

A lesser-known border crossing (the one for international bond proceeds)

By Warren Lovely

With the largest bilateral trading relationship on the planet, it follows that a lot of 'stuff' flows across the Canada-U.S. border in a given day, week, month or year. Indeed, economists spend a lot of time analyzing the value and volume of all the cars and parts, barrels of oil, board feet of lumber and assorted consumer goods that pass between Canada and the U.S., all with a view to fine-tuning their North American macro outlook(s). We're not minimizing this work.

Rather than counting the 18-wheelers passing over the Ambassador Bridge, there's a lesser-known cross-border flow that has caught the eye of this strategist. It's in debt capital markets. For Canada, homebound flows from international bond deal proceeds (mainly in

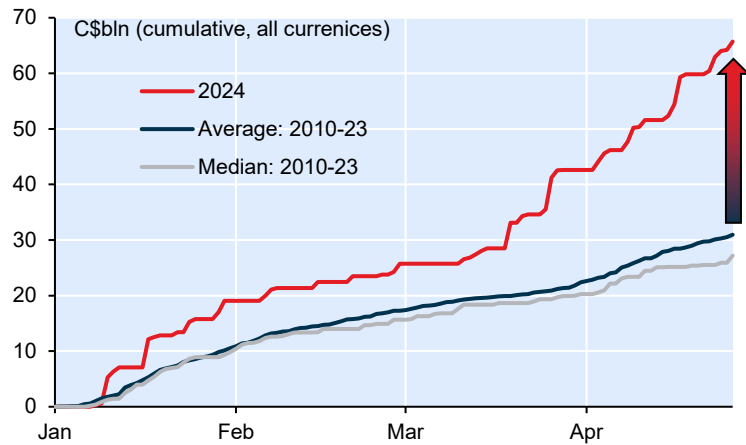
the provincial sphere) intersect with outbound flows (including the conversion of select Maple bond proceeds).

If you've been following along, you may be aware that certain of these flows—notably those linked to provincial deals in USD, EUR and other foreign currencies—are more significant than ever. It has left cross-currency bond flows distinctly unbalanced, with the greater preponderance of northbound traffic contributing to a non-trivial repricing of CORRA-SOFR term spreads. Read on...

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Chart 1: Giddy up! Provi supply in overdrive in 2024

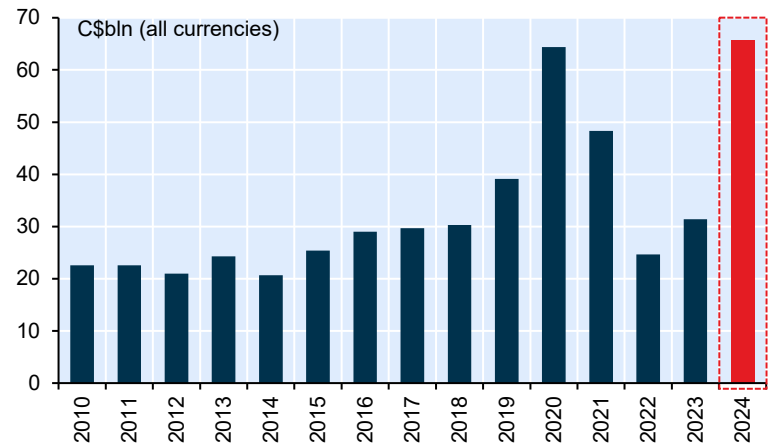
Progression of provincial bond issuance through 26-Apr (2024 vs. prior trend)



Source: NBF, BBG | Note: Cumulative sum of marketable bond issuance, all currencies

Chart 2: YTD supply has so far eclipsed 2020 pace

Provincial bonds issuance through 26-Apr (2024 vs. prior years)

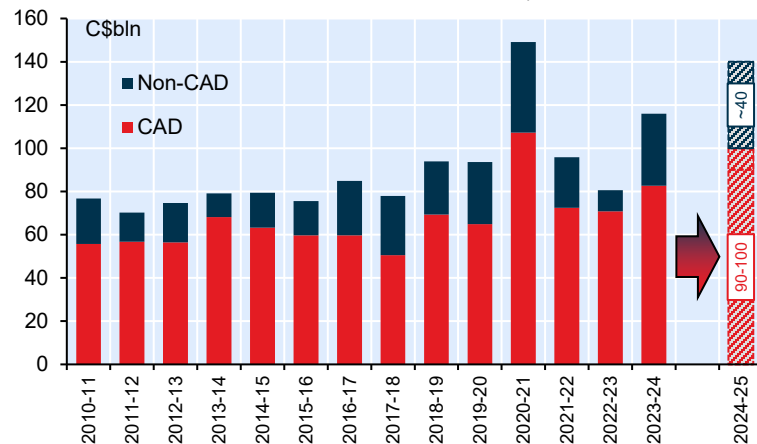


Source: NBF, BBG | Note: Sum of completed issuance (all currencies) by 26-Apr each year

