

Forget bird watching, we're more focused on Fiscal Monitoring

By Warren Lovely/Taylor Schleich

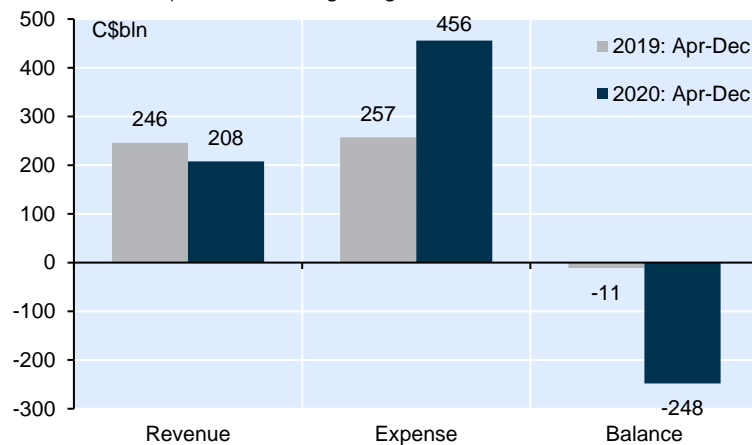
Spring is on its way, with snow a-melting and birds a-chirping. If seasonal shifts aren't your thing, why not tune in to evolving fiscal landscape; it's fascinating in its own special way. It should go without saying that the U.S. fiscal picture is about to be massively upended by Biden's stimulus plans. Closer to home, Canada's budget season has officially kicked off, Alberta being the first out of the gate. We don't yet have an official date for the federal budget, which comes at a pivotal moment for Canada's national economy and public sector finances (with political lives also potentially hanging in the balance).

In the lead up to the federal budget, we were treated to Ottawa's latest *Fiscal Monitor*—a monthly accounting of revenue, spending and net financing activities. The latest release covered the reference month of December 2020. That leaves three months of the 2020-21 fiscal year still unaccounted for, but there were some interesting takeaways all the same. Here's a rapid-fire, chart-heavy look at what the *Fiscal Monitor* tells us about the evolving fiscal/financing picture. Consider this important background material/context for the fiscal decisions PM Trudeau and Deputy PM/Finance Minister Freeland will soon announce. Of note, we've tried to isolate some underlying considerations that could inform the upcoming fiscal year's *Debt Management Strategy* (i.e., how Ottawa intends to fund itself for the 12-month period starting April 2021). We'll offer even greater detail and a few pointed recommendations on the debt strategy in a complementary note coming the week of March 1st.

Key takeaways from Government of Canada's latest Fiscal Monitor, as federal budget comes into focus

Chart 1: Revenue down, spending up, deficit massive

GoC revenue, expense & resulting budget balance: Fiscal YTD basis

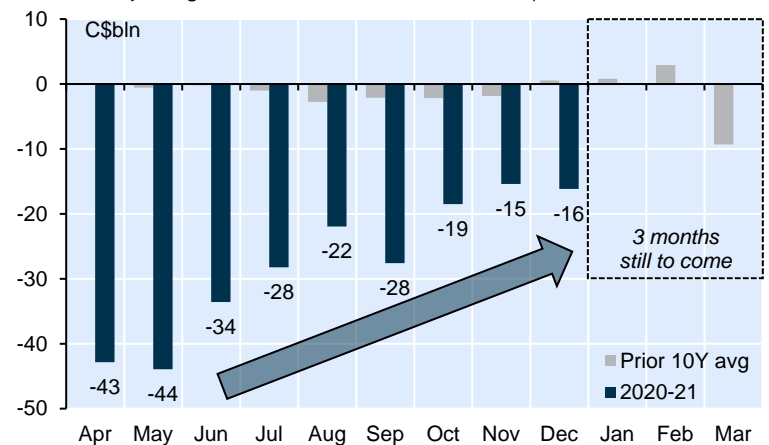


Source: NBF, Finance Canada

Ottawa ran a \$248bln deficit from Apr-Dec 2020. This is a wartime-style shortfall, with revenue off and spending up everywhere you look. The interest bite has been tiny, but increasingly in focus as borrowing rates rise.

