

Staff Q3 2016 report on corporate bond market liquidity

Summary

This report¹ describes developments in the liquidity and functioning of corporate bond markets from July 1, 2016, through September 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 ample in the United States, despite a notable but brief slowdown in early July following the outcome of the U.K. referendum on June 23 regarding exit from the European Union. Both investment- and speculative-grade corporate bond issuance volumes in Q3 stood comparable to the volumes for the same period in 2015. Relative to Q2, however, a larger portion of speculative-grade issuance in Q3 was earmarked for refinancing than for funding of M&A activity. This trend may be the result of firms opportunistically borrowing at historically low rates. During Q3, on net, yields on both investment- and speculative-grade corporate bonds declined to historically low levels along with those on comparable-maturity Treasury securities.
- 2) Measures of secondary bond market liquidity that reflect the ease and cost with which investors can buy and sell corporate bonds improved slightly in Q3 as a whole. The average daily trading volume for both investment- and speculative-grade bonds remained at the higher end of the ranges observed over the last five years, while the average daily

¹ This report has been agreed to by the staffs 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 (such agencies, collectively referred to as the Agencies). The Agencies have expressed no view regarding the analysis, findings, or conclusions contained in this report.

trading turnover² for both investment- and speculative-grade bonds fluctuated around a level typical for the past five years.³ After adjusting for seasonal patterns, average bid-ask spreads for investment-grade bonds narrowed a touch on net since the last report, standing lower than the average since 2010. The average bid-ask spreads for speculative-grade bonds were little changed, fluctuating below the levels observed during the first half of the year. The fraction of trades with large face value – at least \$1 million – and the average size of such trades for investment-grade bonds were both little changed, while those for speculative-grade bonds declined slightly from their Q2 levels. However, both the fraction and size of these trades remained generally within the ranges that have prevailed over the past few years. Meanwhile, reversing the downward trend observed in recent years, dealers’ inventories of corporate and foreign bonds increased slightly in the second quarter of 2016 (latest data available) but remained near their lowest levels over the past decade.⁴

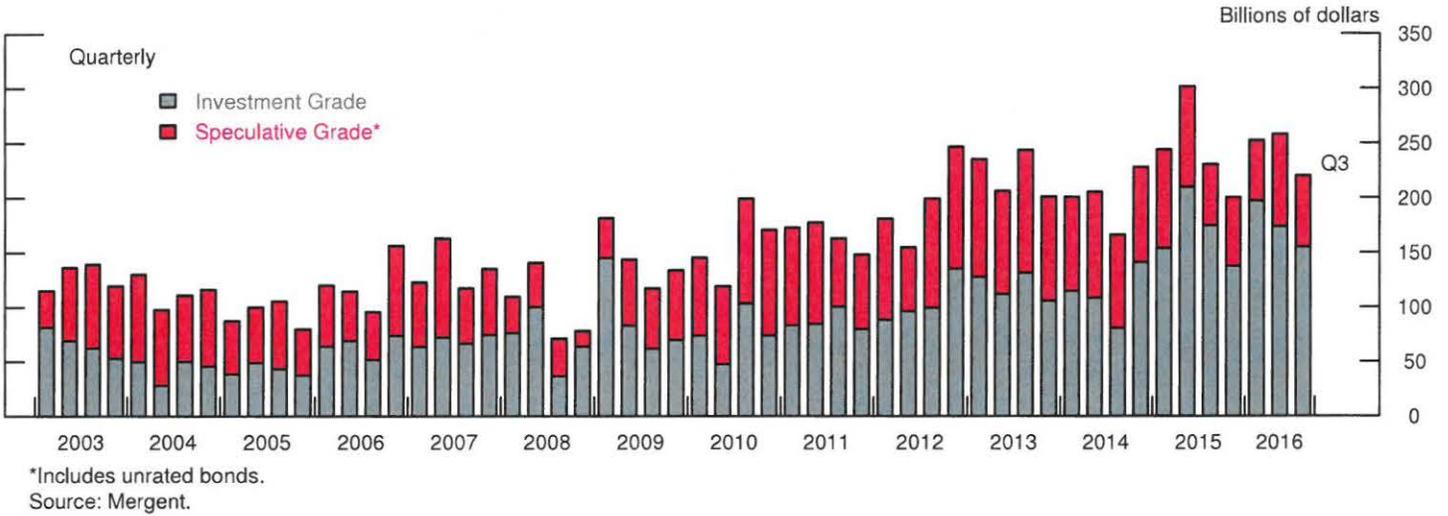
² The average daily trading turnover is a measure of trading volume relative to the face value of bonds outstanding.

