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U.S. States 2026 Outlook: As States Face Widening Challenges, Their Actions Likely Will Uphold Credit Stability

December 3, 2025

This report does not constitute a rating action.

Sector View: Stable

- Meaningful changes to the federal-state policy relationship will test the resilience of states' credit quality, although we believe they have financial cushions and well-embedded management practices to cope with this uncertainty.
- States will continue adjusting to this new policy environment through budgetary and legislative actions to address looming cost increases from many federal program changes and funding shifts.
- Our sector view remains stable, as we believe that most states will be able to balance slowing revenue growth against the rising expenditure needs, while maintaining ample reserve balances.

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What we're watching | U.S. states

Federal policy
Changing federal-state relationship is shifting more costs onto the states.

Tax collection
States continue the multiyear tax-cutting trend, as federal tax conformity changes mute revenue collection expectations.

Demographics
Changing migration patterns and immigration policies coupled with an aging population will likely alter revenue trends, workforce availability, and service delivery needs.

Reserve levels
States have built up strong reserves. Draws are likely, but the purpose and pace of reserve usage will be meaningful to credit trajectory.

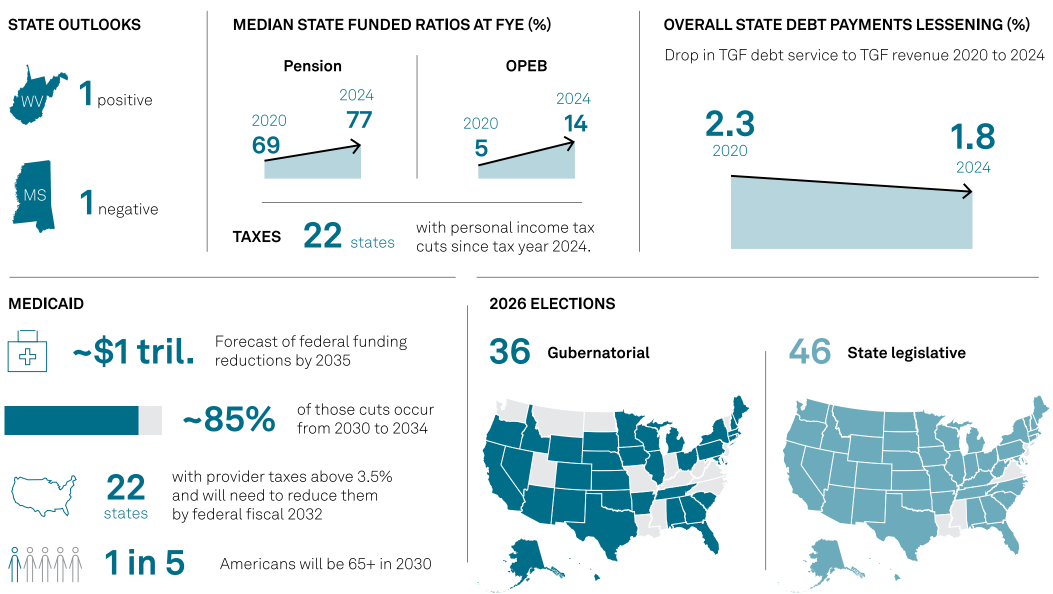
Management actions
Budgetary nimbleness will be needed to address credit pressures on revenues and expenses, forcing budgetary and programmatic changes.

Event risks
Sudden cost and revenue adjustments could be needed to address geopolitical changes, cyberattacks, and extreme weather events.

Source: S&P Global Ratings.

Chart 1

By the numbers | U.S. states



OPEB--Other postemployment benefits. FYE--Fiscal year-end. Sources: U.S. Census Bureau, Congressional Budget Office, S&P Global Ratings.

What's Behind Our Sector View

States have time to adjust to federal policy changes. Federal policy changes, including tariff increases, tax structure adjustments, immigration practices, curtailed federal spending, and support for natural disaster recoveries, have state management teams keeping an equal eye on the administration in Washington, D.C. and the corresponding budgetary changes needed in the state. S&P Global Ratings believes that many of these changes will come with adequate time allowed for states to adjust budgets and programs to limit negative credit impacts. Nevertheless, states will need to take actions, and decisions to ensure structural balance might not be easy to make in statehouses, but we do expect necessary adjustments will occur.