At the end of last week (i.e., up to April 26th), Canada's provinces had already secured more than \$65 billion (CAD equivalent) of term funding from debt capital markets at home and abroad. That's a truly remarkable lift, 2024's calendar year-to-date tally eclipsing the prior high-water mark set in first four months of 2020 (when the arrival of COVID saw funding efforts explode higher). And the provi bond machine is still running, domestic and international funding hardly missing a beat this week.

Chart 3: 2024 budgets flagged hefty gross borrowing needs

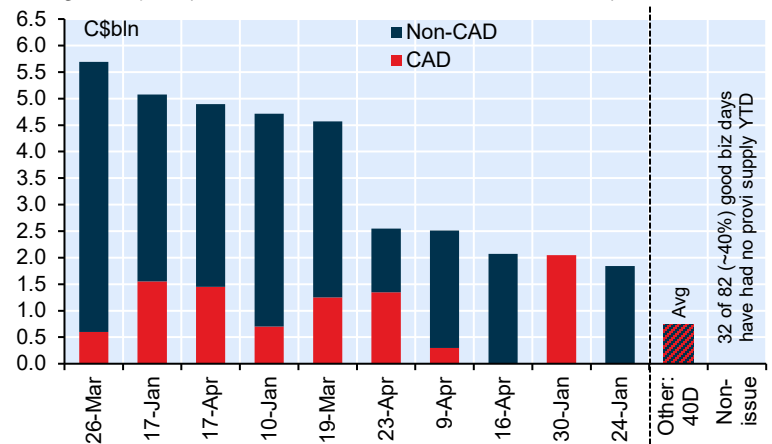
Provincial bond issuance on FY basis, incl. NBF assumption for fiscal 2024-25



Source: NBF, NBF, BBG | Note: FY basis; 2024-25 based on official guidance

Chart 4: International trades big part of early funding success

10 largest days of provincial bond issuance (2024YTD to 26-Apr)

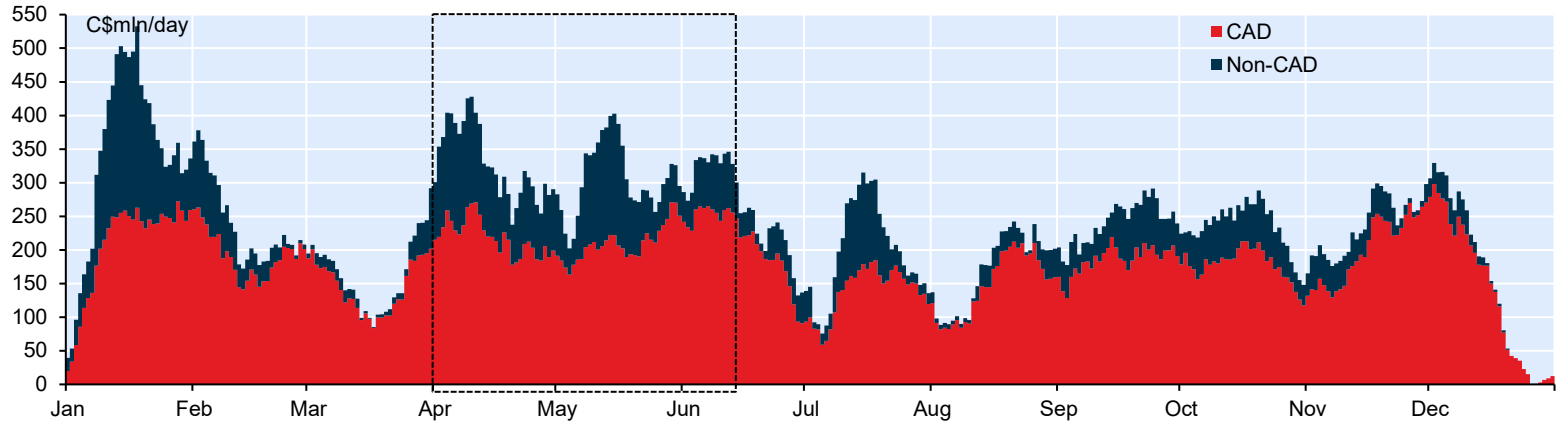


Source: NBF, BBG | Note: 26-Apr was 117th calendar day; 82 have been good biz days

