

# Monthly Municipal Market Update

## Month in review

The U.S. economy continued to glide along its path to recovery in June. Fueled by investor confidence, business investment, and prospects of additional government spending, all three major U.S. stock market indices closed the second quarter at or near record highs.<sup>1</sup> Despite all tenors of the U.S. Treasury yield curve declining in the month's final trading days, the curve ultimately flattened in June. Specifically, yields at the two- and five-year tenors closed the month 10 and eight basis points (bps) higher, respectively, while yields at the 10- and 30-year tenors of the curve closed the month 14 and 20 bps lower, respectively.<sup>2</sup>

Municipal bond yields experienced a relatively active month. After declines across all tenors of the AAA Municipal Market Data (MMD) curve in early June, yields reversed course mid-month. While yields at the one- and two-year tenors of the curve closed the month up five and six bps, respectively, longer-term yields closed the month within a four basis point range of their previous month-end figures. Notably, the 10-year tenor of the AAA Municipal Market Data (MMD) curve closed the month at 0.99% for the third straight month.<sup>3</sup> Meanwhile, investors continue to pour assets into municipal funds, with inflows on pace for a record year (+\$59.5 billion year-to-date).<sup>4</sup>

In June, \$46.2 billion of municipal debt was issued, marking a 37% increase from May's final tally of \$33.7 billion. Taxable municipal issuance, which totaled \$12.9 billion in June, more than doubled month-over-month.<sup>5</sup> July 1 typically presents an outsized level of maturities and coupon payments, and with slowing supply around the July 4 holiday, coupled with record-setting fund inflows, it is expected that munis will be well-supported in July's early weeks.

- At the Federal Open Market Committee (FOMC) meeting in June, policymakers signaled their intent to accelerate monetary tightening against a backdrop of accelerating economic growth and inflation concerns. Specifically, the Fed's median interest rate forecast now projects a two-notch increase in the benchmark rate before the end of 2023, as opposed to the no-rate-hike scenario projected in March. Additionally, FOMC policymakers discussed an eventual tapering of the Fed's bond-buying program, though timing remains uncertain. The Fed's hawkish tone resulted in a jump in short-term U.S. Treasury yields.<sup>6</sup>
- Municipal bonds closed out the second quarter with yet another month of positive performance – the fourth straight month for tax-exempt munis and the third straight for their taxable counterparts. The Bloomberg Barclays Municipal Bond Index gained 0.27%, the Bloomberg Barclays High Yield Municipal Bond Index returned 1.27%, and the Bloomberg Barclays Taxable Municipal Index advanced by 1.68% over the month. June's performance brings year-to-date total returns for the three indices to 1.06%, 6.13%, and 0.30%, respectively.<sup>7</sup>
- Despite strong demand, municipal taxable-equivalent yield spreads to Treasuries widened across nearly the entire curve in June. At month-end, spreads equated to 13 bps at the one-year tenor (up from eight bps), two bps at the two-year tenor (flat), negative five bps at the five-year tenor (down from one bp), 22 bps at the 10-year tenor (up from eight bps), and 46 bps at the 30-year tenor (down from 28 bps).<sup>8\*</sup>
- There were 665,000 total secondary market trades recorded in June, marking a 7% increase from last month but a 6% decrease from June 2020. Total par traded amounted to \$199 billion.<sup>9</sup>

**Figure 1: Market snapshot**

	Muni yields (MMD AAA)			U.S. Treasury yields			Muni taxable equivalent**	
	Yield	MTD change	YTD change	Yield	MTD change	YTD change	Yield	Spread
<b>2-year</b>	0.16%	0.06%	0.02%	0.25%	0.10%	0.13%	0.27%	0.02%
<b>5-year</b>	0.49%	0.01%	0.27%	0.88%	0.08%	0.52%	0.83%	-0.05%
<b>10-year</b>	0.99%	0.00%	0.28%	1.45%	-0.14%	0.53%	1.67%	0.22%
<b>30-year</b>	1.50%	-0.01%	0.11%	2.07%	-0.20%	0.42%	2.53%	0.46%

<b>\$235.4B</b>	<b>+\$12.6B</b>	<b>+\$59.5B</b>	<b>1.06%</b>	<b>+6.13%</b>	<b>+28 bps</b>	<b>+53 bps</b>
YTD muni issuance	M/M muni issuance	YTD muni fund flows	YTD IG return	YTD HY return	YTD change in 10yr muni yield	YTD change in 10yr Treasury yield

\*Figures for total municipal issuance and taxable municipal issuance include both municipal CUSIPs and not-for-profit corporate CUSIPs. \*\*Taxable-equivalent yield assumes 37% federal income tax and 3.8% Medicare investment tax. Spread refers to spreading the municipal taxable equivalent yield against the U.S. Treasury yield.