³ See Exhibit 2, “Trading Volume and Turnover (Seasonally Adjusted).”

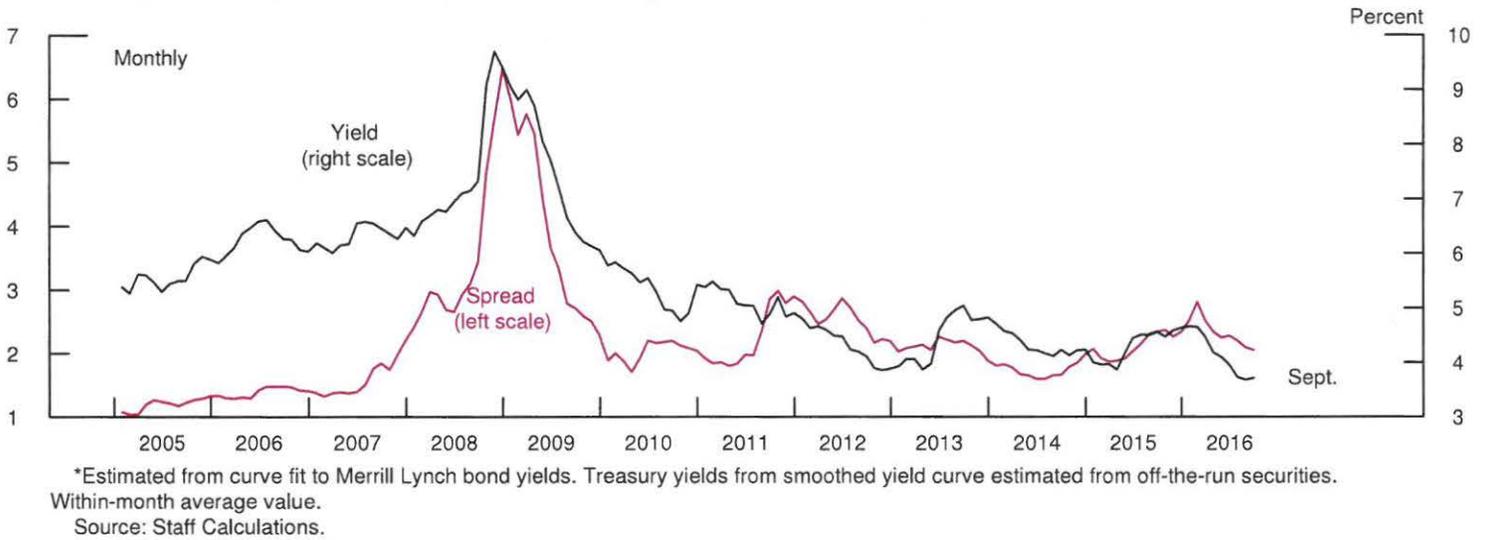
⁴ “Corporate and foreign bonds,” as defined in the Federal Reserve’s Financial Accounts of the United States, includes, in addition to bonds issued in the United States by U.S. corporations and foreign corporate and sovereign entities, all other fixed income instruments (excluding syndicated loans) that are issued in the United States, such as privately-issued mortgage backed securities.

