



Election 2020: A win-win for the municipal bond market?

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The outcome of the 2020 election may benefit the muni bond market — no matter who the victor is.

Among the wreckage of the COVID-19 economic shutdown, state and local government finances have taken a significant hit — and municipal investors have taken notice. The prospect of lower revenue helped spur Congress to provide \$150 billion of direct aid to state and local governments as part of the CARES Act. While the situation is not as dire as reported in the media (some of the most drastic reported declines [didn't account](#) for the delay of state income tax collections from April until July), many economists, including Fed Chair Jerome Powell and Treasury Secretary Steven Mnuchin, feel that there needs to be additional stimulus — and further aid to state and local governments — to shorten the economic damage from the novel coronavirus.

Key questions for municipal investors are: when would this possibly occur and what might it look like? We expect that stimulus will be passed (although probably not until early 2021) and that it will include state and local government assistance. At the higher end of Congressional proposals is a \$718 billion package of aid included within the \$2.2 trillion stimulus bill passed by the House on October 1. A smaller proposal from the Trump administration is reported to have about \$400 billion earmarked for this aid. At the low end, the “skinny stimulus” bill proposed in the Senate offered no additional state and local aid but did provide more flexibility to spend remaining state and local aid money appropriated in the CARES Act. In addition to this fiscal stimulus, the Federal Reserve recently made changes to its Municipal Liquidity Facility (MLF) lending program, including reducing interest rates in order to make it more attractive to state and local government borrowers. So far, only two governments have borrowed through the MLF.

Three key policy areas will shape the demand for municipal bonds for investors. Both President Trump and challenger Joe Biden have proposed tax, infrastructure and fiscal stimulus packages that we believe would be beneficial for muni investors, creating a prospective win-win election result. Of course, the composition of the House and Senate would significantly impact either candidate's ability to implement their proposals.



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▶ Election a win-win for municipals?

	BIDEN PRESIDENCY	TRUMP PRESIDENCY
Tax policy	 <p>Higher individual and corporate tax rates are likely to result in increased demand for munis, especially among high earners</p>	 <p>Lower taxes are unlikely given the federal deficit, resulting in a stable demand for munis</p>
Infrastructure	 <p>Federal spending on clean energy and infrastructure is likely to result in a reduction in tax-exempt supply</p>	 <p>A smaller federal program and a higher reliance on public-private partnership would increase tax-exempt supply</p>
Fiscal stimulus	 <p>More generous federal support would aid weaker state/local governments, improving the muni credit picture</p>	 <p>Less generous federal aid would likely result in higher state/local taxes, increasing the demand for munis</p>

Source: Columbia Threadneedle, September 2020.

Given the projections of COVID-19's economic impact, certain municipal sectors will potentially be more stable as the U.S. economy recovers, including essential service public utilities and local governments funded primarily with property taxes. However, individual entities within any sector will have strengths and weaknesses that affect their specific credit quality. For this reason, it's essential to have a bottom-up approach to security selection rather than investing based on sector alone.

Bottom line: a constructive outlook for municipal bonds

In the run-up to the election, the municipal sector may see higher volatility given uncertainty on a second round of fiscal stimulus. But we believe that either election result bodes well for municipal bonds. A Biden presidency with Democratic control of Congress will most likely be more constructive for the municipal market. But if President Trump wins reelection, less fiscal aid would result in higher state and local taxes, and that should support the market as well.



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