Sources: Muni CUSIP Issuance: The Bond Buyer, including bond and note issuance. Not-for-profit corporate CUSIP issuance: PIMCO analysis of Bloomberg data. Yield and spread data: Thomson Reuters. Muni fund flows: Refinitiv Lipper, inclusive of weekly and monthly reporting funds. YTD IG return: Bloomberg Barclays Municipal Bond Index. YTD HY return: Bloomberg Barclays High Yield Municipal Bond Index. All data as of 30 Jun 2021 except for not-for-profit corporate CUSIP issuance which was sourced on 1 Jul 2021, but as of 30 Jun 2021.

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## Muni technicals in focus: Muni/Treasury ratio inches higher amidst broader market volatility

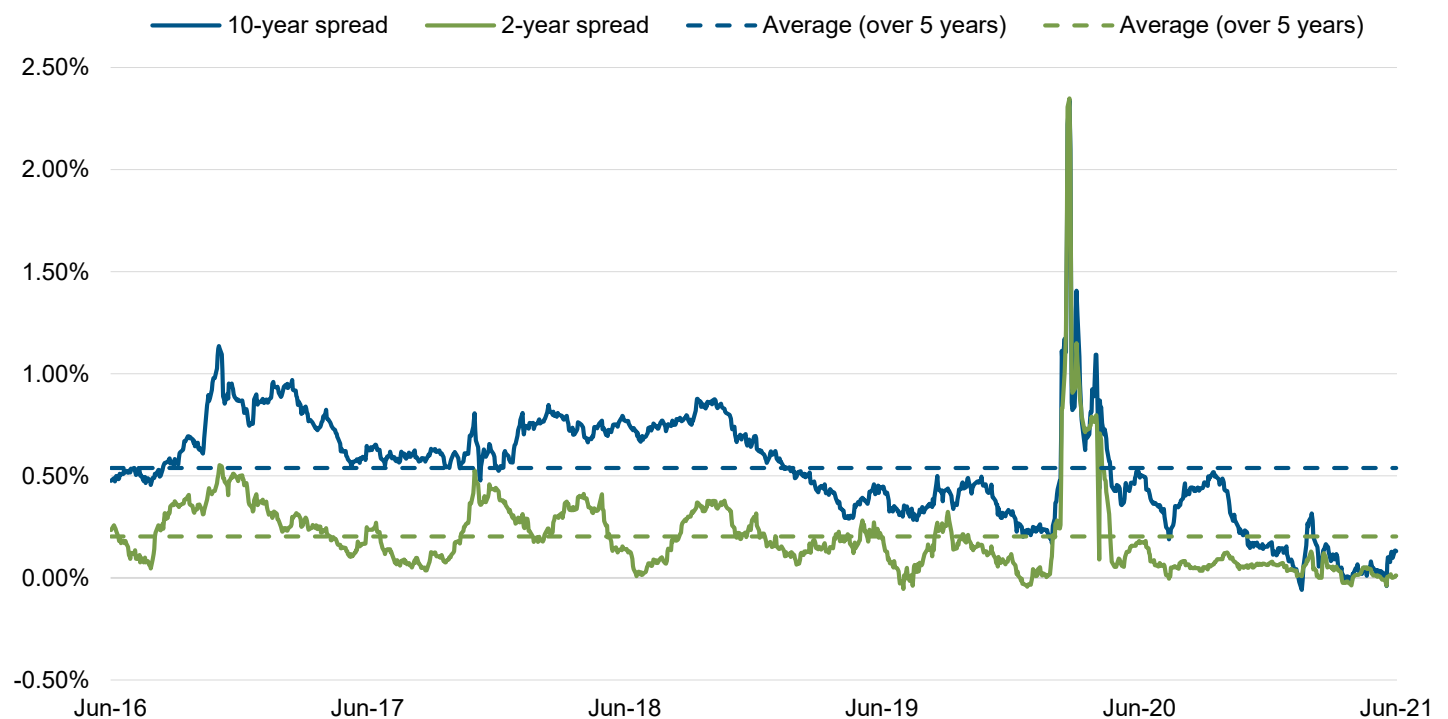
Following the relatively hawkish tone struck at June’s FOMC meeting, the CBOE Volatility Index (VIX) briefly surpassed the 20 threshold and the Treasury curve flattened.<sup>10</sup> The 2-year Treasury yield rose to its highest point since April of last year, while the 30-year Treasury yield plummeted 18 bps over two trading days.<sup>11</sup> Municipal yields subsequently increased across the municipal MMD curve, owing largely to elevated issuance and uncertainty regarding potential tax hikes. In turn, municipal valuations eased from record-low levels.<sup>12</sup> From its mid-month trough of ~56.5%, the 10-year municipal/Treasury ratio climbed to 68% by month-end, its highest since late March.<sup>13</sup>

