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Fitch: Timely US State Budgets Facilitated by Revenue Gains

Fitch Ratings-New York-28 July 2022: Budget enactment before the start of fiscal year 2023 (July 1 for 46 states) for practically all US states is an improvement from the years preceding the pandemic when a number of states delivered belated state budgets, Fitch Ratings says. Seven states entered fiscal 2020, the last pre-pandemic budget cycle, without an enacted budget, according to the National Conference of State Legislatures (NCSL). Fitch attributes budget timeliness this year to large revenue surpluses in fiscal 2022 for many states, easing fiscal decision making.

Earlier this month Pennsylvania's legislature and governor reached agreement on a budget for fiscal 2023, leaving Massachusetts as the only state without an enacted full-year fiscal plan. Massachusetts is close to finalizing its 2023 budget, as the legislature unanimously voted to approve the budget on July 19, and it was sent to the governor, who has 10 days to review it. In each of the last six years, Massachusetts started the fiscal year without an enacted budget.

Fitch expects US growth to slow sharply in 2023 to 1.5% from 2.9% in 2022, due to rapidly rising interest rates. States are well positioned for slower growth, as a result of generally prudent fiscal choices made with tax revenue growth that far outpaced budget projections for two consecutive fiscal years.

States are focused on building fiscal resilience by building up reserves, paying down liabilities and using federal aid for one-time measures such as infrastructure. Most tax changes seem to be prudent, reflecting states' caution with inflationary conditions and risk of recession. States have also made investments in government employee salaries.

Pennsylvania's slight budget delay appeared to reflect policy and fiscal questions around how to utilize significant revenue surpluses reported for the current fiscal year. This is a twist on past budget deliberations, which revolved around fiscal constraints. The commonwealth historically delayed its budget enactment into the start of each new fiscal year with sometimes contentious negotiations between the governor and legislative leadership extending well past July 1.

The Pennsylvania budget is somewhat indicative of other states' budgets in making preparations for deteriorating economic conditions, such as a $2.1 billion deposit to its rainy-day fund and leaving a $3.6 billion unallocated balance in the general fund, despite calls for more substantial policy actions in areas such as K-12 education. The commonwealth's Independent Fiscal Office (IFO) projects a sizable yoy decline in net tax revenue in fiscal 2023 of nearly $1.5 billion, or just over 3% in fiscal 2023, primarily citing weakening macroeconomic trends. This is $1.3 billion worse than the official budget estimate and follows tax revenue growth of $5.5 billion (14.4%), which was ahead of the official estimate in fiscal 2022, and boosted by the waning effects of pandemic-driven federal fiscal and monetary stimulus.

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