

**Debt Management  
Strategy 2010-2011**

Annex

**3**





## Purpose

The *Debt Management Strategy* sets out the Government of Canada's objectives, strategy and plans for the management of its domestic debt and foreign currency liabilities. Borrowing activities support the ongoing refinancing of government debt coming to maturity, the execution of the budget plan, and other financial operations of the Government, including borrowing on behalf of some Crown corporations.

The Financial Administration Act requires that the Government table the *Debt Management Strategy* in Parliament prior to the start of the fiscal year. Further information on the management of the Government's debt and liquid financial assets, including a description of the governance framework and details on program activities and outcomes, can be found in two annual reports that are tabled in Parliament following the tabling of the *Public Accounts of Canada*: the *Debt Management Report* and the *Report on the Management of Canada's Official International Reserves*, both of which can be found on the Department of Finance website.



## Highlights of the Federal Debt Management Strategy

- ✓ Borrowing requirements in 2010–11 are expected to be lower than in 2009–10 as financing for various initiatives under the Extraordinary Financing Framework winds down.
- ✓ In 2010–11, the Government of Canada will continue to issue bonds across all maturity sectors, but at slightly lower levels than in 2009–10.
- ✓ Gross issuance of domestic marketable bonds is planned to be about \$95 billion in 2010–11, \$7 billion lower than the projected \$102 billion for 2009–10. The total bond stock is planned to increase by \$60 billion to \$428 billion.
- ✓ To help smooth the cash flow profile of upcoming maturities, the Government is considering adjusting the maturity dates of certain benchmarks. Market participants will be consulted and any changes will be published well in advance.
- ✓ The size of the regular bond buyback program is planned to be \$5 billion in 2010–11, about \$3 billion higher than the projected amount for 2009–10, and buyback operations will continue to be conducted on a switch basis only.
- ✓ The average size of bi-weekly treasury bill auctions will decrease for 3-month, 6-month and 1-year terms. By the end of 2010–11, the treasury bill stock is projected to be \$150 billion, about \$28 billion lower than the level projected for the end of 2009–10.



## Benefiting From Prudent Fiscal Management

The Government has successfully undertaken substantial new borrowing since 2008–09 to finance its plan to stimulate the economy and improve access to credit. Debt securities issued to fund these measures have found a ready and diversified investor base thanks to Canada’s strong fiscal position, combined with a long-standing policy of maintaining a liquid, well-functioning securities market.

Market debt is expected to rise in 2009–10 due to the deficit and the funding undertaken for the Extraordinary Financing Framework (EFF). EFF measures do not affect the deficit or federal debt, as borrowings to fund the EFF are offset by an associated increase in financial assets such as National Housing Act Mortgage-Backed Securities purchased under the Insured Mortgage Purchase Program.

The proportion of government revenue spent on debt service charges has been falling steadily and is expected to be about 13.5 per cent in 2010–11, close to the lowest level since the 1970s. Low debt service charges free up resources for more productive uses, giving the Government added flexibility to face new challenges.

