Market View
Economics and Strategy

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The 2024-25 *Debt Management Strategy* in 10 charts

By Taylor Schleich

There was plenty to digest in Tuesday's federal budget including, capital gains tax changes, a plethora of housing initiatives, revisions to the fiscal trajectory and countless other new measures. There's no shortage of analysis on these issues but it's a smaller, less-discussed section of the budget that draws the focus of this note. We're talking about the *Debt Management Strategy*, a ten-page Annex to the budget that's vitally important for investors in Canadian debt.

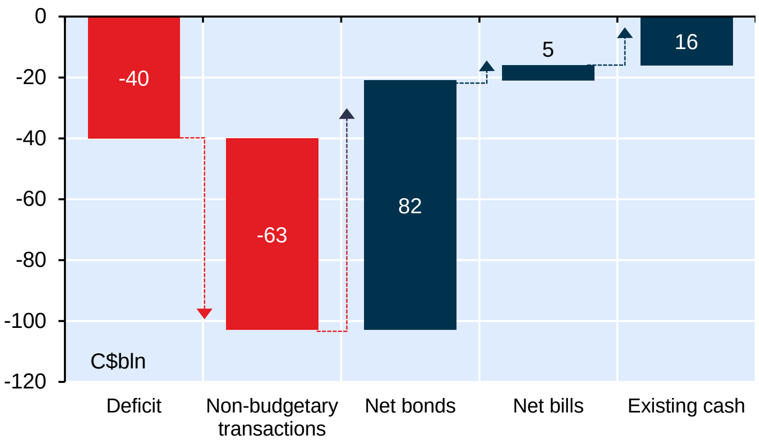
One of the key takeaways from the updated plan is that there's going to be no shortage of debt to be absorbed in 2024-25, or in the years ahead. This year, it will be bonds that do the heavy lifting despite the introduction of a new T-bill tenor that we would've expected to warrant more bill supply. Accounting for the BoC's ongoing QT effort, investors will be asked to absorb a record amount of GoC bonds.

The distribution of marginal issuance (in 5s and 10s) is consistent with government's CMB purchases and also reflects investor demand for more duration. Increasingly, it appears that the bond program will not go back to the short-term focus that characterized the pre-COVID years. Instead, the new steady state looks to be a middle ground between this strategy and the 'term-out' years early in the pandemic.

Below, we try to spotlight these issues and other key takeaways and implications from the DMS, in ten charts:

Chart 1: Over $100 bln in financial requirements in 2024-25...

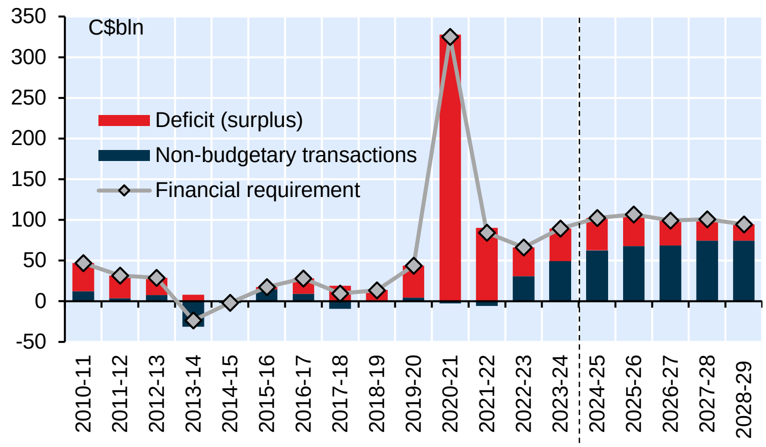
Uses and sources of cash in 2024-25



Source: NBF, GoC | Note: Red bar = cash use, blue bar = cash source. Figures include borrowing in foreign currency.

