

# **Municipal Bond Liquidity**

## **Abstract**

Using new econometric methods, we separately estimate average transaction costs, as a function of trade size, for over 167,000 bonds from a one-year sample of all U.S. municipal bond trades. Unlike in equities, municipal bond transaction costs decrease with trade size and do not depend significantly on trade frequency. Municipal bond trades are also substantially more expensive than similar sized equity trades. We attribute these results to the lack of price transparency in the bond markets. Additional cross-sectional analyses show that bond liquidity increases with credit quality and decreases with instrument complexity, time to maturity, and time since issuance. The results suggest that investors, and perhaps ultimately issuers, could benefit if issuers issued simpler bonds.

Keywords: Municipal bonds, fixed income, liquidity, transaction cost measurement, effective spreads, Municipal Securities Rulemaking Board, MSRB, transparency, market microstructure, dealers.