First Experiences of the New Normal

The Bank of Canada Case

Stéphane Lavoie
Managing Director, Financial Markets Department

Bank of Finland & SUERF Conference on Monetary Policy Implementation: Old Wisdoms and New Trends
June 11, 2025

This presentation is private and off-the-record

Outline

1. The Bank of Canada's process and experience with ending QT: Moving to a new normal
2. Balance sheet normalization: Initial plans and adjustments along the way
3. Early learnings: Lessons learned for the path forward and for other jurisdictions
4. Potential challenges on the road ahead: Navigating uncertainty and adapting to changing conditions

Part 1
The BoC's process and experience with ending QT

Moving to a 'new normal' for monetary policy implementation post-COVID

QT ended in March, just under 3 years after it started

Introduced GBPP April 2020

- GoC bond purchase program (GBPP) introduced to address market strains
- Objective evolved to support recovery, achieve inflation target (i.e., QE)
- Program recalibrated (shift to more LT bonds) to impact borrowing rates
- Moved to a floor system for implementing MP

Taper QE July 2021

- Reduce amount of incremental stimulus
- Purchase amounts reduced twice
- Purchase composition unchanged

Reinvest-ment Phase Nov 2021

- Maintained stimulus by holding total GoC assets roughly constant
- Not 1-for-1, purchases offset maturities over time

Began QT April 2022

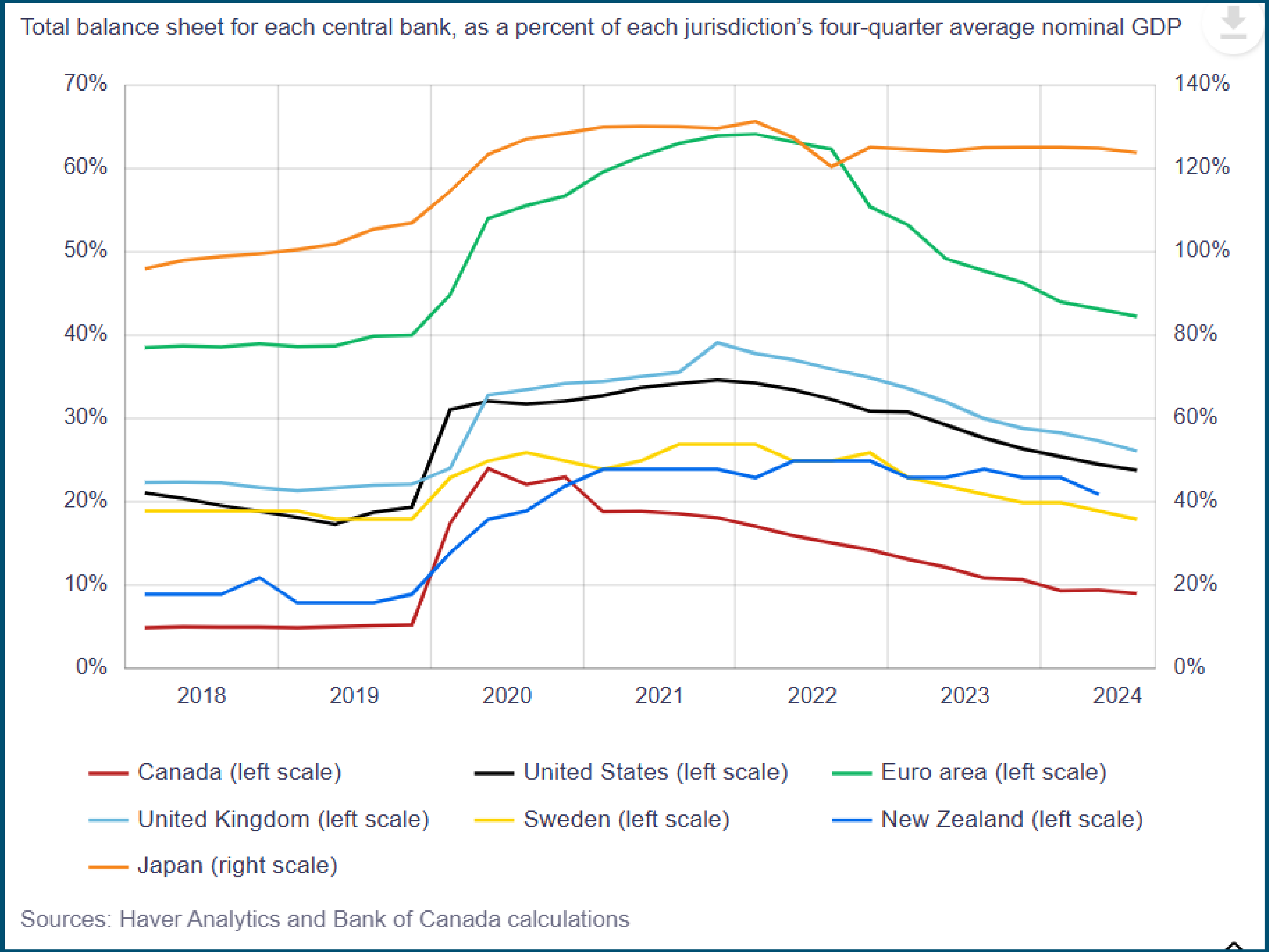
- **Allow bonds to mature passively without replacement**
- No asset purchases or sales made

End QT / restart asset purchases March 2025

- Announced end of QT at 29 Jan 2025 FAD
- Restarted asset purchases via 1- and 3-mth term repos on March 5
- GoC T-bill purchases likely to begin towards end 2025
- GoC bond purchases likely not until late 2026 at the earliest

