
Fitch: U.S. States, Locals Face Shifting Headwinds with Strong Resilience

Fitch Ratings-New York-03 December 2025: Fitch Ratings has assigned a Neutral sector outlook to U.S. state and local governments in 2026, saying that the vast majority of Rating Outlooks are Stable. Credit quality should remain consistent and strong as governments manage slower growth with robust reserves, liability reductions and prudent budgets. Economic performance has exceeded expectations. However, risks are emerging from a slower labor market, tariff-driven inflation, and changes in federal responsibilities. Even so, most governments should be able to absorb these pressures due to strong financial resilience.

Macro risks to revenue include the potential for escalating tariff pass-throughs, which may raise the Consumer Price Index (CPI) and curb consumption; softening payroll growth and potential layoffs; and a slowdown in IT-related capex that could weigh on equity markets and income tax collection in market-sensitive states like California and New York. In addition, housing indicators are weakening, and Fitch expects the residential housing sector to slow in 2026. This could pressure local sales and transaction taxes, as well as assessed property values over time.

Spending pressures persist. States face uncertainty around changes to Medicaid and the Supplemental Nutrition Assistance Program (SNAP) implemented under H.R. 1. Wage growth for public employees remains high, increasing strain on budgets, particularly for local governments. The shift of federal costs to states and local governments could be negative for credit where financial resilience is thinner.

Operating trajectories are broadly stable. Most state and local governments used prior surpluses to build reserves, pay down debt and invest in one-time capital needs, though some with pre-existing challenges still face fiscal constraints. Ongoing implementation of state tax policy changes and softer economic growth could drive volatility in revenue and budgets. For local governments, lags in property tax assessments and tax collection trends allow time to adjust to changing conditions, while an economic downturn would create more immediate strain on governments that rely on sales and income taxes.

Fitch’s “U.S. State and Local Governments Outlook 2026” report is available at www.fitchratings.com

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