2015–16 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 related to the design and operation of the Government of Canada's domestic debt program for 2015–16 and beyond. Regular consultations with market participants are an integral and valued part of the debt management process. All market participants are encouraged to provide input.

The fundamental objective of debt management is to raise stable and low-cost funding to meet the needs of the Government of Canada. An associated objective is to maintain a well-functioning market in Government of Canada securities, which helps to keep debt costs low and stable, and is generally to the benefit of a wide array of domestic market participants.

This year's consultations are focused on obtaining views on the functioning of Government of Canada treasury bill and bond markets, and the review of the terms of participation in auctions.

A summary of comments received from market participants will be made available on the Bank of Canada website concurrently with the release of the *Debt Management Strategy for 2015–16.*

Context

With sound fundamentals, prudent economic management and a commitment to return to balanced budgets in 2015, Canada continues to bear a stable AAA rating from all the major credit rating agencies. Government of Canada securities continue to be among the world's most sought-after high quality investments. Non-residents now hold about 26 per cent of Government of Canada marketable debt securities, almost doubling the average for the five years preceding the global financial crisis.

With expected surpluses in 2015–16 and beyond, the net new supply of Government of Canada bonds is forecasted to decline over time. Annual gross bond issuance is projected to stabilize at around $85 billion in the medium term, while the stock of treasury bills is projected to decline from $153 billion at the start of 2014–15 to about $130 billion by the end of the fiscal year. Over the medium term, the stock of treasury bills will be managed down to eventually represent about 20 per cent of total market debt.

Since September 2012, the Government has reallocated some short-term bond issuance towards long-term bond issuance to take advantage of long-term interest rates that remain near historically low levels. Additional issuance in the 10- and 30-year maturity sectors and the issuance of a 50-year bond have helped the Government achieve its objective of raising stable and low cost funding.

During the debt management strategy consultations held in the fall of 2013, dealers reported that Government of Canada debt securities auctions function well, but there was broad consensus that the rules governing those auctions could be updated to ensure their continued relevance. In particular, most primary dealers and non-primary dealer government securities distributors agreed that the minimum standard for maintaining or acquiring official dealer status should be made more stringent.[1]

Within this context, input received during these consultations will help federal debt managers to ensure that the debt strategy and the distribution framework strike a prudent balance between costs and risks, while remaining appropriate and responsive to changing circumstances.

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[1] Documents related to the fall 2013 consultations can be found on the Bank of Canada website at www.bankofcanada.ca/2013/10/debt-management-strategy-consultations-2014-15/ and www.bankofcanada.ca/2014/02/summary-comments-2014-15-debt-management-strategy-consultations/.

Bond Program

The current bond program includes eight maturity dates (see Table 1). With strong ongoing interest in Government of Canada securities, and the Government's planned return to balanced budgets and surpluses, thought is being given to the appropriate maturity mix and benchmark sizes, the use of fungibility across sectors and the time required to build bonds to benchmark size.

Table 1: Size of Maturity Dates and Benchmark Size Ranges[2]

($ billions)

	Feb.	Mar.	May	June	Aug.	Sept.	Nov.	Dec.
2-year	8–12		8–12		8–12		8–12	
3-year	8–12				8–12			
5-year		10–13				10–13		
10-year				10–14				
30-year								12–15
RRB								10–16
Total	16–24	10–13	8–12	10–14	16–24	10–13	8–12	10–16

1. Are there any issues with the current number of benchmarks, benchmark sizes and maturity dates? Would the market benefit from larger benchmark sizes at the cost of fewer maturities and/or a consolidation of maturity sectors. If so, how would you recommend adjusting the current issuance mix? What are the optimal benchmark sizes across maturity sectors?

2. How would you characterize current demand for long and ultra-long term bonds and how do you see it evolving? What do you view as being the main factors driving the evolution of demand in these maturity sectors over time?

3. How has the investor landscape changed over the last few years in the Government of Canada securities market? Specifically, what changes have you seen in the types of investors that are interested in Government of Canada securities and what changes in investor behaviour, preferences or requirements have you noticed?