Chart 2: ...with more of the same in future years

Breakdown of net financial requirement by fiscal year

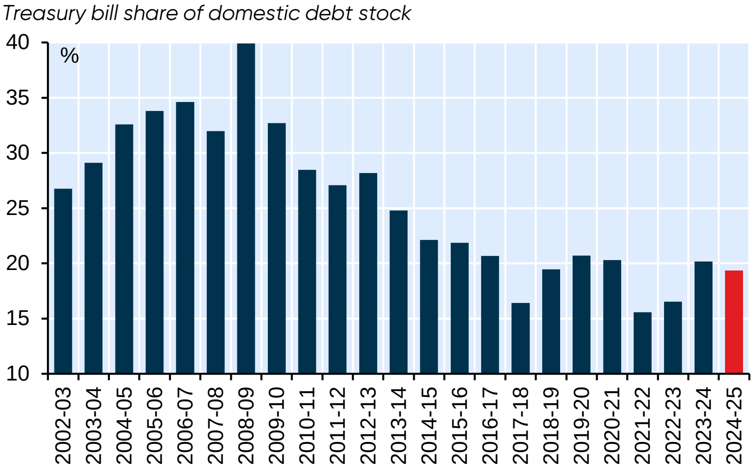


Source: NBF, GoC | Note: Deficits (surpluses) expressed as positive (negative) number

A steady (and material) budgetary shortfall and significant non-budgetary transactions mean lots of borrowing will be conducted in 2024-25. The bill program was leaned on more in 2023-24 so now it's the bond program's turn to do the heavy lifting. The feds can fund some spending and/or bond maturities out of their existing cash balances after these ended the year higher than planned. That will keep borrowing lower than it would otherwise be in 2024-25. Looking beyond this year, net supply is unlikely to relent. Based on current estimates, there may be an additional $20 billion of net borrowing that will be conducted in 2025-26.

Chart 3: The T-bill share of debt will moderate in 2024-25

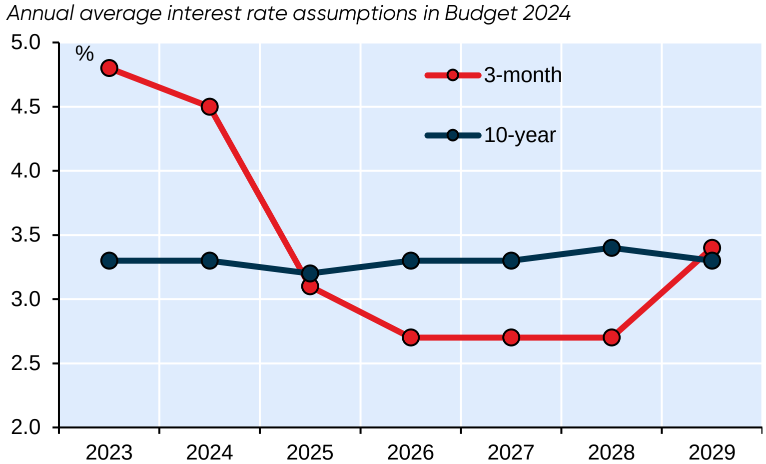
Treasury bill share of domestic debt stock



Source: NBF, BoC, GoC

Chart 4: Short-term funding more attractive in future years

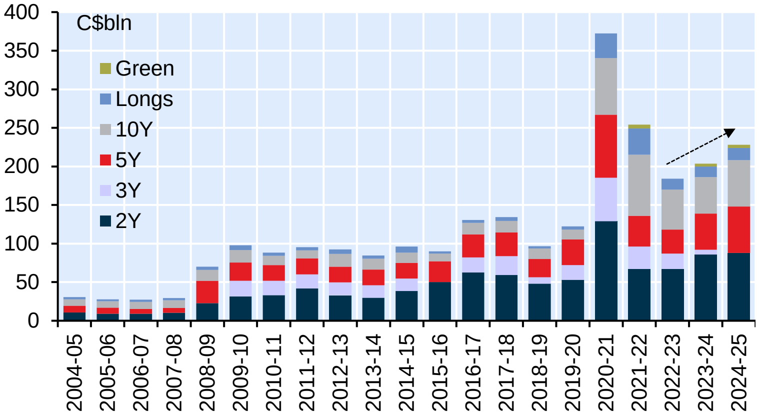
Annual average interest rate assumptions in Budget 2024



Source: NBF, GoC | Note: Assumptions reflect private sector average.

