

Staff Q4 2016 report on corporate bond market liquidity

Summary

This report¹ describes developments in the liquidity and functioning of corporate bond markets from October 1, 2016, through December 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—remained accommodative in the United States, despite slowing down somewhat earlier in the quarter. Both investment- and speculative-grade corporate bond issuance volumes in Q4 stood comparable to the volumes over the same period in 2015, and following the same trend from Q3 2016, the majority of proceeds from speculative-grade issuance continued to be earmarked for refinancing. The still healthy pace of bond issuance may be the result of opportunistic borrowing by firms at low corporate rates. While yields on both investment- and speculative-grade corporate bonds, on net, increased relative to Q3, they stood near historically low ranges over the past decade. In addition, spreads for both investment- and speculative-grade corporate bonds over comparable-maturity Treasury securities tightened notably since the last report.
- 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 Q4, as a whole. The

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.

average daily trading volume for both investment- and speculative-grade bonds remained at the higher end of the ranges observed over the last five years², while the average daily trading turnover³ for both investment- and speculative-grade bonds fluctuated around a level typical for the past five years. After adjusting for seasonal patterns, average bid-ask spreads for investment-grade bonds remained unchanged on net since the last report, standing around the lower ranges of its distribution since 2010. The average bid-ask spreads for speculative-grade bonds declined steadily over Q4, fluctuating below the median levels observed since 2010. 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 were little changed from their Q3 levels. Meanwhile, dealers’ inventories of corporate and foreign bonds are little changed in the third quarter of 2016 (latest data available) from the previous quarter, but remained near their lowest levels over the past decade.⁴

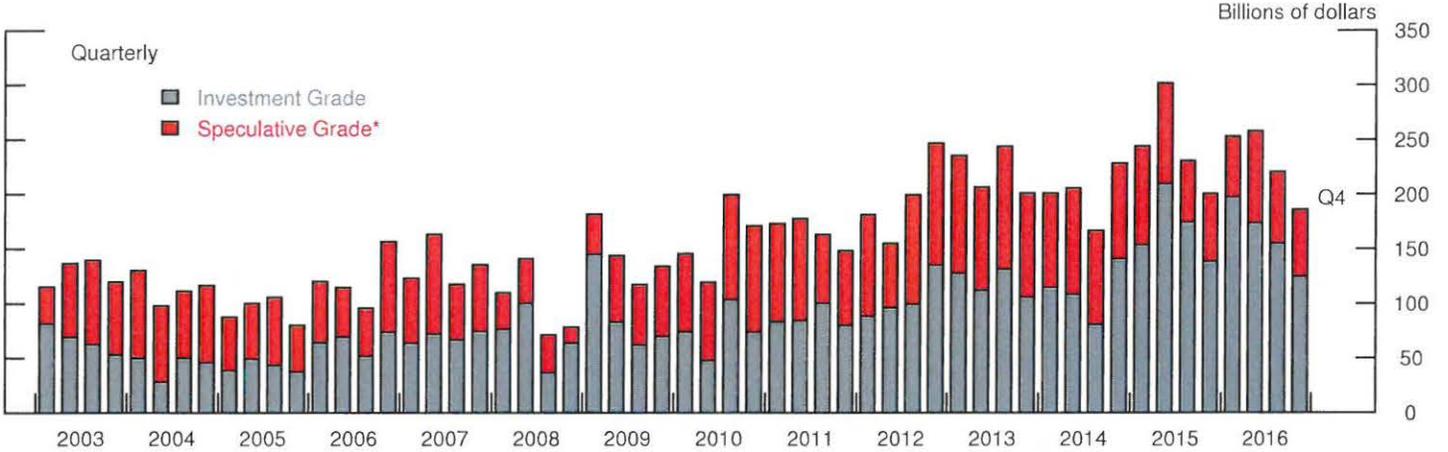
² See Exhibit 2, “Trading Volume and Turnover (Seasonally Adjusted)” and “Trading Volume by Rating (Seasonally Adjusted).”