Chart 2: Deficit large, although gap has narrowed

GoC monthly budget balance: 2020-21 fiscal YTD vs. prior trend

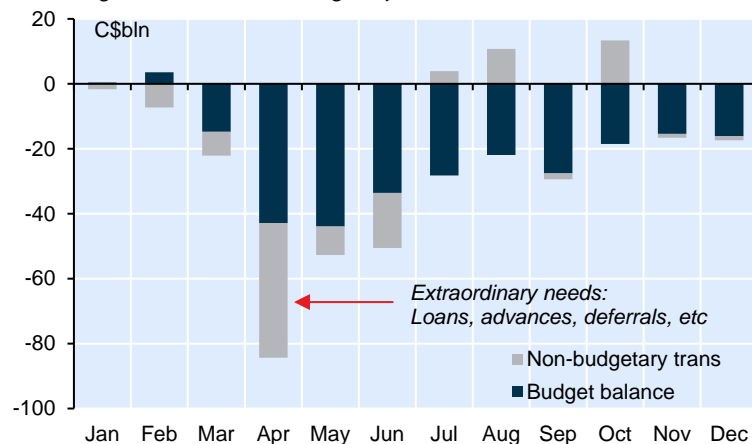


Source: NBF, Finance Canada

Despite the massive shortfall for the fiscal year, the monthly profile shows some improvement. The underlying trend may be Ottawa's friend, given an assumed economic recovery and the boost to nominal GDP from rising energy prices.

Chart 3: Don't lose sight of ephemeral non-budgetary needs

GoC budget balance & non-budgetary transactions: Calendar 2020

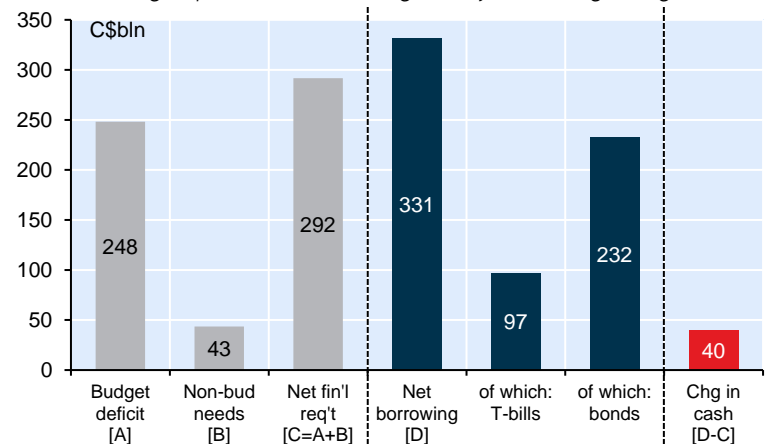


Source: NBF, Finance Canada

Don't forget non-budgetary transactions (e.g., loans, advances, deferrals, etc), which can notably influence net financing needs. Sadly, there's not great visibility here, but a recovery of some deferrals could help in 2021-22.

Chart 4: Aggressive financing activity built up cash reserves

GoC borrowing requirement vs. financing activity (& resulting change in cash)

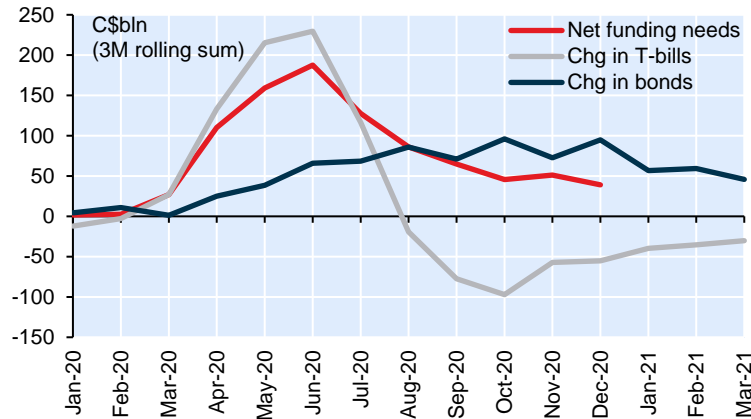


Source: NBF, Finance Canada | Note: Based on Apr-Dec 2020

The deficit plus non-bud needs created a net financial requirement of \$292bln from Apr-Dec 2020. Ottawa borrowed more than that amount (\$331bln), pushing the cash balance \$40bln higher during the first 9 months of the FY.

