

NEW MEXICO ECONOMIC SUMMARY



DECEMBER 2010

SIGNS OF HOPE OVERSHADOWED BY CHALLENGES THAT AWAIT

The U.S. and New Mexico economies continue to post signs that the worst of the recession is over, but the improvements are small and are doing little to prompt a substantial recovery from the drastic job losses that New Mexico and the country have suffered.

First, the good news

Retail sales in the U.S. increased 1.2% in October, the largest increase since March, according to the U.S. Commerce Department. The improvement was driven for the most part by an increase in the sales of motor vehicles. Retail sales between August and October were up 6.3% compared to the same period last year, which is good news because consumer spending is the largest contributor to U.S. economic activity.

The U.S. manufacturing sector expanded in October for the fifteenth consecutive month, and the overall U.S. economy grew for the eighteenth consecutive month, according to the nation's supply executives in the latest Manufacturing Institute for Supply Management survey. While recovery in automobiles, computers and exports were key drivers of the growth in manufacturing, 14 of 18 manufacturing sectors reported some growth in October.

Now, the bad news

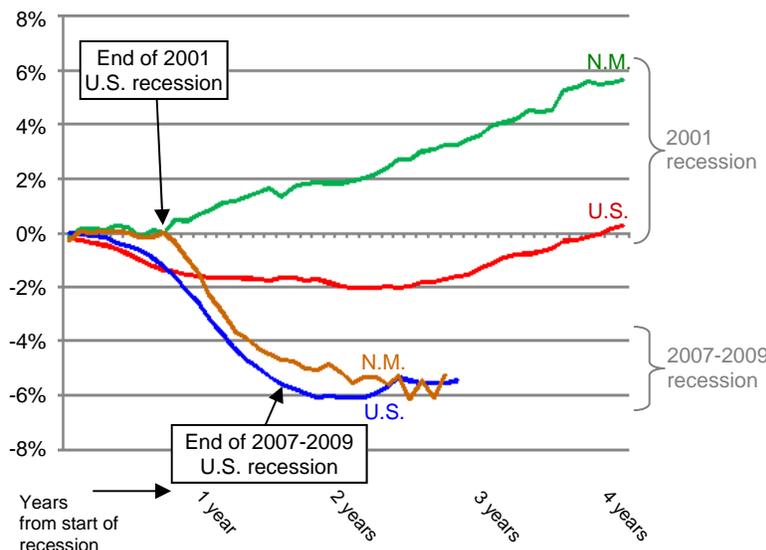
Large sectors of the New Mexico and U.S. economies are in

**Residential Housing Permit Index for New Mexico and the U.S.
January 2000 = 100**



source: U.S. Department of Commerce

**Percent Change in U.S. and New Mexico Non-Farm Employment
Since Start of Recessions in 2001 and 2007: A Comparison**



sources: U.S. Bureau of Labor Statistics and Center on Budget and Policy Priorities

the doldrums, and they are the sectors that contributed to strong economic growth from 2000 through 2005.

Nationwide, residential housing permits were issued in October at an annual rate of 550,000. This is up slightly from the lows of early 2009 but less than a third of the average annual rate of 1.8 million issued during the first half of the decade, as seen in the graph at left. The huge oversupply of houses will keep new construction down for some time to come.

New Mexico residential construction has shown a similar pattern. Although there has been slight improvement recently, monthly housing permits are averaging 390 so far in 2010, down sharply from a peak of 1,390 in June 2004 and an average of 995 per month from 2000 through 2005.

