February 15, 2019

MEMORANDUM

TO:	Representative Patricia Lundstrom, Chair, House Appropriations and Finance Committee Representative Jim Trujillo, Chair, House Taxation and Revenue Committee Senator John Arthur Smith, Chair, Senate Finance Committee
FROM:	Staff Economists of the Legislative Finance Committee, Taxation and Revenue Department, Department of Finance and Administration, and Department of Transportation
SUBJECT:	**Consensus Revenue Estimating Group – 2019 Mid-Session Review of Revenues**

Prior to the mid-point of each legislative session, the Consensus Revenue Estimating Group (CREG) meets to review updated economic indicators and the most recent tax receipt data to determine whether the consensus revenue estimate warrants updating. This memorandum summarizes the work and conclusions of the CREG, comprised of economists from the Legislative Finance Committee (LFC), the Department of Finance and Administration (DFA), the Taxation and Revenue Department (TRD), and the Department of Transportation (DOT).

After careful review of information newly available since the December 2018 forecast, CREG reached consensus to make no changes to the December 2018 forecast. The CREG would caution that even though the forecast remains unchanged, there are upside and downside risks to this forecast.

December 2018 Consensus General Fund, **Recurring Revenue Outlook** (in millions of dollars)

FY18	FY19	FY20	FY21
$6,816.5	$7,590.0	$7,433.1	$7,668.7

In the December 2018 revenue forecast, FY19 ending reserve balances were projected to be 40 percent, and FY20 "new money" – defined as FY20 recurring revenues less FY19 recurring appropriations – was estimated at $1.1 billion, or 17 percent.

To determine potential changes in the forecast, CREG reviewed estimates for general sales taxes (including gross receipts and compensating tax), selective sales taxes (including motor vehicle, tobacco, liquor, and others), income taxes (including personal and corporate income), severance taxes, interest earnings, tribal revenue sharing, and rents and royalties. CREG also reviewed an additional quarter of actual receipts data, which indicated the state is tracking closely with the December 2018 consensus estimate.

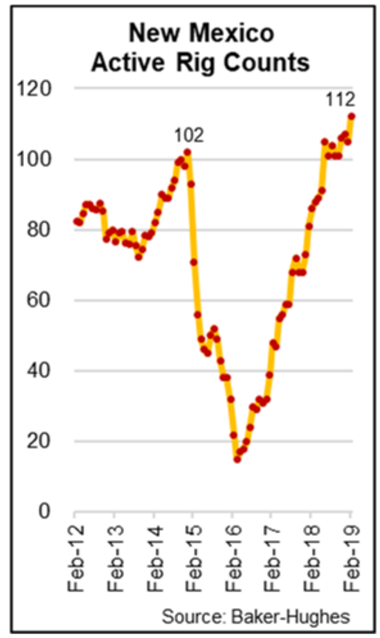
CREG also considered revised national economic indicators – including gross domestic product (GDP), inflation rates, exchange rates, commodity prices, and the federal funds rate – as well as revised New Mexico economic indicators – including growth in employment, personal income, total wages and salaries, housing permits, initial unemployment claims, and gross state product.

The Bureau of Business and Economic Research's estimate for New Mexico's non-agricultural employment growth in FY19 is 1.4 percent, unchanged from the December 2018 estimate. Nominal personal income growth is now forecast at 3.2 percent in FY19, down slightly from a previous forecast of 3.4 percent.

Changes in forecasts for oil and natural gas volumes and prices were incorporated into the review based on five months of New Mexico data. While projected prices were revised down for FY19 and FY20, volumes expectations were revised up significantly, resulting in expected increases in severance taxes and federal royalty payments. These increases largely offset downward revisions in other line items such as permanent fund distributions due to poor stock market performance in December 2018 and lowered gross receipts tax expectations in future fiscal years.

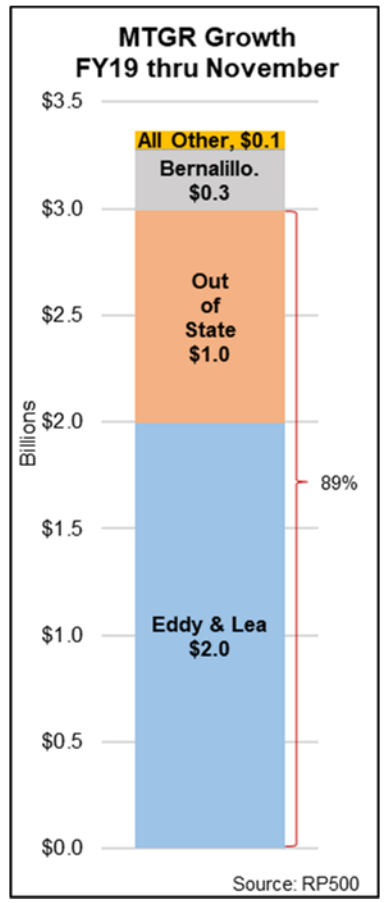
After careful review of additional monthly revenues and new economic data, CREG determined that the December 2018 consensus forecast remains a valid estimate of projected revenues and is not releasing a new estimate. The various increases and decreases would largely negate each other, and any remaining difference would be negligible compared with total revenues and in light of the significant uncertainty regarding economic conditions. However, the additional data confirmed many prior assumptions and expectations, including the state's significant and growing reliance on the energy industry for general fund revenues.

