Market View
Economics and Strategy

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At long last, a new long bond

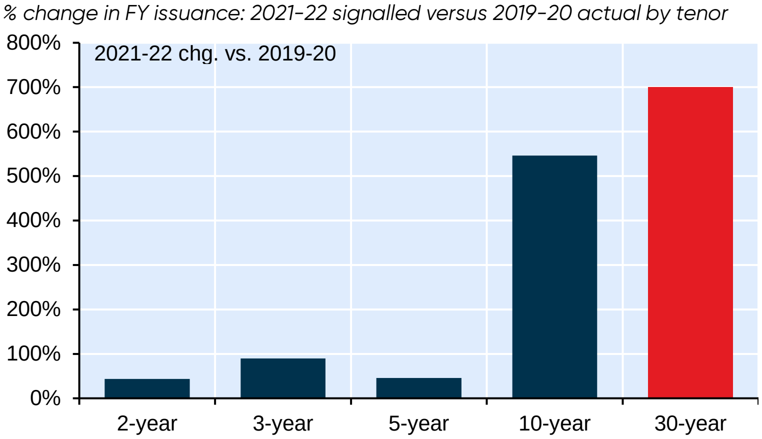
By Taylor Schleich

Right on cue, after we published a note exploring a new Ontario long bond, the Bank of Canada published the call for tender for a new GoC Canada 30-year—the first new long of the COVID era. Instead of a 2052 maturity date that we'll see on the new Ontario 30Y, the next GoC long bond will bear a Dec-2053 maturity. It's not often we get a new sovereign 30Y in Canada—there have been just 7 over the past 23 years (as far back as the BoC provides auction data). So, to us, it's a development worth celebrating with a deep dive in the 30Y GoC dynamics.

- Firstly, we'd reiterate that this is not the 30-year program of the past. While the entire Canada curve saw issuance explode last spring as the COVID grip tightened, no sector saw a more dramatic shift (really, a regime change) than 30s (Chart 1). Moreover, prior long bonds had consistently been issued until there was between $13 and $16 billion outstanding. As a result of the surge in funding needs and GoC term-out, the 2051s more than tripled what had been the status quo "terminal" outstanding (Chart 3). With the GoC still intent on locking in historically low long-term interest rates and with borrowing needs remaining elevated for the foreseeable future, don't look for the 2053s to return to the prior trend. We could well see the 2051s outstandings eventually matched (or exceeded) by this new security.
- Historically, it has taken well over 2 years for 30Y bonds to build to benchmark status. However, that was in the context of auctions that occurred with a frequency of once per quarter (or fewer) and with auction sizes that never exceeded $2 billion. That's not the case anymore. Throughout the COVID era, 30Y auctions have taken place monthly with a consistent lift of $3 billion. True to trend, the initial 2053 offering is set at $3 billion with two more scheduled over the balance of the quarter (though these amounts aren't yet known). While we acknowledge that the GoC's *Debt Management Strategy* signalled a full-year 30Y borrowing target of $32 billion (implying a slowdown at some point this year), we think we'll actually end up exceeding that. As the *DMS* notes, "*Throughout 2021-22, the government will closely monitor financial markets and, subject to favourable market conditions, will seek opportunities to issue more long-term debt*". 30-year rates are significantly lower than they were in April, conditions that scream favourable to us. Thus, we expect the $3 billion monthly pace to remain intact through the year. Beyond this fiscal year, borrowing needs will remain well above the pre-COVID run rate but should *somewhat* normalize. Thus, we might see a modest deceleration in 30Y auction sizes (or frequency) at some point. But even assuming a slowdown in 30Y issuance, (perhaps to $25-30 billion for 2022-23), we'd still be on track to reach the target benchmark size range around the end of 2022 (Chart 4). We'll have to wait for more guidance from the GoC, but for now, we're pencilling in December 2022 as the month the 2053s take over as benchmark. This would likely then give way to a new 2055 bond… but now we're getting ahead of ourselves.
- How do new long bonds trade upon its initial issue date? Through the first 100 days after a new 30Y has been launched, there's been an average tendency for underperformance versus the benchmark. Four of the last five 30Y rolls have cheapened after the initial auction, by an average of 1 bp (Chart 5). The one exception: the Dec51-Dec48 roll. We'd note however, that while older new 30Y issues began trading at a premium to the existing benchmark, the Dec-51s were the first to come at a discount (Chart 6). Today, the when-issued Dec-53s suggest an initial roll of 3-4 bps, though we see fair value at more like 2 bps. In any case, there's a concession built in relative to historicals.
- How about performance ahead of benchmark roll? The historical record is admittedly mixed, but there is an *average* tendency to see the new 30Y outperforming its neighbouring long bond in the 100-day lead-up to benchmark roll—a trend that makes intuitive sense (Chart 7). Of the last 6 benchmark rolls, this has played out 4 times. Narrow your focus to the handful of days immediately before benchmark roll and the relationship appears more consistent (Chart 8), though the outperformance here is admittedly quite modest (roughly half a bp).
- Finally, we'd be remiss if we didn't mention one of the most important factors in the current GoC bond market: QE. It's no secret the BoC has been extremely active in the market over the past year and change. It's meant that there's been tremendous support for government funding as the Bank has swallowed up a majority of net issuance. Unfortunately for the new 2053s, they won't have the same support that its neighbouring 2051s have had. Indeed, despite a total float of nearly $52 billion, a third of the 2051 outstandings are held by the BoC. With QE closer to end of life than beginning, the new 2053s won't get much help from the Bank beyond the regular 13% auction allocation, especially since the Bank tends to let new bonds build before they become eligible for purchase. It follows that, all else equal, we should probably see a cheaper 30Y roll than had historically been the case, particularly if we keep the pedal to the metal on long-term issuance.

