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S&P: U.S. State Budgets Face Lean Margins Despite Mature Economic Expansion.

By most measures, U.S. state budget conditions are adequate to favorable—and they should be. Not only is the economic expansion mature at this point, it showed signs of accelerating during the middle of 2014. And yet, a majority of states—32 by our count—face budget gaps in either fiscal 2015, 2016, or both. In most cases the gaps are manageable and do not represent an immediate threat to credit quality. But in Standard & Poor's Ratings Service's view, the fact that so many states confront shortfalls at all serves as an early warning of sorts. After all, if a state is grappling with a budget deficit now, with the economic expansion approaching its sixth anniversary, what will be its condition when the next slowdown strikes?

Benefitting from the myriad advantages that come with being sovereign entities, U.S. states comprise one of the most creditworthy sectors we rate. We rate 43 'AA' or higher. At the same time, a large majority of the states rely on a combination of sales or personal income taxes to fund their operations. That means that at any time, current economic conditions—over which the states only have limited influence—effectively dictate the tone of their budget negotiations. What tends to differentiate the direction of any individual state's credit quality, therefore, is financial management. Indeed, the states are among the least passive of all the credit sectors within U.S. public finance; fiscal policy decisions have a significant effect on the degree to which economic conditions will affect their credit quality.

Overview

- A majority of states face budget gaps this year or next; most will be manageable.
- Yet this serves as an early warning, as the recovery nears its sixth anniversary.
- Thus the state sector could be approaching a period of rating volatility.

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