U.S. Municipal Bond Market

We Predict $330 Billion of Municipal Bond Issuance for 2024, the Lowest Since 2018

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- Our municipal bond issuance forecast of only $330 billion is a result of the sector's (mostly) conservative budgeting philosophy, declining U.S. economic growth, and prohibitively elevated interest rates.
- We are assuming a "Slower-Trend Growth Scenario" where economic growth will be lower in 2024 compared to 2023. This will again pressure new money issuance, we expect. State and local government credit quality remains very strong and housing prices appreciated compared to pre-pandemic levels. These are key reasons we do not expect new money issuance to fall more sharply. Interest rates are likely to remain prohibitively high, this should cause refunding issuance to fall too.
- Monthly issuance is likely to average about $27.5 billion in 2024, down from the almost $30 billion average we are expecting in 2023. To see $400 billion of annual issuance in 2024 monthly activity would need to average about $33.3 billion.
- Pandemic related and post-pandemic fiscal policy has not and likely will not meaningfully add to municipal bond issuance in 2024.

Factors That Will Keep Issuance on the Financially Manageable (Low) Side

The economic landscape is ever more bewildering as higher interest rates and the potential for them to remain higher for a relatively longer period of time threatens the status quo. "The [U.S.] federal government faces an unsustainable fiscal future," writes the U.S. GAO. This is primarily because, as reported by the CBO, interest on the public debt

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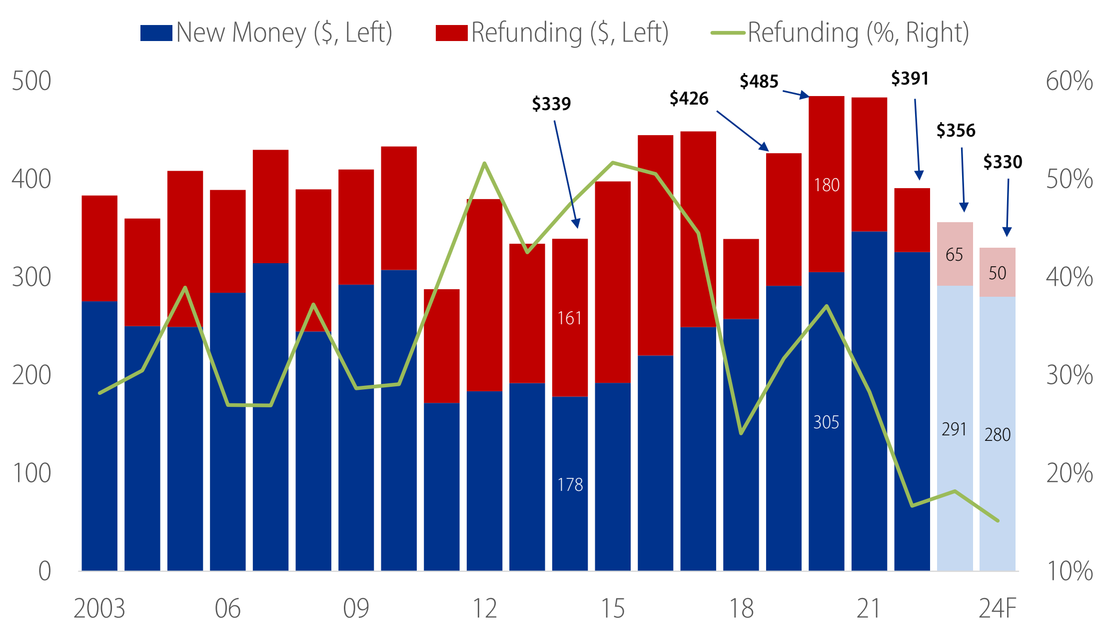
We Expect $330 Billion of Municipal Bond Issuance in 2024



Source: Refinitiv and HilltopSecurities.

Please see disclosure starting on page 5.

rose by $29 billion (or 75%), and it will continue to rise without fiscal policy changes. We highlighted the U.S. debt to G.D.P. ratio was only 35% before the World Financial Crisis, now it stands at 98% and not surprisingly the U.S. debt to GDP ratio is also expected to increase. In addition, concern is growing over corporate debt.

Our municipal bond issuance forecast of only $330 billion is a result of this conservative budgeting philosophy, declining U.S. economic growth, and prohibitively elevated interest rates.

