MONTRÉAL EXCHANGE

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CORRA in 2024: A Year for Forests (Not Trees)

"They can't see the forest for the trees" – Unknown

Fixed income managers often come in two broad types; those who focus on the macroeconomic perspective, or big picture, and those who focus on the minutia of relative value trading. Fortunately, different economic situations usually afford both types of manager ample opportunities although there are clearly "good times" for macro traders and "good times" to be a relative value trader. We suggest that 2024, due to the probable turn in monetary policy and the volatility associated with the end, or anticipated end, of a monetary policy cycle, will be a year where getting the big picture right is far more important than getting the details right.

A Bank of Canada Target Rate Example

We were reminded of the macro/relative value bifurcation of managers recently when looking at the issue of bid/ask in the newly dominant CRA (3-month CORRA Futures) contracts[1] that managers are using to implement trades on Bank of Canada policy at the front end of the yield curve. Given that one can construct a spot curve, use that curve to calculate the implied forward rate between two Bank of Canada (BoC) fixed announcement dates, and then calculate the probability of a change in the target rate from the forward rate, how important is the bid/ask in this type of transaction?

To make our assessment, we used midday CRA contract bid and offer levels on January 30th. From the ask side of the quote, we can calculate an implied probability for BoC policy, but we can also calculate an implied probability using the bid side of the quote. As usual with this type of trade, if we believe that the probability that the Bank cuts rates on some date in the future exceeds the probability implied by the forward rate, in this case the forward rate derived from the ask side of the CRA quote, there is an opportunity to profit if/when the event transpires or a view matching our own becomes priced into the market. The opposite is also true, but we would need to use the bid side of the market since we would be selling CRA contracts to capitalize on the market coming around to our view of pricing a lower probability of a rate cut.

We show the appropriate results of implied policy for both the bid and ask side of the market on January 30th in Figure 1 (bid side, important to the seller of futures) and Figure 2 (ask side, for the buyer of futures). These figures show only the currently known fixed dates for Bank of Canada announcements, but the schedule is largely predictable so one could construct a reliable schedule for 2025 and 2026 if desired[2].

1 CRA contract open interest is now 75% more than BAX (Three-Month Canadian Bankers' Acceptance Futures) open interest.

2 We have done so, assuming the Bank meets on the exact same weeks of the year as 2023, and the results are shown in the final section of this article.

FIGURE 1

BOC FAD	CRA BID CURVE	FORWARD RATE BID	IMPLIED ΔPOLICY	DESCRIPTION
06-Mar-24	5.052%	**5.030%**	Unch'd	12% probability of a hike in overnight rate from 5.00% to 5.25%
10-Apr-24	5.041%	**4.930%**	Unch'd	28% probability of a cut in overnight rate from 5.00% to 4.75%
05-Jun-24	4.992%	**4.775%**	Cut	90% probability of a cut in overnight rate from 5.00% to 4.75%
24-Jul-24	4.932%	**4.626%**	Unch'd	50% probability of a cut in overnight rate from 4.75% to 4.50%
04-Sep-24	4.873%	**4.466%**	Cut	114% probability of a cut in overnight rate from 4.75% to 4.50%
23-Oct-24	4.798%	**4.290%**	Cut	84% probability of a cut in overnight rate from 4.50% to 4.25%
11-Dec-24	4.719%	**4.129%**	Unch'd	48% probability of a cut in overnight rate from 4.25% to 4.00%

Source: Montréal Exchange

FIGURE 2

BOC FAD	CRA ASK CURVE	FORWARD RATE ASK	IMPLIED ΔPOLICY	DESCRIPTION
06-Mar-24	5.052%	**5.028%**	Unch'd	11% probability of a hike in overnight rate from 5.00% to 5.25%
10-Apr-24	5.041%	**4.924%**	Unch'd	30% probability of a cut in overnight rate from 5.00% to 4.75%
05-Jun-24	4.989%	**4.768%**	Cut	93% probability of a cut in overnight rate from 5.00% to 4.75%
24-Jul-24	4.928%	**4.622%**	Cut	51% probability of a cut in overnight rate from 4.75% to 4.50%
04-Sep-24	4.869%	**4.461%**	Unch'd	15% probability of a cut in overnight rate from 4.50% to 4.25%
23-Oct-24	4.794%	**4.284%**	Cut	86% probability of a cut in overnight rate from 4.50% to 4.25%
11-Dec-24	4.715%	**4.124%**	Cut	50% probability of a cut in overnight rate from 4.25% to 4.00%

