

Staff Q1 2016 report on corporate bond market liquidity

Summary

This report¹ describes developments in the liquidity and functioning of corporate bond markets from January 1, 2016, through March 31, 2016. 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:

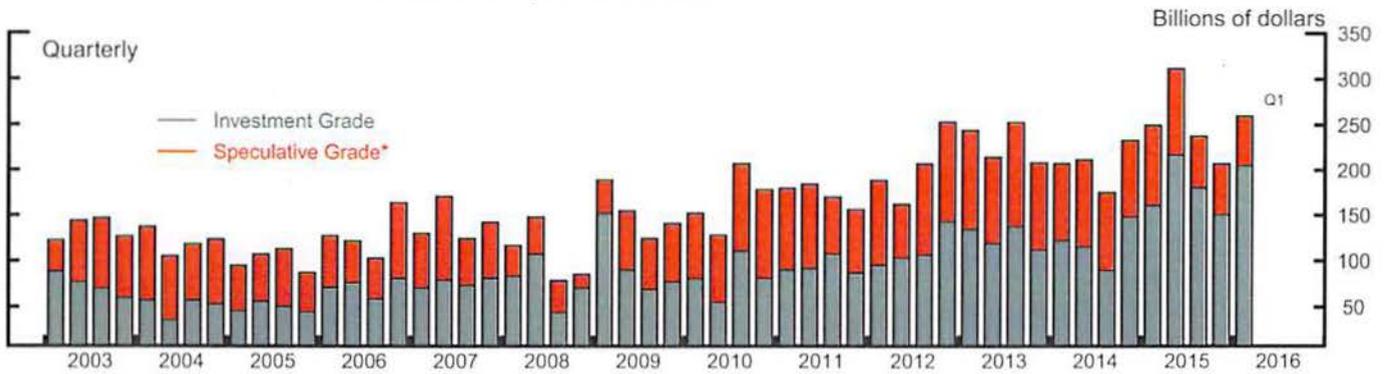
- 1) On balance, liquidity in the primary market – as indicated by the pace of primary corporate bond issuance – continued to be robust in the United States, particularly for highly rated firms. Investment-grade bond issuance increased somewhat from its Q4 level, while speculative-grade issuance remained subdued. On net, yields on both investment- and speculative-grade corporate bonds declined along with those on comparable-maturity Treasury securities in Q1, but remained 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, on balance, in Q1, although most indicators remained within the ranges that have prevailed over the past few years. After adjusting for seasonal patterns, average bid-ask spreads trended up slightly since the last

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.

report for both investment- and speculative-grade bonds but remained at levels similar to those prevailing before the crisis. The average daily trading volume continued an upward trend over the last quarter and remains at the higher end of the range observed over the last five years; turnover – a measure of trading volume relative to face value of bonds outstanding – for both investment – and speculative-grade bonds also trended upward but generally remained close to levels typical for the past five years. The fraction of trades with large face value – at least \$1 million – and the average size of such trades for both investment- and speculative-grade bonds remained generally within the ranges that have prevailed over the past few years. Meanwhile, dealers' inventories of corporate bonds remained at a low level in the fourth quarter of 2015 (latest data available).

