

General Fund Consensus Revenue Estimates

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Introduction:

Today's revenue update reflects a healthy state economy that is weathering a world-wide recession. This forecast reflects reductions in revenues due to lower world oil prices and national natural gas prices, as well as the now well-known national financial crisis. The good news is that New Mexico still may be better off over the next two years than most of the nation.¹ Most states have been negatively impacted by the national circumstances – the collapse of the “housing price bubble,” mortgage foreclosures, a credit crunch, high food and energy prices, and the continued weakness of the dollar – to a greater extent than New Mexico. Other factors, such as the 40% decline in the value of shares traded on the New York Stock Exchange, the \$700 billion “bailout” of the nation's financial sector, and the largest one-month drop in consumer sentiment ever on the Michigan Consumer Sentiment Survey,² continue to have a nation-wide rippling affect. The consensus among economists is that the national gross domestic product (GDP) will have *at least* two consecutive quarters of negative growth in 2008:Q4 and 2009:Q1. The federal fiscal stimulus rebates delayed the decline, but did not dramatically reverse the path of the national economy. The key factor in this update to the revenue forecast is that natural gas and crude oil prices for FY09 and FY10 are expected to decline from the levels reported to this committee in the July and August 2008 consensus revenue forecasts. These prices and volumes are reported in the following table, which repeats a portion of Appendix Table 1.

¹ Federal Funds Information for States, VOLUME 26 ISSUE 18, September 2008, pp 2-9 . The five states with higher Index of State Economic Momentum are North Dakota, Texas, Wyoming, South Dakota and Oklahoma.

² Chicagotribune.com, October 17, 2008, quoting Dow Jones Newswires, “Consumers' view on the economy deteriorated significantly as of the middle of October, with confidence posting its steepest monthly drop on record as consumers fret about the economy. The preliminary Reuters/University of Michigan Consumer Sentiment index came in at a reading of 57.5, from 70.3 the month before. The index is now at its lowest since June of this year. The report said there have only been four surveys that posted declines of 10 index points or more.”

Extract from Appendix Table 1 – Economic Indicators

	FY09			FY10			FY11	
	Dec 07 Est.	Aug 08 Est.	Oct 08 Est.	Dec 07 Est.	Aug 08 Est.	Oct 08 Est.	Aug 08 Est.	Oct 08 Est.
CRUDE OIL AND NATURAL GAS OUTLOOK								
Oil Price (\$/barrel) Gross Sales Price	\$75.00	\$122.00	\$94.00	\$75.00	\$116.00	\$90.00	\$118.00	\$90.00
Taxable Oil Sales (million barrels)	57.0	60.0	60.0	55.9	58.8	59.4	58.8	58.8
Gas Price (\$ per thousand cubic feet) Gross Price	\$6.60	\$9.60	\$6.75	\$6.57	\$9.20	\$7.10	\$8.70	\$7.50
Taxable Gas Sales (billion cubic feet)	1,434	1,474	1,415	1,405	1,455	1,380	1,411	1,345

The volatility in energy prices over this relatively brief time period has been extreme. Natural gas prices have ranged from \$12.31 per MCF on June 20 to \$1.88 per MCF in the San Juan basin on October 13. Similarly, but not quite as extreme, crude oil prices paid to New Mexico producers have ranged from \$143.30 per barrel on July 3 to \$68.35 per barrel on October 16.

The declines in mineral severance prices, coupled with the growing national economic woes, have required a decrease of over \$200 million from the August forecast in the revenue estimates for all fiscal years in the forecast period. Estimated revenues for FY08 are expected to exceed the December 2008 forecast by approximately \$92 million.

Table 1: October 2008 Forecast Changes in Recurring Revenues
(Dollars in millions)

	FY08	FY09	FY10	FY11	FY12	FY13
December 2007 Forecast, adjusted for legislation	5,902.3	6,045.5	6,226.1	6,381.7	6,547.1	
August 2008 Forecast, adjusted for legislation	5,910.6	6,233.6	6,392.3	6,476.3	6,807.6	7,049.7
October 2007 Forecast	5,994.1	5,889.2	6,020.1	6,238.8	6,452.7	6,641.3
Change from December forecast	91.9	-156.2	-206.0	-143.0	-94.4	
Change from August forecast	83.5	-344.4	-372.1	-237.5	-354.9	-408.4
Approximate "New Money"			-6.7			
Approximate current year shortfall (before actions by the Governor and Legislature)		185.8				

The updated October recurring revenue forecast and the changes relative to the August 2008 forecast and the December 2007 budget forecast are shown in Table 1. Since the August forecast, the predicted recurring revenue for FY09 has decreased by \$344.4 million, and the FY10 forecast has been lowered by \$372.1 million. This October forecast has now fallen below the December forecast for both years. The FY11, FY12 and FY13 forecasts have also been decreased from the August forecast. This revenue estimate is predicting a shortfall for the current fiscal year (FY09) of \$185.8 million, and FY09 recurring appropriations exceed FY10 recurring revenues by approximately \$6.7 million.

In response to this forecast, the Governor has taken decisive actions to address the projected shortfall in FY09. On October 17, he directed all executive agencies under his control to take immediate

action to cut costs and to develop longer-term plans to save 5% in FY09 expenditures. This will reduce spending and save \$114 million. The Governor also called upon legislative and judicial leaders to follow his example and help reduce this year's operating costs. In addition, the Governor directed the Department of Finance and Administration to identify earmarked funds, earmarked appropriations and stalled capital outlay projects that could be deauthorized by the legislature and help shore up the General Fund. Governor Richardson believes New Mexico can address this shortfall without raising taxes, dipping below 10% cash reserves by the end of the fiscal year or cutting key services to New Mexicans. These steps, taken together, could save the state as much as \$440 million in FY09 expenditures. These responses in FY09 will likely carry over to the development of the FY10 budget. Many of these savings will require action by the legislature in the 2009 regular session, and the Governor is committed to working with the legislature to maintain a balanced budget.

It should be pointed out that although declining oil and natural gas prices have created a state revenue problem, declining prices are probably a very positive force in helping the economy recover. Lower fuel and energy prices will also relieve pressure on the General Fund budgets proposed for FY10 and will help the State Road Fund complete GRIP I and II projects.

