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Markets and Economy | Municipal Bonds

Biden presidency and split Congress could be tailwind for muni bonds

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Boston - With both Georgia Senate seats to be decided in a runoff on January 5, there's still a chance for Democrats to control the White House and Congress. Barring that, we'll still have a split government, with Republicans holding the Senate. Here's what we think that means for munis:

Likelihood of a smaller aid package

Even as the coronavirus pandemic has escalated, Republicans in the Senate have so far hesitated to do any sort of meaningful fiscal stimulus for state and local governments — specially for the states and municipalities that they view as mismanaged.

With Congress doing less, the Federal Reserve may have to do more, potentially shifting from its current focus on purchases at the front end of the Treasury curve to gradually moving out the curve similar to Operation Twist back in 2011.

Watering down of Biden's tax policy proposals

The new president may try to move the marginal rate from 37% back to 39.6% and raise the corporate tax rate from 21%, but not all the way up to his originally proposed 28%. This should increase demand for municipals from wealthy investors, banks, insurance companies and other nonfinancial institutions.

While a possible revision to the deduction cap for state and local taxes (SALT) would be an offsetting factor on the demand side, we expect that on balance, the changes could provide a tailwind for the municipal bond market.

Biden's $2 trillion plan for infrastructure investment

Incentives for debt issuance to fund projects included in the infrastructure plan would lead to increased municipal supply in general. And assuming the continued inability to refund tax-exempt muni bonds in advance with tax-exempt issues, we could see even greater issuance of taxable munis.

All told, with state revenues faring much better than projected, the outlook for muni credit is becoming more positive. In this environment, we favor high quality with a little longer duration versus the benchmark.

Bottom line: Munis remain attractive relative to other asset classes on a taxable equivalent yield basis and also for diversification within broader portfolios.

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