U.S. Municipal Bond Market

Uncertainty – What the Municipal Market Knows and Doesn’t Know About COVID-19

What do we know?
The U.S. Centers for Disease Control and Prevention (CDC) already told us last week that they are preparing for a potential pandemic. By definition, an epidemic is less widespread than a pandemic. An epidemic is when there is a sudden increase in the number of confirmed cases of a disease that is above what would normally be expected for a certain population. When diseases spread across countries and/or continents, epidemics grow into pandemics and affect larger numbers of people. We are being told to expect a wider spread, though the CDC is unsure how severe.¹

None of the recent infectious disease outbreaks of the last two decades come close to what we are currently experiencing, actually or potentially speaking. The 2002 SARS virus proved deadly but was quickly contained. The 2009 swine flu made its way to the U.S. by way of Mexico but the outbreak was mild and passed relatively quickly as well. A 2014 outbreak of the Ebola virus was traced back to Congo, but it impacted mostly West Africa.²

The total number of global cases has surpassed 90,000 and more than 3,000 have died. The WHO is reporting COVID-19 has killed about 3.4% of confirmed cases, the majority of which are in China. The seasonal flu’s mortality rate is under 1%. The good news is that China is reporting a decline in reported infections. However, the United States has over 100 reported infections and this number is expected to increase.³

Dr. Marc Lipsitch, an infectious disease expert from Harvard, recently said in a CBS News interview, “This is not an existential threat. It is very much like a bad pandemic of influenza, which we experienced arguably twice or three times in the 20th century, but none of those brought civilization to its knees...and this won’t either.” Lipsitch also predicted 40-70% of the world’s adult population could become infected.⁴

On March 3, 2020 the U.S. Federal Reserve took emergency measures by surprising the market with a 50 basis point rate cut because “the coronavirus poses evolving risks to economic activity.” For more on this surprise Fed action please see The Fed Cuts 50 in an Emergency Move, by HilltopSecurities’ Scott McIntyre and Greg Warner. We do know that the Federal Reserve surprise 50 basis point cut probably did not have the desired impact, at least in the short run. Concern about the direction of the economy is elevated. Demand continues to be strong for non-risk investments like U.S. Treasuries. The 10-year Treasury fell below 1.00% for the first time ever and stocks closed down 3.00%. The 10-year AAA Municipal Market Data (MMD) yield closed Tuesday at a yield of 0.96%, up three basis points from Monday’s close of 0.93%.⁵

Please see disclosure starting on page 2.
What do we not know?
We still do not know what to make of those infection numbers. Are they close to being accurate? Is there a point where COVID-19 is going to finally fade into our memories? We do not know the answers to these questions and many others. The concept of “social distancing” could become more mainstream, and we don’t currently have a model for what it looks like or the economic impact. We also do not know how interrupted the economic engine will be here in the U.S. Economic activity could take a hit if schools close and business workers stay home. We just do not have an idea of the extent to what this looks like in two, three, or six months. We also do not know the answers to how much of an impact we are likely to see in economic data reports out of China or here at home. Growth is going to be lower, for sure. Economic activity is going to be lower, for sure. How low growth falls, and for how long it stays low is another big question.

Could We See Stimulus Out of Washington, D.C.?
We do not know what other type of policy might come out of Washington, D.C. Stimulative measures may be under consideration. Just after the rate cut announcement, Senator Elizabeth Warren called for “at least a $400 billion fiscal stimulus package.”† After the rate cut, Reuters reported U.S. Secretary of the Treasury Steven Mnuchin said he is happy to discuss reinstating the state and local tax deduction with President Trump. We also saw a report that the House Ways and Means Committee Chairman Richard Neal told Secretary Mnuchin that a major infrastructure package should be considered a priority for any Washington, D.C. stimulus measure.‡

This entire picture is likely to continue to evolve, and we will continue to monitor the situation for what this may mean for public finance and municipal investors.

§ Coronavirus may infect up to 70% of world’s population, expert warns. CBS News. March 2, 2020.
¶ Bloomberg.