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Is September 1st the new June 1st? Not now, not ever*

By Warren Lovely & Taylor Schleich

Make no mistake, Friday, September 1st is shaping up to be an important day for many. Financial markets will be treated to some grade-A North American economic data in the form of U.S. non-farm payrolls (August) and Canadian GDP (Q2 + July flash estimate). As the first day of the month, bond maturity, coupon and assorted roll effects (alongside generalized monthly portfolio rebalancing) will exert influence on bond index composition and relative valuations in rates and credit. Consider: The day in question—September 1st—sees the largest-ever Government of Canada (GoC) bond maturity, as roughly $40 billion of the CAN 2% 1-Sep-2023 issue comes due. That sounds significant, no?

For bond index watchers, the 'roll out' and/or 'roll over' of a handful of other fixed income securities leaves duration poised to extend in all major buckets on September 1st. Note: The jumbo GoC issue cited above, which just happens to be majority-owned by the Bank of Canada, rolled out of the index *last* September when the effective term to maturity dropped below one year. Detailed simulations suggest, all else being equal, this year's roll impacts are greatest in the 'mid' bucket of Canada's universe bond index (i.e., 5- to 10-year maturities). Mind you, the weighted average duration of the closely watched 'long' bucket (i.e., >10-year maturities) is also due to extend on September 1st. No question, index duration adjustments are once more being spurred by GoC bonds. The rolling of a collection of Quebec-based bonds (from the province, its explicitly guaranteed utility and/or its largest city) will be another material influence, however. Looking at it, presumptive 'long' index roll effects are really skewed to provincial and municipal sectors, spurring some demand for this product, *ceteris paribus*.

Bond issuers are standing by, ready and willing to aid in the deployment of excess investor cash and/or the search for duration. As is customary, a few provinces seemingly wait in the wings. The sovereign herself has a $3.5 billion 10-year bond auction teed up to settle on, you guessed it, September 1st. Canadian PSEs have been active of late and notwithstanding a recent erosion in cross-currency funding arbs, a few SSAs are presumably keeping at least half an eye on Canada. Financials could weigh their funding options post quarterly reporting too. All told, a seasonal up-turn in CAD-denominated bond supply going into and coming out of month end is entirely possible.

From an operational perspective, Canada's bond market will close early on September 1st. That leaves market participants with a condensed schedule to digest all of the above and get positions squared away before the Labour Day long weekend arrives. More than marking the unofficial end to summer for many, this September 1st might then have some extra urgency attached to it.

