Parametric

Municipal Bond Market Insight | June 2025

Beyond the Headlines

Key takeaways

» Market volatility has eased, but trade issues remain a background concern.

» Supply continues, with the first week of June set to be second largest ever.

» The vast majority of municipal issuers were not affected by the US downgrade.

» The House budget proposal doesn't make any changes to the tax exemption for munis.

Thus far 2025 has been a year of headlines—weekly, daily and sometimes even hourly. While a wide range of subjects has been covered, none has captivated the markets' attention like tariffs. Though it may feel like just yesterday, the intense tariff-related bond market volatility of early-April has since faded, with the market having recovered and settled into a what seems to be a range-bound dynamic. In fact, the constant barrage of potentially market-moving trade announcements may have strengthened the market's resiliency.

Toward the end of May, the benchmark 10-year US Treasury yield briefly rose above 4.5% on the heels of a budget proposal that extends many 2017's Tax Cuts and Jobs Act (TCJA) tax cuts and expands deficit spending, only to reverse course and finish the week at 4.4%. News that a federal trade court blocked President Trump's sweeping tariffs, citing lack of authority, potentially contributed to the turnaround.

Meanwhile, US economic data continues to reveal stable to robust readings. Given year-to-date (YTD) market volatility and the uncertainty of proposed and pending US trade agreements, not to mention impacts from DOGE-related federal cutbacks, the broad expectation has been for weakness in hard economic data releases like the monthly payroll situation report. This has yet to transpire, despite weakness showing up in soft data, such as earnings forecasts (or lack thereof) and business and consumer sentiment surveys. This lack of hard evidence has relegated the data-dependent Fed to the sidelines and pushed market expectations for rate cuts to the final months of the year, if at all.

Supply

May issuance was $49.9 billion, up 3.6% year over year (YOY). This makes it five months in a row of YOY monthly gains. Through May, YTD tax-exempt issuance has been $202 billion. This is 15% above 2024 and 48% over the trailing five-year average.

June is set to begin with $18.4 billion in tax-exempt issuance in the first week. This is the second largest week ever. It's possible that some of the recent surge in supply was simply a result of issuance pulled forward because of concerns over tax exemption. With those issues looking as if they might be resolved, the surge may abate, but it also may continue. Through 2024, according to the Securities Industry and Financial Markets Association, the municipal bond market was only 7.8% larger than it was in 2015, the corporate market was 45.6% larger and the Treasury market was 114% larger. So we have some catching up to do. We'd also note that public construction costs have been elevated by inflation, and spending is 35% above the prepandemic peak.

Fixed income returns as of May 30, 2025

	MTD return	YTD return
Bloomberg Muni Index	0.06%	-0.96%
Bloomberg US Treasury Index	-0.96%	2.51%
Bloomberg US Aggregate Index	-0.72%	2.45%
Bloomberg US Corporate Index	-0.01%	2.276%

Source: Bloomberg, 5/30/2025. For illustrative purposes only. It is not possible to invest directly in an index.

Past performance is no guarantee of future results.

Figure 2: AAA municipal yields as of May 30, 2025

Year	Current	MTD change	YTD change
2-year	2.77%	-15 bps	-10 bps
5-year	2.84%	-18 bps	-22 bps
10-year	3.33%	-1 bp	19 bps
30-year	4.52%	28 bps	62 bps

Source: Thomson Reuters Municipal Market Data, 5/30/2025. For illustrative purposes only. Not a recommendation to buy or sell any security.

Past performance is no guarantee of future results.

Figure 3: US Treasury yields as of May 30, 2025

Year	Current	MTD change	YTD change
2-year	3.9%	27 bps	-35 bps
5-year	3.96%	20 bps	-44 bps
10-year	4.4%	22 bps	-18 bps
30-year	4.93%	25 bps	14 bps

Source: Bloomberg, 5/30/2025. For illustrative purposes only. Not a recommendation to buy or sell any security.

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Market opportunity

Circling back to our title, one material headline the White House didn't mention during mid-May was Moody's one-notch downgrade of the US debt rating to Aa1-stable outlook from AAA-negative outlook. The negative outlook had been in place since November 2023. While the downgrade wasn't a surprise to the market and follows similar moves by Fitch in 2023 and Standard & Poor's more than a decade ago in 2011, it did raise questions in the muni market regarding related impacts to public finance ratings.

Direct impacts to muni credit were rather limited and included federally-insured and mortgage-backed-security (MBS) collateralized housing bonds, bonds pre-refunded and escrowed to maturity with US government bonds, bonds backed by federal leases and bonds issues by the Smithsonian, the Tennessee Valley Authority and the Bonneville Power Administration.

According to the Moody's report that accompanied the November 2023 downgrade watch, the following key factors insulate the vast majority of muni issuers from immediate impacts of a lower US credit rating:

- States are sovereign entities. While federal funding is important to states, taxes are their most crucial revenue source.
- Credit strengths can mitigate federal exposure, especially for Aaa-rated state and local governments.
- Higher education, healthcare and most housing finance issuers are broadly resilient. State revolving funds are typically overcollateralized.
- US states have a governing relationship with the federal government that differs from most sub-sovereign issuers globally.
- The bulk of states' and local governments' revenue nationally is derived from their own sources, particularly property, income and sales taxes.
- Federal funding for states in 2021 was 25%, for local governments was 6% and for K-12 public schools was 11%.
- US issuers can have higher credit quality than the US government. In contrast, most issuers globally are rated at or below the level of the sovereign, and only a few are rated above.

