

Foreign buying of Canadian bonds vital feature of BOP

By Warren Lovely

It's not uncommon for the current account to stand in the shadow of Canada's other big quarterly economic release, that for GDP. Today was no different. And while many are presumably biding their time until Tuesday's influential Q4 GDP data land, there was some interesting colour in the Q4 balance of payments (BOP) all the same, with relevancy extending beyond currency markets to fixed income.

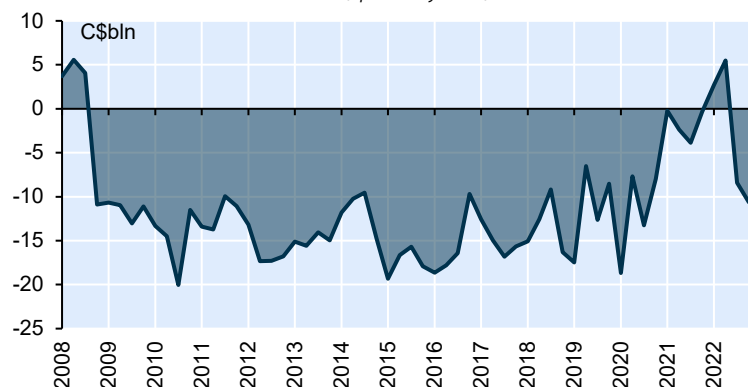
Firstly, Canada's current account slipped deeper into the red in the final quarter of 2022. The seasonally adjusted CA deficit was C\$10.6 billion in Q4. The full-year shortfall wasn't that much worse, owing to a strong(er) first half of the year when commodity prices were more elevated. In the end though, Canada ran a current account shortfall for a 14th straight year in 2022, a streak dating back to 2009 when GFC damage first took hold. How is the current account deficit being financed? Not really via foreign direct investment, where net outflows have generally been the story. Instead, financing Canada's current account shortfall has involved the big-time selling of our portfolio assets to non-residents.

If anything, 2022's portfolio flows were even more striking than 'normal'. For the year as a whole, Canada imported a record C\$151 billion of portfolio capital (net), which factored in a rare international retrenchment by Canadian investors. What type of securities was Canada selling to the world? Easy: bonds and more bonds. Non-residents acquired an unprecedented C\$155 billion of Canadian bonds in 2022, which includes issues denominated in *all* currencies (not just CAD-denominated paper). We pedaled our bonds to all corners of the globe, with last year's net sales into the US, the UK, continental Europe and key Emerging countries more than offsetting Japanese divestment. Individual investors surely have different rationales for taking down Canadian debt, but one presumes the attraction involves some combination of: a relatively cheap currency setting (for those actively playing in CAD issues); a relatively less alarming policy rate outlook for the BoC; fiscal sustainability including still-sterling sovereign credit fundamentals and impressive fiscal momentum for the provinces; a financially sound and well capitalized banking sector; etc. For some it may be as simple as availability of product in a currency, tenor and at a yield or spread that has fit the bill.

Whatever the reason(s), Canadians might well welcome the abiding interest in our bonds from foreign locales. Yes, it means a somewhat higher non-resident ownership share of our fixed income assets, as the forthcoming National Balance Sheets data should make clear. Foreign investor exposure is not without its risks, but non-resident demand helps clear Canada's net bond supply at a lower yield and/or tighter spread than would otherwise be the case. It's a timely source of demand given that our own central bank has started shedding its GoC bond holdings. One hopes the apparent foreign appetite for Canadian debt is maintained in 2023, which represents the peak year for QT at the BoC.

Chart 1: Canada's current account deficit deepens in Q4

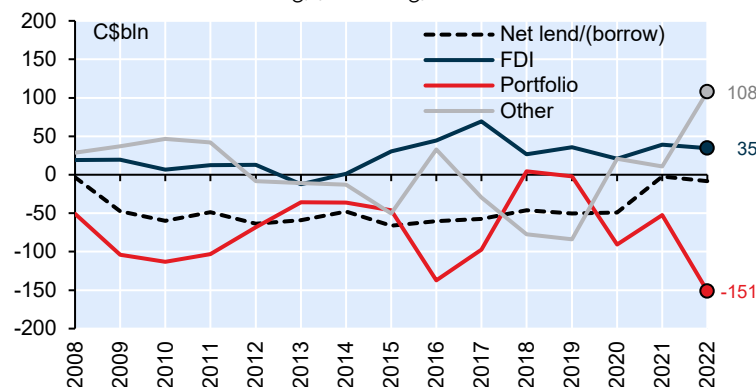
Canada current account balance (quarterly rate)



Source: NBF, StatCan | Note: Quarterly seasonally adjusted data

Chart 2: Net portfolio capital inflow finances CA shortfall

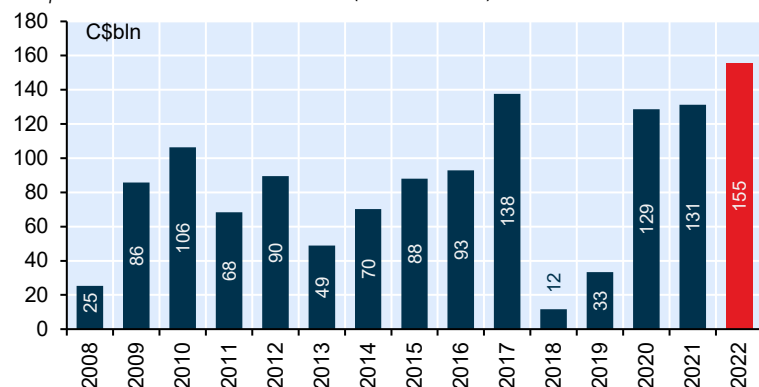
Net flows & overall net lending/(borrowing) in Canada financial account



Source: NBF, StatCan | Note: Annual data; net occurrence of assets less liabilities

Chart 3: Record sales of Canadian bonds to non-res in 2022

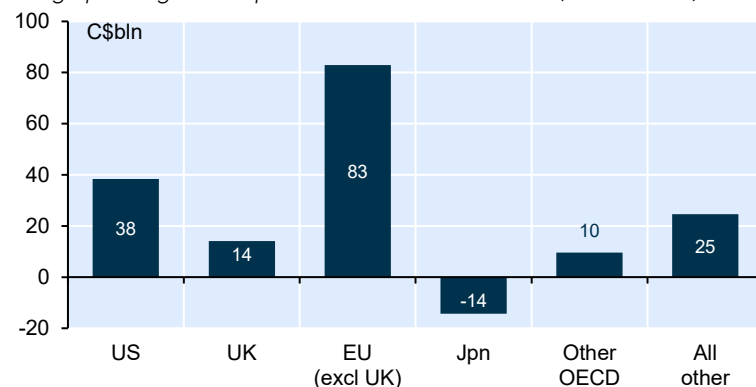
Net purchases of Canadian bonds (all currencies)



Source: NBF, StatCan | Note: Annual data

Chart 4: Where did demand for Canadian bonds come from?

Geographic origin of net purchases of Canadian bonds (all currencies): 2022



Source: NBF, StatCan | Note: Annual figures for 2022 only



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