

January 25, 2021

MEMORANDUM

TO: Representative Patricia Lundstrom, Chair, House Appropriations and Finance Committee
Senator George Muñoz, Chair, Senate Finance Committee

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

THROUGH: Secretary Debbie Romero, Department of Finance and Administration
Secretary Stephanie Schardin Clarke, Taxation and Revenue Department
Director David Abbey, Legislative Finance Committee

SUBJECT: **Consensus Revenue Estimating Group – 2022 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 2021 forecast, the CREG reached consensus to make no changes to the revenue estimate. The CREG would caution that revenue volatility remains a major forecasting challenge.

December 2021 Consensus General Fund, Recurring Revenue Outlook (in millions)

| <u>FY21</u> | <u>FY22</u> | <u>FY23</u> |
|-------------|-------------|-------------|
| \$8,085.2 | \$8,163.1 | \$9,049.1 |

In the December 2021 revenue forecast, FY22 ending reserve balances were projected to be 43.9 percent pending 2022 regular session appropriations, and FY23 “new money” – defined as FY23 recurring revenues less FY22 recurring appropriations – was estimated at \$1.599 billion.

To determine potential changes in the forecast, the CREG reviewed estimates for gross receipts and compensating tax, insurance premium taxes, income taxes (including personal and corporate income), severance taxes, interest earnings, and rents and royalties.

The CREG also reviewed two additional months of actual receipts data and considered revised national and local economic indicators including gross domestic product (GDP), inflation rates, commodity prices, wages, employment, personal income, and the federal funds rate.

Moody’s Analytics and IHS Markit made minimal changes to their macroeconomic forecasts, with average GDP growth estimated in FY23 at 3.5 percent, down from an average of 3.7 percent in the prior forecast. The Bureau of Business and Economic Research’s estimate for New Mexico’s non-agricultural employment growth in FY23 is 2.2 percent, down slightly from the prior estimate of 2.4 percent. The updated forecasts reflect a mostly similar economic environment as was considered in December 2021.

Changes in forecasts for oil and natural gas volumes and prices were considered in the review. Though prices fell significantly in December, they have since rebounded resulting in expectations similar to the previous forecast. Production expectations are higher based on two new months of data, resulting in anticipated increases in severance taxes and federal royalty payments. However, recent statutory reforms to those sources requires revenues in excess of the five-year average to be distributed to other funds. The distribution mechanism insulates the general fund from changes in revenues related to oil and natural gas, leading increased production expectations to result in little change to the general fund revenue estimate.

Gross receipts tax and personal income tax revenue expectations are higher based on three additional months of receipts, however significant uncertainty in both revenues warrants caution. Falling national consumption, rising inflation, the likelihood of federal reserve action on interest rates, and necessity of more data on destination-based sourcing impacts and associated significant changes to taxpayer behavior were sufficient reason against large changes to the gross receipts tax revenue forecast. Similarly, a slowing labor market, tight monetary policy, and market reactions to inflation counterbalance personal income tax strength in the first five months of the fiscal year.

The increased expectations in gross receipts and personal income tax revenue were also offset by a downward outlook in other line items, such as corporate income tax receipts currently tracking below the forecast and interest earnings on treasury balances expecting significant decreases due to market performance and an increasingly difficult investment environment.

For these reasons, the CREG determined the December 2021 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 inappropriate when considering the uncertain economic conditions.

Despite the unchanged estimate, 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 \$30 million impact on the severance tax and royalties, and a 10 cent change in the annual average prices of New Mexico’s natural gas has about a \$14 million impact. Oil and gas prices are inherently volatile and difficult to predict as is estimating production, which heavily depends on prices.

