

## U.S. Municipal Bond Market

# Fed Pledge to Buy Corporates Underway; Nothing New for Municipals

### Summary

- The U.S. Federal Reserve launched its Main Street Lending Program and activated its Secondary Market Corporate Credit Facility, both on Monday of this week.
- Chairman Jerome Powell was also busy communicating with lawmakers this week.
- There is currently nothing available for the municipal bond issuers like the Fed's Main Street Lending Program or its Primary or Secondary Market Corporate Credit Facility and there is no potential for anything similar on the horizon, to our knowledge.
- Over the last week or so, there has been all kinds of activity on the non-municipal front where the Federal Reserve is concerned, but nothing new for state and local governments.

### An Unsurprisingly Busy U.S. Federal Reserve

The numbers show that the U.S. Federal Reserve's balance sheet has fallen slightly from \$7.2 trillion to \$7.1 trillion, according to data that the Fed released yesterday.<sup>1</sup> Yet, Federal Reserve programs, actions, and economic forecasts have seemed to dominate market sentiment and news coverage recently.

It has been a busy few months for the U.S. Federal Reserve and Chairman Jerome Powell, but also an especially busy week. Last week's Fed comments were downright meaningful as well. Toward the middle of last week, Powell's comments from the Fed's two-day meeting helped bring investors back to reality. Among the many sound bites from last week, Powell noted:

- "There is a high level of uncertainty over the forecasts."
- "A good number of Americans won't likely have jobs to go back to for years."
- "The virus still poses considerable risks."
- "The path for the economy will rely heavily on the path of the virus."
- "The next few months will tell the real story."<sup>2</sup>

### This Week – Main Street Lending, Secondary Market Corporate Credit Facility

On Monday, the Federal Reserve launched its \$600 billion Main Street Lending Program (MSLP), nearly three months after the Coronavirus Aid, Relief, and Economic Safety (CARES) Act was signed into law on March 27, 2020.<sup>3</sup> Early Monday afternoon, the Fed announced that it would begin supporting corporate bond market liquidity by buying corporate debt from large employers using its Secondary Market Corporate Credit Facility. This announcement should not have come as a surprise. The Fed was simply following through on plans announced at the end of March.

On March 23, the Federal Reserve announced that it would be creating a Primary and a Secondary Market Corporate Credit Facility. The primary facility has not yet been launched and the magnitude of the Fed's secondary facility activity depends upon the market, according to Powell. "It's really going to depend on the level of market function. If the market function continues to improve, then we are happy to slow or even stop the purchases," Powell said. "If it goes the other way, we will increase."<sup>4</sup>

*Please see disclosure starting on page 4.*

Tom Kozlik

Head of Municipal Strategy & Credit  
214.859.9439  
tom.kozlik@hilltopsecurities.com

*Over the last week or so, there has been all kinds of activity on the non-municipal front where the Federal Reserve is concerned, but nothing new for state and local governments.*

General investor and market sentiment seemed to improve after the announcement that the Secondary Market Corporate Credit Facility was ready to go active, despite some criticism. The criticism by and large was about how the corporate bond market seemed to be functioning effectively without the Fed's secondary market buying. Powell responded to this criticism by managing expectations regarding the Central Bank's near-term buying activity. "It's out of an excess of caution to preserve these gains for market function by following through," Powell said during his semiannual testimony before Congress. "I don't see us wanting to run through the bond market like an elephant snuffing out price signals, things like that."<sup>5</sup>

*General investor and market sentiment seemed to improve after the announcement that the Secondary Market Corporate Credit Facility was ready to go active, despite some criticism.*

### Communication with Congress

Powell was also busy testifying and answering lawmaker questions this week. He spoke to the Senate Banking Committee and the House Financial Services Committee.

### Federal Reserve Seems to Favor Fiscal State and Local Stimulus Rather Than Lending

Powell has made it clear that the Fed is only in the position to use its lending power and that it does not have spending power. Congress possesses the spending power.