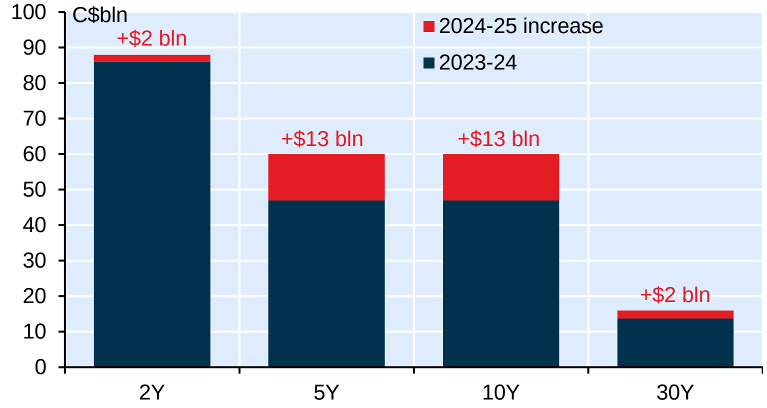
After stepping up in 2023-24, the share of bills in the debt stock will moderate a touch this year, this ratio remaining at the low end of the historical range. The DMS noted that more long-term debt is being offered in response to investor demand. Presumably, more bonds came partially at the expense of marginal bill supply but cost considerations support going longer too. The budget assumes 10-year yields are already near their 'steady state', while bill yields will remain elevated in 2024. The feds aren't going to try to time the market but in 2025, shorter-term financing will be more cost-effective assuming the curve returns to an upward slope as is expected.

Chart 5: Bond issuance jumps for second straight year…
Gross nominal bond issuance by fiscal year



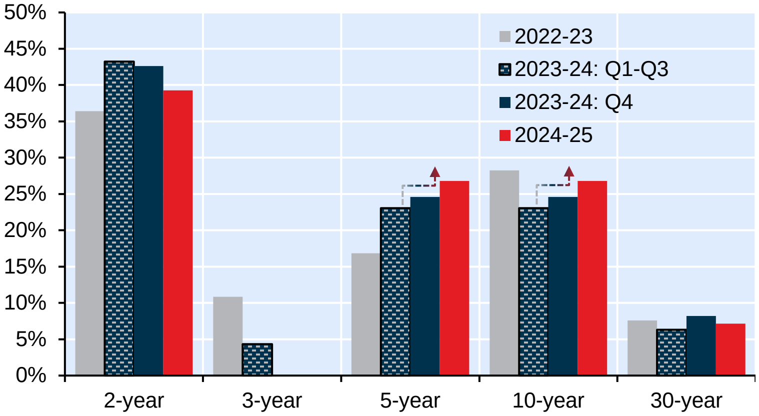
Source: NBF, BoC, GoC | Note: Longs refer to 30Ys and ultra-longs. RRBs excluded.

Chart 6: …with increases skewed to 5- and 10-year sector…
2023-24 gross issuance plus 2024-25 increases, by sector



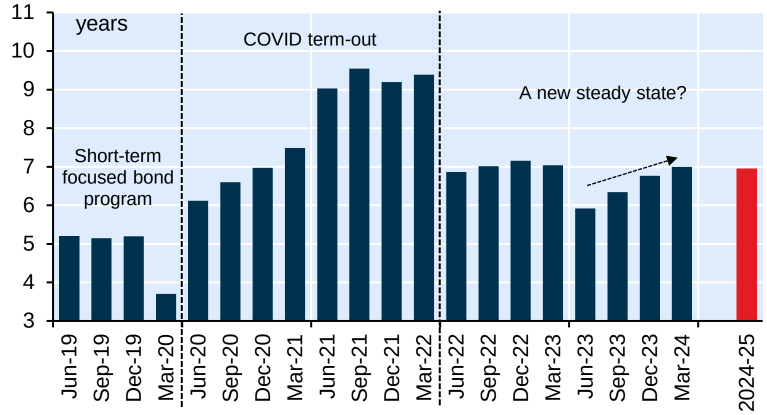
Source: NBF, GoC | Note: 3Ys excluded. There was $6 bln of issuance in 2023-24.

