

Staff Q2 2016 report on corporate bond market liquidity

Summary

This report¹ describes developments in the liquidity and functioning of corporate bond markets from April 1, 2016, through June 30, 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 improving for lower-rated firms. Investment-grade bond issuance decreased relative to its Q1 level, but remained solid. Speculative-grade bond issuance recovered from the subdued level observed in Q1, although remained below its year-ago level. On net, yields on both investment- and speculative-grade corporate bonds declined to historically low levels along with those on comparable-maturity Treasury securities. Notably, the U.K. referendum outcome on June 23 was followed by a decline in investment-grade bond yields and a modest increase in speculative-grade bond yields, the latter of which was reversed in the following days. Relative to Q1, a larger portion of speculative-grade issuance was earmarked for refinancing and less for funding of M&A activity during the quarter.
- 2) Measures of secondary bond market liquidity that reflect the ease and cost with which investors can buy and sell corporate bonds deteriorated somewhat in Q2 as a whole, with

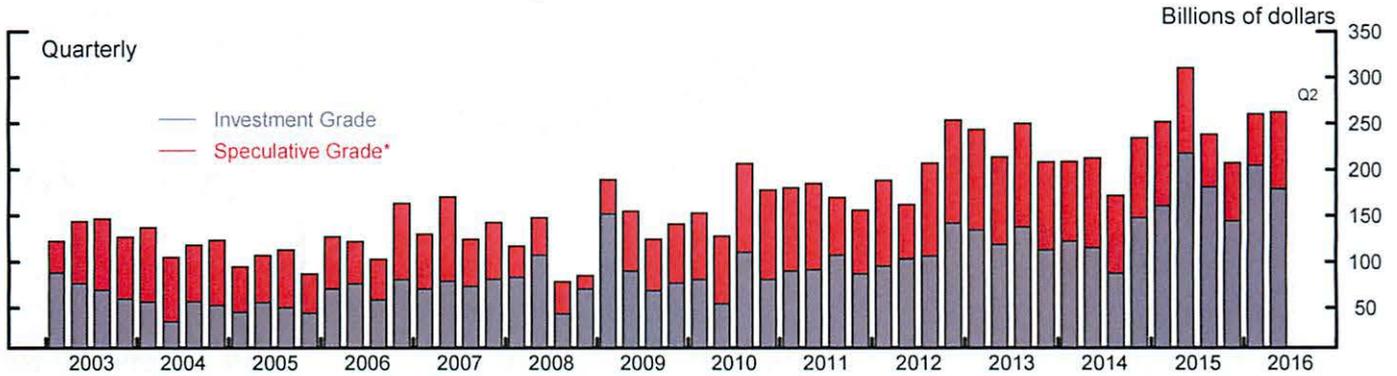
¹ This report has been agreed to by the staff of the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively referred to as the Agencies). The Agencies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

a notable deterioration in several indicators immediately after the U.K. referendum outcome. However, most indicators remained within the ranges that have prevailed over the past few years and before the crisis, and have reversed part of the deterioration as of July. In particular, after adjusting for seasonal patterns, average bid-ask spreads for both investment- and speculative-grade bonds increased on net since the last report, but remained at levels similar to those prevailing before the crisis. Over the last quarter, the average daily trading volume declined for investment-grade bonds and was little changed on net for speculative-grade bonds. Overall, trading volume remained at the higher end of the ranges observed over the last five years for both investment- and speculative-grade bonds. Turnover – a measure of trading volume relative to face value of bonds outstanding – for investment- and speculative-grade bonds combined declined but remained close to levels typical for the past five years. The fraction of trades with large face value – at least \$1 million – for both investment- and speculative-grade bonds increased following the U.K. referendum outcome, while the average size of such trades declined. However, both the fraction and size of these trades remained generally within the ranges that have prevailed over the past few years. Meanwhile, consistent with the downward trend observed in recent years, dealers’ inventories of corporate and foreign bonds declined in the first quarter of 2016 (latest data available) and reached their lowest levels over the past decade.²

² “Corporate and foreign bonds,” as defined in the Federal Reserve’s Financial Accounts of the United States, includes, in addition to bonds issued in the United States by U.S. corporations and foreign corporate and sovereign entities, all other fixed income instruments (excluding syndicated loans) that are issued in the United States, such as privately-issued mortgage backed securities.