Chart 1: 30Y issuance exploded the most vs. pre-COVID

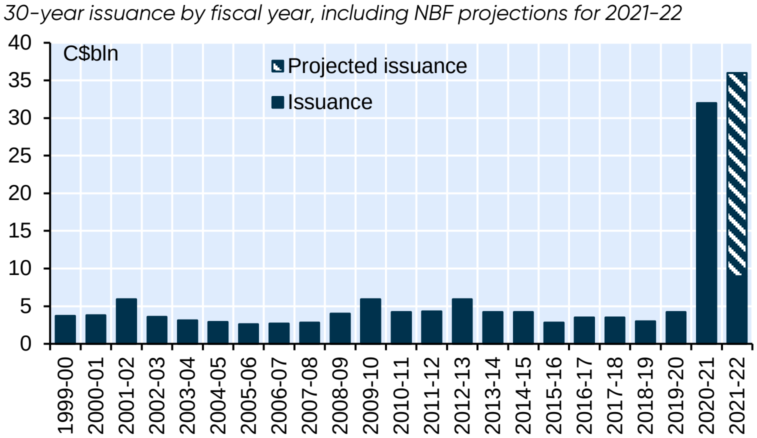
% change in FY issuance: 2021-22 signalled versus 2019-20 actual by tenor



Source: NBF, Government of Canada 2021-22 DMS

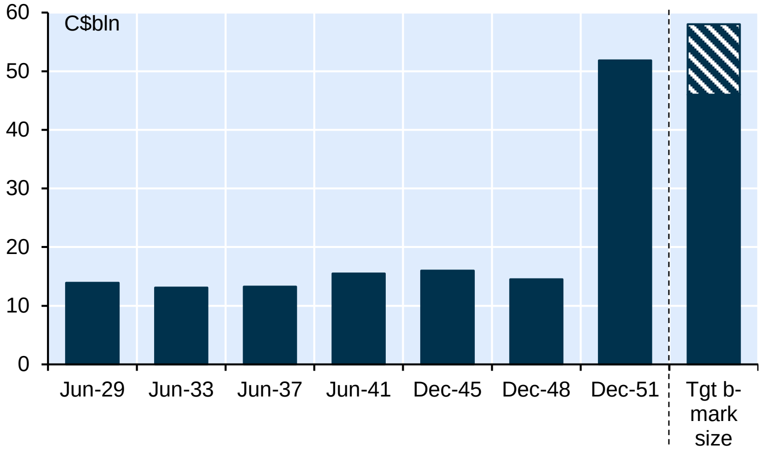
Chart 2: This ain't your old long bond program

