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S&P: Federal Fiscal Policy Discord Could Undermine the Economic and Budgetary Environment for States.

After a roughly two-year reprieve, U.S. state governments need to brace for the possibility of another federal government shutdown, Standard & Poor's Ratings Services believes. In addition, federal spending caps are scheduled to ratchet down again beginning in federal fiscal year 2016 (October 1). As we understand it, avoiding a shutdown may require that Congress and the President reach agreement on changes to the spending caps, no easy task given their stated policy positions. It's not a foregone conclusion, but we believe the state sector may be in for another episode of tumultuous federal fiscal negotiations, including the possibility of a short-term federal government shutdown.

In our view, most states can likely maintain their current rating levels with the slower economic growth rates that would result from a temporary shutdown. Appropriations for certain major federal grants to states are already in place, partially shielding state budgets from the immediate fiscal disruption that a short term federal shutdown would cause. However, from a macroeconomic standpoint, insofar as a shutdown translates to slower revenue growth or higher demand for state services, state fiscal margins could be narrower than presently forecasted. In our view, a shutdown could therefore absorb a portion of the states' budgetary capacity that would otherwise be available in the event of unanticipated economic softening. This could leave states more vulnerable to downside pressure spilling over from a slowdown in the Chinese economy or elsewhere.

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