Corporate Bond Liquidity Monitor Exhibit 1

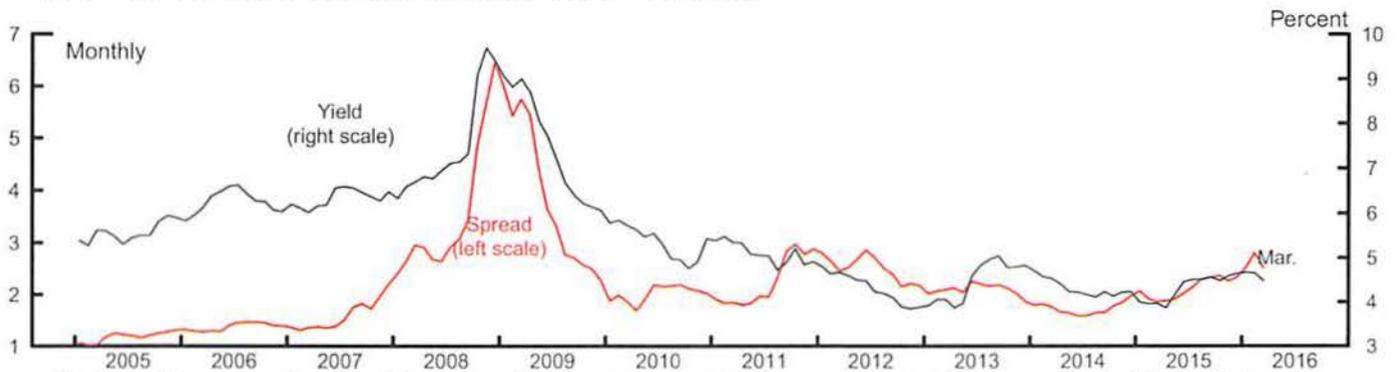
Gross Issuance of Nonfinancial Corporate Bonds



*Includes unrated bonds.

Source: Mergent.

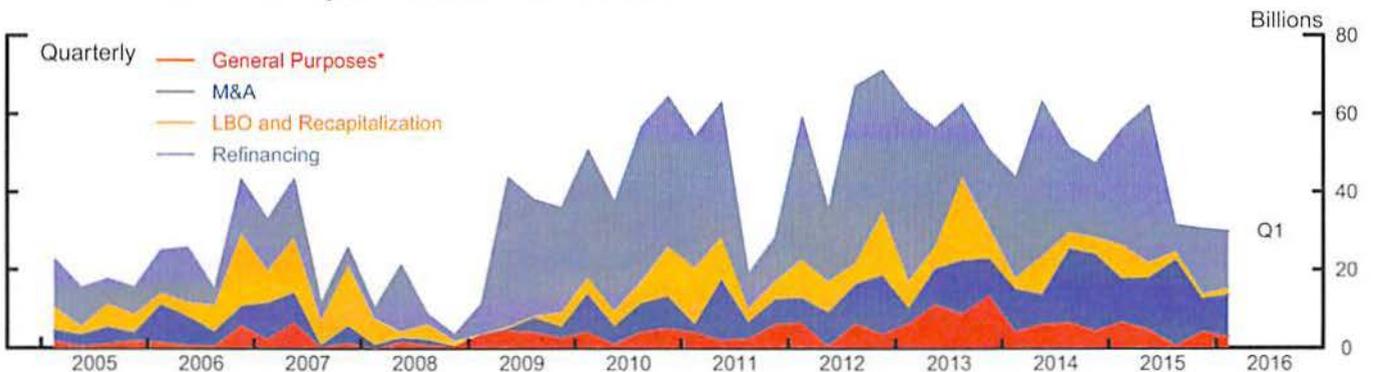
Ten-Year BBB Bond Yield and Spread to Treasury*



*Estimated 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*

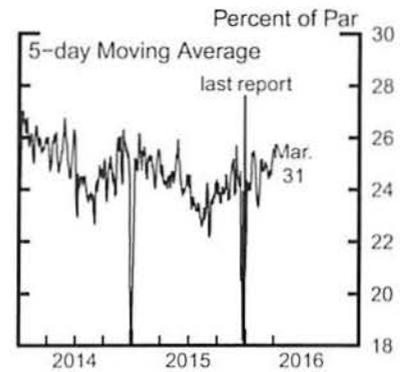
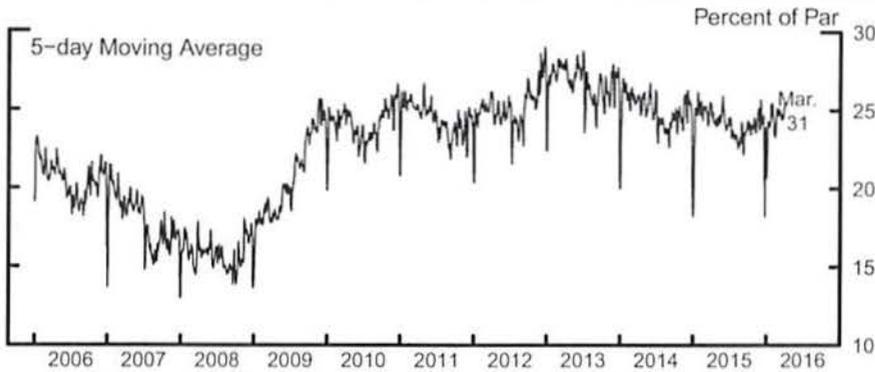