Shorter duration of QE assets allowed BoC to end QT earlier than other CBs

BoC holdings of GoC bonds declined by roughly half over 3 years

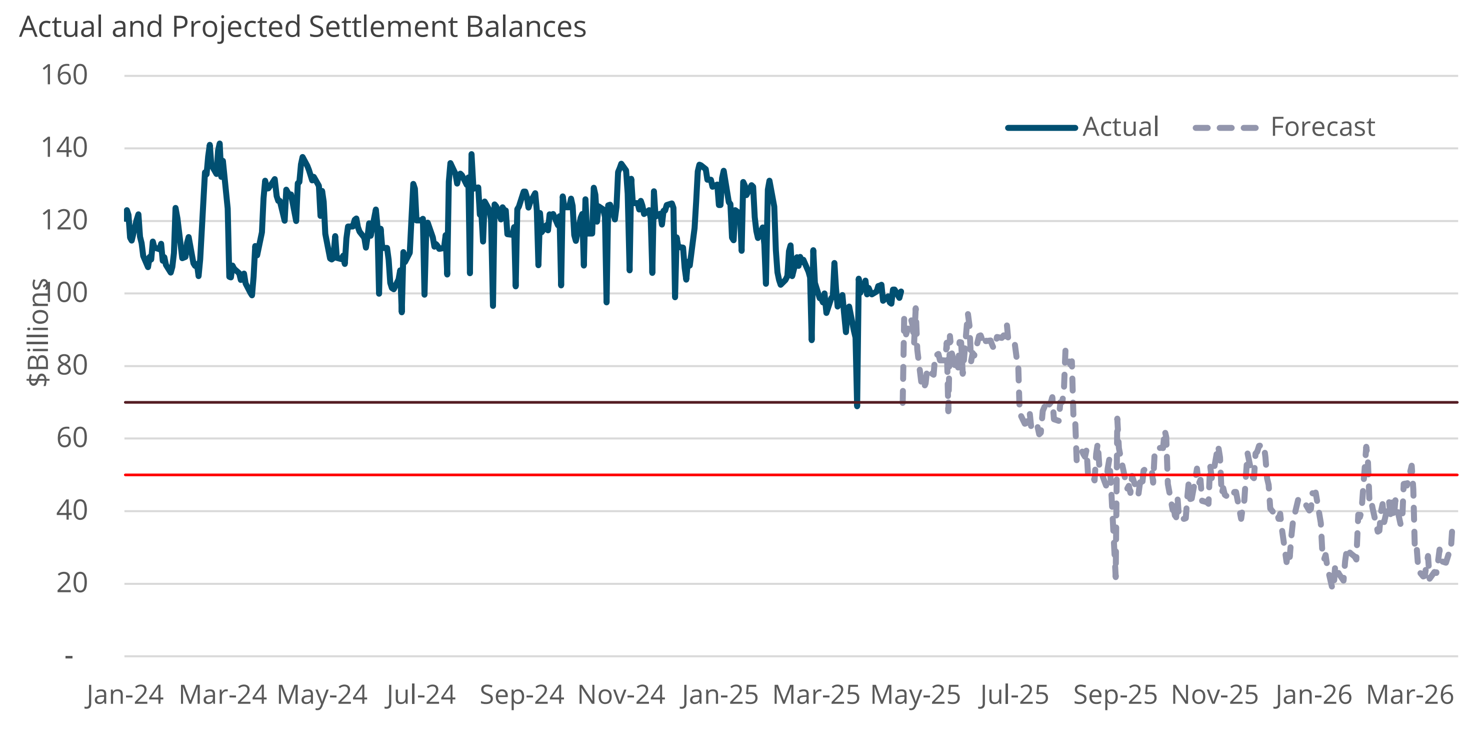


Decision to proactively end QT ahead of actual asset needs

SBs projected to fall well below $50-70bln assumed steady-state range in 2025 Q3 due to large bond maturity on Sept 1

Note: SB forecast is dependent on the Bank's assets maturity profile and the government's RG balance projections. Forecast assumes no asset purchases.

- Given asset maturity profile, faced two options to end QT:
  1. proactively ahead of asset needs, or
  2. reactively when steady state range of settlement balances (SBs) reached
- Given balance of benefits and risks, decision taken to end QT proactively:
  - Communicated QT would end sometime in 2025 H1 in Jan 16 speech
  - Announced end of QT at January 29 FAD
  - First term repo operation conducted March 5
  - SBs still moving towards estimated steady state range



Part 2
The BoC's balance sheet normalization

Initial plans and adjustments along the way

Summary of announcements

Changes made to framework for monetary policy implementation to prepare for post-QT world

- Formally adopted floor system with ample settlement balances (reserves) – Apr 2022
- Fine-tuning of terms for open market operations – July and Oct 2024
- Increased estimated preferred range of settlement balances in steady state to $50-70bln – 16 Jan 2025
- Introduced 5bps spread between reserves lending facility (OR) rate (target) and IOR rate (deposit rate) – 29 Jan 2025

Decision to stay in floor system with marginal reserves supply

In April 2022, BoC announced it would continue using floor system while minimizing reserves supplied

- Rationale for maintaining floor system:
  - Evolving financial system and changing payment landscape
  - Increased demand for safe assets due to regulatory requirements and liquidity risk management
  - Greater control over overnight rate
  - Flexibility to implement monetary policy in both normal and exceptional circumstances
- Aim to supply ***just enough*** reserves to satisfy demand…
- …but no more than needed to operate in a floor system
- Use ad hoc overnight repos to supply additional reserves when upward pressure on overnight rate exceeds tolerance *(in other words, more like a ceiling system)*

Estimate of steady state reserves revised higher

Original estimate of precautionary demand too low: revision informed by surveys and discussions with banks and Lynx participants