Exhibit 1 Corporate Bond Liquidity Monitor

Gross Issuance of Nonfinancial Corporate Bonds



Ten-Year BBB Bond Yield and Spread to Treasury*



Use of Proceeds for Speculative Grade Issues*

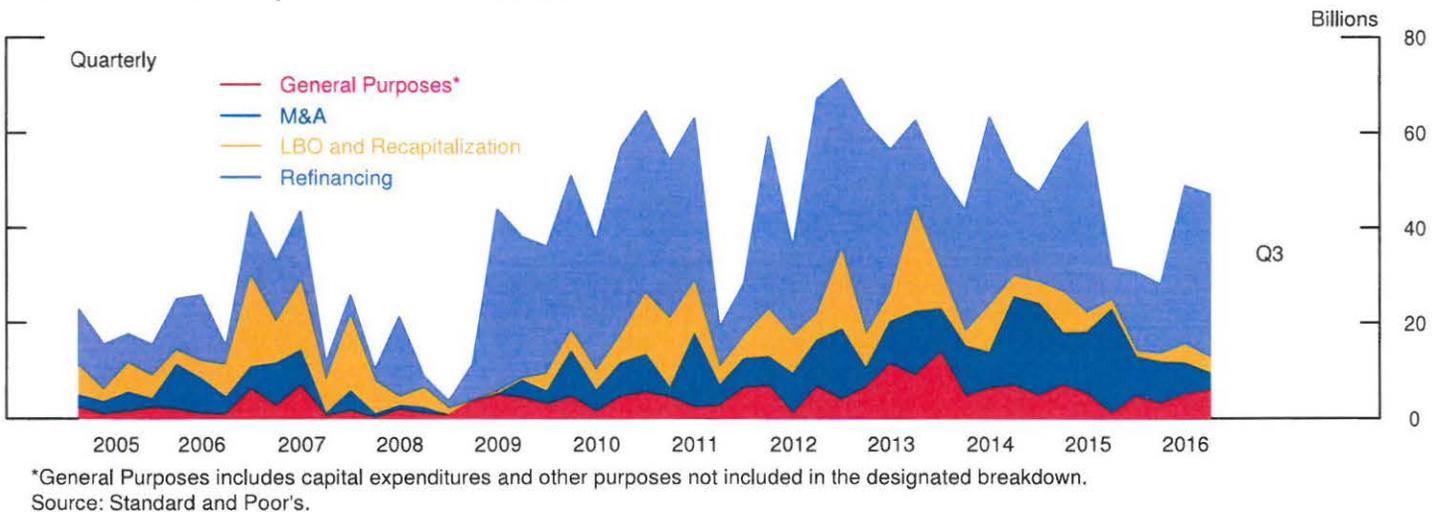
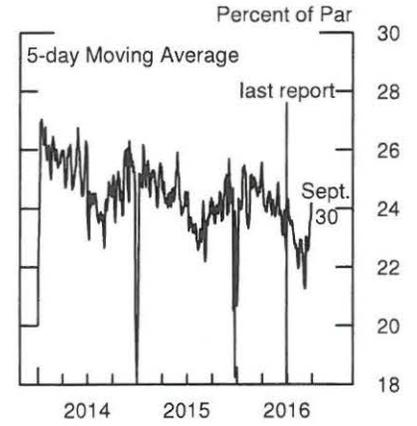
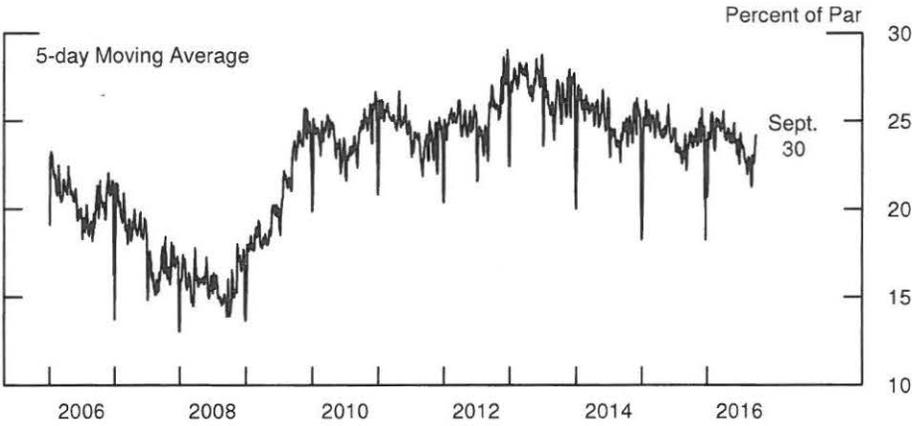


