



Municipal Securities Rulemaking Board

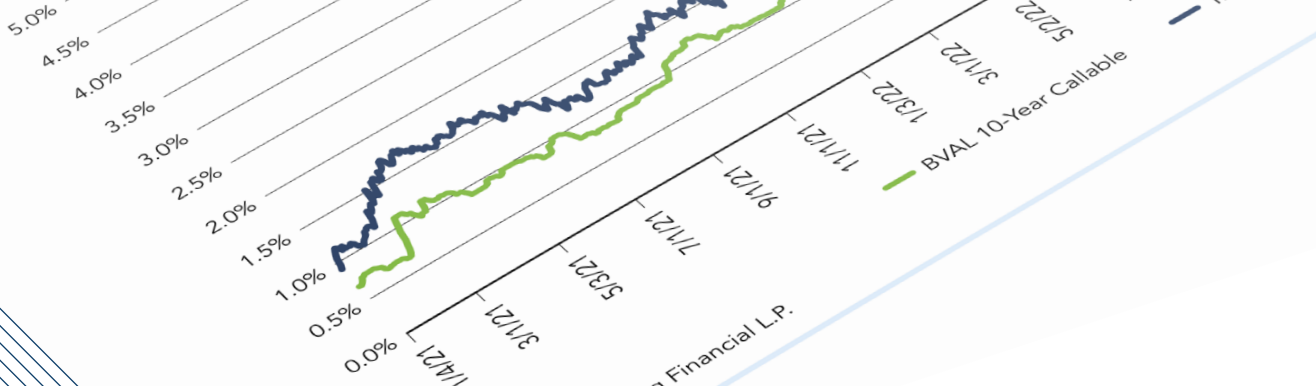
OCTOBER 2023

Third Quarter 2023 Municipal Securities Market Summary

Summary		Bloomberg BVAL® AAA Callable and U.S. Treasury Yields			
TSY 09/30/23	Muni/TSY Ratio	BVAL Q3 23 Change BPS	TSY Q3 23 Change BPS	BVAL 06/30/23	TSY 06/30/23
3.709	68%	72	6	2,994	5,400
3.633	77%	74	16	2,897	4,870
3.493	73%	74	31	2,755	4,130
3.357	75%	77	47	2,590	3,810
3.424	84%	85	78	2,527	4,060
4.127	92%	85	86	3,278	4,060
4.358				3,504	3,850

As shown in Figure 2 below, 10-year benchmark yields began the quarter around 2.52%. Yields rose at the beginning of July but a rally in tax-exempt yields bottomed out at 2.45% in late July. However, from late July through the end of the quarter, 10-year bond yields rose almost 100 basis points. Figure 2 also shows the recent rise in Treasury yields, as well as the relationship of 10-year tax-exempt benchmark yields to 10-year Treasury bond yields.

Figure 2. Treasury 10-Year and Bloomberg BVAL 10-Year U.S. Tax-Exempt Yields, January 2021 - September 2023



Source: Bloomberg Financial L.P.

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Introduction¹

The third quarter of 2023 was highlighted by another strong move to higher benchmark yields across the curve. Continuing concerns about inflation and the potential for additional Federal Reserve Board (Fed) interest rate hikes caused yields to rise in the Treasury market and municipal bond market. Although trade count levels are lower than we saw in the record-setting fourth quarter of 2022, they remain high from a historical perspective indicating continued demand from individual investors. While demand in separately managed accounts has remained strong, continued outflows from tax-exempt mutual funds coupled with banks reducing their holdings of municipal bonds has reduced overall demand from institutional investors. New issue volume remains modest, which is fortunate because a heavy supply of new issues could prove challenging because of limited demand components in the market.

Benchmark Yields

Figure 1 below shows that tax-exempt benchmark rates rose 72-90 basis points as investors remain concerned about inflationary pressures and the potential for further rate hikes by the Fed. Benchmark tax-exempt rates rose significantly more than Treasury bonds on the short end of the curve but at comparable levels on the longer end of the curve. Figure 1 also shows that the Muni/Treasury ratio (M/T) remains historically low through 10 years, indicating that yields on tax-exempt bonds are low relative to the yields on Treasury bonds. This is likely due to enhanced individual investor demand for municipal bonds.

