



## **Research Working Papers**

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

by: Huixin Bi and W. Blake Marsh

December 21, 2020

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.

RWP 20-19, December 2020; updated January 2022

We examine how policy interventions during the COVID pandemic impacted municipal bond market pricing. Focusing on narrow trading windows, we find 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 find 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

## **Article Citation**

 Bi, Huixin, and W. Blake Marsh. 2020. "What Did Policy Interventions Fix in the Municipal Bond Market - Liquidity or Credit?" Federal Reserve Bank of Kansas City, Research Working Paper no. 20-19, December. Available at https://doi.org/10.18651/RWP2020-19

## **Authors**



Huixin Bi Research and Policy Officer

Huixin Bi is a Research and Policy Officer in the Economic Research Department of the Federal Reserve Bank of Kansas City. Previously, Ms. Bi served as an economist at the Bank of Canada from 2010 to 2015. Her main areas of research are fiscal policy, sovereign debt and computational economics. She holds a B.S. in engineering from Nankai University in China, a M.S. in engineering at Rose-Hulman Institute of Technology, and a Ph.D. in economics from Indiana University.



W. Blake Marsh Senior Economist

Blake Marsh is a senior economist at the Federal Reserve Bank of Kansas City. He joined the Banking Research department in July 2016. His research areas are commercial bank regulation and financial intermediation. His current research examines commercial real estate lending, syndicated corporate lending, and financial innovation. Mr. Marsh holds a B.A. in economics from The George Washington University and M.A. and Ph.D. degrees from American University. He previously held positions at the Board of Governors of the Federal Reserve System and in the mortgage industry.