Selectivity drives alpha in 2026

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Our 2026 outlook for municipal bonds

BlackRock's municipal bond experts share their market outlook and the actions you can take to raise your portfolio's potential in 2026.



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2026 – Greater clarity, new risks in a pro-growth environment

Markets in 2025 were defined by uncertainty. Tariff-related shocks, shifting tax and monetary policy expectations, and a gradually weakening labor market contributed to elevated volatility across fixed income. As we enter 2026, many of those uncertainties have diminished, but new risks are emerging as policy priorities become clearer.

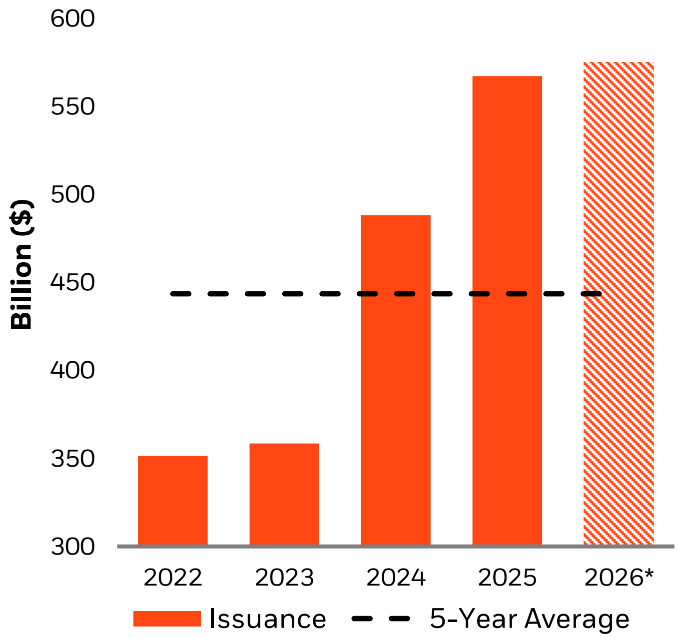
The prevailing macro backdrop appears broadly pro-growth. A renewed focus on affordability amid a K-shaped economic recovery, rising capital expenditures tied to domestic artificial intelligence infrastructure, and a deregulatory agenda are all expected to support economic momentum. At the same time, these initiatives have the potential to put upward pressure on inflation.

We expect the Federal Reserve to navigate this environment cautiously, with policy gradually tilting toward accommodation, and we forecast the federal funds rate will end the year 50 basis points lower in a range of 3.00%–3.25%. At the same time, fiscal dynamics will remain an important consideration. High and rising government debt levels, combined with continued fiscal expansion, suggest long-term rates may remain vulnerable to upward pressure even as front-end yields decline. In response, the Fed could consider nontraditional tools, including renewed quantitative easing or quasi–yield curve control, to limit pressure on long-end rates. While not our base case, new leadership and an evolving committee composition could challenge the status quo and introduce greater policy innovation.

Municipal supply – Elevated, but below consensus expectations

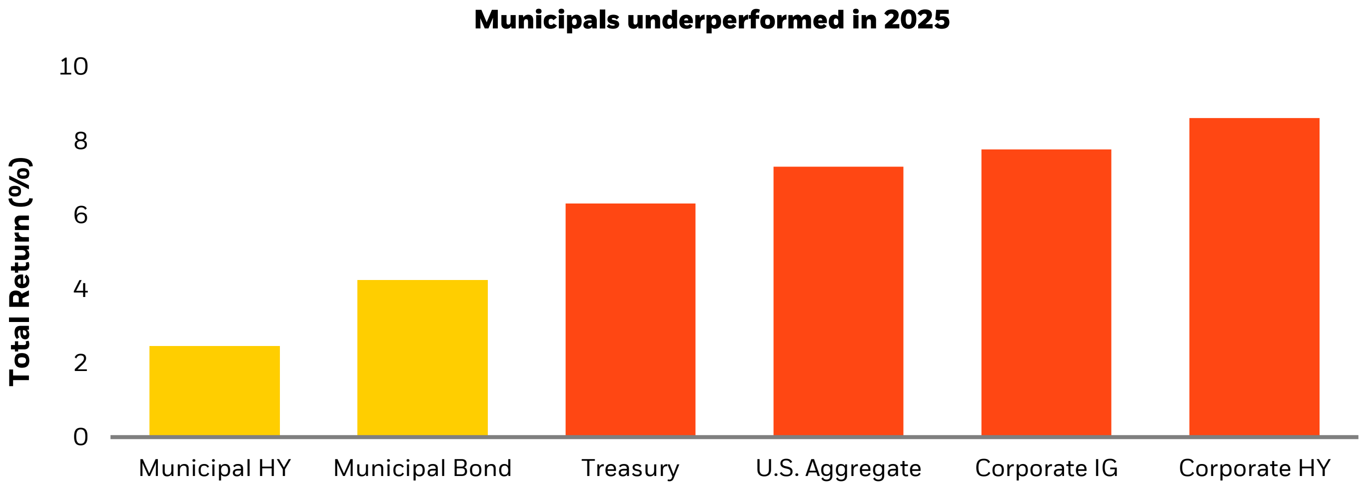
Municipal bond issuance is expected to remain elevated in 2026 as federal COVID-era aid continues to roll off and issuers confront higher construction and labor costs amid significant infrastructure needs. We foresee approximately $575 billion in issuance with $97 billion in net positive supply.