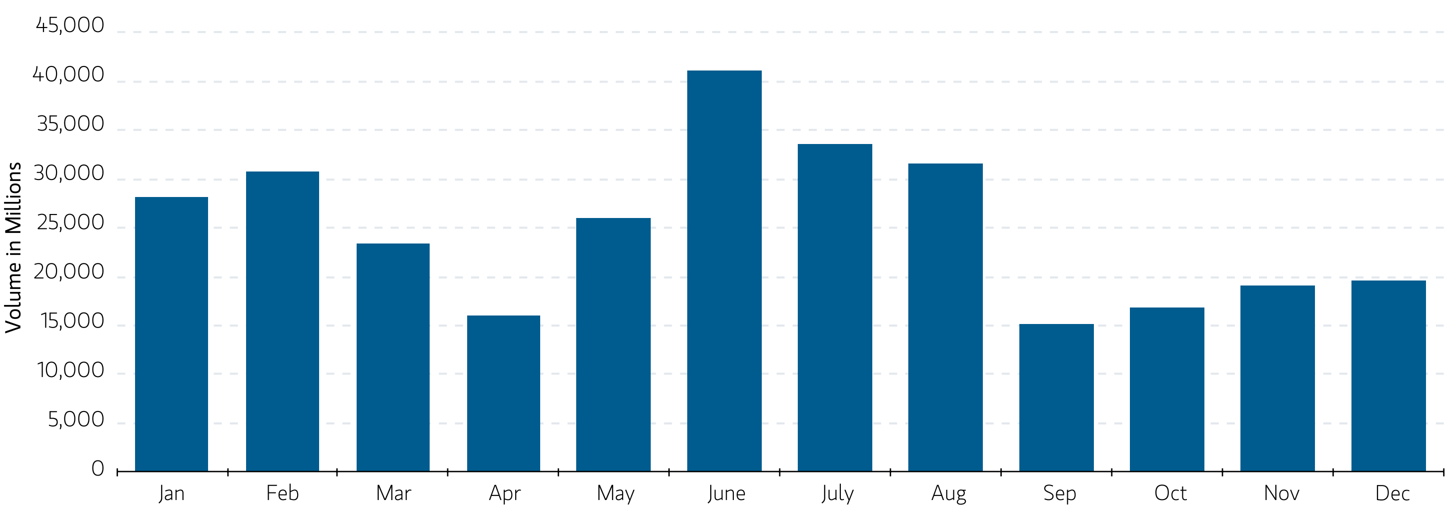
As we noted last month, municipal credit quality remains in good shape, but states and local governments are adjusting to normal budget realities after exhausting federal stimulus funds. Gaps will appear and be closed during the normal budget cycle, with heightened visibility in the coming month, as most states have fiscal years that begin July 1.

Also, June may bring a significant increase in muni market demand as the summer reinvestment season begins. The next three months of the year will see the highest monthly amounts of cash from maturities, called bonds and coupon payments hitting bondholder accounts.

It's likely that munis will outperform in the summer months. We believe now is a good time to add exposure and extend out on the yield curve to intermediate- and long-duration strategies while we're still near decade highs in absolute muni yield and two-year highs in muni versus US Treasury relative value.

DISPLAY 4

US Municipal Bond Redemptions, as of May 12, 2025



Source: ICE Data 5/12/2025. For illustrative purposes only. Not a recommendation to buy or sell any security.

Economic outlook

Ironically, the most material development for the municipal bond market during May didn't even garner headlines. In fact, it was quite literally a non-event: The lack of language in the House budget proposal that would eliminate or limit the federal tax exemption for municipal bond interest. The absence and near elimination of this risk is unequivocally positive for the tax-exempt market.

First, it removes a dark cloud that had been hanging over the muni market since the presidential election, as the promise of tax reform—in this case the extension of the TCJA—typically brings with it concerns that the federal muni exemption will be on the table as an offsetting revenue source. Clearer skies on this front have a dual impact, in that buyers will likely be more comfortable expanding holdings and issuers will likely feel less urgency to rush to market before year-end, potentially slowing the massive issuance surge experienced YTD.

This isn't the case for the opening week in June, as the largest weekly calendar of the year and one of the largest calendars on record at over $18 billion is set to enter the primary market. As noted earlier, meeting this massive calendar is the largest reinvestment flow month of the year for matured, called and coupon bond proceeds, which will hit bondholder accounts in June.

Key economic data

Change in nonfarm payrolls (Apr.)	177K
Unemployment rate (Apr.)	4.2%
Core CPI–YoY change (Apr.)	2.8%
Core PCE–YoY change (Apr.)	2.5%
Average hourly earnings–YoY change (Apr.)	3.8%
Real GDP annualized (Q1 2025)	-0.3%

Source: Bloomberg, 5/8/2025.

In the broader market, pundits look toward the Payroll Situation Report for May, set for release on June 6, with consensus estimates calling for a gain of 128,000 jobs and an unchanged unemployment rate of 4.2%. Analysts generally don't expect the upcoming Federal Open Markets Committee meeting to bring a rate cut, as such expectations have shifted toward year-end and even into 2026, as the data-dependent Fed awaits hard data to support such a move.

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