

Steady as she goes for GoC bond supply

By Taylor Schleich/Alpa Atha

Since COVID-19 took a stranglehold on the globe last spring, government bond supply has been on something of a wild ride. In addition to volatility in quarterly issuance totals, the composition of new supply has been drastically altered in Canada as the Department of Finance engineers a structural term-out of its bond stock. Now, after numerous changes over the last 15 months, it seems that we've entered a period of relative stability judging by the latest Quarterly Bond Schedule, published this afternoon by the Bank of Canada.

Firstly, the number of auctions planned next quarter is expected to remain unchanged at 18. For reference, the prior fiscal year saw the number of auctions jostled from 18 to 22 to 21 and finally to 19 over the final three months of 2020-21 (with even greater swings coming in issue sizes, Chart 3). Secondly, the composition of the Jul-Sep auctions is unchanged versus this outgoing quarter (Table 1). Thirdly, when it comes to amounts, NBF is currently projecting only a slight decline in gross issuance from \$73.4 billion to \$71.3 billion. The small drop is the result of a step down in 2-year and 10-year auction sizes that took place over the past three months. More so than in prior quarters, we have a greater degree of confidence in these estimates given that we have a recent and relevant *Debt Management Strategy* to measure progress against (something we didn't have for large parts of last year) and less overall economic/fiscal uncertainty (at least to the downside).

Through the first three months of 2021-22, we're exactly a quarter of the way towards the full-year sector target for 3-year, 5-year, 10-year and ultra-long bonds. We're slightly above the signalled pace on 2s and 30s, implying that at some point over the balance of the fiscal year, auction sizes might be reduced. For 2s, that may be a story for a future quarter. When it comes to 30-years, one \$3 billion auction followed by slightly smaller \$2.5 billion auctions thereafter would be consistent with hitting the \$32 billion target. However, we'd reiterate a key message from April's *DMS*: "The government will closely monitor financial markets and **may issue more long-term debt** if market conditions are favourable." Long-term interest rates are lower than they were in April when the *DMS* was released so it appears likely that we get more 30-year issuance than was signalled. Thus, we're expecting the COVID-era \$3 billion auction size to remain intact this quarter. As noted, 10-year auction sizes stepped down in May (from \$5.5 bln to \$5 bln). While the total amount raised in this sector in fiscal Q1 is exactly a quarter of the full-year target, we don't expect the BoC to re-increase auction sizes in the coming quarter. As a result, Jul-Sep may result in \$1 billion fewer 10-year bonds, leaving us on track to fall just shy of the full-year target (more on that below). Finally, on the RRB front, the well-established issuance pattern in this sector implies we'll be getting a single \$300 million tap of the new 2054s.

Overall, the \$73.4 billion that will have been raised through the end of June is 25.6% of the full-year total signalled in the *DMS*. Thus, if issuance ends up coming in line with target, we should be in for continued stability throughout the year. However, we might be tempted to take a *slight* under on April's *DMS* target. Growth assumptions laid out in the 2021 Budget (5.8% for real GDP, 9.3% for nominal GDP) now look conservative against our most recent forecasts of 6.0% and 12.6% for real and nominal GDP, respectively. The additional revenue that could flow from that ([fiscal sensitivity analysis](#) would peg this around \$10 billion) might modestly lower borrowing requirements later this year. To be sure, these impacts are still relatively small in the context of a nearly \$300 billion bond program, so any misses to the downside would be modest. Moreover, we recognize that the T-bill program is typically used as the fiscal 'shock absorber', but with insatiable demand here for now, it's unclear how much of a decline the bill stock will be permitted to take. We should learn more in the *DMS Update*, expected to drop in late autumn.

As for *net* issuance (net of maturities and BoC purchases), supply to the street might rise in Jul-Sep despite our slightly smaller gross projection. While there are \$9 billion more maturities in the coming quarter, the ongoing taper of the Bank's QE program (which we expect to continue in July), might mean something like \$13 billion fewer QE purchases through Jul-Sep. Nonetheless, increased net supply won't require much work from the Street: after controlling for maturities, and BoC QE/auction purchases, there may be just \$2-3 billion in net supply to absorb (this was effectively zero in Apr-Jun). Indeed, even with the steady BoC taper, BoC buying continues to limit what would otherwise be a flood of GoC debt. The consequence? A nearly 45% ownership share of the GoC bond market. Though supply shortages had been a result of this outsized footprint, the BoC has taken steps to alleviate this through its SROs, regularly lending \$25+ bln of the paper on its balance sheet (Chart 5).

One final note: The Government signalled its intention to issue a \$5 billion green bond in the April DMS. Given there were no further details provided in today's QBS, this will likely come in the fall or early 2022. We don't have information about where on the curve the Government expects to issue its inaugural green, but if we were to wager a guess, we'd look for it to come in the liquid and relatively low-risk 5-year sector.

