Staff Q4 2015 report on corporate bond market liquidity

Summary

This report[1] describes developments in the liquidity and functioning of corporate bond markets from October 1, 2015, through December 31, 2015. In this update, we use the same measures of liquidity used in the previous reports for both primary and secondary market conditions. The main findings are:

1) Liquidity in the primary market – as indicated by the pace of primary corporate bond issuance – continued to be robust in the United States, on balance, despite a recent slowdown. On net, yields on both investment- and speculative-grade corporate bonds rose along with those on comparable-maturity Treasury securities in Q4, and ended 2015 well above their year-ago levels. Even so, corporate yields stayed very low by historical standards. During the quarter, a large portion of speculative-grade issuance was earmarked for the refinancing and funding of M&A activity.

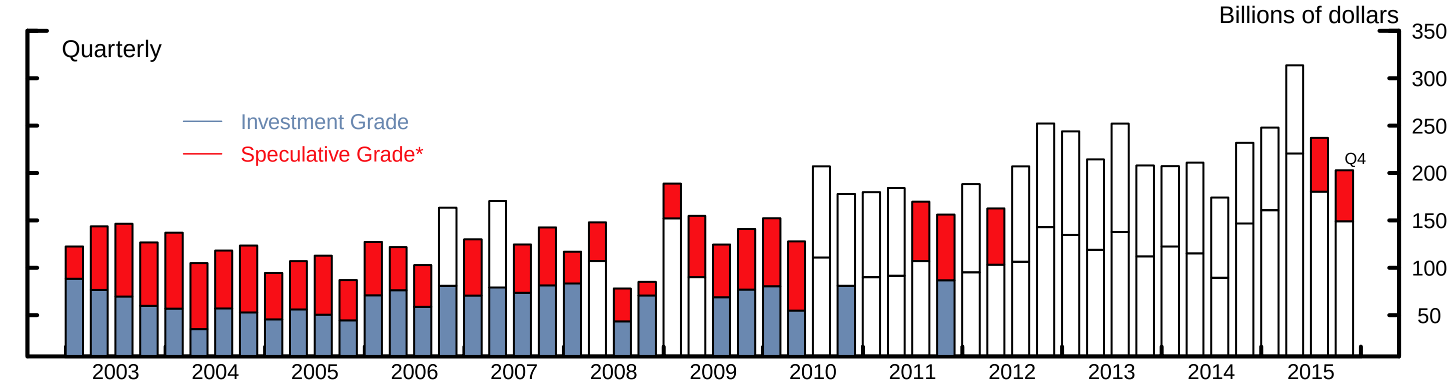
2) Measures of secondary bond market liquidity – the ease and cost with which investors can buy and sell corporate bonds – deteriorated slightly in Q4. The average daily trading volume and the turnover – a measure of trading volume relative to face value of bonds outstanding – for both investment- and speculative-grade bonds fluctuated around a level typical for the past five years. Roughly in line with their typical seasonal pattern, bid-ask spreads spiked around year-end. After adjusting for the seasonal pattern, average bid-ask

[1] This report has been agreed to by the staff of the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively referred to as the Agencies). The Agencies have expressed no view regarding the analysis, findings, or conclusions contained in this report.

spreads trended up slightly since the last report for both investment- and speculative-grade bonds but remained at levels similar to those prevailing before the crisis. The fraction of trades with large face value – at least $1 million – and the average size of such trades declined somewhat for both investment- and speculative-grade bonds, while remaining generally within the ranges that have prevailed over the past few years. Meanwhile, dealers' inventories of corporate bonds edged down a bit further to a low level in the third quarter of 2015 (latest data available). Despite the expression of some heightened concerns of corporate bond liquidity conditions following the December 2015 announcement by the mutual fund Third Avenue that it would suspend redemptions, the direct effects of the announcement on market functioning and pricing generally appear to have been rather limited. The mutual fund largely held low-grade and unrated corporate debt.

