US State Debt Levels Rose in 2021 at Fastest Pace in Five Years.

- **State tax-supported debt increased 4% last year, S&P says**
- **Uptick in debt levels likely a fleeting 'blip' as market turns**

US state debt loads jumped last year as historically low interest rates and a bounty of investor demand led to record sales in the $4 trillion municipal bond market.

State tax-supported debt increased 4% in fiscal year 2021, the fastest in five years and a departure from recent years' declining trends as the market favored issuers with low borrowing costs for much of the year, according to an analysis published on Wednesday by S&P Global Ratings.

About two-thirds of states upped their tax-supported debt loads in 2021, though the bond payments remain manageable, the company said. The median debt-per-capita increased 4.6% to $984, still below the peak level of $1,036 in 2012.

"States have benefited over the past year from an economic environment boosted by federal stimulus injections, low bond interest rates, and strong revenue growth," wrote the analysts at S&P led by Ladunni Okolo.

States and municipalities flooded the municipal bond market last calendar year, selling around $460 billion of bonds spurred by low borrowing costs and unprecedented demand from investors. That environment has shifted in 2022 as the Federal Reserve hikes interest rates to combat inflation, leading municipal bonds and other fixed-income markets to slump and investors to sell their holdings.

The about-face in market sentiment means last year's rise in state debt levels was likely a "blip," S&P said.

"Debt levels will begin to slow down again as the states grapple with economic contraction and cut back on debt issuance either as a result of unfavorable costs of borrowing or a weaker outlook," the group at S&P wrote.

Most states have reasonable debt-service payments which are small compared to other fixed costs like retirement payments and Medicaid, S&P said. However, for some, like Connecticut, New Jersey and Hawaii, debt service expenditures are "near or at high levels and could be a source of budgetary stress in the future."

"While states that lack the flexibility to adjust capital or operating expenditure may have little choice but to increase debt issuance in the face of worsening economic conditions, we expect that for most states, the unfavorable cocktail of headwinds could dampen debt issuance in the short term," the group said.

Bloomberg Markets

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July 7, 2022