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Muni Market Grows in Final Quarter of 2014.

WASHINGTON — The total amount of outstanding municipal securities and loans in the market rose 0.6% to \$3.65 trillion in the fourth quarter of last year, as U.S. bank muni holdings increased 2.5% and mutual fund muni holdings rose to a record high of \$658 billion.

The Federal Reserve Board released the data this week in its quarterly Flow of Funds report. The total size of the muni market was up from \$3.63 trillion in the third quarter of 2014, but the muni market still experienced an overall year-over year decline from \$3.67 trillion at the end of 2013. The size of the muni market has generally been declining for the past several years.

Michael Decker, a managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association, said that the quarterly uptick in the market size could mean that the slide is ending, though it might be too early to draw any conclusions.

"The total outstanding is creeping back up," Decker said. "Maybe the trend of the market is starting to reverse."

Bank holdings have risen sharply in recent years, totaling \$452 billion at the end of 2014 compared to \$419 billion the previous year and only \$255 billion in 2010. Decker said banks would probably continue to increase their holdings of state and local obligations.

"Banks have clearly discovered that this product fits in their portfolios," he said.

Matt Fabian, a partner at Municipal Market Analytics, said the rising bank holdings could actually signal that economic conditions aren't good enough for banks to trust riskier and more lucrative investments.

"That's a bit of an indictment that economic growth is not as strong as people would like," Fabian said.

Fabian said the strong growth in mutual fund muni holdings, and a corresponding drop of \$15 billion in household muni holdings from the third quarter of last year, is probably due in part to brokers and their firms directing retail customers into more managed products and away from direct investments. Mutual fund muni holdings were as low as \$500 billion as recently as the first quarter of 2010. Regulatory requirements that apply to broker-dealers for retail investors in the fixed-income market are creating an incentive for the firms to move to mutual funds, Fabian said.

"From a compliance perspective, it's just easier," he said, but added that the household holdings category is a catch-all that can fluctuate depending on how the Fed decides to evaluate the data.

Money market mutual fund muni holdings ticked up 1.1% to \$281.7 billion in the fourth quarter, the only quarterly increase of the year. The category has dropped sharply since it was \$386.7 billion at the end of 2010 and \$509.5 billion at the end of 2008.

Decker pointed to the relatively low holdings of broker-dealers as a significant sign of market

conditions. Dealers held \$18.9 billion of munis at the end of 2014, a \$2.7 billion increase over the previous quarter but a steep decline from the \$40 billion dealers accounted for in 2010.

“Clearly broker-dealers are holding less inventory,” Decker said. “That suggests overall that the market is less liquid than it was five years ago.”

State and local government holdings of munis have remained stable, rising slightly quarter-over-quarter to \$13.6 billion at the end of last year.

State and local governments accounted for \$2.9 trillion of muni debt, with nonprofit organizations and industrial revenue bonds making up the balance. \$2.87 trillion of those munis are long-term obligations, the Fed data shows.

The Fed funds data is next scheduled for release on June 11.

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BY KYLE GLAZIER

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