January 17, 2025 - (Vol. IX, No. 8)

RIP QT

By Taylor Schleich

After ample speculation, Bank of Canada Deputy Governor Toni Gravelle gave Canada's financial system *some* of the answers it's been waiting for. QT is going to be wound down sometime before the end of June, although exact timing isn't clear. Gravelle's speech conceded that earlier estimates of 'steady state' settlement balances ($20-60 billion) were too low and thus, revised that up to $50-70 billion. That's consistent with an earlier QT end date. Included in the speech were projections of settlement balances in 2025. Not surprisingly, you'll see these reach the upper end of the equilibrium range later in H1. Then, a large maturity on 1-Sep, absent intervention, would send reserves *through* the lower end of the range. To avoid this large sudden drop, Gravelle explained, QT needs to stop, and asset purchases need to resume well in advance.

That's how the BoC estimates its timing for QT winddown, but we judge that settlement balance drainage could end up taking longer. Their projections assume *zero* overnight repo usage even though the Bank has done *at least* $10 billion/day of overnight repos for the last 4+ months (and closer to $20+ billion/day more recently). These operations *create* settlement balances so, assuming some level of repo take-up continues, more time would be needed to reach the steady state. It's not clear this will matter much to the QT end date though, as the H1:2025 timeline sounds set in stone. However, if our assessment is correct, it leaves more liquidity in the financial system at any given point in time.

Gravelle also reiterated elements of his 2024 speech when it comes to the post-QT plan. To stabilize reserves, the Bank will *not* immediately return to the bond market. Rather, they will first opt for term repos. Then, they will transition to buying bills at auction (in 2025:Q4). And then, *well* after that, they will resume bond buying. Unlike pre-COVID, they plan to buy in secondary rather than at auction. The justification for all this is to rebalance their asset-liability mix. They currently hold very few short-term assets, despite over $150 billion in short-term liabilities. Their assets are almost all long-term (i.e., bonds) and these far outweigh long-term liabilities (i.e., currency). This is why the Bank flags late-2026 is the earliest they'll buy bonds again. We agree with this estimate.

From a market perspective, there was little impact post-speech, the announcement to end QT not coming as a huge surprise. Swap spreads were already widening ahead of the speech, but QT's confirmed exit potentially adds a catalyst for spreads to move further off their multi-year lows. For cash bonds, we continue to view the macro backdrop as the most important driver and Canadian risks remain titled lower. That could support GoC outperformance as Trump takes office next week.

Chart 1: Estimates of reserve drainage may be overstated…

BoC estimates of settlement balances at month-end (with O/N repo adjustment)