Corporate Bond Liquidity Monitor Exhibit 1

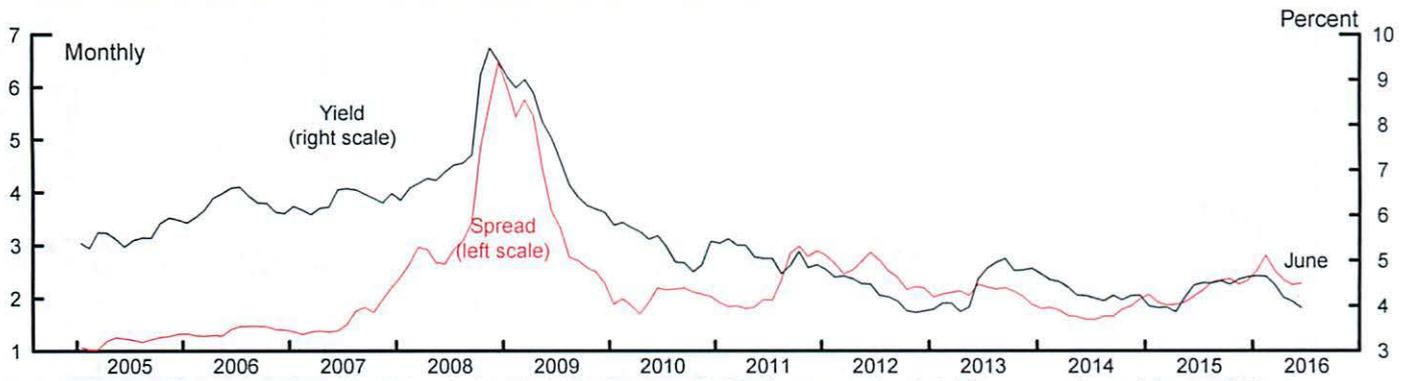
Gross Issuance of Nonfinancial Corporate Bonds



*Includes unrated bonds.

Source: Mergent.

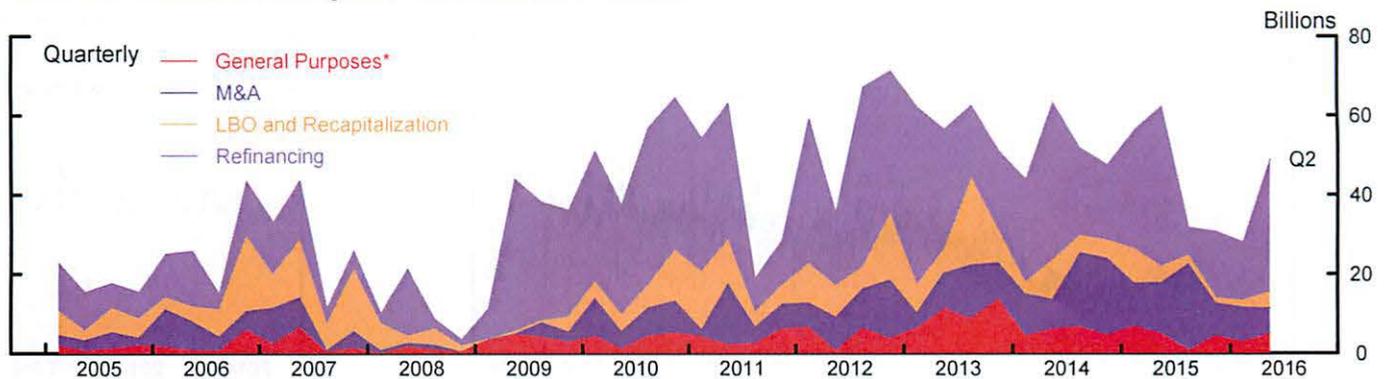
Ten-Year BBB Bond Yield and Spread to Treasury*