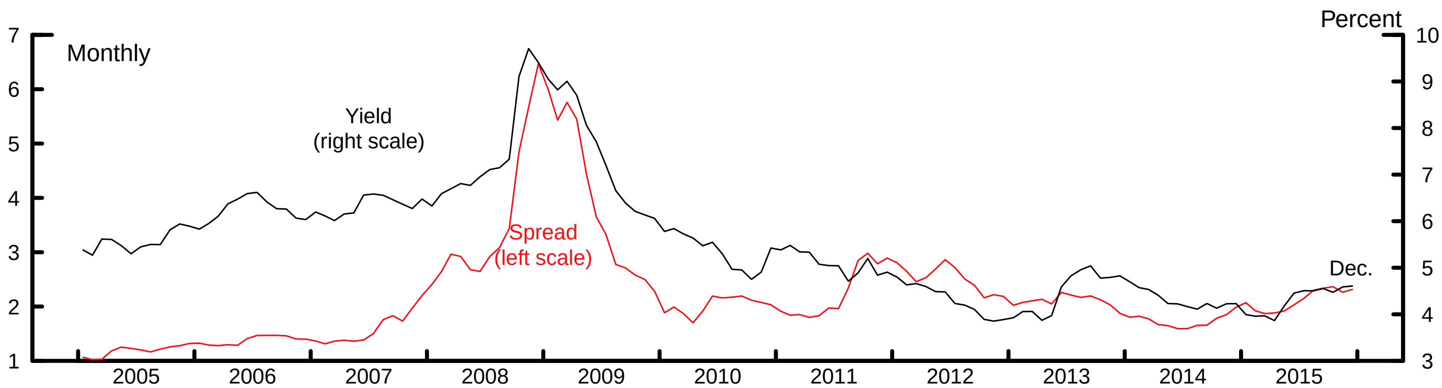
Corporate Bond Liquidity Monitor
Exhibit 1

Gross Issuance of Nonfinancial Corporate Bonds



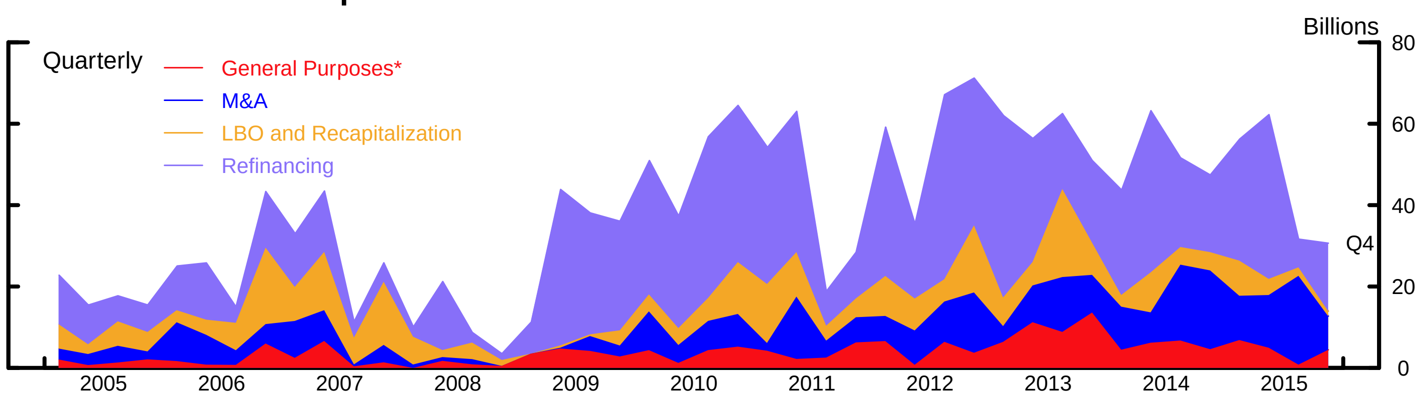
*Includes unrated bonds.
Source: Mergent.