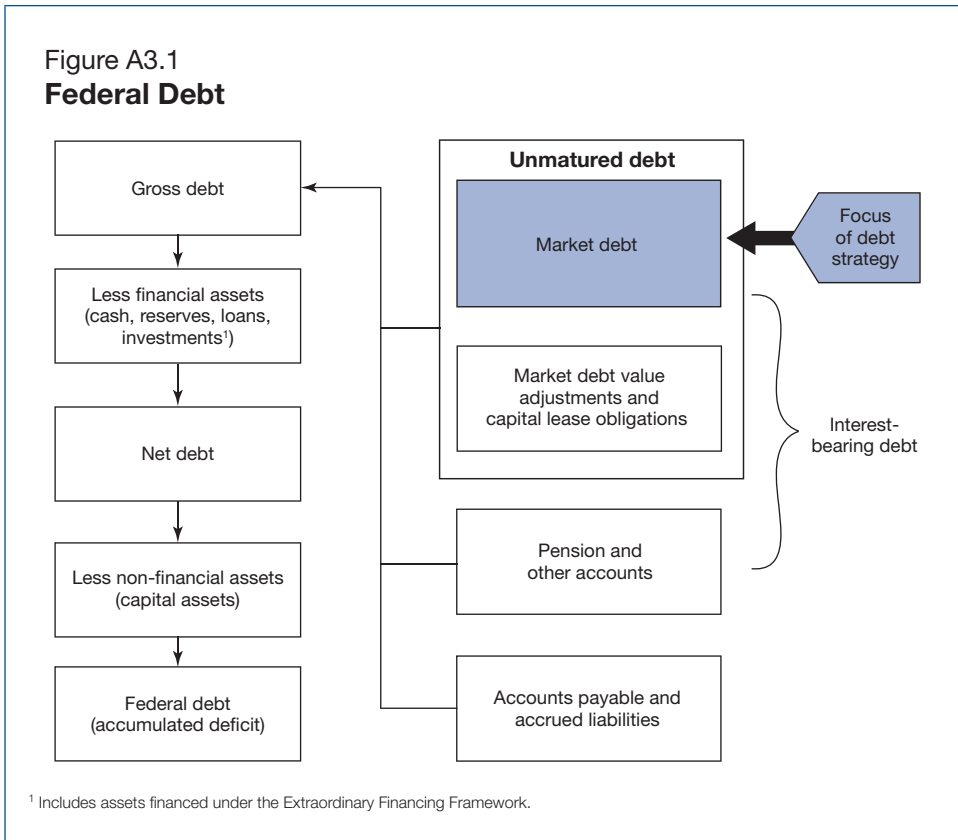
In 2009–10, Canada issued two foreign currency bonds in international markets, the first direct foreign currency borrowing undertaken by Canada in a decade. The proceeds were used to purchase assets for Canada’s foreign exchange reserves. Investor demand for these bonds was extremely high, allowing Canada to diversify its lending base to a wide range of global investors and to raise funds at low cost. The successful completion of these issues reflects international investors’ views on Canada’s prudent fiscal management and strong credit profile.



## Debt Management Framework

### Composition of the Debt

The focus of the Government’s debt strategy is market debt, which is a component of gross debt. The federal debt consists of the total liabilities of the Government of Canada (gross debt) minus financial and non-financial assets. The following diagram illustrates the relationships between the components of the federal debt.





For accounting purposes, gross debt is decomposed into market debt, which is issued and outstanding in financial markets; value adjustments to market debt (for the foreign exchange value of swap liabilities and the net of unamortized premiums and discounts of new issues and buybacks); capital leases; and other liabilities. The rest of the liabilities comprise liabilities held outside capital markets and include obligations to public sector pension plans as well as accounts payable and accrued liabilities and allowances.

Financial assets comprise cash on deposit with the Bank of Canada, chartered banks and other financial institutions; accounts receivable (including tax receivables); foreign exchange accounts; loans (including loans to Crown corporations), investments and advances; and assets financed under the Extraordinary Financing Framework (National Housing Act Mortgage-Backed Securities purchased under the Insured Mortgage Purchase Program and asset-backed securities purchased under the Canadian Secured Credit Facility).

Non-financial assets comprise tangible capital assets, inventories and prepaid expenses.

The liabilities that are actively managed under the debt strategy comprise wholesale and retail debt denominated in Canadian dollars, together with foreign currency liabilities. The latter category comprises both direct foreign currency debt and derivatives (where domestic debt issues are converted to foreign currency via cross-currency swaps).

Borrowing activities support the ongoing refinancing of government debt coming to maturity, the execution of the budget plan, and other financial operations of the Government, including borrowing on behalf of some Crown corporations.

## **Borrowing on Behalf of Crown Corporations**

Since the start of 2008–09, the Government has consolidated the borrowings of three financial Crown corporations—the Business Development Bank of Canada (BDC), Canada Mortgage and Housing Corporation (CMHC) and Farm Credit Canada (FCC)—into the federal debt program.

