Spring 2010 Debt Management Strategy Consultations

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 management of the cash flow profile of Government of Canada securities over the medium term, and demand for long term bonds (nominal and Real Return).

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 and strives to maintain liquid, transparent, regular and diversified borrowing programs. A well-functioning government securities market supports the achievement of the government's fundamental debt management objective of keeping borrowing costs low and stable and 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.

Cash Flow Profile of Upcoming Maturities

The Bank of Canada, as Fiscal Agent for the Government, manages Receiver General cash balances, from which the balances required for Canada's day-to-day operations are drawn. Various programs are used to manage the cash balances, including twice daily auctions of Receiver General cash balances, treasury bill auctions, cash management bill auctions and the cash management bond buyback program.

Cash balances can fluctuate widely over the course of a year owing to the scope of the government's financial operations, including periodic large maturities of Government of Canada bonds.

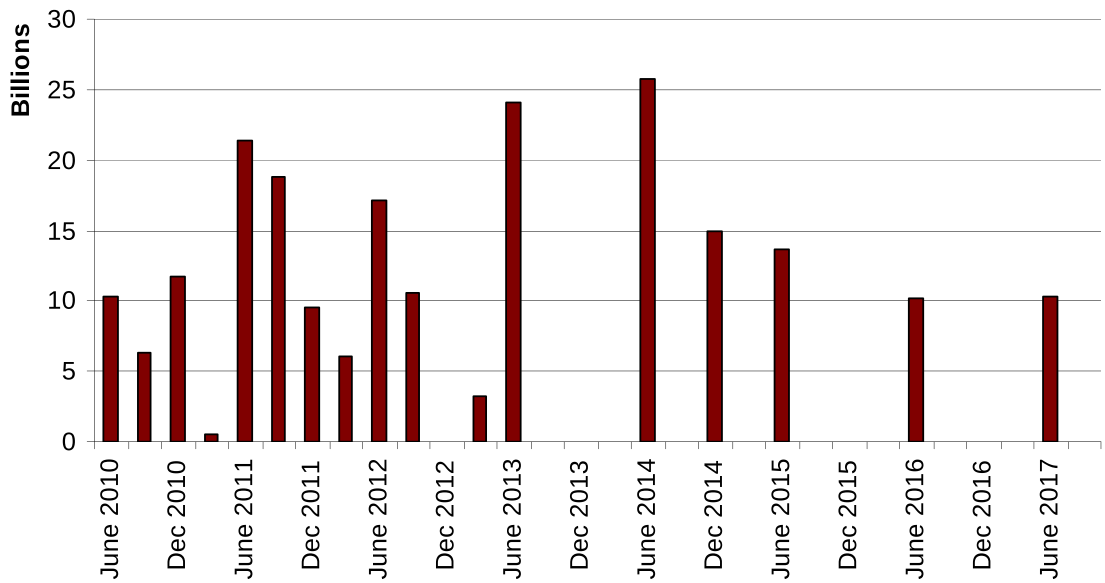
Based on the stock of Government of Canada bonds outstanding as of 31 December 2009, large bond maturities, over $25 billion in some cases, are expected on key dates, more specifically on 1 June dates (see Figure 1). These large cash flow maturity dates would also be subject to coupon payments as well as any future issuance maturing on those dates. As a point of reference, since 2000, the average amount outstanding at maturity has been around $7 billion for June maturities.

The large upcoming bond maturities are the outcome of two factors:

1. Concentration of issuance around the 1 June maturity date in recent years to maintain benchmark liquidity, which was helpful during an era of declining debt issuance; and

2. Significantly larger bond programs since 2008-09.

Maturity Profile as December 2009



The government is looking for input from market participants on how to efficiently manage these large cash flow maturity dates.

Questions for Discussion

1- From a market perspective, do you foresee any issues or risks arising from these large upcoming cash flow maturities?

2- How much emphasis should be placed on the cash management bond buyback program as a means to help manage large upcoming maturities?

3- How can the benchmark cycle or bond maturity dates be modified to help mitigate future peaks in bond maturities?

Demand for Long Term Bonds

In 2007/08, long-term bond issuance was increased by approximately $1 billion in recognition of higher demand for longer-dated securities. High funding requirements in 2008/09 and 2009/10 led to increased issuance across all sectors, including for long-term bonds.

As of 31 December 2009, 30-year nominal and Real Return Bonds represented approximately 29% of outstanding marketable bonds, of which about two-thirds was composed of nominal bonds and one-third of Real Return Bonds.

With decreasing funding requirements projected over the medium-term, and planned reductions in issuance across all sectors, we would like to have a better understanding of dealer and institutional investor interest in long-term bonds.

Questions for Discussion

1- How has the additional supply of long bonds affected the functioning of the sector? Have the increased issuance and switch bond buyback operations for long off-the-run bonds supported liquidity in the sector?

2- Can you describe the current and future state of demand for long-term bonds, both nominal and Real Return? Is the allocation of issuance between nominal and Real Return Bonds appropriate?

3- What are your views regarding the timing for the introduction of new long benchmarks and the frequency and size of long bond auctions?