Questions That Matter

U.S. Public Finance | Will Premature Austerity Worsen The COVID Shock?

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The steep rise in COVID-19 cases in the U.S. will continue to weigh on revenues and expenditures, and uncertainty about additional federal stimulus means credit squeezes ahead.

How this will shape 2021

An uneven health recovery will continue. Despite differences in state and local protocols and virus infection rates, the recent surge of COVID-19 cases across the U.S. has affected nearly all states and contributed to increased social-distancing measures and restrictions. We expect this to last until widespread vaccination is available presumably in mid-2021. This will continue to influence consumer demand, including services such as transportation and higher education.

Economic and credit conditions remain uneven. State revenue collections for March through September ranged from a 10% decline to 3% growth year over year, according to the Brookings Institute. Credit conditions have mirrored this variability. We have taken over 1,600 rating actions since the onset of the recession, affecting about 8% of our rated universe, 80% being outlook changes. Transportation was worst affected: over 90% experienced a negative outlook or downgrade.

Federal stimulus hasn't addressed revenue decline. Swift federal stimulus to stabilize the financial markets helped offset the spending requirements of the pandemic. For many public finance entities in the U.S., revenue deterioration has been a more significant challenge--unaddressed by stimulus--contributing to budget pressure. Given balanced budget requirements, spending cuts will be part of the solution. State and local government represent 11% of total U.S. GDP so this will continue to weigh on the economy.

Unemployment statistics for U.S. states ranged from 3% to 14% year on year in October 2020, reflecting the uneven economic and revenue performance

An acceleration of restrictions tied to surging COVID cases and premature austerity at the federal level will pressure the economic recovery and further challenge management

What we think and why

Fiscal flexibility will diminish despite proactive management. Most public finance entities started 2020 with strong financial reserves, providing flexibility to react to COVID-induced budget shortfalls. Many implemented timely spending reductions, as state and local government employment reductions of 1.3 million (6.4%) since the onset of the recession indicate. Yet, with no additional stimulus, reserve reductions will limit flexibility, and spending cuts will become trickier when they affect core services such as education, public safety, and social service programs.

Federal fiscal and policy direction will be a key focus post-election. U.S. fiscal federalism allows significant autonomy for the state and local government and enterprise obligors that comprise the municipal market. Yet, fiscal interdependencies, as well as regulatory and policy linkages with the federal government influence their credit quality. For example, Medicaid, the co-funded health-care entitlement program, represents nearly 30% of total state spending.

A healthy and functioning municipal bond market is important to recovery. Short-term and long-term debt issuances have provided liquidity and restructuring options at cost-effective rates. The Municipal Liquidity Fund and other actions by the Federal Reserve which helped stabilize the bond market will end on Dec. 31, 2020 so credit on-going market stability will be something to watch in 2021.

Read More

The Post-Election Landscape for U.S. Public Finance, Nov. 18, 2020

COVID-19 Activity In U.S. Public Finance, Nov. 27, 2020

What could go wrong

Duration of the virus. Spiking infection rates for a long duration and any delay in the widespread availability of effective immunization will deepen economic contraction and delay recovery. In this scenario, uneven credit conditions would continue in 2021.

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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