

Do we have a QE misalignment?

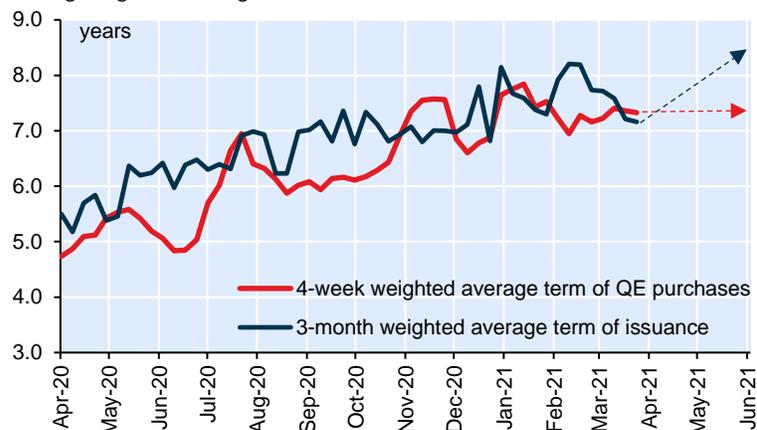
By Taylor Schleich/Warren Lovely

Anyone who's driven a car knows that when your steering wheel starts pulling/shimmying, you've got yourself an alignment issue. The vehicle that is the Bank of Canada's QE program (which would probably better be characterized as a tractor trailer) looks to be drifting out of alignment from the GoC issuance trajectory. To date, the term of the BoC's QE purchases has moved proportionally with the federal government's terming out of supply (Chart 1). However, that looks to change soon based on the new DMS (see our [deep dive](#)). While the Feds will be continuing to provide a heavy stream of longer-term bonds, moving the term of its bond stock higher, we learned this week that the duration of QE purchases will *not* be extending in tandem. Overall, the new proposed issuance plan should see the weighted average term of 2021-22 issuance settle in just shy of 9 years. That could be higher still if the Feds issue *more* long-term debt, as they said they may if market conditions are "favourable". Meanwhile, the average term of QE so far in 2021 has been less than 7.5 years—closely tracking 2020-21 issuance. To be fair, the average QE purchase term is roughly in line with the WAT of the *current* bond stock, but outstandings are only growing longer and we'd argue that QE buying *should* be relatively skewed above the outstanding/issuance term to keep term premiums in check.

As for curve implications, it means that the share of longer-term QE purchases will be exceeded by the share of longer-term issuance in 2021-22. By the same token, the shorter end of the Canada curve will become overrepresented in the Bank's bond buying basket (Chart 2). To be sure, after netting out BoC QE purchases, it remains the case that the 3-year-and-under sectors will see the most issuance. This was the case last year and pre-COVID too. However, it's the deltas on the supply-by-sector measures that really stand out (Chart 3). For both the 2-year and 5-year sectors, the amount of bonds being issued net of QE is below pre-COVID levels despite gross issuance being more than twice as large. 10s and 30s, meanwhile, will be getting 4 times more supply than they did in the 2019-20 fiscal year even after controlling for a still active/supportive BoC (Chart 4). Overall, it suggests that the traditionally flat Canada curve needn't be as flat anymore, all else equal. And Canada-US underperformance over recent weeks could continue. Time will tell if the Bank opts to "realign" its purchases down the road. In the meantime, it means higher rates and steeper curves relative to our outlook before the April BoC meeting and Monday's federal budget. We've incorporated just that, as well as an October 2022 BoC rate hike, in our [fresh Fixed Income Monitor Update](#).

