
Still Budget-Less Illinois Has U.S. Muni Market On Edge.

The possibility that Illinois could enter an unprecedented second straight fiscal year without a budget had the U.S. municipal bond market worried on Wednesday over when the state might begin to make progress in addressing its financial woes.

The Democratic-controlled legislature wrapped up its spring session late on Tuesday without a fiscal 2017 spending plan or even a school funding budget that both the House and Senate could agree on. Democratic leaders, who are battling Republican Governor Bruce Rauner over his pro-business and labor-weakening reform agenda, also refused to immediately take up the governor's short-term budget plan.

Illinois has limped through 11 months of fiscal 2016 as the only U.S. state without a complete budget, operating under court-ordered spending, and continuing and stopgap appropriations. As of Wednesday, any budget legislation would need a more demanding three-fifths majority vote to pass.

"I don't see anyone blinking an eye unless the political pressure becomes so intense or the finances and credit rating of the state become even more dire," said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management.

Credit rating agencies have warned Illinois, which has the lowest bond ratings among the 50 states, of further downgrades if it fails to tackle a $111 billion unfunded pension liability and huge structural budget deficit.

"Political paralysis is preventing the state from addressing its pressing financial challenges," said Ted Hampton, an analyst at Moody's Investors Service, which rates Illinois Baa1 with a negative outlook.

Richard Ciccarone, the head of Merritt Research Services, which analyzes municipal bond credits, said he expects the state's so-called credit spread to widen in the municipal bond market as a result of the continuing impasse.

On Wednesday, the spread for Illinois bonds due in 10 years remained steady at 175 basis points over Municipal Market Data's benchmark triple-A yield scale. By contrast, the spread for New Jersey, another state with fiscal problems, was 100 basis points, while California's was only 20 basis points.

"If (Illinois) made significant changes, the market would applaud with a little support," Ciccarone said.

The state appears to be bracing for credit rating cuts. The governor's budget office has hired consultants to help Illinois disentangle from interest rate swap agreements that could cost the state more than $100 million should its ratings fall below specified levels.

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