We're not all that surprised by the tidal wave of provincial bond issuance. Mounting fiscal pressures, capital spending intentions and looming maturities have long suggested cash needs would step up appreciably. Collectively, provinces signaled almost \$140 billion in gross long-term requirements for fiscal 2024-25. It's generally the case that international markets are leaned on to help tackle large(r) funding needs. No question, foreign markets have feature prominently in this year's funding strategy. Since the start of the calendar year, no less than 40% of total proceeds can be traced to international deals (so far denominated in USD, EUR, AUD and CHF). And the beat goes on, with Ontario pricing a 10-year Kangaroo and Saskatchewan opting for a 10-year EUR benchmark this week. The ability of international trades to advance borrowing programs quickly is undeniable. Look at the top-10 issuance days so far this year; just 12% of good business days but 55% of total provincial supply.

Chart 5: Nothing terribly uncommon about a springtime surge in provincial bond issuance (at home or abroad)...

Average daily provincial bond issuance (2010-23)

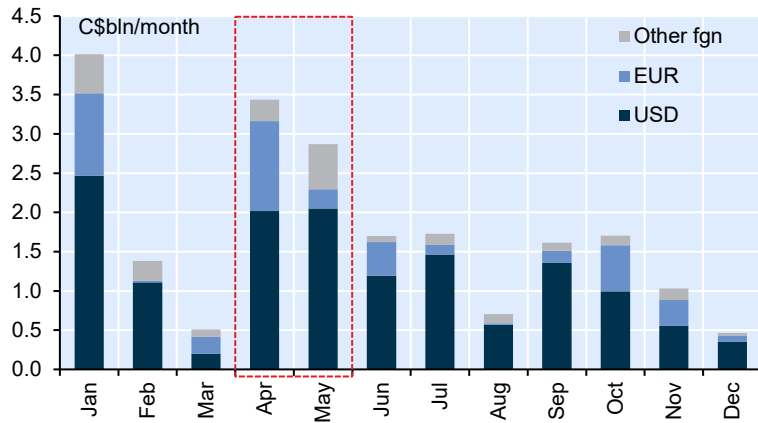


Source: NBF, BBG | Note: Average daily bond supply smoothed +/- 5D

Again, there's nothing terribly surprising about a springtime surge in provincial borrowing. Provinces typically emerge from budget season eager to make quick progress on borrowing programs. That has tended to make April-May (along with January) a distinctly busier-than-normal period of gross bond supply in the post-GFC era.

Chart 6: ... with very clear seasonality to foreign ccy supply...

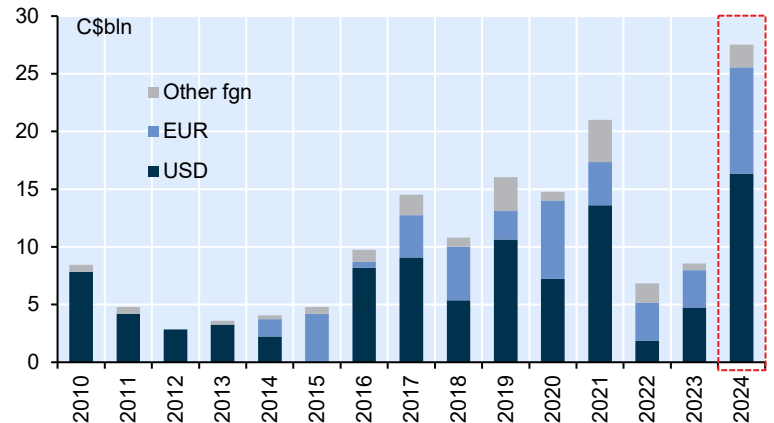
Average monthly provincial bond issuance: Non-CAD issues (2010-23)



Source: NBF, BBG

Chart 7: ... but 2024's supply surge striking all the same

Calendar YTD provincial bond issuance: Non-CAD issues (Jan-Apr)

