
S&P U.S. State Sector 2017 Outlook: Protracted Slow Economic Growth Casts A Shadow.

Credit pressure across the U.S. state sector is likely to remain elevated throughout 2017 as slow tax revenue growth compounded by growing pension contribution requirements and Medicaid expenditures is contributing to fiscal strain for many states. A more pronounced slowdown in state tax revenue growth that began in mid-2015 persisted through 2016 and, following bouts of stock market volatility, is seen in the performance of many states' fiscal 2017 revenues. In the coming year, revenue growth is likely to remain slow and below the rates at which key expenditures are growing. Some of these pressures, years in the making, are already evident in state financial and credit profiles.

In S&P Global Ratings' view, the low-grade fiscal stress that has come to plague the state sector as a manifestation of evolving demographic and structural economic forces is unlikely to abate within our forecast horizon. In addition, the presidential election results raised the prospect that longstanding areas of federal-state fiscal integration will undergo a fundamental reconsideration. And, if enacted policy changes make good on the rhetoric heard in the campaign, federal funding flows are poised to become less responsive to economic cycles. In that case, we would expect state credit ratings to exhibit greater sensitivity to cyclical economic conditions. A shift toward block granting federal Medicaid funds, for instance, could diminish the program's role in functioning as a countercyclical automatic stabilizer. On the other hand, financial markets have–initially at least—been bullish following the presidential election. Equity market appreciation and reflationary signals from the bond markets have favorable implications for states, though it's unclear when—or to what extent—any related capital gains will translate to tax revenue. Nevertheless, the possibility of faster economic growth throughout the next one to two years represents the main source of opportunity for states to strengthen their financial and liability profiles before the next recession.

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