Extract of Appendix Table 3 – General Fund Financial Summary

	Audited FY07	Estimated FY08	Estimated FY09	Estimated FY10
APPROPRIATION ACCOUNT				
Transfer to/from General Fund Operating Reserve	(152.9)	53.1	(253.0)	0.0
GENERAL FUND OPERATING RESERVE				
Ending Balance	156.1	207.8	(46.7)	(48.1)
APPROPRIATION CONTINGENCY FUND				
Ending Balance, Excluding Education Reform	38.7	26.2	(6.8)	(26.8)
Ending Balance, Education Reform	74.9	67.4	67.4	67.4
TAX STABILIZATION RESERVE				
Ending Balance	254.4	254.4	254.4	254.4
TOBACCO SETTLEMENT PERMANENT FUND				
Ending Balance	116.7	137.9	133.9	164.4
TOTAL BALANCES	641.8	694.6	403.1	412.2
Reserves as a % of Current-year Recurring Appropriations	12.6%	12.2%	6.7%	6.8%
New Money—recurring				(6.7)
Shortfall for current year (before corrective actions)			(185.8)	
Nonrecurring subject to appropriation				(189.8)
Restricted sub-accounts		66.2%	113.0%	117.9%

Appendix Table 3, the General Fund Financial Summary, details the estimated balances in each of the various reserve funds of the General Fund. A portion of this table is repeated above. DFA has previously reported to this committee that the structure of the reserves is an issue that needs to be addressed during the regular session so that the General Fund Operating Reserve balances are sufficient to pay the obligations in the appropriation account. Additionally, the balances in the Appropriation Contingency Fund need to be adjusted similarly to cover any unforeseen obligations, which mainly consist of costs associated with emergency declarations.

Bond capacities also have also been revised due to the decreases in oil and gas prices.

	2009		2010		2011		2012		2013	
	Aug 08	Oct 08	Aug 08	Oct 08	Aug 08	Oct 08	Aug 08	Oct 08	Aug 08	Oct 08
Senior STB Capacity										
Long-term STB Bonds	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0
Short-term STB Notes (Sponge)	188.7	188.7	290.2	180.3	248.9	159.8	216.3	138.2	180.4	115.1
Total Senior STB Capacity	388.7	388.7	490.2	380.3	448.9	359.8	416.3	338.2	380.4	315.1
Supplemental STB Capacity										
Supplemental Sponge	240.4	240.4	327.8	235.0	313.6	233.8	306.9	237.3	305.0	247.0
Total Supplemental STB Capacity	240.4	240.4	327.8	235.0	313.6	233.8	306.9	237.3	305.0	247.0
<i>Total STB Capacity</i>	629.1	629.1	818.1	615.3	762.6	593.5	723.2	575.5	685.4	562.1
Differences		0.0		(202.8)		(169.0)		(147.6)		(123.4)

The current estimates of FY10 severance tax bond (STBF) capacities have been reduced by about \$203 million since the August forecast, due primarily to the near-term decreases in the oil and natural gas price estimates compared to August. Bond capacity for FY11 is about \$169 million less than the August estimate, while capacity for FY12 and FY13 shows similar decreases.

The effect of legislation passed in the 2008 Special Session are reflected in this update and are taken into account in the General Fund Financial Summary discussed later in this presentation.

The consensus forecast group, consisting of the career economists in the Legislative Finance Committee, the Department of Finance and Administration, the Taxation and Revenue Department and the Department of Transportation will prepare a pre-session full forecast in early December, just prior to the 2009 legislative session. The consensus group will conduct a mid-session review just before the midpoint of the session, as well.

Review of the Economy:

The U.S. economy shows continued weakness. The current crop of bank failures, buyouts and negotiated takeovers is being described as the “greatest financial crisis since the Great Depression.” These are strong words. As mentioned in the last two presentations to this committee, we will not know for some time whether the combination of more than six months of job losses, an anticipated three quarters of negative GDP growth (2008:Q3, 2008:Q4 and 2009:Q1) and well above target inflation will constitute a technical recession. However, virtually all national economists believe the U.S. is currently in a recession. The debate now centers on “how long and how deep a recession.” The consensus group believes that the Global Insight (GI) October forecast is largely correct. The substance of this GI forecast is shown in Table 4.

Table 4: Global Insight View of the National Economy								
October 2008								
Summary of the U.S. Economy	FY09				FY10			
	2008:3	2008:4	2009:1	2009:2	2009:3	2009:4	2010:1	2010:2
Gross Domestic Product	-0.2	-1.5	-0.7	1.2	1.1	2.1	2.5	3.1
Total Consumption	-2.8	-1.1	1.1	1.7	1.5	2.2	1.9	2.2
Exports	12.2	2.9	4.6	2.8	3.6	4.9	6.6	6.8
Billions of Dollars								
Nominal GDP	14,472	14,491	14,523	14,595	14,686	14,8169	14,978	15,153
Prices & Wages, Percent Change, Annual Rate								
GDP Deflator	5.0	2.0	1.6	0.7	1.4	1.5	1.8	1.6
Consumer Prices	7.0	-1.9	0.0	0.7	2.2	2.1	2.1	2.1
Excl. Food & Energy	3.3	2.3	1.5	1.2	2.1	1.9	2.0	1.9
Other Key Measures								
Oil - WTI (\$ per barrel)	118.0	93.0	90.3	90.0	90.0	90.0	91.0	92.0
Productivity (%chg., saar)	2.2	0.9	0.7	2.5	1.4	1.7	1.6	1.7
Industrial Production (%chg., saar)	-6.6	-0.5	-0.6	-0.6	0.8	1.4	2.0	3.1
Consumer Sentiment Index	64.8	64.7	63.0	62.5	65.0	65.8	68.7	71.5
Light Vehicle Sales (Mil. units, saar)	12.89	12.30	12.93	13.41	13.46	13.83	14.01	14.35
Housing Starts (Mil. units, saar)	0.902	0.783	0.743	0.738	0.819	0.884	0.961	1.051
Exist. House Sales (Total, Mil. saar)	4.918	4.509	4.356	4.403	4.512	4.559	4.454	4.507
Unemployment Rate (%)	6.0	6.4	6.8	7.2	7.4	7.5	7.5	7.5
Payroll Employment (%chg., saar)	-0.7	-1.5	-1.4	-1.2	-0.4	0.5	1.0	1.4
Financial Markets, NSA								
Federal Funds Rate (%)	1.96	1.61	1.08	1.00	1.20	1.71	2.21	2.68
S&P 500 Stock Index	1252	1060	1150	1200	1300	1375	1404	1468
(Four-Quarter % change)	-16.0	-29.1	-14.8	-12.5	3.8	29.7	22.1	22.4
Incomes								
Personal Income (% chg., saar)	2.2	1.3	2.9	2.4	2.8	3.2	3.8	4.3
Real Disposable Income (%chg., saar)	-8.1	1.2	4.3	1.7	1.0	1.2	0.9	2.3
Saving Rate (%)	1.4	1.9	2.6	2.6	2.5	2.3	2.0	2.1
After-Tax Profits (Billions of \$)	1293	1130	1282	1311	1355	1367	1363	1391
(Four-quarter % change)	-10.6	-22.6	-4.9	-2.4	4.8	21.0	6.4	6.1
Disposable Income (%chg., saar)	-2.9	0.5	4.8	2.7	2.6	2.8	2.8	4.1

In general, this GI forecast predicts four quarters of very slow or negative growth beginning 2008:Q3, up to two years of job losses totaling over 1,000,000 jobs from peak to trough, federal funds rate bottoming out at 1% and inflation coming under control. We should note, however, that in the short period after the forecast was developed, spot prices for oil have fallen as low as \$66 per barrel, the federal funds rate is at 1.5%, the S&P 500 index closed at 940.55 on Friday, October 17 and consumer sentiment hit 57.5, down from 70.3 the previous month. This continued deterioration of the national economy is, of course, a concern.

