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Federal Aid Impasse Heightens U.S. Muni Market Credit Risk - Analysts.

CHICAGO, Sept 18 (Reuters) – A political deadlock over a new round of federal aid will elevate credit risk in the $3.9 trillion U.S. municipal bond market as states, cities and other debt issuers struggle with steep revenue losses due to the coronavirus pandemic, analysts said on Friday.

No agreement is on the horizon between Senate Republicans, House Democrats and the White House over using federal dollars to plug those budget holes.

Policy differences are "too significant" for a deal to emerge this month, Barclays analysts said in a research report.

"Unless municipals receive a substantial amount of federal help in the near future, their credit quality will continue to deteriorate for a while, and the default rate might stay elevated for quite some time," the report said, noting that Barclays continues to forecast just a 2% to 4% default rate for 2020.

There are already signs of credit deterioration. Public finance rating downgrades by Moody's Investors Service totaled 81 in the second quarter, versus 52 upgrades, the first time in three years downgrades outpaced upgrades.

In a BofA Global Research report, analysts pointed to "increased downgrade risk as a result of Congress' failure to deliver more aid, which will force muni issuers to confront significant budget gaps and likely stymie economic recovery."

Mark Zandi, chief economist at Moody's Analytics, told a meeting of state lawmakers this week that in order to avoid a backslide into recession, the next round of stimulus should total between $1 trillion and $1.5 trillion and state and local governments should be "at the top of the list of beneficiaries" for that aid.

He added that states and local governments face a collective $450 billion in budget shortfalls through fiscal 2022, an amount that he warned that could rise to $650 billion if there is a second wave of the coronavirus.

By Reuters Staff

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