Moody’s upgrades Oklahoma outlook

Ongoing expansion of the Oklahoma economy and recent actions by state leaders to correct long-standing fiscal management problems are being noticed well beyond the state’s borders.

Analysts at Moody’s Investors Service in New York City have been watching closely for quite some time.

In late September, Moody’s upgraded its outlook for Oklahoma from negative to stable – a very welcome change from the picture of the past few years.

Back in December 2015, in light of a downturn in crude oil and natural gas prices and growing dependence by state policymakers on one-time funds to fill worsening budget shortfalls, Moody’s changed Oklahoma’s credit rating outlook from stable to negative.

The two other main credit rating agencies, Standard and Poor’s Global Ratings (S&P) and Fitch Ratings, later followed suit by downgrading the state’s ratings by one level.

The S&P and Fitch actions put their ratings on par with Moody’s. But the changed outlook by Moody’s sent a clear message: If things don’t improve, a downgrade in Oklahoma’s credit rating, while influenced by governance decisions, is based heavily on economic factors.”

As go the oil fields, so goes the Oklahoma economy

Gross receipts and Oil & Gas employment, Jan. 2008 – Sept. 2018

Shaded area denotes U.S. recession. Sources: Bureau of Labor Statistics & State Treasurer
In October, the governor, treasurer and other state leaders will make their annual trip to New York City to meet with the three largest credit rating agencies to provide an update on the state’s economy and the Fiscal Year 2019 budget.

State leaders will be delivering some good news for a change as the state economy is growing, a structurally balanced budget was adopted with the support of new recurring revenues and the rainy day fund has been replenished with a record deposit.

It’s a far cry from the fiscal situation of the state a year ago that contributed to a downgrade in the state’s credit rating. Citing lagging collections due to a downturn in the energy industry, the persistent structural imbalance in the budget and depletion of reserves, Standard & Poor’s and Fitch downgraded the state’s credit in early 2017. Moody’s, which had placed the state on negative outlook in late 2015, cautioned that it could follow suit if the state’s budgeting practices and fiscal position did not improve.

The structural imbalance in the state budget has been a fixture in meetings with analysts with warnings that the state’s sub-optimal budgeting practices could lead to a credit downgrade, but the action taken by the credit agencies last year brought home the ramifications of such budgeting practices.

To compound matters last year, state leaders were facing a state budget with a $215 million dollar hole as result of the Oklahoma Supreme Court ruling that the cigarette cessation fee was unconstitutional. While the circumstances surrounding the Fiscal Year 2018 budget hole were unique, another year with a budget hole to fill was all too common with the state government having experienced revenue failures in the two previous fiscal years.

During the 2017 meetings, it was evident analysts were closely watching to see how the Fiscal Year 2018 budget would be resolved and whether the state was capable of taking the steps necessary to provide a long-term solution to stabilize the budget. The message was clear, if the state did not correct its budgeting practices its creditworthiness would deteriorate further.

This year is a much different – and

SEE MESSER PAGE 3
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FROM PAGE 2

better – story. As state leaders head to New York City this October, they will be discussing a budget that was brought into structural balance with $694 million in recurring revenue added to the General Revenue Fund from revenue enhancements adopted since 2017. The narrative from state leaders this year includes elimination of the practice of using non-recurring revenue to pay for ongoing expenses, new investments in education, and a state economy that is surging back to life.

These positive trends have already been noticed by analysts, with Moody’s revising its outlook for the state from negative to stable in late September. The move by Moody’s specifically focused on the improved budgeting practice as a key determinant in its decision to move its outlook on the state’s credit in a positive direction.

Oklahomans are resilient and pragmatic, traits that were on full display over the past year as the state weathered a recession in the energy industry and state leaders came together to overcome challenges that at times seemed insurmountable to put the state’s fiscal position on a solid foundation for the future. It’s a message state leaders will be delivering to analysts and one of which Oklahomans can be proud.

