

Pension Brief: U.S. Public Pension Funded Ratios Continue Improvement In 2024

July 25, 2024

Key Takeaways

- We expect U.S. pension funded ratios will continue their upward trajectory in fiscal years 2024 and 2025 due to steadily positive market returns.
- Inflation underscores many aspects of pension funding and continues its descent toward previous lows, but at a slower pace than previously expected.
- Sponsors face contribution volatility risk because market returns are based on increasingly diverse and opaque asset allocations.

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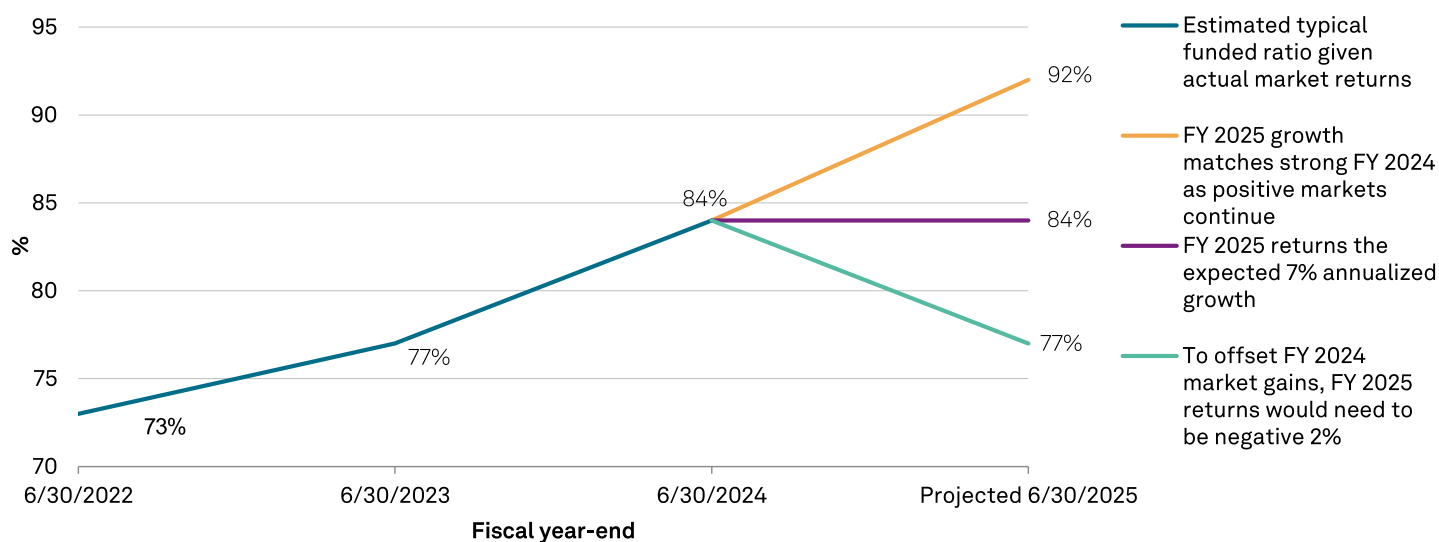
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Impact on the typical U.S. public pension funded ratio under different asset return scenarios



FY--Fiscal year. Source: S&P Global Ratings.

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What We're Watching

S&P Global Ratings expects asset performance will spur notable improvement in U.S. public pension funded ratios for the fiscal year ended June 30, 2024 (July 1, 2023-June 30, 2024), with an expected 16%-17% return, adding to the positive returns for fiscal 2023 estimated at 12%. Given the typical one-year delay from pension measurement to reporting, we expect to see the credit impact play out over the next two years.

Inflation, measured by the Consumer Price Index, spiked in 2022 as noted in our report, "Economic Outlook U.S. Q3 2024: Milder Growth Ahead," published June 24, 2024, on RatingsDirect. It has since dropped to 3% as of June 2024, and we forecast a further decrease to 2% by June 2025.

Why This Matters

U.S. pension plans, on average, assume annual asset returns of 7%, so plan asset growth needs to meet or exceed that assumption to maintain funded ratios and mitigate contribution stress. Year-over-year market returns are built on a combination of inflation and real returns that correspond with market risk inherent within an individual plan's target asset portfolio. To estimate annual returns before plan data can be surveilled, we use the S&P Investment Grade Corporate Bond Index and the S&P 500 Index, weighted 32% and 68%, respectively, to represent the typical U.S. public pension plan.

Before the recent spike, inflation was at historical lows for more than a decade, which led many pension plans to increase market risk in search of higher returns to maintain their funded ratios. The low-inflationary environment also led to limited wage and cost-of-living growth; therefore, pent-up demand for such increases was intensified as inflation rose. While positive market returns help with pension funding in the near term, salary and benefit increases directly add to pension liabilities. As inflation returns to lower levels, we see a general push toward increasing market risk renewed within target portfolios that could lead to contribution volatility and possible budgetary stress. For more information on how increasing private equity and other opaque alternative investments increases market risk within pension plans and budgetary stress of plan sponsors, see "Five U.S. Public Pension And OPEB Points To Watch In 2024," published Jan. 29, 2024.

Related Research

- Economic Outlook U.S. Q3 2024: Milder Growth Ahead, June 24, 2024
- Five U.S. Public Pension And OPEB Points To Watch In 2024, Jan. 29, 2024

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