Fitch Rtgs: Oil Price Plunge to Pressure US Energy States & Locals

Fitch Ratings-Austin/San Francisco/New York-17 March 2020: The sharp decline in oil and natural gas prices will reduce economic output and revenues in US states, cities, counties, and single-purpose districts with significant energy sector exposure, says Fitch Ratings. Governments' vulnerabilities to these fiscal pressures will be compounded by the broader economic pressures caused by the coronavirus outbreak and related containment efforts, although the situation remains uncertain and is evolving rapidly.

The current price decline may represent a longer-term shift in the demand and supply landscape, causing these states and local governments to adjust to a longer period of negative or reduced growth in the building blocks of their revenue bases. This could lead to a change in Fitch's assessment of the underlying economic fundamentals of these credits and in some cases, a reassessment of these ratings.

States that have increased their financial resilience since the 2014-2016 natural resources downturn are expected to weather the current tumult with a limited rating impact, although those outcomes are predicated on the continuation of sound fiscal policies, which include provisions for an extended period of market weakness. Energy states whose revenue systems are less reliant on natural resources development, feature more diverse economies, or have accumulated significant reserves, such as Colorado and Texas, are also expected to maintain greater financial stability.

A sustained drop in oil prices could negatively affect the ratings of a handful of local government issuers with a high degree of economic and taxpayer concentration in the energy sector. However, most local governments in oil producing regions appear well prepared for a transitory period of stress and have withstood temporary prior price declines of up to one to two years with minimal ratings migration.

The effects to the energy sector will be a function of the duration of depressed oil prices and a government's level of economic diversity, structure of its revenue framework, spending flexibility and current level of reserves. The nature of a local government's participation in the industry and location in their state will also determine how vulnerable it may be to declining prices. Communities with 'downstream' energy facilities such as petrochemical manufacturing may benefit from lower energy prices.

Generally, Fitch believes US energy states and most local governments have sufficient fiscal tools to address near-term economic and financial stress linked to energy price drops. However, strained energy markets coupled with the coronavirus pandemic creates significant uncertainty as to the extent to which policy actions can address a longer-term shift in the demand/supply equation, requiring state and local officials to make greater and more fundamental budgetary adjustments than they have in past energy industry downturns.

Following the 2014-2016 natural resources downturn, when the price of West Texas Intermediate dropped to a low of $36.82 per barrel (bbl) from more than $100.00/bbl, sharp declines in financial resilience or weak budgetary responses resulted in rating downgrades for the states of Alaska, Louisiana, Oklahoma and West Virginia. These states have rebuilt their financial resilience since the downturn and are now rated ‘AA-’, ‘AA-’, ‘AA’ and ‘AA’, respectively, all with Stable Rating Outlooks, although Alaska’s multiple downgrades from ‘AAA’ reflected its inability to advance financial policies that ensure stable financial performance.

Texas’ rating of ‘AAA’ remained intact through this period of stress due to its greater economic and revenue diversity and sizable reserves. Montana also sustained its ‘AA+’ rating due to increased economic diversification and conservative fiscal policies. As oil and natural gas development has expanded in the US over the past several years, current oil and natural gas price turmoil may cause economic harm to a broadened group of US states.

As it did during the 2014-2016 period, Fitch is monitoring 15-20 local governments with energy concentration in Texas, California and Alaska that are at elevated risk for negative rating action. Issuers consist primarily of smaller communities in production areas but also include industry headquarter cities. Fitch ultimately took no negative rating actions on at-risk issuers during the last energy downturn as prices recovered, alleviating much of the economic concern. In the current environment, we expect the combination of reduced exploration activity and coronavirus economic pressures will be felt most acutely in the smaller, more concentrated oil-based economies, while larger cities may experience less severe effects, given the size and diversity of their regional economies.

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