BDC, CMHC and FCC unmatured debt issued prior to consolidation continues to remain outstanding in the marketplace. The Minister of Finance approves all Crown borrowing plans within the context of annual corporate plan approvals. Crown corporations are responsible for the governance and management of their treasury functions, including decisions about how much to borrow from the Government of Canada.



The consolidation of Crown borrowing activity does not affect the federal debt (accumulated deficit) or total government net debt, since increased federal borrowing is matched by assets in the form of loans to the Crown corporations.

## **Borrowing Authority**

Authority to borrow in financial markets is provided by Part IV of the Financial Administration Act (FAA), which authorizes the Minister of Finance, with the approval of the Governor in Council, to issue securities and undertake related activities, including entering into financial contracts and derivatives transactions.

To satisfy the requirements under the FAA, anticipated borrowing and planned uses of funds are presented in the next section. Actual borrowing and uses of funds compared with those forecast will be reported in the 2010–11 *Debt Management Report*, and detailed information on outcomes will be provided in the 2011 *Public Accounts of Canada*. Both documents will be tabled in Parliament in the fall of 2011.

To determine the amount of borrowing authority to be requested from the Governor in Council, a margin for prudence is added to facilitate intra-year management of the debt and foreign exchange reserves.

In March 2009, the Governor in Council approved an aggregate borrowing limit of \$370 billion for 2009–10, an increase of \$74 billion from the 2008–09 Submission to Council.<sup>1</sup>

Borrowing requirements in 2010–11 are expected to be lower than in 2009–10 as financing for various initiatives under the Extraordinary Financing Framework winds down. For 2010–11, the aggregate borrowing limit that will be requested from the Governor in Council to meet Budget 2010 financial requirements and provide a margin for prudence will be \$300 billion.

The sources and uses of borrowing are described in the following section and are set out in Table A3.1.

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<sup>1</sup> Approved Orders in Council are available on the Privy Council Office website at [www.pco-bcp.gc.ca/oic-ddc.asp?lang=eng&Page=secretariats](http://www.pco-bcp.gc.ca/oic-ddc.asp?lang=eng&Page=secretariats).



## Planned Borrowing Activities for 2010–11

### Sources of Borrowing

The aggregate principal amount of money required to be borrowed by the Government from financial markets in 2010–11 to finance Budget 2010 stimulus measures, meet refinancing needs and meet other financial requirements is projected to be \$251 billion.

### Uses of Borrowing

#### Refinancing Needs

In 2010–11, refinancing needs are projected to be approximately \$220 billion. The main source of refinancing needs during the year stems from the turnover of treasury bills, which have a term to maturity of one year or less, and bonds that will mature in 2010–11. Other lesser amounts include retail debt (Canada Savings Bonds and Canada Premium Bonds) and foreign currency obligations that mature in 2010–11.

#### Financial Source/Requirement

The other main determinant of borrowing needs is the Government's financial source or requirement. If the Government has a financial source, it can use the source for some of its refinancing needs. If it has a financial requirement, then it must meet that requirement along with its refinancing needs.

The financial source/requirement measures the difference between cash coming into the Government and cash going out. This measure is affected not only by the budgetary balance but also by the Government's non-budgetary transactions.

The budgetary balance is presented on a full accrual basis of accounting, recording government liabilities and assets when they are incurred or acquired, regardless of when the cash is paid or received.

Non-budgetary transactions include changes in federal employee pension accounts; changes in non-financial assets; investing activities through loans, investments and advances (including loans to three Crown corporations—BDC, CMHC and FCC); and other transactions (e.g. changes in other financial assets and liabilities and foreign exchange activities).



For 2010–11, a budgetary deficit of \$49 billion and a financial requirement of \$45 billion are projected. As the planned amount to be borrowed is lower than the planned uses of borrowing, the year-end cash position is projected to decrease by \$15 billion.

Actual borrowing for the year may differ from the forecast due to uncertainty associated with economic and fiscal projections, the timing of cash transactions, and other factors such as changes in foreign reserve needs and Crown borrowings. A full account of actual borrowing against the plan presented here will be provided in the 2010–11 *Debt Management Report*, which will be tabled in Parliament in the fall of 2011.