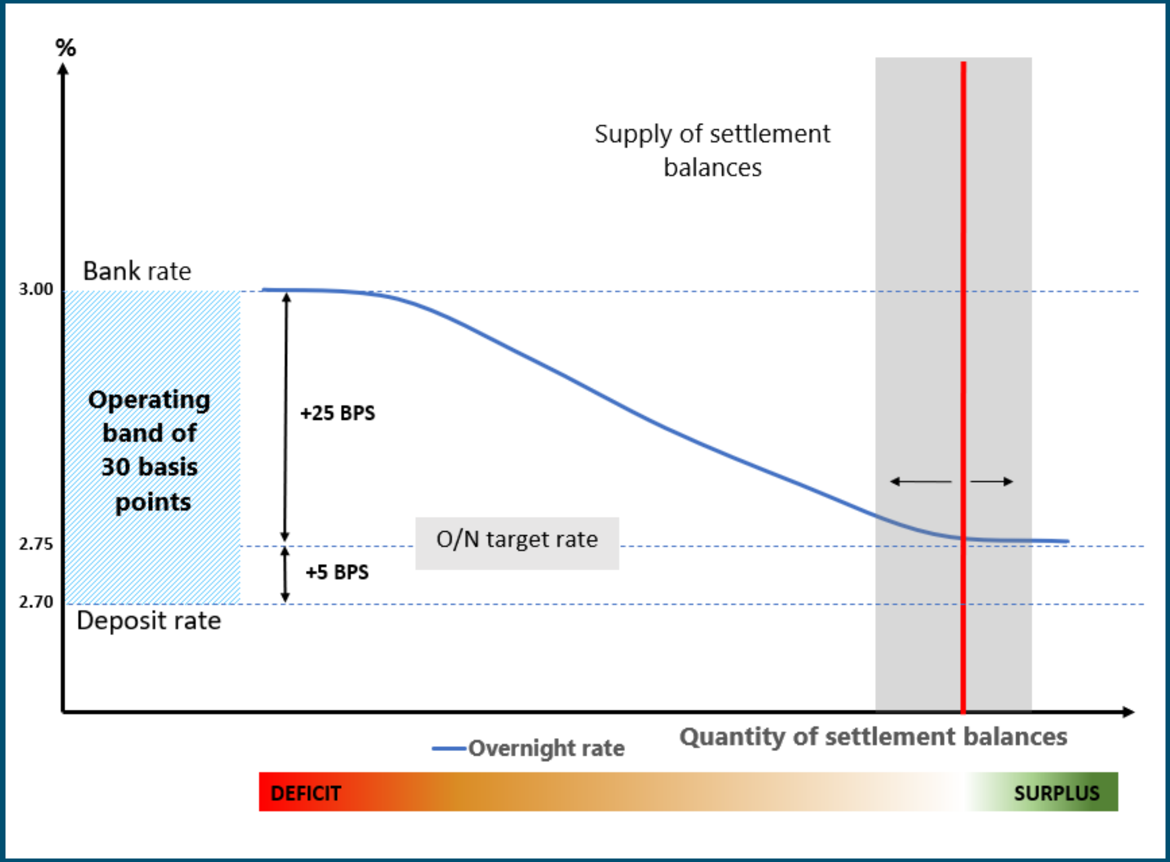
- Measuring payments-related or precautionary demand for settlement balances (reserves) is difficult
- Based on participant demand estimated in 2023, thought QT would end once reserves reached $20-60bln
- In late 2024, determined precautionary demand had grown beyond level previously estimated
- Communicated revised range of $50-70bln in DG speech on January 16
  - $20-30bln still estimated payment system need
  - remaining amount is what we now expect precautionary demand to be
  - Still low relative to peers (~3% GDP)

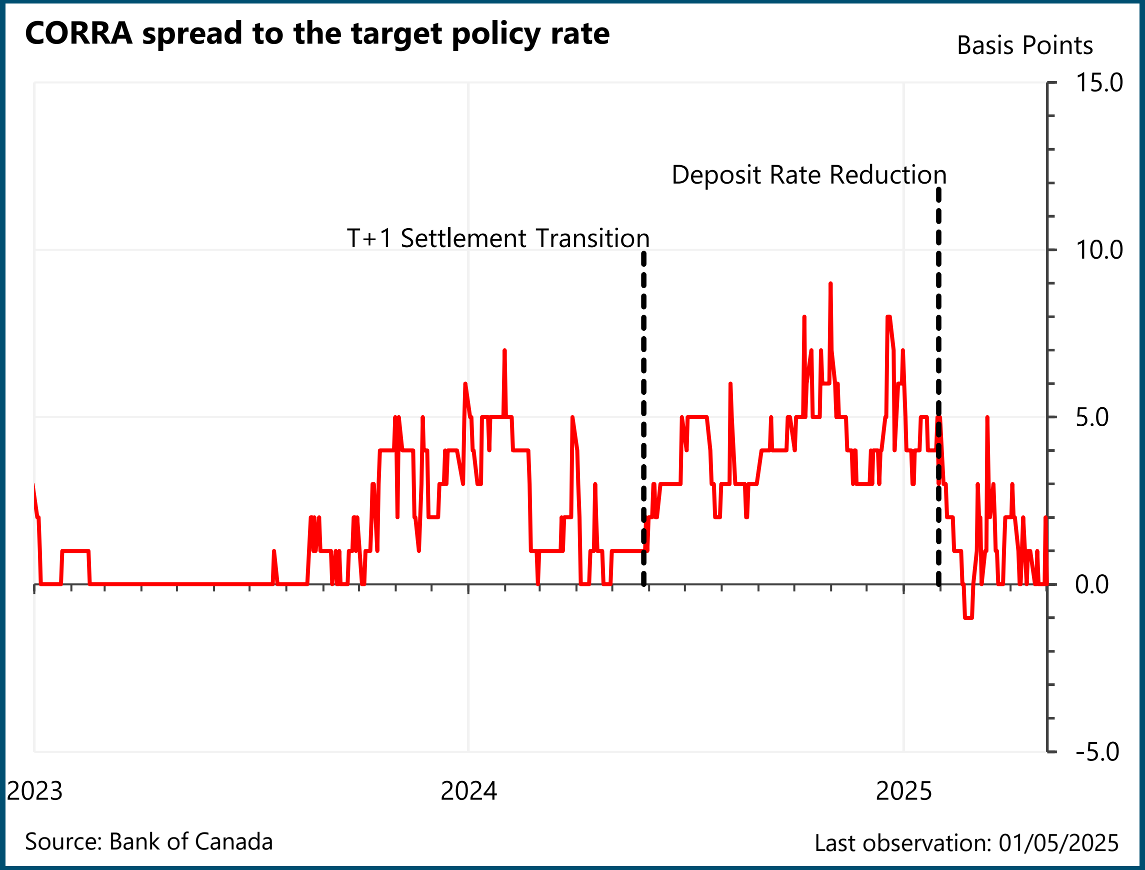
Economic incentives introduced: meet the "*flooridor*"!

