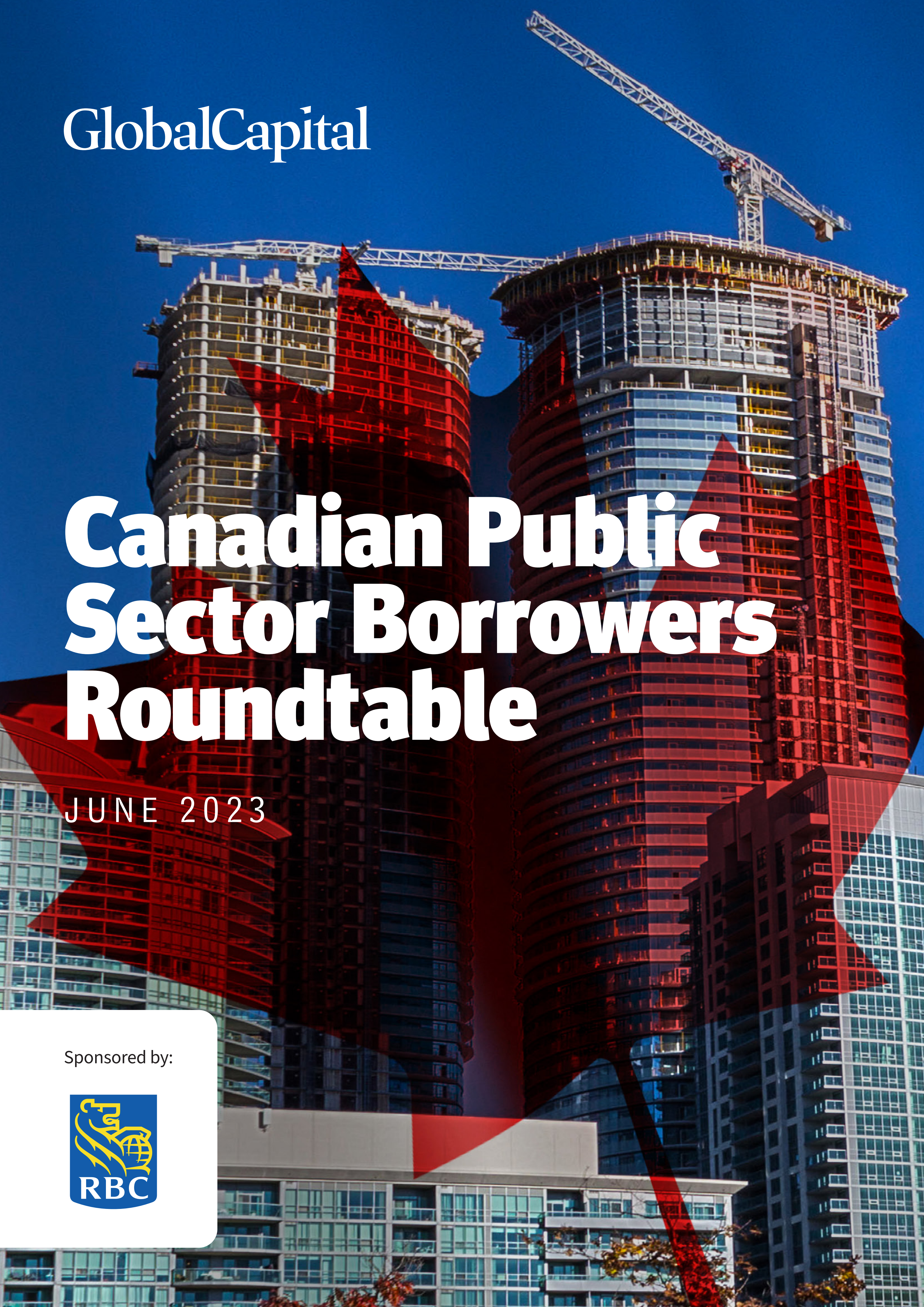

GlobalCapital

Canadian Public Sector Borrowers Roundtable

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Canada has a compelling macroeconomic story to tell. Growth has surprised on the upside, unemployment levels have been testing all-time lows, and public sector debt is low by international standards. How long this bright picture can be maintained is open to question, with inflation still running above Bank of Canada targets in spite of tighter monetary policy.

Sharp rises in interest rates have yet to filter through to the housing market, but economists have been expressing concerns about affordability in the sector. Nevertheless, although diminishing household spending power is likely to push GDP lower, the consensus appears to be that factors such as strong population growth will ensure that Canada's expected economic downturn is mild.

Against this backdrop, it is unsurprising that local and international investor demand for exposure to Canadian public sector issuers remains strong. A number of those borrowers gathered at the RBC Capital Markets/*GlobalCapital* Canadian Public Sector Borrowers roundtable to shed light on their funding strategies in domestic and offshore markets.

Roundtable participants

Participants in the roundtable, which took place in London in June, were:

Toby Fildes, managing editor, *GlobalCapital* (moderator)

Renaud de Jaham, managing director and head of treasury, Public Sector Pension Investment Board (PSP)

Marty White, director, provincial trading, RBC Capital Markets

Alex Caridia, head of public sector markets, RBC Capital Markets

John Sim, portfolio manager, Canada Pension Plan Investments (CPP Investments)

Charles Perreault, director, reserves management, Finance Canada

David Ayre, treasurer, Canada Mortgage and Housing Corporation (CMHC)

Jason Daw, head of North American rates strategy, RBC Capital Markets

James Solomon, director, DCM syndicate, RBC Capital Markets

GlobalCapital: Jason, can you begin by giving us a brief overview of the most significant developments in the rates and credit market affecting the market for Canadian public sector borrowers year-to-date?