³ The average daily trading turnover is a measure of trading volume relative to the face value of bonds outstanding.

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.

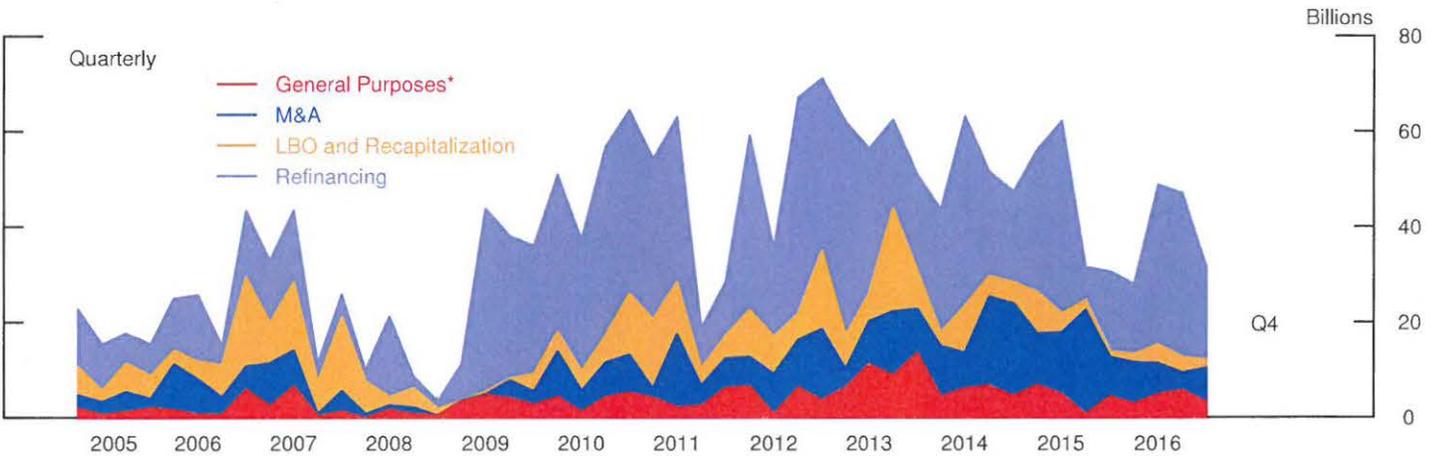
Exhibit 1 Corporate Bond Liquidity Monitor

Gross Issuance of Nonfinancial Corporate Bonds



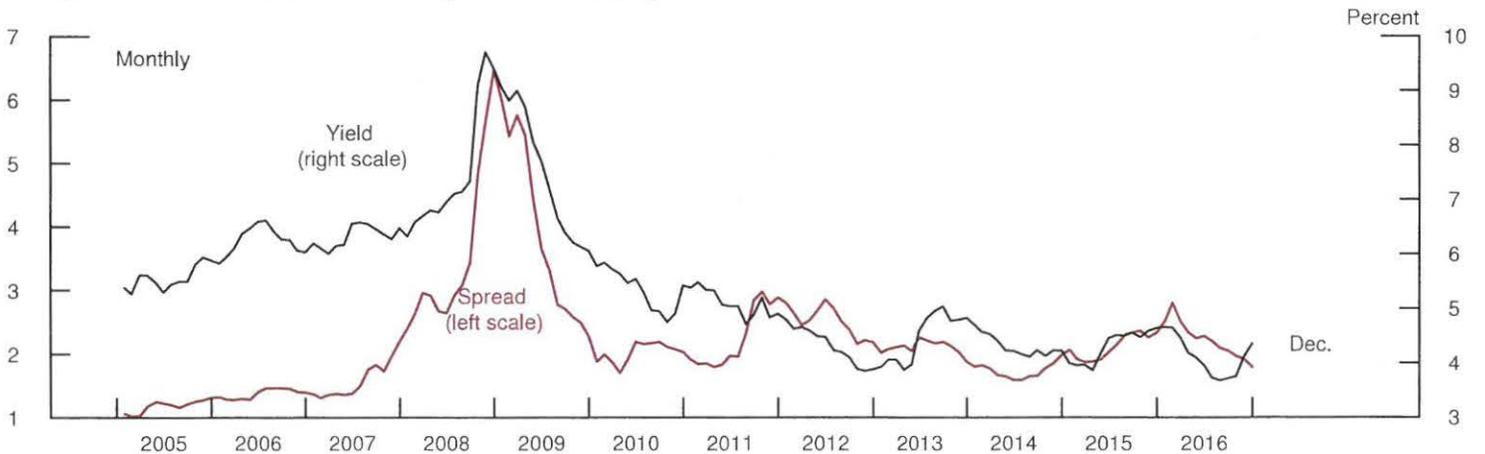
*Includes unrated bonds.
Source: Mergent.