Package of measures to reduce precautionary demand for settlement balances, encourage redistribution; de facto demand-driven framework

- Announced 5bps spread between reserves lending facility rate (target) and IOR rate (deposit rate); further adjustments could be considered
- Change in spread: economic incentive to improve circulation of SBs, increase incentive to trade
- Discussions centered on size of spread given uncertainty regarding impact, desire to stay within intent of a floor
- Other measures to lean against precautionary SB demand:
  - changes aimed at increasing Lynx / DSIBs access to liquidity (use of NMLP; streamlined process for STLF) – *implemented*
  - potential new 1-week repo against narrow collateral priced as spread to deposit rate with large limits – *under consideration*

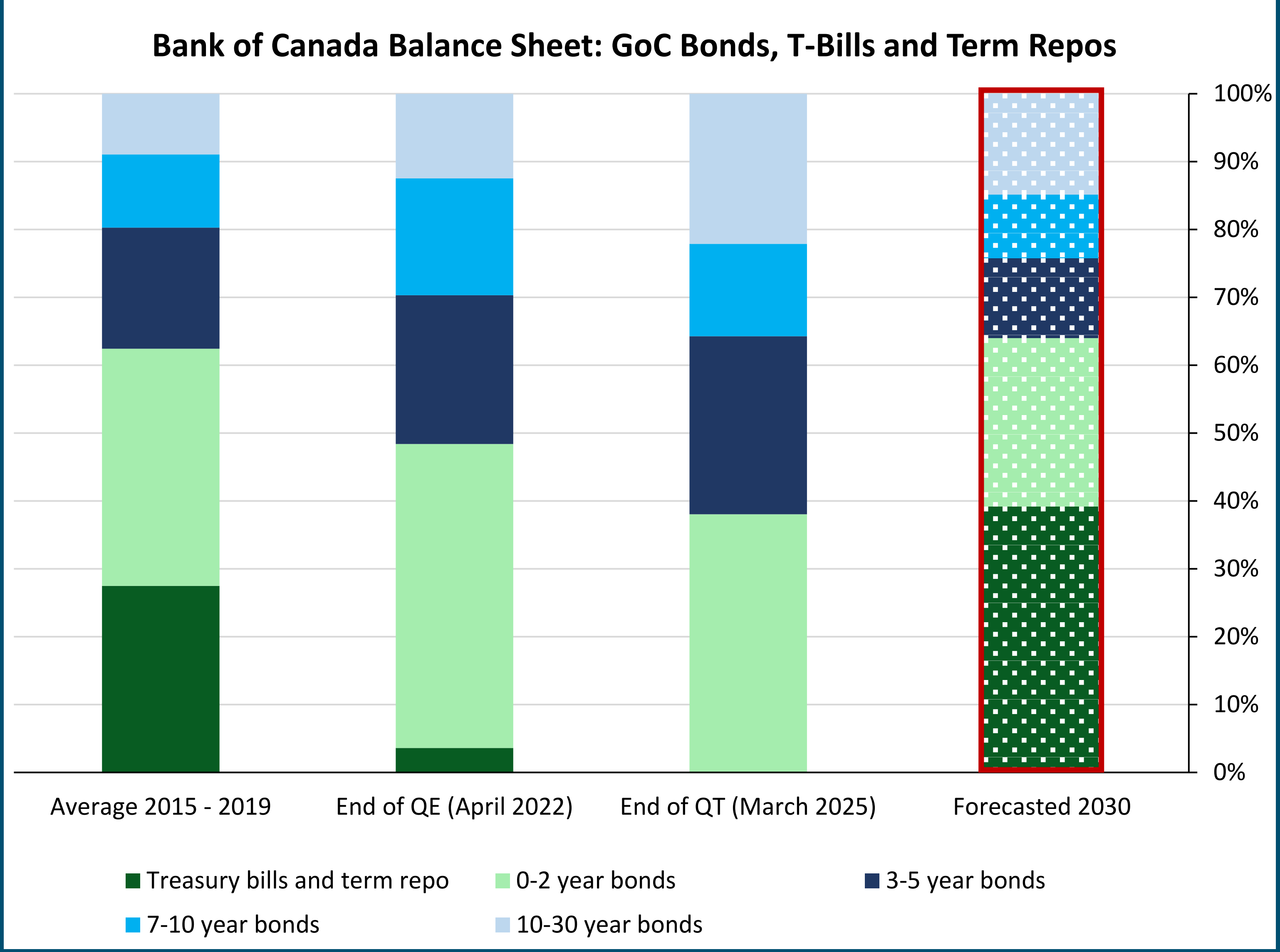
Reduction in deposit rate had an almost immediate impact on CORRA: worked even better than expected





Return to business-as-usual balance sheet management

While QT has ended, composition of BoC asset holdings will not fully normalize until around 2030



GoC bond purchases will be conducted in secondary market

Align with practices at other major central banks, but departure from pre-COVID BoC practice

- Benefits of secondary market purchases:
  - Flexibility to buy GoC bonds outstanding across all maturities, instead of limited to bonds auctioned
  - Ability to more quickly rebalance maturity structure of balance sheet
  - Not bound by government issuance patterns
  - Enhance GoC bond market functioning and liquidity
- Key principles once bond purchases resume:
  - Transparency
  - Predictably
  - Limit market impact
- Potential communication challenge: delineate from ‘QE’

Part 3
Early insights

Lessons learned for the path forward and for other jurisdictions

Importance of flexibility during transition process

Have had to stay open and flexible to update our assumptions, make adjustments to our framework

