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Will Trump Target Muni-Bond Tax Break? Market Sees Little Chance.

- President, Treasury Secretary have show support for subsidy
- Muni yields shows that tax-break most valuable since 2010

Donald Trump and Treasury Secretary Steven Mnuchin have expressed support for maintaining the tax break on municipal bonds. The market takes them at their word.

As the Republican president embarks on a push for tax cuts, top-rated state and local government bonds due in five years are yielding just 65 percent of comparable Treasuries, holding near a more than seven-year low, according to data compiled by Bloomberg. That shows that investors are still placing a high value on the tax exemption. If they expected the tax break to be eliminated — or chipped away at — municipal yields would rise closer Treasuries to compensate for that risk.

“We’re not pricing in any scenario for the tax exemption to go away or be limited,” said Matt Fabian, a partner at Municipal Market Analytics. “The statements out of the administration have been favorable.”

Last week, Mnuchin told the Wall Street Journal that the preferential tax treatment is a subsidy for local governments, not wealthy bondholders. That echoed the arguments of state treasurers and city finance officers, who argue that it allows them to borrow cheaply for public works given that investors are willing to accept lower yields because they don’t have to pay taxes on the interest they receive.

The Treasury Secretary and top White House economic adviser Gary Cohn left the tax-exemption out of a briefing on the broad outlines of the administration’s tax plan in April. And Trump expressed support to U.S. mayors in a meeting before his inauguration.

Other factors have worked to hold up prices in the municipal market recently, too. The amount of new bond sales has dropped 15 percent this year, even though money has continued to flow into the market.

“It’s very difficult to tease out the worries of tax reform and how it’s going to affect municipal bonds,” said Stephen Winterstein, chief municipal fixed-income strategist at Wilmington Trust Co. “Investors probably aren’t putting a whole lot of weight to it.”

But, based on what’s known so far know, Trump’s push to slash corporate and individual taxes won’t have a dramatic impact on the market, Fabian said. Cutting the top personal rate to 35 percent from 39.6 percent, as previously proposed, would be too small to affect demand. And a corporate rate in the mid-to-low 20 percent range also “would not be overly negative for municipals, as banks and insurers would likely still find munis attractive at that tax rate,” Barclays Plc municipal strategists led by Mikhail Foux wrote in a Sept. 8 note.

What’s more, advocacy by state and local officials and Wall Street in support of the tax exemption

has been strong. More than 150 members of Congress of both parties have signed a letter asking leadership to reject any proposal to cap or eliminate the exemption on municipal bonds. Such a change would also be at odds with another administration goal: channeling more money into infrastructure, which is financed by tax-exempt debt.

“There’s enough people in Washington who get how important it is for state and local governments to have a low cost of capital particularly if our governments are going to be the ones funding a lot of the infrastructure initiatives,” said Hugh McGuirk, who oversees $26 billion of municipal bonds at T. Rowe Price Group Inc. “If they’re a part of your plan why are you going to do something to make it more disruptive to them to raise money to fund your initiatives?”

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By Martin Z Braun

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