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THE ECONOMY

SUMMARY
Not a day passes without a bombardment of news about the economy. There are numerous reports of new unemployment claims, reduced home sales and prices and negative changes in gross domestic product, consumer confidence and job creation. But these reports often lack context, do little to help us understand what to expect in the future and frequently include unverifiable, subjective comments that cloud the reports.

This bulletin examines some fundamentals of economics so that conflicting economic reports can be better understood. It also includes the first "New Mexico Economic Indicators" report, a periodic economic briefing to be prepared by the Legislative Council Service.

BACKGROUND
Because state government revenue and the welfare of its residents are heavily influenced by the economic climate, it is important to understand the New Mexico economy and where it may be headed. Low unemployment and steady job growth translate into increased personal income tax revenue. Increases in hourly wages and low inflation enable greater consumption, which promotes higher gross receipts tax collections. Studying consumer confidence can provide a good indication of general public satisfaction.

All of this is important because of the challenges that are confronting state government. Budgeting is the art of allocating scarce resources among worthy programs. The resources seem to be getting scarcer, and worthy programs are more plentiful every year. While the Rail Runner expansion continues, it is widely recognized that reduced federal funding coupled with higher costs for materials are forcing the postponement of many needed road repair projects. Medicaid continues to consume a greater and greater portion of the budget each year, as does the cost of housing prison inmates. The Retiree Health Care Authority is facing financial challenges, and the cost of public education continues to rise.

Added to these budgetary challenges are certain structural tax issues surrounding revenue collections that make policymaking even more difficult. An example includes a continual erosion of the gross receipts tax base because certain income tax credits are much more expensive than originally estimated. Additionally, the recent enactment of tax increment financing has created new challenges to future revenue growth. These issues may restrict revenue growth over the long haul, and, along with the budgetary challenges, they make clear that a basic understanding of economics is essential for charting a course for the future.

COMMON ECONOMIC INDICATORS

Gross Domestic Product
One of the most important economic indicators is gross domestic product (GDP), along with its companion, gross state product (GSP). The GDP of a country is one of the ways of measuring the size of its economy. GDP is defined as the total market value of all final goods and services produced in a given period of time. It is also considered the sum of value added at every stage of production (the

intermediate stages) of all final goods and services produced, and it is given a monetary value.

The most common approach to measuring and understanding GDP is the expenditure method: *GDP = consumption + gross investment + government spending + (exports - imports)* This GDP calculation is then adjusted for inflation and is referred to as real GDP.

Typically, however, what we hear reported is the percent change in GDP from one calendar quarter to the next. GDP is a pivotal indicator. If the change from quarter to quarter is positive, it means that the economy is expanding, making it possible for jobs to be created and households to earn more income. If the change is negative, the economy is contracting and unemployment will increase. It is the difference between expansion and recession.

Consumer Price Index

Equally important to and generally better understood than GDP is the consumer price index (CPI). The CPI is an index number measuring the average price of consumer goods and services purchased by households. It is one of several price indices calculated by national statistical agencies. The percent change in the CPI is a measure of inflation. The CPI is sometimes used to index (i.e., adjust for the effects of inflation) wages, salaries, pensions or regulated or contracted prices.

The price data are collected for a typical "market basket" of items on a sampling basis. From time to time, the market basket is updated because it is not relevant to continue to track the price of buggy whips. The CPI's basket was last revised in 1999, and all items in the market basket were collectively set to a value of 100. As of February 2008, the index stood at 122.25. Stated in percentage terms, the cost of the market basket is 22.25% greater now than it was in 1999. It is the percent change in the index that is typically reported, not the index itself. As an example, the index increased by 3.7% between February 2007 and February 2008, meaning the rate of inflation for this 12-month period was 3.7%.

Consumer Confidence Index

The U.S. Consumer Confidence Index (CCI) is defined as the degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending. It is issued monthly by The Conference Board, an independent economic research organization, and is based on 5,000 households. The measurement is indicative of the consumption component of the GDP. The Federal Reserve looks at the CCI when determining interest rate changes. The CCI can also affect stock market prices by influencing the relative optimism or pessimism of investors.