30-year issuance by fiscal year, including NBF projections for 2021-22



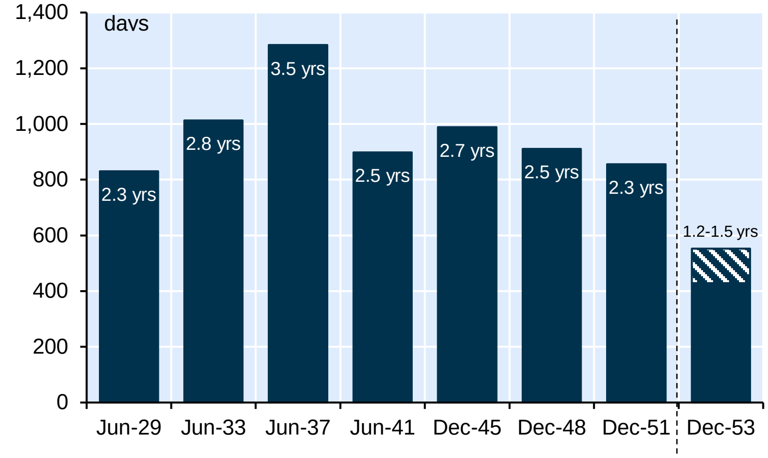
Source: NBF, BoC, GoC | Note: We assume continued monthly $3bln auctions in 2021-22

Chart 3: 30Y outstandings have more than tripled
30Y outstandings by bond after final auction



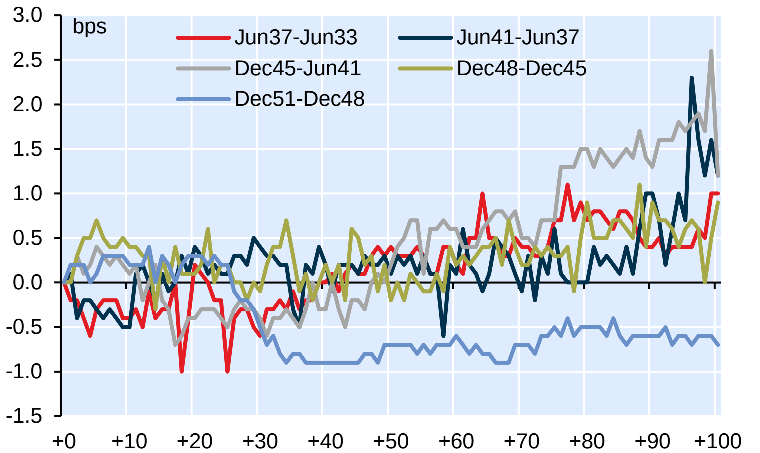
Source: NBF, BoC, GoC | Note: Tgt b-mark size refers to guidance from 2021-22 DMS of $46 -58 billion.

Chart 4: The time to build a benchmark could be halved
Time elapsed between initial auction date and benchmark roll date



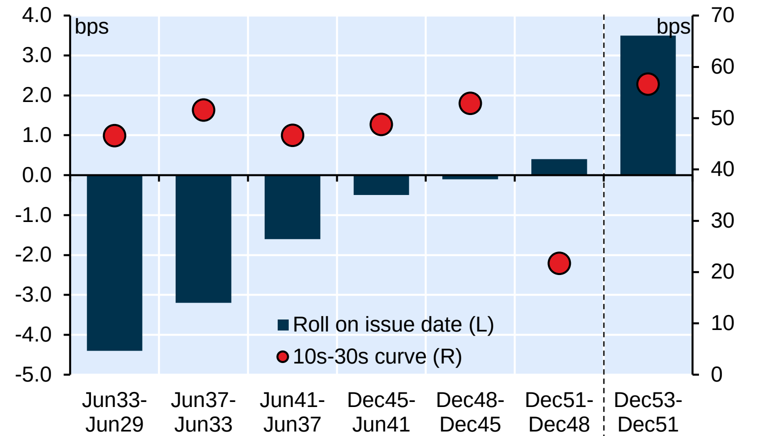
Source: NBF, BoC

Chart 5: The new 30Y has tended to underperform at first...
Change in 30Y roll relative to initial issue date (t=0)



