Research Working Papers

What Did Policy Interventions Fix in the Municipal Bond Market - Liquidity or Credit?

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Policy interventions during the COVID-19 pandemic stabilized the municipal bond market and shifted the pricing of localized credit risks from short-maturity bonds to longer-dated bonds.

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We examine how policy interventions during the COVID pandemic impacted municipal bond market pricing. Focusing on narrow trading windows, we fi nd that announcements of fiscal and direct monetary policy interventions reduced liquidity risk concerns but did not immediately ease credit concerns. Using rolling-window regressions, we fi nd that policy interventions eased credit concerns for short-term bonds over time, while longer-term bond spreads show increased credit risks. The credit risk shift from short- to long-term bonds reflects policy designs that bene fited short-term bonds more, as well as changing investor expectations on state and local government budgets due to the pandemic's persistence.

JEL Classification: E52, E62, G12, H74

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