By month end, a preliminary infrastructure agreement cobbled together by Congress led the Treasury curve to steepen again. The agreement as it stands excludes tax increases, though it incorporates provisions for a Build America Bonds-like program and, importantly to the municipal market, the reinstatement of tax-exempt advance refundings.

June also presented clear evidence of the drastically improved municipal landscape as state budgets included nearly \$1 billion in increased spending plans for fiscal year 2022 – one of the largest upticks in the last decade.<sup>14</sup> All told, nearly 80% of U.S. states are implementing budgets with higher spending relative to 2021. In addition to higher baseline spending, many states are announcing plans to utilize American Rescue Plan funds for a variety of purposes, including an assortment of one-time infrastructure projects, rebuilding unemployment trust funds, and economic development and job creation programs.

In perhaps the most notable illustration of improved state fiscal trends, Illinois was upgraded by Moody’s to Baa2 – the state’s first upgrade in more than 20 years from the agency. In addition, New Jersey enacted a record-setting budget that includes fully funding its actuarially determined pension contribution, a sea change for a state with a checkered history of severely underfunding its annual payments.<sup>15</sup>

**Figure 2: Municipal/Treasury after-tax\* spreads**

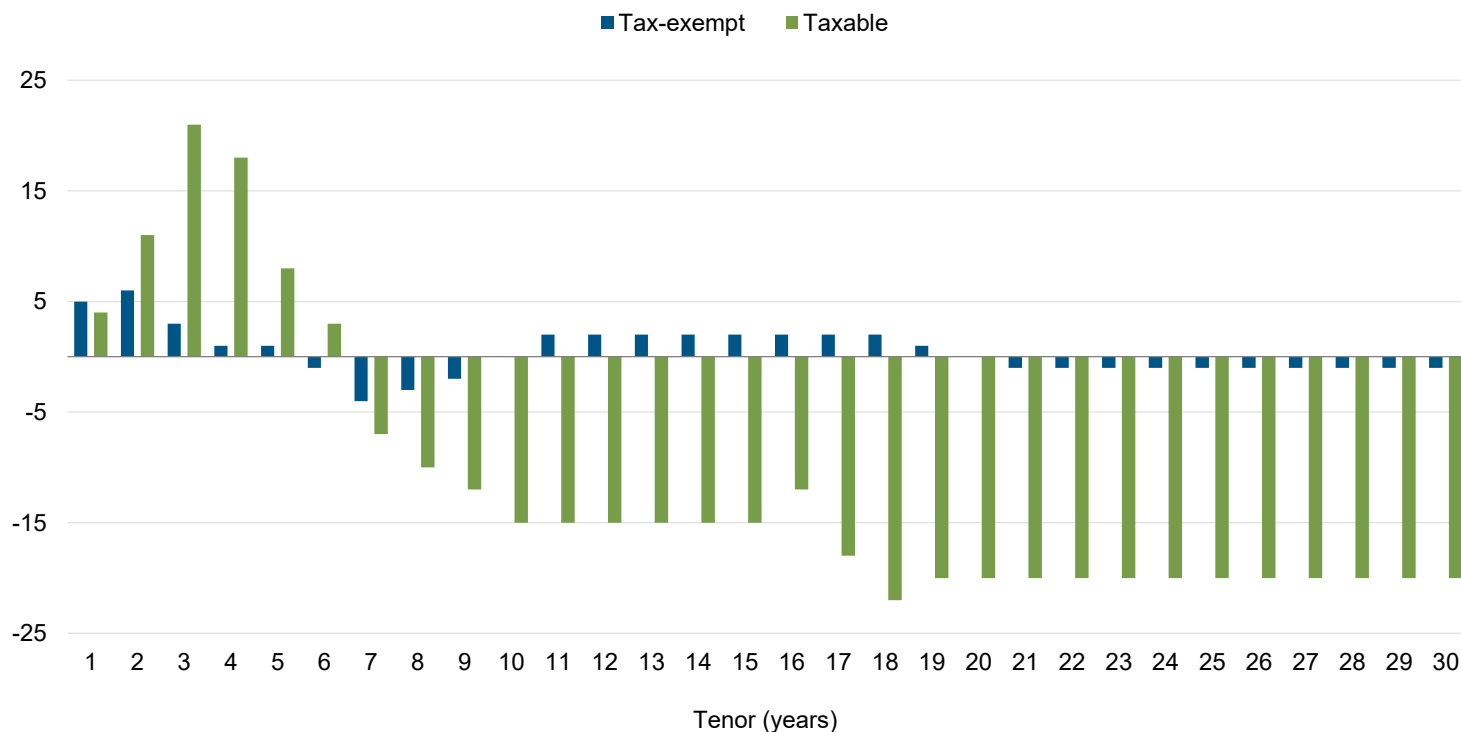


Sources: Figure 2: Thomson Reuters TM3 MMD Interactive as of 30 Jun 2021. 2-year and 10-year average spreads calculated over the last five years, starting 1 Jul 2016. \*Assuming a 37% federal income tax rate and 3.8% Medicare tax rate.

While the overall trends continue to be highly supportive of improved credit quality, the past month has also provided reminders of possible risks, including fears surrounding crime rates that may drive substantial spending demand in some of the nation’s largest cities, and the historic heat wave and sustained drought that could adversely affect some cities and essential service utilities in the West. We continue to closely monitor affected sectors but still expect stronger issuers to have considerable resources and flexibility to respond to challenges without diminishing their credit quality.

