

Looming re-alignment of front-end GoC bills & bonds?

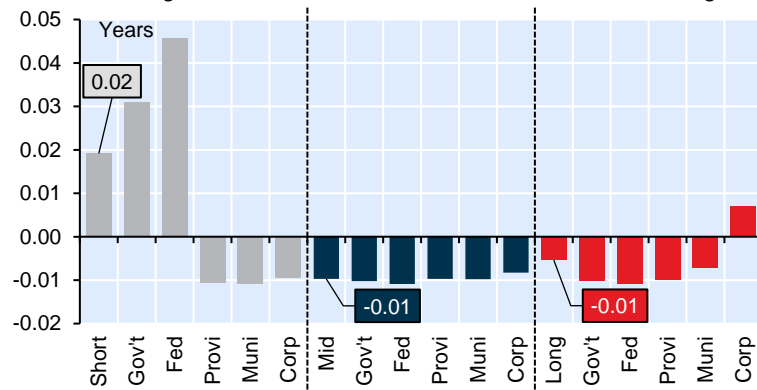
By Warren Lovely

In addition to kicking off the final quarter of the fiscal year for Canadian banks, next week will usher in the latest round of bond index adjustments. August was never going to compete with June or December in terms of outsized index-related swings... really, August takes a backseat to March and September too. Why are we bothering to comment? Well, there is one non-trivial rollout coming in the form of the CAN 0.25% 1-Aug-2022 bond. Fully C\$30 billion of that bond was auctioned from April to July of last year. Considering that the BoC holds more than half of that amount (56% to be precise), effective outstandings (net of BoC) are just over C\$13 billion. That amount drops out of the FTSE Canada Universe Bond Index next week, the adjustment technically coming on Tuesday, August 3rd (owing to the holiday weekend).

Simulation analysis suggests this rollout will see the modified duration of the Short bucket (notably Federal) and the overall Universe extend next Tuesday (Chart 1, Table). Note: There are no bonds rolling from Mid to Short or from Long to Mid in the first few days of August, and relatively little in the way of rollouts or rollovers in the later stages of the month. As it happens, on the very same day the Aug-2022s drop out of the Index, the Government of Canada conducts a C\$19 billion T-bill tender across 3s, 6s and 12s. Based on prevailing levels, the incremental four yards of the CTB 21-Jul-2022s could come in/around 0.26% yield (Chart 2). As for the 1-Aug-2022 bond, we'd quote it 0.235-0.225% at the moment, which is looking relatively rich (not just against 12-month bills but relative to an overnight rate that could be moving up before the bond matures. We understand the impact that the QE squeeze has had on front end bonds. We're likewise cognizant of Delta variant fears. Nonetheless, we're still looking for front-end GoC bonds to cheapen up, and next week's index-driven rollout + supply is a near-term catalyst.

Chart 1: Aug-22 rollout effect to lengthen Index duration

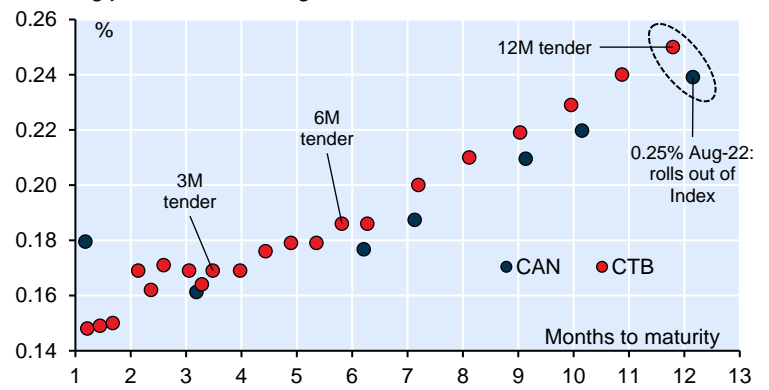
Estimated change in duration of FTSE Canada Universe: 30-Jul to 3-Aug



Source: NBF, FTSE Russell

Chart 2: Are shorter Canada bonds too rich? We believe so

Prevailing yield on outstanding GoC T-bills & short-dated bonds



Source: NBF, Bloomberg | Note: T-bills to be tendered & bond rolling out are labeled

Table: Simulating the August 1st roll effect (to be captured Tuesday, August 3rd given holiday Monday)

Projected change in weight & modified duration of FTSE Canada Universe Bond Index by term & sector: Fri 30-Jul to Tue 3-Aug

	Index weight simulation (%)		Modified duration simulation		Duration change analysis: 30-Jul to 3-Aug			
	30-Jul	3-Aug	30-Jul	3-Aug	Coupon effect	Roll effect	Total change	
Short (1-5 years)	Short Government	28.83	28.34	2.741	2.772	-0.010	0.042	0.031
	Short Federal	20.09	19.55	2.621	2.667	-0.010	0.056	0.046
	Short Provincial	8.18	8.23	3.006	2.995	-0.011	0.000	-0.011
	Short Municipal	0.56	0.56	3.170	3.159	-0.011	0.000	-0.011
	Short Corporate	12.17	12.25	2.812	2.803	-0.009	0.000	-0.009
Short Financial	7.47	7.52	2.793	2.784	-0.009	0.000	-0.009	
Short (Overall)	40.99	40.59	2.762	2.781	-0.010	0.029	0.019	
Mid (6-10 years)	Mid Government	19.63	19.77	7.166	7.156	-0.010	0.000	-0.010
	Mid Federal	9.17	9.24	7.490	7.479	-0.011	0.000	-0.011
	Mid Provincial	9.84	9.91	6.888	6.878	-0.010	0.000	-0.010
	Mid Municipal	0.62	0.62	6.786	6.776	-0.010	0.000	-0.010
	Mid Corporate	6.44	6.48	6.189	6.181	-0.008	0.000	-0.008
Mid Financial	1.47	1.48	6.004	5.999	-0.004	0.000	-0.004	
Mid (Overall)	26.07	26.25	6.925	6.915	-0.010	0.000	-0.010	
Long (10+ years)	Long Government	25.24	25.41	16.603	16.593	-0.010	0.000	-0.010
	Long Federal	4.97	5.00	18.371	18.360	-0.011	0.000	-0.011
	Long Provincial	19.26	19.39	16.253	16.243	-0.010	0.000	-0.010
	Long Municipal	1.01	1.02	14.570	14.563	-0.007	0.000	-0.007
	Long Corporate	7.70	7.75	13.507	13.514	0.007	0.000	0.007
Long Financial	0.51	0.51	12.320	12.317	-0.003	0.000	-0.003	
Long (Overall)	32.94	33.16	15.879	15.873	-0.005	0.000	-0.005	
Universe	100.00	100.00	8.168	8.208	-0.009	0.049	0.040	

Source: NBF, BoC | Note: | Note: NBF simulations conducted 27-Jul, using 26-Jul closing values; assumes no change in yield curve

Rolling out

6 bonds roll out of Universe over course of August, with combined holdings of C\$15.3bln & 0.79% weight. The first and biggest is CAN 0.25% 1-Aug-22 (holdings of C\$13.2bln & 0.67% weight). This bond rolls out on Tue 3-Aug.

Rolling Mid to Short

9 bonds roll over course of August, with combined holdings of C\$3.8bln & 0.21% weight. The first roll comes 5-Aug.

Rolling Long to Mid

Only two bonds roll over course of August, with combined holdings of just C\$850mln & 0.06% weight. The first roll comes 16-Aug.



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