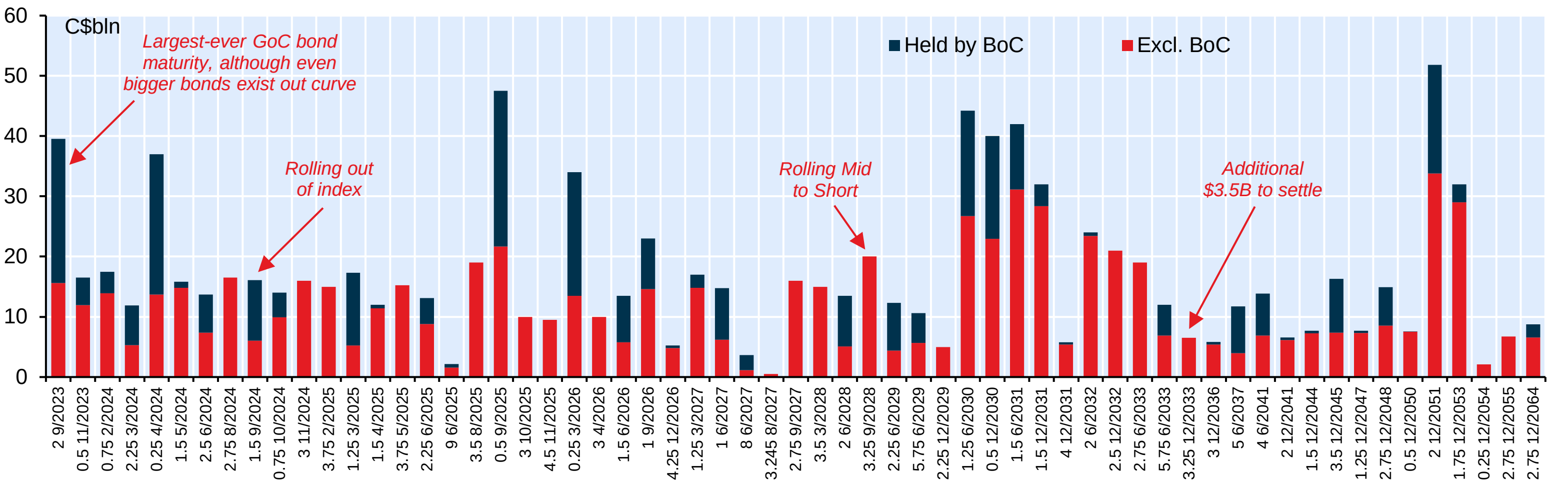
Saying all that, the ultimate impact on end investors isn't as significant as outsize maturity figures/cash flows imply. Simply put, September 1st (or March 1st) is *not* the new June 1st (or December 1st) for Canada's bond market. In some ways, the notional September 1st effect—if you're even willing to call it that—might well fade from here, at least in terms of the day's relative significance vs. the start of June/December. As a final caution, the empirical record suggests that blindly trading Canada's 'cash flow seasonals' (particularly on the follow or *after* the cash) can be something of a mug's game, particularly with the aforementioned economic data likely to trigger some re-pricing of near-term policy rate expectations. So by all means, take note and make all necessary preparations. But keep some perspective just the same.

* For the record: If there's one area where jumbo GoC bond maturities born out of the pandemic exert growing influence, it's in the federal government's cash management practices. With the feds having less excess cash to lean into these days, the looming September 1st GoC bond maturity has prompted some extraordinary/unusual T-bill gymnastics, which we explore in a Topic Box on page 3. On a related note, hefty GoC bond maturities arithmetically advance the BoC balance sheet normalization/QT process, which is by now well in train.

A few angles/perspectives on Canada's looming September 1st cash flow/duration extension 'event'

Chart 1: A record bond maturity on September 1st... although the clear majority of issue held by the central bank

GoC domestic bond maturity profile by issue, including portion held by Bank of Canada vs. end investors

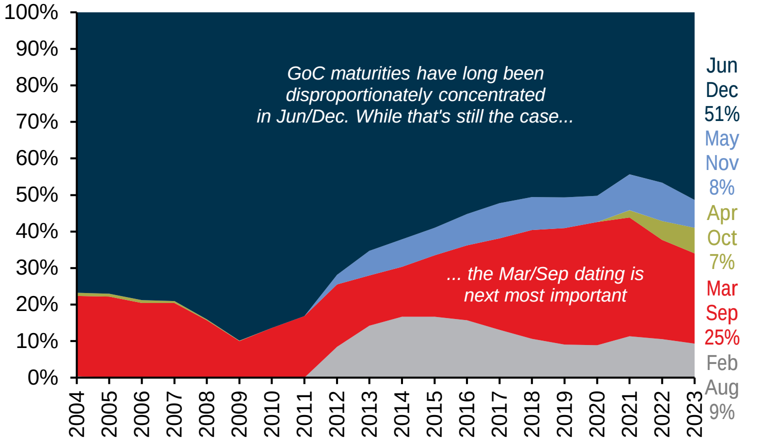


Source: NBF, BoC | Note: All amounts issued/auctioned up to 25-Aug; $3.5bln Dec-33s to be auctioned 30-Aug (settling 1-Sep)

There's just under $40bln of the CAN 2% Sep-23s coming due, setting a record for largest ever Canadian bond maturity. Of course, this bond dropped out of the index last September. Moreover, with the majority of the Sep-23s held by the BoC, the cash redeemed to end investors is much less meaningful than meets the eye. The most significant roll this year? It's the 3.25% Sep-28s, which move from the 'mid' to the 'short' bucket of index. While the 1.5% Sep-24s drop out, as with the Sep-23s the central bank owns more than half of the float, blunting the overall impact on index duration.

