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Supply side economics (as applied to provincial bond volumes)

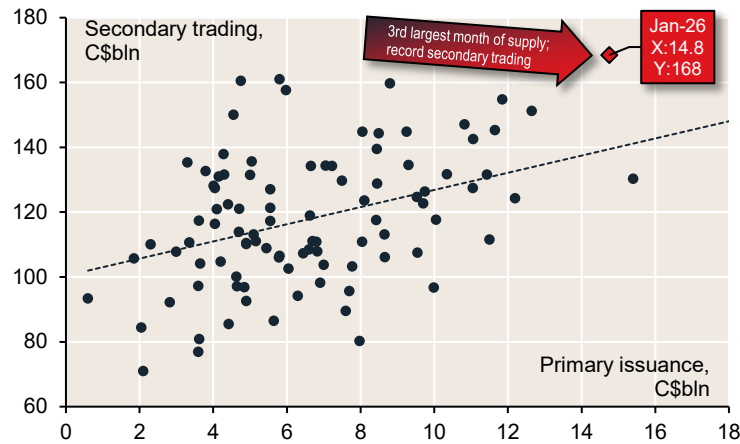
By Warren Lovely

'Supply side economics' may have its detractors, but when it comes to Canada's bond market there's clear evidence that increased **primary supply** catalyzes/contributes to enhanced **secondary activity/trading**. Consider the state of play in Canada's domestic provincial bond market...

CIRO's publicly available bond volume data showed record trading of domestic provincial bonds in Jan-26. (Across all dealers, \$168 billion of provincial product changed hands.) Unprecedented volume coincided with the third-largest month of domestic supply. (January's \$14.8 billion in CAD-denominated gross issuance trailed only Apr-20 and Apr-24.)

Chart 1: Primary supply begets secondary trading?

Domestic provincial bond issuance & bond trading: Monthly (MTRS 2.0 era)

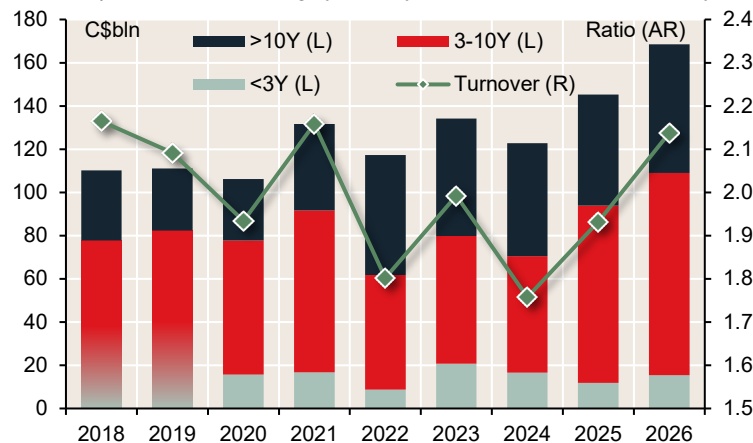


Source: NBC, CIRO, BBG | Note: Monthly gross bond supply (CAD issues only) & all dealer trading volume from Jan-18 to Jan-26; Apr-20 (X:25.8, Y:162) not pictured

With investor demand for spread product running hot to start the New Year, Canada's provinces successfully placed \$14.8 billion in new CAD-denominated bonds in Jan-26—the third largest monthly tally on record. The relationship between a given month's level of primary supply and dealer-wide secondary trading is admittedly imperfect. Still, structurally larger provincial borrowing needs—a function of operational shortfalls, ambitious capital plans and non-trivial refinancing needs—have coincided with (resulted in) more active secondary market-making. But there may be more to it...