A higher issuance environment has become the new normal



Source: BlackRock, as of 12/31/25.

*BlackRock forecast.



Source: Bloomberg Indices, as of 12/31/25.

While this would eclipse last year's all-time high, our forecast is slightly below the median street projection of $600 billion.

With major policy risks now better understood, we expect issuance patterns to normalize, following a more traditional seasonal cadence characterized by lighter issuance early in the year and during the summer months. From a maturity perspective, we anticipate the bulk of supply to be concentrated in the 7–20 year part of the curve, aligning with issuer preferences and investor demand.

Demand – Structural support remains intact

On the demand side, we expect broad continuity from 2025, with SMAs and exchange-traded funds remaining the primary sources of inflows. These channels generated over $100 billion of demand last year and should continue to grow in 2026 as investors prioritize tax-efficient income and scalable portfolio solutions. Accordingly, demand will likely remain most concentrated in the intermediate part of the curve, where these vehicles are most actively deployed. However, declining front-end rates could prompt some duration extension, especially during periods of technical strength.

Performance outlook – Reversion favors municipals

On a relative basis, 2025 was a challenging year with municipals lagging comparable Treasuries. Historically, the asset class has rarely underperformed Treasuries in consecutive years – the last instance occurred during the 2007-2008 financial crisis. Today's backdrop is materially different with stronger fundamentals and a far more supportive macroeconomic backdrop.

As a result, we believe municipals are positioned to recapture lost ground in 2026. We expect mid- to upper-single-digit total returns for investment-grade municipals, driven by coupon income, easing monetary policy, and stable technicals.

In high yield, idiosyncratic credit events may have an outsized impact on index- and fund-level performance. However, outside of these isolated cases, the broader environment remains pro-risk, with technicals supported by strong demand and modest supply in the sector. Accordingly, we expect high yield municipals to outperform investment-grade municipals in 2026.

Strategy – Income-focused, selective, and barbelled

With spreads tight and valuations approaching fair value, the market appears priced for near-perfection. Even so, the Fed remains a supportive force for fixed income assets.

We enter the year with a modestly long duration posture. We continue to favor a barbell yield curve strategy, pairing better valuations in the 0-5 year part of the curve with the steepness in the 15-20 year part of the curve. We see value in AMT bonds, where limited applicability has created compelling opportunities for additional spread pickup. We favor higher coupons and sectors providing high quality carry, such as transportation, housing, prepaid gas, and healthcare.

In our view, staying invested, disciplined, and selective remains paramount in 2026 as the municipal market navigates a year of clearer policy direction but evolving macro risks.

Credit views for 2026

Municipal credit – Sound fundamentals but fewer easy wins

Municipal bonds enter 2026 with sound fundamentals, but the market is moving out of the "easy" part of the cycle and into a slower, more uneven phase.