Ten−Year BBB Bond Yield and Spread to Treasury*



*Esimated from curve fit to Merrill Lynch bond yields. Treasury yields from smoothed yield curve estimated from off−the−run securities.
Source: Staff Calculations

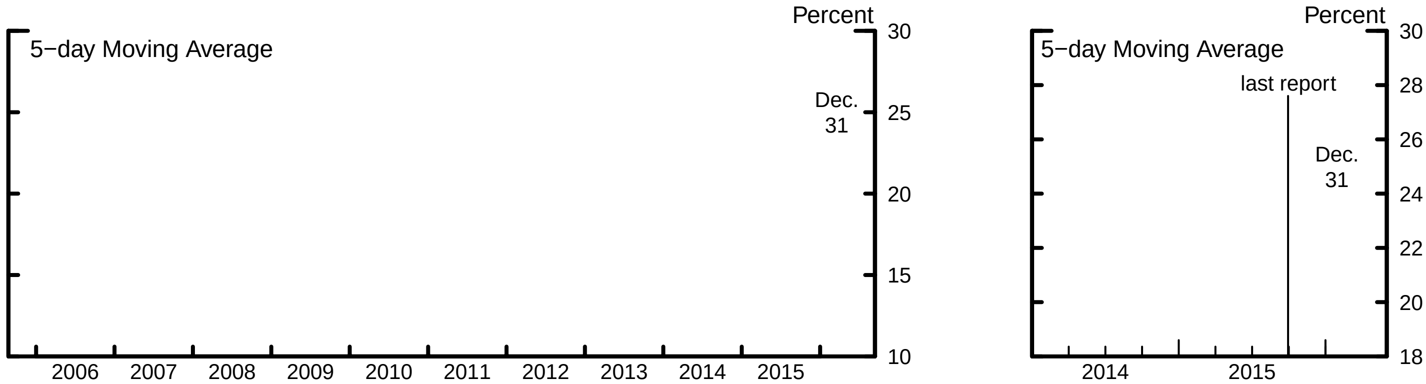
Use of Proceeds for Speculative Grade Issues*



* General Purposes includes capital expenditures and other purposes not included in the designated breakdown.
Source: Standard and Poor’s

Corporate Bond Liquidity Monitor
Exhibit 2

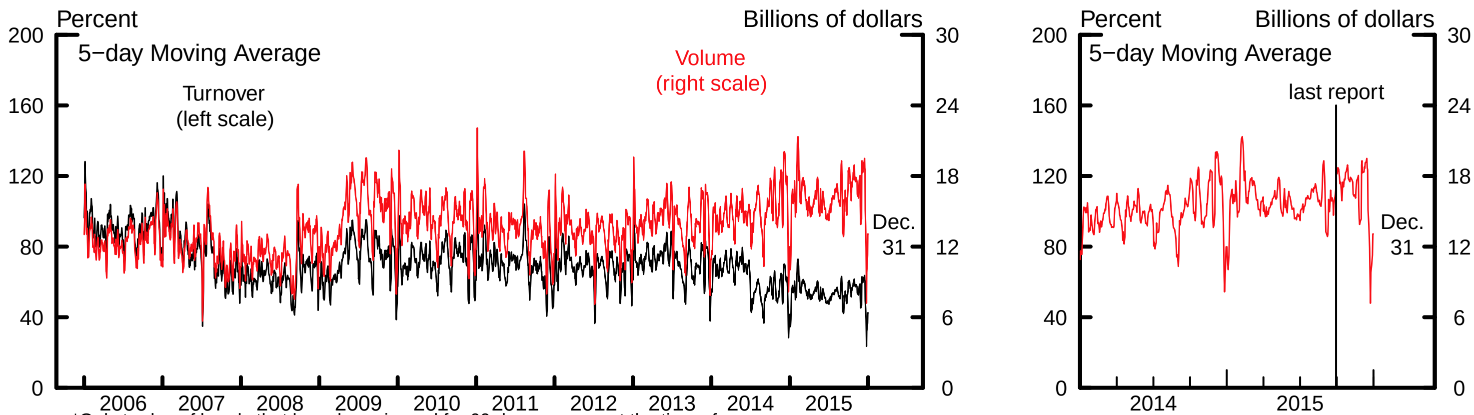
Number of Traded Bonds as a Fraction of Total Disseminated*