Broadly speaking, favorable municipal market technicals continue to persist. Retail investors poured ~\$8.2 billion into municipal funds over the month, bringing the inflow cycle to 17 straight weeks.<sup>16</sup> While reinvestment capital typically tends to outstrip supply during the summer months, the municipal market saw \$46.2 billion in new issuance in June – the second largest monthly volume of the year thus far (March saw \$47.9 billion).<sup>17</sup> Meanwhile, the 0.27% return posted by the Bloomberg Barclays Municipal Bond Index in June marked the fourth straight month of positive returns for the municipal market.<sup>18</sup> Finally, with the municipal credit outlook continuing to improve and credit spreads further tightening, the Bloomberg Barclays High Yield Index returned 1.27%.<sup>19</sup>

**Figure 3: Month-over-month change in AAA MMD yields (bps)**



Sources: Figure 3: Thomson Reuters TM3 MMD Interactive as of 30 Jun 2021.

**Figure 4: Market data****Municipal index returns**

Muni returns	YTW	MTD	YTD
Bloomberg Barclays Muni Index	1.00%	0.27%	1.06%
Bloomberg Barclays 1–10 (1–12)	0.63%	0.07%	0.36%
Bloomberg Barclays Muni Short (1–5)	0.38%	0.01%	0.33%
Bloomberg Barclays High Yield Muni	3.09%	1.27%	6.13%

Source: Bloomberg Barclays as of 30 Jun 2021

**Monthly municipal fund net flows (in millions)**

Month	2021	2020	2019
January	\$12,394	\$11,878	\$7,895
February	\$7,448	\$8,870	\$10,893
March	\$6,333	(\$42,134)	\$7,723
April	\$8,798	(\$3,170)	\$6,342
May	\$5,482	\$5,144	\$7,682
June	\$7,465	\$11,175	\$6,398

Source: Investment Company Institute as of 23 Jun 2021. The most recent month's flows are based on weekly estimates and subject to change.

**Average monthly visible supply (in millions)**

Month	2021	2020	2019
January	\$7,691	\$10,115	\$7,452
February	\$9,432	\$10,310	\$6,991
March	\$11,187	\$13,659	\$7,153
April	\$10,338	\$13,803	\$7,129
May	\$10,815	\$11,498	\$8,232
June	\$12,509	\$13,413	\$8,492

Source: Bloomberg as of 30 Jun 2021

**Secondary market activity (in millions)**

Month	Average par of Bloomberg pick	Average daily bid wanted
Jun-20	\$4,101	\$563
Jul-20	\$2,365	\$434
Aug-20	\$3,197	\$544
Sep-20	\$4,359	\$563
Oct-20	\$3,471	\$700
Nov-20	\$2,737	\$479
Dec-20	\$4,998	\$536
Jan-21	\$6,830	\$559
Feb-21	\$7,662	\$713
Mar-21	\$6,879	\$653
Apr-21	\$6,916	\$564
May-21	\$7,643	\$569
Jun-21	\$7,906	\$537