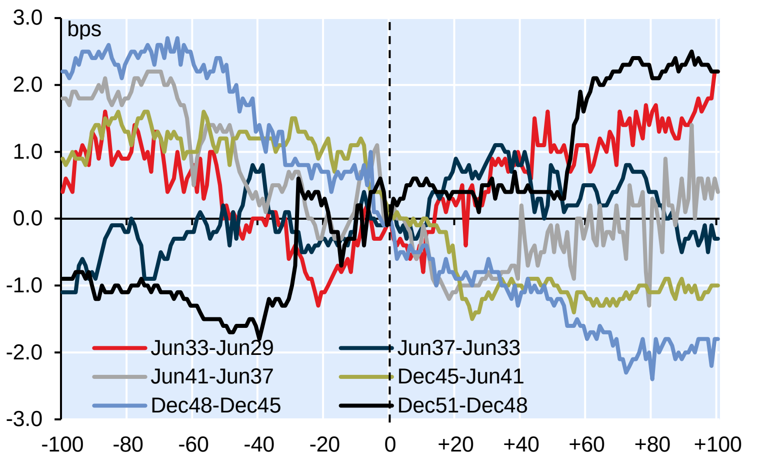
Source: NBF, Bloomberg, BoC | Note: All rolls are normalized to 0 at auction date. An increasing line implied new bond underperformance.

Chart 6: ... but a historical concession exists in WI roll
Roll between new 30Y and benchmark 30Y on issue date vs. 10-30s curve



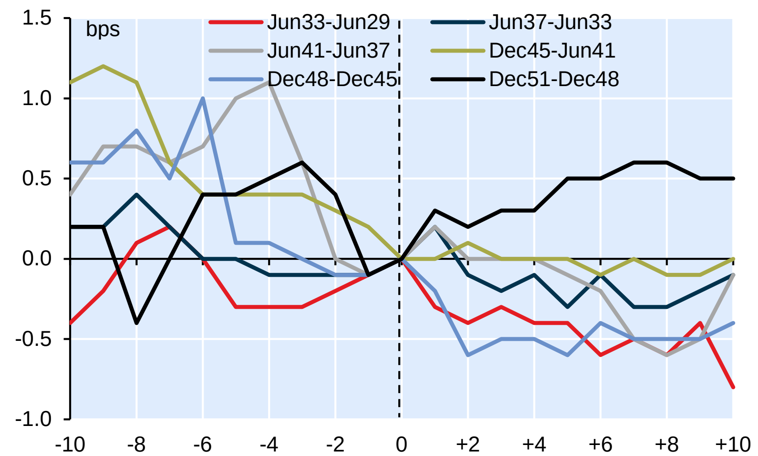
Source: NBF, Bloomberg, BoC | Note: Dec53-Dec51 uses WI bid yield for new Dec53s

Chart 7: Mixed performance into/out of benchmark roll...
Change in 30Y roll relative to benchmark roll date (t=0) 100D before/after



Source: NBF, Bloomberg, BoC | Note: Note: All rolls are normalized to 0 at benchmark roll date. An increasing line implied new bond underperformance relative to T=0 (i.e. benchmark roll date).

Chart 8: ... but *slightly* more consistent in immediate run-up
Change in 30Y roll relative to benchmark roll date (t=0) 10D before/after



Source: NBF, Bloomberg, BoC | Note: Note: All rolls are normalized to 0 at benchmark roll date. An increasing line implied new bond underperformance relative to T=0 (i.e. benchmark roll date)

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