*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.

Source: FINRA, Mergent, Moody's DRD

Trading Volume and Turnover* (Seasonally Adjusted)

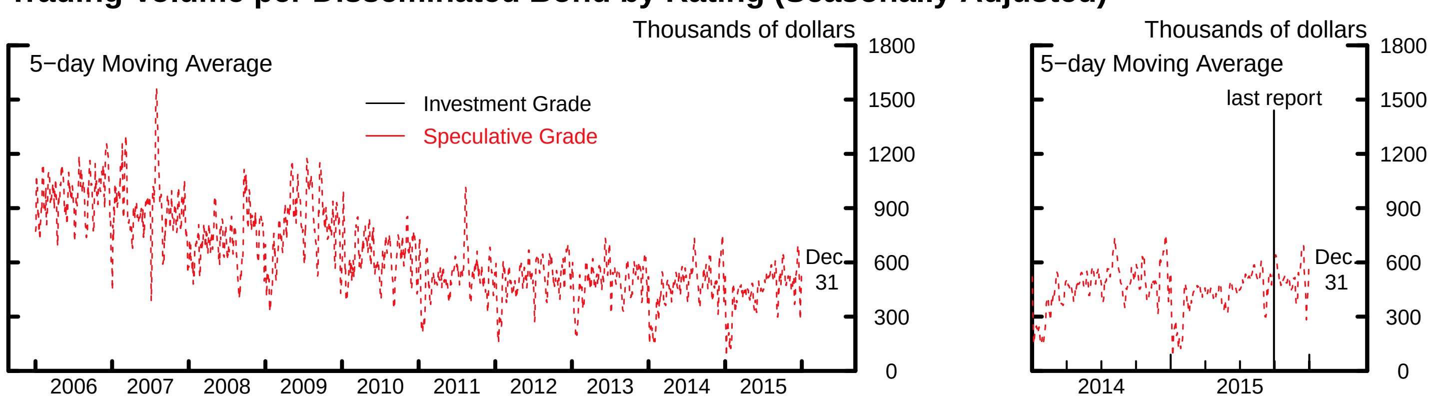


*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.

Note: Turnover series is annualized by multiplying the daily turnover with 251.

