Background information on the Bank of Canada’s Balance Sheet

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Overview of the balance sheet

Given the unique role as the nation’s central bank, the composition of the Bank of Canada’s (the Bank) balance sheet differs from other financial institutions. The Bank’s balance sheet is relatively simple and its holdings of financial assets are generally driven by its role as the exclusive issuer of Canadian bank notes, rather than for the generation of profit.

The issuance of bank notes creates a liability for the Bank – the largest on its balance sheet. The Bank also acts as the Government’s banker and fiscal agent. Government of Canada deposits, including those supporting the Government’s prudential liquidity plan, represent the Bank’s second-largest liability. To offset these liabilities, the Bank invests the proceeds, primarily into Government of Canada securities (**Table 1**).

Table 1: Bank of Canada statement of financial position at year-end 2018 (Can$ million)[1]

Assets		Liabilities and equity	
Government of Canada treasury bills	24,218	Bank notes in circulation	90,193
Canada Mortgage Bonds (CMBs)	251	Government of Canada deposits	21,726
Government of Canada bonds	79,625	Payments Canada member deposits	251
Advances	0	All other deposits	2,830
Repos	10,673	Other liabilities	530
All other assets	1,288	Equity	525
116,055		116,055	

In normal times, the size and growth of the Bank of Canada’s balance sheet is primarily driven by changes in demand for bank notes (see **Chart 1**)[2]. The Bank passively supplies financial institutions with the notes needed to satisfy the demand for currency by businesses and the public.

Chart 1: Bank Notes20102012201420162018200%1%2%3%4%5%6%7%8%9%010,00020,00030,00040,00050,00060,00070,00080,00090,000100,000$ million

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Bank notes in circulation (left scale)Year-over-year percentage change (right scale)

Almost all the assets held on the Bank's balance sheet consist of Government of Canada bonds and bills, acquired on a non-competitive basis at auctions. Given the steady and expected future growth of notes in circulation, absent of any changes, the Bank would have to buy a growing share of the outstanding stock of Government of Canada securities. This would reduce the amount that would be tradable in the market and would reduce liquidity in this key segment of fixed income markets.

Consequently, the Bank tries to diversify its holdings to include other asset types as well. The addition of these other assets reduces its footprint in the Government of Canada securities market and gives the Bank more flexibility in managing the growth in the assets, needed to compensate for the liability-driven growth of the balance sheet. Other types of assets include term repurchase transactions (repos)[3] of high-quality securities as well as the outright purchase of Canada Mortgage Bonds (CMBs).

Asset purchases are governed by the three key principles of prudence, neutrality and transparency as laid out in the ***Statement of Policy Governing the Acquisition and Management of Financial Assets***. Prudence is exercised primarily by selecting assets that have a low credit risk. The Bank achieves transparency by communicating its balance-sheet activities to the public. And to attain neutrality, the Bank acts in a manner that limits market distortions from its investment activities.

Interest revenue generated from the assets backing the bank notes in circulation (net of bank note production and distribution costs) is referred to as **seigniorage**. It provides a stable source of funding for the Bank's operations, ensuring the Bank's operational independence and supporting the execution of its responsibilities. In accordance with the ***Bank of Canada Act***, the Bank remits its surplus to the Receiver General for Canada and does not hold retained earnings. It can operate safely with a low capital base because its balance sheet is not exposed to significant risks.[4]

The Bank's core functions and its balance sheet

The assets and liabilities on the Bank's balance sheet are key to supporting the Bank's core functions around implementing monetary policy, the financial system, currency and funds management.

For example, the Bank implements its **monetary policy framework** (i.e., an interest rate corridor system) by setting the target for the **overnight interest rate** and using its balance sheet to reinforce that target.[5] On fixed announcement dates, the Bank announces the target for the overnight rate. This allows Large Value Transfer System (LVTS) participants to hold overnight deposits with the Bank at the target rate minus 25 basis points, or to take collateralized advances under its **Standing Liquidity Facility** (SLF) for a term of one business day at the target rate plus 25 basis points. These penalty rates provide strong incentives for market participants to trade overnight funds with each other at the target rate or the midpoint of the interest rate corridor rather than with the Bank.

The Bank supports the efficient functioning of Canadian markets through various means, such as supporting the liquidity of Government of Canada securities by being willing to lend, a portion of its holdings that are in high demand through its **securities-lending program** if deemed necessary. The Bank also has a **range of tools** to provide extraordinary liquidity to support financial system stability as required. The Bank can vary the size and composition of its assets to provide additional liquidity to help stabilize the Canadian financial system, as seen during the **2008–09 global financial crisis**.

Of note, the liability-driven process, as described above could change into an asset-driven one during a crisis, if the Bank chose for monetary policy or financial stability purposes to conduct **large-scale asset purchases, credit easing** and/or **provide extraordinary liquidity**. In this instance, the Bank would actively change the size and composition of assets on its balance sheet in a targeted fashion to meet its policy objectives. In turn, Government deposits and/or settlements balances on the liability side of the balance sheet would grow to passively offset assets. Additionally, growth in bank notes in circulation could accelerate in periods of stress or low interest rates.

Detailed breakdown of liabilities

Chart 2: Bank of Canada liabilities (month end)2008201020122014201620182020020,00040,00060,00080,000100,000120,000140,000$ million

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Bank notes in circulationGovernment of Canada depositPayments Canada members depositsOther depositsAll other liabilitiesEquity

Bank notes

Bank notes in circulation represent the majority of the Bank's total liabilities (**Chart 2**)[6]. Typically, the growth rate in bank notes broadly follows the growth rate in the economy (in terms of nominal gross domestic product), or roughly 5 per cent yearly on average. More recently, growth in bank notes in circulation has exceeded the economy's growth rate, averaging closer to 6 per cent (**Chart 1**), which creates a need for the Bank to purchase more assets. Seasonal fluctuations in the demand for bank notes also must be offset with additional assets. Given the temporary nature of seasonal increases in bank notes, the Bank typically does this by conducting term repos, which are short-term and flexible.