Chart 5: As always, T-bills were the 'shock absorber'

GoC net funding needs vs. change in T-bill & bond stock (smoothed)

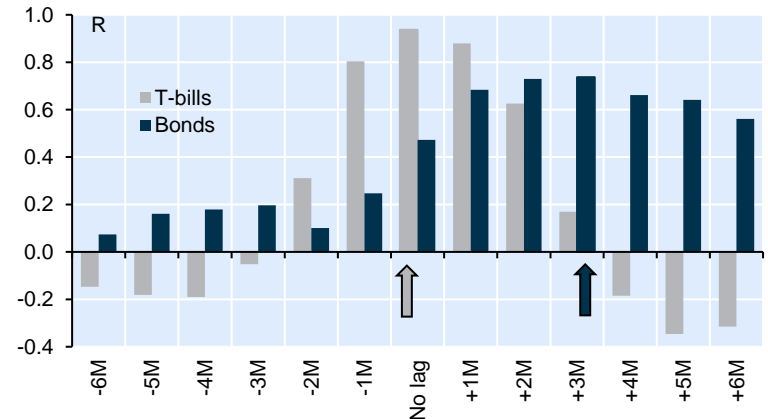


Source: NBF, Finance Canada, Bank of Canada

2020-21 reinforced the idea that T-bills are a key financial shock absorber. The bill stock surged in Apr-Jun but has fallen every month since then. The bond stock was slower off the mark but could continue to grow indefinitely from here.

Chart 6: Testing the bill/bond lag vs. budget balance

Intertemporal correlation btw GoC financing need & net T-bill/bond supply

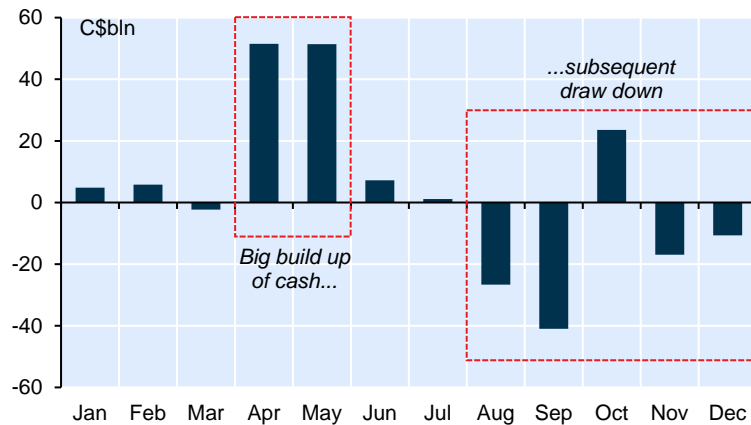


Source: NBF, Finance Canada | Note: Based on 3M rolling sums starting in 2009

Further to the point at left, there's no real lag between net T-bill issuance and GoC financing needs. For bonds, however, it can take 3-months (or more) for net issuance to react to a change in borrowing needs.

Chart 7: Earlier build up of cash now being drawn down

Monthly change in GoC cash balance: Calendar 2020

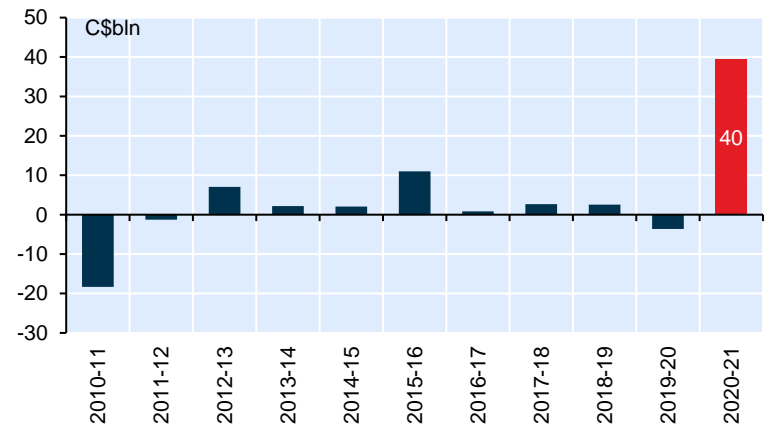


Source: NBF, Finance Canada

Ottawa rushed to build up over \$100bln of cash in Apr-May, a stockpile that has been gradually worked down since the summer. The feds drew down ~\$11bln of cash in December, leaving the cash balance at \$84.2bln.

Chart 8: Excess cash put to work in Jan-Mar 2021?

