Fed Backstop for U.S. Muni Market May Ease Some Rate Pressures.

CHICAGO — The battered U.S. municipal bond market could get a limited boost from the Federal Reserve's announcement it was expanding its money market support program to include short-term muni debt as collateral, analysts said on Friday.

Yields in the $3.8 trillion market where states, cities, schools and other issuers sell debt, have climbed dramatically amid a selling frenzy by investors scrambling for cash as coronavirus fears wreak havoc on markets.

Loans will now be available "to eligible financial institutions secured by certain high-quality assets purchased from single state and other tax-exempt municipal money market mutual funds," through the Money Market Mutual Fund Liquidity Facility the Fed set up on Wednesday, the U.S. central bank said in a statement.

The move is limited to highly rated muni debt with maturities that do not exceed 12 months.

Even so, the iShares National Muni Bond ETF , which tracks overall municipal bond sector, jumped almost 4% after the news and was last up about 0.9%.

Greg Saulnier, a Municipal Market Data (MMD) analyst, said while help was desperately needed, there was no immediate change in the tone of the overall market, where yields on MMD's top-rated, tax-exempt benchmark scale were poised on Friday to add to Thursday's 50 basis-point hike.

"I don't know how much impact that's going to have on stabilizing the rest of the market," he said, noting the Fed was only targeting short-term debt.

But Matt Fabian, the head of market and credit research at Municipal Market Analytics, welcomed the move as a way to help stabilize municipal bond liquidity.

"It will greatly reduce the pressure on the muni money markets to cover investor redemptions while not tanking the value of the underlying municipal bonds they hold, specifically short maturity bonds and notes," he said in an email.

He added that most of the market's liquidity pressure "is exactly in this part of the curve, because investors are converting many of their financial assets to cash without regard to what those assets are," he added.

Investors pulled $4.28 billion from tax-exempt money market funds in the week ended March 18, according to Lipper. An astounding $12.2 billion fled muni bond funds.

Dan Solender, director of the municipal bond group at Lord Abbett, said short-term borrowing costs could fall.

“Right now many of these money market securities are stuck on dealer/bank balance sheets and they keep moving rates higher to try to entice buyers,” he said in an email. “So it will help to clear up some balance sheet space, which could be used to buy longer municipal bonds, but it remains uncertain how much of an impact that would have.”

MMD’s one-year, short-term spot rate has risen from 0.70% on March 10 to 2.02% at Thursday’s close.

By Reuters

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