Jason Daw, RBC Capital Markets: The interesting thing this year was the impact of the US banking crisis which put some pressure on risk assets. They have now come back in and are trading at normal levels. The Canadian dollar has been whipsawed around in a wide range between 1.33 and 1.38 and we're now at the bottom of that range.

On the rates side, the Bank of Canada paused and then restarted the hiking cycle. Front-end rates have risen a lot, while the back end of the curve has remained well behaved. This has led to sizeable curve inversions.

Equities are trading close to their highs in the US, so everything now seems to be behaving fine. But I think the big question is, if risk assets are appropriately pricing in, how deep and drawn-out the recession is going to be

From an economic standpoint, Canada has been very resilient. Its performance has been like what we've seen in other developed countries around the world. In the first half of the year, growth was pretty good. Consumers have been resilient and are drawing down excess savings. The labour market has been reasonably strong. Although some cracks are starting to appear, this is not yet transmitting into the unemployment rate.

So up to now the economy has been resilient but I think that's going to change in the future.

***GlobalCapital*: What are your views on the projected path of interest rates? When do you expect the Bank of Canada to stop tightening monetary policy?**

Daw, RBC Capital Markets: The Bank raised rates in June. There's a short gap between the June and July meetings. I'd be surprised if there is sufficient new data to dissuade the Bank from hiking again in July, which has already been almost fully priced in by the market.

Beyond that, it becomes more difficult and a lot more data dependent. I would say that the chance of the Bank raising rates again in September is probably around 50:50 at this point. I think they will probably be more inclined to hike again after July unless the data persuades them otherwise.

The big risk is that if by November or December the economic data on wages and core inflation looks similar or even slightly weaker than it does now, they might have to raise rates a lot more. The next six months is critical as it is when we would expect to see the economic slowdown kick in.

***GlobalCapital*: So would it be fair to say that the Bank of Canada will almost be following the US Fed in lockstep?**

Daw, RBC Capital Markets: There has been some divergence between the two on timing. The Bank of Canada paused in January and re-hiked in June. The Fed skipped at the June meeting and should hike in July.

History suggests that the Bank of Canada is probably not too concerned about what the Fed does. But this will become an issue if the Fed raises rates more aggressively than the BoC, causing the interest rate gap to widen and putting pressure on the currency and adding to inflationary pressures.

Obviously, the Bank will be more concerned if something were to happen in the US credit channels or the economic situation to start deteriorating before it does in Canada.

James Solomon, RBC Capital Markets: It was interesting that in the last round of central bank activity, it was the surprise hikes from the Canadian Central Bank and the Reserve Bank of Australia that triggered a global rate sell-off and a global re-evaluation of what central banks might be about to do.

Daw, RBC Capital Markets: That's true. We've had maybe five or six occasions over the past year where, through hawkish pivots and proactive tightening, the Bank of Canada has had a notable impact on the treasury market.

GlobalCapital: Charles, how do you view the economic and fiscal outlook for Canada, and what are your forecasts for growth?

Charles Perreault, Finance Canada: I would use the same word as Jason, which is 'resilient'. While the Canadian economy has shown signs of slowing amid several headwinds to growth, economic activity has been more resilient than expected so far in 2023.

We published an economic forecast at the time of our budget in late March and we'll update it in the fall. Our budget forecasts are based on a survey of 13 private sectors economists, including the team at RBC. In Budget 2023, private sector forecasters projected real GDP growth to decelerate to 0.3%. However, since then, both the IMF and the OECD have published stronger growth forecasts for Canada. This reflects a solid labour market with unemployment rate around historic lows, at about 5.2%, solid balance sheets and improving supply chain conditions. But despite a strong start to 2023, the economy is still expected to cool somewhat over the course of the year, notably as the full force of monetary tightening – to rein in inflation – has yet to be felt.

On the fiscal side, Budget 2023 forecasts a declining deficit over the next five years. We also project a steady decline in federal debt, which is the Government of Canada's main fiscal anchor. In addition, we continue to have the lowest net debt to GDP among G7 countries, and we are projected to have as the lowest deficit among the G7 countries this year and next. So Canada clearly has a good fiscal story to tell.

***GlobalCapital*: The rising rate environment has led housing and mortgage costs to shoot up for the average Canadian. What will the impact be on the housing market?**

"The full recourse system in Canada also means that borrowers can't just walk away from their mortgages. They may have to cancel their Disney vacation with the family or put off buying a new car, but most people are going to continue to make their mortgage payments. That's a key component that ought to protect us from a US-style housing crash"

David Ayre, treasurer, Canada Mortgage and Housing Corporation (CMHC)

Daw, RBC Capital Markets: I could talk about this for an hour, but I'll try to limit myself to a couple of minutes. The housing market started to pick up a little bit a few months ago when the Bank of Canada went on hold. Now with more rate hikes, it's probably going to come under some pressure. Affordability levels are such that the average householder is now spending $600 or $700 more a month which is extremely costly. So the cyclical side is clearly negative.

But the structural side of the housing market is very positive. High immigration versus the low level of housing starts is one big driver of this. So there's the immigration angle coupled with the land supply angle, which puts a structural floor under the housing market.

I think we're probably in a multi-year period of stagnation in prices, but the activity level of the housing market needs to pick up. It's running at a level that is unsustainably below trend given Canada's overall demographic profile.

David Ayre, CMHC: I agree. We published some research recently that puts some numbers around the size of the issue in Canada. We already have a housing shortage of about two million units, which is a pretty big number in the context of a population of 40 million.

