
How to Think About Muni Credit in a Year When Federal Funding Is Shrinking.

One of the most durable features of the municipal bond market is its historically low default rate. Investment-grade munis default at a small fraction of the rate of comparably rated corporate bonds, and that track record extends across recessions, financial crises, and periods of significant fiscal stress. For advisors, this history is one of the core arguments for the asset class and a legitimate source of comfort when clients ask whether their muni exposure is safe.

But history is a foundation, not a guarantee — and 2026 introduces a set of credit headwinds that are worth understanding at the sector level, even if the broad market outlook remains stable. The combination of reduced federal funding flows, the Medicaid overhaul embedded in the One Big Beautiful Bill Act, and ongoing state budget pressure from slower revenue growth creates a more differentiated credit environment than the muni market has faced in several years. Not more dangerous — more differentiated. And differentiated credit environments are where credit selection actually matters.

The most significant structural change is the ongoing reduction in federal funding to states and municipalities. The Medicaid provisions of the OBBBA alone — nearly $990 billion in reduced federal spending over ten years — represent the largest shift in federal healthcare funding in decades. Those dollars flowed directly into state budgets and, from there, into hospitals, health systems, and long-term care providers. Hospital revenue bonds are a major component of the muni market, and the credit implications are not uniform across issuers.

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