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.

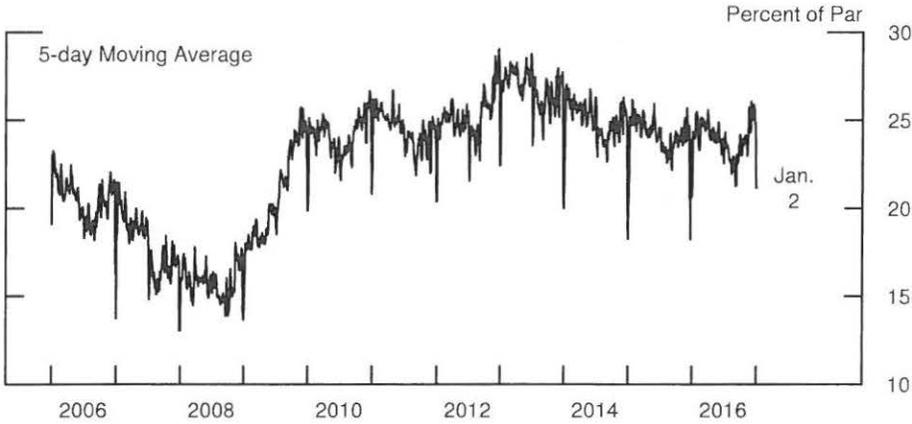
Ten-Year BBB Bond Yield and Spread to Treasury*



*Estimated from curve fit to Merrill Lynch bond yields. Treasury yields from smoothed yield curve estimated from off-the-run securities.
Within-month average value.
Source: Staff Calculations.

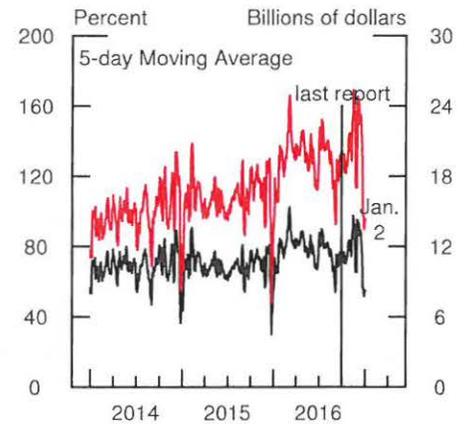
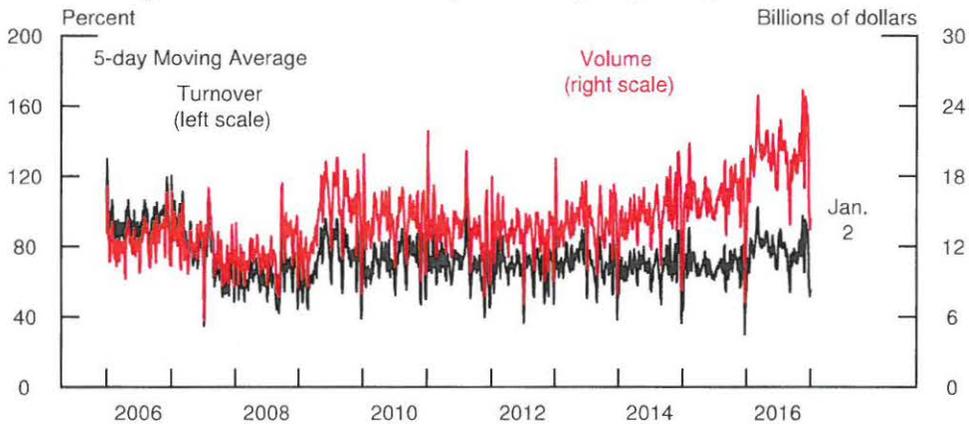
Exhibit 2 Corporate Bond Liquidity Monitor