***GlobalCapital*: Is that partly a result of a construction slowdown during Covid?**

Ayre, CMHC: No, the shortage has been building up for years, since well before Covid. But as Charles mentioned, we've seen significant population growth in recent years. This has been great for the economy, but it presents challenges on the housing front.

In a good year we may be able to produce 250,000 to 275,000 housing starts nationwide. This year we're already tracking at a pace of closer to 200,000 which reflects some of the structural difficulties Jason alluded to. The regulatory environment in Canada is challenging, especially for multi-family projects which in some cities can take upwards of 10 years to complete.

There's also still a significant labour shortage, especially in skilled trades, which remains a big problem in Canada. The average age of our workforce is now getting into the high 50s and early 60s and we're not yet seeing

younger generations come through, which is posing a problem too.

We have a big gap to fill, and we predict it will get bigger. As I said, we're two million units short today. If we continue at the pace of where normal starts have been, that number is going to hit 3.5m by 2030. So it's a big issue. But housing prices remain elevated. Our official view is that we'll probably see prices trend down slightly this year. But next year the market will stabilise and if anything, prices will start rising again because of this supply-demand imbalance.

Daw, RBC Capital Markets: To put this into perspective as far as the Canadian consumer is concerned, household debt-to-GDP in Canada and the US were at similar levels prior to the global financial crisis. Since then, Canada's household debt has continuously risen while in the US it has fallen. That's solely a function of the fact that housing prices have risen so much, and consumers have had to take on more leverage. So the affordability side of the housing market is a big concern.

In "nice" suburbs close to Toronto, houses are trading at US$1,000 per square foot. This is high – almost double – versus desirable areas around NYC like Greenwich, Connecticut and southern New Jersey.

Marty White, RBC Capital Markets: Higher interest rates aren't going to help anybody start any levered new projects either. You're going to see a natural deterioration from that side because it costs more to start projects.

Alex Caridia, RBC Capital Markets: Another feature of the Canadian market is that there is a great deal of disparity between the different regions.

Ayre, CMHC: Absolutely. In Toronto and Vancouver, typical average home prices are now well over $1 million. This is becoming problematic because while there are some government programmes in place helping to get people into the housing market, one of the main caveats on these is that properties cannot be priced at more than $1 million.

This is making it almost impossible for first-time home buyers trying to get into the housing market in Vancouver or Toronto. They need a minimum deposit of 20%, which is quite a big hurdle even for well-educated school-leavers with decent jobs.

***GlobalCapital*: In London, rising prices have pushed up rents as would-be house buyers are forced to stay in the rental sector. Is there a similar dynamic in Canada?**

Daw, RBC Capital Markets: Yes. Rents have risen. From a long-term structural standpoint Canada could increasingly become a rental market, certainly in cities like Vancouver and Toronto, and especially in single family homes.

Ayre, CMHC: In Canada, there haven't been a lot of rental properties built. Back in the 80s and 90s, there was a pretty good push on rental. Over the last 20 or 25 years the market has shifted to condos.

As a government, we're trying to put programmes in place to incentivise the construction of rental housing, but it's a challenge. To Jason's point, I think it's the rental market that needs to meet the challenge of our projected shortfall of 3.5 million units. We need to construct more units, not necessarily single-family homes. We need more density if we're going to solve this problem, because migration flows tend to be concentrated towards the bigger centres like Montreal, Toronto, and Vancouver.

It's not always a lack of funding that prevents these projects from getting done. It's often down to regulatory constraints, a shortage of skilled labour, and the fact that nobody wants this construction taking place in their backyards.

John Sim, CPP Investments: There is a perception that the Canadian economy is more sensitive to interest rates than the US, but we've seen the Fed take an interim pause on rates while Canada continues to hike. How do you square those two trends?

Daw, RBC Capital Markets: Ultimately the economic pain in Canada should be greater than in the US. It'll be a long-drawn-out process as mortgages get reset in batches every year. This won't hit the consumer immediately, but it will be a gradual process.

Ayre, CMHC: On the housing side, I think the regulatory regime in Canada is pretty strong. Finance Canada put a very good framework in place to stress-test borrowers back in late 2016. Rates were then at record lows, and there was a recognition that if they started to rise, borrowers could be hit hard. Borrowers at that point were stress-tested at 200bp over the Bank of Canada's five-year benchmark rate.

We've now started to go into a much higher rate cycle, but as Jason said, there are reset batches every year. We are still seeing arrears and defaults at almost record lows. There are obviously still more resets to come, but the initial data looks pretty good. I think this is indicative of the fact that there's a good safety net in place.

The full recourse system in Canada also means that borrowers can't just walk away from their mortgages. They may have to cancel their Disney vacation with the family or put off buying a new car, but most people are going to continue to make their mortgage payments. That's a key component that ought to protect us from a US-style housing crash.

Daw, RBC Capital Markets: As has been the case in most countries, excess savings are being drawn down, which is probably part of the reason why we've had a little bit more resilience in the economy up to now.

But with the labour market strong, the economy is doing exactly what it should be doing at this point in the cycle. It's over the next six to 12 months where you would normally start to see the impact of higher interest rates filtering through to the economy and to the labour market.

Excess savings coupled with staggered mortgage resets and banks being generous with mortgage issues, maybe draws that out a little and explains some of the economy's resilience. But I think people's views have been coloured by the fact that the rate-hiking cycle has been so large and so aggressive. This has led them to expect the rates impact to happen more quickly. But I think that's the wrong way to look at it.

