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[S&P: U.S. Oil-Producing States' Fiscal Preparedness Varies As Prices Collapse]

NEW YORK (S&P Global Ratings) March 11, 2020–A sustained period of low oil prices is likely to generate negative credit pressures on U.S. oil-producing states (Alaska [AA/Stable], Louisiana [AA-/Stable], Montana [AA/Stable], New Mexico [AA/Stable], North Dakota (AA+/Stable), Oklahoma (AA/Stable), Texas (AAA/Stable), and Wyoming (AA+/Stable)). While shock declines in commodity prices are not new, the timing of this latest rout has potential to upend recent fiscal and economic improvement. It was not until last year–nearly five years after the last price rout–that S&P Global Ratings observed all oil-producing states having positive economic growth (see "With Oil Price Volatility, Recent Economic Gains In U.S. Oil-Producing States Are at Risk," published March 12, 2019, on RatingsDirect). If prices do not rebound quickly or if states fail to make timely budget adjustments, we may see varying degrees of lower-than-expected year-end results for fiscal 2020.

Any sharp pull-back in exploration and production is likely to inflict considerable strain on the economies of oil-producing states, particularly those that lack diversification. Should those states slip back into an economic recession, the three hardest-hit employment sectors will likely be construction, natural resources, and mining; manufacturing; and trade, transportation, and utilities.

The price shock will likely result in many states reconsidering current revenue forecasts and revising proposed fiscal 2021 budgets. S&P Global Ratings recently lowered all of its West Texas Intermediate (WTI) and Brent Henry crude oil price assumptions this week (see "Unrestrained Supply Swamps Oil Outlook: S&P Global Ratings Revises Oil & Gas Assumptions," published March 9, 2020, on RatingsDirect). WTI was revised to $35/bbl for 2020 and to $45/bbl for 2021 from $55/bbl. For fiscal 2020, most states had a price assumption of $50/bbl or higher when enacting their budgets.

S&P Global Ratings has long held that the outsized budget reserves of oil-producing states have provided an effective fiscal cushion during a transition to lower oil prices. Over the past five years, a changing economic outlook and a wide range of fiscal adjustments resulted in an easing of the negative pressure facing state credit quality. However, a fiscal shock to these states, so soon after their economic recovery, is likely to create a challenging budgetary environment.

What we are watching in oil-producing states

Alaska, the state most reliant on oil-related revenue, has depended on reserves to balance its budget since fiscal 2015. A period of austerity and using its vast investment earnings for general operations have provided recent budget relief as traditional reserve balances declined. However, equity market volatility and low oil prices, with already deep expenditure cuts, may limit the state's fiscal flexibility.

While Texas is the nation's largest producer of crude oil and natural gas, its economy has generally shifted toward broad diversification spurred largely by strong demographic trends and growth in the technology and service industries. Nevertheless, the state's extensive oil and gas activities have contributed to its strong economic growth. Following the last oil price shock, Texas' economy grew faster than all other oil-producing states, with real economic growth among the top ten of all states nationally.

Given their size, North Dakota and Wyoming are highly susceptible to energy market volatility, undergoing significant employment growth and contraction during the energy market's boom-an--bust cycles. While mining-related revenue makes up a significant portion of the states' budgets, each has sizable operating reserves to offset revenue volatility. However, Wyoming has been running substantial operating deficits for years as the result of declines in coal severance tax, which increased oil production has not entirely offset. Louisiana, which previously used one-time budget measures (including using reserves) to balance its budget, has over several years continued to work to strengthen its reserves position to help cushion potential economic softness.

Oil-related revenue makes up a small portion of Oklahoma's and Montana's budgets. However, oil production is a significant generator of statewide employment. Oklahoma was already seeing revenue softening this year. A prolonged suppression of oil and gas prices is likely to disrupt business activity and consumer spending, weakening income and sales taxes (Montana does not have a sales tax).

New Mexico, similar to other oil-producing states, has used recent increases in revenue to address pent-up service demands with fiscal 2020 budgeted expenditures increasing nearly 12% year over year. However, the state still has very strong reserve levels, budgeted at 25% of recurring spending. The state legislature has approved a fiscal 2021 budget with further boosts in expenditures. However, the governor has not yet signed it, and based on the recent oil price drop, is likely to announce substantial line-item vetoes to create a cushion against potential revenue decline, with an emphasis on cutting one-time spending.

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