Source: Montréal Exchange

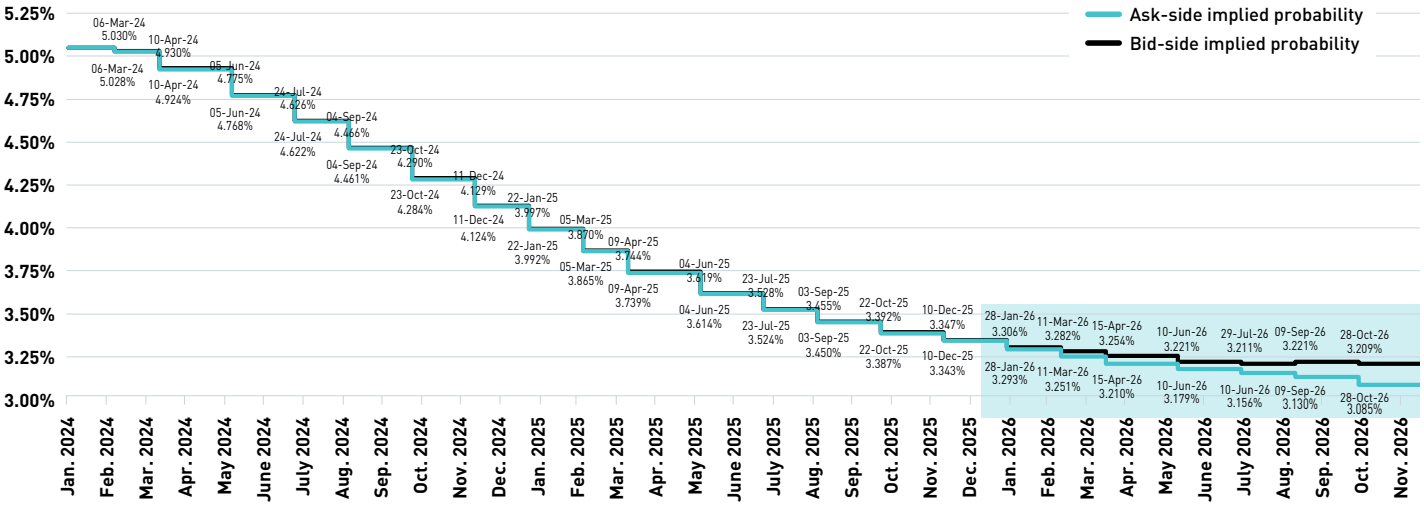
In the figures, the bid and ask side of the market mostly make the same directional prediction for the BoC target rate on each fixed announcement date. However, since the bid price and ask prices differ, the probabilities implied by the two sides of the market will be different. For example, the first date that the market currently implied a rate cut (monetary easing) is more likely to occur than not was June 5th. In Figure 2, we can see that a manager that wanted to express their view that the Bank has more than a 93% probability of easing by 25 basis points on or before this date has an opportunity to profit if they are right.

Similarly, a manager that thought the probability of a rate cut on the same date was less than 90%, from Figure 1, also has an opportunity to profit when the event fails to transpire or when market prices come to reflect this view. Only if a manager believed the probability of the bank cutting rates on June 5th was between 90% and 93% is there no trade here due to the bid/ask spread[3].

Another way to see this same conclusion is to observe the implied rates for the Bank of Canada fixed announcement dates generated from the bid and ask sides of the market plotted on the same chart. In Figure 3, the two series in the step chart for the announcement dates are so close together that they are nearly indistinguishable from each other until after December 2025, which is highlighted in the figure. After December 2025, bid/ask becomes considerably larger and the probability implied by the bid side of the CRA quote differs from the ask side by a greater magnitude.

