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Credit, Muni Markets Shrug Off Treasury Threat to End Fed Programs.

NEW YORK (Reuters) – The credit and municipal bond markets held fast on Friday morning after U.S. Treasury Secretary Steven Mnuchin defended his decision, first announced Thursday evening, to let several of the Federal Reserve's key pandemic lending programs end on Dec. 31.

Mnuchin said on Thursday that some of the Fed's stimulus programs, which have established the central bank as a lender of last resort to U.S. corporations and municipalities, should be allowed to expire and that the unused funds should be given to Congress to reallocate. The announcement was not expected by Fed officials, who had said this week that the programs should be extended, and told Mnuchin so immediately after his decision was made public.

The Fed programs were essential to restoring liquidity in financial markets in March, when nervous lenders seized up and both the credit and municipal bond markets reached levels not seen since the last financial crisis. But both markets were steady on Friday morning, as investors bet that the liquidity established by the Fed's programs would not soon dissipate.

"Markets seem to be acting as if this may be an overblown event," said Kevin Giddis, head of fixed income at Raymond James.

"While the market "righted" itself in March at the idea that these facilities were available so quickly, funding away from the Fed became cheaper and easier for most companies in the capital markets versus Fed-assisted financing."

The iShares exchange-traded funds tracking the high-yield HYG.P and investment-grade LQD.P markets both inched lower on Friday, with a slightly bigger move seen in LQD, last down 0.22%. The Fed's Primary and Secondary Market Corporate Credit Facilities chiefly targeted investment-grade debt.

The $3.9 trillion U.S. municipal bond market opened steady on Friday with Municipal Market Data's initial read of its benchmark triple-A yield scale largely unchanged. The iShares National Muni Bond ETF MUB.N was up slightly.

The Fed's $500 billion Municipal Liquidity Facility (MLF) has so far only attracted two users – Illinois, the lowest-rated state, and New York's Metropolitan Transportation Authority (MTA), which was hit exceptionally hard by a sharp drop in mass transit ridership due to the pandemic.

Greg Saulnier, managing analyst at Municipal Market Data, said Illinois and MTA bonds are trading inside the rates offered through the MLF and that muni market fundamentals are strong.

"Perhaps there is some marginal effect in terms of mentality without the safety blanket there, but I'm not sure how much of that will play out in terms of trading and spreads, if at all," he said.

But Emily Swenson Brock, director of the Government Finance Officers Association's Federal Liaison

Center, said the loan program’s end comes as the resurgence of the virus threatens already weakened state and local government revenue.

“This is a pivotal time for states and local governments and to receive this news is extremely frustrating,” she said.

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NOVEMBER 20, 2020