

January 30, 2020

MEMORANDUM

TO: Representative Patricia Lundstrom, Chair, House Appropriations and Finance Committee
Senator John Arthur Smith, Chair, Senate Finance Committee
Representative Jim Trujillo, Co-Chair, House Taxation and Revenue Committee
Representative Javier Martinez, Co-Chair, House Taxation and Revenue Committee

FROM: Staff Economists of the Legislative Finance Committee, Taxation and Revenue Department, Department of Finance and Administration, and Department of Transportation

THROUGH: Secretary Olivia Padilla-Jackson, Department of Finance and Administration
Secretary Stephanie Schardin Clarke, Taxation and Revenue Department
Director David Abbey, Legislative Finance Committee

SUBJECT: Consensus Revenue Estimating Group – 2020 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 new economic data available since the December 2019 forecast, the CREG reached consensus to make no changes to the December 2019 forecast. The CREG would caution that revenue volatility remains a major forecasting challenge.

December 2019 Consensus General Fund, Recurring Revenue Outlook (in millions)

<u>FY19</u>	<u>FY20</u>	<u>FY21</u>	<u>FY22</u>
\$8,009.5	\$7,776.4	\$7,882.5	\$8,015.2

In the December 2019 revenue forecast, FY20 ending reserve balances were projected to be 34 percent pending 2020 regular session appropriations, and FY21 “new money” – defined as FY21 recurring revenues less FY20 recurring appropriations – was estimated at \$797 million.

To determine potential changes in the forecast, the 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.

The CREG also reviewed two additional months of actual receipts data and 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.

Moody's Analytics and IHS Markit made minimal changes to their macroeconomic forecasts, with GDP growth in FY20 expected at 2.1 percent, up from 2 percent in the prior forecast. The Bureau of Business and Economic Research's estimate for New Mexico's non-agricultural employment growth in FY20 is 1.5 percent, down slightly from the prior estimate, and FY21 employment growth is estimated at 1.2 percent, unchanged from the prior estimate.

Changes in forecasts for oil and natural gas volumes and prices were considered in the review. Production expectations are higher based on two new months of data, resulting in expected increases in severance taxes and federal royalty payments. These increases were partially offset by a downward outlook in other line items, such as interest earnings on treasury balances due to market performance and lowered expectations for insurance premiums tax and corporate income tax receipts that are currently tracking below the forecast.

After careful review of additional monthly revenues and new economic data, the CREG determined the December 2019 consensus forecast remains a valid estimate of projected revenues. The various increases and decreases largely negate each other, and any remaining difference would be negligible compared with total revenues and in light of the uncertainty regarding economic conditions. However, various risks to the forecast remain— both on the upside and downside.

Oil and Natural Gas Variance. The state's considerable dependence on oil- and gas-related revenues means the forecast is sensitive to changes in commodity prices and produced volumes that directly or indirectly affect revenues from severance taxes, federal royalty payments, gross receipts tax, personal income tax, and corporate income tax. This adds significant uncertainty to the revenue forecast. Regarding prices, a \$1 change in the annual average price of New Mexico's oil has about a \$22 million direct impact on the general fund, and a 10 cent change in the annual average prices of New Mexico's natural gas has about a \$17 million direct impact on the general fund. Oil prices are inherently volatile and difficult to predict, and the state continues to face depressed natural gas prices due to pipeline capacity constraints in the Permian Basin.

The consensus estimates for oil volumes assume New Mexico oil prices in the low-\$50s over the forecast horizon. Should prices fall or rise below or above those prices, the volume forecasts and associated revenues could also change. Each additional million barrels of oil generates about \$3 million for the general fund, and each additional 10 billion cubic feet of natural gas generates about \$2 million for the general fund. This means there is significant upside risk to the forecast if production is higher than expected, and significant downside risk if production is lower than expected.

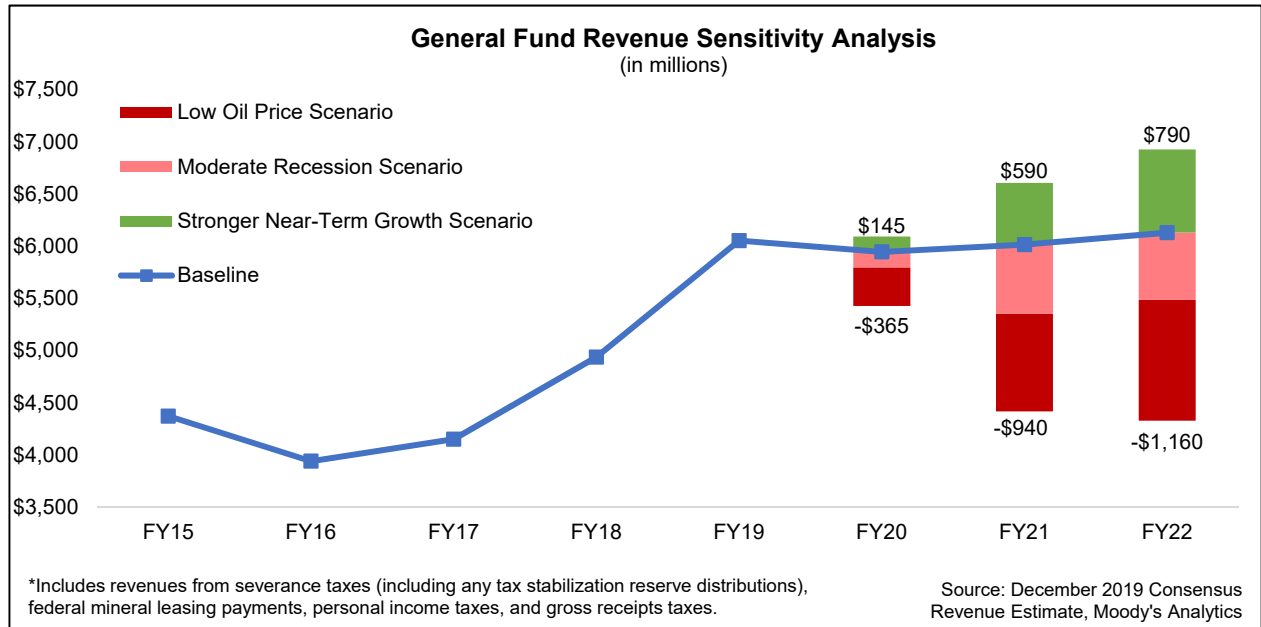
Global Economic Uncertainty. Major forecasting agencies continue to have solid U.S. growth projections for 2020 and 2021. However, some external forecasting agencies have signaled concern for a recession occurring as soon as 2020. Among the most often cited reasons that the economy might shrink are: slowing growth abroad that could worsen, particularly in Europe and China; a worse outcome for Brexit than is expected; an escalation in tariff disputes; geopolitical risks; worsening global economic confidence; tightening employment conditions; and domestic policy choices.