New Mexico Economic Outlook:

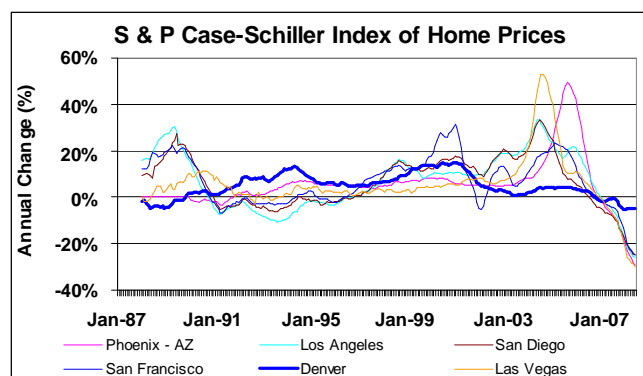
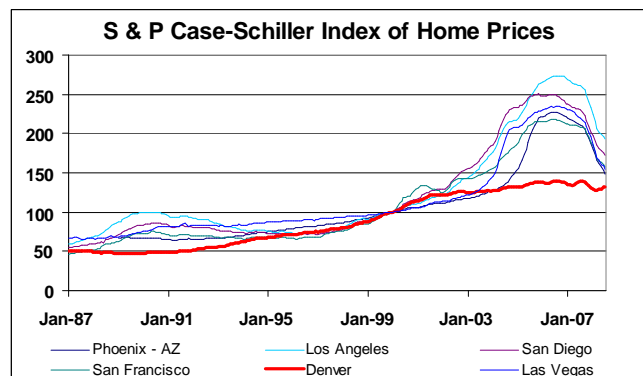
New Mexico, unlike much of the country, is not in recession, nor is it likely to have any quarters of overall job losses – the primary criterion of regional recession (See chart to the right). However, job growth has slowed and there are other issues confronting the New Mexico economy.



- Job growth has slowed in New Mexico, from over 3% in mid-2006 to 0.6% as of August 2008. Texas, Wyoming, Colorado and Oklahoma grew faster than New Mexico in the region for the period July 2007 to July 2008, while New Mexico grew faster than Utah, California, Nevada and Arizona. The U.S. average growth for the July 2007-July 2008 period was -0.3%. New Mexico ranked 16th among all states in job growth for this period.
- The New Mexico economy added 4,700 net new non-agricultural jobs over the year. Year-over-year job growth in New Mexico was 0.6% in August 2008, well above the national rate of -0.3%. The U.S. job market experienced a month-over loss of 159,000 jobs in September 2008, compared to a loss of 84,000 jobs in August 2008, and a loss of 51,000 jobs in July 2008.
- Unemployment in New Mexico averaged 3.5% in 2007, and has increased this year to 4.7% in August. This is an increase from the 3.4% rate in July 2008, but well below the national unemployment rate of 6.1%.
- Total Personal Income – New Mexico's total personal income reached \$64.2 billion in the second quarter of 2008. Using this measure, economic activity expanded at an annual rate of 5.8% from 2007:Q2 to 2008:Q2. National growth in personal income over the same period was 5.3%.
- Wages and Salaries – year-over-year, New Mexico had 8.1% growth in average hourly earnings in construction, 3.0% growth in manufacturing, 4.0% in retail and 9.7% in wholesale. New Mexico's total wage and salary disbursements reached \$33.5 billion in the second quarter of 2008, a 5.6% growth year-over-year. U.S. wages increased 4.1% year over year in the second quarter of 2008. New Mexico's average non-agricultural wage reached \$39,980 per job in the second quarter of 2008. New Mexico's wages averaged 84% of the nation's. Details by sector follow:
 - Construction – housing contributed to a quarter-on-quarter decline in construction employment for the second quarter of 2008. Total housing unit authorizations in New

Mexico are down 40% and construction contract award values are off 24% in the second quarter of 2008, with a 42% drop in single family and 24% drop in multi-family residential contracts, although non-residential contracts showed a 6% increase.

- Trade – retail trade performed well, adding 1,200 jobs or 1.3%, despite a weak economy and several store closings in cities around the state.
- Tourism – New Mexico's travel and tourism sector was fairly flat overall, although the large accommodation and food service sector picked up 667 jobs or 0.8%, somewhat countered by some job losses in arts, entertainment and recreation.
- High Technology – the information sector posted an 8.6% job gain or 1,300 jobs, a large number of which appear to have been in the film industry.
- Energy and Minerals, manufacturing and professional, and business services sectors were flat or slightly declining.
- Health Care – New Mexico's large health care and social assistance sector added the bulk of job growth, 3.8% or 3,767 jobs, largely from hospital expansions.
- Government – New Mexico's government sector increased 2,400 jobs, though mostly at the local level (2,000 jobs or 1.9%) from Native American operations expansions.
- Interest Rates – the 30-year fixed-rate mortgage was 6.01% for September 2008 according to Freddie Mac. On October 9, 2008, the Federal Reserve lowered the target for the federal funds rate to 1.50%, from 2.00%.
- Home Prices – according to the Office of Federal Housing Enterprise Oversight (OFHEO) House Price Appreciation Ranking, New Mexico's house prices were up 1.7% year-over-year for the second quarter of 2008. This ranks New Mexico 20th in the nation for annual housing appreciation. The House Price Index was up 3.4% for New Mexico between the first quarter of 2007 and the first quarter of 2008. The corresponding figure for the U.S. as a whole was a decline of



0.03% for that period. However, the Standard and Poor's Case-Schiller Index of Home Prices – shown in the graph on the preceding page for Denver, clearly shows that not all markets behaved the same during the aggressive price appreciation period of 2005 - 2007. The “housing bubble” was pronounced for most Western cities, with the exception of Denver. We believe that Albuquerque is very similar to the Denver market. If this similarity holds, Albuquerque house prices have probably bottomed out and will resume a slow, but steady increase.

- Foreclosures decreased by 26% in New Mexico between 2006 and 2007, while foreclosures increased 75% nationally during the same period. In the second quarter of 2008, foreclosures increased by 60% over the second quarter of 2007 in New Mexico, while the increase nationwide was 121%. The foreclosure rate in August in New Mexico was one in every 1,724 homes – less than 1/4th of the national rate of one in every 416 homes.
- New Mexico's fiscal situation is significantly better than most state's. The Center on Budget and Policy Priorities (CBPP) reports that at least 29 states plus the District of Columbia, including several of the nation's largest states, faced or are facing an estimated \$48 billion in combined short-falls in their budgets for FY09, which began July 1, 2008 in most states. Three additional states expect budget problems in FY10.

