BANK OF CANADA
BANQUE DU CANADA

Summary of Comments – 2013–14 Debt Management Strategy Consultations

As the sovereign and largest issuer of Canadian-dollar-denominated fixed-income securities, the Government of Canada considers consultations with market participants to be an essential component of its ongoing commitment to a well-functioning government securities market, and an integral part of the debt management process.

In December 2012, bilateral consultations took place with a total of 32 organizations in Victoria, Vancouver, Toronto and Montréal. These debt management strategy consultations sought the views of market participants on the transition to a smaller treasury bill program, the state of demand for longer-term securities, and the impacts of foreign investor interest and regulatory changes on Government of Canada securities markets.

The Bank of Canada and the Department of Finance value the comments provided by market participants during consultations. The following text summarizes the comments that were received.

Bond Program
In general, market participants reported that the Government of Canada securities market remains liquid and functions well across all maturity sectors, although some have observed a decline in liquidity for certain off-the-run long bond issues. Participants also noted an increased use of futures contracts, mainly in the 10-year sector.

Treasury Bill Program
Market participants commented that the impact of the Insured Mortgage Purchase Program (IMPP) asset maturities in 2013–14 on treasury bills has been well communicated and that the market should be able to adjust to the projected decline in the size of the treasury bill stock as well as the biweekly variation in auction sizes. They noted, however, that the effects of strong international interest and increased demand for short-term high-quality collateral resulting from various regulatory changes should be monitored carefully.

Cash Management Bond Buyback (CMBB) Program
Market participants commented that the CMBB program[1] is functioning well and has supported liquidity in the short-term bond market. Given the potential increased need for high-quality collateral as a result of regulatory changes, it was noted that short-term bonds could represent a viable alternative to treasury bills.

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[1] Government of Canada bonds eligible for CMBB operations are those with a term to maturity of up to 18 months, where the total amount of bonds maturing on a given date is greater than $8 billion.

Long-Term Bonds

Dealers and investors reaffirmed that there continues to be strong demand for long-term nominal bonds and Real Return Bonds, and that the debt strategy adjustments announced on 27 September 2012, which reallocated issuance toward long-term bonds, have been well received by the market. Although the need for long-duration assets remains strong, the level of demand for a Government of Canada bond with a maturity of 40 years and longer (ultra-long) is untested. Market participants commented that Canadian dollar ultra-long bonds issued by provinces are mainly purchased by domestic pension funds and life insurance companies. Most participants noted that if the Government of Canada were to issue ultra-long bonds, it should consider distributing them outside the auction process that is used for existing Government of Canada Canadian-dollar-denominated debt.

Foreign Investor Interest

Participants in this year's consultations consistently remarked on the large and growing presence of international investors in Government of Canada securities markets. Foreign investor demand for Government of Canada securities extends across the yield curve, from treasury bills to long-term bonds, with focus mainly in the 2-, 3-, and 5-year sectors. Dealers mentioned that some foreign investors have also expanded their Canadian securities investments to include Canada Mortgage Bonds and provincial issues, as well as positions in futures contracts (mainly 10-year Government of Canada bond futures) as they become more familiar with the Canadian market.

Market participants viewed the increase in foreign investor interest to be generally positive, although many indicated that this is contributing to the increased frequency of securities trading "on special" in the repo market. Foreign investors were generally described as "less active" in the repo market relative to domestic participants.

Regulatory Change

Participants commented that increased liquidity and requirements for collateral resulting from new developments in regulatory frameworks, such as the Liquidity Coverage Ratio standard under Basel III, as well as reforms to the over-the-counter derivatives market, may increase demand for Government of Canada securities.

The implementation of new regulatory frameworks was viewed as affecting the ability of dealers to use their balance sheets for market-making and risk-taking activities. While this was described as not having a direct impact on the on-the-run Government of Canada securities, dealers mentioned a migration away from principal-based market making, where dealers hold large bond inventories, toward a hybrid, agency-based "order-driven" model for less-liquid securities.