Change in GoC cash balance during first 9 months of fiscal year

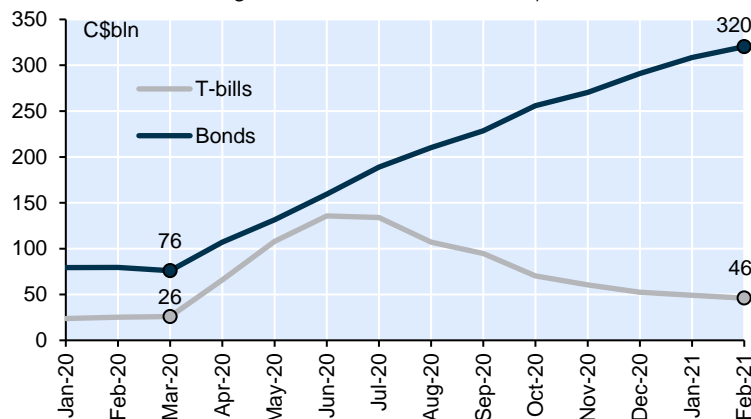


Source: NBF, Finance Canada

Judging from a shrinking T-bill stock in Jan-Mar 2021, some of the excess cash as at December has since been put to work. It's not clear how much cash needs to be built up in 2021-22, but some build prior to Jun outflows may make sense.

Chart 9: Evolution of BoC holdings of GoC bills/bonds

Bank of Canada holdings of a/s GoC T-bills & bonds (par value)

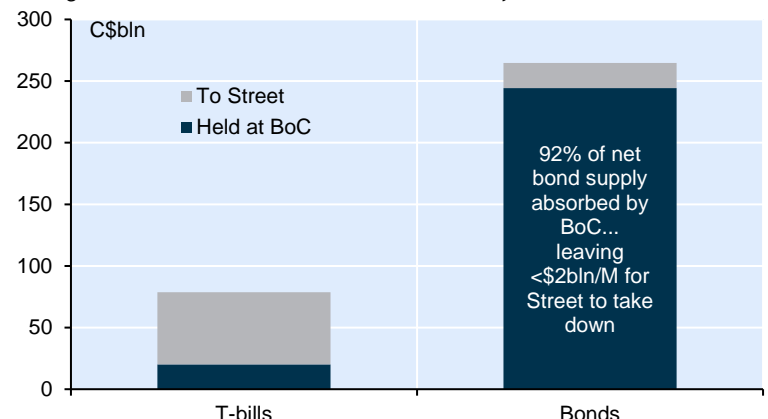


Source: NBF, Bank of Canada | Note: Feb-21 value as of 25th

Critically, markets haven't been left to finance the outsized deficits alone. The BoC stepped up in a big way. It began last spring with large T-bill participation and the introduction of QE. Today, QE is doing the real heavy lifting.

Chart 10: QE absorbs massive share of net GoC bond supply

Change in GoC T-bill/bond stock & share taken by BoC vs. Street

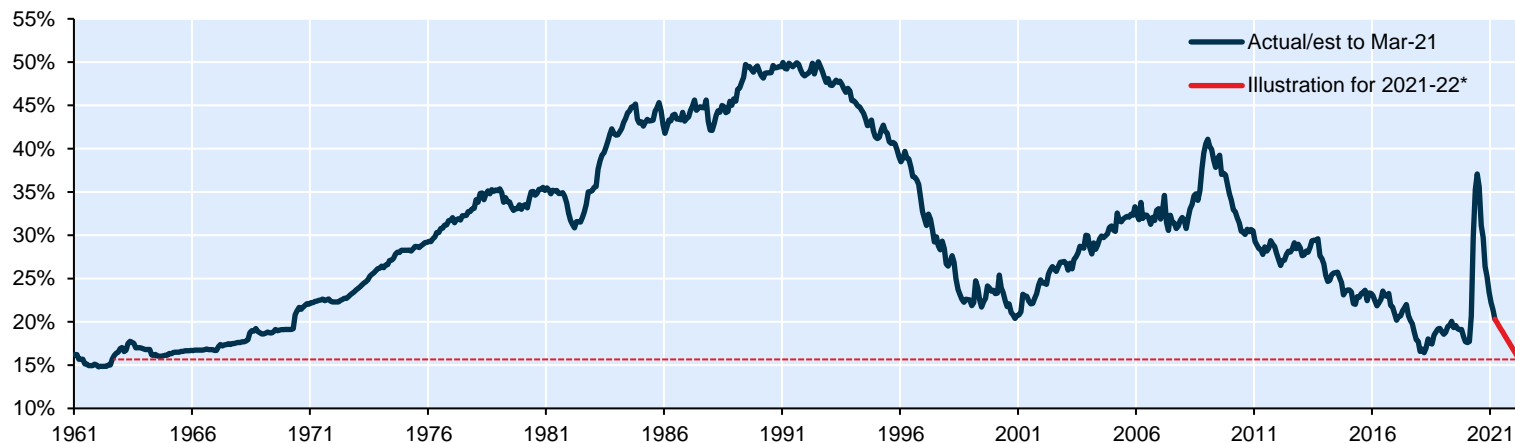


Source: NBF, Finance Canada | Note: 11-month period to Feb-21

The market hasn't had to buy many marginal GoC bonds at all. Over 90% of net bond supply since Apr 2020 has absorbed by the central bank. Hence the ongoing increase in the BoC bond ownership share and argument for tapering.

