July 17, 2025

Investment Insights

Thoughts From The Municipal Bond Desk

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Overview

- The Federal Reserve is expected to keep policy rates unchanged in July, providing an opportunity for investors to collect higher yields for longer.
- Volatility is likely to persist as tariff uncertainty continues, though municipals may be more insulated from the turmoil than some other asset classes.
- The One Big Beautiful Bill was signed into law, extending tax cuts from 2017; however, federal tax brackets and the Medicare surtax were left untouched, which may enhance the appeal of tax-exempt income to high income investors.

Tim: The June US jobs report was better—and stronger—than many had expected, which suggests the Federal Reserve (Fed) may remain on hold when it meets at the end of July. And if the report has closed the door on a rate cut, what do you think it means for the municipal market?

Mark: Believe it or not, I see this as a positive development for investors. Why? Because it means there's still an opportunity to benefit from higher yields. Markets are eager for lower rates, and even the hint of a rate cut can move yields lower. For example, in June, just the possibility of a July rate cut caused yields on US Treasurys to drop noticeably— the 10-year Treasury yield fell from 4.51% to 4.24%, and shorter-term bonds like the 2-year and 5-year also saw similar declines.[1] When the Fed resumes cutting rates, I expect to see a more significant and lasting drop in yields. Right now, municipal bonds are offering attractive yields compared to Treasuries—about 73% and 93% of Treasury yields for the 10-year and 30-year bonds, respectively.[2] This presents a good opportunity to lock in higher yields before rates fall further. In other words, you can "get paid to wait" by investing in these bonds now and collecting attractive income while waiting for rates to eventually come down.

Tim: Tariffs continue to be top of mind, particularly after the July Consumer Price Index (CPI) report ticked a bit higher. What is your team seeing?

Mark: After the 90-day moratorium, President Trump began sending several letters to countries, threatening to impose higher tariffs on a number of countries, including 25% on goods from Japan and South Korea; 30% on South Africa; and 40% on Laos and Myanmar.[3] Then the CPI, which is commonly used to gauge inflation, reported a year-over-year increase of 2.7%, which was slightly higher than consensus estimates of 2.6%, as well as the previous month's increase of 2.4%.[2] While it's too early to know for sure, some are viewing the increase as a sign that tariffs are trickling into the economy. While this could bring back muni market volatility, we again would view this as an opportunity to lock in higher yields as municipal credits remain strong and paying.

Tim: President Donald Trump signed the One Big Beautiful Bill into law on July 4. The legislation temporarily raises the limit on the federal deduction for state and local taxes (SALT) from $10,000 to $40,000.[4] While that sounds significant, haven't you said it is unlikely to help many taxpayers?

Mark: That's right. I don't expect the higher SALT cap to be much of a game changer. Under the $10,000 threshold, approximately 90% of filers have been taking the standard deduction,[5] which had been doubled under the 2017 Tax Cuts and Jobs Act.[4] The average SALT deduction in 2022 was about $10,000 in Connecticut, New York, New Jersey, California, and Massachusetts.[6] This suggests that many taxpayers in these states took the standard deduction because they would not benefit from itemizing. The standard deduction has been increased further under the new law, not to mention, the SALT cap starts to phase out for taxpayers who have income of more than $500,000.[4] And while the 2017 tax cuts have been extended, federal tax brackets and the Medicare surtax are unchanged. In a nutshell, taxes are still high. Tax-exempt income from municipal bonds should continue to offer value to individuals in those high tax brackets.

Munis by the numbers

A quick look at some commonly used municipal market datapoints.