States remain in a position of relative credit strength. In recent years, states have been able to build up rainy day funds while also generating general fund surpluses. This strong reserve position provides ample flexibility as management teams begin to consider more structural changes in the expectation that expenditures will rise faster than revenues. Few expect to draw on reserves at this point in fiscal 2026, but we'll watch to see if more draw from these healthy balances in the fiscal 2027 budget cycle. We rate 45 states in the 'AA' category or higher, making the states cohort one of the highest rated in U.S. public finance. Only four states (Illinois, Kentucky, New Jersey, and Pennsylvania) are rated in the 'A' category and none below that. This highly rated cohort reflects generally strong management practices, tools to help adjust budgets as imbalances are identified, and healthy liquidity both for operational and rainy-day needs.

Our economists forecast slowing but still-positive GDP growth. The U.S. government shutdown has obscured data quality, but S&P Global Ratings Economics expects GDP growth to have slowed for 2025 and to grow at the same 2.0% rate in 2026. We expect the growth will remain supported by the rapid acceleration in data center development as well as several microchip production mega-facilities being constructed. Should these segments of construction wane, other construction fields may not maintain the projected level of GDP growth. Further cuts to the federal funds effective rate, though, should support economic growth. We expect unemployment will peak in the summer below 5%, and the economy will expand faster in the second half of 2026. S&P Global Ratings Economics places a 30% chance of a recession in the next 12 months. Most states have also incorporated slower GDP growth in their revenue forecasts and budgets for fiscal 2026 and therefore, we expect states will generally be able to achieve most revenue targets. For more, see "Economic Outlook U.S. Q1 2026: Steady As She Goes But On A Narrow Path," Nov. 24, 2025.

Table 1

S&P Global Ratings' U.S. economic forecast -- Select data points

	2023	2024	2025f	2026f	2027f	2028f
Real GDP (year % change)	2.9	2.8	2.0	2.0	1.9	1.8
Core CPI (year % change)	4.1	3.4	3.0	2.9	2.4	2.4
Unemployment rate (%)	3.6	4.0	4.2	4.5	4.3	4.1
Federal funds rate (%)	5.0	5.1	4.2	3.5	3.1	3.1
Mortgage rate (30-year conventional, %)	6.8	6.7	6.6	5.8	5.4	5.4
West Texas Intermediate ($/barrel)	77.6	75.9	55.0	60.0	60.0	60.0
Henry Hub ($/MMBTU)	2.6	2.2	3.5	4.0	4.25	4.25

Five Sector Trends

1. Tax cuts and conformity create potential volatility

Achieving revenue forecasts provides a base for operational and financial performance. Through the first few months of fiscal 2026, most states are close to these targets. A closer look though, shows a divergence in the common revenue streams. Personal income tax (PIT) and sales taxes are holding or slightly rising, whereas corporate income taxes (CIT) are down, in many cases, meaningfully. CIT is not as large a component of the overall collection make-up, so this missed forecast is being offset with slight improvements to PIT and sales taxes. With the strong stock market performance in 2025, we're expecting most states will meet PIT forecasts for the rest of fiscal 2026.

As most states exceeded budgeted revenues in recent years, they were faced with the question of what to do with their accumulated surpluses. Many built up rainy day funds, while others made supplemental payments to pension or other postemployment benefit (OPEB) funds. Some states gave rebates and others initiated tax cuts (both temporary and permanent). We're watching states with permanent tax cuts to see if the new tax structure will perform as expected in a slow economy, allowing them to achieve the forecast.

The federal tax and spending bill included many PIT and CIT federal internal revenue code changes and states conform to these new code provisions differently. State management teams estimate the CIT provisions will lower revenues by tens of millions to hundreds of millions, depending on the state. The first four months in fiscal 2026 are showing this to be the case. We're looking to see what 2026 legislative sessions hold for states as they tackle tax code conformity, and if revenue losses are recognized, whether they'll be replaced or expense changes evaluated.

2. Federal government policy changes are asking more of states

Federal policy directives that are designed to shift costs onto the states will add new operating pressure and further slow local economic expansion. This could slow growth from economically derived revenues and exacerbate expenditure line growth in state budgets, so both sides of the balance sheet will be affected. Tariff renegotiations, Supplemental Nutritional Assistance Program (SNAP) changes, Medicaid mandates and cost shifts, and rethinking the Federal Emergency Management Agency (FEMA) will all have the potential to affect ratings. We don't see tariffs as a major economic driver for states because their revenues are primarily derived from the U.S. domestic economy (income taxes, sales taxes, etc.), which S&P Global Ratings Economics projects will continue to grow. But some states with exposure to specific industries, such as agriculture and building materials, could come under unique pressure and all states will be affected should the new tariff regime lead to inflationary cost stress.