Chart 2: For GoC, Mar/Sep an important maturity dating…

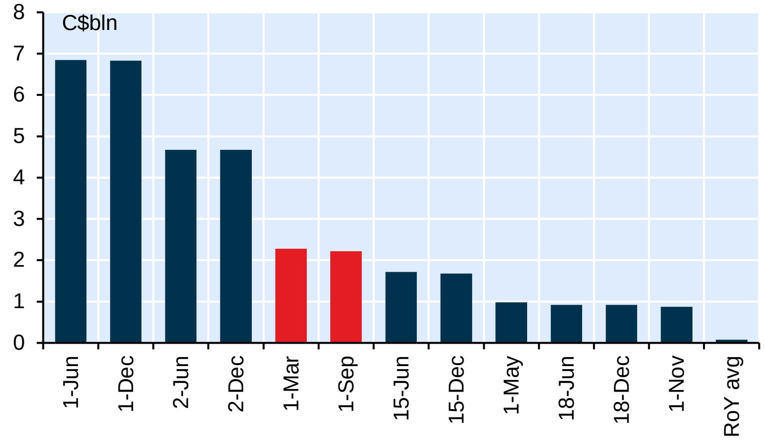
Distribution of outstanding GoC bonds by maturity dating (6-month pairings)



Source: NBF, BoC | Note: Based on all GoC maturities at beginning of calendar year

Chart 3: … making Sep 1st (plus Mar 1st) a top-6 cash flow day

Largest FTSE Canada Universe Bond Index interest income days

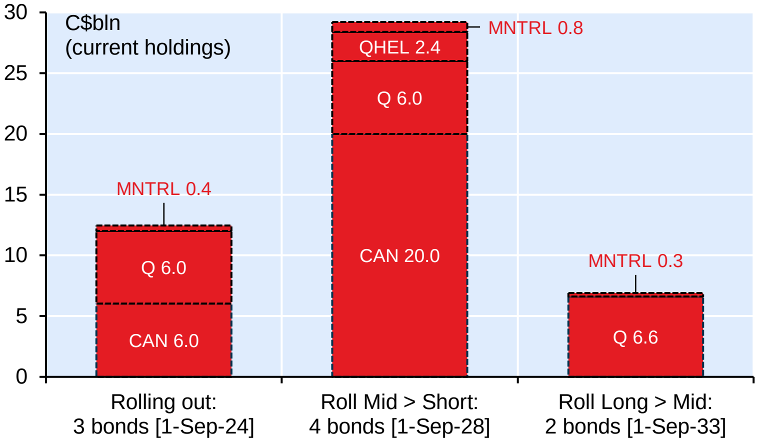


Source: NBF, FTSE Russell | Note: Based on 23-Aug closes

March/September is a key maturity for Ottawa, as 5s are currently issued to this date. Related index cash flows (on March 1st and September 1st) are thus nothing to sneeze at, ranking in top-6 of all cash flow days. Still, nothing compares with June/December maturities/cash. If anything, the current GoC debt strategy would see June/December become relatively more important going forward.

