

## U.S. Municipal Bond Market

# Debt Ceiling Deal Likely to Avert Default, Not Expected to Claw Back State & Local Govt. Fiscal Aid

- Lawmakers agreed on a framework debt ceiling agreement and the draft legislation is titled the Fiscal Responsibility Act of 2023.
- The House is expected to vote on the plan on Wednesday (May 31) and it may take the Senate until the weekend to vote. We expect it will become law before the new "X-date" of June 5.
- We are not expecting Coronavirus State and Local Recovery Funds to be included in the unspent COVID-recovery money clawed back as part of the agreement.
- We only saw relatively small differences in the AAA municipal benchmark on Tuesday (May 30) compared to where AAA MMD closed on Friday before the extended holiday weekend.

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## Lawmakers Compromised on the 2023 Debt Ceiling

House Speaker Kevin McCarthy and President Joe Biden developed a bi-partisan agreement on a debt ceiling compromise over the weekend that would avert a U.S. default, give the Republicans several of the fiscal elements they sought, while leaving much of the President's legislative wins intact. The agreement is being described as one that no one is happy with, and therefore is probably the closest to a true compromise.

*We are not expecting Coronavirus State and Local Recovery Funds to be included in the unspent COVID-recovery money clawed back as part of the agreement.*

We list the major elements of the agreement below, but we want to highlight here that although there could be about \$30 billion of unspent COVID-relief clawed back to Washington, **we are not expecting any of the \$350 billion of Coronavirus State and Local Fiscal Recovery Funds to be clawed back.**

At the end of last week U.S. Treasury Secretary Janet Yellen notified lawmakers that the "X-Date," or the date that Treasury would have insufficient funds was pushed back to June 5. This gave lawmakers more breathing room during their process. This week we are expecting the U.S. House to vote for the Fiscal Responsibility Act of 2023 on Wednesday May 31. The Senate will likely move to quickly vote as well but a date and time are not yet set. Majority Leader Chuck Schumer wrote in a "Dear colleague" letter on Sunday that "Senators should prepare for potential Friday and weekend votes." We are expecting that this legislation will pass, and be signed into law before Treasury's X-date of June 5.

## Potential Debt Ceiling 2023 Timeline

Sat. May 27	Sun. May 28	Tues. May 30	Wed. May 31	Fri.-Sun Jun 2-4	Mon. June 5
-Terms of agreement reached	Lawmakers briefed on details	-House Rules Committee	-House vote expected	-Senate needs to vote, date undetermined	-New "X-date"
-Lawmakers briefed					

Source: HilltopSecurities.

## Major Elements of Debt Ceiling Agreement

Most federal entitlement programs will be unaffected by the Fiscal Responsibility Act of 2023. Therefore, the result from the deal really does not lower U.S. budget deficits by all that much. There is only expected to be a very small negative macro-economic impact as well. However, the interpretation of the spending caps remains open to debate by lawmakers. The White House sees \$1 trillion of lower spending over the next decade, while Republicans are interpreting the spending cut at twice that number. Select others, like Freedom Caucus members, are not at all happy with the agreed upon curbs in spending.

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From a public finance perspective, a key element we have been watching is to see if anything included in the agreement would negatively directly impact sectors within public finance. A potential clawback of unspent COVID relief funds was one area we were concerned about. **We are not expecting any of the Coronavirus State and Local Fiscal Recovery Funds to be included in the clawback.** Therefore, we are not expecting an interruption in the Golden Age of Public Finance, or near-term public finance rating pressure for state and local governments as a result of the Fiscal Responsibility Act of 2023 as it is currently written. These are the larger elements of the Fiscal Responsibility Act of 2023:

- Restrains discretionary, non-defense federal spending
- Increases select defense spending and veterans' benefits
- Expands work requirements for Supplemental Nutrition Assistance Program (SNAP) Temporary Assistance for Needy Families (TANF)
- Clawback of almost \$30 billion of unspent pandemic relief funds
- Scales back IRS funding
- Restarts student loan payments, 60 days after June 30
- Streamlines energy and infrastructure permitting requirements

*We are not expecting any of the Coronavirus State and Local Fiscal Recovery Funds to be included in the clawback.*

## Near-Term Municipal Bond Market Impact

We only saw relatively small differences in the AAA municipal benchmark on Tuesday compared to where AAA MMD closed on Friday before the extended holiday weekend.

### Changes in Select Municipal and Treasury Technical Indicators Since Announcement

Maturity	AAA MMD			U.S. Treasury			M/T Ratio	
	26-May-2023	30-May-2023	Change (%)	26-May-2023	30-May-2023	Change (%)	26-May-2023	30-May-2023
2 Year, 2025	3.15%	3.12%	-0.03%	4.60%	4.48%	-0.12%	68.5%	69.6%
10 Year, 2033	2.72%	2.69%	-0.03%	3.83%	3.70%	-0.13%	71.0%	72.7%
30 Year, 2053	3.62%	3.59%	-0.03%	3.98%	3.90%	-0.08%	91.0%	92.1%

Source: Refinitiv and HilltopSecurities.

## Recent HilltopSecurities Municipal Commentary

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- [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](#)

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