Fall 2024 Debt Management Strategy Consultations Summary

Regular conversations with market participants are an essential component of the Government's ongoing commitment to a well-functioning Government of Canada (GoC) securities market and an integral part of the debt management process. In September and October 2024, the Department of Finance and the Bank of Canada attended bilateral in-person meetings with dealers, investors, and other relevant market participants. These consultations sought the views of market participants on the design and operation of the Government of Canada's domestic debt program for 2025-26.

The Department of Finance and the Bank of Canada value the comments provided by market participants. The views expressed below reflect those provided by market participants and will be taken into consideration when formulating the debt management strategy.

Overall Comments

Demand and liquidity for GoC securities remain strong and the market continues to be able to absorb the increasing supply of securities with no notable impact on prices. The competition for market share among dealers continues to be strong. Existing trends, namely the inflow of hedge funds and international accounts to the GoC securities market and the growing use of interest rate futures contracts, are continuing. The increased presence of those participants is creating a deeper and more liquid fixed income market in Canada, although some voiced mild concern about concentration in certain types of trades. Electronification of transactions is increasing as most dealers now have automated solutions to execute large volumes of small transactions (mostly at month-end when index funds are rebalancing their positions).

The main event in the past year to impact the repo market was the transition to T+1 settlement,[1] with CORRA becoming somewhat more elevated relative to the target for the overnight rate since this time (alongside a significant increase in the volume of CORRA-eligible trades). Some participants observed that there has been some pullback in the amount of repo being made available in Canada; several clients noted that some banks are habitual providers of repo and others are regular seekers of cash. The Bank's continued non-participation at GoC securities auctions was cited as a marginal factor in upwards repo pressure, as it effectively increases the debt stock in circulation and thus increases the demand for more repo financing. Some suggested the declining settlement balances have created challenges for some cash seekers and the take up at the Bank's Overnight Repo operations likely reflects this. The Bank pointed out that the large footprint international hedge funds increasingly have in the cash market and the required funding of such long positions in the repo market has contributed to the need for the Overnight Repo operations. International participants noted Canada's repo system isn't as efficient as some other countries, especially when it comes to term repo, which can create challenges to manage a predictable funding profile. Despite these characteristics and increased expensiveness, the repo market continues to function well.

Many participants cited that Canada is increasingly falling behind in terms of market infrastructure, which are aging and becoming more expensive to participate in. This can act as a deterrent to investors looking to enter Canada's fixed income markets. In terms of the Canadian Collateral Management Service (CCMS) specifically, many participants felt it was too early to provide views given how recently

[1] As of 27 May 2024 for the Canadian secondary market; 3 June 2024 for GoC securities auctions.

this service was introduced, while others noted that there are some challenges in CCMS onboarding for customers which is keeping its current trading volumes and participation low. Several respondents suggested that investments and modernization should be encouraged for the systems used in the broader Canadian fixed income market.

In terms of constraints to dealers' GoC securities business, several mentioned the increasing impact of regulation, the leverage ratio in particular, against Canada's increasing debt program, as well as having to advocate internally for larger allocations of institutional balance sheet for their bond business. As for customers' constraints, these include a reduced capacity at their dealer counterparts in terms of their risk-taking capacity which can create bottlenecks for trading, the recent loss of a primary dealer (HSBC Canada), and Canada's older and less efficient settlement infrastructure (see above).

Participants' commentary on the impact from the government's Canada Mortgage Bond (CMB) purchases were somewhat mixed. Many cited reduced liquidity in newly issued CMBs, but none described this market as being dysfunctional. CMB spreads compared to GoC securities have compressed, especially for the 5-year CMB sector, and typically tighten further around syndications. Many regular investors withdrew from the CMB market during last year's consultation on the program's future and are only recently showing signs of returning. Conversely, hedge funds have become more active in this market. Mortgage originators appear to be more active at CMHC's primary issuances, to unwind their hedging strategies, which causes some price volatility at issuance.

Treasury Bills

There remains a high amount of demand for treasury bills, although a small number of dealers noted that bills are somewhat expensive to hold due to balance sheet costs. Market participants largely communicated that the 3M, 6M and 12M tenor split for treasury bills auctions remains appropriate, with some respondents suggesting that some issuance could be shifted, at the margin, from the 12M to the 6M and/or 3M tenors. Likewise, the target for the treasury bill stock was also seen as appropriate.

Respondents suggested that 1M treasury bill auction sizes could be maintained at current levels or reduced further. Many participants noted that while the program was a useful and responsible action by the government to support the Canadian money market's transition away from Bankers' Acceptances this summer, it is no longer needed and could even be discontinued. The auction settlement and maturity mismatch[2] for the 1M treasury bill has been a notable deterrent for customer interest at auctions. Other factors, such as the larger than expected availability and attractiveness of term deposits and Bearer Deposit Notes from banks, have also contributed to the lesser demand for this bill tenor.

Bonds

[2] The 1M treasury bills are fungible with older treasury bills, many of which were originally issued before this year's transition to T+1 settlement for GoC securities in primary and secondary markets. As a result, the 1M issuances settle on Wednesday whereas the maturing securities they would replace on customers' books do not mature until Thursdays. This phenomenon will steadily disappear as more old treasury bills mature.

Participants are satisfied with the supply of each bond tenor, with few suggestions for minor reallocations on the curve. Some suggested that the long end could see a bit more supply while others mentioned that the sector was well supported by current issuance level. The belly of the curve could see some reallocations from the 2-year sector to the 5-year sector as the monetary policy cycle has progressed toward normalization.

On green bonds, participants outlined that the most fertile part of the curve for future issuance is 10-years and under, with some noting that Canada could also consider issuing a 30-year green bond.

Other comments

Both dealers and customers advocated for a re-introduction of the Real Return Bond (RRB) program. To many participants there is a clear market need for RRBs and room can be made for this product in Canada's expanded borrowing program. To make an RRB program more cost effective to the issuer, participants suggested considering shorter tenors as well as syndicated deals with firm pricing instructions.