Chart 4: GoC & Que-based bonds on our radar this Sep 1st…

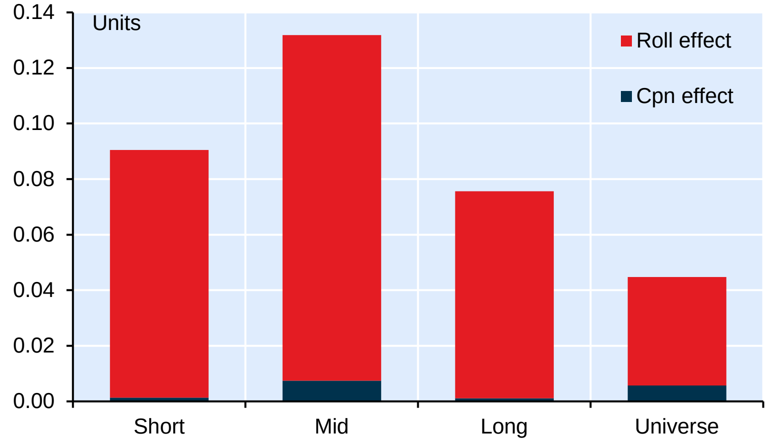
Bonds rolling out or rolling over in FTSE Canada Universe Bond Index: 1-Sep



Source: NBF, FTSE Russell | Note: Based on 24-Aug closes

Chart 5: … with duration set to extend across index

Simulated duration change in FTSE Canada Universe Bond Index: 1-Sep

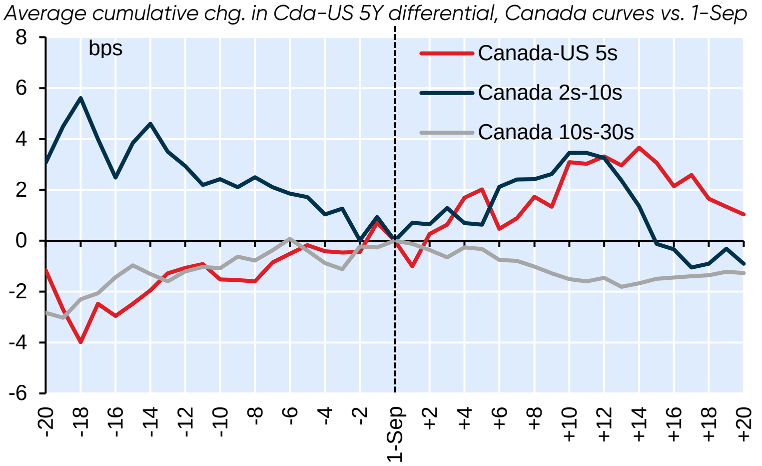


Source: NBF, FTSE Russell | Note: Based on 24-Aug closes; assumes no chg in yield curve

As for specific index adjustments this September 1st, three bonds are set to drop out. There's a proportionately larger impact from the bonds rolling from 'mid' to 'short' (four of them in total). No Canadas roll 'long' to 'mid', although Quebec-related rolls will influence provi/muni duration throughout. All told, we estimate a duration increase of over 0.04 units for the universe, all else being equal.

Chart 6: September 1st effect tenuous *at best* in rates space

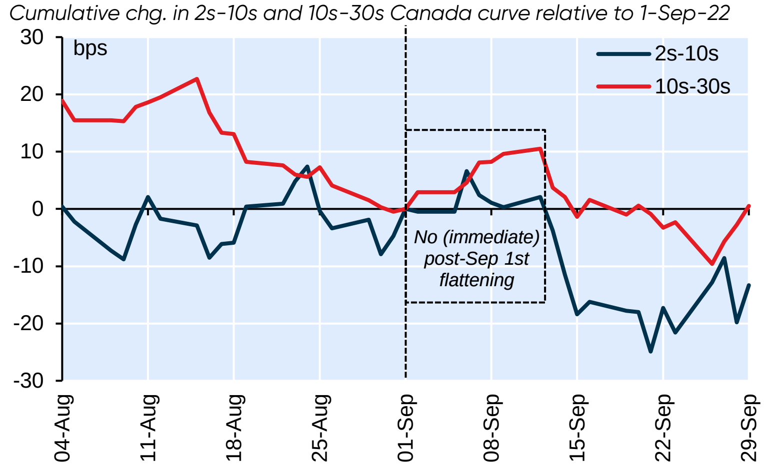
Average cumulative chg. in Cda-US 5Y differential, Canada curves vs. 1-Sep