* General Purposes includes capital expenditures and other purposes not included in the designated breakdown.

Source: Standard and Poor's

**Corporate Bond Liquidity Monitor
Exhibit 2**

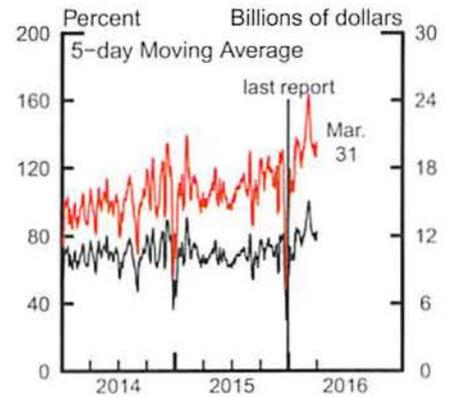
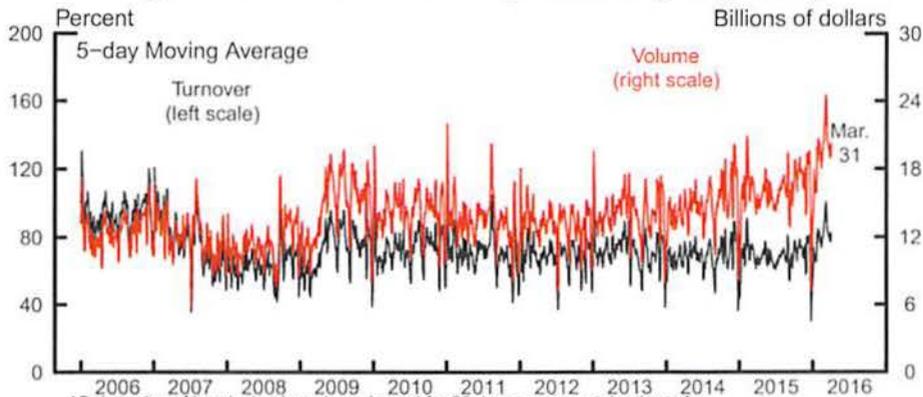
Number of Traded Bonds as a Fraction of Total Disseminated*



*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)

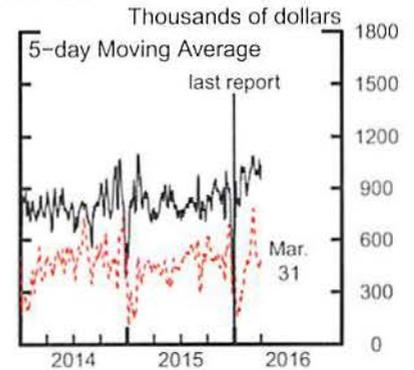
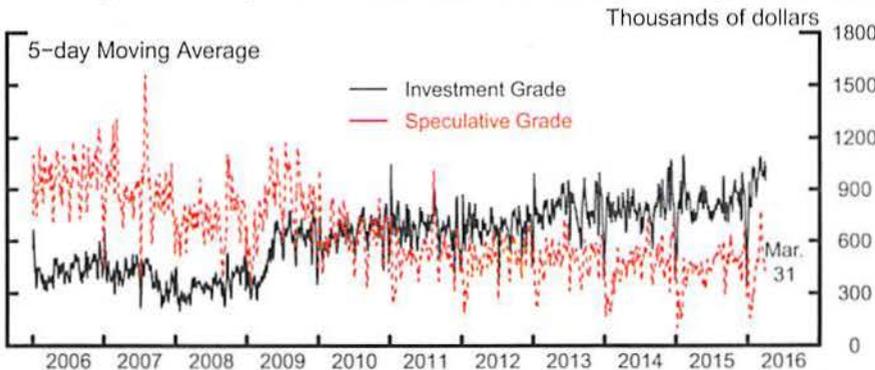