Table 1: Visualizing next quarter's QBS

Auction dates for each of the BoC's tenors of issuance in Q2:2021-22

Tenor	July	August	September	Count	Prior qtr (Apr-Jun)
2Y	15-Jul	05 - Aug 19-Aug	15-Sep	4	4
3Y	8-Jul	25-Aug	-	2	2
5Y	7-Jul	11-Aug	21-Sep	3	3
10Y	21-Jul	4-Aug	02 - Sep 27-Sep	4	4
30Y	29-Jul	26-Aug	16-Sep	3	3
Ultra	-	-	23-Sep	1	1
RRB	-	-	1-Sep	1	1
Count	5 auctions	6 auctions	7 auctions	18	18

Source: NBF, BoC

Table 2: Quarterly issuance finally looks to be stabilizing

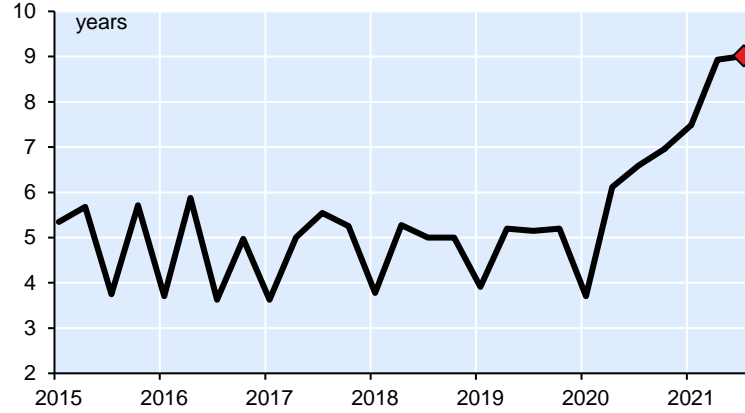
Pre-COVID and 2020-21 issuance & Q2:2021-22 gross issuance projection

	2010-19	2020	2020	2020	2021	2021	2021
	Average	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep
2Y	10.9	24.0	42.0	34.0	29.0	21.0	20.0
3Y	4.0	13.5	15.0	16.0	12.0	9.0	9.0
5Y	6.1	27.5	20.0	18.0	16.0	12.0	12.0
10Y	3.3	13.5	20.0	20.0	20.0	21.0	20.0
30Y	1.0	5.0	9.0	9.0	9.0	9.0	9.0
Ultra	0.1	0.0	0.0	0.0	0.0	1.0	1.0
RRB	0.6	0.4	0.3	0.4	0.3	0.4	0.3
Total	26.2	83.9	106.3	97.4	86.3	73.4	71.3

Source: NBF, BoC | Note: Jul-Sep estimated using QBS and estimated auction sizes.

Chart 1: Perspective on the GoC term out

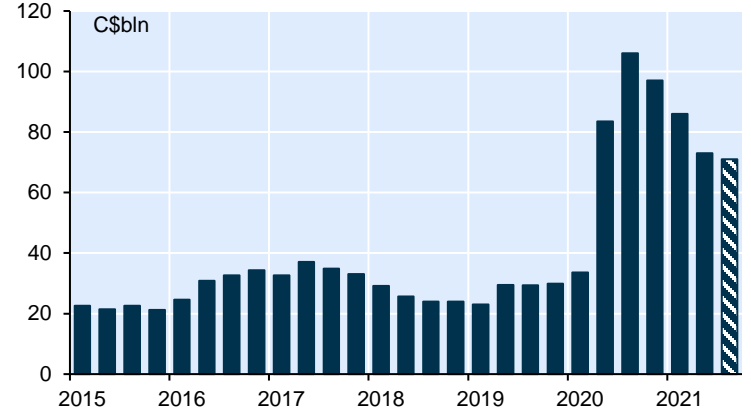
Weighted average term of issuance by quarter



Source: NBF, BoC | Note: Jul-Sep estimated using QBS and most recent auction sizes

Chart 2: Issuance lower than peak-COVID, but still elevated

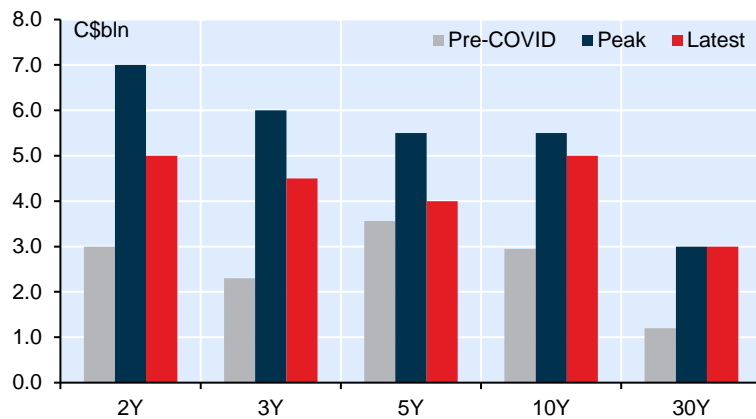
Gross nominal GoC issuance by quarter



Source: NBF, BoC | Note: Jul-Sep estimated using QBS and most recent auction sizes