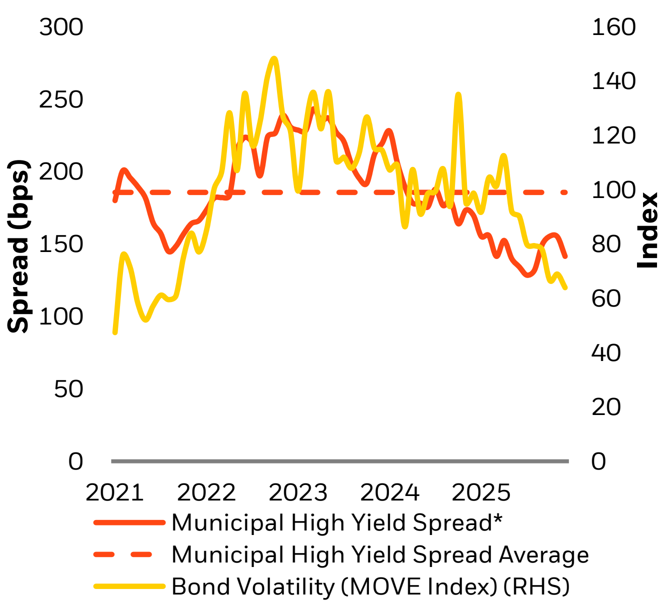
Yields look reasonable relative to recent history. However, spreads remain somewhat tight, particularly in investment-grade, leaving less room for error. This suggests that alpha is more likely to come from security selection than from simply moving down in quality.

Tax-backed – Strength at the state level, dispersion below

States remain the foundation of the tax-backed market. Many continue to hold strong reserves, but discipline will matter more in the next phase of the cycle. We favor states that pair healthy reserves with measured budgeting—and that avoid turning temporary surpluses into permanent tax cuts without credible long-term alignment.

Local governments present a more mixed picture. Fast-growing communities, particularly in the Sun Belt and Mountain West, still benefit from expanding tax bases and business investment, but dispersion across cities and counties is rising. Governance quality and structural balance matter more, and climate-related insurance and resiliency costs are becoming real budget pressures rather than distant risks.

Spreads remain tight amid low volatility, making credit selection key in 2026



Source: Bloomberg Indices, Refinitiv, Bloomberg, BlackRock, as of 12/31/25.
*Bloomberg High Yield Index - 20yr AAA-Rated MMD

School districts remain the weakest segment of the tax-backed market. Legal protections are often strong, but softer enrollment, fading pandemic support, and rising costs—especially special education—are straining finances. Wealthier suburban districts with strong property tax bases tend to be more resilient, while districts heavily reliant on state aid warrant closer scrutiny.

Revenue – A lean towards defensive carry

Revenue bonds remain attractive heading into 2026, supported by essential services that retain the ability to raise rates and fees over time. However, many revenue sectors are entering a more capital-intensive phase, making affordability, management quality, and structure increasingly important.

- **Utilities** face substantial infrastructure and resiliency needs. The key question is whether systems can raise rates without triggering political or affordability pushback.
- **Transportation** remains broadly stable, but outcomes are increasingly asset-specific. Larger, diversified systems are generally better positioned than smaller, more concentrated credits.
- **Hospitals** are stable but policy-sensitive. Strong operators that actively control costs and adapt to reimbursement changes tend to separate from weaker peers.
- **Housing** remains fundamentally steady, but heavy supply and evolving prepayment behavior underscore the importance of bond structure.

High yield – Targeted risk, targeted return

Municipal high yield is compelling in 2026, but this is not a "buy and forget" environment. Spread dispersion across subsectors creates alpha potential for active managers, while defaults are likely to remain idiosyncratic and concentrated in familiar pockets such as senior living, smaller charter schools, certain private colleges, and more speculative project-finance-style deals. Tobacco remains a headline-driven sector where structure often dominates outcomes and should be approached selectively.

Bottom line: maintain a high-quality core anchored in states and essential-service revenues, and add incremental yield only where credit fundamentals, structure, and liquidity are well understood.

BlackRock’s municipal advantage

BlackRock’s size and scale can mean greater access to inventory and tighter trading spreads.*

An award-winning team

In the fragmented municipal market, you need experts to comb through thousands of issuers to identify opportunities and manage risk. BlackRock’s 66 municipal investment professionals[†] are led by a team with over 22 years of industry experience on average.

Technology that sees opportunities & risks

Our experts leverage Aladdin®, BlackRock’s risk management technology, to identify risks and drivers of performance in the market. By digging deeper, Aladdin® empowers our experts to manage risk and seek the right opportunities.

* BlackRock as of 12/31/2025. † BlackRock as of 12/31/2025. Personnel includes Patrick Haskell, CIO of Municipal Fixed Income.

Investment involves risk. *The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. There may be less information available on the financial condition of issuers of municipal securities than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. A portion of the income from tax-exempt bonds may be taxable. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable.* ***Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Past performance is no guarantee of future results.***

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