Government deposits

The Bank is the Government's banker. Government deposits are the second biggest component of the Bank's balance sheet liabilities. A relatively small portion of the deposits meets the operational and day-to-day funding needs of the Government. The majority is maintained for prudential liquidity purposes and is set aside so the Government can meet domestic payment obligations if access to normal funding markets is disrupted.[7]

Payments Canada deposits

Payments Canada members who are direct participants of the LVTS maintain deposits at the Bank known as settlement accounts. The level of deposits is affected by the controlled supply of settlement balances, which the Bank sets as part of the operating framework of its monetary policy. The Bank may vary this amount to reinforce the target for the overnight rate. As of December 2018, Payments Canada deposits in the form of settlement balances were targeted at $250 million.

Other deposits

The Bank also holds cash accounts for other entities. These include foreign central banks and international financial institutions, designated clearing and settlement systems, and other domestic federal government agencies. While the amount of these deposits is small relative to other liabilities, it has grown in recent years due in part to regulators' desire to reduce financial system risk.[8] By leaving their deposits with the Bank rather than with commercial banks, these entities can avoid exposing systemically important infrastructures to banker risk.

Detailed breakdown of assets

Chart 3: Bank of Canada assets (month end)2008201020122014201620182020020,00040,00060,00080,000100,000120,000140,000$ million

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Treasury billsGovernment of Canada bondsCanada Mortgage BondsAdvances to members of Payments CanadaReposAll other assets

Government of Canada bonds and treasury bills

These assets comprise the largest holdings on the Bank's balance sheet (**Chart 3**)[9], which are acquired through non-competitive bids at auctions. The Bank currently buys 13 per cent of the Government of Canada nominal bonds offered when these are auctioned. This percentage has gradually declined from 20 per cent in 2015[10], when, as part of changes to the **Bank's operating framework**, the Bank reduced its footprint at Government auctions to improve market functioning and the liquidity of the Government of Canada benchmark bonds. In contrast to bond purchases, treasury bill purchases vary depending in large part on the Bank's remaining asset requirements. To maintain neutrality, the ratio of bonds-to-bills on the Bank's balance sheet generally mirrors the nominal bond-to-bill ratio of debt issued by the Government overall.

Canada Mortgage Bonds (CMBs)

CMBs provide additional flexibility in the range of high-quality assets the Bank can acquire to offset the continued growth in bank notes in circulation.[11] The Bank purchased its first CMB in December 2018 for $250 million. Purchases are conducted in the primary market, on a non-competitive basis. The Bank chooses the amounts of individual bond purchases in a way that limits market distortions and minimizes impact on market prices and are held to maturity on the balance sheet.

Advances

The Bank occasionally provides advances under its **Standing Liquidity Facility** as collateralized loans to LVTS participants to cover a negative end-of-day cash position. The lending occurs at the top of the Bank's operating band or "**Bank Rate**."

Repos

The two types of repos appearing on the balance sheet serve different purposes in normal times. Overnight repos are predominately used to reinforce the Bank's target for the overnight rate. In addition, the Bank's regular bi-weekly term repos operations allow the Bank to acquire assets on a temporary basis for its balance sheet. This provides flexibility, in combination with T-bills, to offset seasonal and short-term fluctuations in liabilities. As well, these repo operations provide information on conditions in short-term funding markets. The target amount for term repos has been set at 10 per cent of financial assets, plus or minus 5 per cent. Finally, repos may be used to inject extraordinary amounts of liquidity into the financial system and support funding conditions for financial institutions, as seen during the global financial crisis.

Other assets

Other assets on the balance sheet include property and equipment, intangible assets and other non-investment items.

Endnotes

1. Bank of Canada assets and liabilities as reported in the month-end statement of financial position. [←]
2. Banking and Financial Statistics, Bank of Canada assets and liabilities month-end, notes in circulation. [←]
3. A repo is a transaction in which a party sells a security and simultaneously agrees to repurchase it at a given price after a specified time. Repos are classified under *Loans and receivables* on the Bank's statement of financial position, under the line item *Securities purchased under resale agreements*. The Bank may also conduct overnight reverse repos in which it receives cash and sells securities temporarily, which appear as *Securities sold under repurchase agreements* on the Bank's statement of financial position. This item would appear as a liability and is infrequently used, but could be implemented to support the target rate. [←]
4. See Note 7 to the financial statements for further information on the Bank's financial risk management framework. Of note, unlike some other countries, Canada's foreign reserves are not held by the central bank. Rather, the Government of Canada's Exchange Fund Account is the main repository of Canada's official international reserves and is reflected in the Public Accounts. [←]
5. See here for a summary of market operations indicators for monetary policy implementation and LVTS settlement balances. [←]
6. Banking and Financial Statistics, Bank of Canada assets and liabilities month-end [←]
7. The Government announced the Prudential Liquidity Plan in the Debt Management Strategy for 2011–12 and implemented it by the second half of 2013. [←]
8. The Bank of Canada's Risk-Management Standards for Designated FMIs [←]
9. Banking and Financial Statistics, Bank of Canada assets and liabilities month-end [←]
10. The Bank made the following changes to its minimum purchase amount of nominal bonds at auctions: October 1, 2015, reduced to 15 per cent from 20 per cent; February 3, 2017, further reduced to 14 per cent; and December 21, 2017, further reduced to 13 per cent. [←]
11. In November 2018, the Bank announced that it would begin purchasing government-guaranteed securities. [←]