
Fitch: Prolonged US Government Shutdown Could Strain Public Finance Credits

Fitch Ratings-New York/San Francisco-01 October 2025: A brief U.S. government shutdown is unlikely to affect most U.S. public finance (PF) credits, Fitch Ratings says. However, a prolonged shutdown could have negative credit ramifications for USPF issuers, especially those dependent on federal healthcare, housing, and higher education funding. Federal budgets directly support many functions carried out by states, local governments, and not-for-profit entities, and federal spending drives economic activity that underpins public finance credit quality.

Medicaid, which comprises roughly one-third of total state budgets, and Medicare are not funded through annual appropriations and therefore their funding is unaffected by a government shutdown. These programs account for over half of not-for-profit hospitals' payor mix.

The Federal Highway Administration's Highway Trust Fund (HTF), a dedicated funding source for federal highways and transit programs, is funded by gasoline and fuel taxes and is not subject to annual appropriations. HTF funds are expected to continue to flow to states to repay GARVEE bonds. GARVEE bonds also benefit from structural safeguards, and many issuers pre-pay debt service a year in advance.

Non-essential employees have been furloughed or required to work without pay, although the Government Employment Fair Treatment Act of 2019 requires deferred federal salaries be paid after a shutdown. It is unclear if certain federal employees will see permanent changes to their employment or pay status. If there are permanent staff reductions, localities with the highest proportion of federal employment are likely see lasting declines in tax revenues.

An extended federal government shutdown would exacerbate existing pressures on tax revenues and could create additional service demands in the District of Columbia (AA+/Stable). The federal continuing resolution passed in March 2025 allows advance appropriation of local funds for fiscal 2026 and 2027, enabling the District to continue operations during a shutdown.

The macroeconomic impact of a shutdown is limited in the near term. However, a protracted disruption, particularly if accompanied by significant funding withdrawals or workforce reductions, could slightly slow U.S. economic growth. Discretionary federal spending totalled $1.8 trillion in 2024, or about 6.0% of GDP, according to the Congressional Budget Office. A little more than half of this was non-defense discretionary spending. Fitch's USPF ratings account for normal economic cycles, and states' fiscal 2026 budgets anticipate slower economic growth.

Most state and local government ratings assume sufficient flexibility to address federal funding reductions, primarily through their own spending cuts. This reflects their significant autonomy within the U.S. federal structure. Local governments also bear the risk of absorbing state cutbacks after federal reductions, but they typically have broad budget tools and reserves to manage unforeseen developments.

Many states and local governments currently benefit from high reserves and solid liquidity, reflected in Fitch’s generally robust assessment for governments’ financial resilience and high credit ratings. But reserve and liquidity levels may decline, particularly for governments with lower financial resilience assessments, if governments are unable to quickly adjust to slower economic growth and shifts in federal spending priorities. Weaker sovereign public finances and federal spending cuts could diminish the reach and effectiveness of countercyclical actions, leaving USPF issuers vulnerable to a slowdown.

Revenue-supported entities are generally well-positioned to absorb the effects of reduced federal funding. However, an extended spending pause could negatively affect credits that rely on federal funding for certain programs, including those for housing, higher education, and public transit. Backfilling lost federal funds with own-source resources could affect operating performance over time.

The shutdown could also cause non-material operational disruptions at airports if non-essential Federal Aviation Administration and Transportation Security Administration workers are furloughed, although financial risk remains very low. Airport capital projects could be delayed if federal grant funding is held up.