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Municipal Bond Yields Rise, Swept Up in Treasuries Surge.

CHICAGO (Reuters) – Municipal bond yields were following U.S. Treasury yields higher after valuations between the two markets reached unsustainable levels, analysts said on Thursday.

Earlier this year, the $3.9 trillion market where states, cities, schools and other issuers sell debt had been resisting a steep sell off in Treasuries that lifted yields, putting the historically close correlation between the two markets out of whack.

Now, munis are catching up, with the 10-year yield on Municipal Market Data's (MMD) benchmark triple-A scale, which started 2021 at 0.720%, climbing 45 basis points since Feb. 12. It closed up 5 basis points at 1.14% on Thursday.

The iShares National Municipal Bond exchange-traded fund (ETF) fell on Thursday to its lowest level since November at 115.14. The largest muni ETF, which reached an 11-month high of 117.95 on Feb. 11, was last down 0.43% at 115.30.

Flows into municipal bond funds plummeted to $37.68 million in the week ended Feb. 24 from net inflows of nearly $2 billion in the prior week, Lipper reported on Thursday.

"Munis were holding up extremely well to the rest of the bond market and the last week and a half we've seen a reversal in that," said Andrew Richman, senior fixed income strategist at Sterling Capital Management. "The relative value finally got so bad (munis are) starting to move up in the yields right now."

The ratio of top-rated 10-year, tax-exempt bonds to comparable taxable Treasury yields hit an all-time low of 54.7% on Feb. 16, according to Daniel Berger, senior market strategist at MMD Refinitiv, who said ratios that low were a key reason for the recent move higher in muni yields. The ratio was 76.2% on Thursday.

"Munis got incredibly rich to Treasuries," Berger said, adding that "a little more supply this week" was another factor.

Low supply of new debt in January amid high demand from investors heavy with cash from coupon and principal payments helped keep muni yields from following Treasuries higher. The prospect of an income tax hike and new stimulus funding for states and local governments under a Democrat-controlled White House and Congress also held yields in check.

Improving economic data, inflation concerns, and fears of a supply surge to finance massive new fiscal stimulus, have sent the 10-year Treasury yield soaring from 0.930% on Jan. 4 to over 1.6% on Thursday.

Muni yields are typically lower than those of comparable Treasuries because interest income earned on munis is exempt from federal and sometimes state taxation.

Reporting By Karen Pierog; Editing by Alden Bentley and Marguerita Choy