U.S. Municipal Bond Market

Municipal Bond Friendly Elements Could Be Lost if Build Back Better Agenda is Pared Back

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- If the $3.5 trillion Build Back Better Agenda is reduced, which is likely to happen at some point, the public finance friendly elements will likely no longer be included.
- Even if the vote on the bipartisan plan does not happen this week, the prospects for infrastructure legislation is not eliminated. But, significant negotiations among Democrats will need to occur as Senator Joe Manchin has requested several times.
- The fact that the Democratic party is fractured between the new progressives and the moderates is not a new development, but it just so happens that it is manifesting itself as transformative infrastructure legislation that has already approved by the Senate and is waiting to be voted on.
- We still believe there will be about $460 billion of municipal issuance in 2021. We outline below how bond sales could play out in October, November, and December.
- U.S. Treasury Secretary Janet Yellen set the debt ceiling deadline at Oct. 18. Lawmakers are still not sending the market (municipal or otherwise) a clear signal that they are taking the issue seriously.

Near-Term Outlook for Public Finance Friendly Elements Not Trending Positively

Just two weeks ago, the House Ways and Means Committee included several public finance friendly elements in draft legislation that was to be considered for inclusion in the $3.5 trillion Build Back Better social spending package. These provisions would have reinstated advance refundings with tax-exempt bonds and created a new subsidized direct pay taxable bond similar to the 2009 Recovery Act's Build America Bond program, among other public finance friendly elements. However, the likelihood of any, much less all, of the public finance friendly items being included in Build Back Better legislation is dropping.

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Status of Various Legislative Measures Under Consideration in Washington, D.C.

Issue	Timing	Status, Pass/ No Pass
Standalone continuing resolution to fund the govt. until Dec. 3rd, 2021	Expected vote in Senate (Wed), House (Wed or Thurs.)	Likely to pass this week
Debt ceiling action	Treas. Sec. Yellen announced Oct. 18, 2021 deadline	Unkown
$3.5 trillion Build Back Better social agenda	House Progressives still connecting both	Not likely to pass Senate unless amount lowered
$1.2 trillion bi-partisan infrastructure bill	House to vote 9/30	Senate passed Aug 10, waiting on House
Highway funding programs	Senators discussing short-term extension	Unknown

Source: HilltopSecurities.

Senate moderates have firmly stated they are not going to approve Build Back Better social spending legislation that totals $3.5 trillion. Therefore, if lawmakers need to pare down the total spending that is included, as we have written they would need to, then the public finance friendly line-items could be eliminated. We have written it is possible they remain, because they are related to hard infrastructure. However, as lawmakers search for items to drop, it is very possible that the public finance friendly items just don't make the cut.

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Will there Be a Market Reaction?

We do not think the potential political reality is going to change any near-term dynamic where the municipal market is concerned. While most have been following this closely, we believe that the eventual outcome will not come as a surprise. If anything, we think that issuers may begin to execute some taxable refundings in the near-term as some begin to understand tax-exempt refundings are not likely to come back soon. However, we do not think this will be in an amount that will meaningfully move October, November, and December issuance numbers 25% higher than their nine-year averages.

Reiterating our Issuance Expectation for 2021

Therefore, we are going to reiterate that our issuance expectation for all of 2021 remains $460 billion. We revised it up to that level back in July, mostly because of the $650 billion that was included in the March Rescue Plan Act relief that flowed and is flowing to public finance entities. The federal funds not only offered a floor as it relates to almost anything COVID-19 related that could occur, but also stabilized credit quality in the short-term. We think this is a backdrop where issuers may feel more comfortable selling debt, than say compared to the landscape last year at this same time.

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The month of September is likely to end up with about $40 billion of issuance. This result is well over the nine-year average for September. October is likely going to be also above the nine-year average – we just don't know how high. If we see about $55 billion in October and then $30 billion per month in November and December, we should land right on top of our $460 billion revise projection. If there was a chance that issuance would be higher or lower than that amount, we expect that issuance could be slightly over and not under $460 billion for the year.