*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*

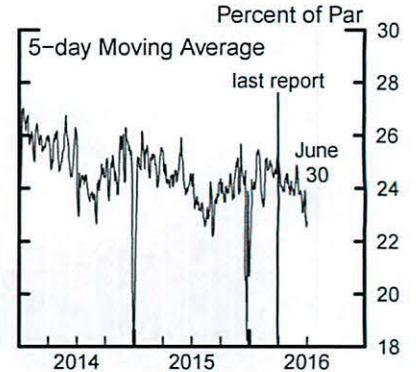
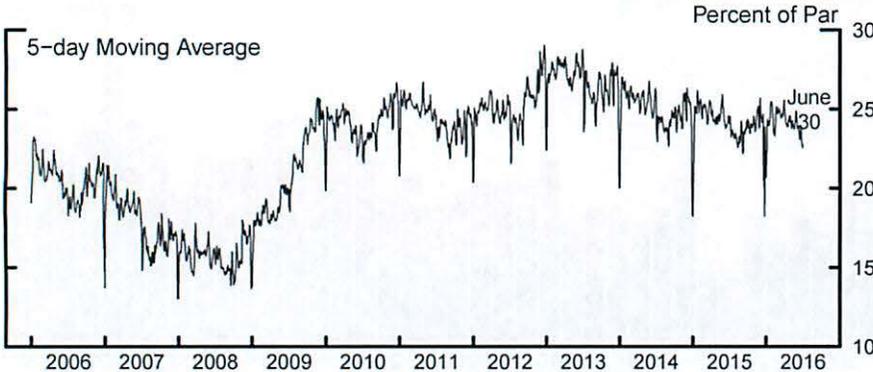


* General Purposes includes capital expenditures and other purposes not included in the designated breakdown.

Source: Standard and Poor's

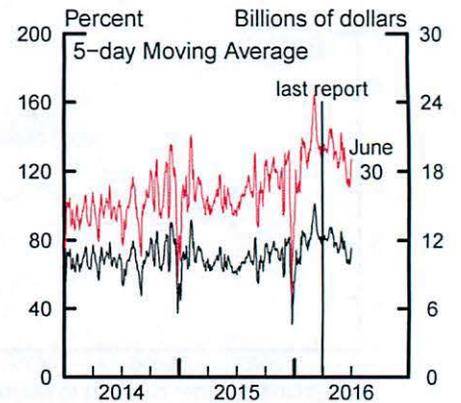
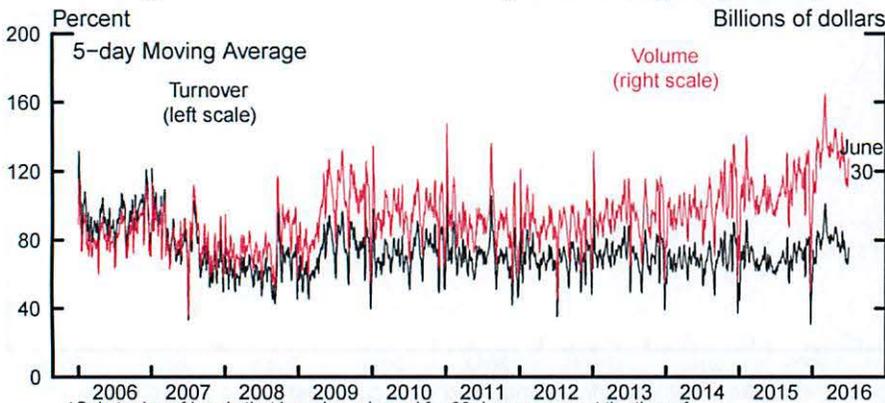
**Corporate Bond Liquidity Monitor
Exhibit 2**