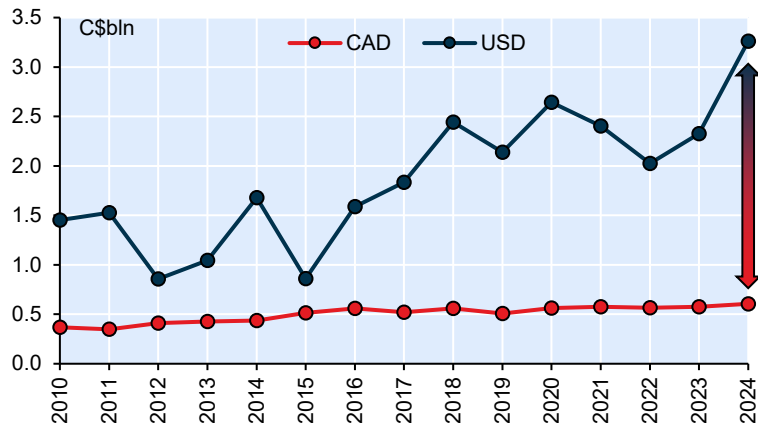


Source: NBF, BBG | Note: 2010-23 based on four full months; 2024 is 1-Jan to 26-Apr

If anything, there's a more pronounced seasonal skew to international funding by the provinces. On average, 30% of a given year's total international bond proceeds are secured in the two-month window from April-May. So yes, we're knee deep in a traditionally busy period. Saying that, what we've witnessed in 2024 is unprecedented.

Chart 8: USD market → What provs gain on efficiency...

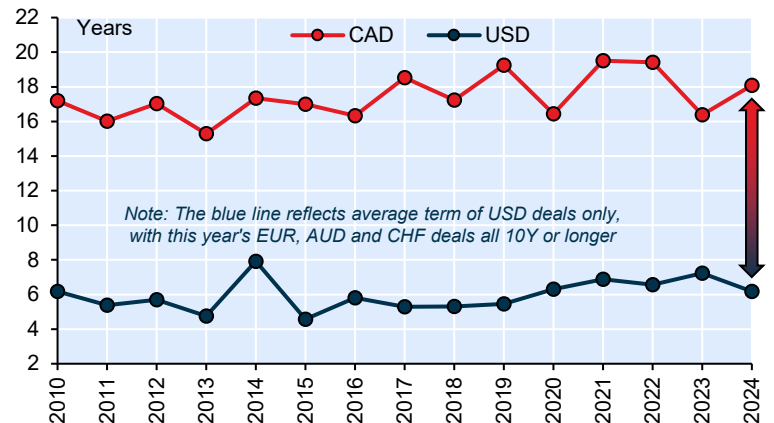
Average provincial bond deal size: CAD vs. USD



Source: NBF, BBG | Note: 2010-23 full-year; 2024 is YTD to 26-Apr

Chart 9: ... they tend to give on term (vs. home market)

Weighted average term to maturity of provincial bond issuance: CAD vs. USD

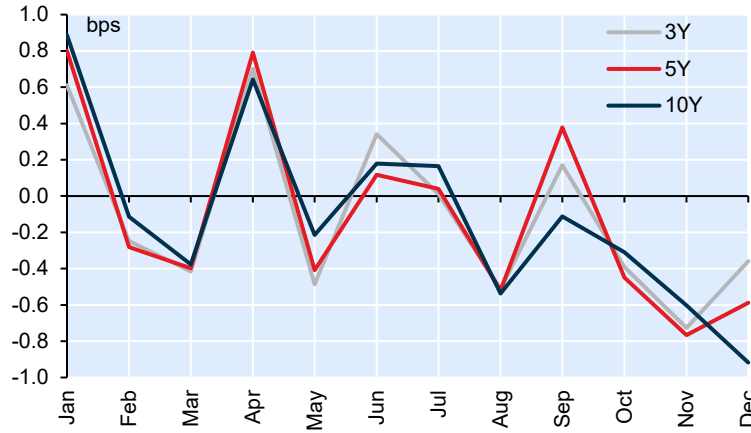


Source: NBF, BBG | Note: 2010-23 full-year; 2024 is YTD to 26-Apr

Often, what the provinces gain in efficiency via large/chunky international bond deals they tend to sacrifice on term (at least at the margin). Notwithstanding this week's 10-year prints (ONT in AUD; SCDA in EUR), the weighted average term of this year's international funding remains far shorter than the average domestic offering. To be clear, we're not saying that provinces have no access to term in international markets. But since 2010, just 4% of non-CAD funding has been in the 'greater than 10Y' bucket. The equivalent share in the domestic (i.e., CAD) market was ten-fold (39%). Obviously, the term of international deals dictates our focus on basis swap dynamics.