Source: FINRA, Mergent, Moody's DRD

Trading Volume per Disseminated Bond by Rating (Seasonally Adjusted)*

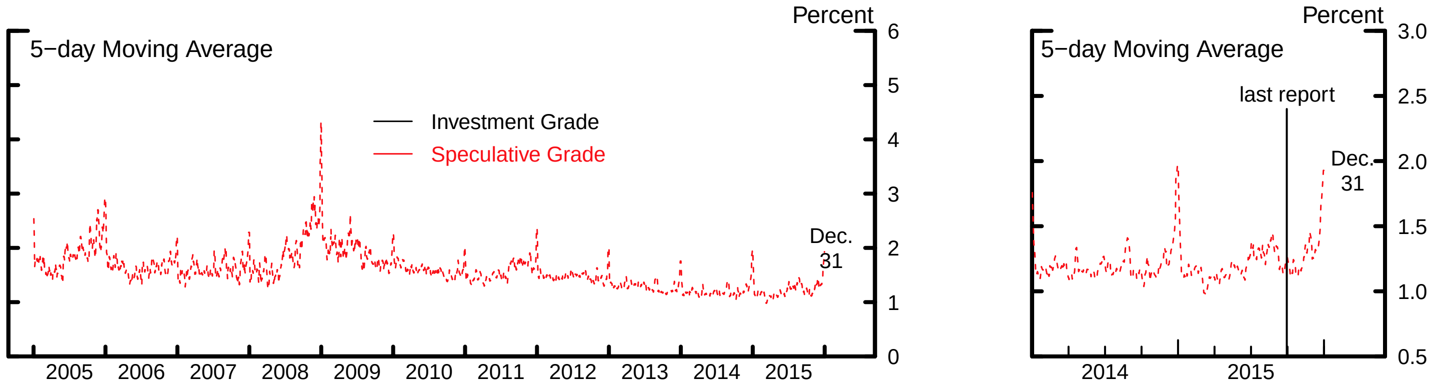


*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.