Chart 1: GoC term-out continues, BoC term-out to halt

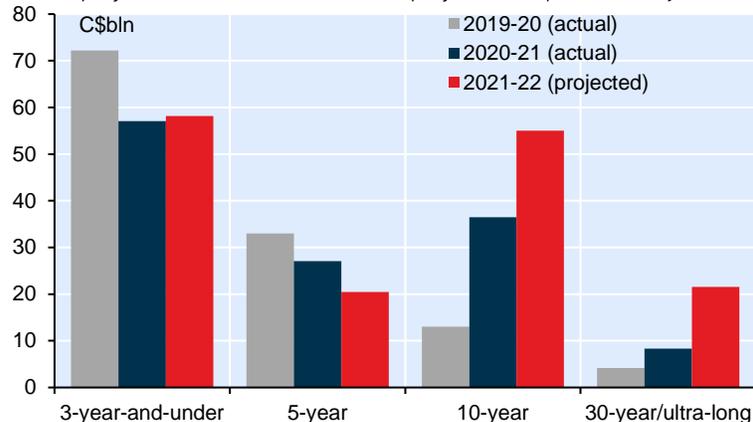
Moving weighted average term of issuance/QE



Source: NBF, BoC | Note: Based on term of actual bonds bought. Data smoothed/moving average utilized for better chart clarity

Chart 3: Less QE means more supply to the street

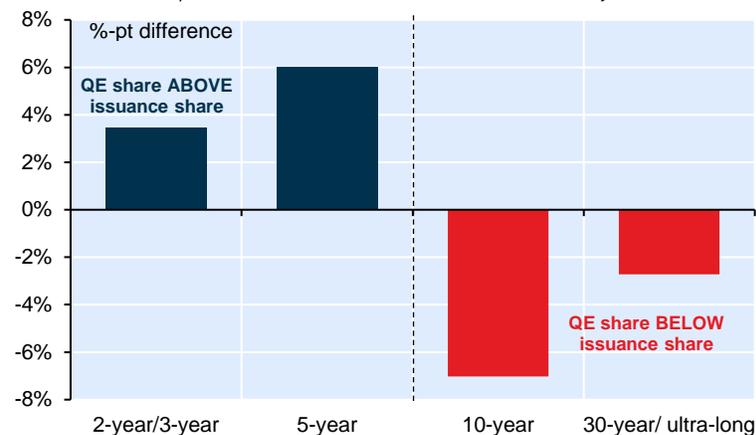
Actual/projected issuance net of actual/projected QE purchases by tenor



Note: NBF, BoC, GoC Budget 2021 | Note: Assumes \$125 billion in total QE purchases in 21-22. 3Y-and-under includes 2Y/3Y issuance and '2-year'/'short-end' QE purchases.

Chart 2: QE looks to be misaligned

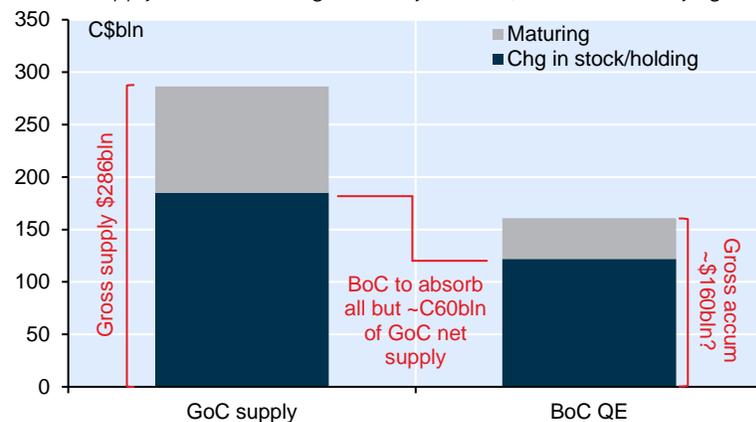
Share of 2021 QE purchases less share of 2021-22 issuance by sector



Source: NBF, BoC, GoC Budget 2021 | Note: Assumes \$125 bln in '21-22 QE. QE shares based on 2021 YTD composition.

Chart 4: BoC still has huge impact, despite taper underway

2021-22 supply and BoC holdings: Maturity rollovers, net issuance/buying



Source: NBF, BoC, GoC Budget 2021 | Note: Assumes \$125 bln in '21-22 QE. Difference in blue bars represents supply "to the street". BoC accum. includes auction purchases



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