Number of Traded Bonds as a Fraction of Total Disseminated*



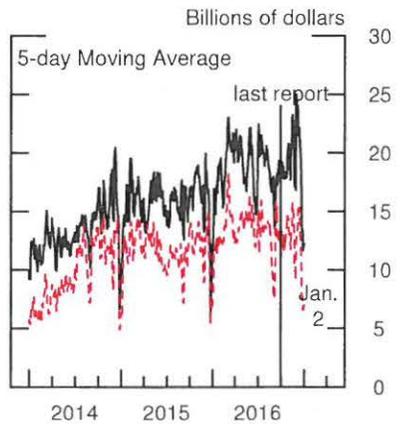
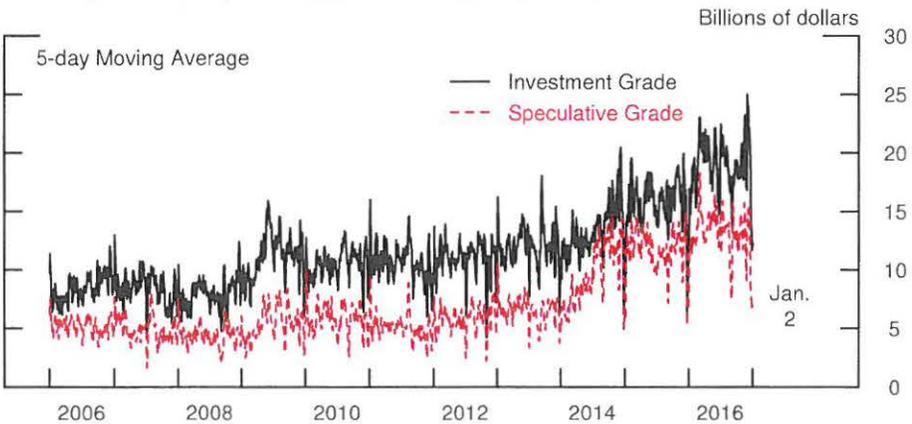
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD.

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.