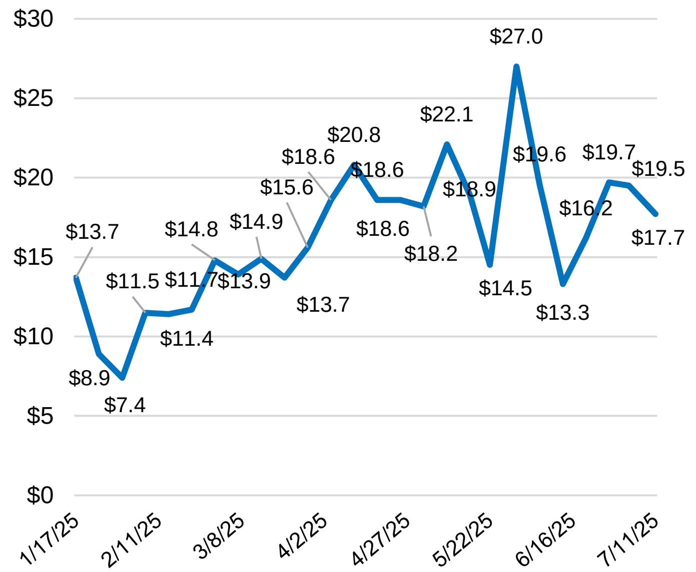
Fund Flows - Weekly and Monthly Reporters ($millions)

Week ended July 9, 2025

	Combined	Open End Mutual Funds	ETFs
All term muni funds	14,427	3,103	11,324
Investment Grade	10,173	(412)	10,585
High Yield	4,254	3,515	739
Long Term (10yr +)	3,495	(1,360)	4,855
Intermediate (5-10yr)	3,687	817	2,871
Short / Intermediate (3-5yr)	2,648	915	1,732
Short (1-3yr)	4,597	2,731	1,866
National funds	14,683	4,191	10,491
New York	(257)	(367)	110
California	722	3	719

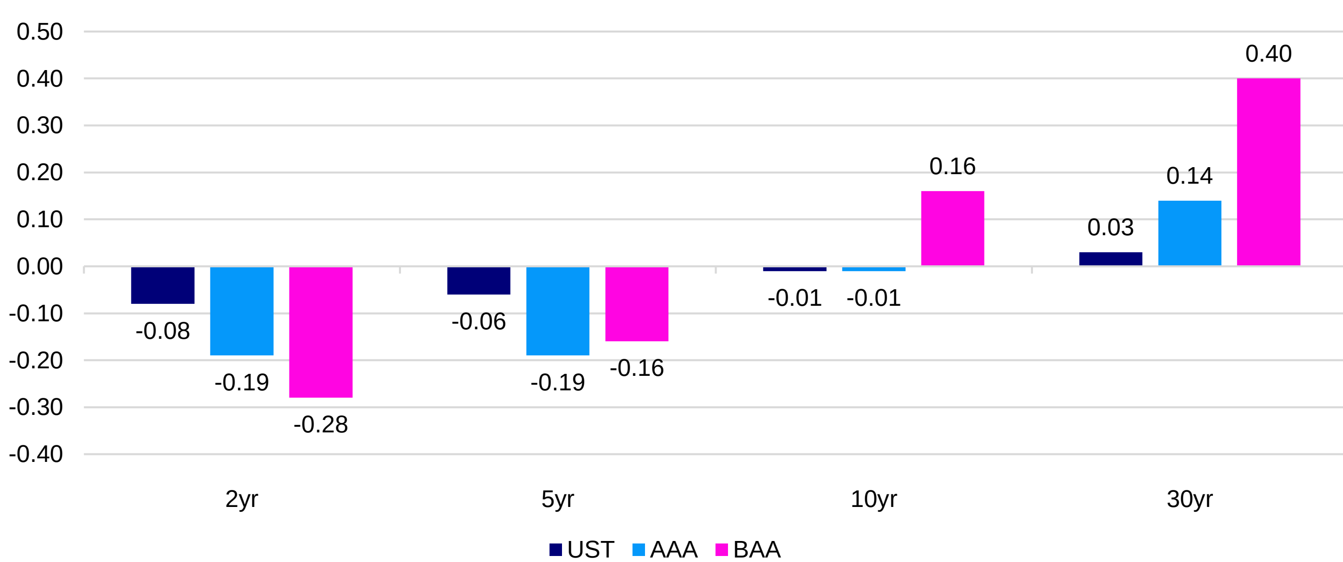
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on July 9, 2025. Note: Figures shown on this table are combination of weekly and monthly reporters.

