Market View
Economics and Strategy

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Assessing supply as the DMS update approaches

By Taylor Schleich & Warren Lovely

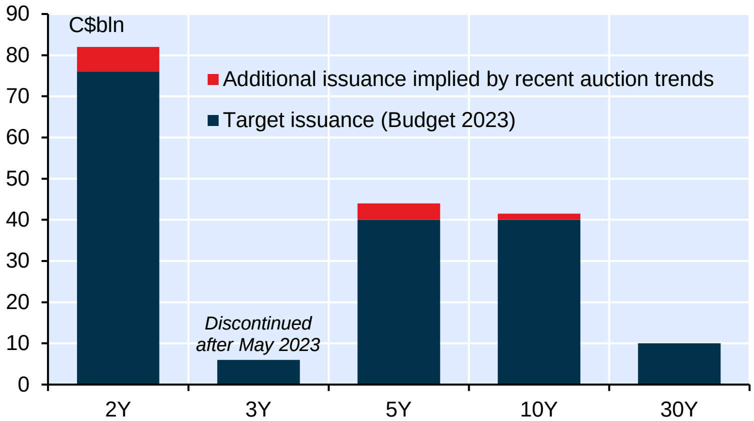
Tuesday's Fall Economic Statement is an event to circle on your calendar in bright red ink for more reasons than one. Trudeau and the reigning Liberal government will try to claw back political support from Canadians driven to despair on affordability. Meanwhile, bond investors are keenly awaiting a decision on the CMB program (see our extensive commentary on this issue on page 2). Bond supply junkies will also get an update on the 2023-24 borrowing program. Supply is a topic garnering more attention than ever, particularly in the U.S. Fortunately, relatively better contained and only mildly expansionary fiscal policy should mean comparatively small changes. Here's what we know and what we expect as the key release day draws nearer:

Deficits will be marginally higher: An updated Economic and Fiscal Outlook from the non-partisan PBO indicates there's ~$6 billion in marginal red ink this year relative to March's budget. That includes everything announced through 15-Sep but won't contain any new measures that might come next week. If Deputy PM/FinMin Freeland's promise for a "responsible" plan materializes, new spending will be minimal. Some targeted affordability measures may be offered but we don't expect broad handouts like Budget 2023's "grocery rebate". Look for emphasis to be on addressing housing supply, the update likely to "re-announce" the removal of GST on purpose-built rentals.

Bond issuance higher and shorter: More supply will be needed to finance a marginally higher budgetary shortfall. Based on where the bond program is tracking, increases will be concentrated at the short end. The recent rise in 2Y auction sizes would imply $6 billion more supply while an additional quarterly 5Y auction creates about $4 billion of upside. Recent 10Y auctions have been inconsistently sized but this target could be nudged up $1-2 billion. We don't expect changes to the 30Y sector. These adjustments would hasten the transition from long-term issuance, pushing the weighted average term of supply closer to pre-COVID levels. While that means less duration for investors, it also means faster rising public debt charges.

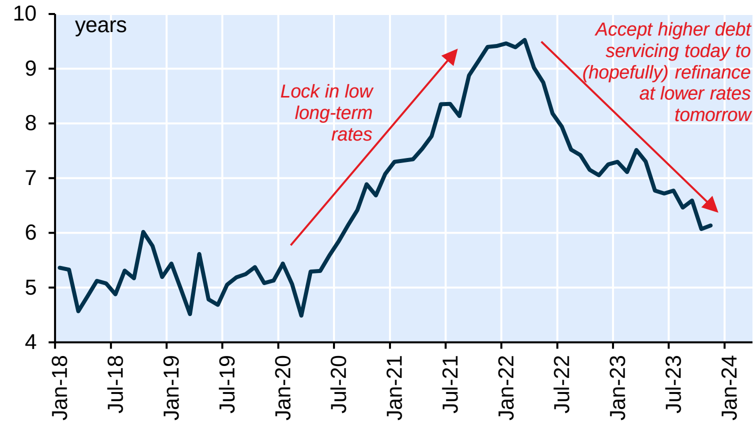
T-bills are a wildcard: The bill stock is already above target, due to large auctions earlier this year. The current run rate ($20 billion bi-weekly) would actually see outstanding retreating from here, finishing the fiscal year ~$4 billion above March's target. Still, we think risks are skewed higher. Consider that between February and June 2024, more than $90 billion in GoC bonds will be maturing. Unlike at the start of the year, GoC cash balances have normalized so this avenue won't be available to pay down debt. Instead, bills (incl. cash management bills) may be leaned on to pay down maturities. This was the exact strategy used in August when $40 billion Sep23s were coming due.

