Case for Fed Rescue of Muni Market Builds With Rout Returning.

- **Yields jump almost 75 basis points this week as prices slide**
- **New deals largely shelved, showing limited access to market**

In the past 48 hours, the $3.9 trillion municipal-bond market is making the case for the Federal Reserve to use its new powers to wade in, whether buyers want it to or not.

That's because the market where states and local governments raise cash is veering back toward the dysfunction that gripped it last month. Bond prices have dropped sharply, sending yields on 30-year debt surging by nearly 0.75 percentage point since Monday morning. Big bond deals are in limbo, effectively shutting off market access. Frightened investors are pulling out.

The liquidity crisis that initially raced through the market has given way to more measured fears about the massive financial toll that the unprecedented economic shutdown will deliver to states, cities, transit agencies, airports and others that stand behind municipal bonds.

The sell-off in the past few days "makes the case that the Fed should get engaged in some capacity in the muni market," said Michael Nicholas, chief executive officer of the Bond Dealers of America, a lobbying group representing banks and dealers. "No doubt."

Groups like the Government Finance Officers Association and National Association of State Treasurers this week sent a letter urging the Fed to start buying municipal bonds in the secondary market, saying that the central bank should purchase longer-dated debt and include both states and smaller entities like towns.

The organizations said they would like to see the creation of a temporary facility to buy municipal debt, as well as a low-interest loan program to help cash-strapped governments that are affected by tax filing deadlines being pushed back.

The central bank is expected to announce a new emergency facility to support municipal debt, as allowed by the $2 trillion stimulus approved last week. House Speaker Nancy Pelosi said on Thursday that she wants Fed chairman Jerome Powell to "think big" about how to help.

Karissa McDonough, chief fixed-income specialist at People's United Advisors, said now the market is waiting for more "clarity" from the central bank.

"We need a little bit in terms of details or actual purchase activity," she said.

Currently, the Fed and the U.S. Treasury Department are operating under Section 13.3 of the Federal Reserve Act. It allows the Fed, with Treasury permission, to open a broad-based facility to support troubled areas of the financial markets in an emergency.

There are questions about what bonds the Fed would buy, given it could open the central bank up to criticism that it’s picking winners and losers among states and cities. There’s also uncertainty over how it would implement a municipal purchasing program — including whether the central bank would turn to an asset management firm like BlackRock Inc, which it’s doing with three of its bond-buying programs.

Even allowing the central bank to help rescue the market from a crisis is a divisive topic in the industry. Citigroup Inc. strategists led by Vikram Rai found in a survey of over 1,146 clients this week that a majority of them would prefer that primary dealers run the Fed’s muni buying program instead of an investment-management firm.

Still, the strategists added later that the results of the survey “ripped through the industry and created much controversy.”

They noted some respondents had particularly strong views: “We have filtered out the racy comments,” the bank strategists said, adding they “tried to synthesize the popular response for most questions.”

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