Treasury yields have risen substantially this year. In fact, the 10-year Treasury reached 4.67% on September 27, a level not seen since 2007. Meanwhile 10-year benchmark tax-exempt yields rose to 3.47% on September 28, surpassing the yields we saw in October 2022 and approaching 10-year yields we last saw in 2011.

¹ The views expressed in the research paper are those of the author(s) and do not necessarily reflect the views and positions of the MSRB Board and other MSRB staff.

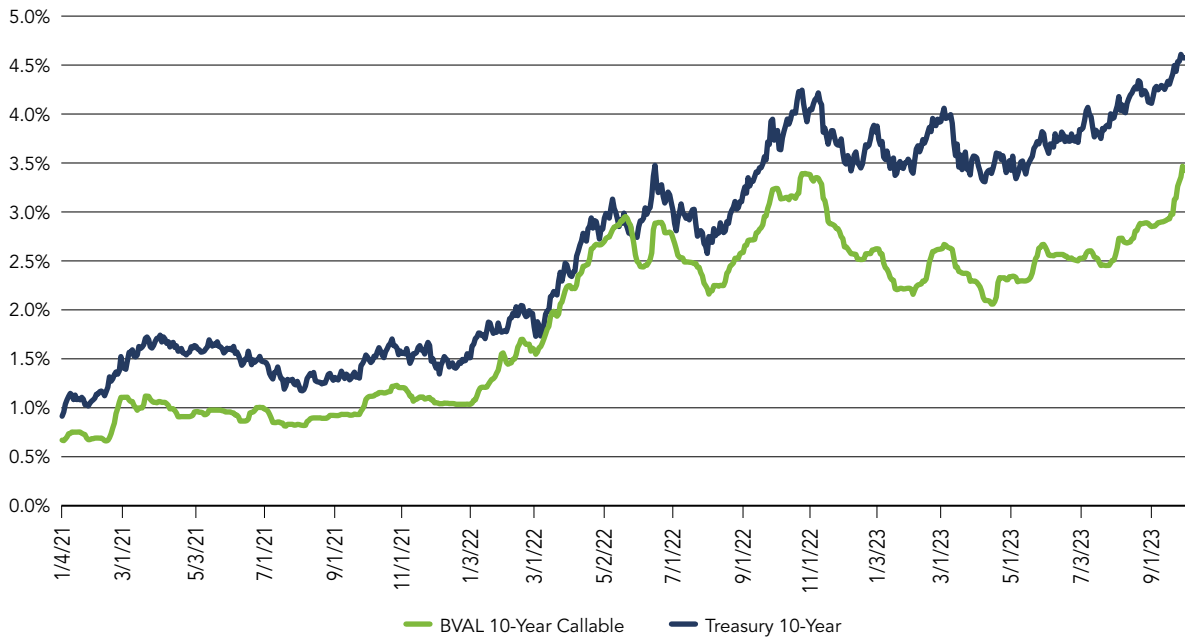
Figure 1. Bloomberg BVAL® AAA Callable and U.S. Treasury Yields

Year	BVAL 09/30/23	TSY 09/30/23	Muni/TSY Ratio	BVAL Q3 23 Change BPS	TSY Q3 23 Change BPS	BVAL 06/30/23	TSY 06/30/23
1	3.709	5.460	68%	72	6	2.994	5.400
2	3.633	5.030	72%	74	16	2.897	4.870
3	3.493	4.800	73%	74	31	2.755	4.490
5	3.357	4.600	73%	77	47	2.590	4.130
10	3.424	4.590	75%	90	78	2.527	3.810
20	4.127	4.920	84%	85	86	3.278	4.060
30	4.358	4.730	92%	85	88	3.504	3.850

Sources: Bloomberg Finance L.P., U.S. Department of the Treasury

As shown in Figure 2 below, 10-year benchmark yields began the quarter around 2.52%. Yields rose at the beginning of July but a rally in tax-exempt bonds saw rates bottom out at 2.45% in late July. However, from late July through the end of the quarter, 10-year tax-exempt yields rose almost 100 basis points. Figure 2 also shows the recent rise in Treasury bond yields, as well as the relationship of 10-year tax-exempt benchmark yields to 10-year Treasury bond yields.

Figure 2. Treasury 10-Year and Bloomberg BVAL 10-Year Callable Yields, January 2021–September 2023



Source: Bloomberg Financial L.P.