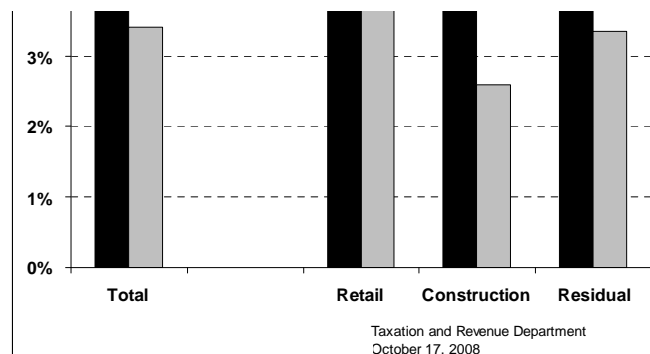
New Mexico Economic Outlook Summary:

- Economic growth for New Mexico is expected to be slow for the next year and then pick up slightly. Employment growth is expected to be 0.8% in 2008, rising to 1.3% in 2009 and near 1.5% annually thereafter, with the unemployment rate expected to remain near 4.0% through the next five years. Personal income growth is expected to reach 5.4% in 2008 and to remain between 4.5% and 5.5% for the next five years.

FY08 Revenue Update:

Revenue Source	Dec-07	Oct-08	Change
Gross receipts and compensating taxes	\$1,974.0	\$1,909.4	(\$64.7)
Selective excise (sales) taxes	\$407.8	\$396.3	(\$11.5)
Personal and corporate income taxes	\$1,587.8	\$1,602.0	\$14.2
Mineral production taxes, federal mineral leasing, state land office income	\$1,097.2	\$1,236.9	\$139.8
Investment income	\$646.8	\$623.6	(\$23.3)
All other sources	\$235.7	\$273.2	\$37.5
Total	\$5,949.3	\$6,041.3	\$92.0

Total General Fund revenues for FY08 are expected to be about \$92 million over the December forecast with weakness in the broad-based taxes and investment income balanced by strength in severance revenues. Appendix Table 2 details by revenue source these FY08 differences (and the FY09 through FY13 forecasts). It should be em-



phasized that DFA has not closed the books on FY08. Unaudited actual and accrued receipts have been posted through June. There are, however, a few revenue sources – particularly refunds – that will not be known with certainty until the final audit. Table 5 above summarizes the differences between preliminary results and the December forecast. Considering the estimating error over the last four years, this performance is noteworthy.

Gross receipts and compensating taxes are the largest source of General Fund revenues, representing about 32% of the total recurring revenue. These taxes are expected to finish FY08 at \$1,909 million compared with the December forecast of \$1,974 million. This change is 3.3% of the original forecast, which will mean that these taxes will have grown only 0.4% from FY07 to FY08, the lowest growth rate in over two decades. The chart above illustrates how the construction sector went from being one of the biggest drivers of growth in FY07 to one of the largest contributors to slow growth in FY08.

Income taxes comprise about 27% of General Fund recurring revenues. Personal income tax (PIT) collections are expected to exceed the December revenue forecast by about 1.5%. Personal income tax net receipts are expected to be flat (0.0% growth) for FY09, primarily because of the final rate cut effective for tax year 2008. FY10 PIT revenues are expected to grow by 3.0% over FY09. Corporate income tax, due to a number of factors, is expected to miss the December estimate by \$36.5 million, 8.3%

under the December estimate. One of the factors affecting corporate income tax revenues is the strength of the Film Production Tax Credit, reflecting New Mexico’s success in developing its film industry. Approved film production tax credits by year are shown in Table 6. It is expected that the level of credits will grow, but at a much slower pace, throughout the forecast period.

Selective excise taxes, particularly the motor vehicle excise tax, are sensitive measures of consumer sentiment. The category total is expected to miss the December estimate by \$1.0 million or less than 0.2% of forecast after correcting for an accounting anomaly in the gaming excise tax. Although the category total estimate was close to forecast, the motor vehicle excise tax recorded a 6% shortfall against the December estimate.

Table 6– Approved Film Production Tax Credits FY03-FY08 (through 6/26/08)						
	FY03	FY04	FY05	FY06	FY07	FY08*
Number of Approved Applications	4	8	13	35	34	52
Approved Film Credits (\$000)	\$1,220	\$3,405	\$2,073	\$10,742	\$17,578	\$46,030

* Through 6/26/08

While the racino (gaming) tax is expected to miss the December forecast by a small amount, tribal revenue sharing continues to outperform estimates. For FY08, tribal revenue sharing is expected to exceed the December estimate by \$2.1 million, a little more than 3% stronger revenue growth than previously expected.

FY08 collections for the Oil and Gas School Tax are expected to exceed the December forecast by at least \$129 million. Federal mineral leasing (royalty) payments are expected to exceed the December forecast by \$10.5 million (1.9%). This modest increase is the net of a number of technical factors, including the federal “sanding” provisions previously discussed with this committee.

State Land Office General Fund distributions are expected to miss the December forecast by \$1.2 million. This is primarily attributable to slightly disappointing lease sale results and lower interest credited on revenues on short-term deposit with the State Treasurer. The federal funds rate for FY08 has fallen from the December forecast of 4.56% to 3.7%.

In addition to lower interest rates, the balances on deposit with the State Treasurer have fallen to about \$2.1 billion from a peak of over \$2.8 billion in July 2006. There are other issues related to the State Treasurer’s deposits that will be discussed later in the “risks to the forecast” section.

FY09 through FY13 Revenue Forecasts:

The general revenue outlook has changed significantly since the August forecast. The biggest adjustments are for the oil and gas revenues. However, the broad based taxes are also exhibiting growth

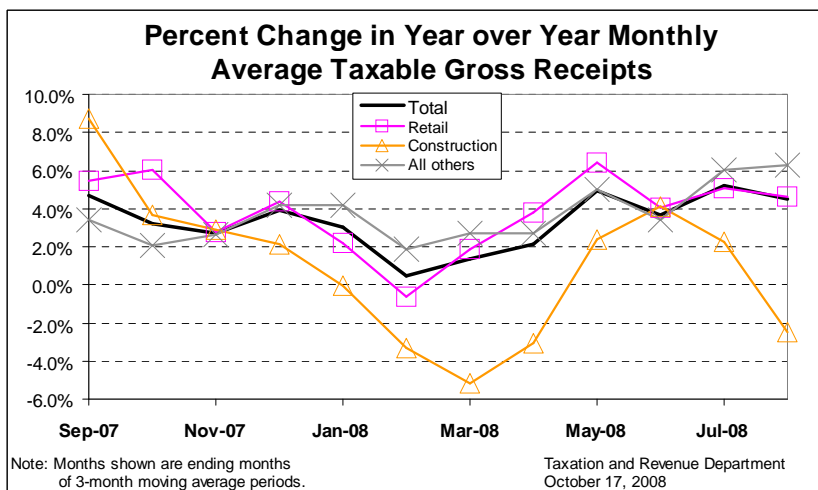
less than the long-term trend. The forecast previously called for near-term strong growth in the oil and gas-related revenues, followed by moderating, but still high, oil and gas prices and for moderate growth over the period in gross receipts, personal income, corporate income, motor vehicle excise taxes and investment income. In this revenue forecast, oil and gas prices are expected to be lower than expected in the August forecast. See *Extract from Appendix Table 1 – Economic Indicators* table in the introduction section of this presentation.

