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Munis Extend Biggest Rally Since April on Puerto Rico Purchases.

The $3.7 trillion municipal-bond market extended its biggest rally since April, with investors buying Puerto Rico, Illinois and California debt ahead of the Federal Reserve's two-day meeting beginning tomorrow.

Yields on top-rated munis maturing in 10 years declined 0.04 percentage point to 2.99 percent at 1 p.m. in New York, the lowest since Aug. 16, according to data compiled by Bloomberg. The tax-exempt interest rate touched a 29-month high of 3.15 percent on Sept. 6 before declining the most in five months.

Dealers today sold bonds from weaker issuers to muni investors at a faster pace than they've bought the securities, according to Municipal Securities Rulemaking Board data compiled by Bloomberg. That includes debt from Puerto Rico, which is on the brink of junk, as well as Illinois and California, the two lowest-rated U.S. states. The MSRB counts all trades over $5 million as $5 million transactions.

Even though Treasuries surrendered some of their earlier gains today, "the muni market rallied nicely," said David Manges, muni trading manager at BNY Mellon Capital Markets LLC in Pittsburgh. "This is likely to be a volatile week."

The muni market's rally preceded two days of deliberations by Fed policy makers on whether the economy is strong enough to begin tapering $85 billion in monthly bond purchases. The $3.1 billion iShares S&P National AMT-Free Municipal Bond Fund, known as MUB (MUB), rose $0.58 to $102.52 at 1:33 p.m. in New York, the biggest jump since July. The price was the highest in a month.

The yield on 10-year U.S. Treasuries fell as much as 0.11 percentage point to 2.78 percent today, Bloomberg data show. The interest rate has since jumped to 2.86 percent as of 1:25 p.m.

States and localities are set to sell $4.1 billion in long-term debt this week, the least for a non-holiday week since Aug. 16, Bloomberg data show.