FIGURE 3

CRA Implied Forward Rates, Bank of Canada Fixed Announcement Dates



Source: Montréal Exchange

3 Assuming the manager has a strong view on the subject, of course.

While we believe strongly that the details matter, in the case of front-end trades, especially in 2024, getting the macro view right is likely to matter much more than the incremental bid/ask that is observed in the first eight CRA contracts[4]. For example, the CRAM24 (3-month CORRA starting in June 2024 and ending in September 2024) contract, to which the rate cut probability for the June 5th BoC meeting is extremely sensitive, has had a very large 32 cent range in the first four trading weeks of 2024. That price range represents more than the difference between a 93% probability of a rate cut and a small probability of a rate hike.

With respect to the current bid/ask, a patient trader may have been able to execute at slightly better levels than shown in the calculations above if they executed all the contracts simultaneously since we used just the observable liquidity on a random Monday to perform our calculations.

Focus on the forest (rate cut or hike, and when) and ignore the trees for these types of trades in 2024.

Tables for Fixed Announcement Dates 2024 to 2026[5]

FIGURE 4

BOC FAD	CRA BID CURVE	FORWARD RATE BID	IMPLIED ΔPOLICY	DESCRIPTION
06-Mar-24	5.052%	**5.030%**	Unch'd	12% probability of a hike in overnight rate from 5.00% to 5.25%
10-Apr-24	5.041%	**4.930%**	Unch'd	28% probability of a cut in overnight rate from 5.00% to 4.75%
05-Jun-24	4.992%	**4.775%**	Cut	90% probability of a cut in overnight rate from 5.00% to 4.75%
24-Jul-24	4.932%	**4.626%**	Unch'd	50% probability of a cut in overnight rate from 4.75% to 4.50%
04-Sep-24	4.873%	**4.466%**	Cut	114% probability of a cut in overnight rate from 4.75% to 4.50%
23-Oct-24	4.798%	**4.290%**	Cut	84% probability of a cut in overnight rate from 4.50% to 4.25%
11-Dec-24	4.719%	**4.129%**	Unch'd	48% probability of a cut in overnight rate from 4.25% to 4.00%
22-Jan-25	4.650%	**3.997%**	Cut	101% probability of a cut in overnight rate from 4.25% to 4.00%
05-Mar-25	4.580%	**3.870%**	Cut	52% probability of a cut in overnight rate from 4.00% to 3.75%
09-Apr-25	4.523%	**3.744%**	Unch'd	2% probability of a cut in overnight rate from 3.75% to 3.50%
04-Jun-25	4.434%	**3.619%**	Cut	52% probability of a cut in overnight rate from 3.75% to 3.50%
23-Jul-25	4.359%	**3.528%**	Unch'd	11% probability of a hike in overnight rate from 3.50% to 3.75%
03-Sep-25	4.299%	**3.455%**	Unch'd	18% probability of a cut in overnight rate from 3.50% to 3.25%
22-Oct-25	4.233%	**3.392%**	Unch'd	43% probability of a cut in overnight rate from 3.50% to 3.25%
10-Dec-25	4.173%	**3.347%**	Cut	61% probability of a cut in overnight rate from 3.50% to 3.25%
28-Jan-26	4.117%	**3.306%**	Unch'd	22% probability of a hike in overnight rate from 3.25% to 3.50%
11-Mar-26	4.072%	**3.282%**	Unch'd	13% probability of a hike in overnight rate from 3.25% to 3.50%
15-Apr-26	4.038%	**3.254%**	Unch'd	1% probability of a hike in overnight rate from 3.25% to 3.50%
10-Jun-26	3.987%	**3.221%**	Unch'd	12% probability of a cut in overnight rate from 3.25% to 3.00%
29-Jul-26	3.945%	**3.211%**	Unch'd	16% probability of a cut in overnight rate from 3.25% to 3.00%
09-Sep-26	3.913%	**3.221%**	Unch'd	11% probability of a cut in overnight rate from 3.25% to 3.00%
28-Oct-26	3.879%	**3.209%**	Unch'd	17% probability of a cut in overnight rate from 3.25% to 3.00%

Source: Montréal Exchange

4 As noted above, there are 12 contracts listed but, for the time being, due to the lack of open interest and liquidity providers in the 11th and 12th contracts especially, bid/ask is much larger. This makes trading the probability of monetary policy changes in 2026 more difficult, although we suspect most managers aren't focused on 2026 right now.

