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Investors Say Fed 'Backstops' Removed by Treasury Were Little Used but Lifted Confidence.

(Reuters) – A surprise move on Thursday by the U.S. Treasury Department to withdraw hundreds of billions of dollars used to support corporate, municipal and other bonds ravaged by the COVID-19 pandemic has injected some new uncertainty in global markets, investors said.

While the support wasn't widely used, even its presence served to bolster investor confidence, said Andy Richman, director of fixed income strategies for Sterling Capital Management.

"They were there as a backstop and even the thought of them was seen as a safety net. If something did go wrong the Fed was there," he said.

Richman said he expected slightly lower equity prices and higher bids for U.S. Treasuries as a safety play on Friday, though the impact could be dulled by other developments in Washington such as a possible deal on relief spending.

Treasury Secretary Steven Mnuchin on Thursday told the Federal Reserve to return money earmarked for pandemic lending to businesses, nonprofits and local governments, ending on Dec. 31 some crisis programs that allowed the Fed to buy corporate bonds and make loans to small businesses and local governments.

The surprise announcement sent benchmark U.S. Treasury yields and equity index futures lower. The 10-year Treasury note yield US10YT=RR slid 2 basis points and was the lowest in 10 days at 0.83%.

Several investors said they were still trying to grasp the full implications of losing access to programs like the Municipal Liquidity Facility, which bought short-term notes directly from U.S. cities, counties and states.

"Without the MLF, the market won't collapse, but it will lack some resilience if its tested by a selloff or more pronounced credit fears," said Matt Fabian, partner at Municipal Market Analytics.

Isaac Boltansky, director of policy research for Compass Point Research and Trading, called the diminished role of the Fed "nonsensical" at a time when the U.S. economic recovery still seems shaky.

"This is a distressing development that injects uncertainty and instability into markets completely unnecessarily," he said. He added that "How many times will Washington trip on its shoelaces in response to this crisis?"

By Ross Kerber

Reporting by Ross Kerber in Boston. Additional reporting by Karen Pierog in Chicago; Editing by Lincoln Feast.

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