

January 22, 2024

MEMORANDUM

TO: Representative Nathan Small, 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 Wayne Propst, Department of Finance and Administration
Secretary Stephanie Schardin Clarke, Taxation and Revenue Department
Director Charles Sallee, Legislative Finance Committee

SUBJECT: Consensus Revenue Estimating Group – 2024 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 (Tax & Rev), and the Department of Transportation (DOT).

After careful review of new economic data available since the December 2023 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 2023 Consensus General Fund, Recurring Revenue Outlook (in millions)

<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
\$11,589.7	\$12,767.8	\$13,047.8

In the December 2023 revenue forecast, FY24 ending reserve balances were projected to be 52.7 percent pending 2024 regular session appropriations, and FY25 “new money” – defined as FY25 recurring revenues less FY24 recurring appropriations – was estimated at \$3.479 billion.

To determine potential changes in the forecast, the CREG reviewed estimates for gross receipts and compensating tax, income taxes (both personal and corporate income tax), 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, active oil drilling rigs, wages, employment, personal income, and the federal funds rate.

Moody’s Analytics and S&P Analytics made minimal changes to their macroeconomic forecasts, with average GDP growth estimated in FY23 at 2.8 percent, up from an average of 2.0 percent in the prior forecast. The updated forecasts reflect a mostly similar economic environment as was considered in December 2023.

Changes in forecasts for oil and natural gas volumes and prices were considered in the review. Oil prices have fallen since the December estimate by \$2.50/bbl in the current year. However, production expectations are similar based on two new months of data. The combined effect would be small reductions in oil and gas direct revenues, but because of insulating measures enacted over the last several years, the general fund is largely shielded from the declines.

Investment revenue expectations in FY24 are higher based on two additional months of receipts, particularly from market valuations of the general fund investment pool. However, significant uncertainty in market expectations of interest rates warrants caution. The likelihood of federal reserve action on interest rates, the unpredictability of such actions, and market reactions to those announcements remain areas of significant risk.

In the gross receipts tax, two additional months of collections show revenues for the source are tracking slightly higher than the December estimate. Yet, a comparison of year-to-date revenue through November compared to the same period in the prior fiscal year illustrates revenue growth is moderating. Additionally, slowing national consumption, moderating inflation, and impacts due to destination-based sourcing were enough 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 this year. Such expectations in personal income and gross receipts tax revenue were largely offsetting and result in similar forecasts for each source as in December.

For these reasons, the CREG determined the December 2023 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 \$53.9 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 \$33.8 million impact. Oil and gas prices are inherently volatile and difficult to predict as is estimating production, which heavily depends on prices.

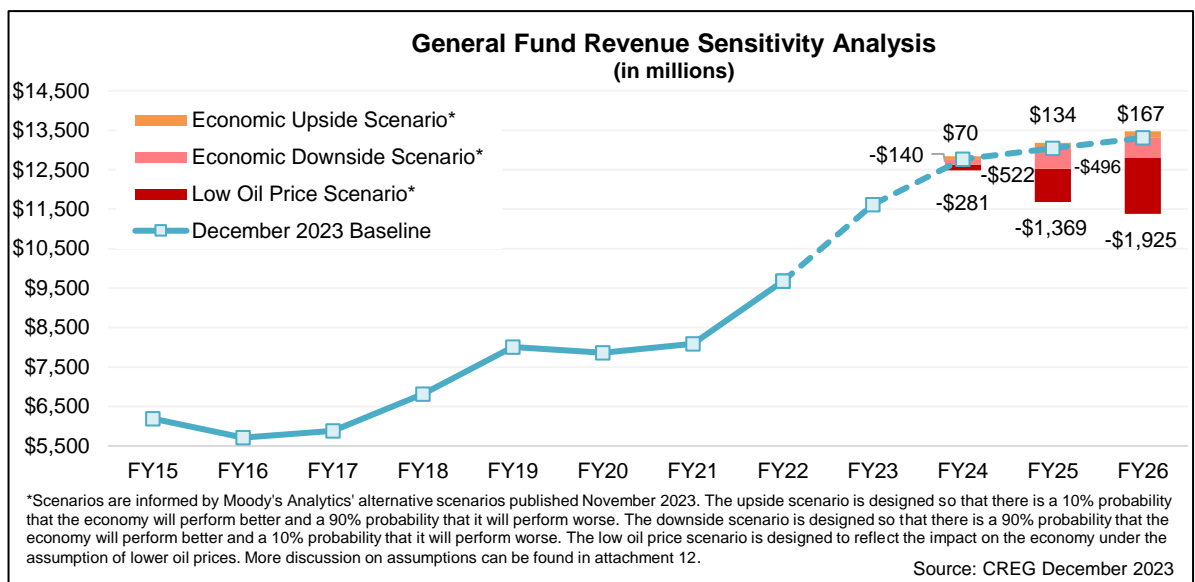
Recession Risks. Major forecasting agencies continue to have U.S. growth projections for 2024. However, the U.S. economy could fall into a recession and experience a slower recovery due to broadening conflicts in Ukraine and Israel, oil and gas fluctuations, eroding supply-chain conditions, sustained high inflation, slowing consumer spending, and rising defaults in commercial lending. Otherwise, tightening employment conditions, tightening monetary policy, and inflation remain significant risks that could significantly hamper economic recovery.