SNAP is already being affected. The tax and spending bill shifted administrative costs to the states (once a 50%-50% split, states now need to fund 75% of those costs), which could result in millions or tens of millions in new state costs that previously were federally covered. Furthermore, beginning in federal fiscal 2027, states could see reductions in allocations based on the error rates (a reporting measure tracking where the money is spent). This could result in tens of millions to hundreds of millions of lost federal revenues for the SNAP program, depending on the state. But states are improving reporting practices, updating software systems, and hiring up to reduce this ultimate cut. “Spend now to get more later” is a recurring theme.

The Congressional Budget Office estimates that the tax and spending bill will result in nearly $1 trillion less federal spending on Medicaid over the next decade. Many of these provisions may not affect state budgets for three-to-five years and full recurring impacts might be pushed even further into the future. These programmatic changes, among other items, include work requirements for recipients, limiting eligibility for segments of the population, phasing down or freezing provider tax rates at set limits for Medicaid expansion and non-expansion states, and limiting state-directed payment practices. These will result in fewer Medicaid enrollees, which could help control Medicaid cost growth, but with fewer people having insurance, county and rural hospitals may experience an increase in uncompensated care and seek financial support from statehouses.

In our view, the robust response from the federal government through FEMA during disaster events has been a credit stabilizing factor for state and local entities. Some proposals floated in this federal administration have included cost shifting to require greater contributions from state and local governments, making fewer disasters eligible for federal support, and even the complete elimination of FEMA. If costs for recovery fall more to states, counties, and cities, then that will reduce their current financial flexibility. We also believe that should the federal government play a diminished role in disaster response, the time to ultimate recovery in many areas will be longer, and this may strain internal liquidity or necessitate interim borrowing to facilitate recovery efforts. A slower recovery could also affect the tax base in many ways, including lost business taxes, reduced personal income taxes, and lower sales taxes over time.

3. Debt capacity and recent pension discipline provide near-term flexibility

States are entering 2026 with stable debt metrics (table 2). Although we expect debt and retirement liabilities will remain manageable for most states in the near term, fiscal pressures from retirement benefits promises are not equal among states. Ongoing risks, including economic and market volatility, aging infrastructure, health care inflation, and aging demographics affecting the public workforce could hinder recent progress without proactive capital planning and disciplined pension and OPEB governance. We also believe that the coming federal highway trust fund debate could lead to continued support for transportation projects.

Table 2

Median U.S. state debt affordability metrics (2020-2024)

	2020	2021	2022	2023	2024
Total governmental fund (TGF) debt service to TGF revenue (%)	2.3	1.9	1.7	1.8	1.8
Net direct debt as a percentage of personal income	1.8	1.7	1.7	1.7	1.6
Net direct debt as a percentage of real GSP	1.7	1.6	1.5	1.4	1.8
Net direct debt per capita (mil. $)	932	1000	1006	1067	1056

Source: S&P Global Ratings.