Tectonic Shifts in the Party Making it Hard to Pass Infrastructure, Social Spending Packages

The U.S. political landscape, very much like earth's geological activity, experiences ongoing adjustment. During some intervals more change occurs than in others, but even so, it takes time to see the result of the ongoing change. Where geology is concerned, the earth's crust has shifted over the years to develop into what is now known as the modern continents. The U.S. political landscape has also evolved and shifted over the last 250 years. The U.S. Democratic party has been experiencing a more significant modification. It appears we have been witnessing a tectonic shift in the Democratic party as negotiations about the menu of issues play out in Washington, D.C.

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Monthly Municipal Bond Issuance

Month	2020	2021	9-Year Average
Jan	$32.793	$27.926	-
Feb	42.229	35.811	-
March	20.262	47.383	-
April	31.689	36.732	-
May	30.991	34.382	-
June	52.387	48.959	-
July	47.741	35.831	-
Aug	43.395	39.747	-
Sept	53.513	**40.000**	31.348
Oct	73.446	**55.000**	43.854
Nov	21.359	**30.000**	31.763
Dec	34.740	**30.000**	33.681
	$484.545	$306.770	Sum through Aug.
		$461.770	Potential 2021 total

Source: Refinitiv, The Bond Buyer, and HilltopSecurities.

We have not only identified there is no clear path to getting infrastructure done, but we also highlighted that the ball is in the Democrats' court right now. And that Democrats are likely going to need to accept a total budget reconciliation package closer to $1.5 trillion (or lower) to complete the current negotiations. As we expected the problem is that progressive Democrats are still not compromising.

By postponing Monday's vote to Thursday, Speaker Pelosi is delinking, again, the pathway of the $1.2 trillion bipartisan plan and the $3.5 trillion Build Back Better social agenda.

Progressives Want the Full $3.5 Trillion Build Back Better Social Spending Package

This dynamic forced House Speaker Nancy Pelosi to postpone Monday's (Sept. 27) vote for the $1.2 trillion bipartisan infrastructure bill until Thursday (Sept. 30). By doing so, Speaker Pelosi is delinking, again, the pathway of the $1.2 trillion bipartisan plan and the $3.5 trillion Build Back Better social agenda.

However, the Democratic party is and has been fractured. Progressive Democrats have stayed strong and are continuing to relay that they are linking the packages. Progressive House Democrats will not vote in favor of the bipartisan infrastructure bill until the Senate passes the full amount of their $3.5 trillion Build Back Better social agenda. These progressives may be counting on some of the voter sentiment we are seeing in favor of the Build Back Better Agenda. Most voters, according to many polling sources report that the bipartisan infrastructure plan and the Build Back Better Agenda are popular. However, this Echelon Insights poll (Aug 20) says overall 40% believe $3.5 trillion is "too much" to spend; 30% reported was the right amount. This result could be a key reason why moderate Senate Democrats are less likely to support the entire $3.5 trillion of spending.

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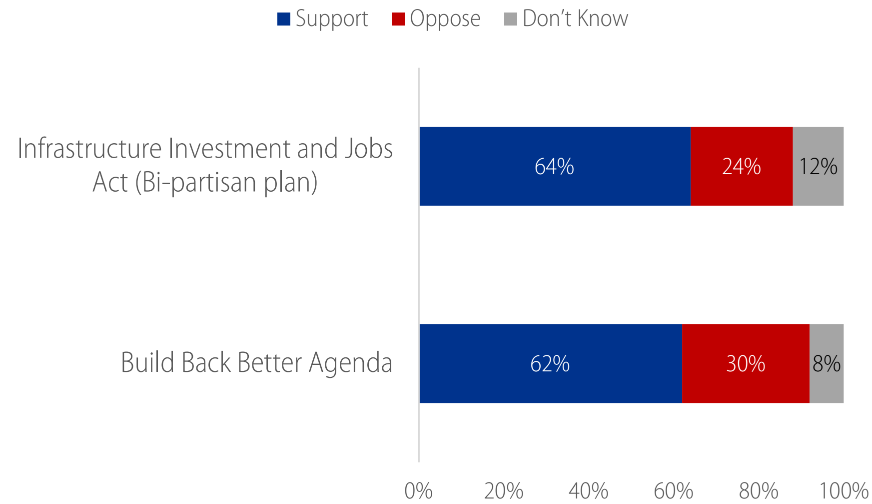
A Majority of Voters Support the Bipartisan Plan and the Build Back Better Agenda



Source: Data for Progress, Sept. 17, 2021 and HilltopSecurities.