Other Significant Risks. Additional forecast risks include potential for uncapped growth in film tax credit payments due to New Mexico film partners, changes from the expected impacts of destination sourcing, taxpayer amendments, state and federal regulatory changes that could affect oil and gas, upcoming changes to the federal Tax Cuts and Jobs Act, outstanding tax protest claims at Tax & Rev that could result in large general fund losses if decided in favor of the taxpayer, and the potential federal government shutdown.

Stress-Testing. The CREG reviewed changes in underlying assumptions in the December 2023 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 cumulative effect of the stronger near-term growth scenario on the general fund for FY24 through FY26 is an additional \$371 million above the current estimate. Conversely, the cumulative effect of the low oil prices scenario on the general fund for FY24 through FY26 is \$3.58 billion below the current estimate, and the effect of the moderate recession scenario for the same period is \$1.2 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.



Scenario	S8: Low Oil Price			S3: Economic Downside			S1: Economic Upside		
	FY24	FY25	FY26	FY24	FY25	FY26	FY24	FY25	FY26
1 Severance Taxes to GF	-\$36	-\$437	-\$480	-\$8	-\$42	-\$25	\$2	\$4	\$5
2 Federal Mineral Leasing to GF	\$0	-\$217	-\$545	\$0	\$0	\$0	\$0	\$0	\$0
3 Gross Receipts Taxes	-\$182	-\$555	-\$712	-\$97	-\$322	-\$319	\$60	\$98	\$116
4 Personal Income Taxes	-\$62	-\$160	-\$188	-\$34	-\$158	-\$151	\$8	\$32	\$46
5 General Fund Difference from Baseline	-\$281	-\$1,369	-\$1,925	-\$140	-\$522	-\$496	\$70	\$134	\$167
6 General Fund Percent of Total Impact	25%	45%	55%	45%	31%	30%	35%	40%	38%
7 Severance Taxes to TSR or ECE	-\$499	-\$428	-\$130	-\$131	-\$428	-\$130	\$34	\$76	\$82
8 Severance Taxes to STPF	0	-\$252	-\$507	0	-\$116	-\$257	0	\$7	\$23
9 Federal Mineral Leasing to ECE	-\$345	-\$708	-\$284	-\$37	-\$636	-\$284	\$94	\$100	\$124
10 Federal Mineral Leasing to STPF	\$0	-\$293	-\$659	\$0	-\$7	-\$459	\$0	\$19	\$42
11 TSR/ECE Transfers Diff. from Baseline	-\$844	-\$1,681	-\$1,580	-\$168	-\$1,187	-\$1,130	\$128	\$201	\$272
12 TSR/ECE/STPF Transfers Percent of Total Impact	75%	55%	45%	55%	69%	70%	65%	60%	62%
13 Total Difference from Baseline	-\$1,125	-\$3,050	-\$3,505	-\$308	-\$1,709	-\$1,626	\$198	\$336	\$439

Note: in millions