Tax Protests. While currently available tax refund claim protest data is insufficient to estimate the value or timing of risk, tax abatement and refund claim protests are a downside risk to the forecast. Protests decided in favor of the taxpayer could result in large general fund losses.

Stress-Testing. The CREG reviewed changes in underlying assumptions in the December 2019 estimate to determine the sensitivity of select revenues – including severance taxes, federal mineral leasing payments, personal income taxes, and gross receipts taxes – based on three scenarios: (1) low oil price and low production, (2) moderate recession, and (3) stronger near-term economic growth.

On the upside, the combined effect of the stronger near-term growth scenario for FY21 and FY22 is an additional \$1.4 billion above the current estimate. Conversely, the combined effect of the low oil prices scenario on FY21 and FY22 is \$2.1 billion below the current estimate, and the combined effect of the moderate recession scenario on those two fiscal years is \$1.3 billion.

While the revenue estimates cannot reasonably account for the various forecast risks, policymakers can prepare for these risks by maintaining robust general fund reserve levels.



U.S. and New Mexico Economic Indicators

		FY19		FY20		FY21		FY22		FY23	
		Dec 19 Forecast	Jan 19 Forecast	Dec 19 Forecast	Jan 19 Forecast	Dec 19 Forecast	Jan 19 Forecast	Dec 19 Forecast	Jan 19 Forecast	Dec 19 Forecast	Jan 19 Forecast
National Economic Indicators											
IHS	US Real GDP Growth (annual avg., % YOY)*	2.6	2.6	2.0	2.1	2.2	2.2	1.7	1.9	1.5	1.6
Moody's	US Real GDP Growth (annual avg., % YOY)*	2.6	2.6	2.0	2.1	1.5	1.7	2.9	2.6	2.5	2.5
IHS	US Inflation Rate (CPI-U, annual avg., % YOY)**	2.1	2.1	2.0	2.0	1.6	1.5	2.2	2.3	2.5	2.5
Moody's	US Inflation Rate (CPI-U, annual avg., % YOY)**	2.1	2.1	1.8	2.1	2.3	2.3	2.4	2.4	2.3	2.3
IHS	Federal Funds Rate (%)	2.2	2.2	1.8	1.8	1.8	1.6	2.3	2.0	2.5	2.3
Moody's	Federal Funds Rate (%)	2.2	2.2	1.8	1.7	1.4	1.6	2.0	2.0	2.7	2.7
New Mexico Labor Market and Income Data											
BBER	NM Non-Agricultural Employment Growth (%)	1.5	1.5	1.7	1.5	1.2	1.2	1.0	1.1	0.8	0.8
Moody's	NM Non-Agricultural Employment Growth (%)	1.4	1.4	1.9	1.8	0.1	0.5	0.4	0.6	0.9	0.6
BBER	NM Nominal Personal Income Growth (%)***	3.8	3.8	5.7	5.3	3.8	4.0	4.5	4.8	4.2	4.5
Moody's	NM Nominal Personal Income Growth (%)***	4.6	4.6	4.6	4.5	2.8	3.1	3.6	3.7	4.1	4.0
BBER	NM Total Wages & Salaries Growth (%)	4.8	4.8	5.8	4.8	4.8	4.9	3.9	4.5	3.7	4.0
Moody's	NM Total Wages & Salaries Growth (%)	4.9	4.9	5.2	4.2	2.1	2.5	1.8	2.0	3.0	2.7
BBER	NM Private Wages & Salaries Growth (%)	5.5	5.5	5.4	5.1	4.7	5.1	4.1	4.9	4.0	4.4
BBER	NM Real Gross State Product (% YOY)	2.4	2.4	1.9	2.9	1.2	1.5	1.3	1.6	1.2	1.6
Moody's	NM Real Gross State Product (% YOY)	3.7	3.7	3.4	4.3	1.9	2.2	2.7	2.4	2.2	2.3

Notes

* Real GDP is BEA chained 2012 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

****The gross gas prices are estimated using a formula of NYMEX, EIA, and IHS Markit (November) future prices

*****The net oil and gas prices represent calculated prices based on taxable values of the product after deductions for transportation, processing, and royalties

Sources: BBER - January 2020 FOR-UNM baseline. IHS Global Insight - January 2020 baseline.

DFA Notes

* Real GDP is BEA chained 2012 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

****The gross gas prices are estimated using a formula of NYMEX, EIA, and Moody's January future prices

*****The net oil and gas prices represent calculated prices based on taxable values of the product after deductions for transportation, processing, and royalties

Sources: January 2020 Moody's economy.com baseline