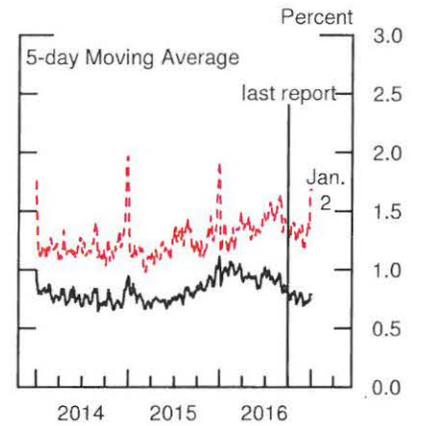
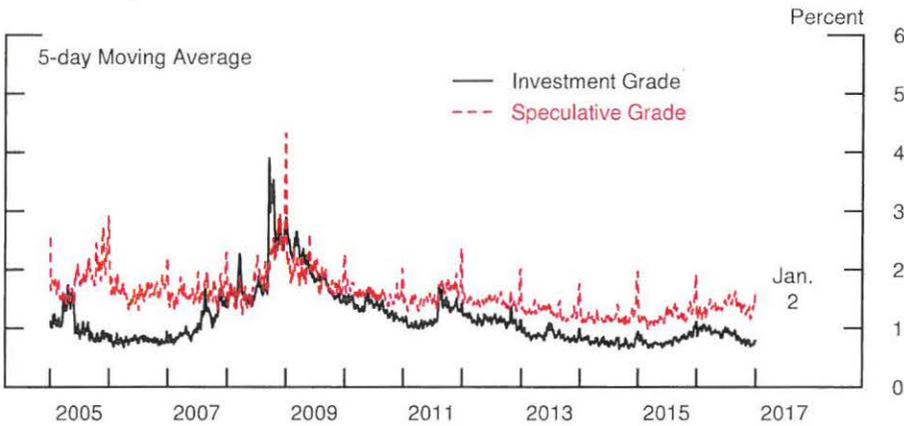
Trading Volume by Rating (Seasonally Adjusted)



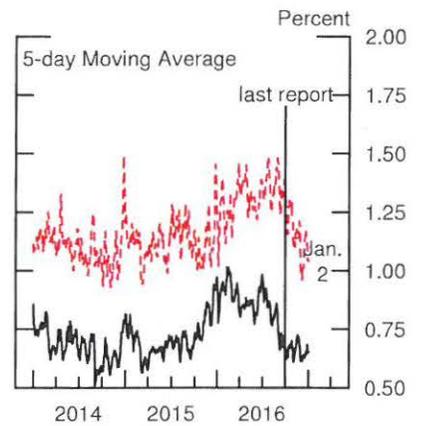
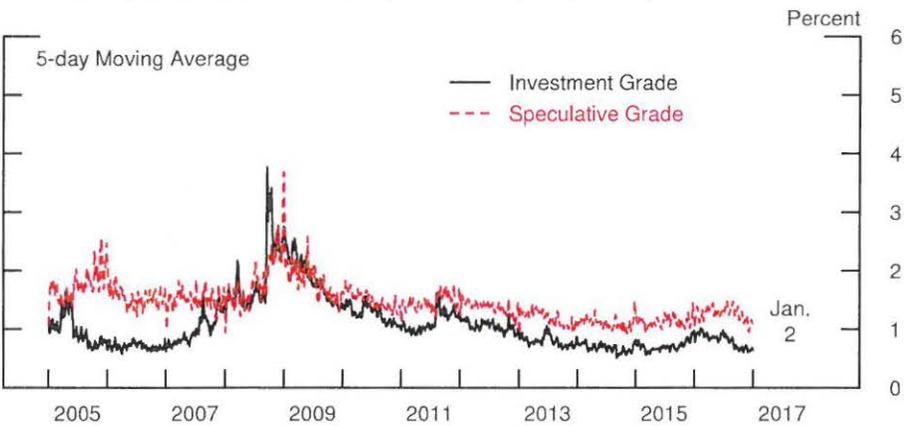
Source: FINRA.