Oil and Natural Gas Production. Oil production continues to grow at a rapid pace, increasing 45.5 percent in the first five months of FY19 over the same period a year ago. Despite oil price declines in November and December 2018, rig counts exceeded the previous peaks of late 2014 and continued to grow, with the state reaching 112 active rigs by early February 2019. Even with modest production growth assumptions for the remainder of FY19, oil production in the state is on track to reach 275 million barrels this fiscal year. While oil prices are expected to remain below previous estimates, New Mexico oil production is estimated to grow to 310 million barrels, or by nearly 13 percent, in FY20. Natural gas production, particularly from southeastern wells, continues to exceed expectations, leading to increased natural gas volume expectations for FY19 and FY20.



Although oil prices fell nearly $30 from October to December 2018 before recovering to the mid-$50s in early 2019, the state's oil production and rig counts did not respond in the same ways the state experienced in the past. Oil producers in the Permian basin have significantly lowered break-even costs, meaning many wells can remain profitable at lower prices. Additionally, technological efficiencies and a significant rise in drilled-but-uncompleted wells, as well as new pipelines, allow for production increases even if future rig counts plateau.

Gross Receipts Taxes (GRT). Production growth and rising rig counts continue to drive increases in gross receipts. For FY19 through November 2018, Eddy and Lea Counties and out-of-state receipts account for 89 percent of all growth in matched taxable gross receipts. Receipts in Eddy County are up 49 percent, and Lea County is up 60 percent. The rest of New Mexico experienced very little growth in the first five months of FY19. Bernalillo County grew 3.9 percent year-over-year, while the rest of the state grew less than 1 percent.



Oil Price Uncertainty. The state's considerable dependence on direct and indirect oil and gas revenues means the forecast remains at risk of sudden oil price shocks that could lead to dramatic increases or decreases in revenues from severance taxes, federal royalty payments, gross receipts tax, and corporate income tax. This adds significant uncertainty to the revenue forecast. Stress tests of the December 2018 consensus estimate showed revenues could come in $1.3 billion above or below projections depending on oil price changes and associated impacts on production and drilling activity.

Global Economic Uncertainty. Signs of slowing growth in China, rising uncertainty over a U.S.-China trade war, concerns over Brexit negotiations, and fears that the Federal Reserve's expected rate increases will slow U.S. growth are all contributing to waning confidence in the strength of the global expansion. Despite the warning signs of a potential global slowdown, major forecasting agencies continue to have solid U.S. growth projections for 2019.

National Economy. Forecasts by IHS Global Insight estimate the federal government shutdown that started December 23 and ended January 25 reduced GDP by 0.1 percentage point in the fourth quarter of 2018 and first quarter of 2019. While the impacts of the federal shutdown are still unknown, New Mexico will likely see an impact on its personal income tax (PIT) and GRT revenues, as about 3 percent of the state's working population is employed by the federal government, and more are employed through federal contracts. Federal initial unemployment claims grew from 18 the week before the shutdown to 182 by mid-January, and non-federal initial unemployment claims jumped from 892 the week before the shutdown to 1,664 by mid-January. While furloughed federal employees can expect back pay for the withheld compensation, some private-sector entities that lost business due to the shutdown will never recoup that lost income, leaving an unknown amount of lost income for those workers and subsequent losses in PIT revenue to New Mexico.

These impacts and risks validate previous concerns and demonstrate the need for robust general fund reserve levels.

U.S. and New Mexico Economic Indicators

		FY18		FY19		FY20		FY21		FY22		FY23	
		Dec 18 Forecast	Jan 19 Forecast	Dec 18 Forecast	Jan 19 Forecast	Dec 18 Forecast	Jan 19 Forecast	Dec 18 Forecast	Jan 19 Forecast	Dec 18 Forecast	Jan 19 Forecast	Dec 18 Forecast	Jan 19 Forecast
	National Economic Indicators												
GI	US Real GDP Growth (annual avg.,% YOY)*	2.6	2.6	3.0	2.9	2.4	2.2	1.8	1.7	1.5	1.5	1.5	1.5
GI	US Inflation Rate (CPI-U, annual avg., % YOY)**	2.2	2.2	2.5	2.0	2.3	2.4	1.9	2.4	2.3	2.5	2.3	2.2
GI	Federal Funds Rate (%)	1.4	1.4	2.3	2.3	3.2	2.8	3.4	3.1	3.4	3.1	3.4	3.1
	New Mexico Labor Market and Income Data												
BBER	NM Non-Agricultural Employment Growth (%)	0.9	0.9	1.4	1.4	1.5	1.4	1.3	1.3	1.2	1.3	1.0	1.1
BBER	NM Nominal Personal Income Growth (%)***	2.4	2.4	3.4	3.2	4.3	4.2	4.1	4.1	4.6	4.5	4.5	4.2
BBER	NM Total Wages & Salaries Growth (%)	3.4	3.3	4.1	3.7	4.8	4.8	4.7	4.5	4.5	4.2	4.2	3.8
BBER	NM Private Wages & Salaries Growth (%)	4.4	4.4	4.8	4.6	5.1	4.7	5.3	4.9	5.0	4.6	4.7	4.2
BBER	NM Real Gross State Product (% YOY)	2.1	0.8	2.8	2.8	2.3	1.7	1.9	1.4	1.7	1.3	1.6	1.2
BBER	Oil Volumes (million barrels)	203.6	204.8	247.9	254.8	284.5	287.9	307.2	310.9	320.9	325.2	336.4	340.8
BBER	Gas Volumes (billion cubic feet)	1,318	1,299	1,409	1,446	1,443	1,472	1,443	1,477	1,443	1,493	1,465	1,509

Notes
* Real GDP is BEA chained 2009 dollars, billions, annual rate
** CPI is all urban, BLS 1982-84=1.00 base
***Nominal Personal Income growth rates are for the calendar year in which each fiscal year begins
Sources: BBER - January 2019 FOR-UNM baseline. IHS Global Insight - January 2018 baseline.