FitchRatings

FITCH WIRE

U.S. States in Strong Fiscal Position Despite Weaker Revenues

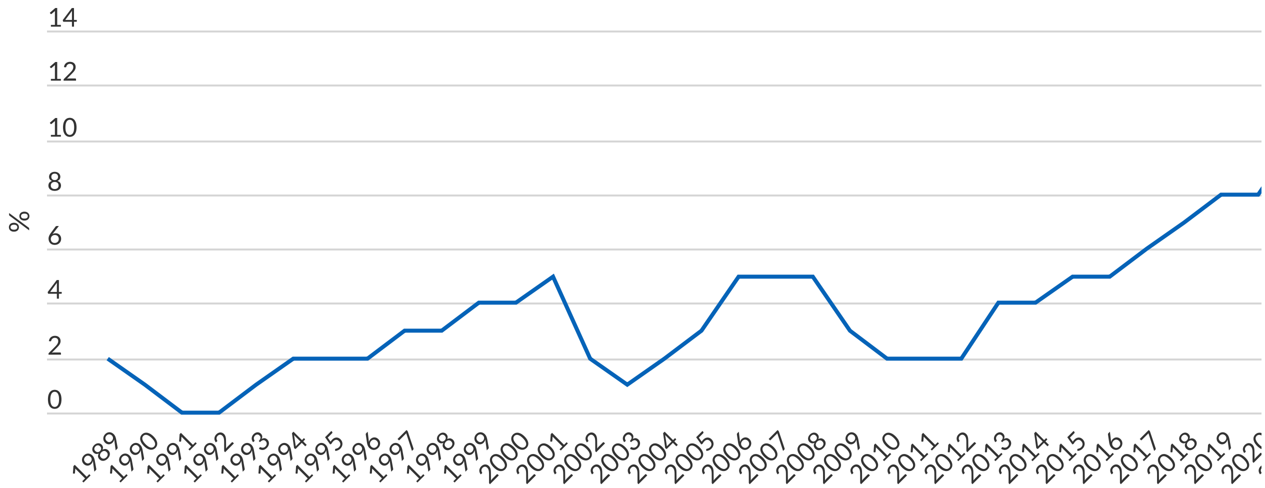
Wed 14 Feb, 2024 - 12:00 PM ET

Fitch Ratings-New York-14 February 2024: Prior-year surpluses and prudent actions will enable most states to manage lower revenue growth or revenue declines in 2024 without affecting overall fiscal resilience and credit ratings, Fitch Ratings says. States that have made large tax cuts or are planning additional cuts are particularly vulnerable to further revenue weakening in the coming year.

Fiscal 2023 was the third straight year state revenues exceeded forecasts. The surpluses helped expand state rainy-day fund balances by $90 billion between 2020 and 2023, growing from a median 8.4% of spending to 12.3%, according to National Association of State Budget Officers (NASBO). States like New Jersey and Illinois have used surplus revenues to pay down long-term liabilities and fund capital expenditures with cash rather than borrowing, further bolstering resilience against future revenue weakness.

State Median Rainy-Day Fund Balance

Percentage of Expenditures



[a] Figures for fiscal 2023 are preliminary; figures for fiscal 2024 are projected based on states' enacted budgets. Figures for fiscal 2024 exclude Georgia and Wisconsin.
Source: Fitch Ratings, National Association of State Budget Officers