Gross Receipts and Compensating Taxes:

The overall momentum of growth in taxable gross receipts has been improving lately as seen in the chart to the right; however, the construction sector is still struggling and could see even further declines. With retail and other sectors continuing to grow moderately, FY 2009 is expected to see 3.1% growth, with a further growth of 3.0% expected for FY10. The last time New Mexico experienced annual GRT growth below 4% was the 2001 - 2002 downturn.

Oil and Natural Gas Revenues:

Oil and gas prices have become highly volatile and extremely difficult to predict. New Mexico volumes, however, appear to be fairly constant. The price of light sweet crude oil has fallen over 52% from an all-time high above \$147 per barrel in July to a low of \$69.85 per barrel on October 16. This is the level that prices were in August 2007. Producers responded to record prices by significantly increasing their supply during a time when demand in the U.S. has fallen significantly. Whereas speculators were partially responsible for some of the



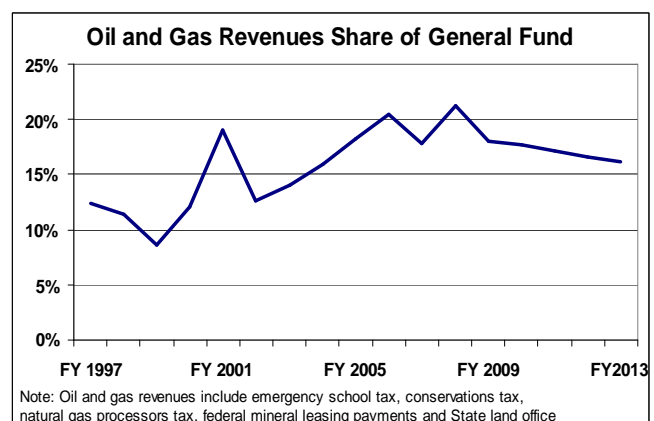
spike in prices, they have since pulled their funds out of the oil futures markets, removing their effect on prices. Although OPEC has called an emergency meeting and is expected to cut production by one million barrels per day, widespread fears of a prolonged global economic downturn could extensively mitigate any impact that such a cut would have on oil prices. Professional forecasters seem to just follow the markets up and down and seem to have no better information than anyone else. Thus upside risk is equally offset by downside risk in such volatile markets. The price forecasts incorporate forecasts from the PIRA Energy Group, Global Insight, Energy Information Administration, NYMEX and historical information from reports filed by New Mexico’s producers, as well as extensive conversations with industry representatives.

Gas prices are equally volatile. New Mexico producers are particularly hit hard by the current fall in prices because of exceptionally high supply from Colorado’s non-conventional gas fields. San Juan gas is currently trading at a five-and-one-half year low. Of equal concern is an over 6% decline in San Juan volumes during FY08. Appendix Table 1 details the assumptions that form the economic basis for the revenue estimates presented here. It is now expected that late FY08 will be the peak of the increase in both oil and natural gas prices, followed by sharp drops. FY09 oil prices in New Mexico are expected to average \$94 per barrel and natural gas prices to average \$6.75 per MCF. Natural gas production is expected to decline at about 2.5% per year, as there is less incentive at the lower prices for the industry to drill more production wells. Oil production is expected to decrease at 1% per year over the forecast period. Both of these volume assumptions are discussed further in the “risks to the forecast” section. FY10 oil prices are expected to moderate to \$90 per barrel and natural gas is expected to increase to \$7.10 per MCF.

With these revisions, the oil and gas share of the General Fund will peak at 21.2% in FY08, and thereafter decline to more typical levels, as shown in the chart to the right. Appendix Table 2 details the FY09 through FY13 forecasts for oil and gas revenues.

Personal Income Tax:

Although gross FY09 personal income tax collections are expected to show modest growth, net personal income tax collections are expected to hold relatively constant from FY08 levels; growth in gross personal income tax collections is expected to be offset by tax credits passed during the 2007 and 2008 regular sessions and the 2008 special legislative session. Specifically, the increase in the Working Families Tax Credit and the Tax Year 2007 Refundable Personal Income Tax Credit are expected to reduce gross FY09 personal income tax revenues by \$63 million.



Corporate Income Tax:

Corporate profits for the non-oil and -gas corporations are expected to drop significantly according to the October 2008 Global Insight forecast, resulting in lower corporate income tax revenues in FY09. Average oil and gas price increases are now expected to be relatively modest for FY09 through FY13 causing a modest increase in corporate income tax revenues for the oil and gas corporations. The film production tax credit is expected to continue to be strong through FY13, demonstrating New Mexico’s success in developing its film industry. The above factors are expected to reduce corporate income tax revenues by about \$36 million in 2009 and cause

subsequent years' revenues to be relatively flat, reflecting the anticipated prolonged downturn in the economy.

General Fund Financial Summary:

Appendix Table 3 shows the General Fund financial summary based on the revenue estimates presented here. This summary shows that there will be a \$6.7 million decrease in FY10 recurring revenues compared with FY09 recurring expenditures and a shortfall of \$185.8 million by the end of FY09, before taking into account the measures announced by Governor Richardson on Friday. The Executive strongly recommends that in these uncertain economic times, we should maintain General Fund balances at 10.0% of current year appropriations. The Governor's announced savings plan will address this year's anticipated revenue shortfall, and will prepare the state agencies to reduce budgets in FY10. Legislative action and voluntary adoption of similar savings plans by the judiciary, legislature, elected public officials, public schools and the higher education establishment will close the rest of the gap.

Risks to the Forecast:

- The principal risk to this forecast is the chance that the national economy will fall into a prolonged, deep recession. This would, of course, affect the forecasts of gross receipts tax, personal income tax, corporate income tax and motor vehicle excise tax.
- If there is a deep national recession, it is also possible that federal revenues will soften and federal spending may be curtailed. New Mexico relies heavily on federal spending, receiving almost \$2 in federal spending of all kinds for each dollar in federal taxes paid by New Mexicans. If this ratio softens, the state might have to use General Fund recurring revenue to make up for reduced federal grants and entitlements.
- There are some concerns about both oil and natural gas production levels. Natural decline rates for both existing oil and gas wells are near 10% per year. If the pace of replacement drilling falters, then the production base could fall far more rapidly than assumed in the forecasting models. A 2.5% decline in natural gas production is expected for the forecast period. Although the near-term crude oil production may be virtually constant, the longer-term expectation is a decline of approximately 1% to 2%, net of replacement drilling. The 1% long-term decline rate has been assumed for FY09 through FY13. Recent data from Baker-Hughes shows there are 17 fewer rigs drilling for natural gas and 12 more rigs drilling for oil. Largely, this change consists of a decline in the San Juan basin and a corresponding increase in drilling in the Permian basin. The consensus group is closely monitoring developments in this area.