Exhibit 3 Corporate Bond Liquidity Monitor

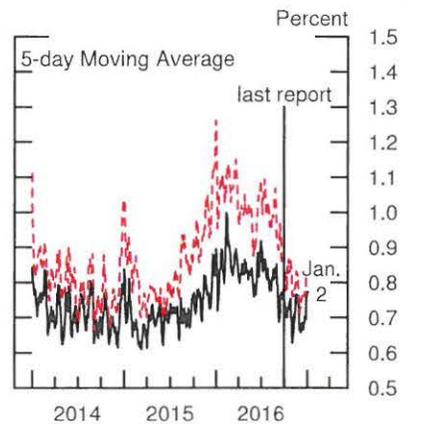
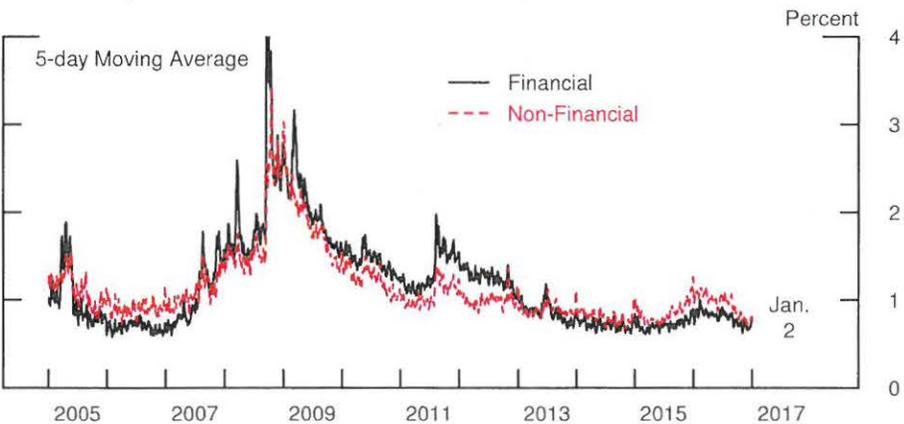
Bid-Ask Spread for All Bonds*



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



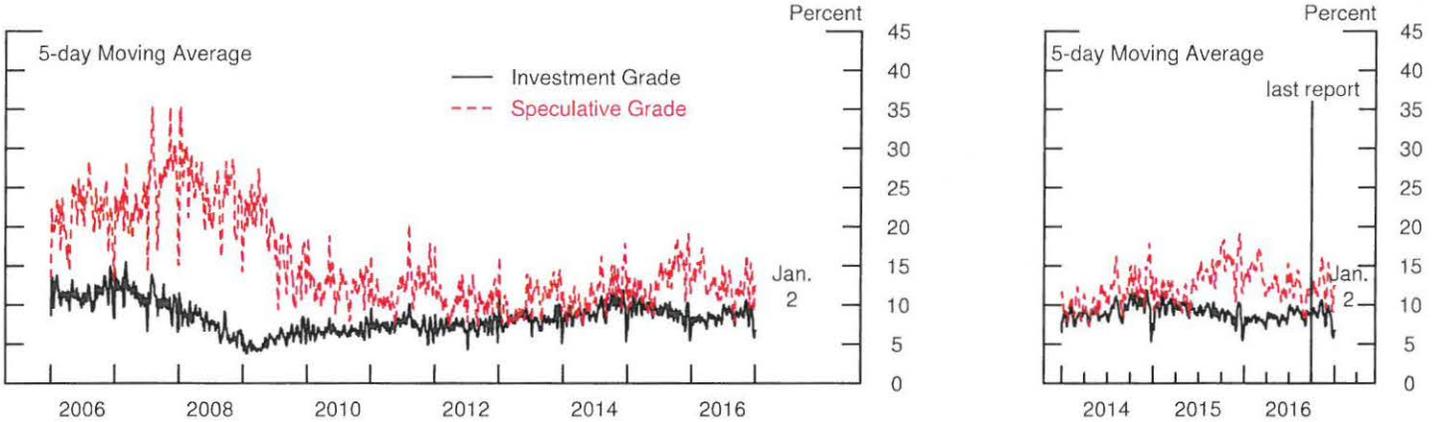
Bid-Ask Spread for Investment Grade Bonds*



*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.