*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.

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)*

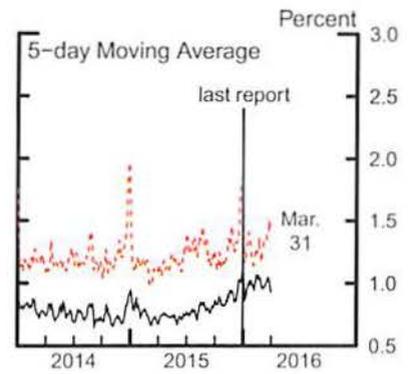
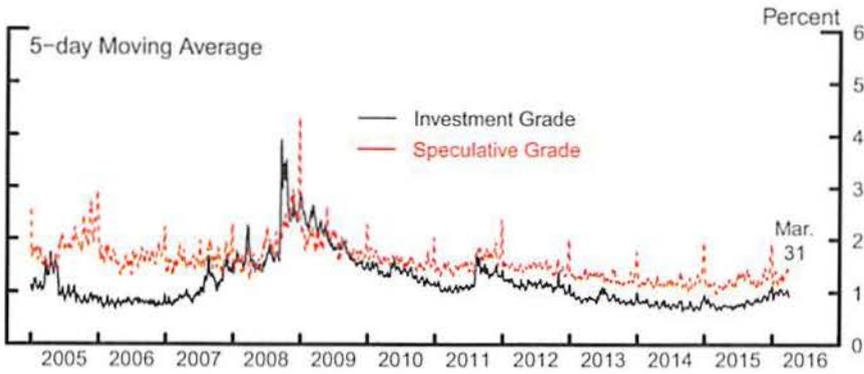


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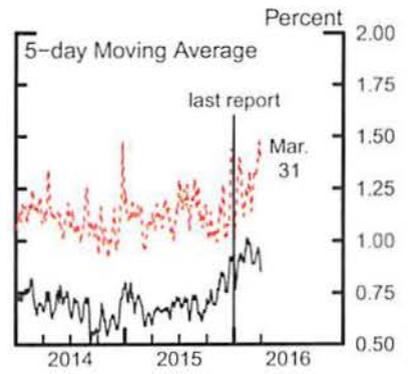
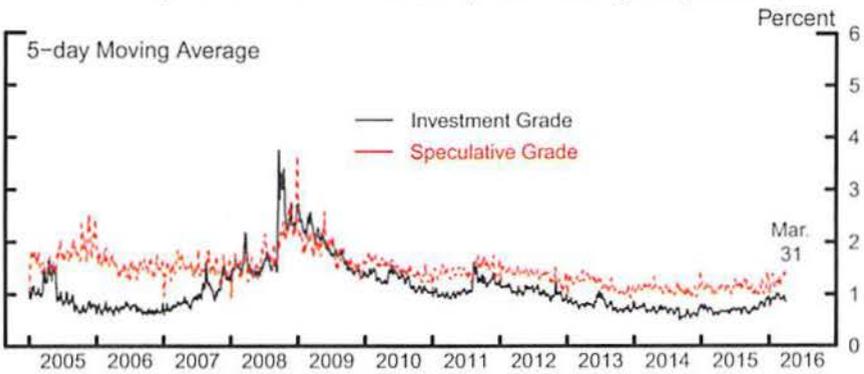
Source: FINRA, Mergent, Moody's DRD