4. There continues to be a trend of Government of Canada securities trading "on special" in the repo market. How do you see this trend evolving, and in your view has that trend had any effect on the liquidity and well-functioning of the Government of Canada securities markets or other Canadian fixed income markets?

5. Government of Canada bond auctions occur on Wednesdays at noon and in some quarters as many as ten bond auctions are conducted. To improve flexibility around selecting bond auction dates, the Government is exploring the possibility of scheduling bond auctions on days other than Wednesdays. Would you have any concerns with scheduling some bond auctions on a Thursday following a Bank of Canada Fixed Announcement Date (i.e., one day later)?

[2] Benchmark size ranges for Real Return Bonds include an estimate for inflation adjustment. The 30-year nominal bond and Real Return Bond typically do not mature in the same year.

Treasury Bill Program

The Government's medium-term debt strategy is aimed at gradually transitioning the debt structure towards one that is more evenly distributed across all maturity sectors. The strategy includes a planned reduction in the stock of treasury bills, which will be managed down to eventually represent about 20 per cent of the total stock of Canadian-dollar market debt outstanding.

Cash management bills (CMBs) are short-dated treasury bills that are used to raise cash balances on short notice before large payments are due, thereby reducing the cost and risk of holding excess cash over long periods. Fungible CMBs share their maturities with previously issued treasury bills, while non-fungible CMBs do not. The average size and term to maturity of CMBs in 2013–14 was $2.3 billion and 30 days, respectively, while for 2014–15, they are $2.2 billion and 16 days based on data to the end of September 2014.

6. What minimum level of treasury bill stock or bi-weekly issuance is necessary to maintain a well-functioning treasury bill market? How would you characterize the market's ability to adjust to a smaller treasury bill stock in the medium term?

7. How would you characterize the market's ability to adapt to variations in the size of treasury bill auctions over time? What maximum variation between a treasury bill maturity and auction amount is the market able to manage efficiently?

8. Currently, three treasury bill maturity terms are used (3, 6 and 12 months). Is the current allocation of issuance among the three sectors appropriate (i.e., 50-60 per cent, 20-25 per cent and 20-25 per cent respectively)?

9. What are your views on the use of fungible and non-fungible CMBs, and their impact on treasury bill auctions and the functioning of the treasury bill market?

Review of the Terms of Participation in Auctions

The Terms of Participation in Auctions (the "Terms") are designed to ensure that the Government can raise stable and low-cost funding through an open and competitive auction framework. They are also designed to support the well-functioning of the market for Government of Canada debt securities by promoting the participation of government securities distributors and investors in both primary and secondary markets[3].

The Department of Finance and the Bank of Canada are working to fine-tune and update the Terms. Work includes "housekeeping" items as well as taking measures to enhance the clarity, transparency and simplicity of the Terms. Feedback received during the fall 2013 consultations is helping to shape the review of the Terms.

10. In order to assist us in this review, would you have views to share on potential improvements to the rules governing Government of Canada securities auctions?

[3] The current terms of participation in auctions for government securities distributors and customers, and the standard terms for auctions of treasury bills, nominal bonds and Real Return Bonds can be found on the Bank of Canada website at www.bankofcanada.ca/markets/government-securities-auctions/.