Trade Volume²

As previous MSRB research has shown, we again saw trade volume rise as tax-exempt yields rose in the last two months of the quarter. In July, the daily average number of trades reported to the MSRB was 43,939. In August and September, when tax-exempt rates rose, the daily average number of trades was just below 52,000, up 18% compared to July.

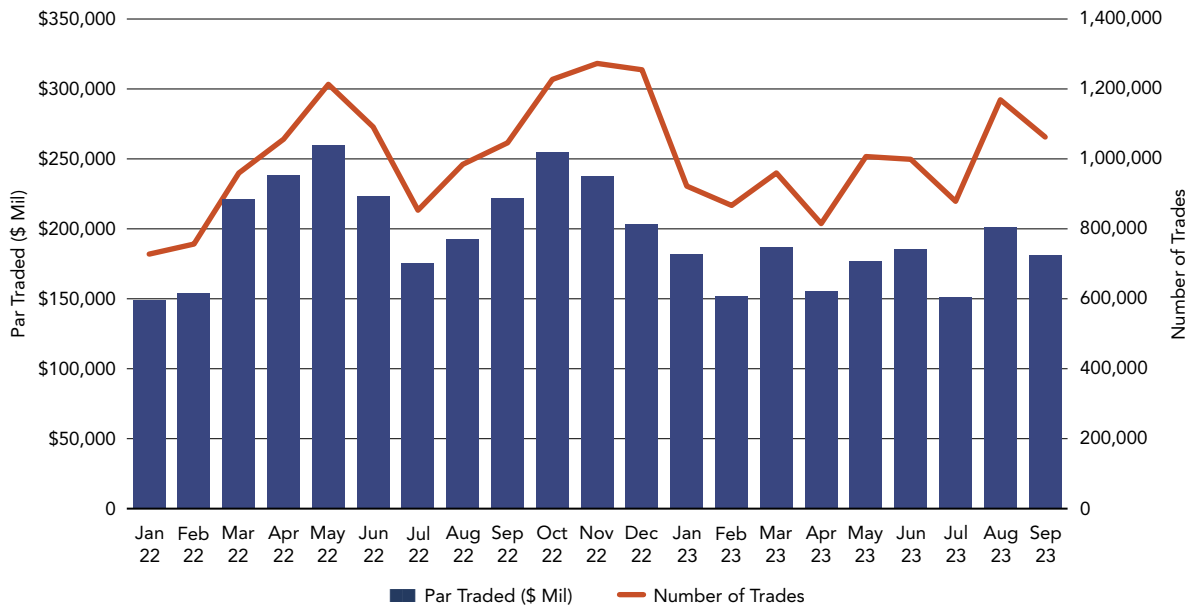
Figure 3 below shows quarterly trade activity measured by the number of trades and par amount traded. For the third quarter, the overall number of trades reported to the MSRB increased to 3.1 million compared to 2.8 million in the second quarter and 2.9 million in the same period of 2022. The average number of trades for the third quarter was 49,369, up 9% compared to the second quarter of 2023 and up 10% compared to the third quarter of 2022. In terms of par amount traded, volume increased 3% in the third quarter compared to the second quarter but decreased 10% compared to the third quarter of 2022.

As for participation of individual investors compared to institutional investors, the number of trades of \$100,000 or less, often used as a proxy for individual investor trades, increased by 11% in the third quarter of 2023 compared to the second quarter of 2023 and 10% compared to the same period in 2022. Whereas trades of \$1,000,000 or more, often used as a proxy for institutional investor trading, decreased by about 3% compared to the second quarter of 2023 and 8% compared to the third quarter of 2022.

The par amount traded in blocks of \$1,000,000 or more increased slightly to \$339.4 billion in the third quarter from \$337.8 billion in the second quarter, but was down 16% compared to the third quarter of 2022. For trades of \$100,000 or less, the third quarter par amount traded was up 12% compared to the second quarter and up 6% compared to the same period in 2022.

² Excluding variable rate securities and municipal commercial paper.

