THE BOND BUYER

Munis little changed, as Silicon Valley Bank collapse fallout continues

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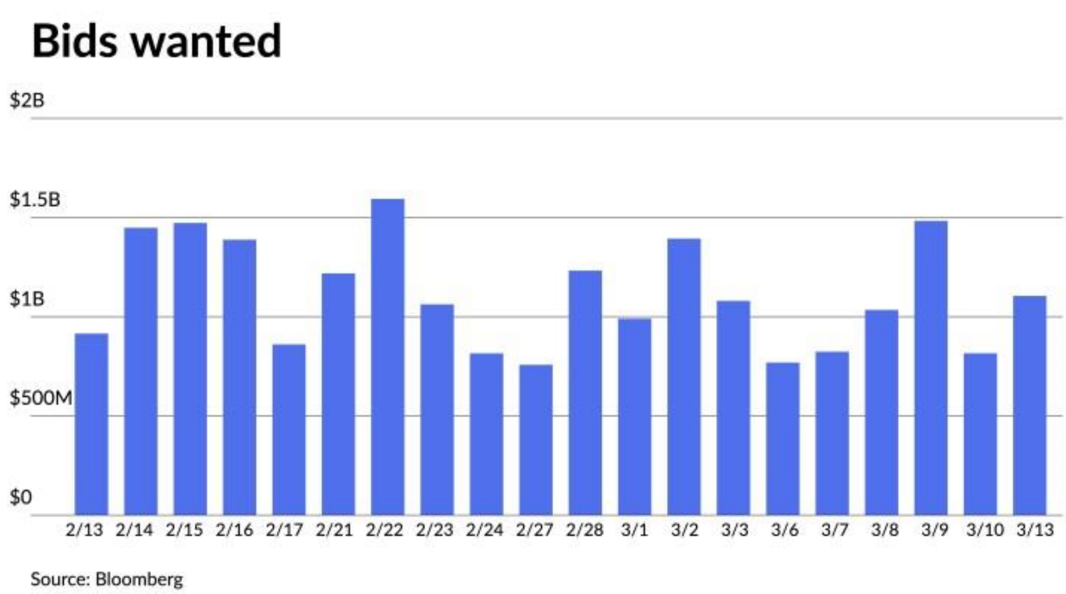
Municipals were little changed Tuesday in secondary trading as the $1.25 billion deal from the New York City Transitional Finance Authority took focus in the primary. Days after the Silicon Valley Bank collapse, U.S. Treasuries reversed course and sold off on the heels of the most recent inflation report. Equities ended up.

Triple-A benchmarks largely ignored UST movements. UST yields rose, with the extremely volatile two-year UST rising 22 basis points after falling 88 basis points in the two prior trading sessions.

The three-year muni-UST ratio was at 63%, the five-year at 65%, the 10-year at 67% and the 30-year at 91%, according to Refinitiv MMD's 3 p.m. ET read. ICE Data Services had the three at 67%, the five at 66%, the 10 at 71% and the 30 at 95% at 4 p.m.



The Silicon Valley Bank collapse continues to impact the municipal market.

"The muni market is no different than others, where fear and greed drive the trends," said Peter Delahunt, StoneX managing director.

Prior to the collapse, he said, "greed drove investors into the front end of the Treasury curve with yields of 5% plus; avoiding the back-up in longer yields eroding NAV prices."

This curtailed "monies coming into the muni funds, yet a dearth of supply capped any significant rate rise for munis; which remained rich to USTs," he noted.

"As the news of a major bank collapse was announced, the resulting fear has driven investors further into the front end of the Treasury curve seeking safety, driving yields down roughly 60 bps," Delahunt said.

Monday's panic-driven yield rally swept munis yields lower along with USTs.

"Muni fundamentals remain sound, while the technicals have kept muni-to-Treasury ratios rich," he said. "The lower yield improvement for munis will improve the NAVs for the funds; which should mitigate the recent outflows that had been drawn away into the 5% plus T-bill yields."

There had been concern Monday, "prompted by rumors of ailing bank contagion, specifically First Republic," he said.

This drew the attention of the muni market, "as First Republic has a much greater holding of muni debt than its peers," Delahunt said.

There was an initial fear that roughly "$17 billion of tax-exempt muni holdings might need to be liquidated," he said, though this appears highly unlikely.

"Meanwhile, the Fed has salved the markets, implementing steps to alleviate funding issues for those banks experiencing a need," according to Delahunt.

The overriding issue now returns to the intentions of the Fed, he said.

"Their primary mandate is to assure the health of our banking system," he noted. "This trumps any mandate to contain inflation. How will they attempt to balance these mandates is the question."

