# Office of Fiscal Analysis

FY 26 Recessionary Stress Test – Governor's Budget February 24, 2025

**Overview**

The Office of Fiscal Analysis (OFA) has updated a methodology for performing a stress test to estimate the State's preparedness in the event of a recession. The stress test provides an analysis of how well the Budget Reserve Fund (BRF), the Volatility Cap, and the Revenue Cap protect the state against recession. We use three different recession scenarios: the 2002 dot-com recession, the 2008 Great Recession, and an example median recession between the 2002 and 2008 recessions. The Stress Test covers the 2 years of the FY 26 and FY 27 Biennium. Please note recessions may cause significant budgetary stress beyond the immediate two-year impact which are not covered in this test. Other key considerations and assumptions are discussed below.

**Recession Protection**

In Millions of Dollars

| | Current Law | Governor | Difference |
|---|---|---|---|
| **Total Recession Protection** | **7,442** | **6,848** | **(593)** |
| Budget Reserve Fund | 4,231 | 4,231 | - |
| Revenue and Volatility Caps | 3,211 | 2,617 | (593) |

## GOVERNOR'S PROPOSED CHANGES

The Governor proposed changes to the volatility cap which would increase the threshold by $289 million in FY 26 and $305 million in FY 27, for a total of $593 million across the biennium.

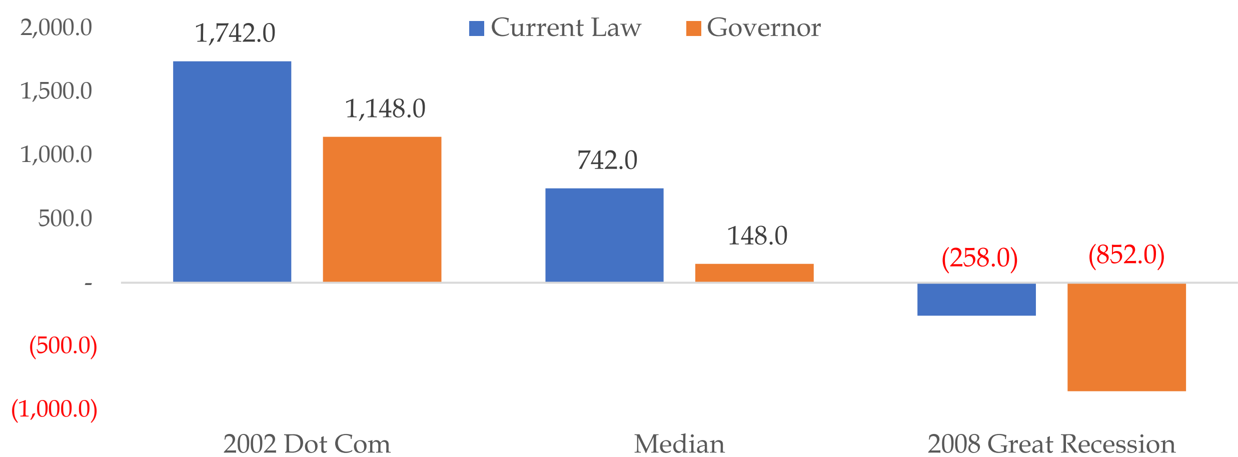
**Stress Test**

In Millions of Dollars

| Stress Test Results | Dot Com Recession | Median Recession | Great Recession |
|---|---|---|---|
| **Recession Scenarios** | **5,700** | **6,700** | **7,700** |
| Current Law Result | 1,742 | 742 | (258) |
| Governor's Proposal Result | 1,148 | 148 | (852) |

**Two-Year BRF Estimated Balance Post-Stress Test**

In Millions of Dollars



## KEY CONSIDERATIONS AND ASSUMPTIONS OF VARIABLES

There are many aspects of a recession that may be worth considering outside the scope of this analysis. In addition, there are major variables and assumptions being made that may significantly alter the stress of a recession which are covered below.

**Key Considerations and Variables**

1. Federal Response
2. Developing Recession Scenarios
   a. Expenditure Growth
3. Time Frame of Analysis
   a. Short-term Impact, 2-Years
   **b.** Long-term Structural Impact, 3-Years and Beyond
4. Managing Caps During Crisis
5. Foundation of Estimates
   **a.** January Consensus

**Federal Response**

The analysis does not include any federal response to the recession. In the past the federal government has provided aid to states in various ways which may significantly lower the overall stress of a recession. Typically, the larger the recession the more help the federal government has provided. This analysis also does not make any assumptions about potential changes from the federal government that reduce overall aid they provide.

**Developing Recession Scenarios**

The recession scenarios are based on an estimate of revenue that is lost compared to the prior year as well as forgone revenue growth which is no longer realized due to the recession. This allows for a relatively moderate amount of expenditure growth ($500 million per year) within a recession. During any budget year there may be expenditure growth pressure which is not covered by this analysis.

**Time Frame of Analysis & Long-term Structural Impact of Recessions**

The stress test only covers a two-year period of a recession where revenues are assumed to decline significantly from the prior year and then remain relatively low in the second year. The third and fourth years of a recession may also result in significant budgetary stress which is outside the scope of this stress test. Recessions typically create long-term structural issues which may require long-term solutions beyond the capacity of the BRF and Caps. Larger Caps and balances in the BRF may help provide the state more time to find solutions to these structural issues, but they do not fix them in the long term.

**Managing Caps During Crisis**

The caps are subject to provisions in statute that place limits on how they can be changed. The stress test analysis assumes that the caps are either turned off or effectively turned off during the two years of the analysis. In addition, the caps may cause additional budgetary stress in year 3 and 4 if they are unable to be turned off.

**Foundation of Estimates**

The estimates are based off January 2025 consensus and may not fully encompass all provisions of a particular budget proposal. For example, the analysis does not include changes to the revenue cap or the BRF balance to account for changes in revenue and appropriations in specific budget proposals. In addition, the estimates may need to be updated based on April 2025 consensus. Revenue cap calculations are based on both the General and Transportation Fund estimates in consensus.