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'Extraordinarily Expensive': Muni-Bond Valuations at Record High

- **Ratio of munis to U.S. Treasuries at lowest level on record**
- **Tax-exempt debt sales may continue to fall: CreditSights**

The muni-bond market has never looked more expensive.

A key measure of relative value in the \$3.9 trillion market for state and local government debt, the ratio of top-rated 10-year muni yields to U.S. Treasury securities, is holding at 67%. That's the lowest level since at least 2001 and in stark contrast to March, when the ratio stood at 215%, according to the Bloomberg BVAL index.

U.S. Treasury yields have risen recently as the market anticipates the beginning of a recovery and additional government spending and potentially higher taxes after Democrats took control of the White House and Congress during the 2020 election cycle.

However, municipal bond yields have not followed that trend, an indication of strong demand as investors look to snap up tax-exempt issuance as a buffer for potential tax increases.

"Muni outperformance has left the market extraordinarily expensive," analysts from Ramirez & Co. wrote in a note on Monday. "We expect this low value muni paradigm to persist until new issue supply increases meaningfully."

Tax-free debt has been in high demand partly due to low interest rates spurring state and local governments to sell taxable bonds for refinancings instead. That's because of 2017 law change preventing governments from issuing tax-exempt bonds to refinance some debt that can't be called.

Taxable issuance could drive new municipal debt sales to more than \$500 billion in 2021, according to some analysts. But that's unlikely to sate the desire for tax-free debt, which could mean the high prices persist, said Patrick Luby, an analyst at CreditSights.

"It's reasonable to expect there could be some challenges finding suitable paper as we go further into the year, if you're looking for tax-exempt munis," said Luby. "The biggest deals on the calendar right now are taxable and we're seeing taxable deals in the pipeline that are going to refund tax-exempt bonds. That's going to further constrain the float in the market for tax-exempt munis."

Bloomberg Markets

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January 12, 2021, 10:45 AM PST

— *With assistance by Amanda Albright*

