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Protests Raise Latest Question Mark for Municipal-Bond Market.

The U.S. municipal-bond market has been largely unscathed by the wave of protests against police brutality and racism, but the specter of delayed economic recovery will weigh on the outlook for munis, analysts said.

"We haven't seen a market reaction, and it's unclear what kind of economic impact will happen," says Randall Gerardes, head of municipal strategy at Wells Fargo. Nevertheless, "civil unrest happening in major cities could have a limiting impact on how quickly the economic environment returns to normal."

Since Memorial Day, when protests began in Minneapolis following the death of George Floyd in police custody, the iShares National Muni Bond exchange-traded fund (ticker: MUB), the largest ETF tracking muni-bond markets, is up 0.4%. The Minnesota Municipal Income fund (ETMNX) is up 0.16%, and the Nuveen Minnesota Municipal Bond fund (FYMNX) is up 0.39%.

As the protests continued, President Donald Trump threatened to deploy the U.S. military.

The protests could delay economic recovery at a time when beleaguered cities face financial woes. Nearly 90% of U.S. cities expect revenue shortfalls, The Wall Street Journal reported.

Meanwhile, the Congressional Budget Office said that gross domestic product isn't expected to catch up to previously forecast levels until the fourth quarter of 2029.

"The recurring violent demonstrations and government reaction is an evolving situation," writes Tom Kozlik, head of municipal strategy at Hilltop Securities. "Unfortunately, the increasing levels of social unrest across the country reallocated efforts and scarce resources away from the former focus of getting state, regional, and local economies back to some semblance of normalcy."

For example, New York City plans to reopen by June 8, yet it also put in place a nighttime curfew that will last until June 7. "What that timeline looks like now is even more tentative," Kozlik writes.

Given the unrest, local governments can't afford to make many substantial cuts to core programs, even though revenues have been crushed.

Some relief will come from the Federal Reserve, which has started a new lending program for municipalities. Illinois announced Tuesday that it will sell $1.2 billion of one-year general-obligation certificates to the Fed's Municipal Liquidity Facility.

Still, the Fed may not be able to help smaller municipalities. This week, Senate Banking Committee Chairman Mike Crapo (R., Idaho) worried that the Fed's municipal facility is still too restrictive.

Meanwhile, other federal help is difficult to imagine. Since the House passed the $3 trillion Heroes Act in mid-May, there hasn't been significant progress on potential relief to state and local governments, says Kozlik. On Friday, Senate Majority Leader Mitch McConnell (R., Ky.), who opposes sending more relief to states and municipalities, said the next coronavirus relief package will be the “final” one and described it as “narrowly crafted, designed to help us where we are a month from now, not where we were three months ago.”

Delays in reopening will hurt revenues further. With property at risk, there is also some academic evidence suggesting property values may be depressed. Meanwhile, violent protests can also cause a shortfall in municipal finances. After protests following the beating of Rodney King by four police officers in 1992, riots in Los Angeles had a lasting impact on the city’s economic performance, according to a 2004 study by Victor Matheson and Robert Baade.

In addition, lack of insurance coverage for smaller retailers will “cause delays and lengthen the amount of time it will take for municipal entities to return to financial equilibrium,” Kozlik says.

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