Fall 2022 Debt Management Strategy Consultations Summary

Regular conversations with market participants are an essential component of the Government's ongoing commitment to a well-functioning Government of Canada (GoC) securities market and an integral part of the debt management process. In September and October 2022, the Department of Finance and the Bank of Canada attended bilateral in-person meetings and received written comments from dealers, investors, and other relevant market participants. These consultations sought the views of market participants on the design and operation of the Government of Canada's domestic debt program for 2023-24. 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 when formulating the debt management strategy.

Overall Comments

Overall, market participants said the Canadian debt market continues to function relatively well in a global environment of increasing interest rates and significantly higher volatility. Market participants identified a general deterioration in global market liquidity, however, liquidity in Canada appears to be better than in other jurisdictions. There is generally good demand for almost all GoC sectors with the exception of 3-year bonds and Real Return Bonds, where demand and liquidity have been relatively weaker.

As the Government's borrowing program continues to normalize post-COVID-19, participants noted that Government should seek to avoid material issuance reductions in most sectors to support continued well-functioning markets. Participants described benchmark bonds as having better liquidity than off-the-run bonds, in part due to the Bank of Canada's large holdings of many of these off-the-run securities.

It was noted that in terms of client participation, demand from hedge funds and international investors has lessened while demand from domestic real money investors remains strong.

Treasury Bills

There continues to be a high level of demand for treasury bills, especially the 3-month tranche. This demand is driven by the uncertainty in markets and the rising interest rate environment. With this strong demand for 3-month treasury bills, some market participants suggested re-allocating some issuance from the 6-month and 12-month tranches to the 3-month, however, this view was not universal. The projected treasury bill stock of about $190 billion was deemed acceptable by participants, although the desired stock is above $200 billion.

The Government sought views on possible demand for a 1-month treasury bill, and whether this could be a substitute for the Bankers' Acceptances (BAs) market which is expected to cease in June 2024 due to regulatory requirements and the cessation of the CDOR reference rate.

While several participants noted that there would be good demand for liquid 1-month risk-free collateral, the general response was that such a security would not be a natural substitute for BAs, which have a higher yield. While some concerns were raised about a possible cliff effect in June 2024 should BA issuance remain at current levels, most market participants believe that one or more market solutions could arise and meet the need for 1-month collateral.

Bonds

Market participants expressed no concerns with the sizes of the 2-year and 5-year sectors, although some believed the 2-year sector could benefit from more issuance. Participants noted that there is little interest in the 3-year sector and that it does not trade like a natural benchmark. Participants would be in favour of a re-allocation of 3-year issuance into the 2-year and 5-year sectors.

Demand for 10-year and 30-year bonds was described as strong, in part due to the reduction of provincial governments' bond programs which tend to be focused on longer tenors. Market participants noted that the market could absorb more issuance in these longer sectors and that existing issuance levels should be maintained to the extent possible. Most participants were content with the move to two 10-year benchmarks during COVID-19 but communicated that this approach can only be kept so long as the benchmark sizes remain reasonable.

On the cancellation of the 50-year ultra long bond, market participants were understanding of the rationale for this decision but criticized the manner in which it was communicated to the market. Participants accepted that deviations from the Debt Management Strategy are sometimes required and advocated for better transparency in future when such adjustments are made.

No concerns were raised regarding the existing level of issuance for Real Return Bonds (RRBs), although participants noted that there continues to be little demand for this product. This low demand reflects RRBs' general lack of liquidity, as well as small stock and benchmark sizes. Foreign investors account for the majority of recent RRB demand, whereas Canadian investors seeking inflation protection are relying on other instruments such as infrastructure projects and U.S. Treasury Inflation-Protection Securities (TIPS).

Bond Buybacks

Market participants would welcome the reintroduction of Cash Management Bond Buybacks (CMBBs). Some participants raised the idea of reintroducing switch operations as well to help improve liquidity. More hesitancy was expressed regarding cash buybacks, as the optics of these operations would be challenging in the current environment of quantitative tightening. If pursued, participants suggested a targeted approach and avoiding bonds with low floats.

For any reintroduction of either buybacks or switches, participants noted the need for clear and transparent communications.

Environmental, Social and Governance (ESG) Securities

Participants were satisfied with the issuance process for Canada's inaugural green bond, which was syndicated in March 2022. Participants also noted that demand for green-labelled bonds continues to grow.

On future issuances, the majority of market participants suggested that Canada re-open its inaugural green bond in 2022-23 via syndication.

Participants also suggested that Canada create a green curve over the coming years, although opinions varied on the maturity to target, with some proposing a continued focus on the 7-year point and others suggesting longer maturities with smaller issuance sizes.

Most participants agreed that Canada should look to adopt a sustainable bond framework in the future, which would incorporate green, social, and even transition bonds. However, most advised that Canada should not rush in developing a new framework and instead should focus on developing the Canadian green bond market in the near term. This would also provide time for related work streams that would aid in the development of a sustainable bond framework in Canada, such as the creation of a transition investment taxonomy by the Sustainable Finance Action Council.

Miscellaneous

Participants were asked if they foresaw any issues about the pending change in the timing of the settlement of bond transactions, which is the time when each party involved in a transaction has access to their new asset. In 2024, settlement in the United States will move from 2 days after the transaction date (T+2) to one day after (T+1). Most market participants did not express material concerns with the idea of moving from T+2 to T+1 for bond settlement in Canada. Warnings were given by participants that the shift to T+1 would likely result in an increase of failed settlements, especially during the initial adjustment period.