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Fitch: Inflation To Pressure U.S. Public Finance Before Long

Fitch Ratings-New York-10 October 2022: Positive rating momentum continued for U.S. public finance last quarter; however, it is only a matter of time before rising inflation makes its presence more resoundingly felt, according to Fitch Ratings' latest quarterly report.

Against high inflation, higher energy costs and persistent supply chain headwinds, Fitch upgraded 47 public finance ratings and downgraded 15 in 3Q22 (compared to 36 and 13, respectively, in 2Q22).

State governments, in particular, had a strong quarter as seen by upgrades to Michigan, Ohio and New Jersey. However, "Rapid Federal Reserve monetary policy tightening could lead to state revenue growth weakening and possibly swinging negative in time," said Arlene Bohner, Fitch's head of U.S. public finance. "Sustained inflation also could add to states' fiscal risks by dampening consumer demand and business activity while raising costs for capital spending."

U.S. not-for-profit (NPF) hospitals held steady last quarter with six upgrades and four downgrades in 3Q22 (compared to five hospital upgrades and four downgrades for 1H22). That said, "high costs and inability to retain medical staff are pointing to tighter operating margins, which in turn will lead to higher downgrades and negative outlooks in the coming months," said Bohner. Conversely, finances of life plan communities (LPC) appear to be on more stable footing heading into 2023 despite a stumbling block last quarter (four LPC downgrades in 3Q22 against no upgrades).

Another sector taking a hit from higher inflation is higher education (three downgrades and no upgrades in 3Q22) with stagnant enrollment the chief reason for last quarter's downgrades. "There are some signs of improvement, including modest prospects for enrollment stabilization from incoming students, though controlling expenses will be challenging in an inflationary cost environment," said Bohner.

Fitch's "U.S. Public Finance Rating Actions Report and Sector Updates: Third-Quarter 2022" is available at www.fitchratings.com.

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