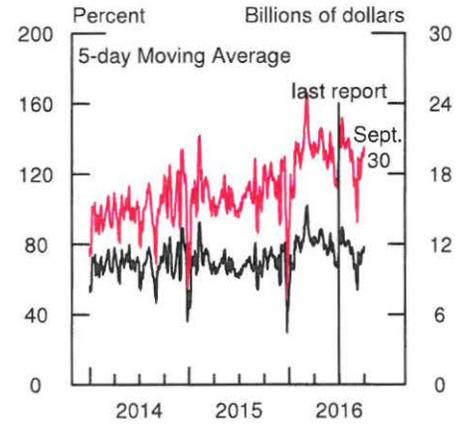
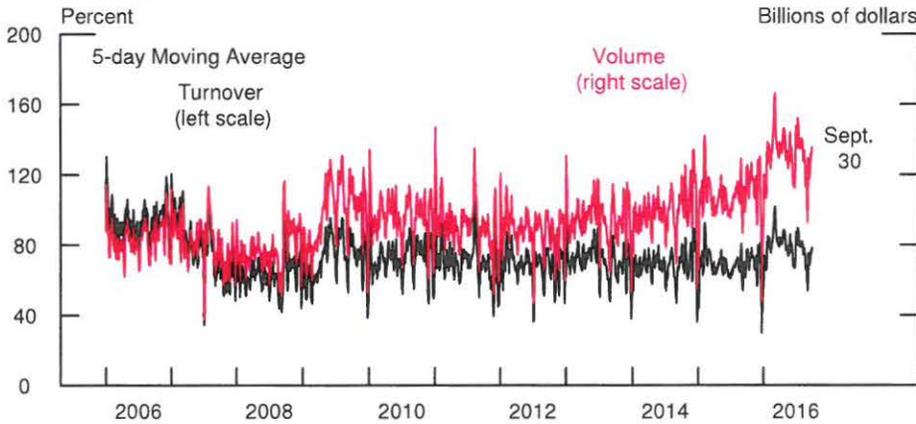
Exhibit 2 Corporate Bond Liquidity Monitor

Number of Traded Bonds as a Fraction of Total Disseminated*



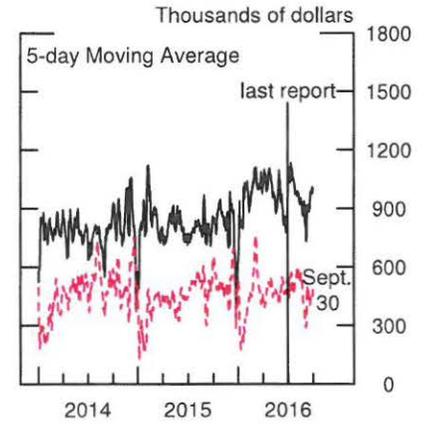
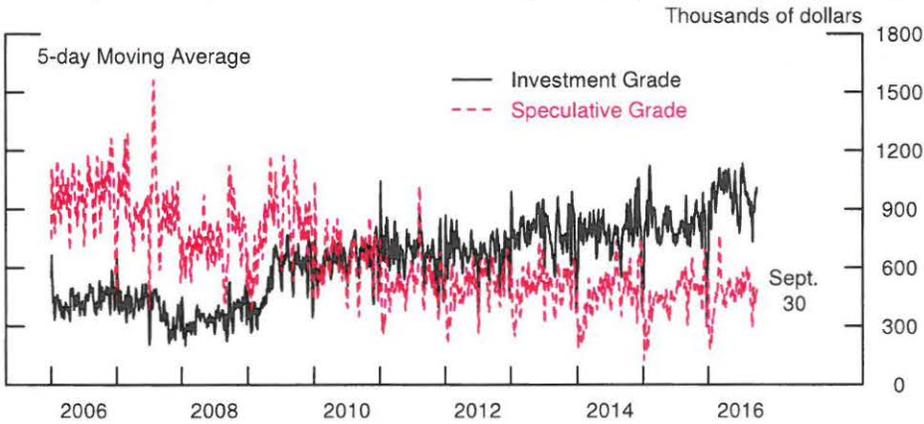
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD.

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.