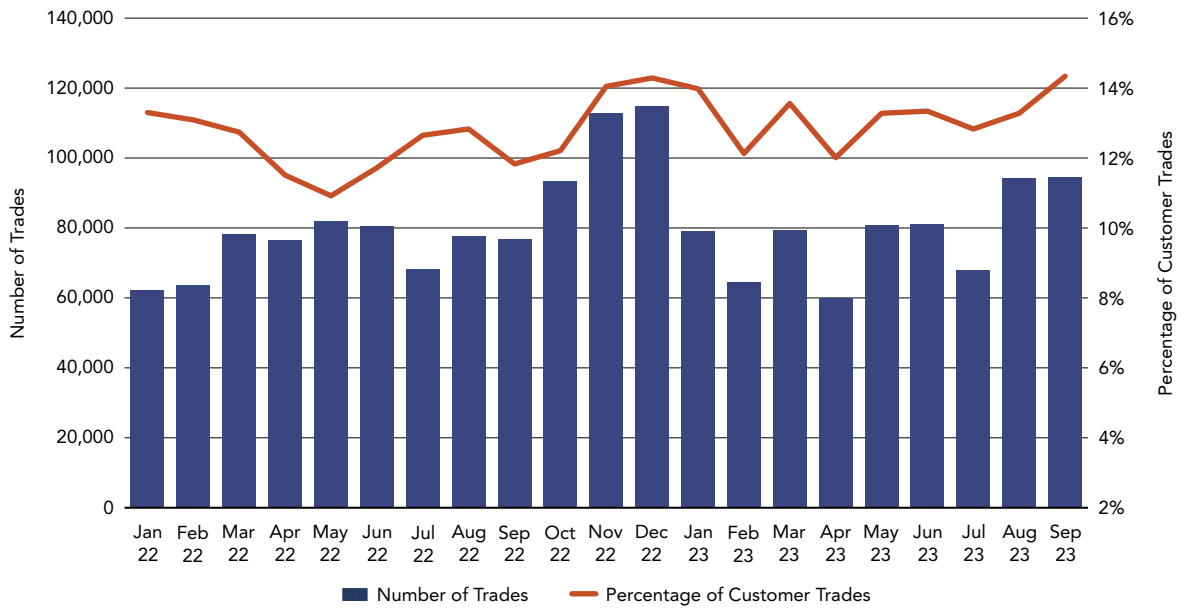
Figure 3. Monthly Municipal Market Activity, Fixed-Rate Securities, January 2022–September 2023



Trading on Alternative Trading Systems

Figure 4 shows the number of customer trades executed with the dealer of an alternative trading system (ATS) as well as the percentage of customer trades executed with the dealers of ATSs compared to all customer trades. The percentage of interdealer trades executed over an ATS was very steady at 57% for the third quarter of 2023, although the percentage in September was the lowest since April of 2022, when ATSs represented 54% of interdealer trades. Meanwhile, ATSs continue to increase their presence in trading with customers. Customer trades executed by a dealer associated with an ATS represented 13.5% of all customer trades for the third quarter of 2023 compared to 12.9% in the second quarter and 12.4% in the same period of 2022, as shown in Figure 4 below. The number of offerings on ATSs also increased substantially in the latter part of the quarter.

Figure 4. Institutional Customer Trades Executed on ATS, January 2022–September 2023



Mutual Fund and Exchange Traded Fund Flows

Although any outflows from tax-exempt mutual funds we see are nowhere near what we saw in 2022, tax-exempt mutual funds continue to struggle to attract net assets. According to the Investment Company Institute (ICI), outflows for the third quarter totaled more than \$6 billion through September 27, 2023.³ Although demand from individual investors has been strong, the lack of consistent inflows likely tempered demand from mutual funds. This is significant because mutual funds tend to buy longer dated bonds than individual investors. So, it could be a struggle to place new issue debt if new issue volume increases in the future.

Unlike mutual funds, tax-exempt exchange traded funds (ETF) saw slight inflows in the third quarter. According to ICI, tax-exempt ETFs saw net inflows of more than \$3 billion through September 29, 2023.⁴ However, these inflows are far less than the net inflows tax-exempt ETFs saw in 2022, and most of the inflows occurred early in the quarter.