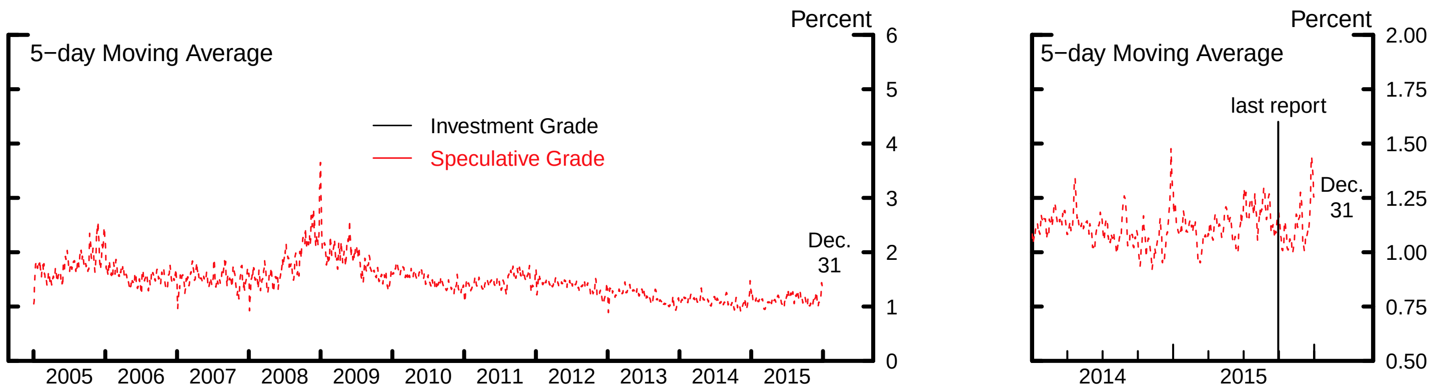
Source: FINRA, Mergent, Moody's DRD

Corporate Bond Liquidity Monitor
Exhibit 3

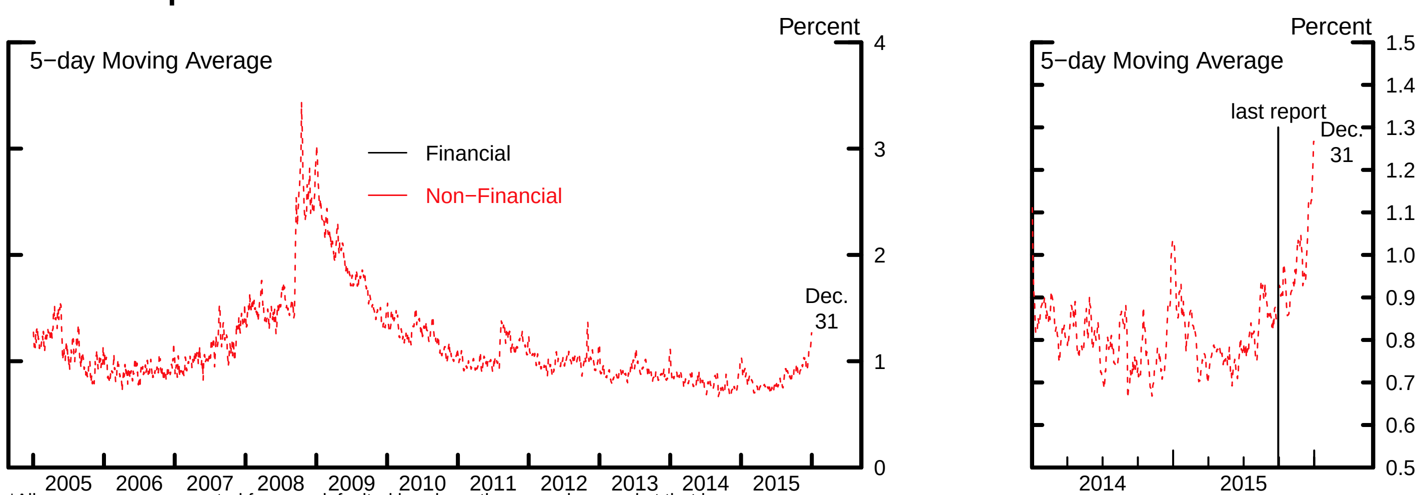
Bid−Ask Spread for All Bonds*



Bid−Ask Spread for All Bonds* (Seasonally Adjusted)



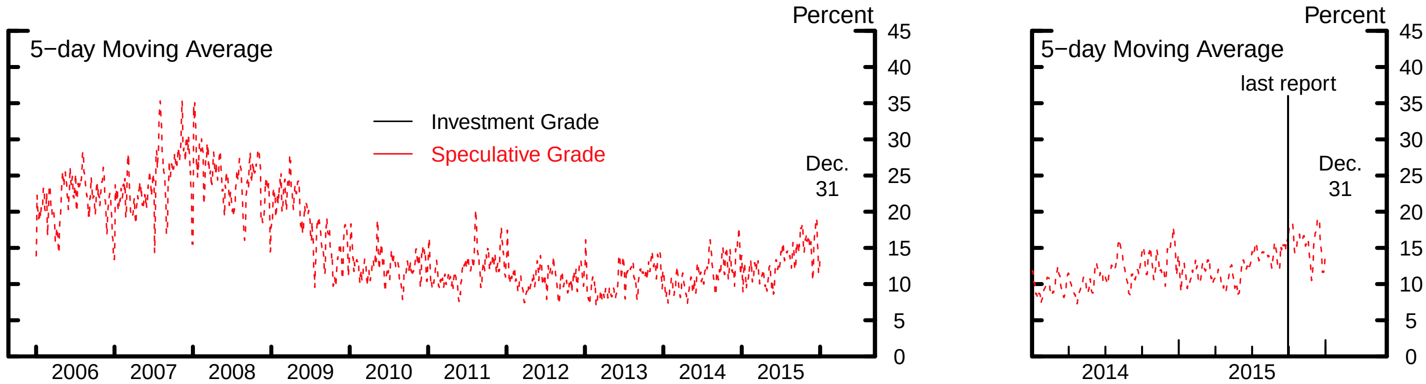
Bid−Ask Spread for Investment Grade Bonds



*All measures are computed for non−defaulted bonds on the secondary market that have traded at least 10 times between 10:30am and 3:30pm. Excluding 144a bonds.
Bid−Ask spread is the difference between weighted average dealer bid prices and ask prices