- Revised up estimate for steady state SBs given new evidence on precautionary demand
- Previously assumed floor system would be operationally easy and not require fine-tuning
  - Frequent use of ORs during transition, successive adjustments to size
  - 5bp adjustment to deposit rate, possibility of more if needed
  - Reintroduced morning auctions of excess government cash balances to manage SBs volatility
  - Increased complexity of managing the balance sheet
  - Greater requirement to forecast SBs and demand for them
- Enhanced how we collect information on demand for SBs
  - Improved relationships and increased dialog with cash managers and liquidity risk managers at banks
  - Conduct periodic surveys on SBs demand

Precautionary demand for settlement balances can be sticky

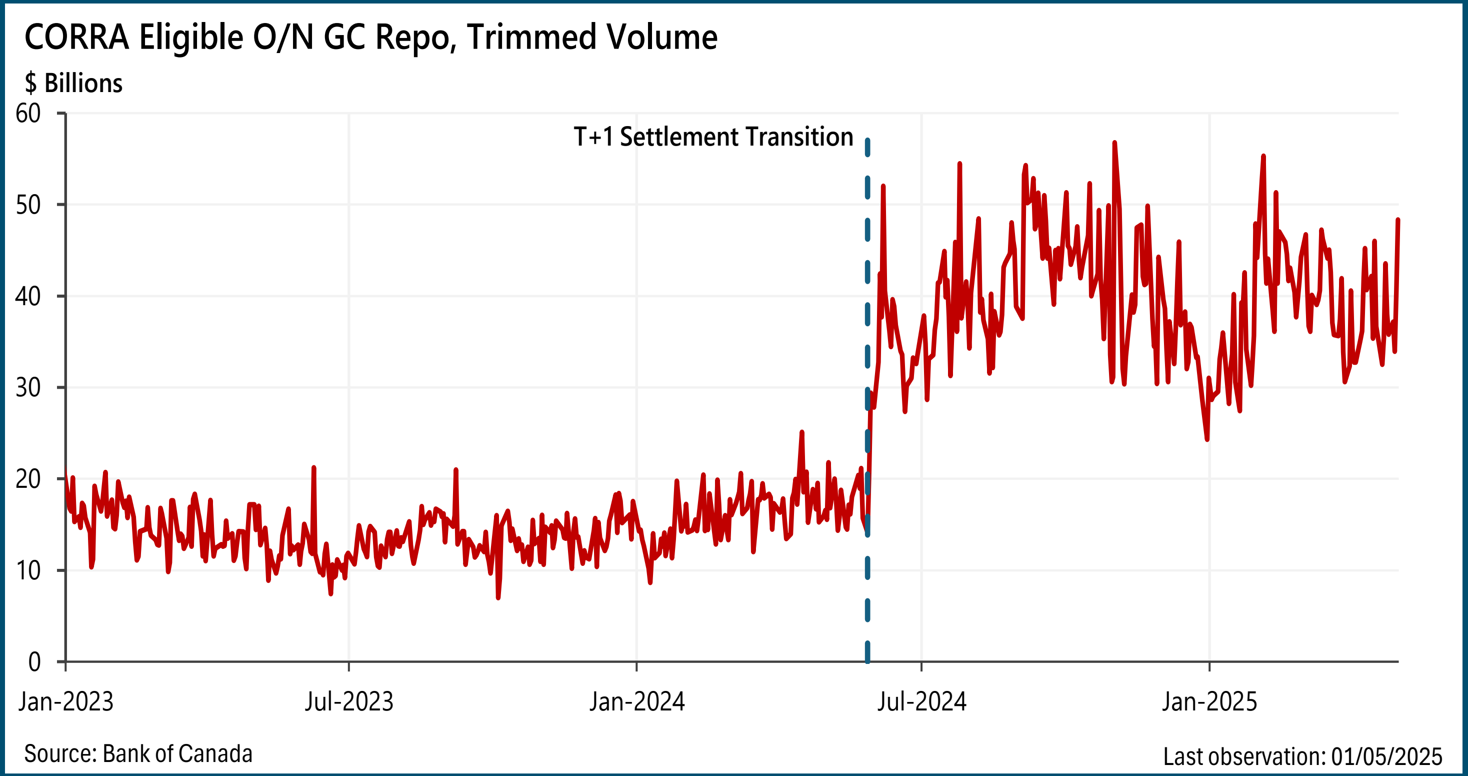
Fine-tuning of the deposit rate was required to better align overnight rate with target and encourage lending of SBs

- Banks more liquidity conscious post-SVB turmoil
- Desire to hold reserves for precautionary reasons reinforced by new supervisory requirements to manage intra-day liquidity risk
- How Lynx participants think about and manage liquidity varies across institutions, as does price sensitivity
- Consequently, distribution of reserves can become concentrated
- 5bp adjustment to deposit rate has proven effective
- Additional adjustments to deposit rate, operational framework may still be required to reach $50-70bln

Trading in overnight repo market has remained robust and increased in 2024

BoC conducts monetary policy by targeting a secured overnight repo rate (proxied by CORRA)

- Volumes increased mid-2024 due to technical factors related to Canadian transition to T+1 settlement
- Increased overnight funding needs due to T+1 transition led to upward pressure on CORRA
  - BoC conducted routine overnight repo operations to reinforce target
    See: *CORRA: Explaining the rise in volumes and resulting upward pressure*



Part 4
Potential challenges on the road ahead

Navigating uncertainty and adapting to changing conditions in the new normal

The path forward: some questions remain

Still early in process of ‘new normal’ for balance sheet management and MP implementation post QT

- Precautionary demand for SBs remains sticky – will additional measures be required to reach $50-70bln? Will the demand evolve over time?
- How will launch of real time retail payment system planned by end 2026 impact demand for SBs?
- Term repo program will be much larger than pre-COVID. Will sufficient demand exist as SBs fall? Will adjustments to operational parameters need to be considered?
- Bond purchases will be conducted via secondary markets when they resume. Will purchases meet our balance sheet needs while supporting liquidity?

