Bond-Market Penalties Fade for States Seeing a Federal Windfall.

- **Coming influx of federal cash eases prior credit concerns**
- **New York bond spreads dip to lowest levels in three months**

As far as Wall Street bond traders are concerned, President Joe Biden's rescue has effectively erased the fiscal problems of America's states.

The nearly $200 billion of direct aid coming to states from Washington is promising to make up for the fiscal hit of the pandemic, with the amount for some poised to be more than enough to close their budget shortfalls.

The coming influx of cash has eased some of the credit concerns for states that were looking for ways to cover revenue losses and right their finances at the height of the pandemic. That means investors aren't pricing in a lot of risk when it comes to states, leaving the yields on most of the state bonds tracked by Bloomberg hovering within basis points of each other.

"The stimulus is a game changer" said Cooper Howard, director of fixed income strategy at the Schwab Center for Financial Research, noting that most state and local governments suffered a less substantial financial hit from the pandemic than they were initially expecting. "Essentially, they're getting a lot of money on what was already an OK starting point."

The yield on New York's 10-year general-obligation bonds has dropped to 4 points less than the AAA benchmark, according to Bloomberg BVAL indexes, even though the state doesn't have the highest rating. Minnesota's yields are also below the benchmark, while Ohio and Washington state bonds are paying just 5 basis points above it.

Overall, general-obligation bond spreads for 16 of the 20 states tracked by Bloomberg are within 15 basis points of each other. Even for an outlier like near-junk rated Illinois, the yield penalty it's facing has dropped to 1.2 percentage points from as much as 4.4 percentage points in May.

Those narrow credit spreads, which shows that investors see little difference in the risks, are likely to persist, said Jeff Lipton, a managing director and municipal debt analyst for Oppenheimer & Co. He attributed those low yield differences to the federal aid, an improving economy, and a steady tide of cash flowing into municipal bond funds.

"The multiple rounds of fiscal relief has certainly contributed to renewed credit stability and preservation of currently tight spreads," Lipton said. "Market technicals will remain a driving force for muni performance."

Bloomberg Markets

By Fola Akinnibi and Anastasia Bergeron

March 25, 2021, 11:04 AM PDT

— With assistance by Danielle Moran