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S&P State and Local Government Credit Conditions Forecast: Growth Rules, With Regional Variation.

The U.S. Commerce Department's stronger-than-expected third estimate of second quarter GDP growth has led Standard & Poor's Ratings Services' economics team to edge up its forecast for U.S. economic expansion in 2015 to 2.5% from 2.3%, which was our forecast in June. An improved GDP outlook reflects that a range of important indicators point to a stronger economy throughout the remainder of 2015. Somewhat softer jobs reports in August and September, however, contradict the notion that the economy is in acceleration mode. Still, through September, year-over-year hourly wage increases of 2.2% remained similar to the 2.3% as of May — which was the strongest since 2011. Housing starts softened a bit in August but remain on track to top the 1 million mark at an annualized rate of 1.13 million. Building permits, a forward looking indicator, remain more favorable, having increased 3.5% in August to a 1.17 million annual rate, enabling our economists to maintain their expectation for about 1.5 million new housing starts by 2017.

Taken together, these key factors underlying the country's economic performance should help state and local tax revenue trends gain some momentum. And even if the national economy is signaling a softer patch ahead, it will take time for that to flow through to state and local coffers. Either way, it's crucial to remember that the underlying economic factors and their consequent tax revenue implications vary considerably by region. States, as well as localities more dependent on oil extraction, for example, are much less likely to lead the way in construction and housing starts. In fact, some of the housing construction now underway in some states — such as in South Dakota — could find that demand has already begun to dry up.

Overview

- State and regional outlooks for 2016 are mostly positive with pockets of slowing or weakness.
- State budget wrangling is greater than we would expect this far into a growth cycle and is affecting some local governments.
- As has generally been the case, areas with population growth have a rosier outlook than those that are stagnant or declining.

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