GlobalCapital: Staying with interest rates, how will CPP Investments and PSP be impacted by the rising cost of debt?

Sim, CPP Investments: We're a floating rate borrower in that every issuance is swapped to floating. Further, we use SOFR as a benchmark for comparison across markets. Therefore, to the extent that the spread to SOFR widens, that's where it has the impact of increasing our funding costs and that impact is materially less than a wholesale shift higher in nominal rates. That being said, most of what we do is buy assets. So if it becomes a little more expensive to issue on the liability side, hopefully this means that we'll be seeing more attractive opportunities on the asset side. We look at the asset and the liability sides of the balance sheet together in determining the impact on the total fund from any rate move.

Renaud de Jaham PSP: We probably have more exposure to duration than CPP does, so interest rate hikes affect the cost of our borrowing. Having said that, we look at our borrowing from a long-term perspective. Because it's part of the portfolio construction, we look at very long-term capital markets assumptions. So even if the average cost of debt is something like 2% more now than it used to be in the past, first there is some sort of normality in today's rates; and second, the expected return on our investments is still way above those borrowing costs.

"Canada's household debt has continuously risen while in the US it has fallen. That's solely a function of the fact that housing prices have risen so much, and consumers have had to take on more leverage. So the affordability side of the housing market is a big concern"

Jason Daw, head of North American rates strategy, RBC Capital Markets

This means it still makes sense from a portfolio construction perspective to maintain our commitment to our debt capital markets programme, even at the yields we see today.

***GlobalCapital*: David, before getting your views on how rising interest rates will impact the Canada Mortgage Bond (CMB) programme, it would be helpful if you could give us an update on the Budget 2023 initiative to potentially consolidate CMBs into the regular Government of Canada borrowing programme.**

Ayre, CHMC: Absolutely. As part of the 2023 budget, Finance Canada is looking at potentially consolidating the CMB programme. There will be a public consultation on this which all stakeholders will be able to participate in. I think it's a fair question for Canada Finance to ask, because we're the same credit as Canada but we obviously issue at a spread to the government.

The background to the CMB programme is that we've operated as a sort of arm's length, SSA-type issuer for 22 years now. Over that time, we've built a fairly deep global investor base, some of which is certainly incremental to the government's because we come at a spread. Since inception we've attracted over 900 unique investors to the programme which is a big number. In other words, this has become a really large, globally accepted programme. Typically, about 30% of our issuance is offshore, with probably about 40% of our outstandings now sitting outside Canada. So it has been a big driver of foreign investment into Canada.

When the programme was introduced back in 2001, the mortgage market probably wasn't sufficiently competitive, because it was dominated by a few large banks. The CMB programme has played an important role in encouraging more competition in the market process by prioritising funding for some of the smaller lenders. They have played an important role in keeping mortgage rates competitive in Canada, but they haven't benefited from the same funding channels as the larger banks. If you look at the mortgage landscape in Canada, there are now over 100 small lenders that are accessing the programme for funding, so it has been a great tool for promoting greater competition.

I'd say the programme sets a baseline for mortgage funding in Canada. If you look at the tiers of mortgage funding, consumer deposits are typically the cheapest source of funding. Then you move up the curve, to CMB, covered bonds and NHA MBS [National Housing Act Mortgage-Backed Securities].

We've brought a very stable and predictable issuance pattern to the market. We issue eight times a year, in good and bad times. We've seen some quite bad markets over the years, but we've never pulled an issue. We give our investor base an assurance that no matter how bad markets may become, we will always issue.

Think back to the early part of March 2020 when things were melting down and nobody knew where markets were going. We had a scheduled $5bn trade coming up which we were obviously nervous about. On the Saturday night before the deal, we were discussing what we should do, and our conclusion was that we should definitely go ahead. We brought the deal, and it raised $6bn, which spoke to the strength of this programme. The world was melting down and we still got a $6bn trade done. If I remember correctly, I think ours was the only deal that was successfully completed in Canada at the time.

Caridia, RBC Capital Markets: I think the CMB programme also aligns Canada with a lot of other countries with active agency sectors which are used as a policy tool for governments. Germany, for example, certainly uses KfW as a policy tool. It's the same in France, Spain, and Austria. Most developed markets have some kind of government agency.

In the case of Canada, the focus is on educating the investor base and bringing more investors into either the CMB programme or the other agencies' programmes that you might not otherwise attract through sovereign issuance alone. I think if the CMB programme were to fall away, it would set Canada apart from other developed economies.

Perreault, Finance Canada: From the Government of Canada's standpoint, we announced a consultation in the budget which we launched a few weeks ago. We set up a website which is now live where people can post their input.

The government looks at this from a funding efficiency perspective based on the fact that CMBs are the same credit as Canada and are backed by the full faith of the government.

The government is looking seriously at the consultations. More efficient funding could allow for the financing of other housing initiatives in areas like affordable housing or in the renting space. Also – and this is an important point – the government isn't looking at changing the NHA MBS side of it. It is looking purely at the funding side.

***GlobalCapital*: And you wouldn't hypothecate the borrowing. You would just borrow on a general basis and distribute accordingly?**

Perreault, Finance Canada: Exactly. The consultation is very wide on both sides and there is no prescription as to what our funding programme would look like afterwards.

Ayre, CMHC: We're at the table with Canada Finance on this. It is a fair, open consultation. There are potential risks on the other side because if you're looking at increasing Canada's borrowings by $250bn, you need to assess what the impact may be on the sovereign curve. There are pros and cons to it. I'm obviously on the pros side.

