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U.S. Muni Market Remains Under Watchful Eye of Fed, Official Says.

CHICAGO, July 13 (Reuters) – The U.S. Federal Reserve stands ready to consider further intervention in the municipal bond market, which is not "necessarily out of the woods" after recovering from unprecedented volatility arising from the coronavirus pandemic, a Fed official said on Monday.

A selling frenzy by virus-rattled investors in the $3.8 trillion market where states, cities, schools and other issuers sell debt sent yields skyrocketing in March. Moves by the Fed to aid short-term debt markets, as well as a loan program for states and eligible local governments facing a cash crunch, helped restore calm. "My job and our team's job is to monitor the market and if additional intervention is required, the Fed's prepared to consider it," Kent Hiteshew, a former muni banker and U.S. Treasury official who joined the Fed's financial stability division in March, said at the Brookings Institution's municipal finance conference.

Hiteshew said the municipal liquidity facility (MLF), which the Fed authorized in April, was designed as a backstop for the market, allowing governments to access short-term, cash-flow loans from the Fed.

As of June 30, however, the MLF had only loaned $1.2 billion to Illinois, the state with the lowest credit ratings at a notch above junk, Fed data shows.

Cash-strapped New Jersey, meanwhile, is eyeing the MLF as an option for a significant portion of a $9.9 billion borrowing agreed to last week by its governor and legislative leaders.

High borrowing costs in the $500 billion program have deterred participation.

Hiteshew said that fiscal issues for states and local governments caused by sinking tax revenue "have only just begun," and that some were balancing their budgets on the hope of future federal monetary aid.

He added the Fed's job is to make sure markets function and that it cannot solve the governments' "huge lost revenue problem."

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