

**SECTOR COMMENT**

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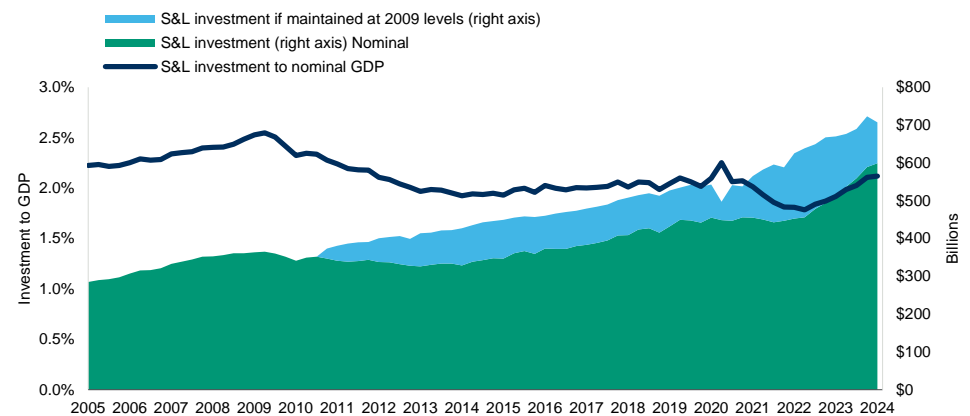
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State and Local Government - US

**Infrastructure investment reaches new high but inflation erodes gains**

On 30 May, the US Bureau of Economic Analysis in its updated GDP report showed that state and local government infrastructure investment is on pace to reach nearly \$600 billion annually, a record nominal value after a prolonged period of slow spending growth. Despite this recent increase, relative to GDP, infrastructure investment is still below historical averages (see Exhibit 1) and is not keeping pace with economic growth. Persistent shortfalls in infrastructure investment will raise costs for essential projects in the future, a credit negative for the sector.

Exhibit 1  
**State and local government infrastructure investment relative to GDP rebounded recently**

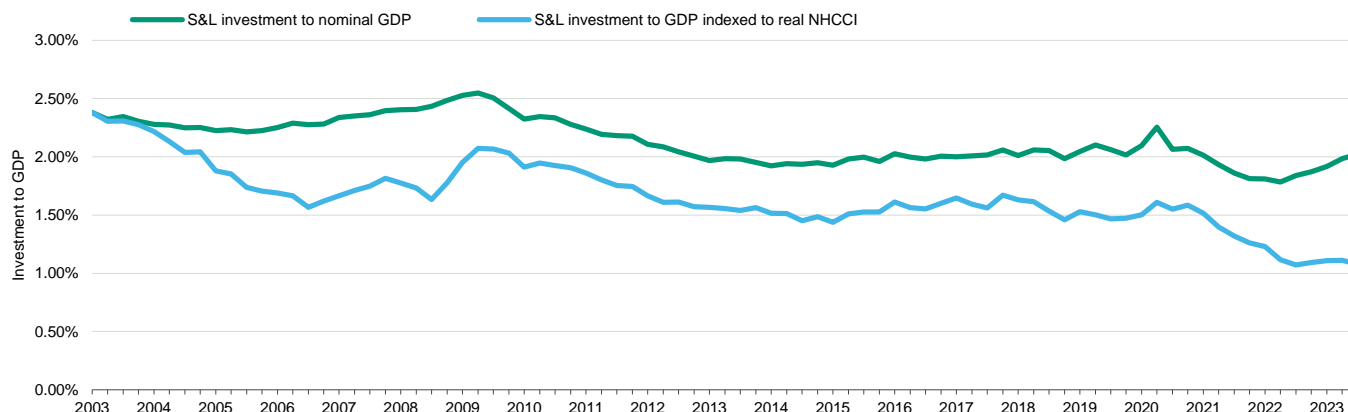


Source: Bureau of Economic Analysis

Adjusted for inflation, state and local government investment is falling even further behind (see Exhibit 2). Based on the [National Highway Construction Cost Index \(NHCCI\)](#) produced by the US Department of Transportation's Federal Highway Administration, state and local infrastructure investment has been falling in real terms for many years and fell precipitously between 2022 and 2024. The index measures the average change over time in the prices paid by state transportation departments for roadway construction materials and services and is a better proxy for price changes in road-related infrastructure investment than the Consumer Price Index. Despite broad-based inflation eroding buying power in the economy, government entities making infrastructure investments are facing even worse price inflation, which will either delay essential projects to keep budgets intact or will require making difficult trade-offs with other budget priorities.

Exhibit 2

**Inflation is eroding state and local government infrastructure investment gains**



Sources: Federal Highway Administration and Bureau of Economic Analysis

This rapid deterioration in real buying power for government infrastructure investment brings real spending down to 1% of GDP – two-thirds of what it was just four years ago. While there are myriad contributors to inflation, asphalt, a petroleum dependent sector, and grading and excavation are consistently the biggest drivers. In the third quarter of 2023, NHCCI grew by nearly 8%, with 4% coming from asphalt and 2% due to grading and excavation.

Inflation also mutes the impact of the 2021 [Infrastructure Investment and Jobs Act](#) (IIJA). According to the Bureau of Transportation Statistics (BTS), more than half (56%) of the \$380 billion of funding is for highway infrastructure. While the funds have been approved, they will be expended on a reimbursement basis in the coming years. This means that inflation will further increase costs and reduce the law's impact. The BTS estimates that construction cost inflation at 2021 and 2022 levels could erode the buying power of the IIJA funding for highways by as much as 40%.

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