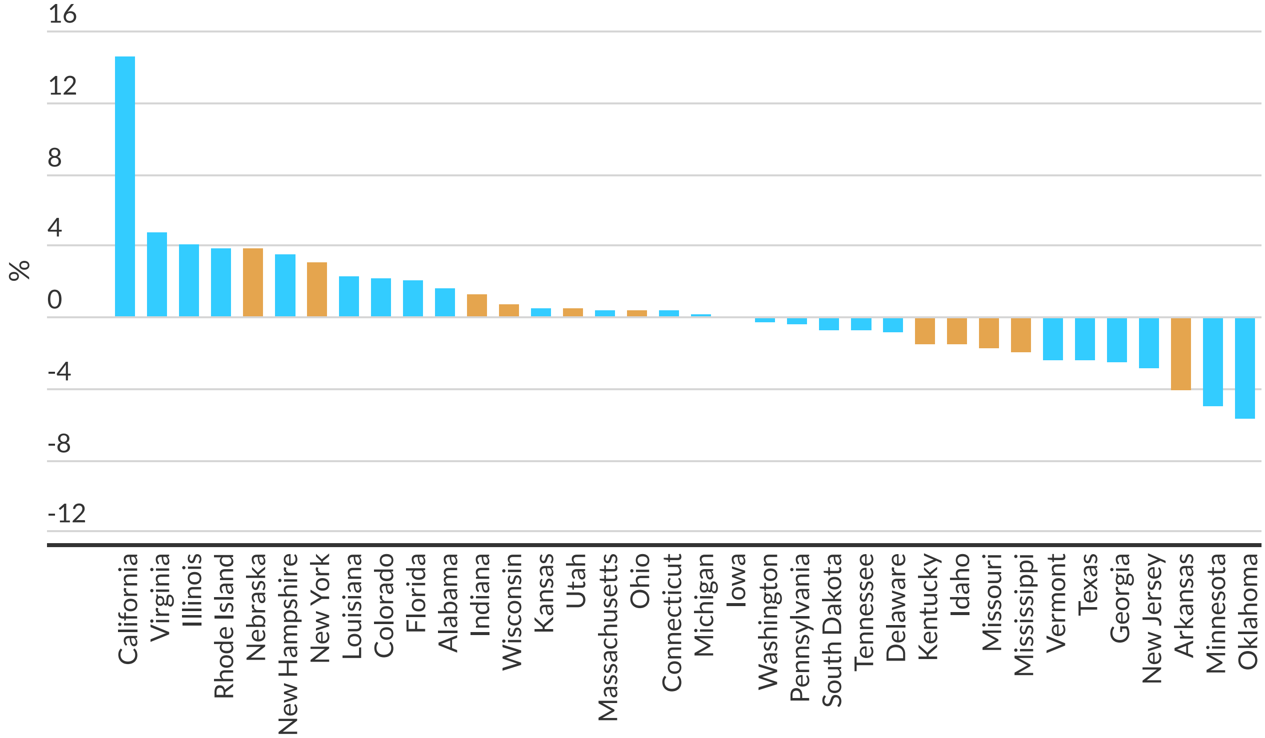
FitchRatings

State tax revenue trended weakly through the second half of calendar 2023 (first half of fiscal 2024 for most states), continuing a sharp reversal in revenue trends that began in fiscal 2023. A Fitch review of 41 states’ monthly revenue reports found YOY declines in 21 states and overall median growth slightly below zero, driven by lower personal savings, cooling inflation, and tax cuts. Monthly revenue reports vary greatly by state, with different presentations of tax revenue. This data is timely and indicative, but not necessarily definitive.

State Tax Revenue Weakened in Second Half of 2023

YOY growth in total state taxes

States with PIT rate cuts in 2023 indicated in orange



Note: Includes states that have reported December 2023 revenue. In 2023, California's tax filing deadline was extended from April to November, inflating collections in the July-December 2023 period. Data for Georgia adjusts for the gas tax suspension in 2022, as reported by the state. Data for Kentucky and Nebraska exclude pass-through entity tax payments in 2023 which will be offset in subsequent years. Data for Idaho represents general fund revenue prior to distributions.
Source: Fitch Ratings analysis of monthly state revenue reports

FitchRatings

Slower revenue growth or revenue declines are not immediately triggering budget challenges in all states. The extent of fiscal pressure depends on how revenues perform relative to budget expectations. Despite a deep revenue decline, West Virginia is not planning major budget changes as the fiscal 2024 budget anticipated lower revenues. Conversely, Arizona's revenues are falling short of budget and the governor has proposed mid-year balancing actions.

In many states, revenue growth would have been more robust if not for large tax cuts adopted in the last few years. NASBO estimates that states enacted $13 billion in cuts to fiscal 2024 general fund revenue, about 1.1% of forecasted revenues. These reductions are on top of $19.3 billion in tax revenue cuts to fiscal 2023 revenues. NASBO estimates 40% of the cuts to fiscal 2024 revenues were one-time reductions, meaning $7.9 billion were permanent cuts.