Chart 1: Recent auctions imply more bonds at shorter term…
Gross bond issuance by term: Budget 2023 vs. total implied by recent auctions



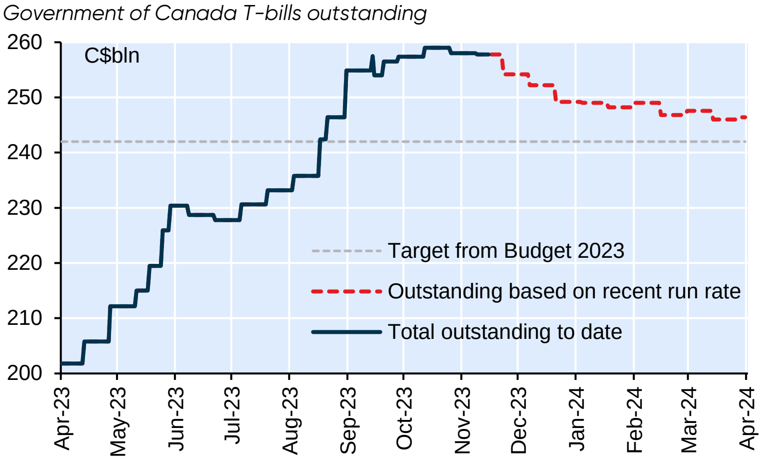
Source: NBF, BoC, GoC

Chart 2: …pushing WAT towards pre-COVID levels
6-month rolling weighted average term of gross bond supply



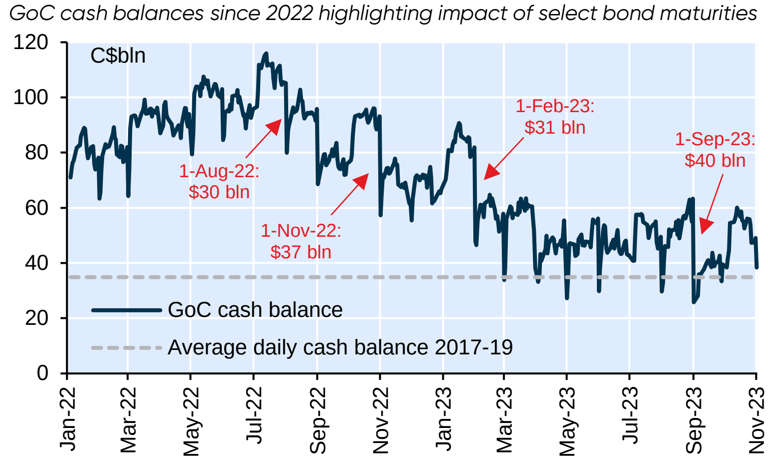
Source: NBF, BoC

Chart 3: Recent bill auctions imply shrinking bill stock…
Government of Canada T-bills outstanding



Source: NBF, GoC, BoC

Chart 4: … but early 2024 bond maturities require lots of cash
GoC cash balances since 2022 highlighting impact of select bond maturities



Source: NBF, GoC, BoC

For reference, the following is a list of other CMB-related reports and comments produced from this desk:

Date	Vol:#	Title (with embedded hyperlink)	Pages
20-Oct	VII:76	CMB saga: How are we left? Cheaper and steeper	2
		Where we reflect on relative and absolute CMB performance in the face of both overall program uncertainty and the government's decision to expand the annual limit on Canada Mortgage Bonds from $40 billion to $60 billion.	
29-Sep	VII:69	Op-ed: On CMBs, a clear and timely decision is needed	2
		Where the author reflects candidly on where things stand following the federal government's announced increased in the annual limit on gross CMB issuance, from $40 billion to $60 billion.	
27-Sep	VII:68	The most important chart in Canada	1
		Where we illustrate Canada's extraordinary immigration-fueled population growth. We argue that the implications of outsized population growth extend far and wide. We point to related demand for affordable housing and new multi-unit construction as an impetus for the government's decision to expand the annual limit on Canada Mortgage Bonds from $40 billion to $60 billion.	
19-Jul	VII:58	CMB liquidity: Worst fears realized? Not quite, but…	2
		Where we reflect on the deterioration in secondary market liquidity for Canada Mortgage Bonds following the government's announcement that consolidation of CMBs within the regular GoC program would be considered.	
11-May	VII:37 Special	CMB consolidation: How much of a GoC yield back-up? (Taking a guess)	6
		An in-depth look at the potential impact on Canada's risk-free borrowing rate that could be expected were CMB supply to be consolidated within the regular GoC bond program. Our analysis suggested that the enlarged GoC debt program needed to accommodate consolidation might initially require a 2-4 bp back-up in GoC bond yields, dulling direct interest savings for Ottawa. We further cautioned that even this modest increase in GoC yields (if fully passed through and sustained) could negatively impact certain other Canadian borrowers, perhaps fully offsetting the 'notional' interest savings that motivated the proposed CMB consolidation in the first place.	
4-Apr	VII:29	CMB consolidation: Contextualizing the notional interest savings	2
		Where we quantified the 'notional' interest savings if the full agency spread on CMBs were to be captured in a consolidated world. In current dollars, we estimated the figure to be in/around $1 billion/year in a steady state (i.e., by year 10). We cautioned, however, that savings calculations on predicated on an unreasonable assumption of no net impact on the risk-free curve.	
3-Apr	VII:28	CMB consolidation: The $100 billion question	1
		Where we broke down non-resident holdings of Canadian bonds by currency of issue and sector, identifying ~$100 billion of CMBs that have been placed internationally. That was equivalent to nearly 40% of the outstanding CMB stock, making CMBs the sector of the domestic bond market with the highest relative share of foreign investor participation.	
22-Mar	VII:24	Op-ed: The bonds must go through!	2
		Where we reflected on the demonstrated ability of CMBs to be successfully marketed and placed even in the most turbulent of market conditions, such as the U.S. regional banking crisis. We considered March's CMB offering but one example of a program that has provided a predictable and cost-effective means of pooling and securitizing insured mortgages since it was first launched way back in 2001.	

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

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