While the CCI is a subjective measurement, it is regarded as important because it can be a harbinger of things to come. A rise in the index suggests that consumers are feeling confident enough to spend freely. A decline indicates consumer angst and unease, which may lead to less spending, particularly discretionary spending, and increased frustration with policymakers. Consumer spending fuels two-thirds of the GDP and can result in new factory orders, increased employment, more money in circulation, higher wages, etc. A decline in the index suggests just the opposite.

The CCI is typically reported as an index, not a percent change. The index was last rebased in 1985 (1985=100). In February 2008, the index was 76.4, and it fell to 64.5 in March 2008, its lowest level since March 2003.

NEW MEXICO

To this point we have been examining national economic indicators. Of particular importance to our state economy are the following New Mexico specific indicators.

- Non-Agricultural Employment. This information is reported quarterly in each of 15 sectors of the economy. The distribution of jobs in New Mexico for 2007 is shown in the following table:

Government	23.1%
Professional and Business Services	12.9%
Health Care and Social Assistance	11.6%
Retail Trade	11.4%
Accommodation and Food Services	9.4%
Construction	7.0%
Manufacturing	4.4%
Financial Activities	4.2%
Other Services	3.5%
Transportation and Warehousing	3.0%
Wholesale Trade	2.8%
Natural Resources and Mining	2.3%
Information Technology	1.9%
Educational Services	1.6%
Arts, Entertainment and Recreation	1.0%

- Personal Income. This is income received by persons from all sources. It is the sum of compensation of employees, supplements to wages and salaries, proprietors' income, rental income, personal income, certain government transfer payments and receipts on assets. The number is reported quarterly for all residents collectively. In the fourth quarter of 2007, total New Mexico personal income was $60,330,000,000.

- Oil Production in Barrels and Natural Gas Production in Thousands of Cubic Feet. These are important indicators because of the importance of severance tax revenue to New Mexico.

- Private Sector Wages and Salary. This information is reported quarterly in the form of average weekly wages. Data are provided for all sectors of non-agricultural employment except for government. It should be noted that there is little correlation between average weekly wages and the share of New Mexico jobs represented by a sector, e.g., natural resources and mining ranks number one in wages but represents only 2.3% of all employment. Average weekly wages in 2007 are shown in the following table:

Natural Resources and Mining	$1,188.47
Professional and Business Services	928.78
Manufacturing	900.58
Wholesale Trade	879.07
Transportation and Warehousing	840.92
Financial Activities	800.05
Information Technology	744.25
Construction	691.41
Health Care and Social Assistance	667.21
Educational Services	562.24
Other Services	491.51
Retail Trade	472.44
Arts, Entertainment and Recreation	359.91
Accommodation and Food Services	262.73

Fiscal vs. Monetary Policy

Fiscal policy refers to government policy that attempts to influence the direction of the economy through changes in government spending or taxes. Fiscal policy can be contrasted with the other main type of economic policy, monetary policy, which attempts to stabilize the economy by controlling interest rates and the supply of money. The two main instruments of fiscal policy are government spending and taxation. Changes in the level and composition of taxation and government spending can Affect the economy. A good example of fiscal policy is the Economic Stimulus Act of 2008 and the tax rebate payments that are intended to spur job growth through increased consumer spending.

Monetary policy is the process by which the government, central bank or monetary authority manages the supply of money or trading in foreign exchange markets. Monetary policy is generally referred to as being either an expansionary policy or a contractionary policy, where an expansionary policy increases the total supply of money in the economy, and a contractionary policy decreases the total money supply. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy has the goal of raising interest rates to combat inflation (or cool an otherwise overheated economy). Monetary policy should be contrasted with fiscal policy, which refers to government borrowing, spending and taxation.

The Federal Reserve System or Federal Reserve is the central banking system of the United States. Created in 1913 by the enactment of the Federal Reserve Act, it is a quasi-public system. Currently, Ben Bernanke serves as chair of the Board of Governors of the Federal Reserve System. The Federal Reserve is responsible for setting monetary policy.

In the months to come, the Legislative Council Service will periodically publish a one-page economic update report that tracks economic indicators, revenue and topical issues.