³ Investment Company Institute: Long-Term Mutual Fund Net New Cash Flow

⁴ Investment Company Institute: ETF Asset Report

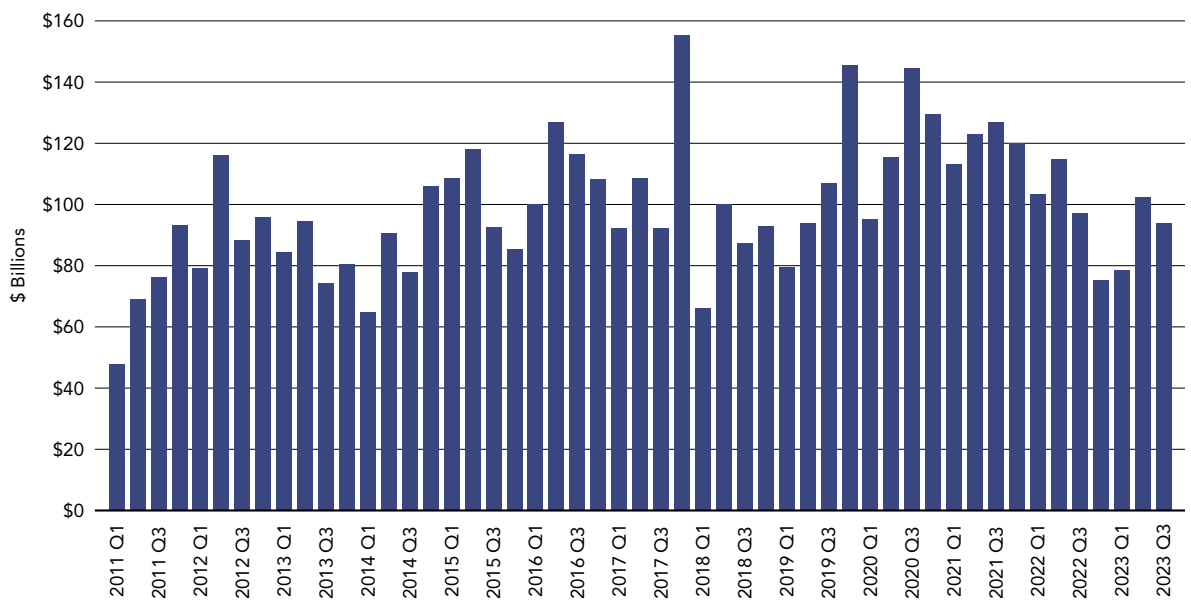
New Issue Volume

Figure 5 shows the par amount of new issuance by quarter since 2011. New issue volume remains muted, with \$94 billion issued in the third quarter of 2023.⁵ This represents a decrease of 8% compared to the second quarter of 2023 and a decrease of 3% compared to the same period in 2022. If we compare this quarter's volume with issuance for the same period in 2021, when significantly lower interest rates prevailed, we see volume down nearly \$33 billion or 26%.

Tax-exempt issuance decreased to \$84 billion in the third quarter of 2023, down 8% from the previous quarter but up 8% from the same quarter of 2022.

Higher interest rates continue to impact taxable issuance far more than tax-exempt issuance. Taxable issuance was down 15% compared to the second quarter and 51% compared to the third quarter of 2022. Taxable issuance represented 6.8% of total volume for the third quarter of 2023 compared to 7.3% in the previous quarter, and 13.3% and 23.6%, respectively, in the third quarter of 2022 and 2021.

Figure 5. Municipal Market Issuance, Q1 2011–Q3 2023



Source: Refinitiv

⁵ Refinitiv

Conclusion

The municipal bond market continued to struggle in the third quarter as concerns about inflation and potential further rates hikes by the Fed caused yields in the municipal bond market and the Treasury bond market to rise significantly. Although demand from individual investors remains strong, overall demand in the municipal bond market is muted because of continued net outflows from tax-exempt mutual funds as well as a reduction in holdings by banks.

ABOUT THE MSRB

The Municipal Securities Rulemaking Board (MSRB) protects and strengthens the municipal bond market, enabling access to capital, economic growth, and societal progress in tens of thousands of communities across the country. The MSRB fulfills this mission by creating trust in our market through informed regulation of dealers and municipal advisors that protects investors, issuers and the public interest; building technology systems that power our market and provide transparency for issuers, institutions, and the investing public; and serving as the steward of market data that empowers better decisions and fuels innovation for the future. The MSRB is a self-regulatory organization governed by a board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is overseen by the Securities and Exchange Commission and Congress.



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