Moody’s

FROM PAGE 1

credit rating would be the likely result.

The economic downturn

Oklahoma’s credit rating, while influenced by governance decisions, is based heavily on economic factors. Thus, the recovery from the supply-driven energy price downturn helped provide a boost to the general outlook for the state.

For context, the Oklahoma economy is much more dependent on the oil and gas industry than the United States as a whole.

The mining supersector, which includes oil and gas, accounts for 2 percent of the U.S. Gross Domestic Project (GDP), but provides 12 percent of the Oklahoma GDP, according to the federal government’s Bureau of Economic Analysis.

Throughout the state’s history, government financial crises have always started within a few months of energy downturns. This linkage can be seen in the chart on page 1 of this report, which compares employment in the mining supersector to the rolling 12-month total of Oklahoma Gross Receipts to the Treasury.

Governance factors

In its 2015 outlook change, Moody’s was critical of the state’s ongoing reliance on nonrecurring revenue sources to fund ongoing expenses.

Moody’s also expressed concern with low balances in the state’s reserve funds. Since the credit ratings are based on the state’s ability to make payments on its debt, this was a substantial factor in the outlook decision.

The high bar required to enact tax increases, under the provisions added to the state constitution with voter approval of State Question 640, continues to be a negative factor in credit agencies’ analyses of Oklahoma.

The Oklahoma turnaround

In early 2016, oil and gas prices hit their trough and began a slow rebound. Some months later, energy companies began adding jobs, and as has historically been the case, state revenues began to recover.

Work on the fiscal issues facing state government would take more time to address. However, during the 2017
Moody’s
FROM PAGE 3

and 2018 legislative sessions, state policymakers enhanced revenues and substantially reduced the use of nonrecurring revenue to adopt a structurally balanced FY-19 budget.

The first tax increase since the 1992 adoption of State Question 640, requiring approval of three-quarters of each house, was adopted.

With economic expansion well underway, FY-18 revenue collections exceeded 100 percent of the certified estimate by 7 percent, resulting in a record deposit of $381 million into the Constitutional Reserve Fund, or rainy day fund.

Moody’s – in their own words

In its Credit Opinion of September 28, Moody’s painted a relatively positive picture of Oklahoma’s economy and fiscal management.

“Oklahoma has begun to rebound after a few years of economic and fiscal challenges. Economic growth has improved and is once again on par with U.S. averages, particularly as the turnaround in the oil and gas sector has progressed,” the report reads.

“Concomitantly, the state’s finances have stabilized, as new revenue sources have essentially closed the structural deficit and the rainy day fund has been replenished. The state has also benefited from low debt levels and a modest pension burden,” the Moody’s report continues.

The opinion, however, says challenges remain.

“The economy and the budget remain dependent on the oil and gas sector which may yield further difficulties during the next recession.

“Additionally, strict constitutional requirements and a divisive political environment continue to challenge the ability of lawmakers to adjust government revenues to changing economic and fiscal conditions,” the report states.

Moody’s lists as credit strengths the state government’s “very low debt and pension liabilities,” and “high levels of financial reserves.”

Potential problems listed by Moody’s include a “history of persistent structural budget imbalance, revenue sensitivity to commodity prices and production,” and the “supermajority requirement to raise taxes that limits financial flexibility.”

Moody’s writes, “The stable outlook reflects an expectation of modest economic growth, despite continued reliance on the oil and gas sector, and the stabilization of the state’s finances driven by recent revenue growth.

“The replenishment of reserves will help cushion the state from fiscal pressure during the next economic downturn,” the report reads.

Oklahoma vs. United States Economy

Oklahoma more dependent on oil sector

The replenishment of reserves will help cushion the state from fiscal pressure during the next economic downturn.” – Moody’s

Source: 2017 nominal GDP, BEA, Moody’s Investors Service

www.treasurer.ok.gov • Page 4
Gross Receipts to the Treasury soar to record heights

Oklahoma Gross Receipts to the Treasury, which reflect general state economic activity, surged by 14 percent in September – the tenth month of double-digit growth in the past year, State Treasurer Ken Miller announced.