He stressed how public sector layoffs can have an impact on the delivery of essential services by entities that are on the front lines of the health crisis. He emphasized in statements to lawmakers that public sector layoffs have a human cost and can also have an economic cost by acting as an anchor to economic activity and growth. Powell noted, "Effectively all states have balanced budget requirements so [when] revenues drop and costs rise, they lay people off, cut essential services. Both of those things can weigh on economic activity in addition to the human cost,"<sup>6</sup> in response to a question from Nevada Senator Cortez Masto. Powell went further and seemed to be coaxing Congress into moving on state and local relief. Powell pointed out:

*Powell has made it clear that the Fed is only in the position to use its lending power and that it does not have spending power. Congress possesses the spending power.*

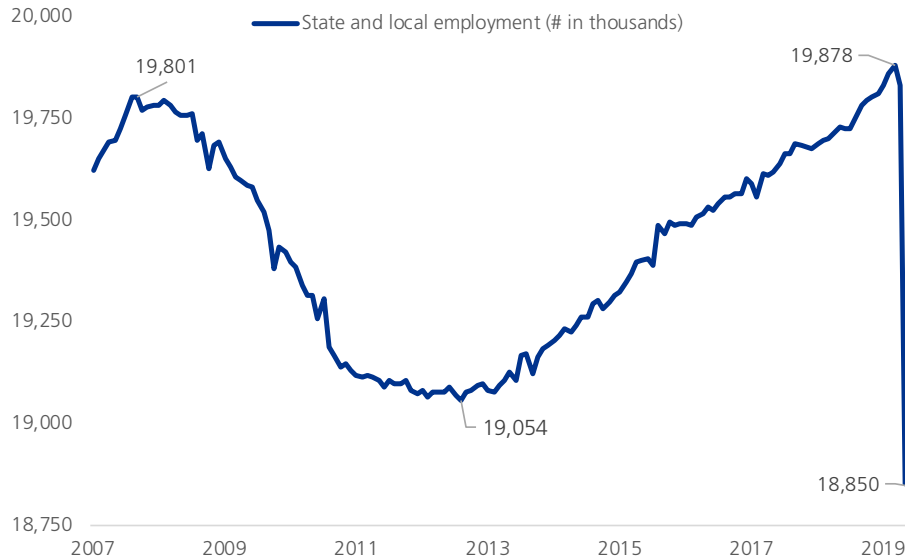
"We do not play a role in advising Congress on specific fiscal policy, but state and local governments are major employers and they provide essential services and that's certainly an area worthy of your interest."<sup>7</sup>

The backdrop of policymakers' back-and-forth has seen nothing less than a gutting of public sector jobs. Public finance officers, as Powell identifies, have responded to the severe fiscal challenges they currently face – and those challenges are budget shortfalls and revenue losses at the state and local government levels that are projected to be over \$1 trillion by now.

It should come as no surprise that state and local government job losses, by April of this year, already surpassed those in the wake of the Great Recession. Even though May's employment data was better than expected, state and locals continued layoffs.<sup>8</sup> We saw evidence that essential service jobs, including jobs in education were shed in data released on June 18.<sup>9</sup>

*It should come as no surprise that state and local government job losses, by April of this year, already surpassed those in the wake of the Great Recession.*

## State and Local Government Job Losses Were Larger than the Great Recession by April 2020



Source: Bureau of Labor Statistics, Economic Policy Institute, and HilltopSecurities.

### Too Little, Hopefully Not Too Late for State and Local Budgets

There seems to be no recent inspiration for Congress to act on state and local government aid, despite severe need. There was only \$150 billion in direct funds for state and local governments included in the CARES Act and those funds came with COVID-19 restrictions.<sup>10</sup> The \$150 billion is only a drop in the bucket compared to the shortfalls public entities currently face.

Although Powell has underscored the Fed's lending ability, it's only barely being utilized where municipal entities are concerned. State and local governments do not possess anywhere near the number of lending options on the Central Bank's menu. In fact, there is still only one choice.

The Fed's Municipal Liquidity Facility, despite its numerous enhancements, was only designed as a last resort, it's only available for short term notes and the pricing is very high.<sup>11</sup> It's still only available to states, a very limited number of local governments and two revenue-type bond issuers per state.<sup>12</sup> So far, only Illinois has contentiously tapped the MLF for \$1.2 billion.<sup>13</sup> While Illinois followed every necessary Fed requirement, the outcome remains touchy to some because the state did in fact have market access in May. It just so happened that the high pricing of the MLF was more attractive than what the market was willing to offer.

### Nothing New from the Federal Reserve for Municipals

There is currently nothing available for the municipal bond issuers like the Fed's Main Street Lending Program or its Primary or Secondary Market Corporate Credit Facility, and there is no potential for anything similar on the horizon, to our knowledge. In summary, there has been all kinds of activity on the non-municipal front where the Federal Reserve is concerned, but nothing new for state and local governments.

