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Moody's U.S. State and Local Government Credit Conditions Outlook: Smoother Sailing--Maybe--After a Turbulent Start.

The turbulence that defined equity markets in early 2016 has subsided somewhat and various indicators suggest that the U.S. economy should continue to expand at a moderate pace throughout the year. In fact, Standard & Poor's Ratings Services' economic outlook as of April looks remarkably similar to its January forecast despite the intervening volatility. Due to slower first quarter growth than we had anticipated, we have lowered our forecast of real GDP growth in 2016 to 2.3% from the 2.7% we projected at the outset of the year. The revised growth rate does not correspond with a higher risk of recession, however. The forecast estimates a relatively low—15% to 20%-likelihood of recession this year.

For state and local governments, the forecast anticipates a broadly stable economic backdrop, albeit one that lacks the underlying vitality we would typically expect to see at this stage of the business cycle. We expect trends in consumer spending and a housing market that continues to gather momentum to be among the key supports for U.S. economic growth through 2016 and into 2017. We project housing starts to continue marching upward, reaching 1.2 million in 2016 and 1.4 million in 2017. Real consumer spending should continue to increase, but at 2.8% in 2016 and 2.6% in 2017, the pace of growth would be slightly slower than the 3.1% growth rate in 2015. This anticipated levelling-off in consumer spending is consistent with the now five-month low in consumer sentiment and what we observe in state tax revenue forecasts. Almost across the board, states are forecasting slower, though still positive, rates of personal income and retail sales tax revenue growth.

Overview

- Revised forecast anticipates slower economic growth in 2016.
- Risk of recession remains relatively low—15% to 20%.
- Slower economic growth aligns with state revenue forecasts, which have also been dialed back.
- Key economic supports are consumer spending and momentum in the housing market.
- Regional forecasts anticipate that states in the Mountain, South Atlantic, and Pacific regions are leading the way.

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19-Apr-2016