Chart 10: Provi flows may influence xccy basis swap...

Average monthly change in CAD-USD term basis swaps (2014-23)

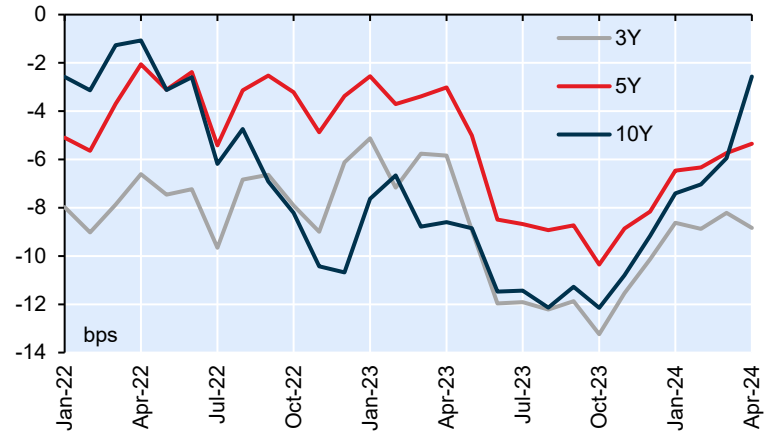


Source: NBF, BBG | Note: Based on monthly avg levels; CORRA-SOFR starting 2022

The ebb and flow of CAD-USD basis swaps mimics the concentration of international funding by the provinces, the basis often moving to the right (i.e., higher) in the big supply months of January, April and September. The more recent surge in international funding by the provinces has helped push CORRA-SOFR term spreads higher.

Chart 11: ... with CORRA-SOFR moving 'to the right' of late

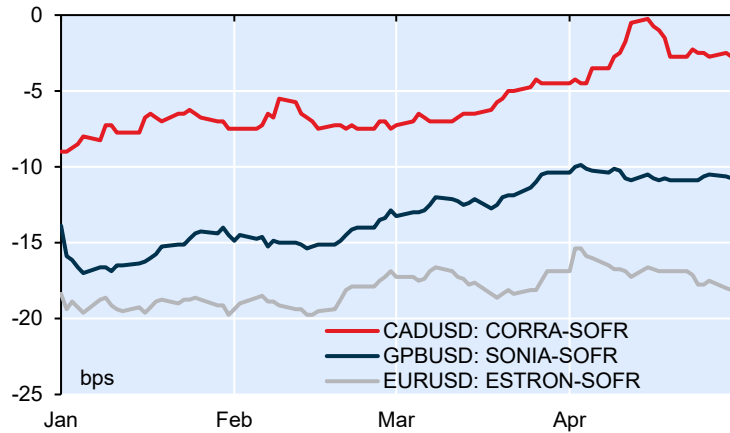
CORRA-SOFR term basis swaps



Source: NBF, BBG | Note: Monthly avg levels; Apr-24 up to 30-Apr

Chart 12: Putting recent CORRA-SOFR move in perspective

Select 10-year cross-currency basis swaps (2024YTD)

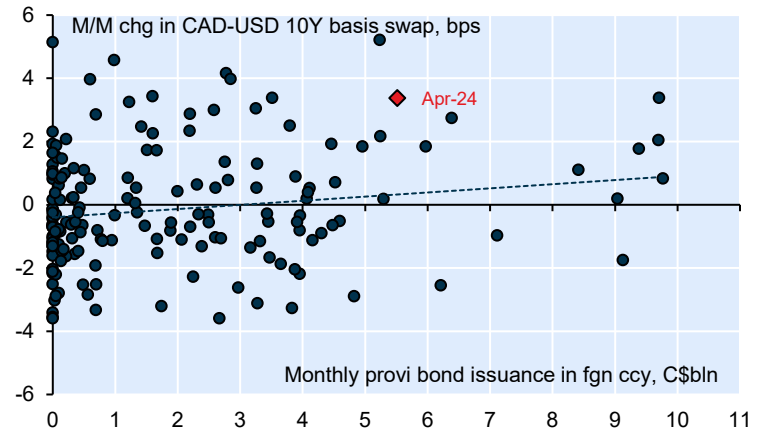


Source: NBF, BBG | Note: Latest data point refers to 30-Apr

We're reluctant to overplay the sheer explanatory power of international bond flows when dictating where xccy basis swaps will trade. Still, the record amount of international funding currently being carried out by the provinces looks to be exerting relatively greater influence on CORRA-SOFR term spreads (vs. other key markets).