Number of Traded Bonds as a Fraction of Total Disseminated*



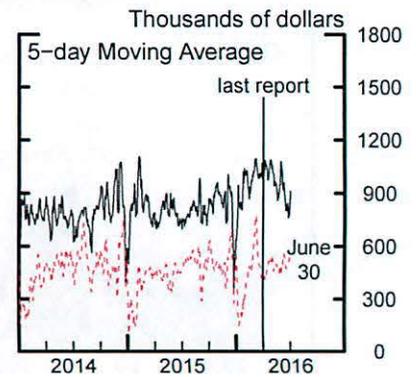
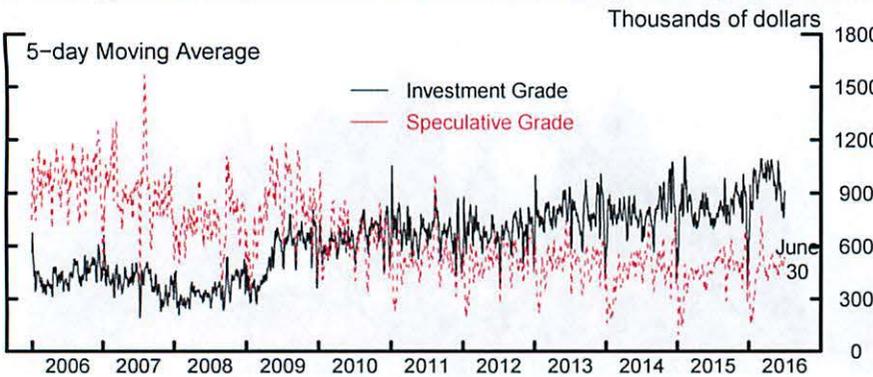
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD

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

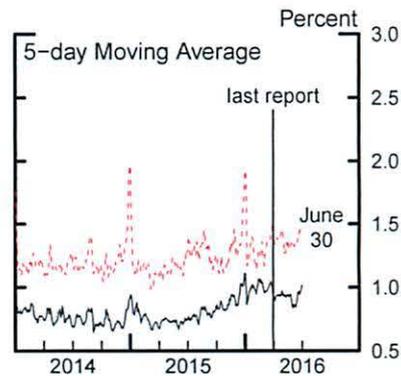
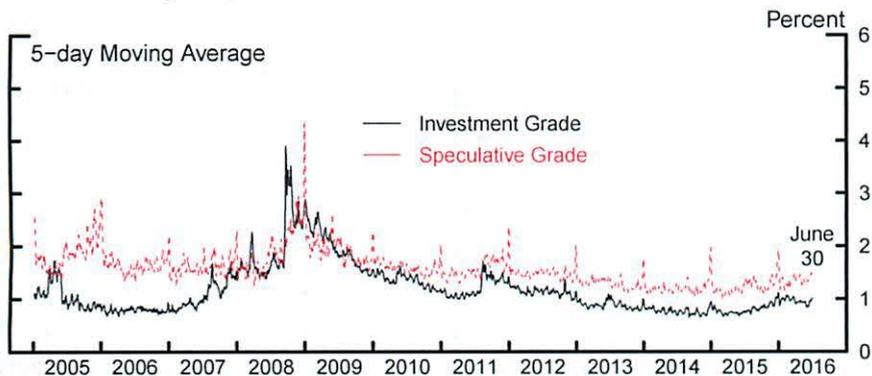
Trading Volume per Disseminated Bond by Rating (Seasonally Adjusted)*



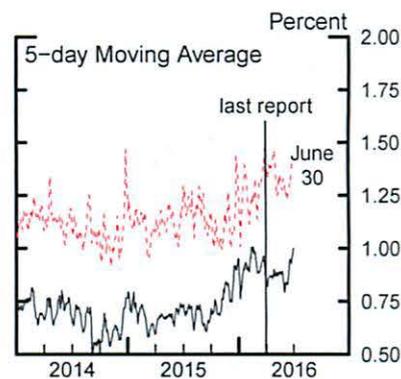
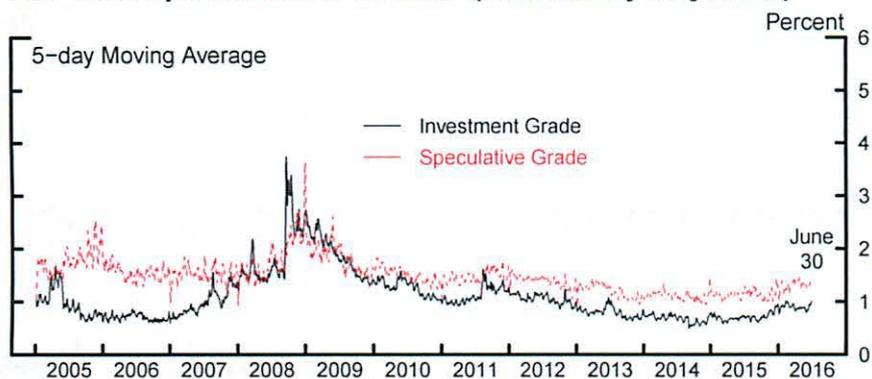
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD

