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Variable-Rate Muni Yields Fall in Wake of Latest Fed Action.

CHICAGO, March 23 (Reuters) – Yields on variable-rate municipal debt tumbled on Monday after the Federal Reserve took another step to help ease a liquidity crunch as part of an unprecedented credit support package to backstop an economy reeling from coronavirus shutdowns.

The U.S. municipal bond market was steady through midday, according to a preliminary read of Municipal Market Data's benchmark triple-A yield scale, while the daily variable rate demand note (VRDN) yield reset fell to around 5.56% from a whopping 7.23% on Friday.

"That's probably a direct effect of the Fed's announcement," said Greg Saulnier, an MMD managing analyst, not it was "probably a stretch" to attribute tentatively unchanged yields across the curve to the central bank's move.

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

The Fed on Monday expanded eligible collateral for loans in money market and commercial paper facility programs to include municipal VRDNs and "high-quality" tax-exempt commercial paper. On Friday, the Fed allowed highly rated short-term muni debt to be used in the money market program.

The iShares National Muni Bond ETF, which tracks the overall municipal bond sector, was last up 1.6%, extending Friday's bounce a day after it hit the lowest level since April 2011.

In a statement, the central bank cited "tremendous hardship" due to the spreading coronavirus and the need for aggressive efforts in the public and private sectors "to limit the losses to jobs and incomes and to promote a swift recovery once the disruptions abate."

Muni analysts at Barclays noted in a report on Monday: "This is likely to help to start unfreezing tax-exempt money markets; however, outright purchases of munis might still be needed."

Michael Decker, vice president for federal policy at Bond Dealers of America, said the muni market "is generally not performing as it's supposed to, but it's being felt most acutely at the short end of the yield curve."

While the spot yield on one-year, short-term munis has soared this month, VRDNs have fared even worse. Daily VRDN yields reset on Friday at 7.23%, up from 1.59% on March 13, according to MMD.

Decker described VRDNs, which fell out of favor in the wake of the previous market meltdown, as "sort of the commercial paper of the municipal world," although the debt is designed with longer maturities.

Issuance of VRDNs, which peaked over the last two decades at $121 billion in 2008, fell to just $8.7 billion in 2015 and totaled $25 billion in 2019, according to Refinitiv data. Muni issuers, meanwhile, sold $44.7 billion of short-term debt last year. Tax-exempt commercial paper issuance is relatively small, analysts said.

(Reporting By Karen Pierog; Editing by Alden Bentley)