

U.S. Municipal Bond Market

A Public Finance and Infrastructure Fiscal Policy Checklist and a Warning

- The fiscal year 2023 \$1.6 trillion omnibus package signed into law in December 2022 included a PAYGO budget rule waiver allowing Build America Bond subsidy payments to continue to flow to issuers.
- Financial Data Transparency Act-like requirements were included in the National Defense Authorization Act for fiscal year 2023 that became law in December 2022 mandating data and document collection in a machine-readable format for public finance entities.
- A U.S. debt ceiling clash could occur near the end of the summer of 2023. Our concern about how lawmakers may exploit the situation rose last week as we watched activity in the U.S. House of Representatives. It would be disastrous not just for public finance but for the world financial system if the U.S. did not raise or suspend the debt limit requirement.

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U.S. Fiscal Policy is Enormously Impactful for Public Finance

Two of the events that have most impacted U.S. public finance in the last decade or so have originated in Washington D.C. The Tax Cuts and Jobs Act of 2017 and the American Rescue Plan Act of 2021 were both enormously impactful to the whole of public finance. In some ways they were positive and some ways they were negative. Recognizing their impact is imperative because it stresses the importance of watching what may be coming down the line from D.C. lawmakers as it relates to public finance and infrastructure.

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Deadlines and Status of Select U.S. Fiscal Policies

Policy Issue	Deadline / Status	More Information
Statutory PAYGO	Waived	Waiver included in the FY2023 omnibus in Dec. 2022
Financial Data Transparency Act	Became law	Included in 2023 Nat. Defense Auth. Act in Dec. 2022
Debt Ceiling Limit	Summer 2023	Will need to be raised or suspended after a \$2.5 trillion debt limit increase enacted in Dec. 2021 is exhausted.
Funding the Federal Govt. / Appropriations	Sept 30, 2023	Congress enacted a FY2023 omnibus in late Dec. 2022 funding the government through the end of the fiscal year. Will need to be addressed again.
Statutory PAYGO (Again)	Dec. 2024 or Jan. 2025	If it is not waived (again) across the board spending cuts could threaten Build America Bond subsidy payments.
Tax Cuts and Jobs Act of 2017 Provisions	End of 2025	TCJA individual income tax provisions expire, repeal or extension of \$10,000 SALT cap at issue
Surface transportation programs	End of FY2026	Surface transportation programs provided by the Infrastructure Investment and Jobs Act are set to expire
Highway Trust Fund	End of FY2027	The Highway Trust Fund finances the federal govt's highway & mass transit programs. In about four years it will again approach insolvency.

Source: Committee for a Responsible Federal Budget and HilltopSecurities.

Please see disclosure starting on page 3.

FY23 \$1.6 Trillion Omnibus Package Included PAYGO Waiver

The lame duck 117th Congress was busy catching up with their work in December. Lawmakers approved and President Biden signed H.R. 2617 into law which was a \$1.6 trillion omnibus appropriations bill for fiscal year 2023. See the overview from the Committee for a Responsible Federal Budget (CRFB) for a summary. Overall, it raised federal spending by almost 9% according to the CRFB, not an inflation-friendly trajectory. This outsized increase could also be an issue for Congressional budget-hawks. The spending package also importantly included a waiver for the PAYGO budget rule which allows Build America Bond subsidy payments to continue to flow to issuers.

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Financial Data Transparency Act-Like Language Included in NDAA

Industry groups, led by the Government Finance Officers Association (GFOA), lobbied unsuccessfully to keep the Financial Data Transparency Act related requirements from becoming law in 2022. The GFOA wrote that the proposed requirements were a "costly and burdensome unfunded mandate." There was a provision included in the \$848 billion National Defense Authorization Act for fiscal year 2023 that mandates data and document collection in a machine readable format such as the eXtensible Business Reporting Language or (XBRL) format. Regulators led by the Securities and Exchange Commission have two years to create and communicate standards to market participants. The standards are set to be enforced in four years. This should give public finance entities enough time to adjust to the new standards. We expected an outcome similar to this as described in our Sept. 14 commentary.

We have grown concerned that the debt ceiling battle that ensues this summer could be worse than the confrontation witnessed during the summer of 2011.

The Next Debt Ceiling Clash

When we started this fiscal policy review of December 2022 and preview for 2023 (and beyond) our expectation was that it would simply be a checklist of topics for observers to watch in the near-term. Events in the U.S. House of Representatives in recent days are leading us to highlight one important item on that checklist, and issue notice to investors and observers. We are still months away. However, sometime this summer the U.S. debt ceiling will need to be raised or suspended again. We have grown concerned that the debt ceiling battle that ensues this summer could be worse than the confrontation witnessed during the summer of 2011. It would be disastrous not just for public finance but for the world financial system if the U.S. did not raise or suspend the debt limit requirement when needed this year.

The debt ceiling showdown in 2011 caused market turmoil that lasted for months, resulted in budget sequestration and is what caused S&P to downgrade the U.S. rating below AAA and more strongly question the predictability of the U.S. policymaking process. When S&P downgraded the U.S. sovereign rating (in 2011) the rating agency indicated, "The political brinkmanship of recent months highlights what we see as America's governance and policymaking becoming less stable, less effective, and less predictable than what we previously believed. The statutory debt ceiling and the threat of default have become political bargaining chips in the debate over fiscal policy."

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A default scenario would be "cataclysmic," according to a Sept. 2021 Moody's Analytics analysis. The economic examination highlights that U.S. G.D.P. could decline by almost 4%, 6 million jobs would be lost, unemployment would rise to 9%, stock prices would

decline by a third, and yields would spike. Moody's Analytics also importantly points out that U.S. Treasuries would no longer be seen as risk-free, and future generations in the U.S. would "pay a steep economic price."

We are closely watching the political landscape in order to assess what the financial impact may be in coming months.

We have closely watched the recent debt ceiling back-and-forth going back to the summer of 2021 in [Lawmakers May Exploit the Debt Ceiling Limit Again](#) (July, 2021) and [What Could "Irreparable Harm" Look Like if Lawmakers Fail to Extend or Suspend the Debt Ceiling Limit?](#) (August 12, 2021). Charged lawmakers may again exploit the need to raise or suspend the limit as an opportunity to force concessions. This could have limited to significant financial implications not only for public finance and the U.S. municipal bond market but for the world financial system. We are closely watching the political landscape in order to assess what the financial impact may be in coming months.

Additional Reading and Resources

- [Upcoming Congressional Fiscal Policy Deadlines, Committee for a Responsible Federal Budget](#), Jan. 3, 2023
- [The Debt Limit Since 2011, Congressional Research Service](#), Dec. 23, 2022
- [2023 Congressional Calendar \(118th Congress\), CQ Roll Call](#), Dec. 13, 2022

Recent HilltopSecurities Municipal Commentary

- [Web3, Blockchain and U.S. Public Finance](#), Dec. 15, 2022
- [The Texas PSF is Up Against a Federally Allocated Cap](#), Dec. 8, 2022
- [State Credit Mainly Improved & Most Positioned to Withstand a Recession](#), Dec. 6, 2022
- [Anticipating Municipal Issuance Will Remain Challenged Again in 2023: Our Forecast](#), Nov. 1, 2022

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

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