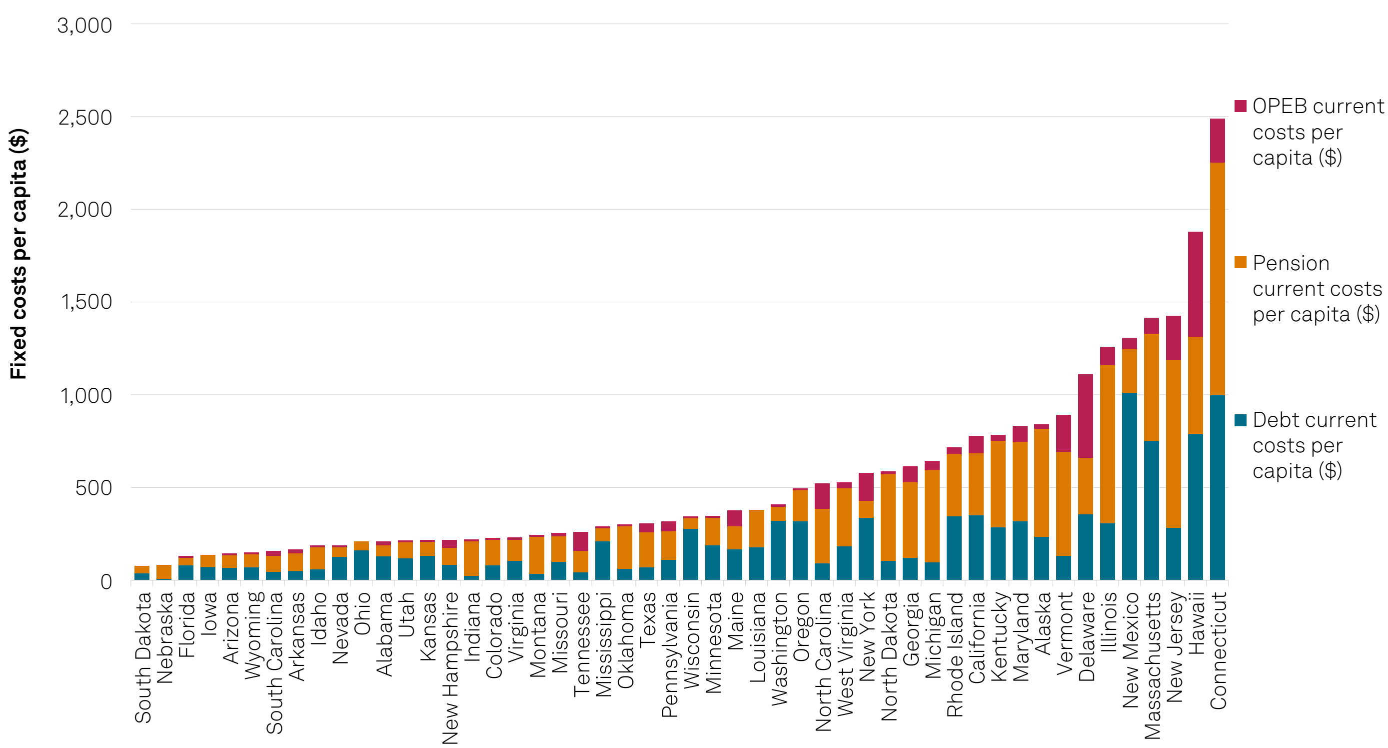
Not all states have the same fixed costs flexibility. The median aggregate carrying cost per capita for debt, pension, and OPEB in fiscal 2024 was $331, but seven states exceed $1,000 per capita (chart 1). We believe that the higher the amount, the less financial flexibility a state may have to address future costs. We continue to monitor the growth of alternate assets in pension fund holdings. This growth is occluding risks within an asset allocation structure, as reporting is limited.

For more on state fixed cost obligations, see "Debt Eases, Pension And OPEB Funding Up In 2024: U.S. States Gain Ground, Complex Challenges Remain," Oct. 22, 2025.

Chart 2

U.S. states' fixed costs per capita for fiscal 2024

(median fixed costs per capita in 2024 = $331)