Table A3.1

### Planned Sources and Uses of Borrowing for 2010–11

	(\$ billions)
<b>Sources of Borrowings</b>	
Payable in Canadian currency	
Treasury bills <sup>1</sup>	150
Bonds	95
Retail debt	2
Total payable in Canadian currency	247
Payable in foreign currencies	4
Total cash raised through borrowing activities	251
<b>Uses of Borrowings</b>	
Payable in Canadian currency	
Treasury bills	178
Bonds	35
Of which:	
Regular bond buybacks	5
Cash management bond buybacks	10
Retail debt	3
Canada Pension Plan bonds and notes	–
Total payable in Canadian currency	216
Payable in foreign currencies	4
Total refinancing needs	220
<b>Financial source/requirement</b>	
Budgetary balance	49
Non-budgetary transactions	
Pension and other accounts	-6
Non-financial assets	4
Loans, investments and advances	
<i>Enterprise Crown corporations</i>	6
<i>Other</i>	-3
Total Loans, investments and advances	3
Other transactions <sup>2</sup>	-5
Total non-budgetary transactions	-5
Total financial source/requirement	45
Total uses of borrowings	265
Other unmatured debt transactions <sup>3</sup>	–
<b>Net Increase or Decrease (-) in Cash</b>	<b>-15</b>

Notes: Numbers may not add due to rounding. A negative sign denotes a financial source.

<sup>1</sup> These securities are rolled over, or refinanced, a number of times during the year. This results in a larger number of new issues per year than the stock outstanding at the end of the fiscal year, which is presented in the table.

<sup>2</sup> Other transactions primarily comprise the conversion of accrual adjustments into cash, such as tax and other account receivables, provincial and territorial tax collection agreements, and tax payables and other liabilities.

<sup>3</sup> These transactions comprise cross-currency swap revaluation, unamortized discounts on debt issues and obligation related to capital leases.



## 2010–11 Debt Strategy

### Objectives

The fundamental objective of debt management is to raise stable and low-cost funding to meet the needs of the Government of Canada.

An associated objective is to maintain a well-functioning market in Government of Canada securities, which helps to keep debt costs low and stable and is generally to the benefit of a wide array of domestic market participants.

### Debt Structure

In general, achieving stable, low-cost funding involves striking a balance between cost and risk in the debt structure, which is achieved through the selection of debt instruments.

The main operational measure used to describe the debt structure is the fixed-rate share, which is the proportion of all interest-bearing debt that does not mature or need to be repriced within one year relative to the total amount of Government of Canada interest-bearing debt. The fixed-rate measure is used in combination with other measures to assess the Government's exposure to changes in interest rates over time. The fixed-rate share of the debt was 61 per cent at the end of 2008–09. It is projected to rise to almost 63 per cent by the end of 2009–10, and rise slightly further in 2010–11. This increase in the fixed-rate share largely reflects an increase in the size of the bond stock relative to the stock of treasury bills.<sup>2</sup>

### Maintaining a Well-Functioning Government Securities Market

Maintaining a well-functioning government securities market ensures that large volumes of funding can be raised efficiently to meet the Government's increased operational needs in difficult economic times. To support a liquid and well-functioning market for its securities, the Government has strived to maintain transparent, regular and diversified borrowing programs.

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<sup>2</sup> More precisely, the fixed-rate share is calculated on a net basis by excluding components of the debt that are matched with financial assets of the same term and therefore do not represent an exposure to interest rate risk. The federal liabilities netted out from the fixed-rate share calculation include liabilities funding the assets in the Exchange Fund Account; debt securities matched with corresponding loans to Crown corporations; Government of Canada debt securities held by the Bank of Canada; matched assets related to the Insured Mortgage Purchase Program; and the debt offset by Receiver General cash and deposit balances.



The promotion of competition and participation at government securities auctions and in the secondary market also helps to keep debt costs low and benefits a wide array of domestic market participants.

## **Market Consultations**

As in past years, market participants were consulted as part of the process of developing the debt strategy. Consultations conducted in November 2009 focused on obtaining feedback on the market impacts of higher issuance and recent measures introduced by the Government and the Bank of Canada to support liquidity in the financial system.