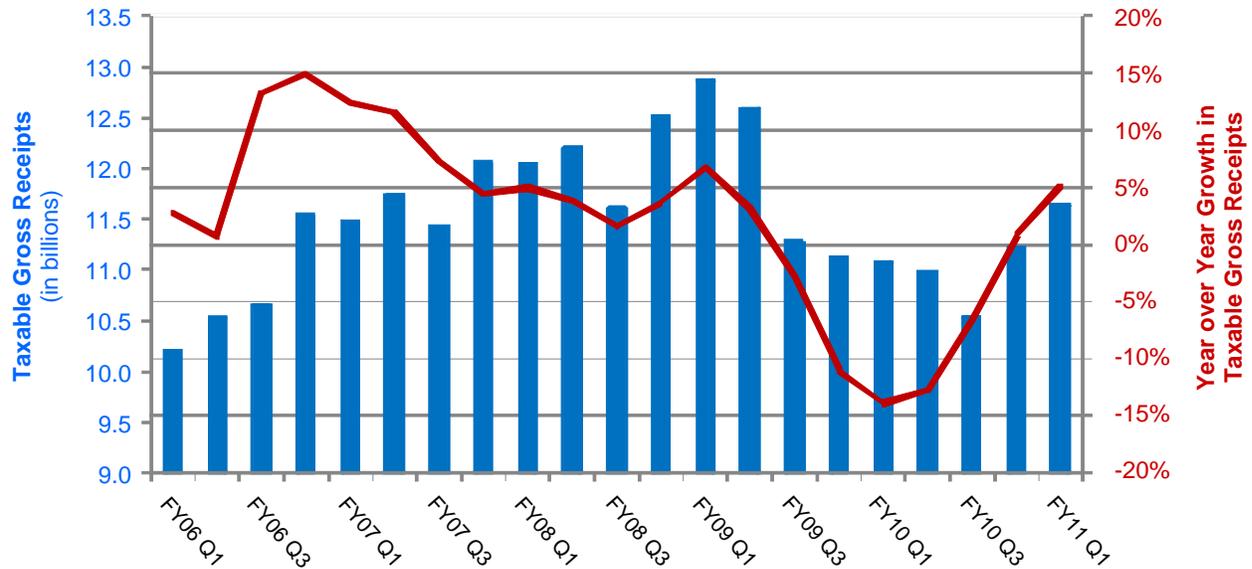
There were 63 oil and gas rigs working in New Mexico in October, up from a low of 36 in April 2009 but still well below the most recent peak of 103 in March 2006.

Due to high economic uncertainty and excess capacity across the economy, the recent improvements in retail sales, manufacturing, mining and construction are resulting in only very weak U.S. job growth, and New Mexico may still be losing jobs.

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TAXABLE GROSS RECEIPTS

Taxable Gross Receipts by Quarter



- ▶ Taxable gross receipts (TGR), the base of the gross receipts tax, increased by just less than 1% in the fourth quarter of FY 2010 and approximately 5% in the first quarter of FY 2011, after six quarters of negative growth.
- ▶ The state first reached the current level of TGR in the fourth quarter of FY 2006.
- ▶ TGR in the first quarter of FY 2011 is 9.5% below its peak level in the first quarter of FY 2009.
- ▶ TGR is projected to continue on its upward trend during FY 2011 and FY 2012, with projected increases in the gross receipts tax of 6.5% in FY 2011 and 4% in FY 2012. A portion of this increase is due to the one-eighth percent increase in the gross receipts tax passed during the 2010 session.

RECURRING REVENUE GROWTH RATES

FY 2010		Revenue Source	Annual Growth Rate		
in millions	% of total		FY 2010	FY 2011	FY 2012
\$1,685.3	35.1%	Gross Receipts Tax	(10.8%)	6.5%	4.0%
372.9	7.8%	Selective Sales Taxes	(7.9%)	16.4%	2.8%
956.6	19.9%	Personal Income Tax	(0.2%)	10.3%	3.8%
125.1	2.6%	Corporate Income Tax	(23.0%)	75.9%	18.2%
813.7	17.0%	Energy-Related Revenues	(17.3%)	(1.7%)	6.6%
646.3	13.5%	Investment Earnings	(6.7%)	0.0%	1.0%
198.8	4.1%	Other Revenues	16.0%	7.8%	1.3%
\$4,798.7		Total Recurring Revenue	(9.8%)	7.6%	4.4%

- ▶ Recurring revenue growth is forecast at 7.6% in FY 2011 and 4.4% in FY 2012. Roughly half of the FY 2011 increase is due to revenue-enhancement legislation passed during the 2010 sessions. Absent this legislation, FY 2011 growth is forecast at 3.8%.
- ▶ Gross receipts tax revenue, which is more than one-third of total revenue, is expected to grow by 6.5% during FY 2011, augmented by the recently enacted one-eighth percent tax rate increase. Without the rate increase, revenue growth would have been only 3.8%.
- ▶ Personal income taxes are expected to increase 10% in FY 2011 after a 21% decline from a peak of \$1.2 billion in FY 2009.