Chart 13: Caution: Supply less-than-perfect basis swap driver

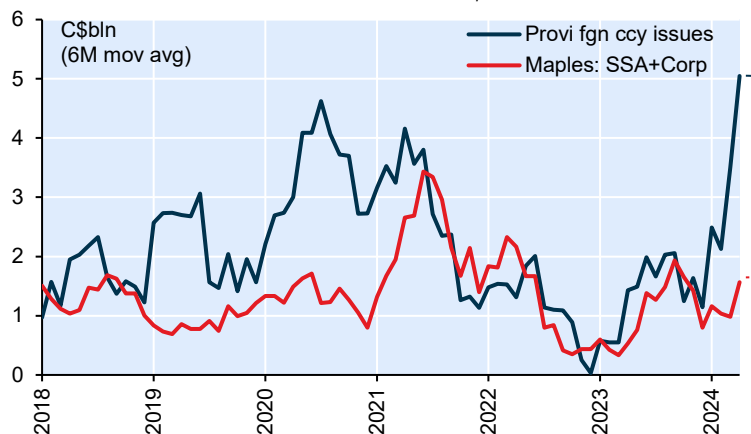
International provincial bond issuance vs. chg in CAD-USD basis swap



Source: NBF, BBG | Note: Monthly data from 2010 on; latest includes supply up to 26-Apr

Chart 14: Flow of bond issuance proceeds unbalanced...

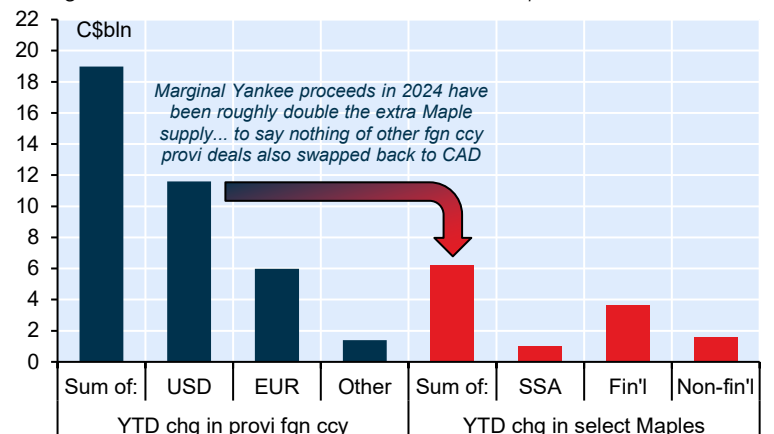
Bond issuance trend: Provincial non-CAD vs. Maples



Source: NBF, BBG | Note: Based on total supply up to 26-Apr-24

Chart 15: ... as marginal Maples swamped by foreign ccy provis

Change in bond issuance: Provincial non-CAD vs. Maples (2024 vs. 2023)

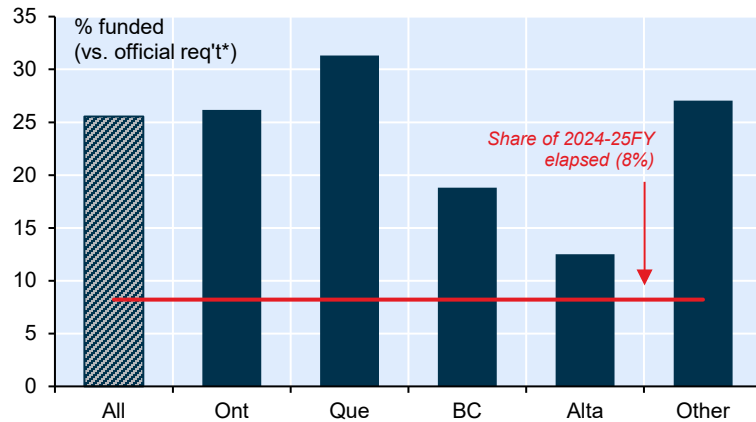


Source: NBF, BBG | Note: YTD chg in gross issuance, based on total supply up to 26-Apr

The recent tendency towards higher CORRA-SOFR term spreads seems to partly capture genuinely imbalanced primary bond flows. So far this year, homebound flows (i.e., into CAD) from more frequent and chunky provincial trades in USD, EUR and other foreign currencies have dwarfed southbound (i.e., CAD to USD) flows originating out of the Maple bond market. To be clear, we're seeing Maple supply (mainly SSAs and financials)... it just hasn't matched the foreign funding flood from provinces.