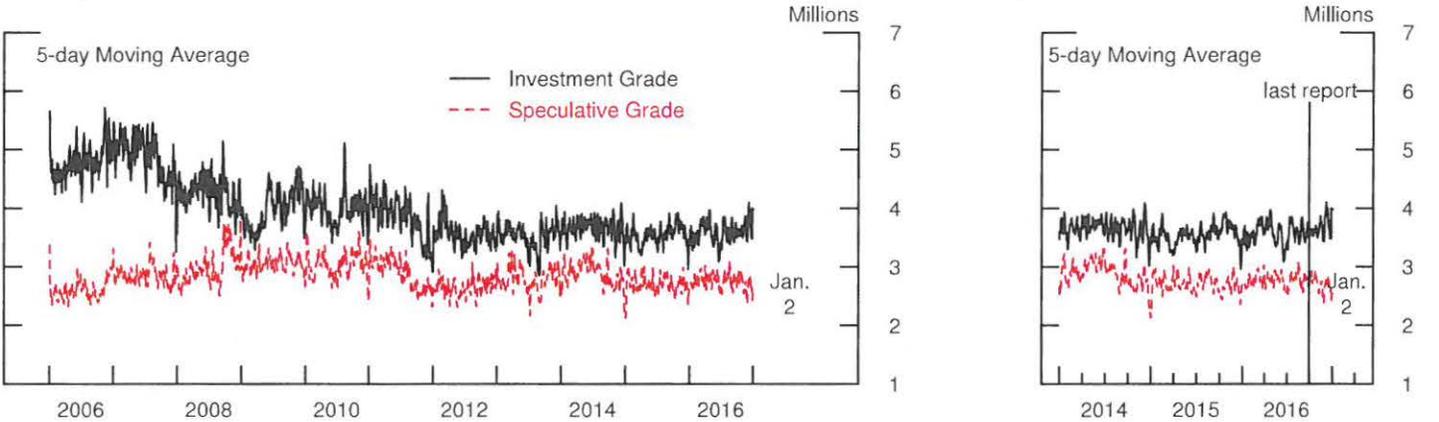
Exhibit 4 Corporate Bond Liquidity Monitor

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



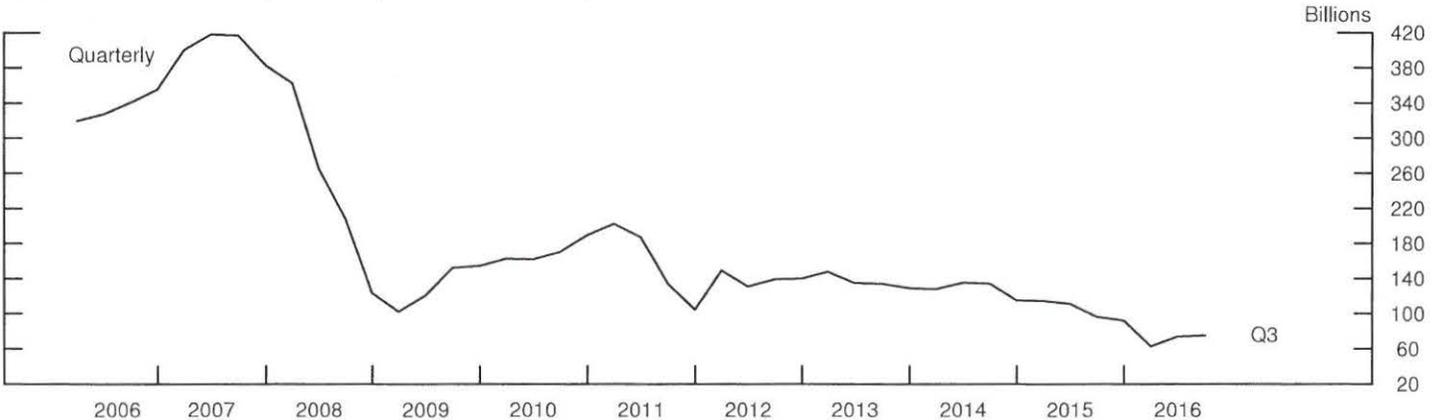
*Only trades of bonds that have been issued for 60 days or more at the time of trading are included. Excluding 144a bonds.
Source: FINRA, Mergent, Moody's DRD.

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.