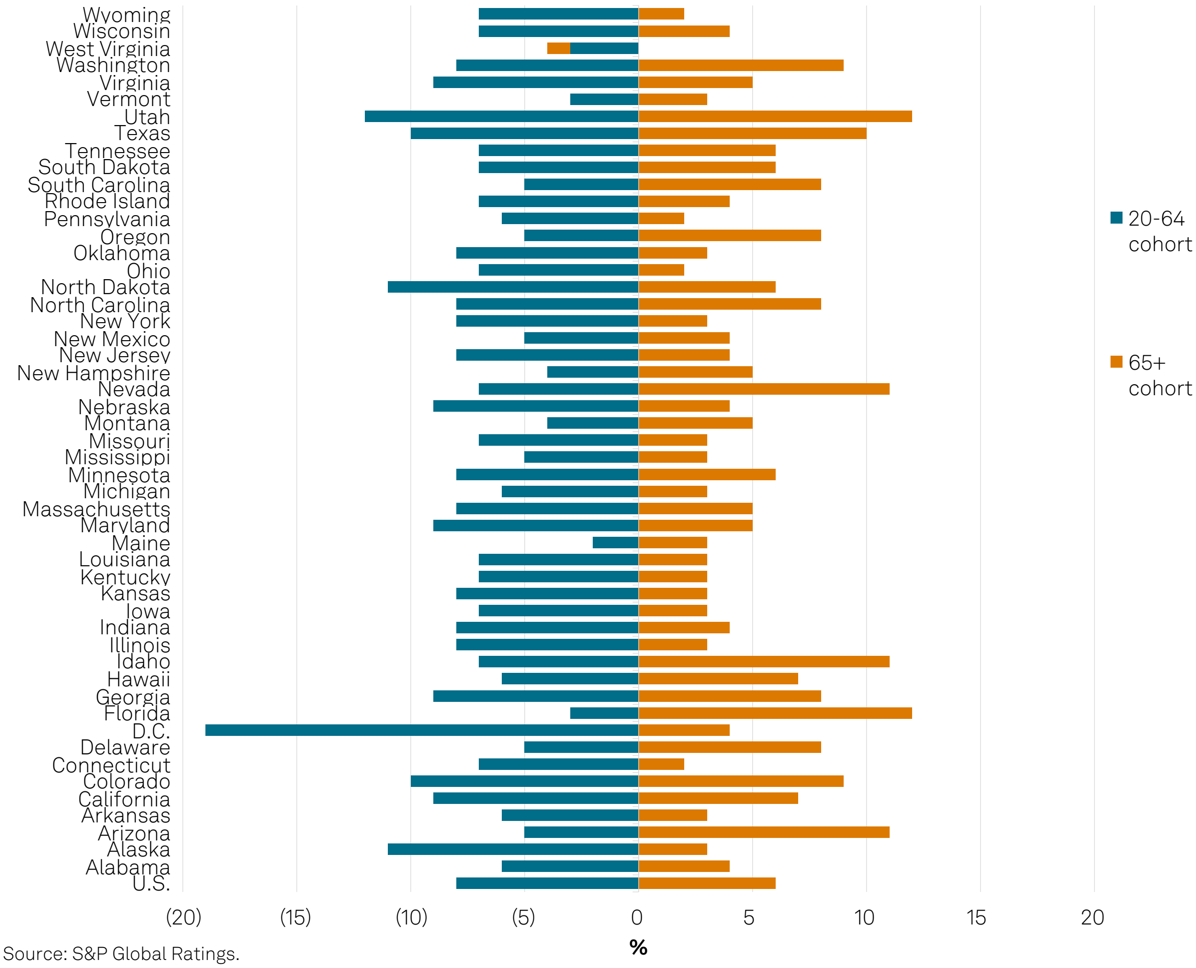
Source: S&P Global Ratings. *2024 annual comprehensive financial reports are unavailable for Arizona, Illinois, Mississippi, Nevada, Oklahoma. For these states, S&P Global Ratings carried forward certain debt, pension, and OPEB costs from fiscal 2023.

4. Demographic challenges of an aging and slower-growing nation

We see global aging as a mega-trend in ratings, with the potential to affect all entities. One of the reasons GDP growth is slowing is that any productivity gains will not be able to fully overcome likely labor shortages. As the population ages, fewer will work the longer hours and as the federal immigration policy continues to ramp up, there won't be the foreign backfill of jobs to the same extent that there was previously. Like pension pressures, risks evolving from aging are not equal among states, with those projecting to have steady growth having an advantage.

Chart 3

Change in proportion of population



Source: S&P Global Ratings.

In addition, an older population typically has a fixed income source and is less likely to change jobs or housing. The 65+ cohort also requires different services, both governmental and health care related, driving different state financial and debt decisions than those for younger people. According to the U.S. Census Bureau, the U.S. population will peak in 2080 and then diminish, but the growth rate is already falling, and by 2100, the share of the population over 65 will be about 30% of the total, compared with just 17% today. This aging and slowing population will create program needs and service delivery level changes that will stress state budgets in the years to come. For more, see "Changing Demographic Trends Could Affect U.S. Public Finance Issuers' Creditworthiness In Varying Ways," June 26, 2025.

5. Energy states' growth trajectory is changing

The recent pace of GDP growth in states with larger mineral-producing segments is slowing. In recent years, active financial management and budgetary discipline conditioned by previous oil and gas price swings have preserved, and in some cases strengthened, overall credit quality. S&P Global Ratings Economics expects an energy sector slowdown, with lower prices for commodities than in recent years. With economic growth trends normalizing, some of these states likely will lag peers in 2026, as we don't expect meaningful sector employment gains based on short-term production forecasts and current sector productivity. For more information, see "Swirling Economic Winds Keep Mineral-Producing U.S. States On Their Toes," March 19, 2025.

