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The Fed Is Now Buying Munis, More or Less.

The Federal Reserve is expanding its program to bolster money-market funds by extending its support to municipal debt, as well.

The Fed's original money-market lending program, introduced late Wednesday, was created to finance banks' purchases of short-term corporate securities known as commercial paper (specifically from money-market funds). After this latest expansion, the Fed will also finance similar bank purchases of municipal debt maturing in less than one year.

In a typical transaction, a bank will buy short-term municipal bonds from a money-market fund or funds, and then pledge those bonds to the Fed as collateral for a cash loan. As of today, the interest rate on that loan would be 0.5%. These Fed loans will end at the same time the municipal bonds reach maturity. So the program is, in effect, the Fed buying the bonds from banks, in exchange for regular interest payments from those banks.

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