Illilinois Bond Trading Hits Five-Month High.

- **Volume shows market remains liquid despite downgrade risk**
- **‘Bonds are already trading as if below investment grade’**

Illinois bond trading volume has increased amid a two-year long budget impasse that’s left the government at imminent risk of becoming the first U.S. state to have its bond rating cut to junk.

The average daily trade volume of Illinois debt has jumped to $616 million this month from $346 million in May, with $1.14 billion changing hands on Wednesday, the most since January 20, according to data compiled by Bloomberg. Daily trading three times this month has exceeded $1 billion, a level previously not breached since January.

The figures show that the bonds remain liquid despite widespread anticipation they’ll lose their investment-grade rating, which would prevent some mutual funds from purchasing them and could scare off the individual investors who are the biggest buyers of municipal bonds.

The yields on Illinois securities have risen since S&P Global Ratings and Moody’s Investors Service downgraded the state to one step above junk on June 1, with S&P warning that another cut could come around July 1 if a budget isn’t enacted. The state’s 10-year debt yields about 4.6 percent, or 2.8 percentage points more than top-rated bonds, according to Bloomberg’s indexes. That spread jumped to as much as 3.4 percentage points earlier this month.

“If you look at your benchmark maturities in block size, bonds are already trading as if below investment grade,” said Jeffrey Lipton, head of municipal research at Oppenheimer & Co. “The downgrade had already been baked in.”

Municipal analysts have said they don’t anticipate a massive sell-off of Illinois debt if the rating is cut because the move has been telegraphed well in advance, giving investors who want to reduce their holdings ample time to do so. Some of the biggest mutual funds that hold the state’s bonds have said the loss of an investment-grade rank won’t force them to dump the securities.

Lipton said he’ll be keeping an eye out for “any pick up in hedge fund interest when coming into a downgrade,” with the funds seeking to profit by snapping up steeply discounted bonds.

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