***GlobalCapital*: In the case of CPP Investments and PSP, how have the movements in interest rates and yield curves this year changed your borrowing strategies, if at all?**

Sim, CPP Investments: We've been affected to the extent that investor appetite has changed. The yield curve inversion has naturally meant that investors have become far more interested in the front end. Since we're a floating rate borrower and we don't have a yield target to hit, we can be reasonably flexible in terms of accommodating investor needs. So I'd say our issuance has been a little more short-dated than you would have seen in the past.

De Jaham, PSP: I would add that 2022 was a very difficult year from an issuer's perspective as well as for investors who were more defensive in the face of rate hikes and elevated volatility.

The latter part of 2022 was especially challenging with demand unpredictable. So in terms of strategy, we had to issue smaller amounts in order to ensure that investors would continue to support our programmes.

Having said that, I would say the strategy stayed pretty much the same for PSP. It was tilted towards continuing to build our curve in the domestic market a little bit below US levels. One beneficial change was that, in order to issue also smaller sizes here and there, we established a private placement programme which I think added value. The idea for that programme was a product of the difficult issuance environment in 2022.

***GlobalCapital*: Let's move on to inflation. Jason, what does RBC expect for the path of inflation over the next 12-24 months?**

Daw, RBC Capital Markets: I think it's reasonable to assume that by the end of this year, headline inflation on a year-on-year basis will be close to 2%. I don't think that will be too difficult to achieve, given that much of it will come from base effects.

Going into the end of this year and into 2024, tackling core inflation will be a little bit trickier. Wages are still too high, core inflation trends are still running at 3.5%, and super core is closer to 4% or 4.5%. Bringing this down will be a slow process. I think by the end of this year, we may be at 3% in year-on-year core inflation. But it's going to take until the end of 2024 to get it back down to 2%.

The worrying thing that's happening now, which was probably one of the factors that led the Bank of Canada to raise rates in June, was the fact that when you look at the CPI releases that we've had this year, sequential changes have been elevated. Even with oil prices falling significantly, we've been printing monthly sequential rises in headline inflation well in excess of 0.2-0.3%. That's just way too high.

So it is going to be sticky, and there will be plenty of debate on whether we can get structural inflation back down to 2%, or whether this will remain higher now due to changes in demographics, supply chains and so on. There are a lot of open questions out there and we will probably only know the answer in one or two years' time.

***GlobalCapital*: Turning to Finance Canada again, can we discuss the rationale behind the decision to stop issuing Government of Canada Real Return Bonds?**

Perreault, Finance Canada: Sure. The decision was not related to rising inflation. In simple terms, there was just very low demand for Real Return Bonds. There were three main objectives when the RRB programme was introduced in 1991. These were to be a cost-effective way to borrow, to develop into a liquid, well-functioning secondary market, and to establish a relatively useful guide for inflation expectations. Over the years, and especially recently, it has become apparent that the programme was not achieving those objectives.

Just looking at inflation, when we hit a peak of around 8% in Canada, the breakeven rate of RRBs was suggesting inflation expectations of below 2%. So there was a bit of a disconnect in the market which indicated low liquidity and weak demand for the product.

We launched extensive consultations in 2019 about RRBs and the feedback was that there was low demand and low liquidity, that these weren't a very useful tool and that larger pension funds were not really active in the market for RRBs.

After 2019, we introduced some tweaks to the programme. Then Covid happened, diverting attention to more pressing funding issues. Fast forward to the fall of 2022, in our Debt Management Strategy consultations, the low level of demand for the product was reiterated by participants. The government then decided to cancel the programme last fall.

"We continue to have the lowest net debt to GDP among G7 countries, and we are projected to have as the lowest deficit among the G7 countries this year and next. So Canada clearly has a good fiscal story to tell"

Charles Perreault, director, reserves management, Finance Canada

GlobalCapital: Would CPP Investments and PSP ever consider linkers?

Sim, CPP Investments: We've looked at this at a very high level because it has been topical, but we haven't done a deep dive on it. There are a couple of considerations for us. One is that it tends to be more of a duration market and we don't necessarily have demand in our liabilities portfolio for longer-term duration. This means there would be a mismatch between what the investor would be looking for and what we could provide.

We also want to make sure that everything we do is scalable, replicable and gives us a real presence in the market. This is a feature of our Canadian dollar strategy which I'll talk about later. But there is a question mark over how scalable linkers would be for us.

De Jaham, PSP: We have a similar view. We see inflation-linked bonds as probably a niche product, and as our debt programme is fairly small, we feel that we have other tools available to us that would serve our needs better than inflation-linked bonds over the long run. This is not something we've looked at for the moment. Maybe we'll look at it again 10 years from now but, in the short-term, it's a pass.

GlobalCapital: Jason, what are your views on likely dynamics in the oil and gas market over the next year?

Daw, RBC Capital Markets: My impression is that analysts forecasting the oil market have consistently misjudged the supply and demand balance. Whenever you start getting supply cuts coming out of OPEC, they tend to translate that into a bullish view on the oil market.

The simple way I look at this is that it is interest rates that act as the great equaliser by influencing fluctuations in demand for oil, rather than things that happens on the supply side — unless of course that supply side effect is extremely large.

We've seen the oil price come down quite a bit this year, to below $80 a barrel. But I personally think the market is still not priced for the growth downturn that we're probably going to see. So I would say that the risk to the oil price is on the downside for the next six to 12 months.