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New Mexico Economic Indicators

April 2008

Flash Report: No Recession Yet

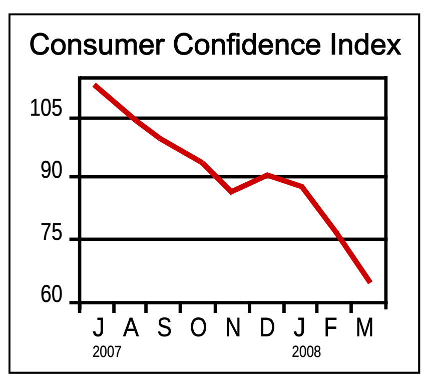
Real gross domestic product (GDP) — the output of goods and services produced by labor and property located in the United States — increased at an annual rate of 0.6% in the first quarter of 2008, according to advance estimates released by the U.S. Bureau of Economic Analysis (BEA). In the fourth quarter of 2007, real GDP also increased 0.6%.

The increase in real GDP in the first quarter primarily reflected positive contributions from consumer expenditures for services, private inventory investment, exports of goods and services and federal government spending. These increases were partly offset by negative contributions from residential fixed investment and reduced demand for durable goods.

While the increase in GDP is modest, to say the least, it is positive growth nonetheless. It remains to be seen if we have avoided a recession entirely or if the onset has only been delayed one quarter. Global Insight, Inc., the firm upon which the state relies when estimating revenue, notes that there is a 25% risk that the economy will be slow to turn around, particularly if oil remains above $115 per barrel and continued problems in the housing industry undermine consumer confidence.

U.S. Consumer Confidence Close to Five-Year Low

The Conference Board reports that consumer confidence has declined steadily since July 2007, reaching 64.5 in March 2008 (1985=100). This is the lowest level of consumer confidence since March 2003, when the index stood at 61.4.



Because consumer spending fuels two-thirds of GDP growth, this decline in confidence threatens the nation's economic recovery.

What's Ahead for New Mexico?

With nearly 25% of New Mexico jobs in the government sector and high oil and gas prices encouraging new drilling, employment in New Mexico may be more stable than in the national economy. It should be noted that New Mexico has not suffered a recession since 1981-82, when stagflation (the combination of high unemployment and high inflation) affected the economy. The recession of 1990-91, brought on by the collapse of junk bonds, and the 2001 recession, brought on by the burst of the dot.com bubble, accounting scandals and the September 11, 2001 attacks, had little impact on New Mexico.

By the Numbers

New Mexico's Economy at a Glance

New Mexico Indicators	**2006** 4th Qtr.	**2007** 1st Qtr.	**2007** 2nd Qtr.	**2007** 3rd Qtr.	**2007** 4th Qtr.
Gross State Product (dollars in billions)	71.049	71.858	72.647	73.466	74.346
% Change from One Year Ago	5.9	5.0	4.6	4.6	4.6
Oil Production (millions of barrels)	15.243	14.693	14.944	14.883	15.160
% Change from One Year Ago	0.2	-2.1	-0.1	-0.5	-0.5
Gas Production (billions of cubic feet)	392.432	354.256	367.937	371.222	403.746
% Change from One Year Ago	2.2	-5.9	-3.2	-3.6	2.9
Nonagricultural Employment	842,233	833,533	844,200	844,500	850,433
% Change from One Year Ago	2.5	1.8	1.3	1.2	1.0
Personal Income (dollars in billions)	57.517	58.241	58.941	59.613	60.350
% Change from One Year Ago	5.4	5.4	5.1	4.7	4.9
<u>Average Weekly Wages:</u>					
Professional/Business Services	$977.76	$914.65	$900.49	$898.84	$1,001.15
% Change from One Year Ago	9.2	14.4	10.8	2.9	2.4
Health Care and Social Assistance	$699.86	$645.11	$651.09	$671.10	$701.55
% Change from One Year Ago	1.4	-2.5	2.7	3.1	0.2
Retail Trade	$471.30	$467.66	$471.13	$469.30	$481.67
% Change from One Year Ago	4.5	3.4	3.1	3.1	2.2
Accommodation/Food Services	$261.17	$257.11	$259.46	$266.55	$267.82
% Change from One Year Ago	3.2	2.8	4.6	4.1	2.5
Construction	$737.26	$659.51	$675.85	$701.52	$728.78
% Change from One Year Ago	6.4	2.7	3.5	7.3	-1.2
Manufacturing	$868.70	$887.13	$874.42	$931.05	$909.73
% Change from One Year Ago	6.0	0.7	6.3	14.0	4.7

New Mexico Economic Indicators is a publication of the New Mexico Legislative Council Service.
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