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Municipal Markets and the Municipal Liquidity Facility.

Municipal bond markets experienced a significant amount of strain in response to the COVID-19 crisis, creating liquidity and credit concerns among market participants. During the economic shutdown resulting from the pandemic, income tax revenues were deferred and sales tax revenues decreased beginning in spring 2020, while the cost of borrowing significantly increased for municipal issuers. To aid municipal borrowing needs, the Federal Reserve implemented the Municipal Liquidity Facility (MLF) on April 9, 2020. In this analysis we describe the municipal market conditions as they evolved during 2020, we document the response by the Federal Reserve to municipal market distress with a focus on the MLF, and we conduct an event study to examine MLF-related impacts on market index yield spreads. We detail two case studies that compare yield spreads for two issuers that had sold debt to the MLF and find that yield spreads in secondary market transactions for these two issuers were notably reduced after a public announcement of intent to sell debt to the MLF. Our results present additional evidence that the MLF had a positive impact on municipal market functioning during the pandemic period.

Read the paper.

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