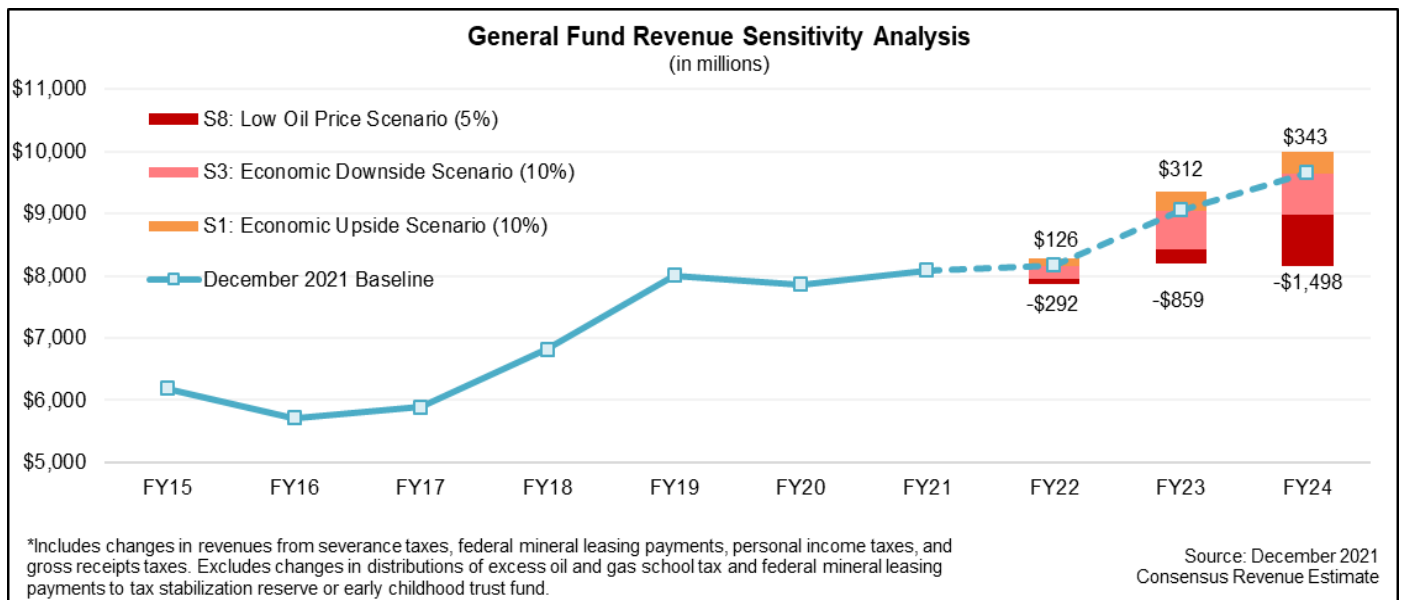
Pandemic Uncertainty and Recession Risks. Major forecasting agencies continue to have solid U.S. growth projections for 2022 and 2023. However, the U.S. economy could return to a recession and experience a slower recovery due to more severe COVID-19 strains, increased infections, or new containment measures, which would result in job losses and declines in consumer spending. Otherwise, tightening employment conditions, a tightening monetary policy, and inflation remain significant risks and could significantly hamper the economic recovery.

Other Significant Risks. Additional forecast risks include potential for uncapped growth in film tax credit payments due to New Mexico film partners, higher than expected municipal distributions and taxpayer amendments related to destination sourcing, state and federal regulatory changes that could affect oil and gas, and outstanding tax protest claims at TRD that could result in large general fund losses if decided in favor of the taxpayer.

Stress-Testing. The CREG reviewed changes in underlying assumptions in the December 2021 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 effect of the stronger near-term growth scenario on the general fund for FY22 through FY24 is an additional \$781 million above the current estimate. Conversely, the combined effect of the low oil prices scenario on the general fund for FY22 through FY24 is \$2.6 billion below the current estimate, and the effect of the moderate recession scenario for the same period is \$1.5 billion.