U.S. AND NEW MEXICO ECONOMIC OUTLOOK

	FY 2010		FY 2011		FY 2012	
	Oct 10 Prelim.	Dec 10 Prelim.	Oct 10 Estimate	Dec 10 Estimate	Oct 10 Estimate	Dec 10 Estimate
NATIONAL ECONOMIC INDICATORS						
U.S. Real GDP Growth (level annual avg., % year over year)*	0.7	0.7	2.2	2.5	2.7	2.6
U.S. Inflation Rate (CPI, annual avg., % year over year)**	1.0	1.0	1.3	1.3	1.8	1.7
Federal Funds Rate (%)	0.15	0.15	0.14	0.15	0.3	0.3
NEW MEXICO LABOR MARKET AND INCOME DATA						
NM Non-Agricultural Employment Growth (%)	(3.3)	(3.2)	(0.3)	0.2	1.0	1.0
NM Personal Income Growth (%)***	0.0	0.0	3.2	3.5	2.0	2.2
NM Private Wages and Salaries Growth (%)	(2.3)	(2.3)	1.3	2.2	3.2	3.6
CRUDE OIL AND NATURAL GAS OUTLOOK						
NM Oil Price (\$ per barrel)	\$71.29	\$71.29	\$76.50	\$76.87	\$83.00	\$82.69
NM Taxable Oil Sales (million barrels)	62.7	62.9	63.3	64.2	64.0	64.2
NM Gas Price (\$ per thousand cubic feet)****	\$5.18	\$5.20	\$5.00	\$5.00	\$5.75	\$5.75
NM Taxable Gas Sales (billion cubic feet)	1,285	1,283	1,234	1,229	1,197	1,191

*Real GDP is BEA chained 2005 dollars, billions, annual rate.

**CPI is all urban, BLS 1982-84 = 1.00 base.

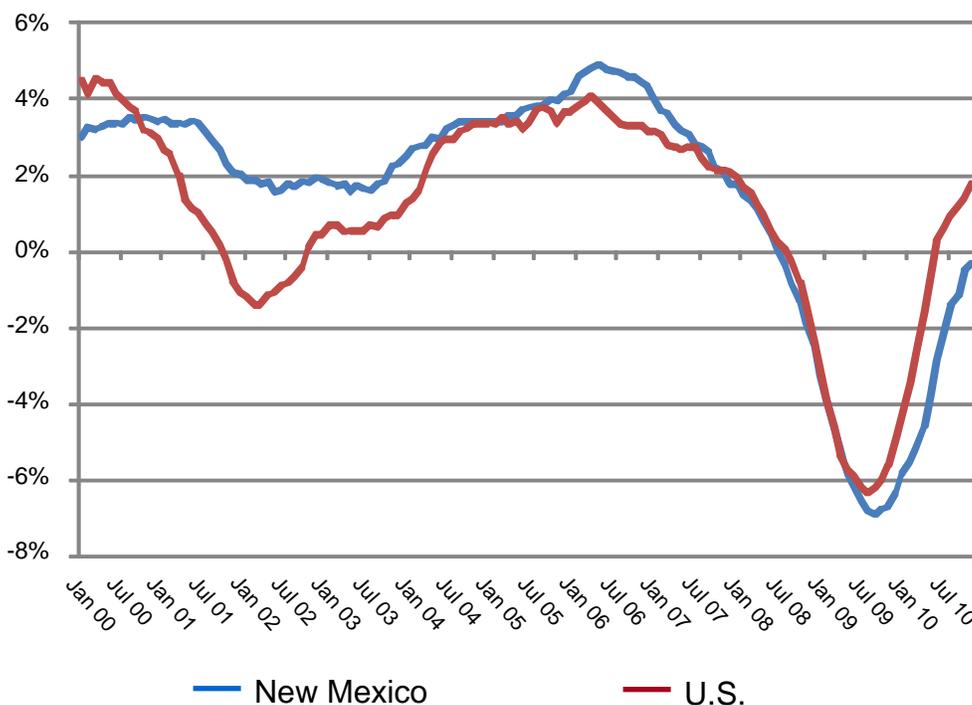
***Personal income growth rates are for the calendar year in which each fiscal year begins.

****Gas prices are estimated using a formula of NYMEX, PIRA and Global Insight future prices as well as liquid premium based on oil prices.

