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Muni Bonds Face 'Steep Decline' Ahead, Challenging Trump's Infrastructure Plan.

- **Muni bonds face ‘steep decline’ ahead, challenging Trump’s infrastructure plan Municipal bonds are expected to be considerably scarcer in 2018, with one firm projecting a “steep decline” in issuance.**
- **Rising yields are raising costs for governments, while changes in tax laws have made munis less appealing.**
- **President Donald Trump is pushing an aggressive infrastructure agenda, so crimps in the muni market could hurt his plans.**

The precipitous rise in bond yields is being felt across a number of markets but perhaps none more than municipal bonds, where the trend ultimately could help jeopardize a critical part of President Donald Trump’s economic agenda.

For local and state governments, the cost to finance debt has spiked on some levels even more than the surge in Treasurys.

As a result, fixed-income experts are expecting a major drop in muni issuance. Already, January issuance fell 26 percent from the same period in 2017 and dropped 57 percent from December, which along with November saw a huge rush ahead of new tax laws taking effect.

“This pattern of request volume, layered on top of a secular trend of slowing municipal bond issuance, suggests that new muni volume in 2018 is indeed headed for a steep decline,” CUSIP Global Services said in a report this week.

Tax overhaul legislation that Congress passed in December represented a good news/bad news scenario for the $3.8 trillion U.S. municipal bond market. On the plus side, the legislation preserved tax-exempt private activity bonds, which are used to finance a slew of local projects including infrastructure and nonprofit entities including hospitals.

But the industry, for now, is focusing on the loss of advanced refunding for munis, a key tool governments use to refinance old debt at lower costs.

“We’re still seeing fallout from the Tax Cuts & Jobs Act in our muni request volumes,” Gerard Faulkner, director of operations for CUSIP, said in a statement. “While lawmakers are currently reviewing a new bill that would restore the tax exemption for advance refunding bonds, for now, the marketplace is reacting to the tax reform by dramatically curtailing their pre-trade activity.”

Problems aren’t just on the investor side. Issuers face higher costs now that yields are rising.

Top AAA-rated debt for a 10-year term now carries a yield of 2.4 percent, up from 1.98 percent at the end of 2017. The yield on 30-year debt has zoomed from 2.54 percent in December to 2.95 percent now.

The surge in costs and drop in issuance comes at an inopportune time for the White House. The Trump administration has released the broad sketches for a program aimed at pumping in $1.5 trillion in new spending for America's ailing infrastructure system.

A tepid muni environment could threaten the program's success, particularly if Congress continues to tinker with the tax-exempt areas of fixed-income markets as a way to raise revenue.

"Tax reform dealt three curveballs to the municipal market in 2017, and it is conceivable that more surprises could await in 2018," S&P Global Ratings said in a report. "These potential sources of revenue may remain targets for budget drafters in the coming year."

Sagging muni issuance runs counter to the broader trend, with the U.S. government expected to issue $1.3 trillion in Treasurys this year. In addition, corporate issuance is likely to be robust, thanks to the tax bill that lowered rates for companies from 35 percent to 21 percent. That also could make corporate debt preferable to muni and could be another factor in driving up the latter's yields.

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