Corporate Bond Liquidity Monitor Exhibit 3

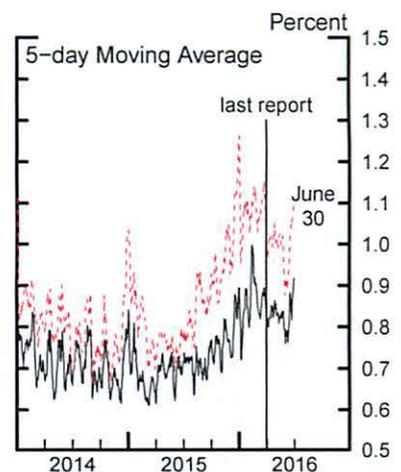
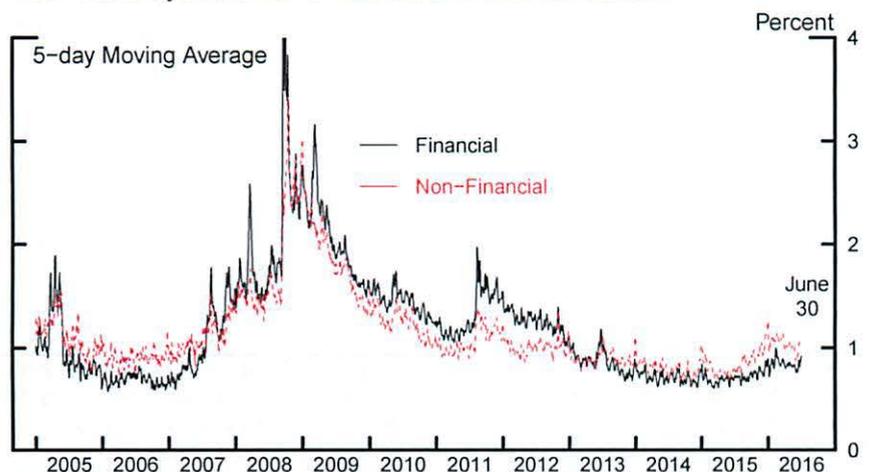
Bid-Ask Spread for All Bonds*



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



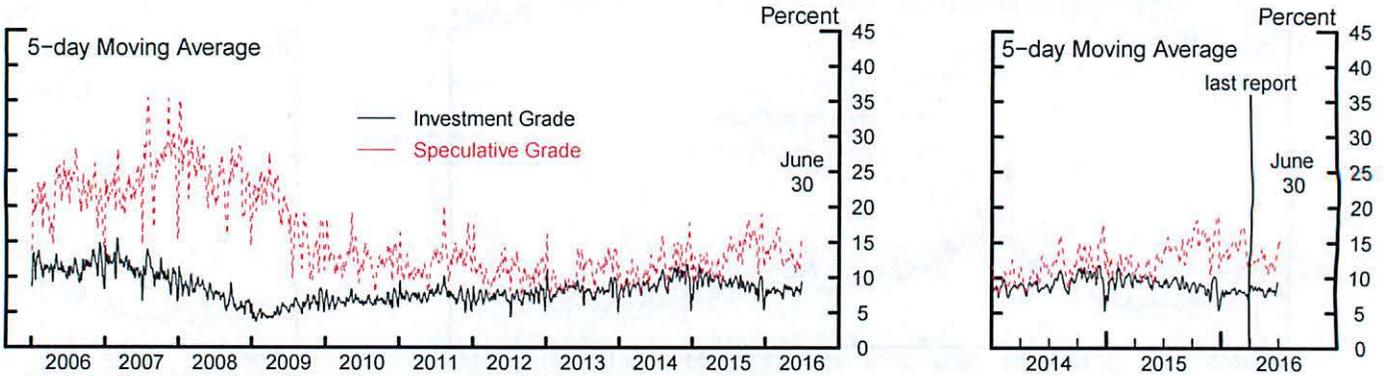
Bid-Ask Spread for Investment Grade Bonds