30-day Visible Supply ($billions)



Source: Bond Buyer Weekly 30-Day Visible Supply - Total dollar volume of bonds to be offered over the next thirty days. It does not include 'Sealed Bids Invited' or 'Proposed Bond Issues'. Only includes Municipal Bonds. From January 17, 2025 – July 11, 2025.

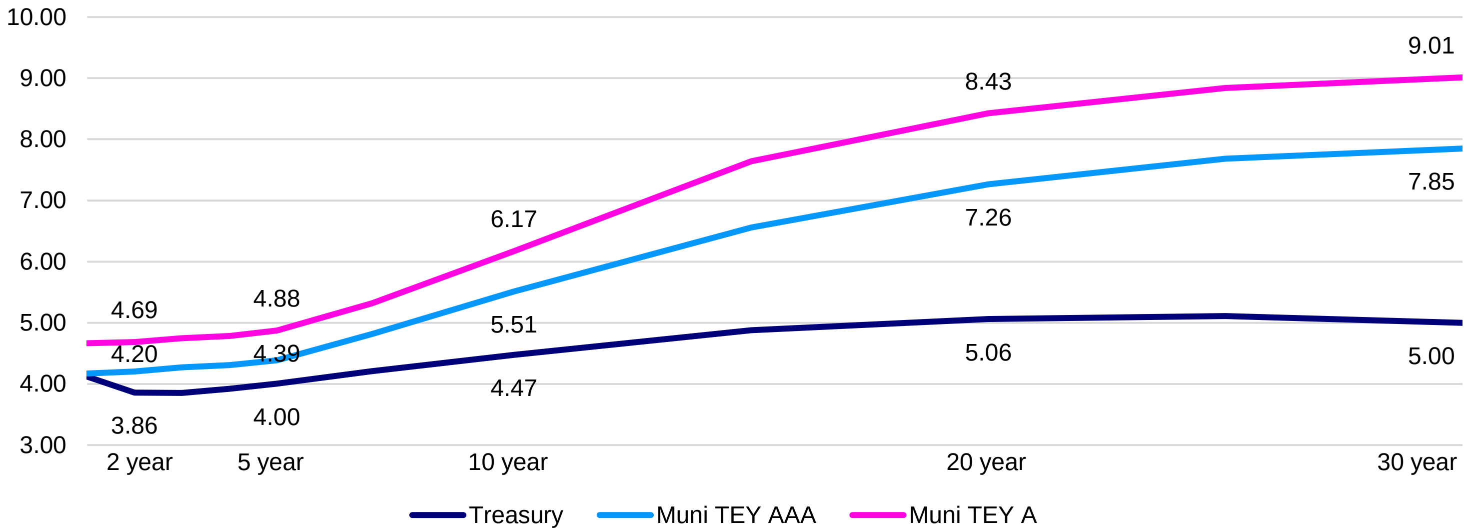
1-Month Yield Change 6/16/25 – 7/16/25 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from June 16, 2025 – July 16, 2025. UST = United States Treasury. A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage.; https://ratings.moodys.io/ratings and select 'Rating Methodologies' on the homepage.; www.fitchratings.com and select 'Ratings Definitions Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

