

DBRS Canada Newsletter

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COMMERCIAL PAPER MARKETS IN CANADA: FREEZE? WHAT FREEZE?

It began in early 2007 with the failures of sub-prime mortgage lenders New Century and Fremont, escalating into a full global credit crunch by the summer of 2007. The crisis ultimately led to the demise of numerous financial institutions, including the liquidation heard around the world: Lehman Brothers in September 2008.

In this newsletter, DBRS looks at the effects of the global credit crunch on the Canadian Commercial Paper (CP) market in 2008 (see the table at the end of the newsletter with a breakdown of CP issuance in Canada from 2000 to 2008). Specifically, we draw several key conclusions about the behaviour of the market in 2008, and make some general observations about 2009.

Total Canadian CP Market: December 2007 to December 2008

- Total outstandings of \$365 billion increased by 11% or \$37 billion;
- The growth in issuance was led by governments with \$66 billion, banks with \$4.4 billion and corporations with \$3.3 billion;
- The contraction in issuance was led by the asset-backed commercial paper (ABCP) market with a 32% or \$24 billion decline (excluding the Montréal Accord non-bank ABCP) and;
- The withdrawal of some \$12.7 billion by foreign financial borrowers or a 90% drop.

Clearly, issuance by governments, banks and domestic corporations increased year-over-year and reflected the flight to quality for domestic names, which belies a credit freeze for Canadian entities. The real contraction occurred with bank sponsored ABCP and secondly, foreign financial issuers.

Corporate Issuance

- Corporate outstandings of \$27.6 billion (excluding foreign, bank, investment bank and finance company issuance) increased by 13.8% or \$3.3 billion;
- Corporate outstandings as defined above were 3.5% higher in February 2009 than February 2007;
- Foreign finance issuance dropped some \$12.7 billion or 90%;
- In the years 2001, 2002 and 2003, corporate outstandings fell by 20%, 9% and 14%, respectively, hence a more dramatic change than currently seen in this recession.

DBRS categorizes the corporate sector to include foreign financials but when they are excluded, issuance by corporates actually rose by \$3.3 billion. The real story therefore was that foreign issuers either chose not to tap the Canadian CP market or in most cases, could no longer tap the market as demand dried up. Closer scrutiny of the post-Lehman market in the fall of 2008 reveals that domestic corporate issuers in the main continued to roll their paper, albeit at shorter maturities and wider spreads. In some cases, domestic corporations drew on their Bankers' Acceptances (BA) lines either to test that availability or for economic reasons.

Bank Issuance

- Banker Acceptance outstandings increased by 7% or \$4.4 billion.

Canadian BA continues to attract demand as evidenced by the increased outstandings. Generally, Canadian banks fared better throughout 2008 than their international peer group, however the post-Lehman period of September and October did see a 4.3% drop, followed by a 9% rebound in November. Bank liquidity was aided by the Bank of Canada's G-7 statement of support for systemically important banks in October, government programs including the Insured Mortgage Purchase Program and the flight to quality of Canadian banks due to their relative strength.

Government Issuance

- Total government (federal, provincial and municipal) outstandings of \$220 billion increased by 43% or some \$66 billion;
- Federal government T-Bill and agency issuance increased by 39% or \$52 billion;
- Provincial issuance increased by 64% or \$14 billion;
- There were 25 government programs, similar to the 2005 through 2007 period.

The increased issuance by governments in 2008 primarily reflected actions taken at the federal level to mitigate the impact of the credit crunch on Canada's financial institutions, as well as weakening fiscal results and higher capital requirements in certain provinces. A desire by some issuers to take advantage of the lower short-term financing rates afforded by the investor flight to quality amidst volatile and, at times, less favourable long-term borrowing conditions, also contributed to the increase.

Securitization Issuance

- ABCP public outstandings of \$51.7 billion (excluding the Montréal Accord assets) dropped by 31.7% or \$24 billion;
- Auto-related exposure accounted for more than half of the decline;
- 99% of the paper outstanding at year-end was rated R-1 (high) by DBRS;
- There were 26 programs at year-end, down from 43 in 2007 and a peak of 72 in 2006.

The ABCP market beyond the Montréal Accord shrank in 2008 due to a combination of forces including conduit sponsors' decisions to reduce contingent liquidity funding exposure, all in pricing to asset originators and reduced investor demand for the paper. It is worth noting however that approximately \$15 billion of new assets were funded using ABCP during 2008, which reduced the magnitude of the decline in total outstandings.

