HilltopSecurities

U.S. Municipal Bond Market

First Quarter 2023 Public Finance Infrastructure Financings Lower, as Expected - Our Update on Issuance, Fund Flows, & Benchmark Yields

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- The supply and demand dynamic is typically a driving factor influencing the value of municipal bonds. For the first quarter of 2023 issuance was 27% lower year-over-year, a decline very close to what we expected to materialize.
- We forecast only $350 billion of annual issuance and continue to believe that amount is still probable for the year.
- The worst of the investment flows out of municipal funds could be over. Only $92 million was pulled from municipal mutual funds as of the week ending April 6 per Lipper data.
- Municipal benchmark yields have fallen since the bank stress in March. CPI data out this morning reinforced the likelihood that at least one more quarter point hike by the U.S. Fed at their May 3 meeting is to be expected.

Infrastructure Financing Lower in the First Quarter of 2023

The U.S. municipal bond market is one of the primary sources of infrastructure financing for U.S. public finance entities. Various organizations such as state governments, large and small local governments, school districts of all sizes, charter schools, non-profit hospitals, higher education institutions (public and private), public sector utilities and transportation entities (and others) are among those that access investor investment dollars via the U.S. municipal bond market. We follow this activity

The HTS 2023 Municipal Bond Issuance Forecast Remains $350 Billion *($ in billions)*

Ten Year Average '13 - '22	Month	2020 Actual	2021 Actual	2022 Actual	2023 Actual	% Change from 2022	Iss. Required for $350B in 2023	Iss. Required for $400B in 2023	HTS Initial 2023 Forecast (Nov. 22)
$27	January	$33	$28	$26	$23	-12%	$29	$33	$25
28	February	42	37	32	21	-35%	29	33	25
35	March	20	48	46	32	-30%	29	33	30
34	April	32	37	40	-	-	29	33	30
34	May	31	35	37	-	-	29	33	25
40	June	52	50	38	-	-	29	33	40
32	July	48	38	28	-	-	29	33	30
37	August	43	45	42	-	-	29	33	30
33	September	54	45	27	-	-	29	33	30
43	October	73	42	29	-	-	29	33	35
32	November	21	37	26	-	-	29	33	25
34	December	35	41	20	-	-	31	37	25
$409	**Total**	**$485**	**$483**	**$391**	**$75**	**-27%**	**$350**	**$400**	**$350**

Source: Refinitiv, The Bond Buyer and HilltopSecurities.

closely because it impacts the planning that public finance entities go through when raising investment dollars. Also, investors are keenly interested to know what may happen and what has happened because the supply and demand dynamic of primary municipal bond issuance is a driving factor of the value of tax-exempt and taxable municipal bonds.

Municipal market issuance has been 27% lower through the first three months of the year compared to the same period last year.

What Happened with Issuance in the First Quarter of 2023?

Municipal market issuance has been 27% lower through the first three months of the year compared to the same period last year. For the first three months of 2023 we have seen only about $75 billion of municipal bond primary market issuance. There was about $103 billion of issuance in the first quarter of 2022 in comparison. January issuance was down by 12%. February issuance was down by 35% and March issuance was 30% year-over-year. Almost all major sectors were lower in issuance activity through the first quarter. Most notable is the 68% decline of issuance in the non-profit health care sector. Refunding issuance, unsurprisingly, was down over 30%. New money issuance was also down over 20% through the first three months year-over-year.

Why is Issuance Lower?