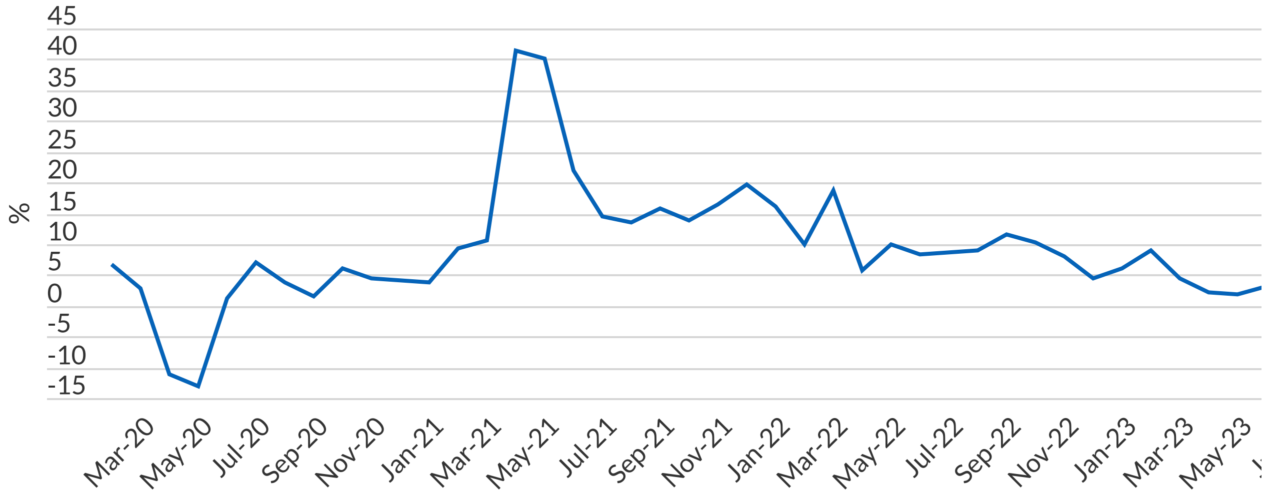
The majority of tax cuts were personal income tax (PIT) reductions. Rate cuts varied widely from modest reductions for the lowest tax brackets in Wisconsin to a 21.25% across-the-board rate cut in West Virginia. Several states adopted reductions that phase in over multiple years, including some that could significantly lower PIT revenue further if statutory triggers are met, such as in Kentucky and West Virginia.

While some governors, including those in Georgia, Iowa, Mississippi and Oklahoma, have called for additional income tax cuts, Fitch expects to see less wide-ranging tax reductions across states in the current budget cycle, given forecasts for slower revenue and economic growth.

In fiscal 2023, revenues in states with greater reliance on sales taxes generally fared better than those more dependent on PIT revenue. However, sales taxes are no longer recording the massive growth that marked the post-pandemic recovery. A general slowdown in sales tax revenue growth that began in 2022 continued through 2023 and turned negative in some states with the slower pace of consumer spending and cooling inflation. Rate cuts and new exemptions also depressed sales tax growth in states such as South Dakota, Tennessee and Florida. Median state sales tax YOY growth was just 0.5% in November 2023, and we expect sales tax revenue growth to contract further in 2024 given our projections for lower consumer spending growth of 1.2% in 2024 from 2.2% in 2023.

State Sales Tax Growth Has Fallen Dramatically from Pandemic-Era Highs

Median YOY Change in State Sales Tax Revenue



Source: Fitch Ratings, Urban Institute

FitchRatings

Contacts:

Tammy Gamerman
Director, US Public Finance
+1 212 908 0216
tammy.gamerman@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th Street
New York, NY 10019

Eric Kim
Senior Director, Head of US State Ratings
US Public Finance
+1 212 908 0241
eric.kim@fitchratings.com

Sarah Repucci
Senior Director, Fitch Wire
Credit Policy - Research

+1 212 908 0726
sarah.repucci@fitchratings.com

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided 'as is' without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues