

(BN) Municipal Bond Market Applauds State Budget Approval Snooze

By Amanda Albright

(Bloomberg) -- There's a lot less nail-biting in the \$3.8 trillion municipal-bond market this summer, given that investors have been mostly spared drama over state budgets.

All states except Massachusetts have enacted fiscal 2019 budgets, something that is likely encouraging to bondholders given that late spending plans can signal political dysfunction or financial woes. Late budgets can even affect states' borrowing costs, according to one study.

This year, just three states started the fiscal year without a budget, compared to 10 last year, according to the National Conference of State Legislatures. The absence of fighting between lawmakers that results in stalled state budgets is a good sign for credit conditions, said Cooper Howard, senior research analyst at the Schwab Center for Financial Research.

"It's a positive compared to where we've been in years past," he said.

The impasse that left Illinois without a budget for two years threatened the state's investment-grade rating last year and caused investors to demand higher compensation on the state's general-obligation debt. This year, state lawmakers passed a budget on time without much fanfare and spreads have tightened to 1.7 percentage points on 10-year general-obligation debt from as high as 3.4 percentage points in June 2017.

Massachusetts is operating under a temporary budget that would last through July, said Brendan Moss, a spokesman for the governor's office.

Instead of state budget theatrics, rising interest rates and the impact of Congress' overhaul of the tax code have been the focus of the municipal-bond market in 2018, said Bryan DiDonato, fixed income portfolio manager at Abner Herrman & Brock LLC.

State and local debt has posted a 0.1 percent loss amid concerns the Federal Reserve will raise interest rates at a faster-than-expected pace. Meanwhile, tax-exempt bonds are less attractive to banks and insurance companies under a lower corporate tax rate.

"Those issues have kind of trumped the state budget issues that each individual credit's dealing with," DiDonato said.

--With assistance from Elizabeth Campbell.

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