Source: NBF, Bloomberg | Note: Avg change based on 12Y period from 2010-21

Chart 7: Even last year's outsize extension fizzled after fact

Cumulative chg. in 2s-10s and 10s-30s Canada curves relative to 1-Sep-22



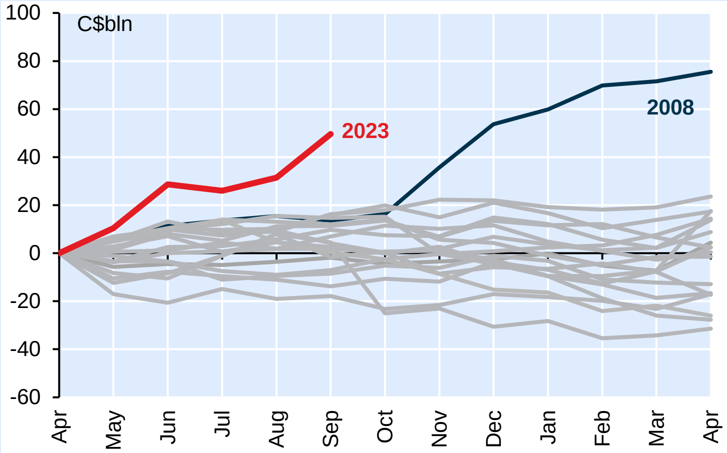
Source: NBF, Bloomberg

With ample cash meeting with an extension bias, we could imagine some setting up for a prospective outperformance of Canadas and/or curve flattener. Looking at 10s-30s, the $3.5bln auction of the Dec-33s might add impetus to the flattener. We caution, however, that all else is not always equal. The empirical track record (x-market & curve) is relatively uninspiring in/around September 1st and last year's extension bias did little to produce a flatter curve after the fact. This go round, we've key data to digest a September 6th BoC decision to mull over. So proceed with some caution.

Topic Box: Treasury bill gymnastics

Arguably the most significant indirect impact of September's outsized maturity can be seen in Canada's treasury bill market. For context, through the first five months of the fiscal year, the stock of outstanding Government of Canada treasury bills grew at a faster pace than any year in the past two decades, outside of an exceptional fiscal 2020 when the government was quickly raising money to fund its COVID-19 response.

Chart T1: The bill stock has risen quickly this fiscal year
Cumulative change in Treasury bill stock from start of fiscal year: 2003-23

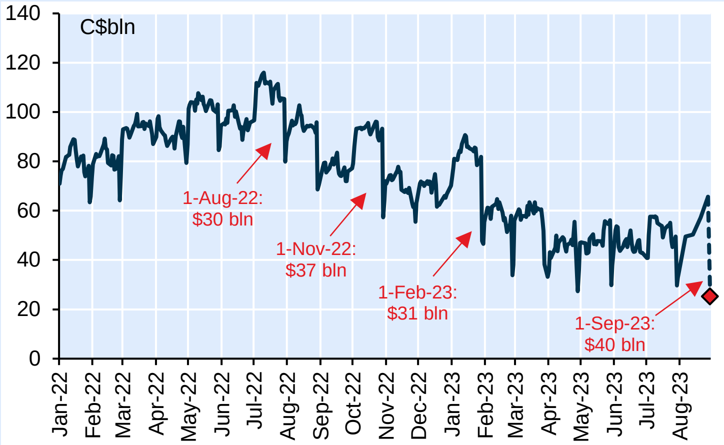


Source: NBF, Bank of Canada | Note: 2020-21 fiscal year excluded from chart

How does this relate to September's XXL maturity? On September 1st, the feds will have to disperse nearly $40 billion to extinguish its debt and, although its deposit account at the Bank of Canada is large, it would take a significant chunk out of their available funds. Thus, to ensure there is sufficient cash on hand to make the largest bond maturity payment in the Government of Canada's history, the T-bill market—long viewed as a financial shock absorber—has been used to quickly get cash in the door. That's meant the biggest bill tenders since the peak of COVID (plus a cash management bill auction), bringing GoC cash from below $30 billion at the start of August to roughly $60 billion by the end of the month.