Chart 7: …although this shift had already started in 2023-24
Sector share of nominal bond issuance by fiscal year



Source: NBF, BBG

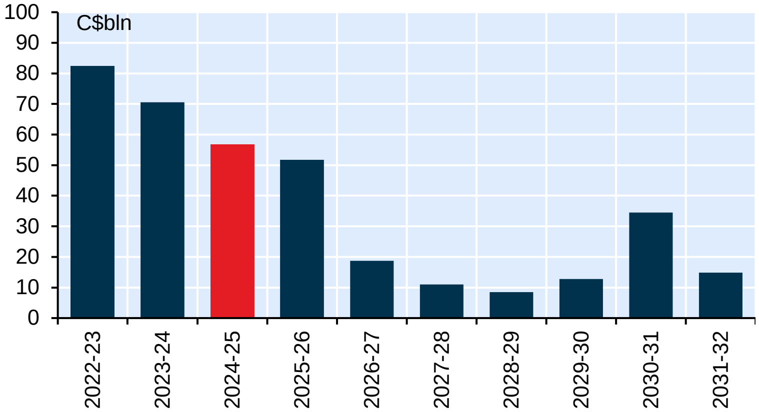
Chart 8: A new steady state for the GoC's term of issuance?
Weighted average term of nominal bond issuance by quarter



Source: NBF, BoC, GoC

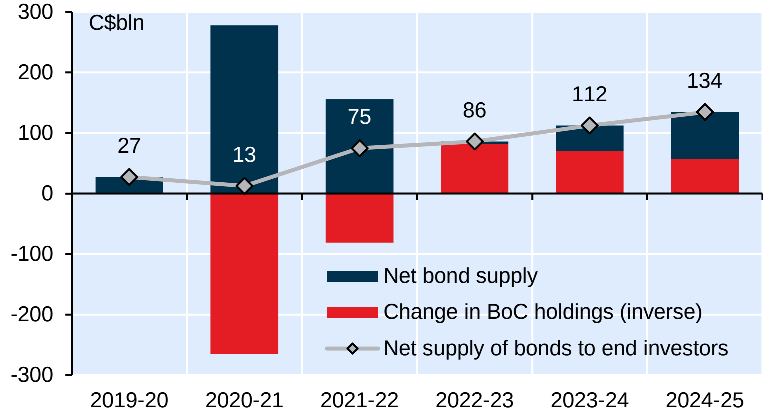
Bond issuance will grow again in 2024-25, registering a second straight double-digit increase (in billions or percent terms). Gross supply of $228 billion is nearly double the pre-pandemic run rate. Compared to last year, increases are concentrated in 5s and 10s but a full-year comparison masks a shift that had already been underway. The FES announced the government would be purchasing CMBs in primary which meant marginal supply was distributed towards 5s and 10s in the last quarter of 2023-24. This new DMS advances that shift a bit further. Despite some slight moderation, the 2-year sector still makes up nearly 40% of the borrowing program. It is also noted that a larger share of long-term debt (10s and 30s) will be issued. Again, that's true on a full-year basis but this was already playing out as the weighted average term (WAT) of issuance this year will be roughly the same as Q4:2023-24. Zooming out, the WAT has more or less settled between the pre-pandemic norm and the peak term-out year of 2021-22. It appears less and less likely that we'll be going back to the 'old days' where 85% of issuance was in 5-years-and-under.

Chart 9: QT to bring over $50 billion to end investors…
Size. of BoC runoff/QT (past years), maturing bonds held by BoC (future years)



Source: NBF, BoC

Chart 10: …helping set a record *effective* net supply
Change in GoC bonds by held by end investors (i.e., excl. BoC) by major driver



Source: NBF, BoC, GoC | Note: Negative (positive) grey bar reflects net BoC buying (selling)

QT may end in early 2025 according to the BoC, but they've said they won't be back to buying bonds right after (instead they'll lean on term repos and T-bills to stabilize settlement balances). Thus, there's more than $50 billion that will shift from the BoC's balance sheet to that of the private sector this year. Add in regular net bond supply and end investors will be tasked with absorbing a record amount of GoC bonds. QE shielded investors during the pandemic, but that supply is hitting the street now.

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