- The volatility in the financial markets and the meltdown of the credit market has significantly affected immediate returns and State Treasurer's Office balances. The longer-term effect on interest rates and STO investments is still to be determined.
- The model for balances in the Tobacco Settlement Permanent Fund assumes a 20% drop in the corpus of the fund and a 4% investment return for FY09. If the stock markets continue to fall, that 20% could become 25% or 30% and the balances in the fund, which are considered General Fund reserves, when coupled with revenue declines from other sources could reduce the level of those reserves even further.
- There is a moderate upside risk to this forecast. There have been extensive talks in Congress about a second stimulus package in the range of \$140 to \$150 billion. Approximately \$15 to \$20 billion of any package enacted after the election or early in 2009 could be allocated directly to the states and would include an enhancement of Medicaid matching rates and infrastructure spending on roads and bridges.

**APPENDIX TABLE 1: U.S. and New Mexico Economic Indicators
October 2008**

	FY2008		FY2009			FY2010			FY2011		FY2012		FY2013	
	Aug 08 Est.	Oct 08 Est.	Dec 07 Est.	Aug 08 Est.	Oct 08 Est.	Dec 07 Est.	Aug 08 Est.	Oct 08 Est.	Aug 08 Est.	Oct 08 Est.	Aug 08 Est.	Oct 08 Est.	Aug 08 Est.	Oct 08 Est.
NATIONAL ECONOMIC INDICATORS														
US Real GDP Growth (% SAAR)	1.8	2.1	2.9	0.7	-0.3	2.9	2.9	2.2	3.1	3.0	2.9	3.4	2.4	2.7
US Inflation Rate (CPI, %, SAAR)*	4.3	4.3	1.6	3.5	1.4	1.9	1.7	2.1	1.8	2.4	2.4	2.5	2.1	2.6
Overnight Yield (%)**	3.71	3.71	2.00	2.01	1.41	4.75	3.40	1.95	4.72	3.94	4.75	4.75	4.75	4.75
NEW MEXICO LABOR MARKET AND INCOME														
NM Non-Agricultural Employment Growth (%)	0.9	1.0	1.1	1.1	0.5	1.6	1.5	1.2	1.5	1.8	1.7	1.9	1.6	1.6
NM Personal Income Growth (%)***	5.8	5.7	4.3	4.3	3.0	4.8	4.9	4.1	4.8	5.2	5.4	5.3	5.3	5.4
NM Private Wages & Salaries Growth (%)	4.4	6.0	3.8	3.8	3.6	3.8	5.2	3.4	3.8	4.4	4.8	4.6	4.7	4.9
CRUDE OIL AND NATURAL GAS OUTLOOK														
Oil Price (\$/barrel) Gross Sales Value	\$91.80	\$92.44	\$75.00	\$122.00	\$94.00	\$75.00	\$116.00	\$90.00	\$118.00	\$90.00	\$116.00	\$95.00	\$114.0	\$100.00
Taxable Oil Sales (million barrels)	60.3	60.0	57.0	60.0	60.0	55.9	58.8	59.4	58.8	58.8	58.8	58.2	57.6	57.8
Gas Price (\$ per thousand cubic feet) Gross Value	\$8.20	\$8.30	\$6.60	\$9.60	\$6.75	\$6.57	\$9.20	\$7.10	\$8.70	\$7.50	\$8.60	\$7.60	\$8.50	\$7.60
Taxable Gas Sales (billion cubic feet)	1,452	1,429	1,434	1,474	1,415	1,405	1,455	1,380	1,411	1,345	1,369	1,312	1,328	1,280
*CPI is all-Urban consumers.														
**Overnight Yield = Federal Funds Rate														
***Personal Income growth rates are for the calendar year in which each fiscal year begins.														
Sources: October 2008 economic indicators based on October 2008 Global Insight (national), October 2008 FOR-UNM (state), oil and gas prices in September 2008 PIRA, October 1-9 NYMEX and October 2008 Global Insight..														

APPENDIX TABLE 2: CONSENSUS REVENUE FORECAST

October 2008

(dollars in millions) (1)

