
Illinois Owes Georgia Voters a Debt of Gratitude.

The state is no longer at risk of Moody's cutting its credit rating to junk soon, and bond traders like the prospect of federal support.

Before the U.S. elections in November, I wrote that the fate of Illinois's investment-grade credit rating was on the ballot. I got that right — but I wrongly assumed that the state's voters would make or break its fortunes.

Instead, it turned out to be Georgians who pulled Illinois back from the brink of junk. The state owes them a huge debt of gratitude, given just how much Illinois taxpayers are poised to save in the municipal-bond market because of the January runoff victories for Democratic Senators Jon Ossoff and Raphael Warnock.

The yield spread between 10-year Illinois bonds and top-rated tax-exempt debt shrunk last week to 111 basis points, the smallest since the start of the Covid-19 pandemic. It's a narrower gap than at any time between mid-2014 through 2019, a feat all the more impressive when considering that muni bonds held their ground in the first three months of the year as interest rates increased around the world, outperforming U.S. Treasuries by the most since 2009. Illinois already saved millions of dollars when it borrowed $1.26 billion in mid-March. That sale included bonds due in 2024 that yielded 1.09%, a sharply lower rate than the 3.42% coupon on $2 billion of similar-dated debt that the state placed with the Federal Reserve's Municipal Liquidity Facility in December.

The origins of this muni market windfall for the lowest-rated U.S. state may seem to begin in November, but clearly the Jan. 5 runoff elections in Georgia marked a turning point. The extra yield on Illinois 10-year bonds plunged 34 basis points the next day, when it became clear that Democrats would win both races and divide the Senate 50-50. That was a bigger drop than any day in the previous two months except for Nov. 6, when results indicated that there would in fact be two runoffs in Georgia and a chance for an evenly split Senate. Illinois debt outperformed again in February after Vice President Kamala Harris broke a tie to clear the path for a sweeping fiscal stimulus package to become law without Republican support. That included sending hundreds of billions of dollars in aid to state and local governments.

By March 9, about a week before Illinois's bond sale, S&P Global Ratings had seen enough to raise its outlook on the state's general obligation bonds to stable from negative, removing the risk of an imminent downgrade. Any borrower would welcome such a move, but it's especially beneficial for Illinois, which is rated BBB-, just one step above junk.

Then came arguably the biggest vote of confidence: Moody's Investors Service on March 26 also improved the state's outlook to stable from negative, which it says effectively removes the possibility of a downgrade in the next year or two. Moody's has historically taken a harsher view on Illinois and Chicago than S&P and Fitch Ratings. For instance, in June 2016, when political deadlock left the state headed toward a second consecutive year without a budget, Moody's swiftly cut its rating to Baa2, one step lower than the BBB+ grade assigned by S&P and Fitch. Moody's also shocked the muni market in 2015 when it dropped Chicago's credit by two levels to junk. At that time, S&P had the city at A+, the fifth-highest rank.

Moody’s is forthcoming that its change of heart comes down to fiscal stimulus. “State and local government funds expected under the latest federal aid package may help the state repay deficit financing loans, support its financially pressured local governments and spur employment, income and tax revenue growth,” lead analyst Ted Hampton wrote. He cautioned, however, that “the longer-term challenges associated with the state’s very large unfunded post-employment liabilities remain.”

Of course, Illinois isn’t out of the woods entirely. Fitch still has a negative outlook and could always pull a shock downgrade, though it seems unlikely to do so now given that it held steady even after state voters rejected a constitutional amendment that would have repealed its 50-year-old flat-rate income tax and raised levies on the wealthiest residents. That was what I was referring to when I said the state’s credit rating was on the ballot. Illinois still needs to put in the hard work to chip away at its large pension burden. But Moody’s raised Connecticut’s rating last week, its first upgrade in two decades, so a turnaround isn’t impossible.

Georgia voters made this Herculean task just a bit easier. Even if federal aid is only a stopgap for a couple of years, that’s enough time to save Illinois tens of millions of dollars in interest costs alone. Those savings, in turn, can be deployed to buoy both its post-pandemic economy and its pension funds. Contrary to some rhetoric coming out of Washington, the state isn’t being “bailed out” by any stretch — but it has another chance to remain investment grade. That’s more than enough reason for Chicagoans to send some deep dish pizza down to Atlanta.

Bloomberg Markets

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April 5, 2021, 7:08 AM MDT