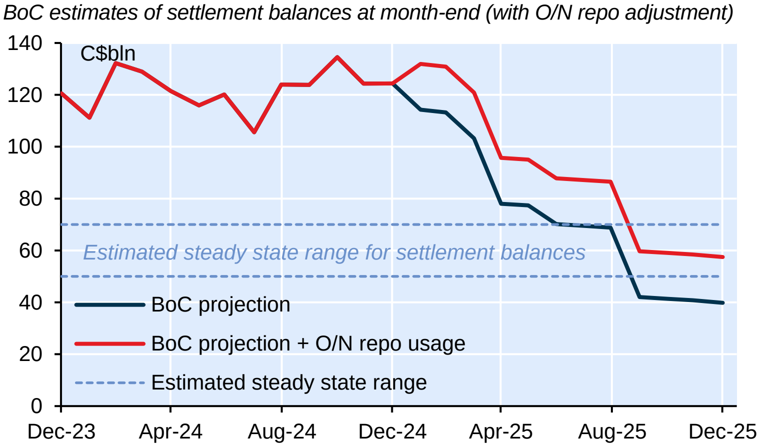


Chart 2: …due to ongoing (and growing) overnight repo usage

Daily amount allocated in BoC overnight repo operations since mid-2024

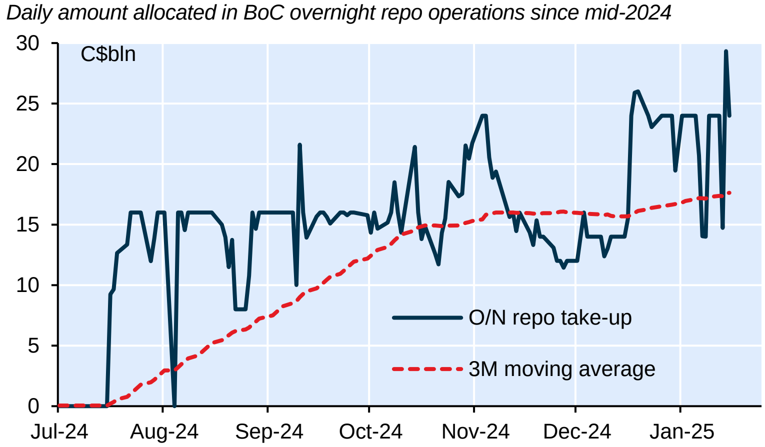


Chart 3: The BoC wants to normalize its asset-liability mix…

Select balance sheet assets and liabilities: Pre-COVID & latest (25-Dec)

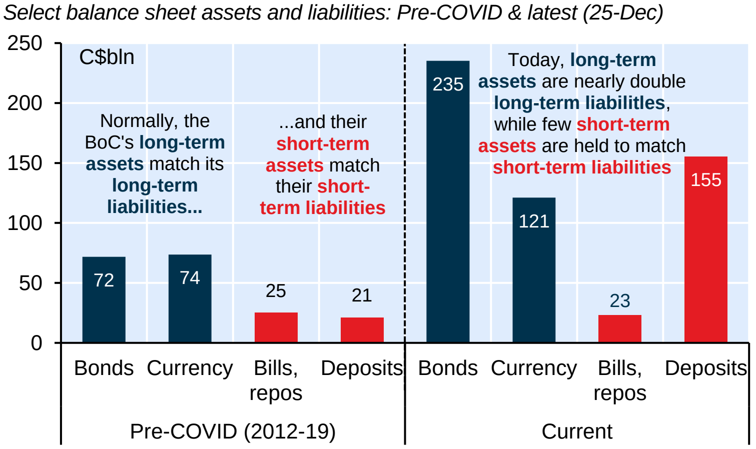
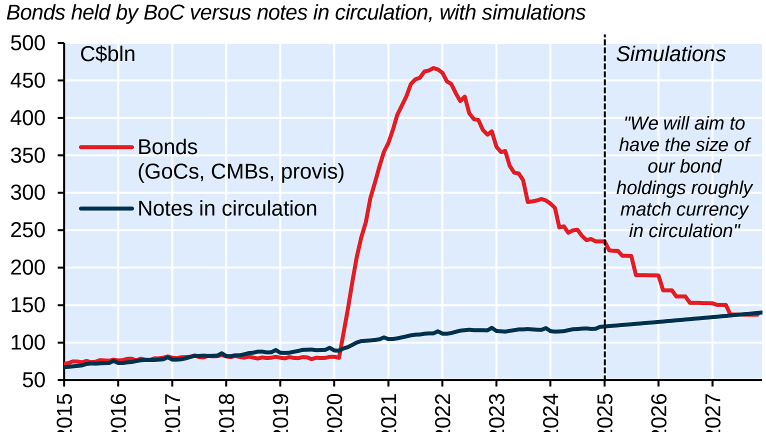


Chart 4: …which means bond buying is years away

Bonds held by BoC versus notes in circulation, with simulations



Sources for Charts 1-4: NBC, BOC | Notes: [C1] Uses 90D avg of O/N repo usage for adjustment. [C3] Assets shown are >90% of total assets. [C4] Assumes 5% annual currency growth.

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