"Most of what we do is buy assets. So if it becomes a little more expensive to issue on the liability side, hopefully this means that we'll be seeing more attractive opportunities on the asset side"

John Sim, portfolio manager, Canada Pension Plan Investments (CPP Investments)

GlobalCapital: Do you think China coming back on stream will increase general demand?

Daw, RBC Capital Markets: I think the impact of China's re-opening on the global economy gave the market a massive head fake. China's reopening didn't mean anything for the goods production side of the economy. It meant everything from a travel and tourism standpoint as far as China was concerned. Everybody interpreted the re-opening of China as an event that would be very bullish for oil. But the price has actually fallen by $20 a barrel since then because of weakness on the demand side.

China will remain the marginal consumer of every commodity, but I don't see much chance of its economy reaccelerating from here. The level of credit in the economy is too high, the demographics are unfavourable and they're on a slow growth path. So China will remain the marginal consumer but I don't see it having the same effect on the commodity market as it has had over the past 20 years.

GlobalCapital: It's an interesting theme that China pre-Covid is very different from China post-Covid in terms of its role in the global economy. But we're not here to talk about China. One topic we are here to talk about is green bonds and ESG frameworks. What are your plans for issuing ESG bonds over the rest of the year?

Ayre, CMHC: At CMB we've never had a formally labelled ESG programme. We've been looking at a framework, which is challenging on the mortgage side due to the way the system is structured in Canada. But we aren't at the stage yet where we're ready to do a labelled programme.

However, we introduced an initiative in January of last year which has used the CMB programme to help tackle the affordability crisis in Canada by changing our allocation methodology for funding. Essentially what happens in Canada is that multi-family properties, which we consider to be a more affordable type of housing, are typically funded with 10-year mortgages. We told mortgage originators that if they bring us these so-called affordable pools, we will give them priority access to 10-year CMB funding.

This a nice carrot for these lenders because they're getting 10-year funding at attractive levels. We started to ramp up our programme about a year ahead of launching this initiative. We worked very closely with our syndicate programme and explained that we were expecting rising demand for 10-year funding because we wanted to support the construction of more housing in the affordable space.

We told our syndicate that we wanted to increase our benchmarks from between $2bn and $2.5bn a quarter to between $3.5bn and $4bn, which was quite a big ask. The syndicate did a great job and within a year we were consistently doing between $3.5bn and $4bn. Our spreads moved very little, so I would argue we didn't pay very much for attracting incremental private capital to help fund affordable housing in Canada.

So although it's not a labelled programme, today almost all our 10-year funding is being taken down by these affordable mortgages. We're now doing about $15bn a year of essentially targeted affordable housing funding via the CMB programme. We took some of the five-year cap away which is targeted to single-family home type funding and shifted it over to the 10-year, which has worked well. It's not formally labelled but I would say it has performed a very valuable social function.

The labelling aspect is tricky. There are some structural issues in Canada, particularly relating to the amortisation of mortgages. How the principal gets reinvested can be complicated with respect to the framework. It's easy enough to get a label on day one, classifying a bond as social or green because we can tag the mortgages. But that principal can quickly run off to a significant degree, and depending on where that money is reinvested, it can make it difficult to put a framework in place.

De Jaham, PSP: One of the pillars of PSP Investments' strategy is climate change initiatives and reducing the carbon footprint of our portfolio. To support that strategy, we think we should have targets on the liability side. So we've set an achievable goal of ensuring that by 2026, 10% of PSP's debt outstanding will have to carry a sustainability label.

We've issued in labelled format once in the past. This was a $1bn bond, and we feel that by issuing one benchmark transaction per year we will be able to achieve our target by 2026. And then we'll probably broaden our sustainability framework, which at the moment is tilted towards just green bonds. Therefore, it will definitely be a priority this year to issue a benchmark green bond.

***GlobalCapital*: So what happens if you don't hit that 10% target by 2026?**

De Jaham, PSP: I can assure you that we will!

Sim, CPP Investments: On the asset side, the E, the S and the G are integral to our investment decisions. On the liabilities side, our focus has been on green bonds. We aim to issue one a year, in line with which we did a $500m three-year Aussie dollar issue a few weeks ago. Our framework allows us to issue green bonds in all our five core currencies, which are Canadian, US and Aussie dollars, as well as sterling and euros. But typically, we focus the green label on issuance in Canadian and Aussie dollars and historically in Euros as well, simply because those are the currencies where we see the strongest investor demand for the green product. Issuing across these currencies is certainly helping us to build a more diversified investor base in the programme.

Perreault, Finance Canada: In the case of Canada, we issued our first green bond in March 2022. It was very successful, and we were happy with the outcome. That said, the green capital market is a very rapidly evolving environment and right now we're looking at the evolution of guidelines such as Canada's Sustainable Finance Action Council (SFAC) roadmap and the EU taxonomies. We're in the process of reviewing all of this with the aim of updating our framework before we issue our next green bond.

Green is certainly a priority for the government. In the 2023 budget we reiterated our commitment to exploring a sustainable bond framework which in addition to green could contain social and potentially transition bonds, which would make a lot of sense for Canada. It's still early days for that but the commitment is there.

Caridia, RBC Capital Markets: That's interesting. I always thought Canada was probably five to seven years behind Europe in terms of green bond issuance, and even further behind in social bonds. This year, volumes in Canada are down significantly, running at only $6bn or so gross issuance of green, social and sustainability bonds versus $23bn last year. And 60% of that $6bn has been from non-Canadian borrowers.