The municipal market seems healthy based on the strength of credit and the orderly flow of trading activity, making it poised for a comeback once macro volatility subsides, according to Mark Paris, chief investment officer and head of municipals, and Stephanie Larosiliere, senior municipal strategist at Invesco.

"We think the valuable benefits of municipal bonds, including tax-exempt income, will eventually prevail once the Fed is on the sidelines and inflation is no longer making waves," Larosiliere said.

Municipalities' finances— including Illinois, New York City, and Las Vegas — are better than they were entering 2020, because of upgrades, Paris and Larosiliere said.

"During the month of January 2023 rating upgrades of municipal issuers continued to exceed downgrades by a ratio of 2.6:1," Larosiliere said. "This positive dynamic can be largely attributed to the federal stimulus, which has given municipalities room to shore up rainy-day funds and strengthen their balance sheets," she added.

Municipal issuance has remained extremely low because issuers don't have an urgency to borrow at this time, they said. "They can afford to wait out the high rates because of their strong fiscal positioning," Larosiliere said.

In February, tax-exempt supply was 24% less than it was in February 2022, she noted, and 17% less than the five-year average for the month.

On the buyside, demand is mixed, they pointed out.

"Mutual funds are generally focused on primary markets where you can get some relative value, particularly on the long part of the curve — 20 years and out — and the lower-rated options — single-A and triple-B — where you can pick up more incremental yield," Larosiliere explained.

She noted the municipal curve is still relatively steep versus other curves.

"The SMAs are focused 10 years and in because of their general concern about taking on the duration," she said. "Long 4s at a discount also seem to be pretty popular in the individual bond space."

Technicals, according to Larosiliere, are a big driver of activity and act as a tailwind.

"With supply being down roughly 25% year-over-year, and a healthy amount of cash in the system, funds have fared well so far," she said, noting demand has skewed toward new issuance.

"The secondary activity has started to focus more on swaps now that we have backed up," Larosiliere added, while ratios remain on the rich side.

"We think people have developed a more cautious tone as we roll into tax season," she said.

The team believes the municipal market remains cautious ahead of the Federal Reserve Board's next meeting. "Consensus is that we will see a 25 basis point increase," she said. "This continued rise in yields could impact flows."

In terms of supply, Paris and Larosiliere expect secondary volume will be relatively muted away from swap activity, while new issue activity "will continue to be the focus as we get back to the herd mentality of munis."

In the primary market Tuesday, Ramirez & Co. priced for institutions $950 million of future tax-secured subordinated bonds from the New York City Transitional Finance Authority (Aa1/AAA/AAA/) with small bumps on the front end of the curve and cuts up to 14 basis points out long from Monday's retail order: 5s of 2/2025 at 2.78% (-3), 5s of 2028 at 2.59% (-2), 5s of 2038 at 3.38% (unch), 5s of 2043 at 3.90% (+13), 5.25s of 2047 at 3.99% (+11) and 4s of 2051 at 4.45% (+14), callable 2/1/2033.

BofA Securities held a one-day retail order for $819.870 million of Oregon GOs (Aa1/AA+/AA+/). The first tranche, $664.285 million of 2023 Series A, saw 5s of 5/2024 at 2.73%, 5s of 2028 at 2.57%, 5s of 2033 at 2.64%, 5s of 2038 at 3.35%, 5s of 2043 at 3.57% and 5s of 2048 at 3.72%, callable 5/1/2033.

The second tranche, $155.585 million of tax-exempts, 2023 Series D, saw 5s of 5/2024 at 2.73%, 5s of 2028 at 2.57%, 5s of 2033 at 2.64%, 5s of 2038 at 3.35%, 5s of 2043 at 3.57% and 5s of 2048 at 3.72%, callable 5/1/2033.

In the competitive, the New York City Transitional Finance Authority (Aa1/AAA/AAA/) sold $180.390 million of taxable future tax-secured subordinated bonds, Fiscal 2023 Series F, Subseries F-2, to BofA Securities, with all bonds pricing at par: 4.6s of 2/2028 and 5s of 2033, noncall.

The authority also sold $119.610 million of taxable future tax-secured subordinated bonds, Fiscal 2023 Series F, Subseries F-2, to J.P. Morgan Securities, with 5.03s of 2/2034 at par and 5.15s of 2036 at 5.18%, callable 2/1/2033.

Muni CUSIP requests

Municipal CUSIP request volume decreased in February on a year-over-year basis, following a decrease in January, according to CUSIP Global Services.

For muni bonds specifically, there was a decrease of 1.2% month-over-month and a 28.3% decrease year-over-year.