	FY 2008						FY 2009					
	Dec. 07	Aug 08	Oct 08	Chng from Dec 07	Chng from Previous	% Chng From	Dec. 07 Adj.	Aug 08 Adj.	Oct 08	Chng from Dec 07	Chng from Previous	% Chng From
	Estimate	Estimate	Prelim.	Estimate	Estimate	FY07	Estimate	Estimate	Estimate	Estimate	Estimate	FY08
Gross Receipts	1,910.0	1,846.0	1,845.6	-64.4	-0.4	0.3%	1,974.0	1,937.3	1,903.3	-70.7	-53.8	3.1%
Compensating	64.0	64.0	63.8	-0.2	-0.2	4.0%	66.8	65.5	65.5	-1.3	0.0	2.7%
Total General Sales Taxes	1,974.0	1,910.0	1,909.4	-64.7	-0.7	0.4%	2,040.8	2,002.8	1,968.8	-72.0	-53.8	3.1%
Tobacco	46.2	42.5	48.1	1.9	5.6	2.9%	46.2	46.2	48.2	2.0	2.2	0.2%
Alcohol	25.8	25.6	25.1	-0.7	-0.5	-6.1%	26.1	26.1	25.6	-0.4	-0.6	2.2%
Insurance	105.7	109.6	107.7	2.0	-1.9	-0.3%	108.5	102.7	121.5	13.0	27.6	12.8%
Fire Protection Fund	19.1	19.2	21.1	2.0	2.0	5.9%	18.4	18.0	19.2	0.8	1.6	-9.3%
Motor Vehicle Excise	136.0	130.1	127.6	-8.4	-2.5	-2.8%	141.8	133.0	121.2	-20.6	-12.1	-5.0%
Gaming tax	68.3	66.3	56.2	-12.1	-10.1	-20.8%	71.6	66.8	79.5	7.8	-1.5	41.5%
Leased Vehicle Surcharge	4.7	6.9	7.5	2.9	0.6	24.9%	4.7	5.5	5.5	0.8	0.0	-27.1%
Other (2)	2.0	5.6	2.9	0.9	-2.7	-4.8%	2.1	2.8	3.1	1.0	0.3	6.0%
Total Selective Sales Taxes	407.8	405.7	396.3	-11.5	-9.5	-4.1%	419.4	401.1	423.7	4.4	17.6	6.9%
Personal Income	1,147.8	1,160.0	1,198.4	50.6	38.4	1.5%	1,174.4	1,132.4	1,198.4	24.0	49.1	0.0%
Corporate & Franchise Income	440.0	407.7	403.5	-36.5	-4.1	-12.3%	451.0	393.0	350.0	-101.0	-57.0	-13.3%
Estate	0.0	0.0	0.0	0.0	0.0	-48.9%	0.0	0.0	0.0	0.0	0.0	
Total Income Taxes	1,587.8	1,567.7	1,602.0	14.2	34.3	-2.3%	1,625.3	1,525.4	1,548.4	-76.9	-7.9	-3.3%
Oil & Gas School Tax	427.9	543.1	557.3	129.4	14.3	32.6%	420.7	647.5	462.2	41.5	-149.2	-17.1%
Oil Conservation Tax	19.7	25.4	27.1	7.3	1.6	35.8%	19.3	29.9	22.1	2.9	-6.3	-18.2%
Resources Excise	13.2	10.1	11.7	-1.6	1.6	8.2%	13.2	10.1	13.4	0.2	4.4	14.8%
Natural Gas Processors	35.3	31.6	30.6	-4.7	-0.9	-14.1%	32.2	32.0	32.2	0.0	-10.7	5.0%
Total Mineral Production Taxes	496.2	610.1	626.7	130.5	16.5	28.8%	485.4	719.5	529.9	44.5	-161.9	-15.4%
Total License Fees	49.7	48.0	50.7	0.4	2.7	3.5%	52.0	52.6	50.5	-1.5	-2.0	-0.3%
Land Grant Permanent Fund	390.7	390.7	390.5	-0.2	-0.2	7.1%	433.8	433.7	433.7	-0.1	-19.7	11.1%
Earnings on State Balances	79.0	48.5	55.9	-23.1	7.4	-15.9%	70.0	27.0	21.5	-48.5	-14.0	-61.6%
Severance Tax Perm. Fund	177.2	177.2	177.2	0.0	0.0	3.6%	191.6	191.3	191.3	-0.3	-6.5	8.0%
Total Investment Income	646.8	616.4	623.6	-23.3	7.2	3.6%	695.4	652.0	646.5	-49.0	-40.2	3.7%
Federal Mineral Leasing	553.7	564.0	564.2	10.5	0.2	12.6%	535.6	660.4	504.0	-31.6	-116.0	-10.7%
State Land Office	47.3	45.0	46.1	-1.2	1.1	-8.6%	46.3	70.8	42.0	-4.3	-27.4	-8.9%
Total Rents, Royalties	601.0	609.0	610.3	9.3	1.3	10.6%	581.9	731.2	546.0	-35.9	-185.2	-10.5%
Total Miscellaneous Receipts	35.4	37.5	50.0	14.6	12.5	35.1%	35.7	35.7	43.9	8.1	8.1	-12.3%
Tribal Revenue Sharing	64.5	68.2	66.6	2.1	-1.6	18.5%	69.2	73.0	72.8	3.6	-0.3	9.3%
Reversions	39.1	38.0	58.8	19.7	20.8	59.5%	40.3	40.3	58.8	18.4	18.5	0.0%
Total Recurring Revenue	5,902.3	5,910.6	5,994.1	91.3	83.5	3.8%	6,045.5	6,233.6	5,889.2	-156.2	-344.4	-1.7%
Adjustments & Non-Recurring	47.0	47.1	47.2	0.2	0.0			-55.8	-55.7	-55.7	0.1	
Grand Total Revenue	5,949.3	5,957.7	6,041.3	91.4	83.5	4.6%	6,045.5	6,177.8	5,833.5	-211.9	-344.3	-3.4%
Oil and gas share of General Fund	18.4%	20.5%	21.2%				17.4%	23.1%	18.0%			

(1) Detail may not add to column totals due to independent rounding.

(2) Other selective sales taxes include racing, private car, boat excise, gasoline excise, and telecommunications relay surcharge 3% administrative fee.

APPENDIX TABLE 2: CONSENSUS REVENUE FORECAST

October 2008

(dollars in millions) (1)

