.7	103.7	41.3	62.4	719.0	139.4	277.9	23.9	277.8
Total other private financial institutions	566.4	109.4	35.4	74.0	456.9	71.9	98.8	4.5	281.8
Financial gov't business enterprises	271.9	11.6	8.5	3.1	260.3	10.3	4.3	0.1	245.6
General governments	369.9	97.0	19.7	77.4	272.8	49.6	109.9	5.6	107.8
Federal general government	9.7	0.5	0.1	0.4	9.2	7.8	0.1	0.0	1.2
Other levels of general government	252.9	72.8	19.6	53.2	180.0	26.8	69.8	4.6	78.8
Provincial & territorial governments	213.5	65.2	19.5	45.7	148.2	23.8	57.5	0.3	66.6
Local governments	39.4	7.6	0.1	7.5	31.8	3.0	12.3	4.3	12.2
Social security funds	107.3	23.7	0.0	23.7	83.5	15.0	39.9	0.9	27.8
Non-residents	1,871.9	220.4	30.8	189.6	1,651.5	288.7	221.6	9.0	1,132.2

Distribution of holdings by security type (%)	Cdn debt securities	Canadian short-term paper			Canadian bonds				
		All Cdn ST paper	Gov't of Canada	Other sectors	All Cdn bonds	Gov't of Canada	Provincial gov'ts	Local gov'ts	Other sectors*
Total all sectors	100%	100%	100%	100%	100%	100%	100%	100%	100%
Domestically held (incl. monetary authority)	62%	68%	83%	62%	61%	72%	75%	87%	51%
Households & non-profit institutions	2%	1%	1%	1%	2%	2%	2%	26%	2%
Corporations	53%	52%	72%	45%	53%	65%	60%	52%	45%
Non-financial corporations	2%	8%	7%	8%	1%	1%	0%	0%	2%
Financial corporations	51%	44%	65%	37%	52%	64%	60%	52%	43%
<b>Bank of Canada</b>	<b>8.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>9.3%</b>	<b>37.1%</b>	<b>1.4%</b>	<b>0.0%</b>	<b>0.4%</b>
Chartered banks & quasi-banks	9%	11%	19%	9%	9%	6%	15%	9%	8%
Insurance & pension funds	17%	15%	22%	13%	17%	14%	32%	36%	12%
Total other private financial institutions	11%	16%	19%	15%	11%	7%	11%	7%	12%
Financial gov't business enterprises	5%	2%	5%	1%	6%	1%	0%	0%	11%
General governments	7%	14%	11%	16%	6%	5%	13%	8%	5%
Federal general government	0%	0%	0%	0%	0%	1%	0%	0%	0%
Other levels of general government	5%	11%	11%	11%	4%	3%	8%	7%	3%
Provincial & territorial governments	4%	10%	11%	9%	3%	2%	7%	1%	3%
Local governments	1%	1%	0%	2%	1%	0%	1%	6%	1%
Social security funds	2%	3%	0%	5%	2%	1%	5%	1%	1%
Non-residents	38%	32%	17%	38%	39%	28%	25%	13%	49%

**Table 2: Spotlight on GoC bond holdings, as BoC running off holdings**

Market value & share of Government of Canada bond holdings by select NBS sector (as at 2022:Q3)

GoC bond holdings (market value)	All sectors	BoC	Domestic ex. BoC	Households & non-fin'l corps	Banks	Insurance companies	Trusteed pensions	Other private FIs	Financial GBEs	Federal gov't	Other levels of gov't	Social security funds	Non-residents
Current: Level (C\$bln)	1,017.6	377.2	351.8	23.1	57.4	51.7	87.7	71.9	10.3	7.8	26.8	15.0	288.7
Share (% of total)	100.0%	37.1%	34.6%	2.3%	5.6%	5.1%	8.6%	7.1%	1.0%	0.8%	2.6%	1.5%	28.4%
Q/Q: Level chg (C\$bln)	-7.0	-15.9	-2.2	-1.5	3.2	0.1	-4.8	-1.5	-1.0	0.2	2.0	1.2	11.1
Share chg (%-pts)	0.0%	-1.3%	0.0%	-0.1%	0.3%	0.0%	-0.4%	-0.1%	-0.1%	0.0%	0.2%	0.1%	1.3%
YTD: Level chg (C\$bln)	-70.1	-65.5	0.6	-3.9	6.6	0.4	-14.3	19.0	-5.0	0.5	-4.0	1.3	-5.2
Share chg (%-pts)	0.0%	-3.6%	2.3%	-0.2%	1.0%	0.4%	-0.8%	2.2%	-0.4%	0.1%	-0.2%	0.2%	1.3%

Source: NBF, StatCan | Notes to Table 1-2: Canadian debt securities includes issues denominated in CAD as well as securities denominated in foreign currencies; other Canadian bond sectors includes corporates, CMB, GBEs, other public sector, etc; YTD refers to first three quarters of 2022; Q/Q & YTD change in holdings of GoC bonds influenced by significant revaluation effects (since data are reported on market value basis); par value of outstanding GoC bonds had increased on YTD basis



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