The aggregate total of identifier requests for new municipal securities, including municipal bonds, long-term and short-term notes, and commercial paper, fell 3.1% versus January totals. On a year-over-year basis, overall municipal volumes were down 23.5%. CUSIP requests are an indicator of future issuance.

Secondary trading

Washington 5s of 2024 at 2.64% versus 2.89% on 3/9. California 5s of 2024 at 2.58%. NYC 5s of 2025 at 2.70%-2.80%.

NYC TFA 5s of 2029 at 2.62%. Florida BOE 5s of 2030 at 2.49%-2.47%. DC 5s of 2030 at 2.51% versus 2.77% original on Friday.

Indiana Finance Authority 5s of 2034 at 2.83% versus 3.04% on 3/2.

LA DWP 5s of 2052 at 3.75% versus 3.79% Monday. San Jose Financing Authority 5s of 2052 at 3.57% versus 3.72% Thursday and 3.72%-3.70% on 3/6. Massachusetts 5s of 2052 at 3.76% versus 3.77% Monday and 2.83% Friday.

AAA scales

Refinitiv MMD's scale was bumped up to two basis points. The one-year was at 2.70% (-2) and 2.69% (-2) in two years. The five-year was at 2.47% (-2), the 10-year at 2.45% (unch) and the 30-year at 3.42% (unch) at 3 p.m.

The ICE AAA yield curve was mixed: 2.71% (-2) in 2024 and 2.71% (flat) in 2025. The five-year was at 2.47% (+1), the 10-year was at 2.48% (+2) and the 30-year yield was at 3.50% (+2) at 4 p.m.

The IHS Markit municipal curve was unchanged: 2.73% in 2024 and 2.71% in 2025. The five-year was at 2.47%, the 10-year was at 2.43% and the 30-year yield was at 3.40% at a 4 p.m. read.

Bloomberg BVAL was little changed: 2.79% (unch) in 2024 and 2.71% (unch) in 2025. The five-year at 2.45% (unch), the 10-year at 2.44% (unch) and the 30-year at 3.42% (unch).

Treasuries sold off.

The two-year UST was yielding 4.235% (+22), the three-year was at 4.076% (+19), the five-year at 3.824% (+15), the seven-year at 3772% (+13), the 10-year at 3.664% (+12), the 20-year at 3.924% (+8) and the 30-year Treasury was yielding 3.785% (+10) at 4 p.m.

CPI mostly as expected

While the SVB collapse is expected to be a hot topic at the Federal Open Market Committee meeting next week, inflation will be a major concern as well.

The February consumer price index came in mostly as expected, up 0.4% in the month and 6.0% year-over-year, while the core grew 0.5% in the month and 5.5% year-over-year.

The numbers reflect "the slowest annual increase in consumer prices since September 2021," said Nigel Green, CEO and founder of deVere Group.

"Whilst prices in February were 6% higher than a year ago, they are down from an annual rate of 6.4% in January and considerably lower than the 9.1% peak of inflation experienced in June 2022," he said.

While CPI came in as expected, Sean Snaith, director of the University of Central Florida's Institute for Economic Forecasting, noted, "you still have persistent high inflation and double digits in key areas like food and electricity — these are big shares of consumers' budgets still rising every month at a pretty rapid pace."

Wells Fargo Securities Senior Economist Sarah House and Economist Michael Pugliese noted not "many signs of cooling," They pointed to grocery store prices, which grew 0.3% — the smallest rise since March 2021 — and used car prices, which declines 2.8%, among the positives.

"But beyond these pockets of improvement, core CPI inflation remained entrenched at uncomfortably high levels," they said.

The core increase translates into an annualized rate of more than 5%, House and Pugliese noted.

In isolation, the labor market and inflation data "clearly argue for another 25 bps rate hike at the March 22 FOMC meeting," the Wells Fargo strategists said. However, they said, "the significant developments in financial markets and the banking system cloud the outlook."

The fallout "from the failures of Silicon Valley Bank and Signature Bank raises additional concerns about the economic outlook," House and Pugliese said.

Policymakers, they said, "have taken meaningful steps to address the financial system challenges, such as the Fed's new bank lending facility and making all depositors whole at the aforementioned two banks."

"If the medicine proves effective, we suspect the Fed will continue to gradually tighten monetary policy in the months ahead," the Wells Fargo strategists said. "But, with more than a week to go until the next FOMC meeting, a 25 bp rate hike is still a distinct possibility if financial stresses ease."

"While the Fed is probably inclined to hike 25 bp, this is contingent on calm being restored to the financial system," said ING Chief International Economist James Knightley. "Irrespective of this, the fallout from recent events will inevitably lead to a tightening of lending conditions, which will weigh on growth and inflation."