In contrast, state and local government debt levels are quite manageable in comparison. U.S. state government net tax supported debt (NTSD) rose by only 0.6% to $615 billion in fiscal year 2022, less than own-source revenue growth (11.6%), according to Moody's Investor Service (Sept 2023). The median (also Moody's) outstanding amount of debt city governments possess is only $32 million. Even though state and local governments and other public finance entities had every opportunity to gorge at the low-interest credit market buffet, they mostly did not. Annual new money issuance peaked at only about $347 billion in 2021. The majority of public finance entities exercised conservative financial fundamentals since the end of the pandemic (and mostly before). We predict they will do the same in 2024 and keep outstanding debt in the form of bonds on the financially manageable side. Our municipal bond issuance forecast of only $330 billion is a result of this conservative budgeting philosophy, declining U.S. economic growth, and prohibitively elevated interest rates.

Key Assumptions to Our Forecast

The U.S. economy avoided a recession in the first half of 2023 and came roaring back to life led by consumer spending and business investment. The economy's resiliency astonished most forecasters, but municipal bond issuance year-over-year (compared to 2022) is still likely to fall by 9%. It looks like we will see issuance of approximately $356 billion in all of 2023, very close to the $350 billion forecast we published back on November 1, 2022 in Anticipating Municipal Issuance Will Remain Challenged Again in 2023: Our Forecast. Again, the U.S. economy surprised to the upside in 2023, but it is likely to cool in 2024. We are assuming the U.S economy grows at only 0.9% in 2024, and the Federal Reserve is likely to begin to lower its target rate as a result.

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Therefore, the key drivers of municipal bond issuance clearly point to lower activity. There is currently no catalyst that takes issuance higher in 2024 compared to 2023, at least not that we can see now. We are assuming that the economic scenario most likely to play out in 2024 is closely aligned to the "Slower-Trend Growth Scenario" (S5) published by Moody's Analytics. In this scenario higher interest rates slow spending, tighter bank lending standards appear, resulting in lower overall growth.

Key Assumptions Driving Our 2024 Municipal Bond Issuance Forecast

Indicator	2020	2021	2022	2023	2024
	Actual	Actual	Actual	Est	Est
U.S. GDP	-2.8%	5.9%	1.9%	2.1%	0.9%
Fed Funds Rate	0.25%	0.25%	2.02%	5.00%	4.80%

Source: U.S. Dept. of Commerce, Fed Reserve, Moody's Analytics and HilltopSecurities.

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Details of the HilltopSecurities 2024 Issuance Forecast

We are expecting 2024 municipal bond issuance of only $330 billion. That will be 7% lower than the $356 billion we are expecting to see in all of 2023. New money issuance is likely to decline by about $10 billion to $280 billion. The fact that new money issuance is likely to remain closer to $300 billion and not fall to or below $200 billion like it did for the five-year period between 2011 and 2016 is because municipal market credit remains very strong. Housing prices are an important driver and indicator for many entities in the public finance, they remain threatened by higher rates, but they have risen massively compared to pre-pandemic levels. The S&P/Case Schiller U.S. National Home Price Index rose almost by half to 311 (Aug. 2023) from 212 (Dec. 2019). There is cushion there that state and especially local governments could leverage if they so choose to, but they typically have not. Mostly we think budgeting teams learned from the lessons experienced just after the housing market collapse of the previous decade.

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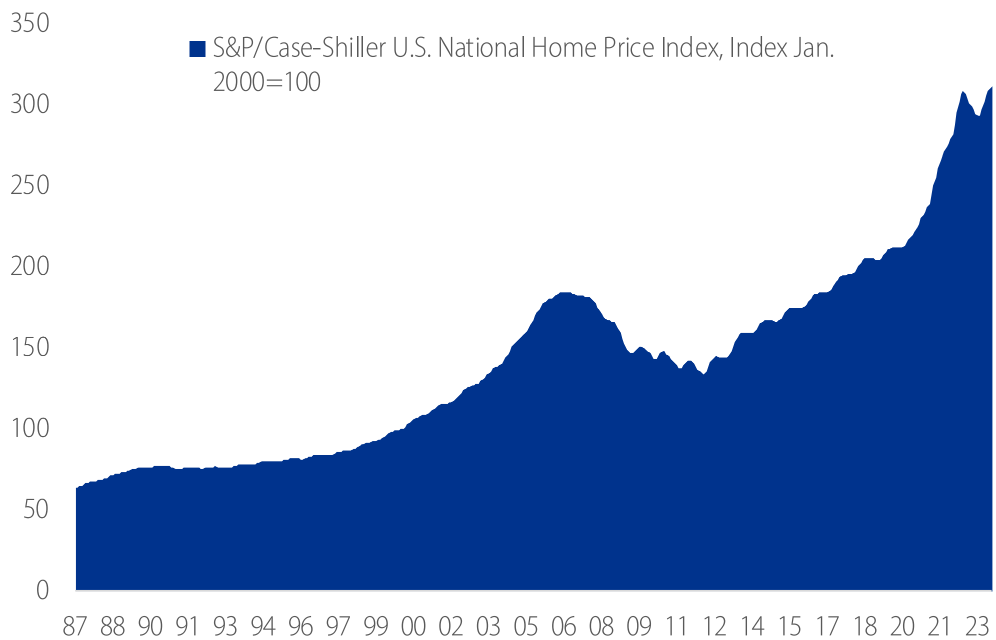
U.S. Housing Prices Remain Very Healthy Compared to Pre-Pandemic Levels



Source: S&P Dow Jones Indices LLC, FRED and HilltopSecurities.