Market participants reported that liquidity is excellent for government benchmarks as a result of higher issuance, and that it has vastly improved for off-the-run bonds. Regarding bond auctions, participants were confident that additional issuances could be absorbed, particularly in shorter-term maturities, while demand for Real Return Bonds (RRBs) continues to be strong. It was also indicated that the use of switch buybacks had greatly helped relieve liquidity pressures in off-the-run long bonds. Market participants agreed that the treasury bill program continues to function well and that there is capacity to absorb a gradual and moderate increase in auction sizes.

Market participants also highlighted the importance of the Government communicating changes to the debt management or issuance strategy in a timely and predictable manner.

More details on the subjects of discussion and the views expressed during the consultations can be found at [www.bankofcanada.ca/en/notices\\_fmd/index.html](http://www.bankofcanada.ca/en/notices_fmd/index.html).

## **Communications**

As was the case in 2009–10, changes to the planned debt program may be required depending on the evolution of government financial requirements and financial markets. To provide market participants with as much transparency and predictability as possible regarding Government of Canada securities operations, any changes to the debt strategy plan will be published in advance, and consultations with market participants will be undertaken, as required.



## Bond Program

The size of the bond program is based on the expected financial source/requirement, the amount of bonds maturing, forecast Crown corporation borrowing requirements, the plan for regular buybacks and the need for fixed-rate borrowing for other purposes, such as funding the foreign reserves.

In 2010–11, the level of gross bond issuance is planned to be about \$95 billion, \$7 billion lower than the projected \$102 billion for 2009–10 (Table A3.2).

Table A3.2

### Bond Issuance Plan for 2010–11

	2008–09 Actual	2009–10 Projected <sup>1</sup>	2010–11 Planned
	(\$ billions)		
Gross bond issuance	75	102	95
Buybacks	-6	-2	-5
Net issuance	69	100	90
Maturing bonds and adjustments <sup>2</sup>	-27	-27	-30
Change in bond stock	42	73	60

<sup>1</sup> Includes bond issuance to fund the Insured Mortgage Purchase Program and Crown corporation loans.

<sup>2</sup> Includes cash management bond buybacks and the inflation adjustment for RRBs.

The stock of market debt is projected to have increased by \$133 billion since 2008–09 (Table A3.3). However, since a significant proportion of market debt issued since 2008–09 was used to acquire interest-bearing investments, the increase in the federal debt (accumulated deficit) is much lower.

Table A3.3

### Change in Composition of Market Debt

	2008–09 Actual	2009–10 Estimated	2010–11 Planned
	(\$ billions)		
Treasury bill stock	192	178	150
Marketable bonds	295	368	428
Retail stock	13	13	12
Foreign debt stock	10	8	8
CPP bond stock	0.5	0.5	0
<b>Total market debt</b>	<b>511</b>	<b>568</b>	<b>597</b>



## Benchmark Bond Targets

The bond program for 2010–11 will support liquidity in the key maturities (i.e. 2-, 3-, 5-, 10- and 30-year).

To help smooth the cash flow profile of upcoming maturities, the Government is considering adjusting the maturity dates of certain benchmarks (e.g. switching from a June/December to a March/September cycle). Market participants will be consulted and any changes will be published well in advance.

In 2010–11, the 2-, 3-, 5-, 10- and 30-year minimum benchmark target sizes will be maintained.

- 2-year bonds: \$7 billion to \$10 billion.
- 3-year bonds: \$7 billion to \$10 billion.
- 5-year bonds: \$9 billion to \$12 billion.
- 10-year bonds: \$10 billion to \$14 billion.
- 30-year bonds: \$12 billion to \$15 billion.

For bond issues that are fungible with existing old benchmarks (2- and 5-year bonds with a June 1 maturity), minimum benchmark target sizes are deemed to be attained once the combined size of the new benchmark and the old benchmark has largely reached the minimum target sizes mentioned above. In 2010–11, maximum benchmark target sizes may be exceeded in some sectors.

