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S&P U.S. State and Local Government Credit Conditions Forecast: Financial Management Stands Out In an Age of Economic Limitations.

With little fanfare, the current U.S. economic expansion marked its sixth anniversary in June. Any cause for more celebration was dampened by weaker-than-expected performance in the first quarter, when real GDP contracted by 0.2%. The dip–owing mostly to temporary factors–means state and local governments once again will likely have to settle for a year of subdued economic growth. In Standard & Poor's Ratings Services' view, the persistence of a slow recovery has increased the relative importance of financial management in terms of the strength of state and local government credit profiles. The overall positive tilt we continue to see in the balance of our rating changes, therefore, reflects that the sector as a whole has continued to embrace a certain amount of fiscal austerity. Nowhere is this more apparent than in state and local government payrolls. Whereas, by May 2014, the overall U.S. economy had recovered all 8.7 million jobs lost during the Great Recession, even as of June 2015 the state and local government sector still had replaced only 17% of the 758,000 jobs it shed.

Absent the stronger revenue trends that would likely accompany a more robust economic expansion, we've observed that many state and local governments have maintained leaner operations. Those that have done so have been able to hold the line financially and, in many cases, maintain or rebuild their reserves. But it's not universal. We've found that credit deterioration is most likely to occur where pockets of either acute or sustained economic distress couple with imprudent financial management. Recent events in Puerto Rico illustrate, albeit as a more exaggerated example, how protracted economic contraction and weak financial management practices can undermine credit quality.

Overview

- Continued slow GDP growth will require state and local government financial managers to maintain and follow prudent policies.
- The aging of society, including governmental workforces, and higher pension costs are a source of fiscal pressure for some governments.
- We project that growth will accelerate somewhat in most regions in 2016.
- Growth will likely be highest in the Mountain region in 2015 and in the South Atlantic in 2016 and lowest in East South Central in 2015 and in New England in 2016.

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