Issuance is generally lower because of the severe increases in interest rates we have seen since the Fed began its path to control inflation in March of 2022. See more about the Fed path on pages 2-4 in Municipals Seen as Quality Amid Bank Stress, Economic Uncertainty (April 6). Also please see Odds of May Rate Hike Rise on Mixed Job Report, for more on what the Fed's next action may be when it meets on May 3. We also address this topic in greater detail below in our discussion about municipal benchmark yields as a result of new Consumer Price Index (CPI) data that was released today. The significantly higher interest rates we have seen since last year have made it so refundings hardly make economic sense. Public finance entities have also continually experienced sticker shock on the new money side as well. At these levels relatively speaking a portion of issuers are broadcasting that they would rather wait. Many are also holding off because they are continuing to develop and or execute their policy with which to maximize the allocation of federal relief dollars they have received since March of 2022. This decrease of issuance activity through the first three months of 2023 does not come as a surprise to us. We continue to anticipate this level (lower relative to 2022) of activity will continue for the rest of 2023. In November 2022 we forecast total issuance of $350 billion for 2023.

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What is Likely to Happen With Issuance During the Rest of Year?

We continue to believe municipal issuance will be capped at $350 billion in 2023. Therefore, we will likely see an average of about $29 billion of monthly issuance for the rest of the year. To get to $400 billion for the year, or just above 2022's $391 billion we would need to see a little over $33 billion a month. This is a small but consequential difference. We are not projecting that there are going to be many months this year where issuance is going to be over $30 billion. There could be one month where issuance rises to $40 billion, but we would still be very surprised to see multiple months of $40+ billion of primary market activity. In the table above we listed in the last column about where we think monthly issuance will end up for the year.

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Worst of Fund Flow Activity May Be Behind Us

There were a few weeks in 2023 already where investors added to municipal mutual finds. The weekly numbers have been negative over the last eight weeks, but over the last four weeks we have seen an decreasing amount of flows out of municipal funds. Tax time is typically a challenge for municipal flows. It does appear that the worst could be over for investment flows out of municipal mutual funds. Last year we saw multiple weeks where there were billions of dollars of outflows. That has not been the case this year year and we are now poised to potentially see a rebound in fund flows after the 2023 tax season. We are not likely to see a massive amount of inflows, but we do think that worst of the outflows could be over now.

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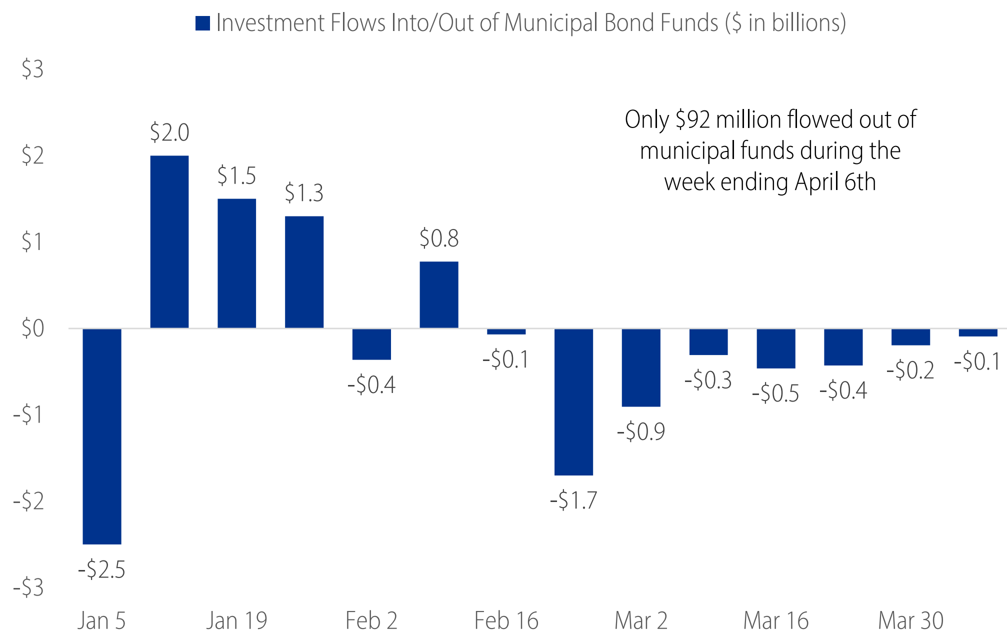
Flows Out of Municipal Funds Have Slowed



Source: Lipper and HilltopSecurities.

