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Fitch: US State Taxes, Credit Quality Remain Strong Ahead of Downturn

Fitch Ratings-New York-27 October 2022: Monthly state tax collections continue to show strong yoy gains through fiscal 1Q23 ended Sept. 30, 2022, but will slow as economic activity cools, Fitch Ratings says. Even with lower revenue growth, US states' credit quality will remain strong and ratings stable, given generally prudent budget management in recent years that has resulted in robust fiscal reserves.

Total tax revenues from July through September 2022 grew at a median rate of 7.6% yoy, with only California reporting a yoy decline, based on Fitch's review of the 15 largest states with available data. Sales tax and income tax revenues continued to grow at a healthy pace, driven by the strong labor market, consumer spending and inflation. Two of the states included in the analysis, New York and Texas, have fiscal years that begin on April 1 and Sept. 1, respectively.

Inflation is a key driver of revenue growth, given the fixed nature of most tax rates. Forecast lower inflation in 2023 will put downward pressure on revenue, although we expect tax revenues will continue to grow, albeit at a slower pace. Even on an inflation-adjusted basis, consumer spending is still increasing, suggesting continued near-term economic and revenue gains. Real personal consumption expenditures were up 0.1% for the month and 1.8% for the year in August, according to the US Bureau of Economic Analysis. However, with slower job growth and rising unemployment in 2023, inflation and rising rates will take a toll on consumer spending.

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