All the borrowers around the table today have either already issued or done a lot of preparatory work around issuing, but I'm surprised that only two out of the 10 provincials have issued green bonds so far. There has been issuance from a couple of municipalities, but in the public sector space there have been fewer issuers than I would have expected, given a lot of the issuers' mandates. Perhaps Marty could comment on whether this has something to do with the liquidity of green versus non-green bonds.

White, RBC Capital Markets: Sure. The two major issuers from the provincial side are obviously the two largest borrowers, Ontario and Quebec. Ontario has made quite an effort to issue large size deals and tap them when appropriate. The liquidity between Ontario's green and regular bonds is almost indistinguishable, because it has done so much to increase the size of its issues and make them very tradable.

Quebec has a slightly smaller programme, although most recently they've done some larger benchmarks in the 10 year sector which greatly aids the liquidity. Some of their shorter issues are more difficult to locate as they roll down the curve, but I think Quebec also recognises the need to make a sustained effort to grow and tap future deals to add to the liquidity.

***GlobalCapital*: Does the fact that so few provinces have issued green bonds speak to the amount of work that needs to be put into the initial launch? You hear from some sovereign issuers that they spend as much as nine months of their entire year working on the initial framework. That's a lot of work on top of everything else they have to do. I'm wondering if that has held green issuance back.**

Caridia, RBC Capital Markets: That's certainly part of the reason. If you don't have a large funding programme, there are maybe some concerns that it takes away from your mainstream product a little bit as well. And some of the issuers, especially the provinces, take the view that because everything they do is governed by an ESG mandate in any case, why should they add another product? I guess that discussion is evolving.

If you look back a few years, a lot of European issuers took the same view. I remember some of the large European agencies telling me that as everything they did was green, why would they need to issue a green bond? Now, they've all issued green bonds and the conversation is coming round to the fact that the market is more driven by investors scrutinising an issuer's overall ESG profile. They're asking whether, on the basis of issuers' overall ESG scoring, they fit into their portfolio.

***GlobalCapital*: Would Canada consider a sustainability-linked bond, having seen sovereigns like Chile and Uruguay issuing in that format?**

Perreault, Finance Canada: As I said earlier, we're looking at a sustainable bond framework. But it's early days and our focus for now is on standard green bonds.

Caridia, RBC Capital Markets: I find the SLB instrument interesting because the incentive for issuers and investors seems to be totally misaligned. As an investor, if the company doesn't meet its targets, you get paid more. So you almost want the issuer to fail to meet their targets.

***GlobalCapital*: I'd like to move on to domestic funding. There was a significant increase in Canadian dollar issuance in 2022. Can we discuss the drivers behind this shift and the outlook for Canadian dollar borrowing needs over the rest of the year?**

"As more clients transition away from CDOR into CORRA, which we're seeing fairly heavily in the swap market right now, that's going to lend itself naturally to the CORRA-linked product"

Marty White, director, provincial trading, RBC Capital Markets

Sim, CPP Investments: We refocused on the Canadian dollar market in 2022. The big driver of that was frankly just how large our programme was becoming. We now have an annual issuance programme of C$15bn which will continue to grow. This means we're now able to allocate a sizeable amount of funding volume towards building large liquid benchmarks in Canadian dollars. Since January 2022, we have increased our borrowings outstanding in Canadian dollars from about C$6bn to a little over C$13bn.

We've been very pleased with the take-up and the reception from the investor base. Our initial target was to dedicate about 30% of the programme to Canadian dollars. But in response to investor demand we're now running closer to 50% of the programme this year in Canadian dollars.

***GlobalCapital*: Has this take-up been from domestic investors?**

Sim, CPP Investments: Yes, there's a lot more of a domestic base in Canada. If you look at the investor breakdown in our deals, you find that Canadian dollar issuance is heavily skewed to Canadian investors.

De Jaham, PSP: Our approach has not changed at all. In 2022, about 40% of our programme was done in Canadian dollars which is a very important market for us. We've been issuing in Canadian dollars for a while, so I would consider it to be our core market.

It's important to compare the Canadian dollar market with offshore funding. The cross-currency basis is making the Canadian markets much more attractive, and we're seeing significant demand for Canadian dollar products. From a cost of funding perspective, it makes no sense for us to issue in euros or in US dollars for the time being, at least for short maturities where spreads are probably 20bp, 30bp or 40bp wider.

The cost of funding is part of the reason why international borrowers have been coming to the Canadian market. You've seen more and more SSAs issuing Maple bonds. This may prompt us to review our borrowing strategy for this year, and to come to the Canadian market more often instead of tapping other markets.

Sim, CPP Investments: On that point I'd add that we've seen a good number of the international investors who support us in our other core global markets follow us over into our Canadian dollar issuance.

***GlobalCapital*: What are your views on the prospects for CORRA [Canadian Overnight Repo Rate Average] issuance?**

Ayre, CHMC: CMB was not the first issuer of CORRA in Canada but we're far and away the largest. We did our first issue last May and we'll typically $1bn to $1.5bn four times a year. It's been very successful. Books have been well-subscribed. In our last deal we issued $1.25bn on a book of about $2.5bn.

We've played an important role in CORRA by bringing regular issuance to the market and acting as a liquidity leader. We've seen secondary trading in CORRA pick up quite significantly. When we were transitioning from CDOR [Canadian Dollar Offered Rate], we found our CDOR deals were clearing $1bn but they weren't gangbuster trades by any stretch. But since we've transitioned to CORRA we've seen more and more investors participating.

We're hearing that it's some of the simple things that are still keeping a number of fairly large buyers out of the programme. Some folks that used to buy our CDOR floaters have told us they'd love to buy the CORRA issues but they haven't yet upgraded their systems. So it seems that there are still some technical hurdles in the CORRA market. But we're committed to our issuance schedule, and it's been nice to see secondary trading picking up.