## Bond Auction Schedule

In 2010–11, there will be auctions of all maturities in every quarter, except for 30-year nominal bonds, which will not be auctioned in the last quarter of the fiscal year (Table A3.4). Bond auctions will be announced through the *Quarterly Bond Schedule* on the Bank of Canada website before the start of each quarter ([www.bankofcanada.ca/cars/bd\\_auction\\_schedule.html](http://www.bankofcanada.ca/cars/bd_auction_schedule.html)).



Table A3.4

**Bond Auctions by Quarter**

Fiscal Year 2009–10				Fiscal Year 2010–11			
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
2-year	2-year	2-year	2-year	2-year	2-year	2-year	2-year
3-year	3-year	3-year	3-year	3-year	3-year	3-year	3-year
5-year	5-year	5-year	5-year	5-year	5-year	5-year	5-year
10-year	10-year	10-year	10-year	10-year	10-year	10-year	10-year
30-year	30-year	30-year	30-year	30-year	30-year	30-year	–
RRB	RRB	RRB	RRB	RRB	RRB	RRB	RRB

The order of bond auctions within each quarter may be adjusted to support the borrowing program, and there may be multiple auctions of the same benchmarks in some quarters.

**Bond Buyback Programs**

Two types of bond buyback operations will continue to be conducted: regular bond buybacks and cash management bond buybacks.

***Regular Bond Buyback Operations***

The size of the regular bond buyback program is planned to be \$5 billion in 2010–11, about \$3 billion higher than the projected amount for 2009–10. The Government will continue to conduct buyback operations on a switch basis only. This will support the liquidity of current benchmarks, while facilitating the management of auction sizes and the Government’s debt maturity profile.

The date of each operation will be announced through the *Quarterly Bond Schedule*.

***Cash Management Bond Buyback Operations***

The cash management bond buyback program helps manage the Government’s cash requirements by reducing the high levels of cash balances needed ahead of large bond maturities. In light of large upcoming cash flow maturities, particularly for June dates, the eligibility criteria for the inclusion of Government of Canada bonds in cash management bond buyback operations were broadened in December 2009.



## Treasury Bill Program

The average size of bi-weekly treasury bill auctions will decrease for 3-month, 6-month and 1-year terms. By the end of 2010–11, the treasury bill stock is projected to be \$150 billion, about \$28 billion lower than the end-of-year level projected for 2009–10.

Cash management bills (i.e. short-dated treasury bills) help the Government manage its cash requirements in an efficient manner. The Government intends to continue to actively use cash management bills in 2010–11.

## Retail Debt Program

The objective of the retail debt program for 2010–11 is to provide Canadians with access to Government of Canada retail savings products (Canada Savings Bonds and Canada Premium Bonds) in a cost-effective manner.

In 2010–11, the retail debt stock is expected to decline as redemptions continue to exceed sales in an environment of continued competition from other retail savings instruments in the marketplace. Over the coming year, the Government will continue to look for opportunities to reduce overall program delivery costs in order to support the sustainability of the program.

Further information on the retail debt program is available at [www.csb.gc.ca](http://www.csb.gc.ca).

## Foreign Currency Funding

The Government's foreign currency reserves are financed through foreign currency liabilities to minimize exposure to currency risk. The purpose of the Exchange Fund Account (EFA) is to aid in the control and protection of the external value of the Canadian dollar. Assets held in the EFA are managed to provide foreign currency liquidity to the Government and to promote orderly conditions for the Canadian dollar in the foreign exchange markets, if required.

The Government has access to a range of direct sources of funding for its foreign currency assets. These include a short-term US-dollar paper program, medium-term note issuance in various markets, international bond issues, short-term purchases and sales of US dollars in foreign exchange markets, and cross-currency swaps involving the exchange of domestic liabilities for US-dollar and euro-denominated liabilities.



The mix of funding sources used in 2010–11 will depend on a number of considerations, including relative cost, market conditions, and the objective of maintaining a prudent foreign-currency-denominated debt maturity structure.

Further information on the management of foreign currency reserves and funding objectives is provided in the *Report on the Management of Canada's Official International Reserves*, which is available on the Department of Finance website.