Bond Case Briefs

Municipal Finance Law Since 1971

Fitch: Public Finance Credit Resilient to Short-Term U.S. Government Shutdown

Fitch Ratings-New York-20 December 2024: A short-term U.S. government shutdown is unlikely to affect most U.S. public finance credits, Fitch Ratings says. However, a prolonged shutdown could have negative credit ramifications for USPF issuers, especially those that rely on federal funding for healthcare services, housing subsidies and grants, higher education grants and student loans, and other programs. Federal budgets directly support a wide range of functions carried out by states, local governments, and not-for-profit entities, and broader federal spending is meaningful to the economic activity that underpins the credit quality of USPF issuers.

Medicaid, which comprises roughly one-third of total state budgets, and Medicare are not funded through annual appropriations and therefore their funding is unaffected. These programs are more than one-half of the payor mix for not-for-profit hospitals.

Similarly, the Federal Highway Administration's Highway Trust Fund (HTF), a dedicated funding source for federal highway and transit programs, is funded by gasoline and fuel taxes and is not subject to annual appropriations. GARVEE bond issuers have indicated that HTF funds are expected to continue to flow to the states as usual. In addition, the bonds benefit from structural safeguards, and many issuers pre-pay GARVEE debt service a year in advance.

Most federal employees, including Defense and the US Postal Service, which together make up almost half of the total of employees, would not see changes to their employment or pay status. Other employees could be furloughed or required to work without pay. Localities with the highest proportion of federal employment are unlikely to see long-lasting effects on economically sensitive tax revenues as the Government Employment Fair Treatment Act (GEFTA) of 2019 ensures payment of federal salaries deferred during a shutdown. The District of Columbia's operations are largely protected by the fiscal 2024 D.C. Appropriations bill, which exempts the district government from a shutdown in fiscal 2025. Similar provisions have been in place since 2014.

While Fitch's USPF ratings anticipate normal economic cycles, a prolonged federal budget impasse could potentially be a marginal drag on growth, with state economies still likely to see continued economic growth. The Congressional Budget Office estimates discretionary federal spending will be 6.3% of GDP in FY24, near the historical low, down slightly from 6.4% in FY23).

Most state and local government ratings assume sufficient flexibility to respond to reduced federal funding, primarily with their own spending cuts, reflecting their significant autonomy within the U.S. federal structure. Local governments bear the added risk of absorbing potential state tightening that could follow federal cuts, although they typically have broad budgetary tools and reserves to cushion unforeseen developments. Many states and local governments currently benefit from historically high reserves and solid liquidity given multiple rounds of pandemic-related federal economic stimulus and generally prudent fiscal management. Nevertheless, weaker public finances and spending cuts could diminish the reach and effectiveness of countercyclical actions, leaving USPF issuers vulnerable to a protracted slowdown.

Revenue-supported entities are also generally well-positioned to absorb the effects of reduced federal funding. However, an extended pause in spending could negatively affect USPF credits that rely on federal funding for certain programs, including housing subsidies and grants, higher education grants, and public transit. Backfilling lost federal funds with own-source resources could affect operating performance over time.

The shutdown could also cause non-material operational disruptions at airports with non-essential FAA and TSA worker furloughed, although the risk to finances is very low. Airport capital projects could be delayed if federal grant funding is held up.