	FY 2010				FY 2011				FY 2012			
	Aug 08 Adj	Oct 08	Chng from Previous	% Chng From	Aug 08 Adj.	Oct 08	Chng from Previous	% Chng From	Aug 08 Adj.	Oct 08	Chng from Previous	% Chng From
	Estimate	Estimate	Estimate	FY09	Estimate	Estimate	Estimate	FY10	Estimate	Estimate	Estimate	FY11
Gross Receipts	2,014.2	1,960.4	-53.8	3.0%	2,081.1	2,041.6	-39.5	4.1%	2,165.8	2,129.6	-36.2	4.3%
Compensating	66.8	66.8	0.0	2.0%	64.4	64.4	0.0	-3.5%	67.2	67.2	0.0	4.3%
Total General Sales Taxes	2,081.0	2,027.2	-53.8	3.0%	2,145.5	2,106.0	-39.5	3.9%	2,233.0	2,196.8	-36.2	4.3%
Tobacco	46.2	48.4	2.2	0.4%	46.2	48.6	2.4	0.4%	46.2	48.9	2.7	0.6%
Alcohol	26.6	26.0	-0.6	1.5%	27.2	26.4	-0.8	1.3%	27.7	26.7	-1.0	1.3%
Insurance	107.4	135.0	27.6	11.1%	112.3	142.2	29.9	5.3%	117.5	149.7	32.2	5.3%
Fire Protection Fund	16.4	18.0	1.6	-6.0%	14.7	16.4	1.7	-9.2%	13.1	14.7	1.6	-10.1%
Motor Vehicle Excise	137.0	124.9	-12.1	3.0%	141.1	128.6	-12.5	3.0%	145.3	132.5	-12.8	3.0%
Gaming tax	75.3	73.9	-1.5	-7.0%	73.8	74.0	0.3	0.2%	71.5	74.2	2.7	0.2%
Leased Vehicle Surcharge	5.9	5.9	0.0	6.5%	5.8	5.8	0.0	-1.9%	5.8	5.8	0.0	1.4%
Other (2)	2.8	3.1	0.3	1.8%	2.9	3.2	0.3	1.9%	2.9	3.3	0.4	1.9%
Total Selective Sales Taxes	417.6	435.2	17.6	2.7%	423.8	445.1	21.2	2.3%	429.9	455.8	25.8	2.4%
Personal Income	1,185.2	1,234.3	49.1	3.0%	1,255.0	1,306.3	51.3	5.8%	1,332.7	1,389.3	56.6	6.3%
Corporate & Franchise Income	408.0	351.0	-57.0	0.3%	427.0	364.0	-63.0	3.7%	450.0	364.0	-86.0	0.0%
Estate	0.0	0.0	0.0		0.0	0.0	0.0		0.0	0.0	0.0	
Total Income Taxes	1,593.2	1,585.3	-7.9	2.4%	1,682.0	1,670.3	-11.7	5.4%	1,782.7	1,753.3	-29.5	5.0%
Oil & Gas School Tax	612.4	463.2	-149.2	0.2%	588.7	473.4	-115.3	2.2%	580.3	477.8	-102.5	0.9%
Oil Conservation Tax	28.3	22.0	-6.3	-0.7%	27.1	22.3	-4.8	1.4%	26.7	22.5	-4.2	0.9%
Resources Excise	10.1	14.5	4.4	8.0%	10.1	15.6	5.5	8.0%	10.1	16.9	6.8	8.0%
Natural Gas Processors	44.5	33.7	-10.7	4.9%	41.0	29.4	-11.5	-12.7%	40.8	30.3	-10.5	3.0%
Total Mineral Production Taxes	695.3	533.4	-161.9	0.7%	666.9	540.8	-126.2	1.4%	657.9	547.5	-110.4	1.2%
Total License Fees	54.2	52.2	-2.0	3.3%	57.1	55.4	-1.8	6.1%	59.8	58.8	-1.0	6.1%
Land Grant Permanent Fund	464.2	444.5	-19.7	2.5%	495.2	451.6	-43.6	1.6%	528.2	459.3	-68.9	1.7%
Earnings on State Balances	39.0	25.0	-14.0	16.3%	53.0	44.0	-9.0	76.0%	65.0	55.0	-10.0	25.0%
Severance Tax Perm. Fund	199.4	192.9	-6.5	0.8%	207.5	192.4	-15.1	-0.2%	216.4	192.3	-24.2	-0.1%
Total Investment Income	702.6	662.4	-40.2	2.5%	755.7	688.0	-67.7	3.9%	809.6	706.6	-103.0	2.7%
Federal Mineral Leasing	618.0	502.0	-116.0	-0.4%	501.4	505.0	3.6	0.6%	582.0	500.0	-82.0	-1.0%
State Land Office	69.4	42.0	-27.4	0.0%	72.0	42.3	-29.7	0.7%	72.0	42.7	-29.3	0.9%
Total Rents, Royalties	687.4	544.0	-143.4	-0.4%	573.4	547.3	-26.1	0.6%	654.0	542.7	-111.3	-0.8%
Total Miscellaneous Receipts	36.1	44.2	8.2	0.8%	36.4	44.6	8.2	0.8%	36.8	45.0	8.1	0.9%
Tribal Revenue Sharing	82.7	77.4	-5.3	6.4%	94.1	82.6	-11.5	6.7%	98.9	87.7	-11.2	6.1%
Reversions	42.2	58.8	16.6	0.0%	41.3	58.8	17.5	0.0%	45.0	58.8	13.8	0.0%
Total Recurring Revenue	6,392.3	6,020.1	-372.1	2.2%	6,476.3	6,238.8	-237.5	3.6%	6,807.6	6,452.7	-354.9	3.4%
Adjustments & Non-Recurring	0.0	0.0	0.0		0.0	0.0	0.0		0.0	0.0	0.0	
Grand Total Revenue	6,392.3	6,020.1	-372.1	3.2%	6,476.3	6,238.8	-237.5	3.6%	6,807.6	6,452.7	-354.9	3.4%
Oil and gas share of General Fund	21.5%	17.7%			19.0%	17.2%			19.1%	16.6%		

(1) Detail may not add to column totals due to independent rounding.

(2) Other selective sales taxes include racing, private car, boat excise, gasoline excise, and telecommunications relay surcharge 3% administrative fee.

Appendix Table 3 – General Fund Financial Summary
October 2008 Consensus Forecast
(Dollars in Millions)

	Audited FY07	Estimated FY08	Estimated FY09	Estimated FY10
APPROPRIATION ACCOUNT				
Recurring Revenue, October 2008 Consensus Estimates	5,774.5	5,994.1	5,889.2	6,020.1
Nonrecurring Revenue, October 2008 Consensus Estimates	0.0	47.2	(55.7)	-
TOTAL REVENUE	5,774.5	6,041.3	5,833.5	6,020.1
Appropriations				
Recurring Appropriations	5,113.1	5,675.1	6,026.8	6,020.1
Nonrecurring Appropriations	814.3	313.0	59.7	-
Total Appropriations	5,927.4	5,988.1	6,086.5	6,020.1
Transfer to/from General Fund Operating Reserve	(152.9)	53.1	(253.0)	0.0
GENERAL FUND OPERATING RESERVE				
Beginning Balance	359.5	156.1	207.8	(46.7)
Reversions	0.4			
Appropriations	(10.8)	(1.5)	(1.5)	(1.5)
Transfers In Appropriation Account	-	53.1	-	0.0
Transfers Out Appropriation Account	(152.9)	-	(253.0)	-
Other	(40.0)	-	-	-
Ending Balance	156.1	207.8	(46.7)	(48.1)
Ending Balances as a % of Prior Year Recurring Appropriations	3.3%	4.1%	-0.8%	-0.8%
STATE SUPPORT RESERVE:				
Beginning Balance	-	1.0	1.0	1.0
Transfers In	1.0	-	-	-
Ending Balance	1.0	1.0	1.0	1.0
APPROPRIATION CONTINGENCY FUND				
Beginning Balance, Excluding Education Reform	19.9	38.7	26.2	(6.8)
Expenditures	(22.8)	(18.4)	(33.0)	(20.0)
Revenue, Transfers and Reversions	41.6	5.9		-
Ending Balance, Excluding Education Reform	38.7	26.2	(6.8)	(26.8)
Education Reform, Beginning Balance	79.8	74.9	67.4	67.4
Transfers In	-	-	-	-
Transfers Out	(4.9)	(7.5)	-	-
Ending Balance, Education Reform	74.9	67.4	67.4	67.4
Ending Balance	113.6	93.6	60.6	40.6
TAX STABILIZATION RESERVE				
Beginning Balance	254.4	254.4	254.4	254.4
Transfers In	-	-	-	-
Ending Balance	254.4	254.4	254.4	254.4
Ending Balances as a % of Prior Year Recurring Appropriations	5.4%	5.0%	4.5%	4.2%
TOBACCO SETTLEMENT PERMANENT FUND				
Beginning Balance	84.6	116.7	137.9	133.9
Transfers In, October 2008 Consensus Estimate	36.2	44.9	47.2	50.4
Transfers Out	(18.1)	(22.4)	(23.6)	(25.2)
Gains or (Losses)	14.0	(1.3)	(27.6)	5.4
Ending Balance	116.7	137.9	133.9	164.4
TOTAL BALANCES	641.8	694.6	403.1	412.2
Reserves as a Percentage of Current-year Recurring Appropriations	12.6%	12.2%	6.7%	6.8%
New Money—recurring				(6.7)
Shortfall/Deficit for current year (before corrective actions)			(185.8)	
Nonrecurring subject to appropriation				(189.8)
Restricted sub-accounts		66.2%	113.0%	117.9%