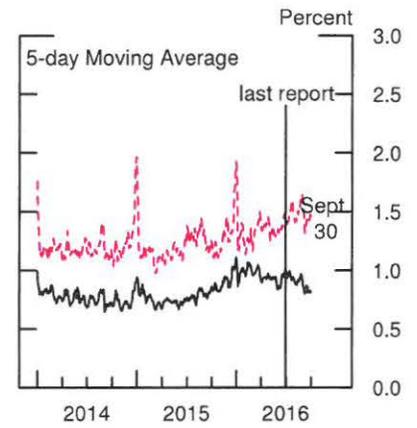
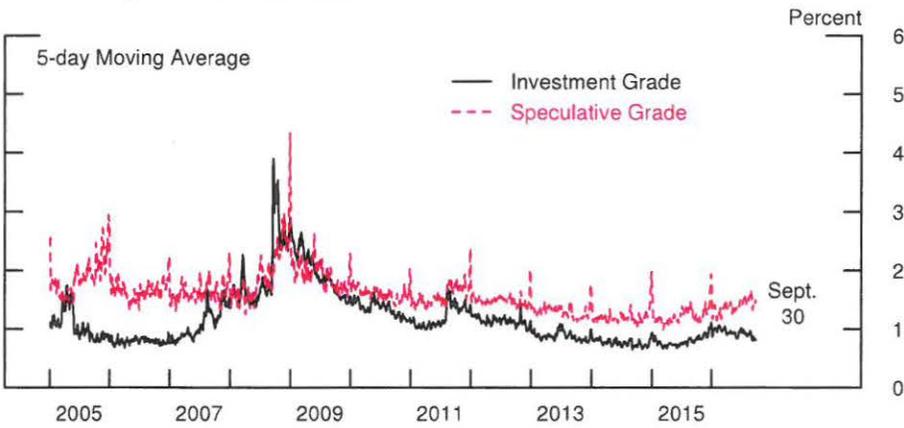
Trading Volume per Disseminated Bond by Rating (Seasonally Adjusted)*



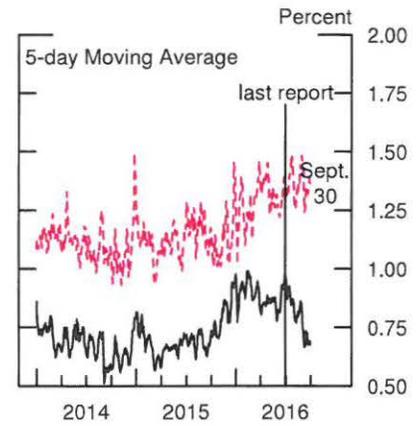
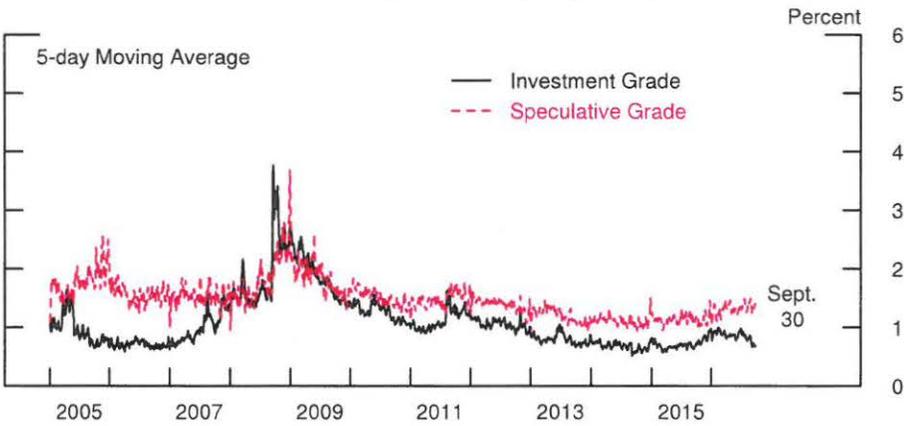
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD.