Munis by the numbers

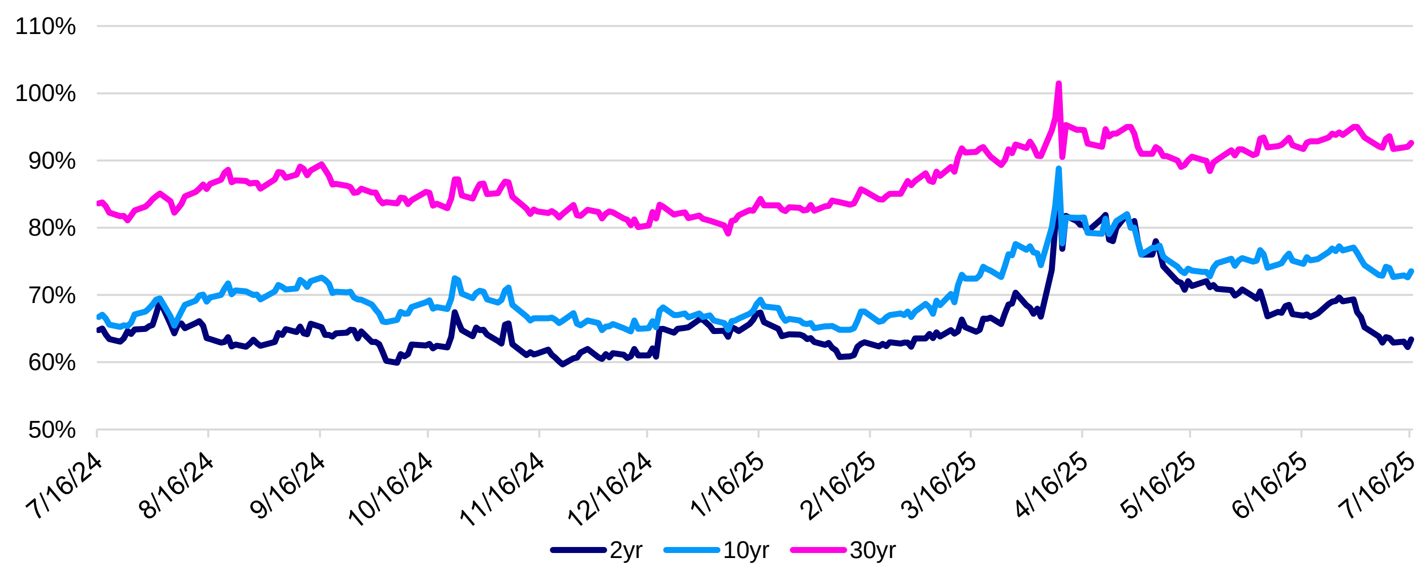
Current Muni Treasury Ratio and Tax-Equivalent Yields (%)



Term	US Treasury (UST)	Muni AAA	Muni A	Muni TEY AAA	Muni TEY A	Muni UST Ratio	Muni TEY UST Ratio
2 year	3.86	2.49	2.77	4.20	4.69	64.5%	108.9%
5 year	4.00	2.60	2.89	4.39	4.88	64.9%	109.7%
10 year	4.47	3.26	3.65	5.51	6.17	72.9%	123.2%
20 year	5.06	4.30	4.99	7.26	8.43	85.0%	143.6%
30 year	5.00	4.65	5.34	7.85	9.01	92.9%	157.0%

Source: Bloomberg as of July 16, 2025. TEY = Tax-Equivalent Yield. UST = United States Treasury. US Treasury is represented by the public obligations of the US Treasury. Treasurys are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. Muni AAA is represented by the Municipal AAA GO bond yield, a Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of $2million-plus market activity in both the primary and secondary bond market. The Muni TEY AAA is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni AAA yield. Muni A is the Bloomberg Municipal Bond A Index is an unmanaged index of the A-rated municipal bond market. The Muni TEY A is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni A yield. The Muni UST Ratio is the comparison of the Muni AAA vs. the yield on the US Treasury. The Muni TEY UST Ratio is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni UST Ratio. An investment cannot be made directly into an index.
Tax-Equivalent Yield is assuming a top tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2025. Irs.gov, as of October 22, 2024. Top marginal tax rate for single taxpayers with more than $626,350 in taxable income or couples with $751,600 or more. NIIT is the net investment income tax investment income for single taxpayers with more than $200,000 in taxable income or couples with $250,000 or more.

Municipal/Treasury Ratio



Source: Thomson Reuters TM3, as of July 16, 2025. US Treasury is represented by the public obligations of the US Treasury. Treasurys are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest. The Municipal AAA GO bond yield is represented by the Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of $2million-plus market activity in both the primary and secondary bond market. Past performance does not predict future returns. An investment cannot be made directly into an index.

US Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas. Average price data for select utility, automotive fuel, and food items are also available.

Sources:

1. US Department of the Treasury, June 2025.
2. Bloomberg ,as of July 16, 2025.
3. The Bond Buyer, as of July 5, 2025.
4. CNBC, as of July 3, 2025.
5. Internal Revenue Service, CNBC, as of July 3, 2025.
6. Bipartisan Policy Center analysis with the latest IRS data, CNBC, as of July 3, 2025.

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds.

All data as of July 16, 2025, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

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