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Fitch: U.S. State & Local Governments Positioned for Return to Normal in 2025

Fitch Ratings-New York-11 December 2024: Robust reserves, significant liability reductions and prudent budget management position U.S. state and local governments well for 2025 as pre-pandemic fiscal conditions take hold again, according to Fitch Ratings in its annual outlook report for both sectors.

Fitch has a neutral sector outlook in place for both sectors. Against the possibility of economic growth tailing off somewhat in 2025, credit quality will be stable given governments' ability to manage a weaker, but normalized, revenue environment with strong financial resilience.

The incoming presidential administration will be an area to watch for states. Of note is the imposition of a broad tariff regime as proposed by the president-elect which could in turn trigger retaliatory tariffs and increase the likelihood of a sharp downturn beyond Fitch's expectations, according to Senior Director Eric Kim. "Louisiana and Texas have the highest amount of international trade exports as a percentage of state GDP, with oil and gas exports being a primary driver," said Kim.

Outside of wage pressures, local government spending is largely tethered to affordable housing, homeless assistance, mental health, and community safety, according to Senior Director Michael Rinaldi. "Identifying sustainable revenue to support these programs may prove challenging, crowding out resources for other critical needs and/or increasing dependence on non-structural solutions that could weaken financial resilience and overall credit quality," said Rinaldi

Working in favor of local governments are budget contingencies, which remain an important safeguard against unanticipated spending, such as migrant shelter costs which have affected many large cities over the last several years, given limited capacity to adjust revenue mid-year.

Fitch's 'U.S. State and Local Governments Outlook 2025' report is available at www.fitchratings.com.