Since the potential consolidation announced in the budget we've seen an impact on volumes. This suggests that some investors may be holding their bonds for now pending the outcome of the consultation.

White, RBC Capital Markets: As more clients transition away from CDOR into CORRA, which we're seeing fairly heavily in the swap market right now, that's going to lend itself naturally to the CORRA-linked product.

***GlobalCapital*: Let's move on to offshore funding. You've described how committed you are to Canadian dollars, but let's also discuss what you're doing offshore, which I'm sure is largely strategic rather opportunistic.**

Perreault, Finance Canada: Our offshore funding strategy is straightforward and transparent. We issue one US dollar global bond a year. The Government of Canada issues in foreign currency for only one purpose, to fund our foreign exchange reserves We typically issue our global bond in the first quarter of our fiscal year, which is the April to June period. This year, we issued in April. The objective for our global bond program is to be a dependable issuer which borrows on a regular basis. As the majority of our foreign exchange reserves are funded through cross-currency swaps, global bond issuances serve to diversify our funding sources. Being a regular issuer in that space helps keep those lines open for when we might need it.

De Jaham, PSP: You're quite right to say that offshore funding is strategic. It's still very important for us. When you build programmes, you're looking to broaden the investor base and to reach out to international investors, which is why the US and euro markets are so important to us. Having said that, there's a price to be paid for issuance in these markets, and there comes a point where you think that cost is just too high.

We've been actively reaching out to euro investors in preparation for an inaugural euro transaction. As levels have remained unfavourable for us, we've decided to postpone, but euros will certainly remain a priority.

Having said that, when we look at global markets, there is also the Australian dollar market where CPP Investments is active. We will look at that market very seriously this year because it's a good fit, given PSP's overall currency exposure. It makes sense for us to have liabilities in Australian dollars.

Sim, CPP Investments: We focus on five core currencies, and we want to be active in each of those markets each year in benchmark size. 85% of our assets are outside Canada. So from a liabilities and funding perspective, we want to be active in all five of those currencies where our investor base expects us to maintain a presence.

We've recently become a lot more active in Aussie dollars and we're happy with how that's progressing and the amount of liquidity we've seen in that market. We've had a couple of larger transactions this year, of A$1.25bn and A$1.6bn, and we've seen very strong take-up there.

***GlobalCapital*: Has there been any osmosis of existing investors into those deals? Or is it a brand-new investor base?**

Sim, CPP Investments: It's a bit of both. We've had some good traction from new Australian investors, and from large institutional investors with Aussie dollar portfolios. Some investors who buy us in US dollars have also started to buy us in Aussie dollars.

***GlobalCapital*: It would be interesting to ask quickly about the whole process of investor relations. It seems that a lot of people are trying different things post-Covid. During Covid issuers obviously did a lot remotely. But they now seem to be adopting more of a hybrid approach to maintaining their investor base. There is some face-to-face interaction but issuers don't seem to be going 100% back to where they were pre-Covid. They're still doing a lot of video meetings. Where do you stand on the whole IR front? Are you changing what you are doing? Are you sticking to what you were doing previously? What's changing?**

Sim, CPP Investments: I'd agree that hybrid is probably a good way to describe it. We'll tend to use video calls if there's something very topical that we want to speak to investors about, or if there's something urgent that we need to chat through with them. But I don't think you can fully replace in-person discussion. That kind of human connection is very important and you can't fully achieve it over a Zoom call.

Ayre, CMHC: I agree. I think personal contact is absolutely massive. We've also shifted to a hybrid model, but to your point, I find that in-person meetings will far more often convert to a real order. When you go and meet somebody, it often translates into real interest whereas when you do a Teams call, it doesn't necessarily convert into an order.

An interesting feature of the Canadian issuer community is that we all help each other. We work with Finance, as well as with the CPPI and PSP teams. So it really is a Team Canada effort. It sounds a little bit corny but we genuinely feed off each other.

We've seen the results of a good IR commitment. As I said earlier, we've had over 900 accounts globally, upwards of 700 of which are international. That doesn't just happen by making Teams phone calls. We've spent 22 years getting out there, building relationships, building this programme. And I genuinely think this has brought incremental investors to Canada.

***GlobalCapital*: We've heard reports of people flying to Hong Kong and China only to find that investors in those markets still prefer to have a dialogue remotely — so issuers are having to speak to Asia-based investors**

from their Hong Kong or Singapore hotel rooms…

Solomon, RBC Capital Markets: There have certainly been some jurisdictions that have been quicker to open up to physical marketing efforts than others. But we're hearing increasingly positive feed-back from investors about issuers who make the effort to get out there on the road.

***GlobalCapital*: Charles, does what the other issuers around the table are saying about IR efforts ring true for you too?**

Perreault, Finance Canada: For sure. Coming out of Covid it has become more of a priority for us. We don't have a formal roadshow programme in the sense that we go out every quarter to meet investors. But typically, direct engagement with investors is important for us. When possible, we also visit investors along with fellow issuers, because we believe it has synergistic benefits.

Ayre, CMHC: RBC did something last year that was a breakthrough idea. This was to send us all out on a roadshow together. We went to Asia and we met with a lot of investors, all together in some cases, and on a one-on-one basis in others. I have to say they were fabulous meetings. In the case of some of the larger institutional guys, there was a very good chance they were buying bonds from all the issuers around the table today. It was great having us all there. It showed a united front. And it showed that Canada is open for business. GC