This morning, Wednesday April 12, saw headline CPI on a year-over-year basis come in on the low end (5.0% versus 5.1% expected) and core CPI meet analyst expectations (5.6% versus 5.6% expected).

Today's CPI Data Reinforce Potential Fed Rate Hike on May 3rd

Municipal yields continued to fall through April 11, just before the March 2023 Consumer Price Index (CPI) result was released. This morning, Wednesday April 12, saw headline CPI on a year-over-year basis come in on the low end (5.0% versus 5.1% expected) and core CPI meet analyst expectations (5.6% versus 5.6% expected). From a big picture perspective CPI growth is slowing which shows that the indicator continues to move in the right direction. It is likely however, that the results still indicate a Fed rate hike is on the table at their May 3 meeting. Hilltop's Scott McIntyre and Greg Warner wrote today that, "Given the stubbornness of core inflation, and the Fed's determination to reach its +2.0% long-term inflation goal, it's too early to declare victory. At least one more quarter point hike is still the most likely outcome. If price pressures continue to cool, it's reasonable to expect a pause at the June meeting, but the idea of a rate cut before yearend is a stretch" in their report titled, Markets Cheer Cooler CPI, but Elevated Underlying Prices Still Point to May Hike (April 12).

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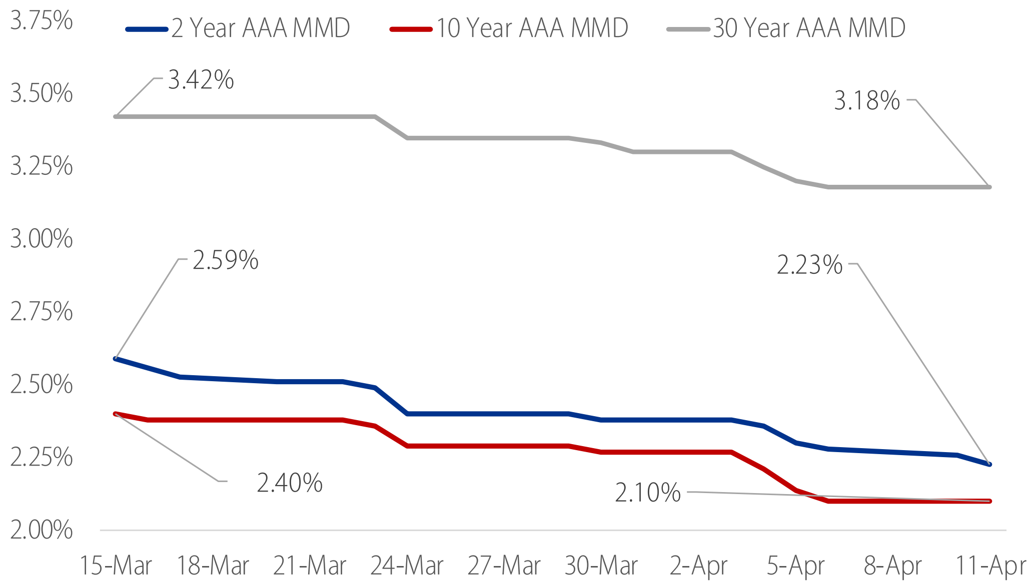
Municipal Benchmark Yields Continued to Fall Since the March 2023 Bank Stress



Source: Refinitiv and HilltopSecurities.

Recent HilltopSecurities Municipal Commentary

- Municipals Seen as Quality Amid Bank Stress, Economic Uncertainty, April 6, 2023
- The Fed is Not Changing Course, Reaffirms Our 2023 Municipal Outlook, Feb. 3, 2023
- The Municipal Market in 2023, Hilltop's Municipal Sector Credit Outlooks, Jan. 17, 2023
- The Texas Permanent School Fund's Bond Guarantee Program Slows to a Roll, Jan. 18, 2023

Readers may view all of the HilltopSecurities Municipal Commentary here.