Of course, this isn't the first time the government has had to make supersized maturity payments. The COVID-19 issuance 'echo-effect' has been evident since mid-2022 when 2-year bonds sold in the early days of the pandemic began to mature. However, there was less direct evidence of this in the T-bill market prior to this month. In fact, the bill stock marginally *shrank* in the first half of calendar 2022 despite large second half maturities coming into focus. That's because the government, for most of last year, was swimming in cash. For this they can thank a stronger-than-expected economic recovery and a once-in-a-generation nominal GDP surge that kept government coffers full. Over the course of 2023, the government's cash balances normalized, hovering around $50 billion. The September 1st maturity payment, while not necessarily sending the federal government into overdraft, would leave a sizeable dent that would have seen its available funds fall below the prudential liquidity level ($20 billion). When the government had $100 billion parked at the Bank of Canada, a payment of this size wouldn't be an issue.

Chart T2: Large payments visible in fed's deposit account
Government of Canada deposits at the Bank of Canada since 2022

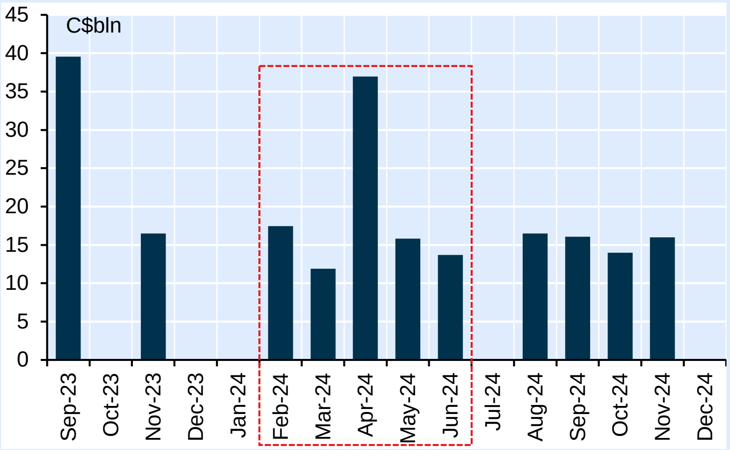


Source: NBF, Bank of Canada | Note: Dotted line reflects estimated trajectory for cash based on late August bill and bond auctions and maturities.

This week, the government will step up its auction size again (to $26 billion) to help fund the September 1st maturity payment. For the next four months, however, there will only be a relatively modest $16.5 billion in GoC bonds maturing, which should allow for some 'normalization' in T-bill auctions over coming months. Given that the outstanding bill stock already exceeds the end-of-fiscal-year target, an average auction size of ~$20 billion would be needed for outstanding bills to gradually fall back in line.

At the same time, although there may be a moderation in the coming months, keep an eye on spring 2024. More than $95 billion will be retired between February and June, including another jumbo maturity payment along the way ($37 billion on April 1st). Depending on how federal revenues and expenses evolve the rest of the fiscal year, cash balances may again come under pressure. That could mean a repeat of recent weeks, where bill auction sizes are quickly ramped up. This could also become formally reflected in a *Debt Management Strategy* update coming in the fall. Revisions, should they occur, are skewed to the upside in our view. That could drive a relative cheapening in bills (vs. OIS) in spring 2024. So, mark your calendars. And in the meantime, follow the government's cash. It's likely this will inform the T-bill outlook.

Chart T3: The feds will need lots of cash in spring 2024
Government of Canada bond maturities by month: 2023-24



Source: NBF, Bank of Canada

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