Source: Bloomberg as of 30 Jun 2021

**10-year municipal vs. 10-year Treasury yields**

Day	Municipal	Treasury
5/31/2021	0.99	1.59
6/30/2021	0.99	1.45

Source: Thomson Reuters as of 30 Jun 2021

**Monthly new issuance (in millions)**

Month	2021	2020	2019
January	\$30,527	\$36,224	\$25,706
February	\$36,739	\$44,895	\$26,760
March	\$47,905	\$21,267	\$28,070
April	\$40,288	\$34,236	\$28,154
May	\$33,664	\$37,007	\$29,512
June	\$46,249	\$57,539	\$37,386

Source: Muni CUSIP issuance sourced from The Bond Buyer, including bond and note issuance, as of 30 Jun 2021. Not-for-profit corporate CUSIP issuance based on PIMCO analysis of Bloomberg data sourced on 1 Jul 2021, but as of 30 Jun 2021.

**Monthly bond redemptions (in millions)**

Month	Amount matured	Amount called
Jul-20	\$39,651	\$3,028
Aug-20	\$47,455	\$5,918
Sep-20	\$22,898	\$6,457
Oct-20	\$29,719	\$9,916
Nov-20	\$27,364	\$7,816
Dec-20	\$33,357	\$9,549
Jan-21	\$21,903	\$4,703
Feb-21	\$28,728	\$4,481
Mar-21	\$26,080	\$5,860
Apr-21	\$22,270	\$5,746
May-21	\$25,711	\$4,049
Jun-21	\$45,427	\$8,908

Source: Bloomberg as of 30 Jun 2021

**Sector returns**

Select sectors	Jun '21	YTD	2020
General obligation	0.19%	0.55%	5.49%
Pre-refunded	0.02%	0.06%	2.76%
Revenue	0.33%	1.36%	5.31%
Education	0.36%	1.13%	5.39%
Healthcare	0.50%	2.15%	5.70%
Industrial development	0.36%	1.21%	5.46%
Lease-backed	0.45%	1.85%	5.04%
Power	0.15%	0.47%	5.40%
Special tax	0.30%	1.11%	4.73%
Transportation	0.39%	1.93%	5.16%
Water & sewer	0.15%	0.34%	5.86%
HY tobacco	1.32%	6.30%	13.93%
HY Puerto Rico	1.44%	5.33%	10.68%

Source: Bloomberg Barclays Indices as of 30 Jun 2021

<sup>1</sup> Anna Hirtenstein and Hardika Singh, "U.S. Stocks Edge Higher to End Quarter," Wall Street Journal, 30 Jun 2021; Will Horner and Caitlin McCabe, "Stocks' Modest Gains Give Nasdaq, S&P 500 Records," Wall Street Journal, 29 Jun 2021

<sup>2</sup> Thomson Reuters TM3 MMD Interactive Data, 30 Jun 2021

<sup>3</sup> Thomson Reuters TM3 MMD Interactive Data, 30 Jun 2021

<sup>4</sup> Refinitiv Lipper, 30 Jun 2021

<sup>5</sup> The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 30 Jun 2021; Bloomberg, 1 Jul 2021

<sup>6</sup> Paul Kiernan, "Fed Pencils In Earlier Interest-Rate Increase," Wall Street Journal, 16 Jun 2021; Matthew Boesler and Craig Torres, "Fed Sees Two Rate Hikes by End of 2023," Bloomberg Daily Brief: Muni, 17 Jun 2021;

<sup>7</sup> Bloomberg Barclays, 30 Jun 2021

<sup>8</sup> Thomson Reuters TM3 MMD Interactive Data, 30 Jun 2021

<sup>9</sup> The Bond Buyer: Secondary Market Data, 2 Jul 2021

<sup>10</sup> Bloomberg Barclays, 30 Jun 2021

<sup>11</sup> Thomson Reuters TM3 MMD Interactive Data, 30 Jun 2021

<sup>12</sup> Ibid

<sup>13</sup> Ibid

<sup>14</sup> NASBO, "Fiscal Survey of States," Spring 2021

<sup>15</sup> The State's GO rating has consistently been downgraded by Moody's since it was a Aa2 in 2000, with the only upward movement being a change in rating scale in Apr 2010. The State's GO rating was raised to Baa2 on 29 Jun 2021.

<sup>16</sup> Refinitiv Lipper, 30 Jun 2021. \*Data is inclusive of weekly reporting funds and does not include monthly reporting funds.

<sup>17</sup> The Bond Buyer, "Bond Sales (Latest Month)", 30 Jun 2021

<sup>18</sup> Bloomberg Barclays, 30 Jun 2021

<sup>19</sup> Ibid

#### Past performance is not a guarantee or a reliable indicator of future results.

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