Appendix

BOND PORTFOLIO

Term to Maturity (years)	Coupon	Maturity	Issuance Sector	Outstanding Net of Repurchased (CAD Millions)	Repurchased (CAD Millions)	Duration	YTM (%)
Nominal Bonds							
0.1	1%	Nov 2014	2Y	7 913	1 987	0.09	0.94
0.2	2%	Dec 2014	5Y	8,030	6,970	0.16	0.94
0.3	1%	Feb 2015	2Y	13,407	2,193	0.34	0.97
0.6	1%	May 2015	2Y	7,575	2,325	0.58	0.99
0.7	2.5%	Jun 2015	5Y	4,476	4,524	0.65	0.97
0.7	4.5%	Jun 2015	10Y	8,378	1,922	0.65	0.97
0.7	11.25%	Jun 2015	25Y	375	1,975	0.64	0.84
0.8	1.5%	Aug 2015	2Y	12,085	3,215	0.82	1.00
1.1	1%	Nov 2015	2Y	9,473	427	1.07	1.01
1.2	3%	Dec 2015	5Y	11,117	225	1.14	1.01
1.3	1.25%	Feb 2016	2Y	14,700	0	1.32	1.05
1.6	1%	May 2016	2Y	10,000	0	1.56	1.09
1.7	2%	Jun 2016	5Y	9,900	0	1.63	1.10
1.7	4%	Jun 2016	10Y	10,157	143	1.60	1.10
1.8	1%	Aug 2016	2Y	17,100	0	1.81	1.12
1.9	2.75%	Sep 2016	5Y	10,500	0	1.86	1.11
2.1	1%	Nov 2016	2Y	6,800	0	2.05	1.14
2.3	1.5%	Feb 2017	3Y	8,100	0	2.28	1.16
2.4	1.5%	Mar 2017	5Y	10,500	0	2.36	1.16
2.7	4%	Jun 2017	10Y	10,343	0	2.51	1.17
2.8	1.25%	Aug 2017	3Y	8,100	0	2.77	1.28
2.9	1.5%	Sep 2017	5Y	10,200	0	2.84	1.28
3.4	1.25%	Mar 2018	5Y	10,200	0	3.32	1.35
3.7	4.25%	Jun 2018	10Y	10,623	0	3.38	1.40
3.9	1.25%	Sep 2018	5Y	10,200	0	3.80	1.47
4.4	1.75%	Mar 2019	5Y	10,200	0	4.23	1.54
4.7	3.75%	Jun 2019	10Y	17,650	0	4.26	1.55
4.9	1.75%	Sep 2019	5Y	10,200	0	4.68	1.63
5.7	3.5%	Jun 2020	10Y	13,100	0	5.11	1.67
6.5	10.5%	Mar 2021	30Y	567	1,233	5.13	1.74
6.7	3.25%	Jun 2021	10Y	11,500	0	5.96	1.78
6.7	9.75%	Jun 2021	30Y	286	4,364	5.22	1.72
7.7	2.75%	Jun 2022	10Y	12,700	0	6.86	1.94
7.7	9.25%	Jun 2022	30Y	206	2,344	5.90	1.87
8.7	1.5%	Jun 2023	10Y	14,200	0	8.01	2.06
8.7	8%	Jun 2023	30Y	2,359	5,841	6.67	2.00
9.7	2.5%	Jun 2024	10Y	13,800	0	8.50	2.15
10.7	2.25%	Jun 2025	10Y	5,400	0	9.38	2.25
10.7	9%	Jun 2025	30Y	2,303	6,597	7.70	2.17
12.7	8%	Jun 2027	30Y	4,430	5,170	8.97	2.31
14.7	5.75%	Jun 2029	30Y	11,142	2,758	10.62	2.42
18.7	5.75%	Jun 2033	30Y	12,796	614	12.67	2.54
22.7	5%	Jun 2037	30Y	13,587	412	14.90	2.63
26.7	4%	Jun 2041	30Y	15,693	107	17.36	2.67
31.2	3.5%	Dec 2045	30Y	16,400	0	19.74	2.67
34.2	2.75%	Dec 2048	30Y	1,800	0	21.97	2.68
50.2	2.75%	Dec 2064	50Y	2,500	0	27.20	2.65
RRBs							
7.2	4.25%	Dec 2021	RRB	5,175	0	3.16	0.08
12.2	4.25%	Dec 2026	RRB	5,250	0	5.00	0.40
17.2	4%	Dec 2031	RRB	5,800	0	6.74	0.49
22.2	3%	Dec 2036	RRB	5,850	0	8.69	0.61
27.2	2%	Dec 2041	RRB	6,550	0	10.91	0.71
30.2	1.5%	Dec 2044	RRB	7,700	0	12.39	0.76
33.2	1.25%	Dec 2047	RRB	2,200	0	13.74	0.79

Benchmark **Building to Benchmark**

**Source: Bloomberg as of 30 Sept 2014*

**RRB numbers do not include inflation adjustment*