Exhibit 3 Corporate Bond Liquidity Monitor

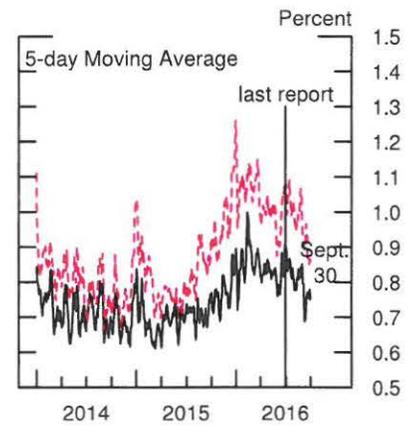
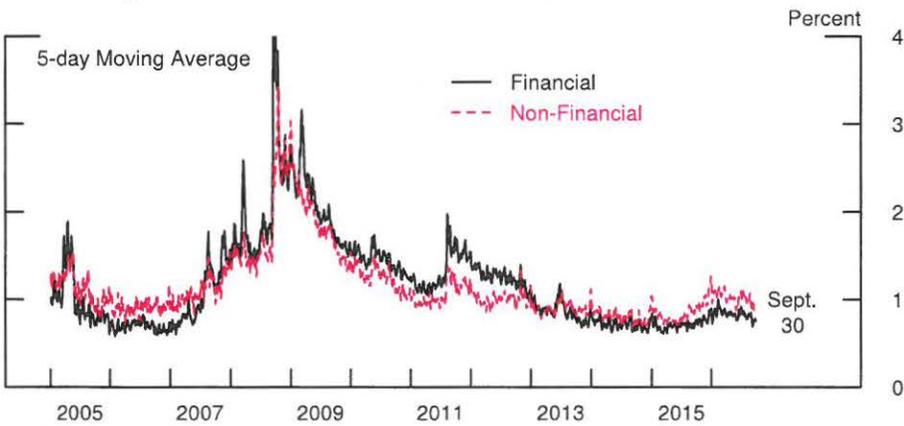
Bid-Ask Spread for All Bonds*



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



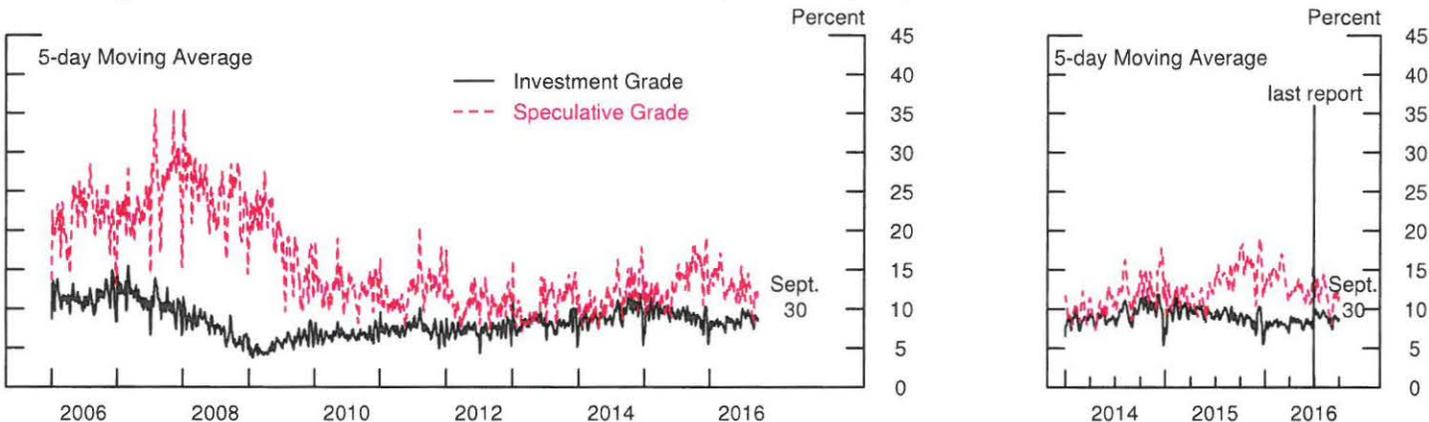
Bid-Ask Spread for Investment Grade Bonds*



*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.