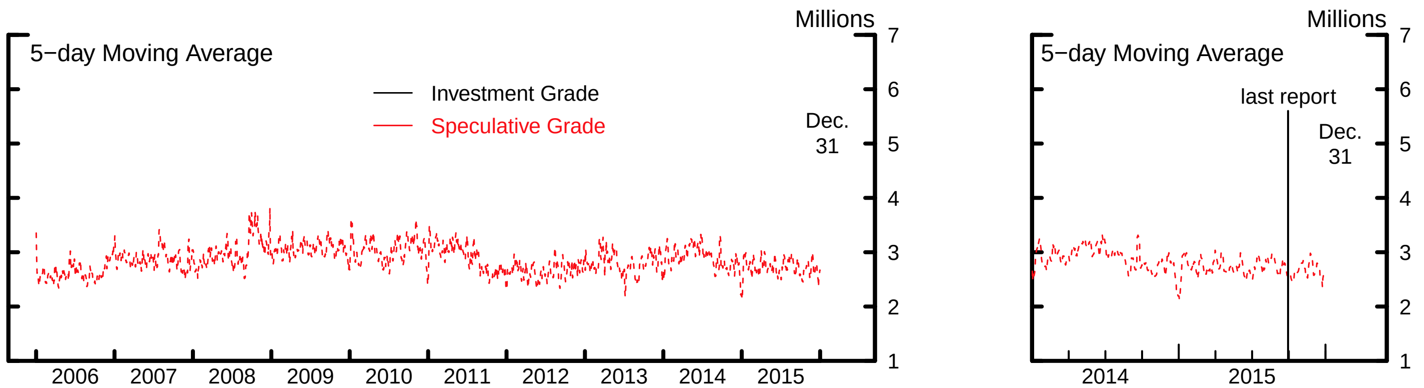
Corporate Bond Liquidity Monitor
Exhibit 4

Percentage of Trades Greater than 1 Million in Par Value* (Seasonally Adjusted)



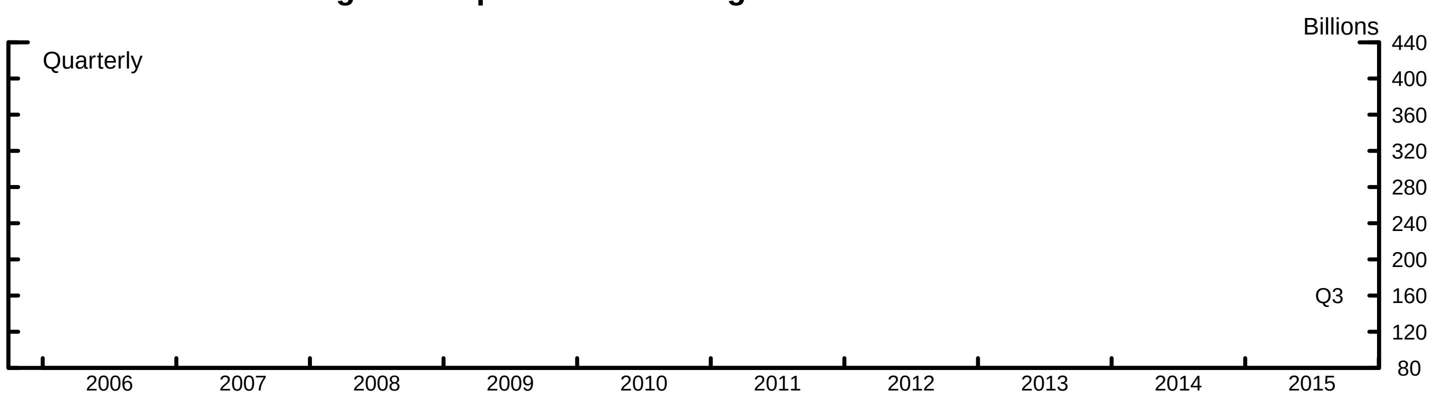
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody’s DRD

Average Size of Trades that are Greater than 1 Million in Par Value* (Seasonally Adjusted)



*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody’s DRD

Broker−Dealer Holdings of Corporate and Foreign Bonds*



*Series FL663063005.Q is plotted.
Source: Federal Reserve Flow of Funds Account.