Chart 3: COVID-related volatility in auction sizes

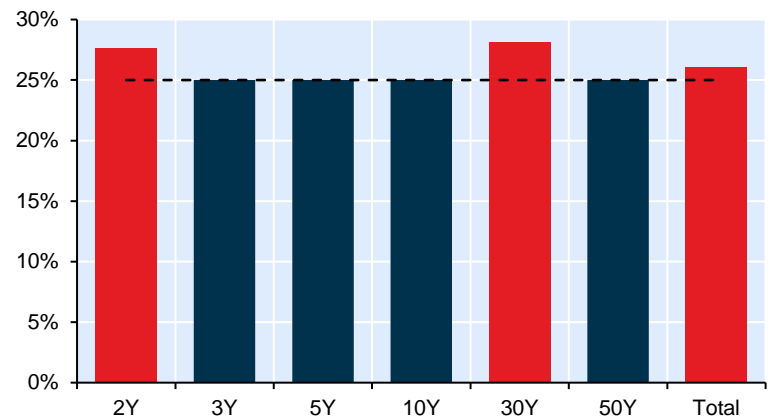
Auction sizes by tenor: Pre-COVID average, peak size and latest



Source: NBF, BoC | Note: Pre-COVID average based on 24 months prior to March 2020.

Chart 4: Through three months, issuance on track for target

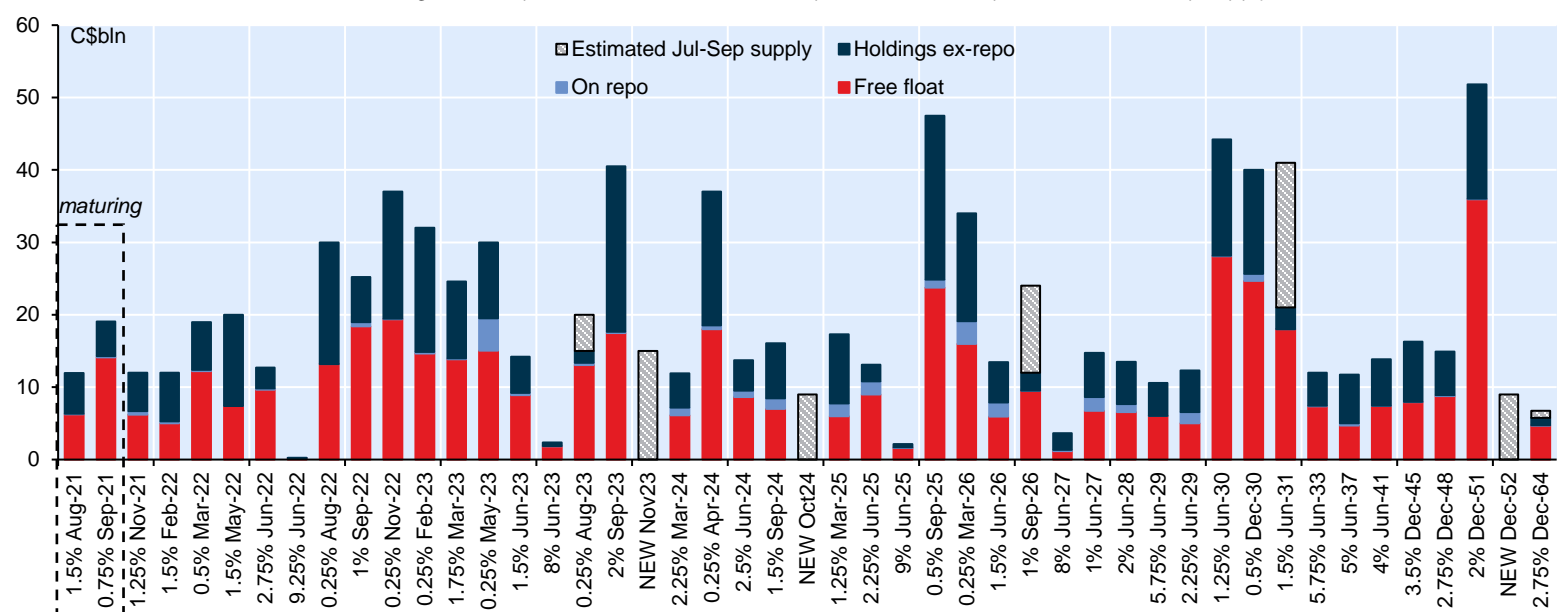
Fiscal Q1 issuance tenor as a share of full-year target from DMS



Source: NBF, BoC, GoC Budget 2021

Chart 5: Visualizing the Government of Canada bond stock

Nominal GoC bonds: Free float, BoC holdings net of repo'd securities, securities on repo and estimated placement of Jul-Sep supply



Source: NBF, BoC, GoC Budget 2021 | Note: Estimated Jul-Sep supply is based on target benchmark size ranges from 2021 DMS. Totals include remainder of expected June issuance. "On repo" based on June 24 Securities Repo Operation. Sum of light and dark blue bar is total BoC holdings.

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