Chart 11: Back to the 1960s for T-bill share of marketable debt?

GoC T-bill share of combined T-bill/bond stock (marketable domestic securities), with illustration of where ratio could stand come March 2022



Source: NBF, Bank of Canada | Note: Divides the T-bill stock by the combined total of outstanding T-bills & marketable bonds; C\$ issues only; red line is NBF illustration to Mar-22

The heavy and quick use of T-bills to secure needed liquidity saw the bill share of marketable GoC debt soar last spring. But a subsequent reversal—what you might call a bill-to-bond term-out—is well underway. The T-bill share is now almost back to pre-COVID levels. At the current run rate, this ratio could reach a 60-year low in a year's time. This light(er) T-bill share already implies reduced refi risk for the federal government, which is a hot topic (given large deficits, extra debt and now an aggressive back-up in rates). The feds have clearly been focused on terming out and skewing more bond supply to longer tenors. But it's not clear to us that Ottawa needs to keep pushing so much paper into the long end. The current cost-benefit analysis of printing 30-year money looks much less compelling than last year, when a major switch was announced (i.e., the marginal refi reduction remains limited and the marginal cost is increasing). Then again, purely financial considerations don't always rule the day when it comes to setting the debt strategy. We'll have more to say on this in an upcoming note, where we attempt to ballpark the coming fiscal year's bond program and humbly propose a balanced issuance strategy for the various benchmark tenors. Stay tuned.

Table: By the numbers... a closer look at Ottawa's budget balance by fiscal year and month

GoC monthly budget balance, as per Fiscal Monitor (C\$millions)

Month (FY basis)	FY2010 2010-11	FY2011 2011-12	FY2012 2012-13	FY2013 2013-14	FY2014 2014-15	FY2015 2015-16	FY2016 2016-17	FY2017 2017-18	FY2018 2018-19	FY2019 2019-20	FY2020 2020-21	Prior 10Y avg
April	-2,440	746	-713	-283	-1,414	2,544	706	-351	2,538	-2,126	-42,837	-79
May	-1,989	-2,727	-1,106	-2,427	267	1,401	-592	335	644	713	-43,932	-548
June	-2,801	-2,263	-993	157	1,571	1,066	-1,109	-26	1,113	1,329	-33,580	-196
July	-473	-1,683	-1,351	-1,983	-1,231	150	-1,764	-235	142	-1,470	-28,228	-990
August	-5,810	-3,098	-3,041	-2,039	-316	-2,338	-2,686	-2,629	-1,875	-3,667	-21,937	-2,750
September	-3,923	-2,748	-2,225	-3,772	379	-1,249	-2,366	-3,275	-1,356	-578	-27,593	-2,111
October	-4,108	-2,125	-2,516	-2,484	-3,207	-940	-1,529	-391	-1,113	-3,254	-18,506	-2,167
November	-4,471	-1,626	-1,674	-554	622	392	-3,324	-2,881	-2,219	-2,700	-15,403	-1,844
December	-1,352	-538	-732	1,203	2,426	2,173	-1,328	523	2,452	782	-16,153	561
January	-301	1,948	480	2,216	2,211	1,070	1,243	125	-1,536	415	NA	787
February	-592	1,487	3,190	5,204	4,627	3,205	1,293	2,784	4,306	3,577	NA	2,908
March	-6,181	-8,959	-8,012	-6,657	-2,993	-9,436	-10,388	-10,671	-14,900	-14,794	NA	-9,299
Apr-Dec	-27,367	-16,062	-14,351	-12,182	-903	3,199	-13,992	-8,930	326	-10,971	-248,169	-10,123
Full 12M	-34,441	-21,586	-18,693	-11,419	2,942	-1,962	-21,844	-16,692	-11,804	-21,773	NA	-15,727

Source: NBF, Finance Canada | Note: Final three months of 2020-21 fiscal year not yet available; 12M sum is not to be confused with final budget balance for fiscal year, owing to end-of-year adjustments (e.g., revenue accruals, valuation adjustments on assets & liabilities, factoring in of budget measures following Royal Assent of enabling legislation)



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