5 Dates for 2025 and 2026 are estimated and not yet determined or published by the Bank of Canada.

FIGURE 5

BOC FAD	CRA ASK CURVE	FORWARD RATE ASK	IMPLIED ΔPOLICY	DESCRIPTION
06-Mar-24	5.052%	**5.028%**	Unch'd	11% probability of a hike in overnight rate from 5.00% to 5.25%
10-Apr-24	5.041%	**4.924%**	Unch'd	30% probability of a cut in overnight rate from 5.00% to 4.75%
05-Jun-24	4.989%	**4.768%**	Cut	93% probability of a cut in overnight rate from 5.00% to 4.75%
24-Jul-24	4.928%	**4.622%**	Cut	51% probability of a cut in overnight rate from 4.75% to 4.50%
04-Sep-24	4.869%	**4.461%**	Unch'd	15% probability of a cut in overnight rate from 4.50% to 4.25%
23-Oct-24	4.794%	**4.284%**	Cut	86% probability of a cut in overnight rate from 4.50% to 4.25%
11-Dec-24	4.715%	**4.124%**	Cut	50% probability of a cut in overnight rate from 4.25% to 4.00%
22-Jan-25	4.645%	**3.992%**	Unch'd	3% probability of a cut in overnight rate from 4.00% to 3.75%
05-Mar-25	4.576%	**3.865%**	Cut	54% probability of a cut in overnight rate from 4.00% to 3.75%
09-Apr-25	4.518%	**3.739%**	Unch'd	4% probability of a cut in overnight rate from 3.75% to 3.50%
04-Jun-25	4.429%	**3.614%**	Cut	54% probability of a cut in overnight rate from 3.75% to 3.50%
23-Jul-25	4.355%	**3.524%**	Unch'd	9% probability of a hike in overnight rate from 3.50% to 3.75%
03-Sep-25	4.295%	**3.450%**	Unch'd	20% probability of a cut in overnight rate from 3.50% to 3.25%
22-Oct-25	4.229%	**3.387%**	Unch'd	45% probability of a cut in overnight rate from 3.50% to 3.25%
10-Dec-25	4.168%	**3.343%**	Cut	63% probability of a cut in overnight rate from 3.50% to 3.25%
28-Jan-26	4.112%	**3.293%**	Unch'd	17% probability of a hike in overnight rate from 3.25% to 3.50%
11-Mar-26	4.067%	**3.251%**	Unch'd	1% probability of a hike in overnight rate from 3.25% to 3.50%
15-Apr-26	4.032%	**3.210%**	Unch'd	16% probability of a cut in overnight rate from 3.25% to 3.00%
10-Jun-26	3.978%	**3.179%**	Unch'd	28% probability of a cut in overnight rate from 3.25% to 3.00%
29-Jul-26	3.935%	**3.156%**	Unch'd	37% probability of a cut in overnight rate from 3.25% to 3.00%
09-Sep-26	3.900%	**3.130%**	Unch'd	48% probability of a cut in overnight rate from 3.25% to 3.00%
28-Oct-26	3.863%	**3.085%**	Cut	66% probability of a cut in overnight rate from 3.25% to 3.00%

Source: Montréal Exchange

Kevin Dribnenki writes about fixed income derivatives and opportunities in Canadian markets. He spent over 10 years managing fixed income relative value portfolios as a Portfolio Manager first at Ontario Teachers' Pension Plan and then BlueCrest Capital Management. During that time he managed domestic cash bond portfolios as well as international leveraged alpha portfolios and has presented at several fixed income and derivatives conferences. He received a BA in Economics from the University of Victoria, an MBA from the Richard Ivey School of Business, and holds the Chartered Financial Analyst designation.

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