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Some Democratic party leaders are trying to communicate that something is better than nothing, and that passing nothing is failure. John Podesta, former chief of staff to Bill Clinton and advisor to Barack Obama wrote, "You are either getting both bills or neither — and the prospect of neither is unconscionable. It would signal a complete and utter failure of our democratic duty, and a reckless abdication of our responsibility. It would define our generation's history and show that, when our time came, we failed, both for Americans now and in the years to come," in a memo sent to every Democratic representative in Washington, D.C.

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This Divide in the Democratic Party is Not New

We've seen this stance from progressives before. This is just the latest example of progressive Democrats trying to push the party agenda further to left. Observers should not be surprised by the recent infighting in the Democratic party. For example, Sen. Bernie Sanders' 2016 campaign and supporters aggravated former Senator and Secretary of State Hillary Clinton up to and just before the 2016 general election.

The 2020 Democratic presidential primary election was more chaotic than in previous years. The field of Democratic potential nominees was so large that debates had to be held on multiple nights. In the early going, Sen. Kamala Harris scored early by attacking then Vice President Biden. The Biden campaign looked like it may lose to the progressive movement after his campaign lost the Iowa Caucus, then lost again in New Hampshire and again in Nevada. Biden finally gained momentum after winning in South Carolina and after making a strong showing on Super Tuesday (March 3, 2020). But progressives such as Sanders, and Sen. Elizabeth Warren made a very strong showing in their campaigns and absolutely created a formidable movement that the moderates in the party could not ignore. This combined with the progressive wins in the 2018 primary made outreach to the left of the party a priority for candidate Biden. He knew that defeating the Republicans was urgent but keeping the Democratic party together was a close second where priorities were concerned.

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The fact that the Democratic party is fractured between the new progressives and the moderates is not a new development, but it just so happens that it is manifesting itself as transformative infrastructure legislation that is already approved by the Senate and waiting to be voted on. Again, the problem is very close to how James Carville indicated back in April when he said that Democrats "don't have the votes" to be "more liberal" than Sen. Joe Manchin.

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Keep in mind, even if the Sept. 30 vote does not occur or even fails, lawmakers can continue to negotiate.

Debt Ceiling Deadline is Now October 18

At the beginning of this week, Treasury Secretary Janet Yellen sent a letter to Congressional leadership indicating that the Treasury's extraordinary measures will run out and that Congress will need to raise or suspend the debt limit by Oct. 18. Washington lawmakers have still not figured out how the debt ceiling is going to be addressed. All lawmakers have done in recent weeks is tell one another, and the market, what they are not going to do. None have taken this topic as seriously as it needs to be taken, and no representative has given the market a clear signal that it will be addressed well ahead of Oct. 18. This is an alarming development, and we are surprised that the rating agencies have not addressed this by now.

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Six former Treasury secretaries urged Congress in a letter to take quick action to raise or suspend the U.S. debt ceiling or else risk "serious economic and national security harm." This Moody's Analytics article notes Congress is Playing a Dangerous Game With the Debt Limit (Sept. 21). Mark Zandi and his team indicated, "Americans would pay for this default for generations, as global investors would rightly believe that the federal government's finances have been politicized and that a time may come when they would not be paid what they are owed when owed it." The Moody's Analytics analysis in a default scenario is described as "cataclysmic" by the authors and found that:

- Real GDP would decline almost 4% peak to trough;
- Nearly 6 million jobs would be lost;
- The unemployment rate would rise close to 9%;
- Stock prices would be cut almost in one-third at the worst of the selloff, wiping out $15 trillion in household wealth;
- Treasury yields, mortgage rates, and other consumer and corporate borrowing rates spike, at least until the debt limit is resolved and Treasury payments resume. Even then, rates never fall back to where they were previously; and
- Since U.S. Treasury securities no longer would be risk free, future generations of Americans would pay a steep economic price.

Sec. Yellen warned of irreparable harm back in August and this is around the same time when we reviewed the negative impact from just the 11th hour agreement that occurred in the summer of 2011 (see page 2). A default cannot happen, and everyone seems to agree on that fact. However, lawmakers are not doing a very good job of assuring the market (municipal and otherwise) that they are taking the potential outcome very seriously.

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- Lawmakers Moved Closer on Infrastructure in August, [there is] Still No Clear Path, Sept. 1, 2021

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