Sources: November Global Insight, November PIRA and November FOR-UNM BBER

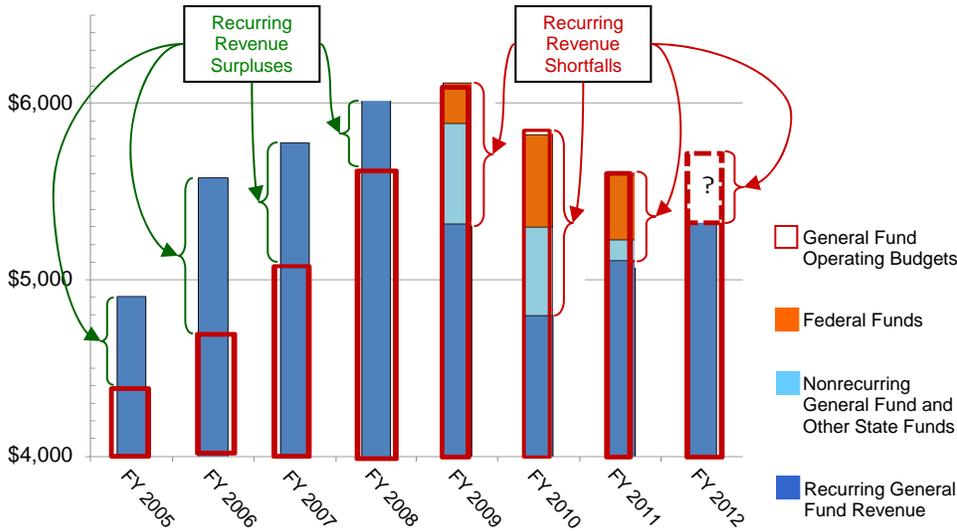
EMPLOYMENT GROWTH

U.S. and New Mexico Employment Growth



- ▶ U.S. employment growth returned to positive territory last summer. October employment was up 1.8% compared with the same period last year.
- ▶ New Mexico was still losing jobs as of October 2010. Although the state followed a similar trajectory as the U.S. going into the recession, it is on a slower path to recovery.
- ▶ New Mexico job growth is poised to return soon, probably by the end of the year. If the state continues to follow the national trajectory, New Mexico should see good employment growth before the end of 2011.

**General Fund Operating Budgets and One-Time Funds
Supplanting General Fund
(in millions)**



source: New Mexico Legislative Finance Committee

(Continued from page 1)

U.S. non-farm employment has fallen by about 5.4% (7.5 million jobs) since the recession began in December 2007, as seen in the employment graph on the opening page. Although U.S. employment growth turned positive in July 2010, only about 100,000 jobs per month are being added. The economy would have to add more than 300,000 jobs per month to return to pre-recession levels within two years.

New Mexico employment has also fallen by about 6% since the beginning of the recession, and although the rate of decline is slowing, no clear signs of improvement are evident. According to the latest University of New Mexico Bureau of Business and Economic Research forecast for New Mexico, the previous peak level of employment in 2008 will not be reached again until 2013.

The fact that employment in New Mexico has fallen by the same percentage as in the U.S. but is recovering more slowly is different from what was seen in the 2001 recession, as the employment graph illustrates. Although U.S. job loss in that recession was mild compared to the most recent recession, it took almost four years for U.S. employment to reach pre-recession levels. New Mexico employment stayed basically flat throughout the 2001 recession and then took off, posting job growth of almost 6% over pre-recession levels during the four years it took the U.S. employment to get back to its pre-recession level.

This severe boom-bust cycle with the projected slow recovery in the New Mexico economy has had and will continue to have severe implications for New Mexico's budget. The state's

recurring revenues are very sensitive to the performance of the U.S. and New Mexico economies in general and the petroleum sector in particular. With the concurrent expansion of the U.S. economy and increase in oil and gas prices, recurring general fund revenue increased by about \$1.9 billion, or 25%, between 2005 and 2008, and the state ran large recurring revenue surpluses for fiscal years 2005 through 2008, as seen in the graph at left. Recurring general fund revenue peaked at just over \$6 billion in FY 2008, and the surpluses in those years went to shore up general fund reserves and to fund capital outlay and other nonrecurring expenditures.

In just two years, the previous four years of revenue gains were wiped out, with a \$1.2 billion, or 20%, decline in revenues from FY 2008 to FY 2010. This precipitous decline in revenue and an increase in demand for government services due to the economic downturn contributed to large recurring revenue shortfalls in those years, with the gap in the budget filled from balances in the general fund and other state funds, as well as the use of federal stimulus funds to supplant what would have been recurring general fund revenue.

The continued slow growth projected for the New Mexico economy translates into slow recurring revenue growth. Total recurring general fund revenue is not projected to hit FY 2008 levels until FY 2015.

As a result, the budget includes recurring revenue shortfalls in FY 2011 and FY 2012, in spite of budget cuts and tax increases. Although the budget gap is once again filled in FY 2011 with fund balances, nonrecurring general fund spending reductions and temporary federal stimulus funds, the federal funds are not expected to be available in FY 2012. Budget shortfall estimates for FY 2012 range from \$215 million to \$410 million, assuming a flat general fund budget and depending on assumptions regarding the cost of maintaining the Medicaid program and the passage of legislation to shift the cost of certain programs away from the general fund.

Regardless of the exact amount of the FY 2012 shortfall, the historic speed and depth of the plunge in the New Mexico economy and state revenues, the slow pace of the recovery and the expected reduction in federal funds create a very difficult starting point for upcoming budget deliberations.