Post-Lehman Credit Freeze: August 2008 to December 2008

Through the critical months of the fall of 2008, CP issuance the world over saw dramatic dislocations. Numerous issuers could not roll their paper, and those that could often had to pay higher rates with shorter maturities. Those that could not roll their paper drew on their existing bank lines which put an additional strain on bank balance sheets. Indeed, corporate outstandings as defined above fell by \$6.4 billion or 18.7% from August to December of 2008.

The concerted efforts of the world's central banks and the G-20 to provide liquidity and restore confidence clearly had the intended effect. Since December 2008, corporates have increased their outstandings by \$1.1 billion and evidence is accumulating that current demand is outstripping supply, which may impact future pricing. Indeed, evidence would now seem to indicate that domestic investor appetite has increased and that corporate issuers have again begun to increase their outstandings, and at longer maturities and tighter spreads.

Finally, it should be noted that there continues to be some foreign finance paper issued in Canada but that outstandings represent less than 0.5% of the total Canadian market. That said, it appears that demand by and for the foreign or "maple market" will remain low for the foreseeable future.

Expectations for 2009

Early evidence through the first quarter of 2009 would indicate a thawing in the Canadian CP market as investors again begin to cautiously search for yield, and to diversify credit exposure. Beneficiaries will continue to be governments, banks and corporations with strong fundamentals and liquidity support. Foreign financials will continue to fund in their home markets with cross border issuance negligible and subsidiary financing similarly low. Finally, the ABCP market will continue to downsize as maturities roll off and new assets are not added.

For further information, please contact Peter Bethlenfalvy at pbethlenfalvy@dbrs.com.

CP Issuance in Canada and Year-over-Year Change, 2000 to 2008

CAD Millions	As of Decemeber-31								
	2008	2007	2006	2005	2004	2003	2002	2001	2000
Corporates	\$27,649	\$24,300	\$28,624	\$27,771	\$31,047	\$29,191	\$33,891	\$37,436	\$47,003
	14%	-15%	3%	-11%	6%	-14%	-9%	-20%	
Foreign Financials*	\$1,354	\$14,038	\$26,239	\$20,398	\$16,042	\$11,693	\$12,726	\$15,808	\$15,807
	-90%	-46%	29%	27%	37%	-8%	-19%	0%	
Securitized	\$51,699	\$75,714	\$108,183	\$83,987	\$65,438	\$62,567	\$63,391	\$61,525	\$60,323
	-32%	-30%	29%	28%	5%	-1%	3%	2%	
Bankers Acceptances	\$63,904	\$59,531	\$52,530	\$39,059	\$32,524	\$32,274	\$37,360	\$44,287	\$51,517
	7%	13%	34%	20%	1%	-14%	-16%	-14%	
Total Corporates	\$144,606	\$173,583	\$215,576	\$171,215	\$145,051	\$135,725	\$147,368	\$159,056	\$174,650
	-17%	-19%	26%	18%	7%	-8%	-7%	-9%	
Provinces/Municipalities	\$36,171	\$21,991	\$16,243	\$13,821	\$18,771	\$21,246	\$21,109	\$18,236	\$18,141
	64%	35%	18%	-26%	-12%	1%	16%	1%	
Fed Agencies	\$7,138	\$16,148	\$15,211	\$11,407	\$10,494	\$9,833	\$11,460	\$11,462	\$10,294
	-56%	6%	33%	9%	7%	-14%	0%	11%	
Federal Government	\$176,800	\$115,800	\$124,700	\$127,100	\$117,050	\$116,800	\$104,350	\$95,000	\$78,700
	53%	-7%	-2%	9%	0%	12%	10%	21%	
Total Government	\$220,109	\$153,939	\$156,154	\$152,328	\$146,315	\$147,879	\$136,919	\$124,698	\$107,135
	43%	-1%	3%	4%	-1%	8%	10%	16%	
Total	\$364,715	\$327,522	\$371,730	\$323,543	\$291,366	\$283,604	\$284,287	\$283,754	\$281,785
	11%	-12%	15%	11%	3%	0%	0%	1%	

*Includes Consumer & Commercial Finance, Foreign Banks and Investment Dealers.

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