**Corporate Bond Liquidity Monitor
Exhibit 3**

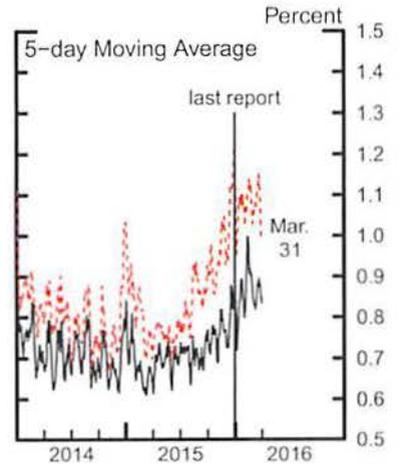
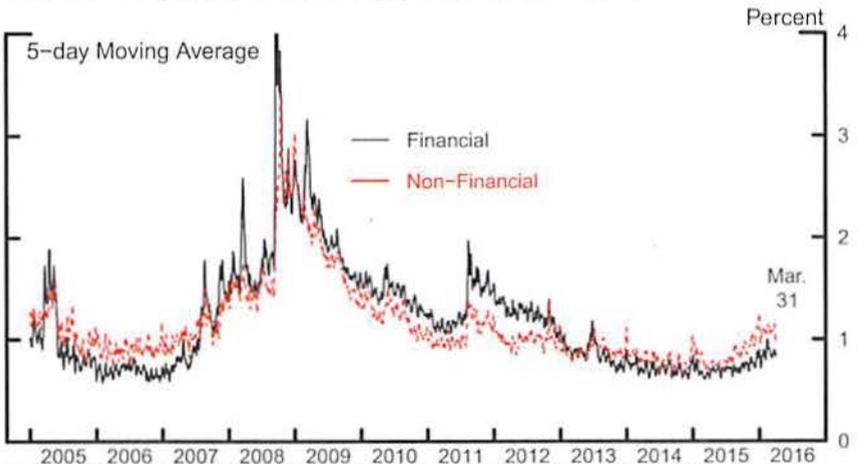
Bid-Ask Spread for All Bonds*



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



Bid-Ask Spread for Investment Grade Bonds

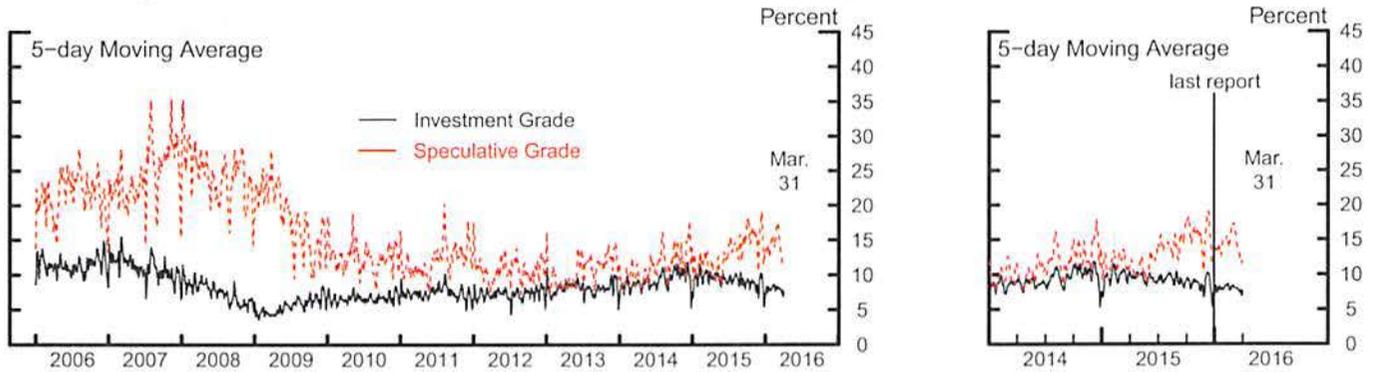


*All measures are computed for non-defaulted bonds on the secondary market that have traded at least 10 times between 10:30am and 3:30pm. Excluding 144a bonds.