Indicators we will track as we progress

Estimated SBs range and balance sheet management activities will evolve over time

- Persistent upward pressure on CORRA, take-up at ORs or need for multiple rounds per day
- Broad-based funding pressures that go beyond overnight repo market
- Payment system participants requiring overnight advances from Standing Liquidity Facility
- Feedback from payment system cash and liquidity managers on demand for SBs
- Utilization of term repo program, feedback from primary dealers
- Participation in secondary market bond purchases, impact on GoC market liquidity

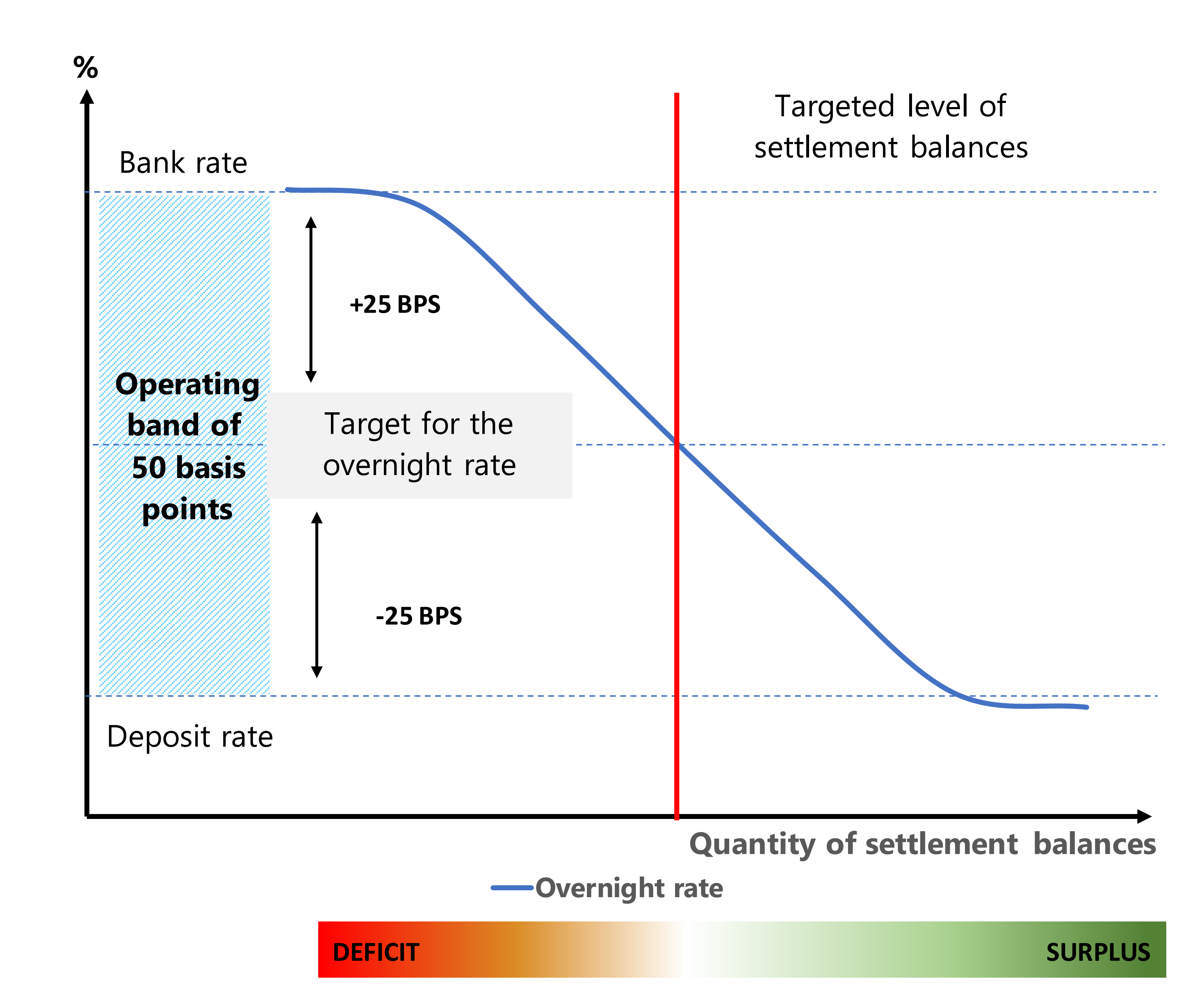
Thank you

Additional reference slides

