Debt Strategy Consultations – 2010-11

Overview

The Department of Finance and the Bank of Canada are seeking the views of government securities distributors, institutional investors, and other interested parties on issues relating to the design and operation of the domestic Government of Canada debt program for the fiscal year 2010-11 and beyond. The government considers these consultations to be an integral part of the debt-management process. Views are also sought on the functioning and liquidity of the Government of Canada domestic debt and related fixed-income markets.

A summary of the comments received will be released on the Bank of Canada website concurrently with the release of the *Debt Management Strategy 2010-11* publication.

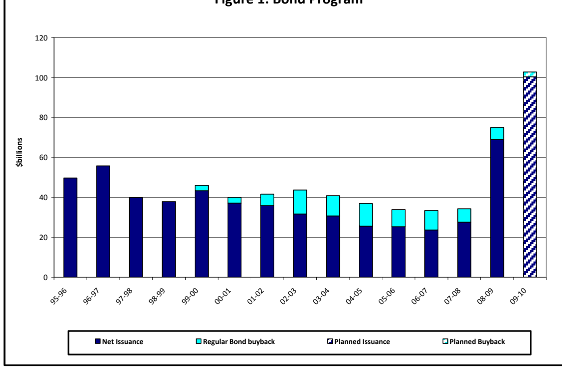
Background

As the sovereign and the largest borrower in the Canadian fixed-income market, the Government of Canada has a strong interest in sustaining a well-functioning market for its securities. A well-functioning government securities market also contributes to the effective functioning of the broader Canadian fixed-income market by providing pricing and hedging tools for traders, investors, and other Canadian borrowers.

Over the past twelve months, in the context of a global economic downturn, the Government of Canada has taken extraordinary actions to support the Canadian economy. In fact, the Extraordinary Financing Framework, which is part of Canada's Economic Action Plan and includes the related Insured Mortgage Purchase Program (IMPP), has provided over $131 billion in extraordinary support to improve access to financing for Canadian households and businesses.

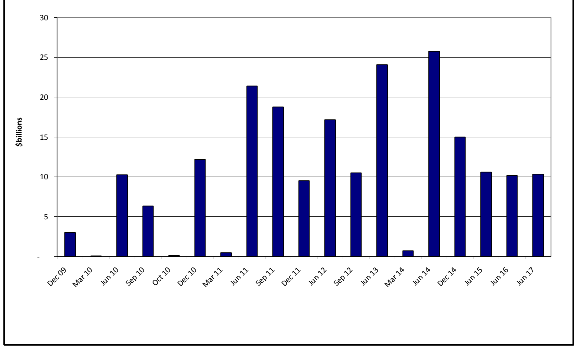
As indicated on 25 June 2009, gross Government of Canada domestic bond issuance for 2009-10 is projected to be about 25% higher than the $82 billion announced in the *Debt Management Strategy 2009-10*. This is higher than the $75 billion issued in 2008-09, and the $34 billion in 2007-08 (see Figure 1).

Figure 1: Bond Program



The increase in bond issuance and the establishment of large and liquid Government of Canada benchmark bonds have resulted in large bond maturities on specific key dates, over $25 billion in some cases (see Figure 2). As a point of reference, since 2000, the average amount outstanding at maturity has been around $7 billion for June maturities.

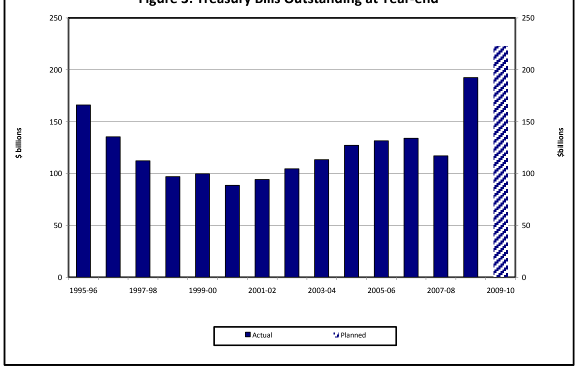
Figure 2: Maturity Profile
as of October 2009



In addition, given the fungibility of some bond issues and current issuance patterns, there could be large differences, within a given sector, in the total amount outstanding between benchmarks with different maturity months (i.e., June versus December).

The stock of outstanding treasury bills has increased over the last year and is projected to be about $223 billion by the end of 2009-10 as compared to about $193 billion at 31 March 2009 (see Figure 3).

Figure 3: Treasury Bills Outstanding at Year-end



Treasury bill and bond auctions continue to function well, with auction tails normalizing towards historical averages.

Issues for Discussion

The Department of Finance and the Bank of Canada are seeking views of market participants on the functioning of the Government of Canada securities market and related fixed-income markets over the recent period of increased market volatility and higher borrowing requirements. The government is also interested in the views on adjustments made to the debt program in 2009-10, and their impact on the future borrowing program and on potential operational initiatives for the purposes of formulating the debt strategy for 2010-11 and future years.

Current Market Conditions

1. What are your views regarding the liquidity and functioning of Government of Canada securities across the various maturity sectors and related fixed-income markets (e.g., repo, derivatives, strip, provincial, corporate)? How have these markets impacted the functioning of Government of Canada securities markets?

2. How has activity evolved on electronic trading platforms?

Bond Program

In 2009-10, a 3-year bond was reintroduced with March and September maturities, additional March and September maturities were added in the 2-year sector, and a December maturity was added in the 5-year sector. In June 2009, it was announced that the bond program would be increased by about 25% from the initial plan. Finally, the maximum benchmark target sizes have been exceeded in most sectors.

3. How has the additional bond supply impacted the market in various sectors and overall?

4. What are your views regarding the balance between the frequency and size of bond auctions?

5. In light of heightened borrowing requirements and significant size of the outstanding amount for some specific maturity dates, are the cycles of the benchmark maturities still appropriate?

In the past, the coupon rate for new issues of Real Return Bonds was set in advance and announced in the Call for Tender.

6. Do you have any views on how the coupon rate should be set for the next new Real Return Bond?

Treasury Bill Program

Since the beginning of the fiscal year, the size of biweekly treasury bill auctions has ranged between $12 billion and $18 billion.

7. Do you have any comments regarding the functioning of the treasury bill program?

Bond Buyback Program

In 2009-10, there have been quarterly bond buyback operations in the long end of the curve, which have been conducted solely on a switch basis.

8. Have these operations been useful to alleviate liquidity pressures experienced earlier in the year? Do you foresee a continued need for these operations in the future?

9. In light of the significant size of some specific key maturity dates, what are your views on the future role of the bond buyback program?

Currently, the bond buyback basket for the 30-year sector contains bonds with maturities between March 2021 and June 2037. Within the basket, two bond maturities are approaching the floor of $3 billion at which point they will no longer be eligible for inclusion in the bond buyback basket, leaving only three eligible bonds with more than $3 billion outstanding in the 30-year sector.

10. What are your views with regards to the threshold beyond which a bond is no longer eligible for regular bond buyback operations?

Operational Issues

Following requests received by a number of government securities distributors, the Bank of Canada and the Department of Finance are considering changing the timing of bond auctions. For instance, bond auctions could be held at the same time as treasury bill auctions and switch operations (10:30 ET).

11. In light of general market activity, data release times, and other factors, what are your views on standardizing auction times to 10:30 (ET) for treasury bill and bond operations? Do you foresee any impact related to the reporting of the auction net position?

The Government has an interest in maintaining a well-functioning primary market for the distribution of its securities.

12. What are your views on the functioning of the treasury bill and bond auctions?