

U.S. Municipal Bond Market

A Stronger-Than-Expected Economy Is Offering Less Support to the Public Sector, While Municipal Yields and Relative Value Remain Very Attractive

Summary

- Stronger than expected U.S. economic growth is masking uneven conditions, while softer hiring and weaker public-sector employment point to greater variation in municipal credit quality.
- Market and macroeconomic noise may persist, but the attractive entry point for municipal investors remains intact.

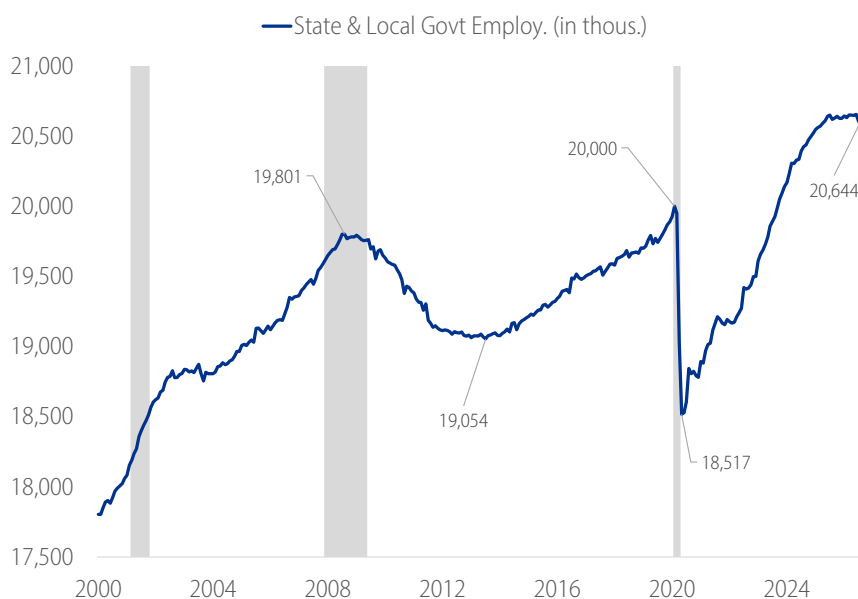
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A Stronger-Than-Expected Economy Is Masking Uneven Conditions

Much of last week's data suggests the U.S. economy has more momentum than the September nonfarm payroll report indicates. But that strength is uneven, with economic activity varying across regions and sectors. A stronger national economy does not necessarily translate into stronger conditions for every state, local government, or public-sector credit. It tells us that the stronger than expected economy is offering less support to the public sector as a whole, again reinforcing the importance of credit selection when allocating investment dollars to U.S. municipal bonds. A choice we are still in favor of because of the recent highs municipal yields have reached and because of still attractive relative value.

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State & Local Employment Started Leveling Out in Fall of 2025



Source: Bureau of Labor Statistics and HilltopSecurities.

The upward revision to U.S. gross domestic product (GDP) growth, which we think was the most important economic data point last week, showed that the economy continued to grow at a rapid pace in the second quarter of 2026. At the same time, weaker-than-expected September nonfarm payroll growth showed that stronger economic activity is not necessarily translating into broad-based hiring across regions and sectors.

Public-sector employment is providing less of the stabilizing support that it has during past economic cycles.

Public-sector employment is providing less of the stabilizing support that it has during past economic cycles. Federal employment has fallen sharply, while state and local government employment began leveling out in fall 2025 and has shown little growth since.

None of this suggests that the broader economy is approaching recession, nor does it change our generally constructive view of municipal credit quality. Public entities, however, are still grappling with the Post-Golden Age Realignment. Slower hiring, declining federal employment, and the leveling out of state and local government payrolls point toward greater variation in economic and credit outcomes among public-sector entities. That makes issuer and sector selection increasingly important, a point that we have been making for much of 2026, but it is worth repeating again because of last week's data.

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The weaker-than-expected September nonfarm payroll report also reduced expectations for additional Federal Reserve tightening at the Oct. 28 meeting. Fed funds futures placed the probability of another increase in the federal funds target rate at approximately 24% as of the afternoon of Monday, Oct. 5.

Municipal yields ended last week well below the highs reached earlier in the week. The Bloomberg Municipal Bond Index yield, for example, ended the week at 4.63%, down 23 basis points from Tuesday's peak of 4.86%. The move was significant, but yields remain historically attractive. The Bloomberg Muni Index yield of 4.63% remains among its highest levels of the past several decades and municipals generally remain inexpensive relative to U.S. Treasuries.

The municipal bond opportunity may have been at its most attractive point near the beginning to middle of last week, before yields moved sharply lower. Even after that rally, however, municipal yields remain attractive, as do Municipal-to-Treasury ratios (M/T ratios), although relative value is somewhat less compelling than it was at last week's peak.

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- The Municipal Opportunity Strengthens as Yields and Relative Value Rise, September 28, 2026
- The Return of Higher Yields Rewards Investors and Tests Borrowers, September 21, 2026
- The Bond Market Selloff Is Making Attractive M/T Ratios the New Municipal Opportunity of 2026, September 14, 2026
- Warsh Calls on the Fed to Meet the Moment as Rate Hike Odds and Municipal Yields Rise, September 2, 2026
- The Market Thought Lower Rates Were Coming, August 27, 2026

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