Pre-COVID, Monetary policy implemented using corridor system

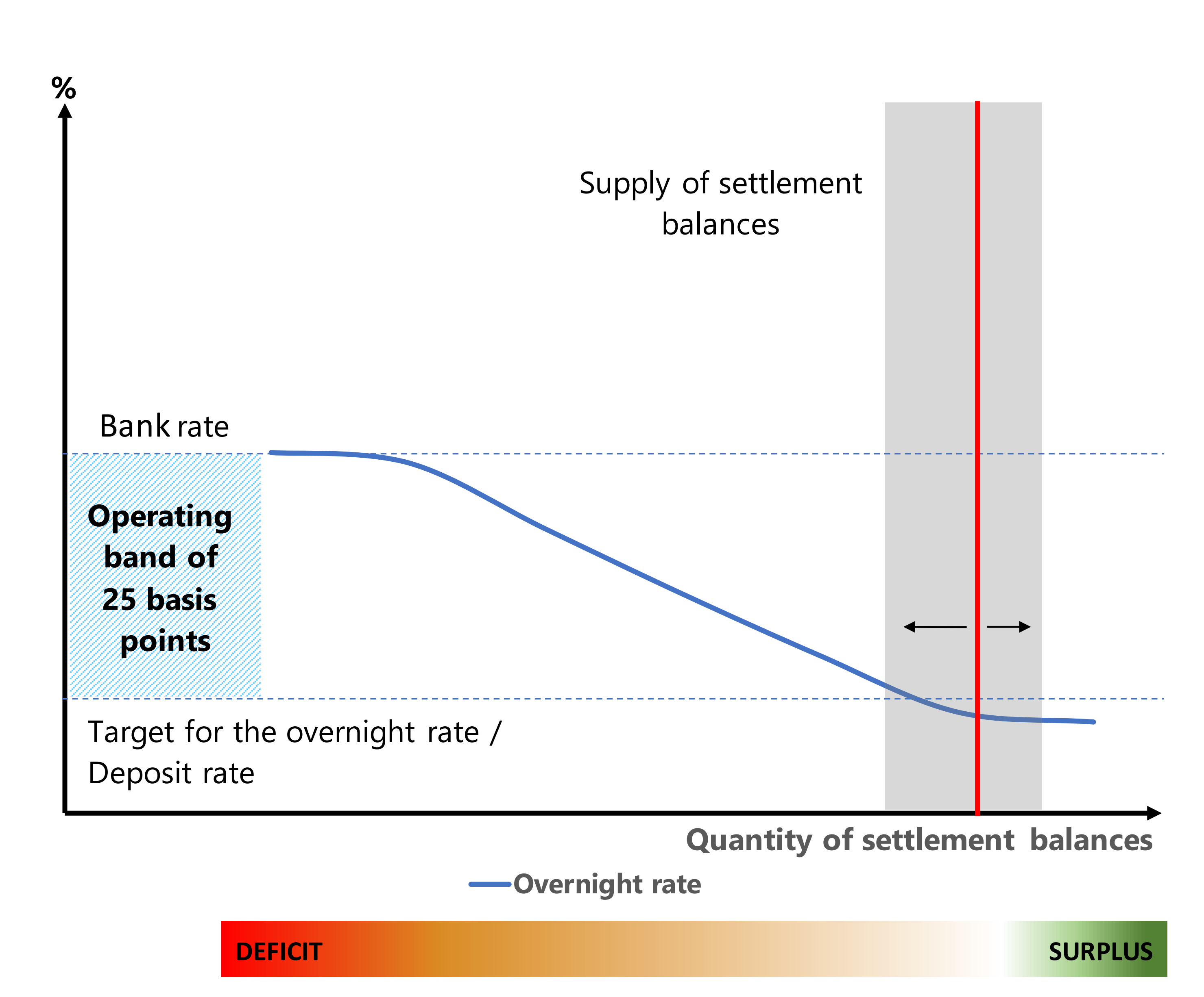
50bps corridor system with near-zero settlement balances

Overnight repos (ORs) and reverse repos (ORRs) with Primary Dealers used at BoC discretion to reinforce target rate



Monetary policy implementation shifted to floor system in April 2020

Once QE began, provided high amount of settlement balances, moved to 25bps operating band

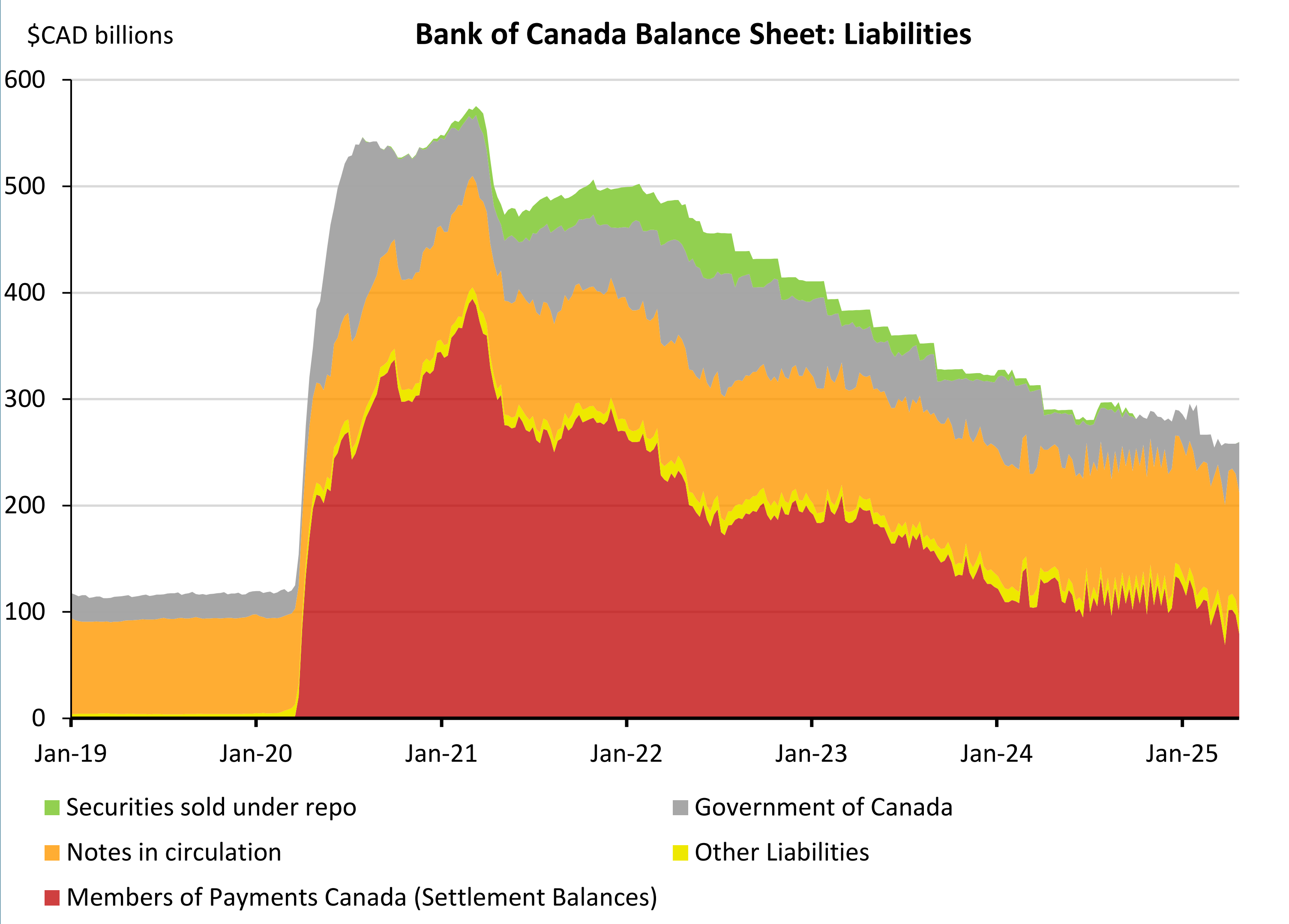


Balance sheet was relatively small and driven by growth in liabilities pre-COVID

Liability growth (mostly bank notes in circulation) was exogenously determined, balance sheet growth was slow, passive and predictable