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



U.S. and New Mexico Economic Indicators

| | FY21 | FY22 | | FY23 | | FY24 | | FY25 | | FY26 | |
|---|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| | Jan 22 | Dec 21 | Jan 22 | Dec 21 | Jan 22 | Dec 21 | Jan 22 | Dec 21 | Jan 22 | Dec 21 | Jan 22 |
| | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast | Forecast |
| National Economic Indicators | | | | | | | | | | | |
| IHS US Real GDP Growth (annual avg., % YOY)* | 1.6 | 4.6 | 4.8 | 3.8 | 3.3 | 2.6 | 2.4 | 2.7 | 2.5 | 2.6 | 2.4 |
| Moody's US Real GDP Growth (annual avg., % YOY)* | 1.6 | 5.0 | 4.8 | 3.6 | 3.6 | 2.7 | 3.0 | 2.5 | 2.7 | 2.3 | 2.4 |
| IHS US Inflation Rate (CPI-U, annual avg., % YOY)** | 2.3 | 5.0 | 5.7 | 2.2 | 2.7 | 2.2 | 2.1 | 2.2 | 2.1 | 2.2 | 2.1 |
| Moody's US Inflation Rate (CPI-U, annual avg., % YOY)** | 2.3 | 5.2 | 6.0 | 2.5 | 2.9 | 2.3 | 2.2 | 2.3 | 2.3 | 2.3 | 2.4 |
| IHS Federal Funds Rate (%) | 0.1 | 0.1 | 0.1 | 0.2 | 0.9 | 0.6 | 1.5 | 1.3 | 2.0 | 2.0 | 2.3 |
| Moody's Federal Funds Rate (%) | 0.1 | 0.1 | 0.1 | 0.3 | 0.9 | 1.2 | 1.9 | 2.2 | 2.5 | 2.6 | 2.5 |
| New Mexico Labor Market and Income Data | | | | | | | | | | | |
| BBER NM Non-Agricultural Employment Growth (%) | -5.3 | 3.4 | 3.8 | 2.4 | 2.2 | 1.7 | 1.6 | 1.4 | 1.4 | 1.4 | 1.5 |
| Moody's NM Non-Agricultural Employment Growth (%) | -5.9 | 4.6 | 4.9 | 2.4 | 2.8 | 1.1 | 1.4 | 0.5 | 0.7 | 0.3 | 0.3 |
| BBER NM Nominal Personal Income Growth (%)*** | 7.8 | 5.1 | 6.7 | -4.6 | -3.8 | 4.6 | 4.8 | 4.9 | 5.1 | 5.2 | 5.2 |
| Moody's NM Nominal Personal Income Growth (%)*** | 7.8 | 6.2 | 7.5 | -0.8 | 1.0 | 4.9 | 4.9 | 4.7 | 4.7 | 4.4 | 4.5 |
| BBER NM Total Wages & Salaries Growth (%) | 2.7 | 3.5 | 6.7 | 5.7 | 5.5 | 4.4 | 4.6 | 4.5 | 4.7 | 4.4 | 4.7 |
| Moody's NM Total Wages & Salaries Growth (%) | 2.7 | 7.7 | 9.2 | 5.3 | 5.8 | 5.2 | 5.2 | 4.3 | 4.5 | 4.3 | 4.3 |
| BBER NM Private Wages & Salaries Growth (%) | 3.0 | 3.8 | 7.7 | 6.0 | 5.6 | 4.9 | 4.9 | 4.9 | 5.0 | 4.9 | 5.0 |
| BBER NM Real Gross State Product (% YOY) | 0.8 | 3.3 | 3.4 | 2.7 | 3.0 | 2.5 | 2.4 | 2.5 | 2.4 | 2.1 | 2.1 |
| Moody's NM Real Gross State Product (% YOY) | 0.8 | 5.7 | 3.8 | 3.6 | 3.4 | 2.6 | 2.7 | 2.1 | 2.3 | 2.1 | 2.2 |

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 - October 2020 FOR-UNM baseline. IHS Global Insight - November 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 Moodys 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 2022 Moody's economy.com baseline