Bond Case Briefs

Municipal Finance Law Since 1971

Record-Breaking or Austere? What to Expect from the Municipal Bond Market in 2022.

Everyone agrees: the 'real question' is the Fed

Municipal bond market experts have different takes on what 2022 will bring, although there's one constant: demand for the debt issued by state and local governments is likely to remain exceptionally strong.

"Big picture, the municipal market is fundamentally as strong as it's been in a number of years," said Paul Malloy, head of municipal investments at Vanguard.

"There was a significant amount of federal aid in 2021, tax receipts are up, market returns SPX, -1.03% have been strong, and that's aiding pension funds," Malloy told MarketWatch. "The real question mark into 2022 is the level of interest rates and their impact."

Malloy believes the federal aid doled out over the past two years in response to the COVID-19 pandemic will keep municipalities "flush with cash" and less likely to sell bonds in 2022. His forecast of $400 billion worth of new issuance would make 2022 one of the leanest years of the past decade. Through November of this year, $432 billion has been issued, according to SIFMA.

In contrast, Tom Kozlik, head of municipal research for Hilltop Securities, expects a record-breaking 2022, with $495 billion in issuance. Kozlik has deemed the current moment "a golden age of public finance" because of the possibilities for spending that have been opened up by federal largesse.

While there's no precise way to predict how the municipal market — tens of thousands of state and local governments, transportation agencies, universities, and more across the country — will behave, it's worth noting that several sources who spoke with MarketWatch in November universally appreciated the fact that federal aid would allow them to avoid the expense — and administrative headache — of issuing bonds.

One thing is certain: relatively lean supply will continue to support bond prices. Eric Kazatsky, head of municipal strategy for Bloomberg Intelligence, reckons that the market could support $475 billion of issuance.

That will continue a stretch of outsize demand. Throughout 2021, multiple weeks in a row have seen inflows to municipal-bond funds smash records. A closely-watched metric, the ratio of 10-year muni yields to those of comparable U.S. Treasurys was at about 64% at the end of November, according to IHS Markit data, below the long-term average of about 80%, and suggesting investors have been willing to pay more for the tax advantages munis bring.

That's Kazatsky's premise for 2022: "buyers of municipals will still be motivated by tax avoidance, absent a large individual tax cut," he wrote in an outlook piece, "while the bonds' low correlation to other asset classes could prove their 'safer'-haven status should the economy struggle in an era of rising rates."

The question of how the economy might do – whether in the face of monetary policy normalization or just the tail end of the global pandemic – also sets up some differences among muni experts on just how to invest.

Vanguard’s Malloy thinks there are pockets of value in areas that “haven’t completely come back from the pandemic,” including higher education and some student housing deals. But others are more wary: Kozlik has a cautious to negative view on higher education, noting that “college campuses are not as safe as we expected from virus spread.”

And despite the fact that municipalities are in strong shape now, Kazatsky writes that he continues to favor bonds “with identifiable revenue streams vs. stand-alone general-obligation pledges” – that is, those backed by taxes. What’s more, he added, if stocks pull back or interest rates spike, it could exacerbate legacy fixed costs for those governments, such as public pensions.

MarketWatch

By Andrea Riquier

Dec. 15, 2021