Fall 2021 Debt Management Strategy Consultations Summary

Regular consultations with market participants are an essential component of the government's ongoing commitment to a well-functioning Government of Canada securities market and an integral part of the debt management process, especially in the context of the management of the ongoing COVID-19 pandemic. In October 2021, the Department of Finance and the Bank of Canada held over 30 bilateral virtual meetings and received written comments from dealers, investors and other relevant market participants. These consultations sought the views of market participants on issues related to the design and operation of the Government of Canada's domestic debt program for 2022-23, as can be found at the following link. 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 in formulating the debt management strategy.

Overall Comments

Market participants indicated that fiscal and monetary policy normalization have been orderly so far and changes to the debt program and the Bank of Canada's various financial market support programs were responsive to market needs, transparent, and clearly communicated.

Market participants indicated that Canadian fixed income markets continued to work remarkably well over the course of 2021. The primary and secondary markets were supported by the Government Bond Purchase Program (GBPP) of the Bank of Canada. The secondary market also benefited of the securities lending facility of the Bank of Canada. However, some market participants noted that friction exists in the secondary market in transacting off-the-run bonds, likely related to the Bank of Canada's large holdings.

Based on anecdotal evidence, some participants indicated that more investors have entered the Government of Canada debt market as issuance grew during COVID-19. These investors were possibly attracted by the bigger benchmark sizes and the possibility of selling older bonds into the GBPP of the Bank of Canada. However, some market participants also mentioned that the increased presence of international fast money investors can negatively affect liquidity at times. This is particularly felt in the long end sectors.

Declining Issuance Post-COVID-19

A majority of market participants indicated that in case of materially lower borrowing needs in 2022-23, the T-Bill sector should not be lowered materially below the current level and that the issuance of ultra-long bonds and the 3-year sectors could be terminated. The ultra-long bond issuance is seen as choppy and the 3-year bond is not considered a useful benchmark by most market participants. Market participants indicated that the 2-year bond is deemed close to its minimum issuance levels, and that the government could issue more in this sector in 2022-23, not less. Market participants support the current level of 5-year issuance. In general, market participants indicated that long bond issuance should be reduced as the GBPP is tapering and financial requirements appear materially lower than projected during Budget 2021.

Long-Term Bonds

Market participants indicated that the long end of the Government of Canada market repriced somewhat higher (mostly in the 50-year sector) but was functioning well. Despite coming down from $5B a week to entering its reinvestment phase over the course of the year, the GBPP remained a key element of stability for the long end of the Government of Canada market. A number of market participants indicated that for 2022-23, the 10-year sector could readily absorb more net issuance since the sector benefits from a liquid and well-developed futures market. Some market participants stated that the net issuance in the net 30-year sector could also be increased somewhat in 2022-23 but not without putting further pressure on yields. Accordingly, the government could consider reducing its gross 30-year issuance as net supply is going to increase.

For ultra-long bonds, a clear majority of participants, including typical long-bond investors, do not support additional issuance in the 50-year sector. These investors indicated limited demand for these very long instruments mainly due to low yields or other asset-liability management strategies with higher return.

Bond Operational Considerations

Market participants indicated that the two benchmarks per year in the 10-year sector is functioning well but suggested that they should be built earlier; a minority suggested going back to one benchmark per year.

In general, market participants indicated that they understood the rationale for having the 3-year on its own cycle, but most do not support the sector since the swap market has not adopted it. Some suggested to make it fungible again with old 5-year bonds while a few others mentioned that issuance in the 3-year should be redirected to the 2-year and 5-year sectors.

A few market participants mentioned that a well-developed futures market is key to attract international investors to a specific issuance sector. They also suggested changing the auction format to a format better suited for investors with fiduciary duties, including international investors. The recent added transparency in the Quarterly Bond Schedule is perceived as a positive change as more clarity is appreciated by the international participants that do not follow Canada's benchmark cycle as closely.

Treasury Bills

Over the past year, treasury bills remained in high demand due to excess cash in the financial markets, both from domestic and international investors. Monetary policy normalisation expectations and international arbitrage also increased the demand for treasury bills. The treasury bill market has been functioning well despite some friction as the stock outstanding approaches $200B. Short-end bills (3-months and under) continue to be in high demand and participants noted that, if it wished to, the government could issue a regular 1-month treasury bill (i.e., add a bill tenor). Investors noted that this would help alleviate some liquidity constraints for very short bills.

Currently close to its minimum, there is ample room, if needed, to increase treasury bills issuance as evidenced by yields remaining well below the overnight rate.

Going from a t+2 to a t+1 settlement at issuance received mixed views with some supporting the change while others mentioning potential short-term downfalls of such a change. Those against this change

indicated a preference to keep treasury bill auctions on Tuesdays to avoid provincial issuance on Wednesdays, however, this would create a one year transition i.e., misalignments of cash flows (maturing treasury bills would settle t+2 (on Thursdays) while new issued treasury bills would settle on t+1 (Wednesdays)).

Environmental, Social and Governance (ESG) Securities

It was mentioned that the Canadian social bonds market is still in its infancy and is significantly smaller than the green bonds market. Nonetheless, given the interest in ESG space, market participants expected that there would still be demand for a Government of Canada social bond. Most noted, however, that while the investor base is similar to green bonds, it is doubtful for a social bond to receive similar levels of demand given the current size of the market.

Many suggested focusing on establishing the Canada's green bond program first to help develop the ESG market in Canada. The government could eventually consider evolving the program into a sustainable bond framework, which could be used to issue various labelled bonds like green, social, or sustainable bonds. However, some cautioned to avoid eroding demand for the regular debt program with various ESG labelled bonds, and that new lines be added only if the government can maintain liquidity in existing regular debt sectors.

Finally, some market participants noted that a Canada social bond could help develop the market as it would demonstrate leadership and encourage other issuers and investors to be active in social/sustainable funding markets.