Chart 3: Enhanced turnover in the provincial bond market

Domestic provincial bond trading by maturity bucket & turnover ratio: January



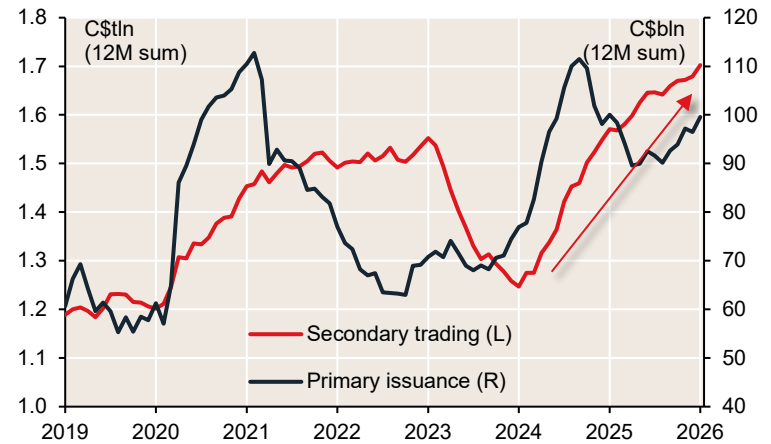
Source: NBC, CIRO, BBG | Note: Based on all dealer totals; for 2018-19, 0-3Y & 3-10Y buckets combined; turnover ratio is trading volume vs. bonds o/s (prior qtr end, annualized)

Note that turnover in Canada's provincial bond market has been moving up, consistent with what we see as a still-healthy liquidity profile for Canada's broader fixed income market. In provincials (and elsewhere), there's evidence of greater investor breadth and depth, including a (much) more active non-resident sector. Of course, provincial issuers have long courted foreign demand, feeding no little amount of bond supply into international markets directly. But there's now a more attentive non-resident investor base playing in domestic provincials. While related flows have been broadly spread supportive up till now, the upcoming budget season provides a window for fundamental/technical re-assessment. Fair to say non-residents are likewise eying provincial political developments.

While structurally higher provincial funding needs (and the resulting growth in the bond stock) support secondary market making, there may be more going on. We'd note that the relative turnover of domestic provincial bonds has been ticking up (i.e., secondary volumes have been growing faster than outstandings). While all major counterparty types have been trading more provincial bonds of late, foreign engagement trends are particularly noteworthy. Non-residents traded more provincial bonds than ever in January, as spreads hovered in/around cyclical tights.

Chart 2: Secondary provincial bond trading trends higher

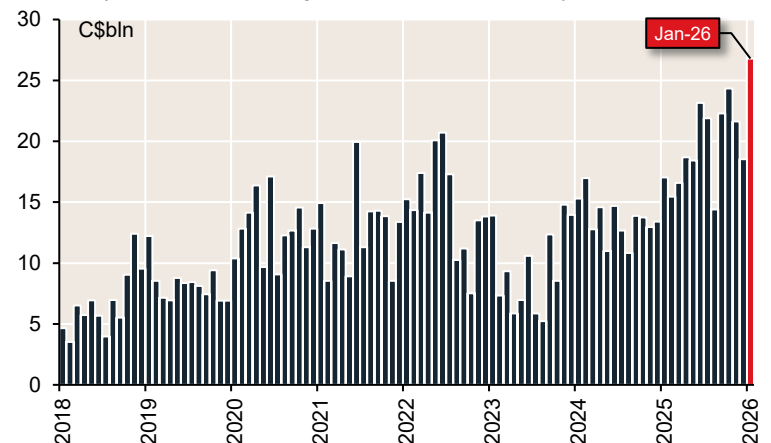
Domestic provincial bond issuance & bond trading: 12M trend



Source: NBC, CIRO, BBG | Note: 12-month moving sum of gross bond supply (right) & all dealer trading volume (left); latest data point refers to Jan-26

Chart 4: Non-residents increasingly active/relevant

Domestic provincial bond trading with non-residents: Monthly



Source: NBC, CIRO | Note: Based on all dealer totals; for Jan-26, C\$26.8bln in secondary trading with non-residents represented 16% of total provincial bond volume



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