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Wall Street Diverges on Muni Sales as Citi Sees $550 Billion.

- **Supply forecasts range from $375 billion to $550 billion**
- **States and local government budgets pressured by pandemic**

Wall Street banks don't have a consensus on how much municipal bond business they'll have next year.

Strategists that cover the $3.9 trillion state and local government debt market have 2021 supply forecasts that range from $375 billion to $550 billion. Low borrowing rates and issuance to bolster pandemic-induced deficits will lead to a record year of sales, according to some firms, while others believe that states and cities whose budgets were hammered by the coronavirus pandemic will refrain from selling bonds for new projects. State and local governments have sold $421 billion of long-term bonds so far this year.

Citigroup Inc. analysts led by Vikram Rai had the highest forecast, projecting governments will sell $550 billion in municipal bonds next year. "We are convinced of extremely robust municipal supply next year," the group wrote in a Nov. 2 note. "Municipal issuance will be utilized by public agencies and state and local governments to rebuild their respective budgets and economies (and infrastructure) as the nation recovers from the pandemic."

Tom Kozlik, head of municipal strategy and credit at Hilltop Securities, said he expects issuance to fall to about $375 billion next year, the smallest among the nine firms which provided forecasts. He said many deals were pulled ahead into this year and that governments will issue less for infrastructure projects because of revenue uncertainty and balance sheet concerns.

"State and local governments and other municipal bond issuers are likely going to approach 2021 cautiously," Kozlik wrote in a note dated Nov. 19. "We think there is still a significant amount of uncertainty about what revenues could look like for the rest of FY21 and for the beginning of FY22."

The range in forecasts illustrates the uncertainty that grips the state and local government debt market amid political debates over additional stimulus aid and the longevity of the coronavirus pandemic.

"It's a mixed bag at the state and local level which makes it hard to make a macro prediction," said Natalie Cohen, president at National Municipal Research Inc., a consulting firm. While some local governments are contracting and may be cautious of taking on new debt, others are seeing a population surge and will need to sell bonds to finance infrastructure, she said. "You can't just look at one side of the contraction and not look at the growth that is going on in a lot of communities," Cohen said in an interview.

The market would need about $440 billion of supply to meet current demand, according to Bloomberg Intelligence analyst Eric Kazatsky. His outlook is based on the latest muni-fund flows and bondholder reinvestment data.

Bankers have already seen a surge of sales this fall as governments rushed to market in October, selling a record $71 billion worth of debt as they sought to get in the market ahead of any election-related volatility.

Nearly a third of the $421 billion of long-term muni sales so far this year were subject to federal income taxes, a 130% increase from the same period last year. Rates held near record lows for much of 2020, allowing governments to realize savings by refinancing outstanding debt with taxable securities.

Analysts at UBS said that taxable munis are likely to maintain a “meaningful market share” in the coming year as issuers are “likely to continue to take advantage of refinancing opportunities through the taxable muni market.”

Key Insights

- State and local financial conditions in 2021 are likely to be closer to those seen in the second half of this year compared to 2019 leading to a “similar performance in the primary market calendar,” wrote Matt Fabian and Lisa Washburn at Municipal Market Analytics in a research note published Nov. 16. They forecast about $500 billion in total sales with about 30% taxable.
- Bank of America’s Yingchen Li and Ian Rogow expect sales to reach $470 billion next year, $170 billion of which will be federally taxable. Even with the expected uptick in sales, they said market demand will outweigh supply. The group expects overall municipal returns to be 3.5% in 2021.
- Morgan Stanley strategists project $520 billion in gross-supply in 2021, driven by taxable advanced refundings that will shift net issuance from the tax-exempt market, the team led by Michael Zezas wrote in a note. “We expect the impact of supply to be muted relative to macro drivers,” the group wrote, saying the supply uptick is unlikely to pressure performance.
- Analysts at Oppenheimer and Barclays both forecast a range of $420 billion to $440 billion in total sales. Supply will be lower than 2020 as municipalities “will likely be cautious about funding new projects in an uncertain economic environment, as well as issuers’ having pulled deals forward into this year,” Barclays analysts led by Mayur Patel wrote in a Nov. 10 research note.
- UBS analysts led by Thomas McLoughlin said that new issuance is expected to move lower as issuers are cautious about financing new projects in an uncertain economic environment. Bond ballot proposals were “relatively light” in November, which could depress future issuance, he said. The outlook could increase by a “meaningful amount” if Congress approves an infrastructure bill in the first half of 2021.
- RBC estimates total sales to reach $425 billion next year, below the firm’s 2020 projection, according to a research note by Christopher Mauro, the bank’s municipal desk analyst. “We anticipate that refunding activity will decline next year because we estimate that the pool of eligible refunding candidates in 2021 will be smaller than it was this year,” he wrote. Still, taxable advanced refundings will continue at a “brisk pace.”

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