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An Ominous Signal in the Muni-Bond Market Now Seen as Just Noise.

- **Governments may start selling debt faster than it's paid off**
- **Barclays sees positive net supply of $80 billion in 2020**

An ominous signal in the municipal-bond market shouldn't scare buyers too much.

State and local governments' frenzy to seize on lower interest rates could leave them issuing new bonds next year at a faster pace than they're paying them off, causing an increase in the net supply of outstanding securities. Usually, that's viewed as a negative in the $3.8 trillion municipal market, given that the increase in supply can exert a drag on prices.

But this time, the jump may be matched by a flood of cash that's been washing into the market all year as Americans burned by the limit on state and local tax deductions use the investments to drive down what they owe to the federal government. Municipal-bond mutual funds last week alone received a record $2.36 billion of new cash, according to Refinitiv Lipper US Fund Flows data, extending an unprecedented influx that's continued since January.

"Higher net supply is not going to be oversupply," said Peter Block, head of municipal strategy at Ramirez & Co., which is projecting positive net supply of $98 billion next year.

The increase follows what had been a slowdown in new municipal-bond sales, which caused the size of the market to shrink in 2018 and during the first half of this year, according to Federal Reserve figures. That led mutual fund managers to complain about the competition and high prices being paid for new debt issues, though the drop in yields also saved state and local governments money.

With the market's interest rates now holding not far from more than half-century lows, Wall Street underwriters anticipate the pace of borrowing to pick up. Barclays Plc is forecasting that will cause the size of the market to grow by $80 billion in 2020, which the company projects would be the biggest increase since 2016. Bank of America Corp. strategists last month predicted a similar rise.

The ballooning supply is driven heavily by state and local governments' push to refinance their debt with taxable securities. While that may be a drag on that corner of the market, analysts say it's unlikely to trickle into demand for traditional tax-exempt bonds, which will also benefit from interest and principal payments that bondholders will seek to reinvest.

Barclays strategists led by Mikhail Foux said their forecast for positive net supply in 2020 won't be problematic for tax-free buyers because those sales won't increase "materially."

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By Amanda Albright

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