Bid-Ask spread is the difference between weighted average dealer bid prices and ask prices

**Corporate Bond Liquidity Monitor
Exhibit 4**

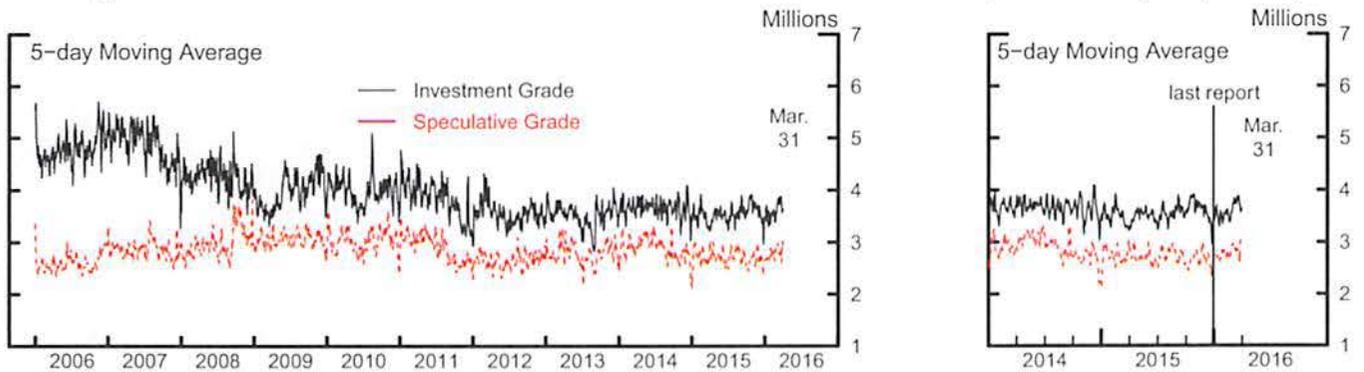
Percentage of Trades Greater than 1 Million in Par Value* (Seasonally Adjusted)



*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

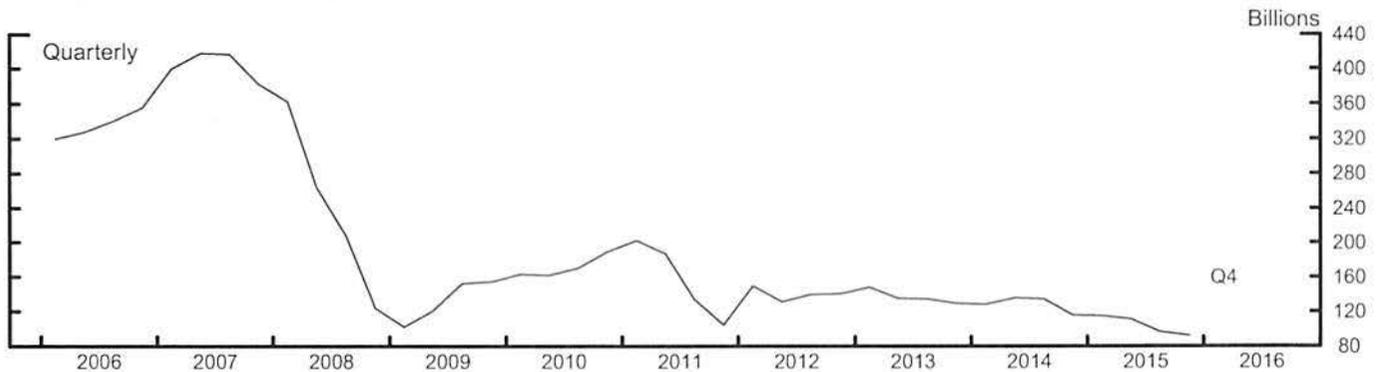
Average Size of Trades that are Greater than 1 Million in Par Value* (Seasonally Adjusted)



*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.