*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**

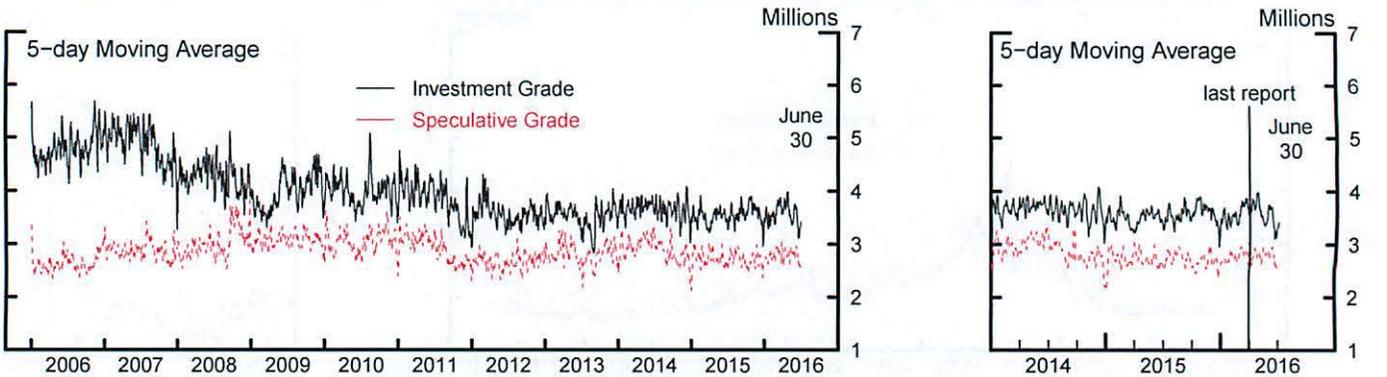
Percentage of Trades Greater than 1 Million in Par Value* (Seasonally Adjusted)



*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

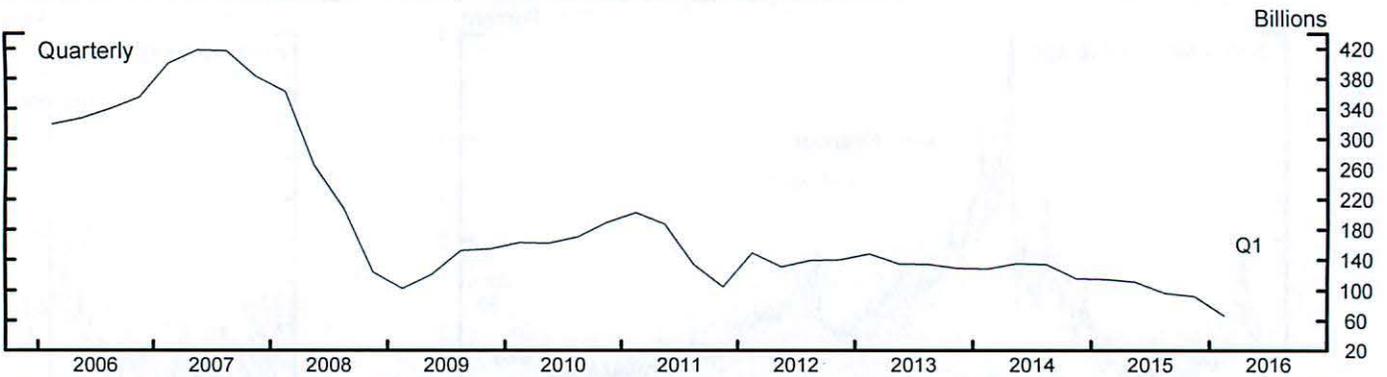
Average Size of Trades that are Greater than 1 Million in Par Value* (Seasonally Adjusted)



*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. Aggregate holdings of U.S. corporate and foreign bonds by U.S. domiciled security brokers and dealers. It includes all other fixed income instruments (excluding syndicated loans) that are issued in the United States, such as privately-issued mortgage backed securities. Source: Federal Reserve. Financial Accounts of the United States.