Chart 16: At some point, provi funding pace will slow...

Progress towards to official provincial borrowing requirement: Fiscal 2024-25

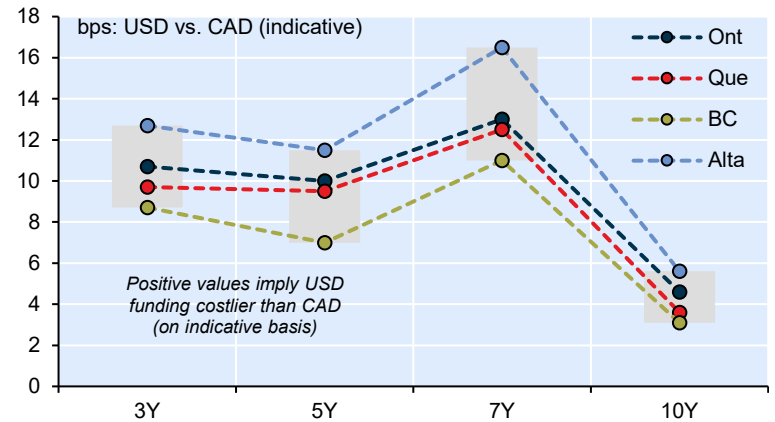


Source: NBF | Note: Official req'ts subject to change; funded status as at 30-Apr

Without overplaying the impact of primary market flows, those actively playing the cross-currency basis may wonder where to from here? On one hand, the breakneck pace of provincial funding seems destined to slow... at some point... as borrowing programs have vaulted well ahead of schedule early in 2024-25. The non-CAD share of total supply is likewise north of where we expect it to settle. Saying that, some international funding opportunities may remain appealing. As things stand, the 10-year USD arb is close(ish) for some. Moreover, as recent international deals demonstrate, foreign investor demand is both broad and deep. That could be enticing.

Chart 17: ... although some international options appealing

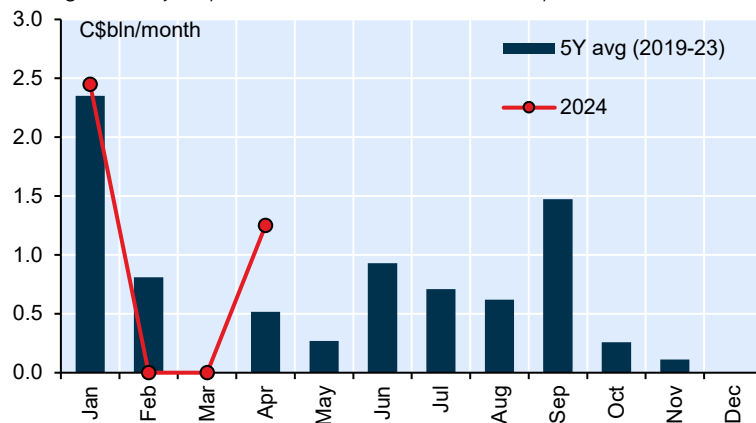
NBF estimate of USD provincial funding arbitrage (re-offer basis)



Source: NBF, BBG | Note: NBF indications as at 29-Apr; select provincial issuers

Chart 18: Assessing the traditional skew to SSA Maple supply

Average monthly Maple bond issuance: SSAs (2024 vs. prior trend)