*There seems to be no recent inspiration for Congress to act on state and local government aid, despite severe need.*

*Although Powell has underscored the Fed's lending ability, it's only barely being utilized where municipal entities are concerned. State and local governments do not possess anywhere near the number of lending options on the Central Bank's menu.*

*There has been all kinds of activity on the non-municipal front where the Federal Reserve is concerned, but nothing new for state and local governments.*

<sup>1</sup> Factors Affecting Reserves Balances H.4.1; Federal Reserve Statistical Release; June 18, 2020.

<sup>2</sup> Please see more in: McIntyre, Scott and Greg Warner; Cautious Fed to hold rates at zero through 2022. HilltopSecurities; June 10, 2020.

<sup>3</sup> Please see more in: Kozlik, Tom; Fed launches Main Street Lending Program, mulls expansion to nonprofits; HilltopSecurities; June 15, 2020.

<sup>4</sup> Ibid.

<sup>5</sup> Cox, Jeff; Powell says the Fed doesn't want to 'run through the bond market like an elephant'; CNBC; June 16, 2020.

<sup>6</sup> National Governors Association tweet. Citing an answer Chairman Powell gave to Senator Cortez Masto. June 17, 2020 10:05AM.

<sup>7</sup> Ibid, see video for remaining Chair Powell quote.

<sup>8</sup> Kozlik, Tom; Jobs added, unemployment rate down, government jobs gutted; HilltopSecurities; June 5, 2020.

<sup>9</sup> Kozlik, Tom; Labor market remains significantly challenged; jobless claims (1.508 Million) above consensus estimate fuels relief demand; HilltopSecurities; June 18, 2020.

<sup>10</sup> See a summary of the municipal market elements of the CARES Act in: Kozlik, Tom; Agreement on the \$2+ Trillion CARES Act; not nearly enough for state and local governments; HilltopSecurities; March 25, 2020.

<sup>11</sup> Kozlik, Tom; Updated pricing detail: Federal Reserve's municipal liquidity facility; HilltopSecurities; May 11, 2020.

<sup>12</sup> For one of the first general descriptions of the MLF see: Kozlik, Tom; Fed expands municipal liquidity facility, provides details; HilltopSecurities; April 29, 2020.

For the June 3rd expansion please see: Kozlik, Tom; Illinois taps Fed's municipal liquidity facility, Fed expands eligibility; HilltopSecurities; June 3, 2020.

<sup>13</sup> For more on the Illinois MLF pricing see Kozlik, Tom; Illinois taps Fed's municipal liquidity facility, Fed expands eligibility; HilltopSecurities; June 3, 2020.

## Recent HilltopSecurities COVID-19 Municipal Commentary

- [Labor Market Remains Significantly Challenged; Jobless Claims \(1.508 Million\) Above Consensus Estimate Fuels Relief Demand](#), June 18, 2020
- [Infrastructure Rising to Top of Legislative Agendas](#), June 16, 2020
- [Fed Launches Main Street Lending Program, Mulls Expansion to Non-Profits](#), June 15, 2020
- [Local Schools on the Road to Reopening](#), June 11, 2020
- [The Decline of Social Distancing and its Economic Impact](#), June 9, 2020
- ["Defund the Police" Meaning, Influence on Budgets and Pensions](#), June 8, 2020
- [Jobs Added, Unemployment Rate Down, Government Jobs Gutted](#), June 5, 2020
- [State & Local Relief Not Likely Until July; Delayed by Demonstrations, Other Agenda Items](#), June 4, 2020
- [Illinois Taps Fed's Municipal Liquidity Facility, Fed Expands Eligibility](#), June 3, 2020
- [Inherent Conflict in Returning to Normal](#), June 2, 2020
- [More Hurdles to Financial Equilibrium, Recovery, and Growth](#), June 1, 2020

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

*The paper/commentary was prepared by Hilltop Securities (HTS). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS as of the date of the document and may differ from the views of other divisions/departments of affiliate Hilltop Securities Inc. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. This material has not been prepared in accordance with the guidelines or requirements to promote investment research, it is not a research report and is not intended as such. Sources available upon request.*

Hilltop Securities Inc. is a registered broker-dealer, registered investment adviser and municipal advisor firm that does not provide tax or legal advice. HTS are wholly owned subsidiaries of Hilltop Holdings, Inc. (NYSE: HTH) located at 1201 Elm Street, Suite 3500, Dallas, Texas 75270, (214) 859-1800, 833-4HILLTOP