"Recent inflation and labor market data are consistent with resilient economic activity and robust aggregate demand that is providing businesses with the flexibility to pass on cost increases to consumers," said Mickey Levy and Mahmoud Abu Ghzalah of Berenberg Capital Markets.

"Sticky inflation poses a challenge for the Fed, which is grappling with turmoil in the domestic banking sector and financial stability concerns in the wake of a string of high-profile bank failures," they said.

Under normal circumstances, they said, "the strength of labor market and inflation data since the turn of the year would likely have prompted the Fed to hike rates by 50 bp at its March meeting."

However, Levy and Ghzalah noted, "given recent developments, we expect the Fed to opt for the more conservative option and deliver a 25 bp hike in March as it assesses the full extent of the fallout in the banking sector."

Snaith cautioned the Fed against "getting distracted by SVB and the regional banking calamities of the past few days — and continue its fight against inflation."

"It's not looking like a re-do of 2008 at this point," he said of the bank failures. "I don't think it's anything that should distract the Fed from its primary objective of getting inflation down."

Snaith is "still encouraging the Fed to raise rates by a half-percentage point at its meeting next week—or at least a quarter-percentage point if it feels it needs to temper the markets and investors in light of bank failures."

The CPI report "together with the collapse of Silicon Valley Bank and Signature Bank ... will certainly give the Fed cause to reconsider their rate hiking agenda," according to Green.

However, he said, "against a backdrop of a robust labor market, we still expect the central bank will raise interest rates by a quarter-point at their next meeting on March 22."

Should the Fed pause the rate hike agenda now, Green said, "it puts them at risk of exposing themselves to inflation speeding up again," which would force them to be more aggressive in the future, and "would harm their objective and dent their credibility, so they can be expected to err on the side of caution."

As such, they said, "it is likely that they will hike rates, albeit by a quarter-point."

"But due to the time-lag associated with CPI data, we would champion a move by the Fed not to raise rates at all later this month," Green said.

Primary to come:

The Massachusetts Bay Transportation Authority, meanwhile, will sell $618.2 million of 2023 senior sales tax bonds Thursday, following a Wednesday retail order period. The deal, which is rated AA by S&P, and triple-A by both Fitch and Kroll Bond Rating Agency, consists of $510.2 million of Series A-1 bonds structured as serials from 2025-2030, 2032-2033, 2035-2043 and terms in 2048 and 2053; as well as $107.9 million of Series A2 sustainability bonds maturing serially from 2025-2030, 2032-2033, and 2035-2038. The bonds will be senior managed by Barclays Capital.

A $485.7 million sale of gas project revenue bonds is planned by the Black Belt Energy Gas District. The revenue bonds are rated A1 by Moody's and will be senior managed by Goldman, Sachs & Co.

The Los Angeles Department of Water and Power plans a $305.5 million sale of power system revenue bonds for Thursday. The Series A serial bonds mature from 2023-2024 and 2026-2032 and are being senior managed by Ramirez. The bonds are rated Aa2 by Moody's, AA-minus by S&P, and AA by Fitch.

The Gerald Ford International Airport Authority, Michigan, will sell $165.3 million of revenue bonds in a taxable Series 2023A sale of limited tax GO paper maturing from 2028 to 2038 with terms in 2043 and 2053. The Wednesday sale is rated triple-A by Moody's and S&P and is being senior-led by Citigroup.

A $150 million sale of homeowner mortgage revenue bonds is planned for Thursday by the State of New York Mortgage Agency. The social bonds will consist of $115.8 million Series 250 non-AMT paper structured with term bonds in 2038, 2043, 2048, and 2053. Series 251 AMT paper will consist of $34.1 million maturing from 2023 to 2034 with a term bond in 2036.

The Idaho Housing & Finance Association will sell $115.2 million of single-family mortgage bonds in a two-pronged offering that is rated Aa1 by Moody's. The

$65.1 million Series A fixed-rated, non-AMT bonds mature serially from 2024 to 2035 with terms in 2038, 2043, 2048, and 2053, while Series B-1 consists of $50 million of fixed-rate taxable paper maturing serially from 2024 to 2035 with term bonds in 2038, 2041, and 2053. Barclays is the lead book runner.

Competitive:

Maryland will sell $400 million of bonds Wednesday: $50 million taxable state and local facilities loan GOs and $184.1 million and $165.8 million of tax-exempt GOs.

The Davis School District is planning a $100 million sale of GOs backed by the Utah School District Bond Guaranty Program on Monday. The bonds are rated Aaa by Moody's.