

## Questions That Matter

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

Robin Prunty  
New York  
robin.prunty@  
spglobal.com  
+ 1 212 438 2081

**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.

## 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.

## 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.

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

## 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

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](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an “as is” basis. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.capitaliq.com](http://www.capitaliq.com) (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

Australia: S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

**[spglobal.com/ratings](http://spglobal.com/ratings)**