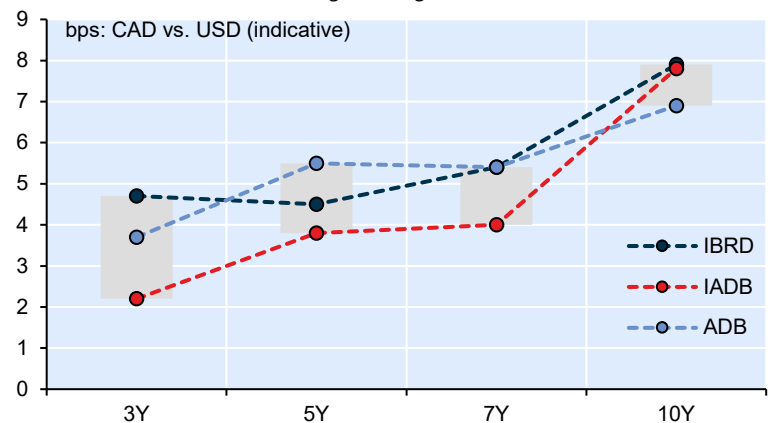


Source: NBF, BBG | Note: For 2024, SSA bond supply up to 26-Apr

As far as counterbalancing flows via Maple bonds, SSAs are one obvious outlet. Notwithstanding sizeable funding needs and the classification of CAD as a 'strategic' currency by some, seasonal tendencies and indicative funding levels don't necessarily scream 'SSA supply surge' for Canada. But the situation is fluid, so stay tuned.

Chart 19: SSA Maple arbs look a bit better down curve

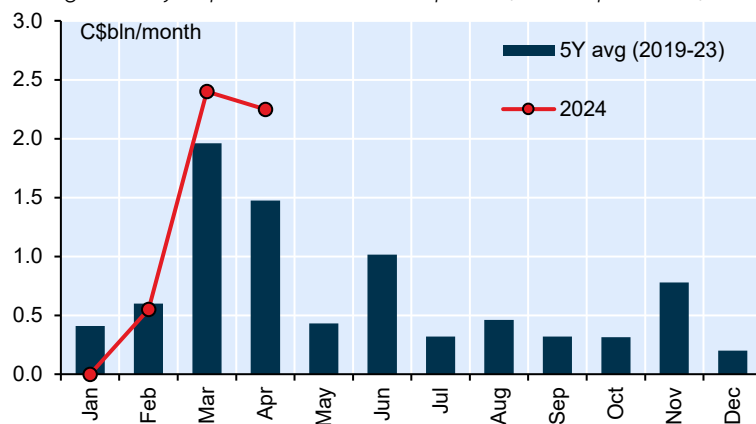
NBF estimate of CAD SSA funding arbitrage (vs. USD cost of funds)



Source: NBF, BBG | Note: NBF indications as at 29-Apr; select Tier 1 SSA issuers

Chart 20: Maple financial supply another offsetting flow?

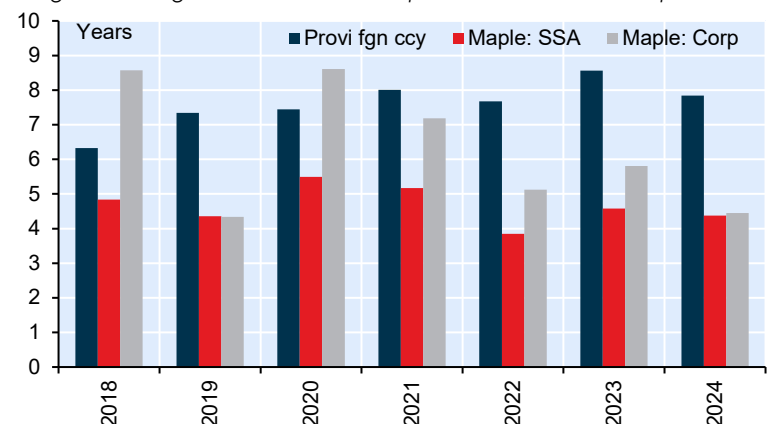
Average monthly Maple bond issuance: Corporate (2024 vs. prior trend)



Source: NBF, BBG | Note: For 2024, financial & non-financial corp supply up to 26-Apr

Chart 21: Not exactly a perfect match in term

Weighted average term of international provincial issuance vs. Maple bonds



Source: NBF, BBG | Note: 2024 based on supply up to 26-Apr

Foreign corps (largely financials) are another traditional source of Maple bond supply. This supply has picked up some in recent months. Related proceeds could flow south, inoculating (to a degree) against homebound flows from international provi trades. Mind you, Maples tend to be shorter duration than non-CAD provi deals, which could leave longer-term CORRA-SOFR spreads biased higher... at least until the outsized wave of international provincial issuance abates.



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