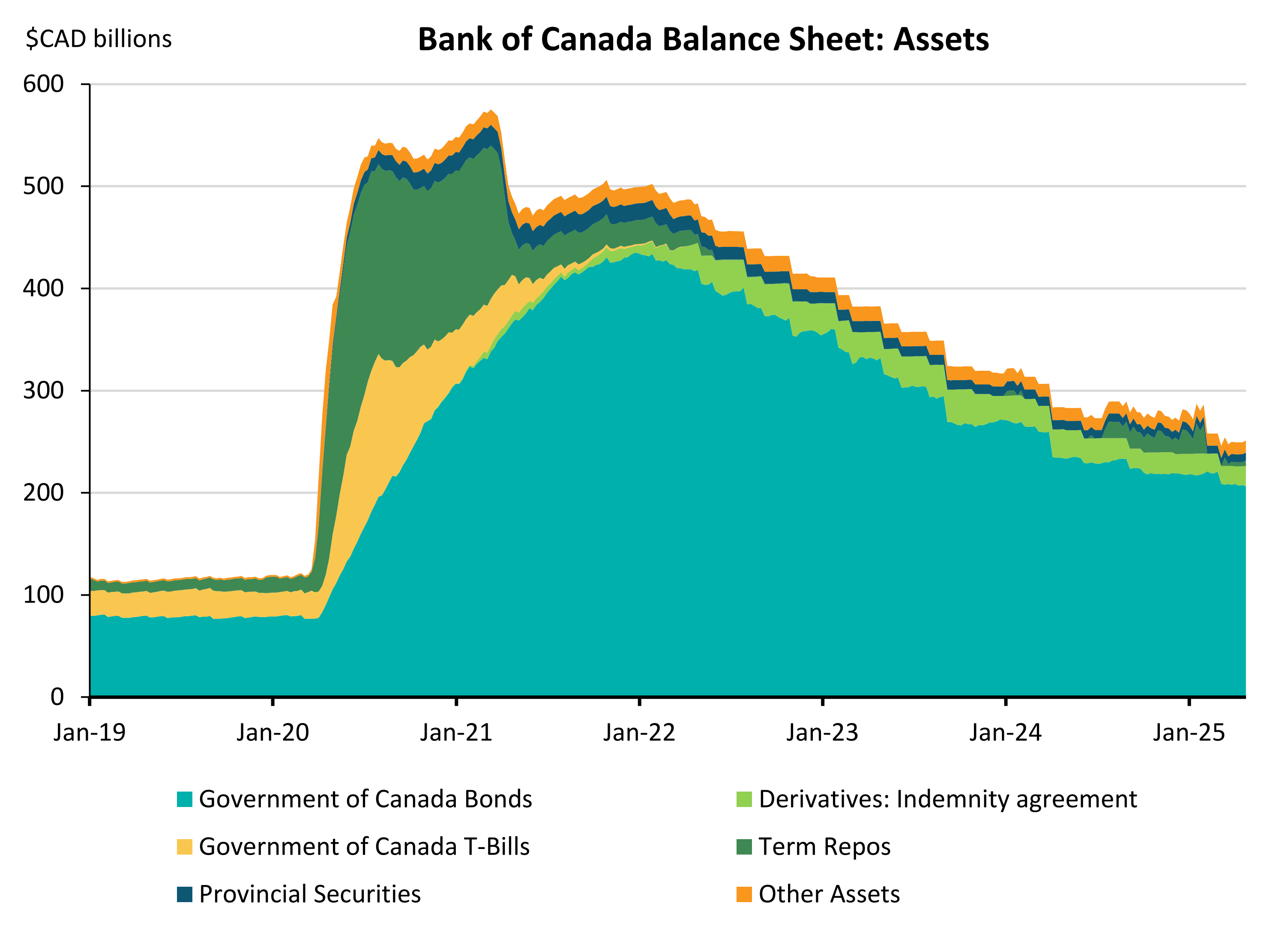
During COVID, the Bank's balance sheet expanded due to liquidity and asset purchase programs

Source: Bank of Canada calculations
Last observation: 23 April 2025



Asset size and composition very stable pre-2020, expanded sharply due to COVID response

Assets primarily consisted of GoC securities acquired at primary auctions, along with federal and provincial gov't securities acquired via term repos



Source: Bank of Canada
Last observation: 23 April, 2025

Comparing frameworks

Central bank	Policy rate target	Interest on reserves	Ceiling rate (reserves supply rate)	Reserves supplying facility type	Spread between ceiling and deposit rate
BoC	Secured overnight rate (CORRA)	5 bps below policy target	At policy rate (min. bid rate)	Ad hoc: OR auctions; any day; multiple if needed	5 bps
Fed	Unsecured rate (Fed Funds)	10 bps below top of range (~7 bps > FFs)	Top of range (min. bid rate)	Standing; daily; SRF auctions	10 bps
ECB	Unsecured rate (ESTER)	At target rate	15 bps above policy target	Standing; full allot. MRO; weekly; weekly term	15 bps
RBA	Unsecured rate (Cash rate)	10 bps below policy target	10 bps above policy target	Standing; full allot. OMO; weekly, weekly term	20 bps