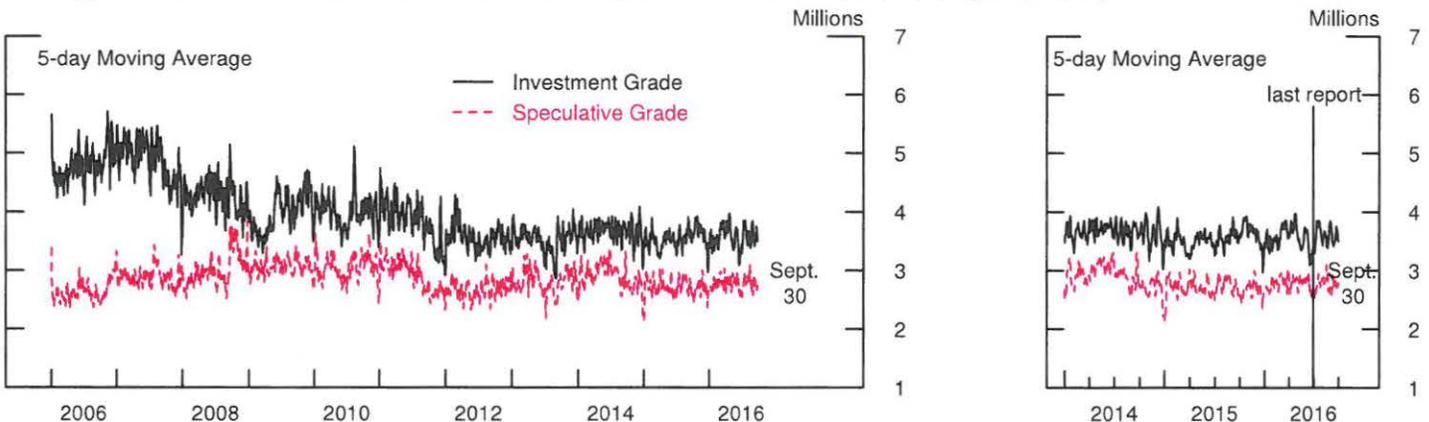
Exhibit 4 Corporate Bond Liquidity Monitor

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



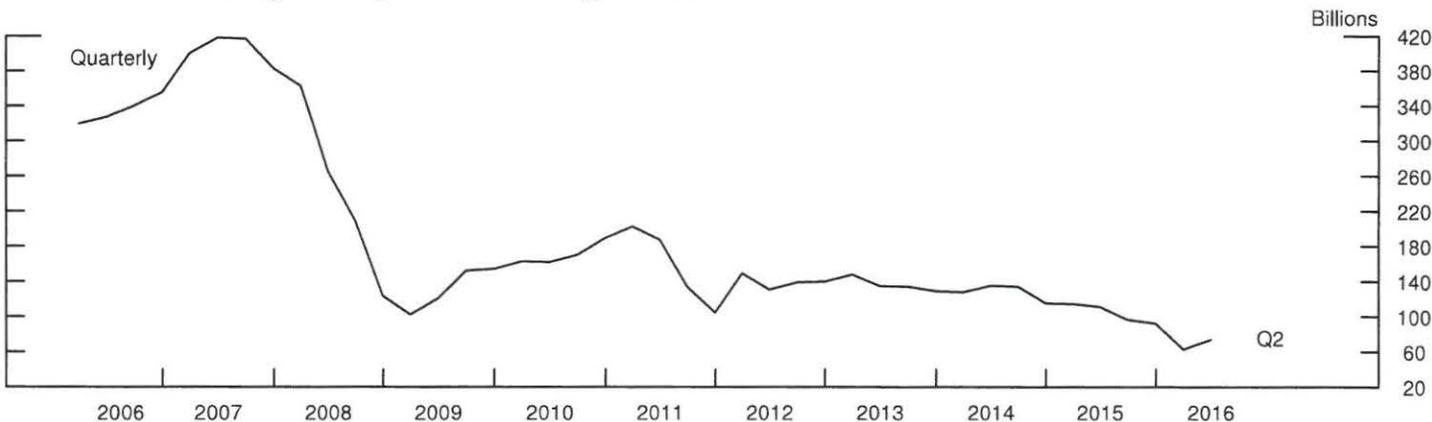
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD.

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.