Ratings Performance

Table 3

State GO rating actions in 2025

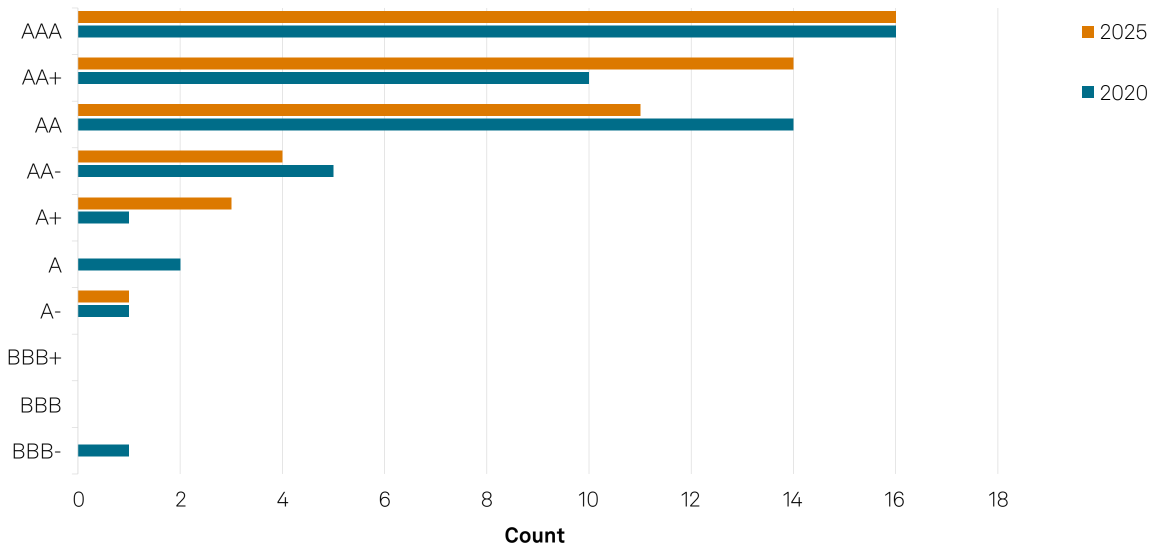
State	Date	Action	Rating	Outlook
Kansas	3/19/2025	Outlook revision	AA-	Stable
Oklahoma	3/26/2025	Upgrade	AA+	Stable
Arkansas	5/15/2025	Upgrade	AA+	Stable
New Jersey	8/11/2025	Upgrade	A+	Stable
Wyoming	9/11/2025	Upgrade	AA+	Stable
Arizona	9/24/2025	Outlook revision	AA	Stable
Washington	10/17/2025	Outlook revision	AA+	Stable
West Virginia	10/21/2025	Outlook revision	AA-	Positive
Pennsylvania	11/14/2025	Outlook revision	A+	Stable

We took more favorable state rating actions in 2025, continuing the trend from the prior three years, but made more unfavorable outlook revisions as well. We upgraded four states and revised the outlook on one to positive, whereas we revised the outlook to stable from positive on four states: Arizona, Kansas, Pennsylvania, and Washington. Mississippi remains the only state with a negative outlook. Mississippi and West Virginia are the only states with non-stable outlooks.

Chart 4

State rating distribution 2020 vs. 2025

As of Dec. 1, 2025



Source: S&P Global Ratings.

Related Research

- From Surge To Steady: U.S. States And Transportation Sales Tax Trends Reflect Moderate Growth, Nov. 3, 2025
- Debt Eases, Pension And OPEB Funding Up In 2024: U.S. States Gain Ground, Complex Challenges Remain, Oct. 22, 2025
- Credit FAQ: The Changing U.S. Federal-State Relationship's Impact On State Credit Quality, Sept. 24, 2025
- Changing Demographic Trends Could Affect U.S. Public Finance Issuers' Creditworthiness In Varying Ways, June 26, 2025
- Federal Disaster Relief Funding Proposals Could Elevate Credit Risks For U.S. Governments, June 4, 2025
- Swirling Economic Winds Keep Mineral-Producing U.S. States On Their Toes, March 19, 2025

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