U.S. Municipal Bond Market

A Second Look at Last Year's Yields as Investors Revisit Stability Amid Foreign Policy, Macro, and Technology Uncertainty

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- March has delivered a sharp reset higher in yields, driven by heightened uncertainty around energy prices, geopolitics, and a Federal Reserve that remains firmly in wait-and-see mode.
- Higher tax-exempt yields have created better entry points for buyers, supported by steady municipal demand from investors continuing to seek stability even as primary market supply remains elevated.
- Policy risk remains a background issue for municipals, as uneven foreign policy and deficit discussions keep the tax-exemption threat periodically in view, even though no near-term legislative effort to curtail it has materialized and bond-friendly proposals like Senator Joni Ernst's Modernizing Agricultural and Manufacturing Bonds Act are positive but not close to imminent.

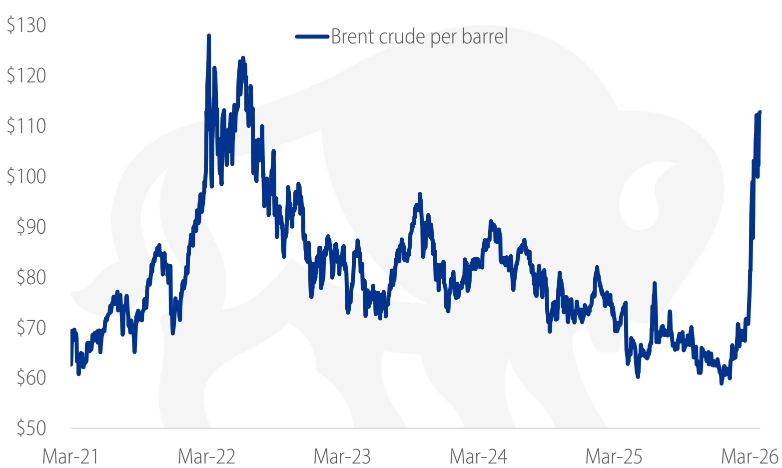
Rates Reset Higher as Investors Search for Equilibrium

Investors struggled to find equilibrium throughout March. The Municipal Market Data (MMD) 10-year AAA municipal yield, the key benchmark for municipals, closed yesterday at 3.16%, and has risen 64 basis points since Feb. 27. The Bloomberg Municipal Bond Index closed yesterday at a 3.80% yield, up 51 basis points since Feb. 27. The 10-year U.S. Treasury closed yesterday at a 4.35%, a 41-basis point increase since the end of February.

One of the most important indicators markets have watched this month is related to energy.

At the March Federal Reserve meeting, the FOMC left its target rate unchanged and emphasized patience, offering little indication that conditions for easing are close. At the same time, some market participants and observers now acknowledge that a rate increase cannot be ruled out. One of the most important indicators markets have watched this month is related to energy. Brent crude ranged from roughly $77 a barrel to as high as $113.

Oil Price Shock is Creating Market Uncertainty



Source: Bloomberg and HilltopSecurities.

Investors are trying to infer and forecast at least three things simultaneously related to the conflict in the Middle East.

First, markets are trying to decipher the Trump administration's actual intentions toward Iran. Second, how Iran is likely to retaliate, and whether that retaliation changes the energy market structurally rather than temporarily. Third, whether Brent crude remains high for long enough to turn a regional military conflict into a U.S. inflation (or recession) problem. That is why market sentiment has remained uncertain.

Treasury Secretary Scott Bessent did little to calm markets last Sunday when he said on Meet the Press that "sometimes you have to escalate to de-escalate." Markets probably should have taken the Treasury Secretary's' words more literally. He was indicating that escalation is coming and that this conflict may not end quickly. Policy signals from Washington remain mixed, even as the Pentagon prepares to send 3,000 troops from the Army's 82nd Airborne Division to the region.

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For municipals, the immediate impact has been a rates shock. We are not yet at a point where a significant credit impact appears likely. However, the potential for either positive or negative credit effects grows the longer oil prices remain elevated. Tax-exempt yields rising at the pace described above are not supportive for near-term municipal prices, but they do improve near-term conditions for buyers of new bonds. **New capital is being paid more to step in, and buyers are being handed a better entry point than we have seen in months.**

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Investors' Continued Search for Stability Supports Municipal Bond Demand

The supply and demand dynamic is always important in the municipal market. It matters even more now because demand has remained strong and consistent, while supply is elevated. If anything, demand has remained firm in part because **investors continue to seek stability** in their portfolios. In the first two months of 2026, investors largely sought strength in response to technology-related developments. In March alone, nearly $4 billion has already flowed into municipal mutual funds per Lipper data, with another week to go. Year-to-date inflows now total just over $17 billion. At this point last year, flows were net positive but totaled just under $6 billion.

Washington Policy and the Ongoing Threat to the Tax-Exemption

- Uneven foreign policy signals from Washington are a key driver of the uncertainty markets have faced since the beginning of the month. Reports indicate the Trump administration is likely to ask Congress for approximately $200 billion to finance current U.S. actions against Iran and to shore up domestic defense readiness. At the same time, the president's approval rating has fallen to 36%, according to a Reuters/Ipsos poll, following rising gasoline prices and uncertainty around the objectives of the latest strikes. In recent days, the Pentagon has been preparing to send an additional 3,000 troops to the Middle East.

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- A longer-term policy risk tied to the U.S. deficit and the municipal bond tax exemption is resurfacing. Earlier this month, Senators John Curtis and Angus King introduced bipartisan legislation, the Fiscal Commission Act, which would establish a fiscal commission charged with stabilizing spending and reducing the national debt, which they estimate now exceeds $38.8 trillion.

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The comparison to the Bowles-Simpson National Commission on Fiscal Responsibility and Reform is unavoidable. The 2010 commission also attempted to force a reckoning with long-run fiscal imbalance. It did not produce immediate legislative action, but it did elevate deficit reduction and tax expenditures as central policy questions. That is why any new fiscal commission warrants close attention from municipal market participants. Increased scrutiny could place federal tax preferences under a brighter light, and the municipal bond tax exemption remains one of the largest and most visible preferences in the tax code.

Reconciliation 2.0 Update and MAMBA Proposal

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Talk of a second reconciliation bill in 2026 has resurfaced, but it remains highly speculative. Its likelihood is constrained by the absence of a clear agenda, the lack of a viable legislative vehicle, and the realities of midterm-year politics. While reconciliation always keeps the tax exemption theoretically in view, there is little evidence that Congress is organizing around a revenue-driven effort that would put it back squarely in the crosshairs. The tax exemption is never fully off the board, but there is still little indication that curtailing it has become an active congressional priority in this moment.

Senator Joni Ernst's Modernizing Agricultural and Manufacturing Bonds Act (MAMBA) proposal is far more concrete. It would modernize Industrial Development Bonds and Aggie Bonds, carries bipartisan support, and has earned broad backing from market participants. It is clearly supportive of the municipal bond market. Its challenge is not policy logic, but finding a legislative vehicle, and for now it remains credible and constructive, but not imminent.

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- A Simple Fix to Keep the American Dream Alive: Carve Housing Bonds Out of the Volume Cap Limitation, Feb.10, 2026
- February's Playbook: Flows Stay Loud, Credit Selection Matters, Feb. 9, 2026
- The Municipal Market in 2026, HilltopSecurities' Sector Credit Outlooks, Feb. 6, 2026
- January 2026 Was an Important Month for U.S. Municipals, Feb. 2, 2026

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