Refunding issuance is also likely to decline by a little over $10 billion to $50 billion for the year. Even if interest rates slightly decline like Moody's Analytics assumes in their scenario, rates would have to plummet in order to have an impact on municipal bond refunding activity next year. We are not expecting them to plummet, but this is a risk factor to our 2024 forecast.

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Seasonality and monthly variability are important factors when considering what issuance trends could look like. Issuance ranged from $40 billion to as low as $22 billion (Feb.) and there is the potential for issuance in November or December to remain light as well keep in mind. In 2023 only one month of issuance (June) was near or just over $40 billion. There were three other months where activity was close to $35 billion. Monthly issuance in 2023 is likely to average about $30 billion. For 2024 we are expecting monthly average of only about $27.5 billion. For issuance to rise to $400 billion in 2024 monthly issuance would have to average $33.3 billion a month.

Monthly issuance in 2023 is likely to average about $30 billion. For 2024 we are expecting monthly average of only about $27.5 billion.

Summary of HTS Issuance Forecast Details for 2024

Ten Year Average '13 - '22	Month	2021 Actual Issuance	2022 Actual Issuance	Likely Total in 2023 Issuance	% Change from 2022	Issuance Required for $400B in 2024	HTS Initial 2024 Forecast	% Change from 2023
$27	January	$28	$26	$23	-11%	33	20	-14%
28	February	37	32	22	-30%	33	20	-9%
35	March	48	46	34	-25%	33	30	-12%
34	April	37	40	33	-17%	33	25	-25%
34	May	35	37	30	-18%	33	25	-16%
41	June	50	38	40	5%	33	35	-11%
32	July	38	28	28	-2%	33	30	9%
38	August	45	42	39	-7%	33	35	-10%
34	September	45	27	30	11%	34	30	-1%
44	October	42	29	37	29%	34	35	-6%
32	November	37	26	20	-24%	34	25	25%
34	December	41	20	20	-1%	34	20	0%
$412	Total	483	391	356	-9%	400	330	-7%

Source: Refinitiv and HilltopSecurities.

Fiscal Policy Will Still Not Materialize Into Meaningful Municipal Bond Issuance

We have indicated in the past and maintain the opinion that public finance entities will not meaningfully increase bond issuance because of fiscal policy such as the CARES Act (2020), American Rescue Plan (2021), the Infrastructure Investment and Jobs Act (2021), and the Inflation Reduction Act (2022). The categories of spending and amounts do not lend themselves to material increases in annual municipal bond issuance. A recent GAO analysis helped support our contention when it reported the majority of Rescue Plan Act money was spent on revenue replacement (68%) and negative economic impacts (12%).

Select Meaningful Legislation Passed Since Biden Became President

Amount ($ in billions)	Title of Legislation	Note	Status
$738	Inflation Reduction Act of 2022	Via budget reconcilation (no bi-partisan support)	Signed into law Aug. 16, 2022
$280	Chips and Science Act of 2022	-	Signed into law Aug 9, 2022
$550	Infrastructure Investment and Jobs Act of 2021	-	Signed into law Nov. 15, 2021
$1,900	American Rescue Plan Act of 2021	Via budget reconcilation (no bi-partisan support)	Signed into law March 11, 2021
$3,468	**Total**		

Source: HilltopSecurities.

Recent HilltopSecurities Municipal Commentary

- State and Local Credit is Incredibly Resilient, and We Expect Only a Very Limited Credit Impact from Commercial Real Estate Weakness, Nov. 2, 2023
- U.S. State Fiscal Health: State Reserves Remain Near Record Levels, State and Local Employment Still Rising, Oct. 19, 2023
- Municipal Yields Remain Generationally Enticing Amongst the Latest Flight to Quality, Future Attractive Investment Opportunities May Occur But Will Be Less Frequent, Oct. 11, 2023
- Appealing Municipal Market Indicators and Strong Economic Data is Fueling the Golden Age of Municipals Despite Near-Term Uncertainty, Sept. 19, 2023

Readers may view all of the HilltopSecurities Municipal Commentary here.