Gross receipts of $1.2 billion during the past month are the highest September total on record. Cumulative gross receipts from the past 12 months, at $12.5 billion, are also at an all-time high.

"Oklahoma's economy continues to climb the expansion side of the business cycle," Treasurer Miller said. "As we saw last week with the ratings outlook upgrade from negative to stable by Moody's Investors Service, the state’s economic and policy improvements are being noticed well beyond our borders."

August Gross Receipts to the Treasury totalled $995.1 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received $454.6 million, or 45.7%, of the total.

The GRF received between 33.5% and 57% of monthly gross receipts during the past 12 months.

From August gross receipts, the GRF received:
- Individual income tax: 58.7%
- Corporate income tax: None
- Sales tax: 38.6%
- Gross production-Gas: 69.2%
- Gross production-Oil: 15%
- Motor vehicle tax: 25.8%
- Other sources: 56.1%

August GRF allocations were below the above the estimate by 6.6%. Year-to-date allocations are above the estimate by 2.1%.

August insurance premium taxes totaled $3.9 million, a decrease of $2.1 million, or 35.3%, from the prior year.

Tribal gaming fees generated $12.6 million during the month, up by $363,217, or 3%, from July 2017.

<table>
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<tr>
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<th>September-17</th>
<th>September-18</th>
<th>Variance From Prior Year</th>
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<td>Income Tax</td>
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<td>Motor Vehicle</td>
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<td><strong>TOTAL REVENUE</strong></td>
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<td><strong>$1,153.4</strong></td>
<td><strong>$141.4</strong></td>
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</tbody>
</table>

Dollar change (in millions) from prior year

Source: Office of the State Treasurer
increased collections in every major revenue stream compared to the same month of last year, ranging from 110 percent in gross production taxes on oil and natural gas to 0.1 percent in motor vehicle taxes.

Twelve-month gross receipts show healthy increases in collections in all major tax sources compared to the prior period.

**New Tax Revenue**

Revenue generated by increased tax rates approved in House Bill 1010XX last March added $48.7 million to monthly collections, 4.2 percent of September gross receipts.

The biggest share, $31.2 million, came from the increase from 3 percent to 5 percent in the incentive tax rate on oil and natural gas gross production. Raising the tax on gasoline and diesel fuel generated $8.3 million, and the $1 per pack hike in cigarette taxes added $9.3 million to the bottom line.

**Other indicators**

The Oklahoma Business Conditions Index has topped growth neutral for 14 consecutive months. The September index was set at 57.6, down slightly from 60.4 in August. Numbers above 50 indicate anticipated economic growth during the next three to six months.

Oklahoma’s seasonally adjusted unemployment rate of 3.7 percent in August is down by one-tenth of a percentage point from July. The U.S. jobless rate of 3.9 percent is unchanged from the prior month, according to figures released by the Oklahoma Employment Security Commission.

**September collections**

September gross collections total $1.2 billion, up $141.4 million, or 14 percent, from September 2017.

Gross income tax collections, a combination of individual and corporate income taxes, generated $410 million, an increase of $42 million, or 11.4 percent, from the previous September.

Individual income tax collections for the month are $320.3 million, up by $22.9 million, or 7.7 percent, from the prior year. Corporate collections are $89.7 million, an increase of $19.1 million, or 27.1 percent.

Sales tax collections, including remittances on behalf of cities and counties, total $409.4 million in September. That is $25.3 million, or 6.6 percent, more than September 2017.

Gross production taxes on oil and natural gas generated $105.3 million in September, an increase of $55.2 million, or 110 percent, from last September.

Compared to August reports, gross production collections are up by $33.4 million, or 46.5 percent.

Motor vehicle taxes produced $60 million, up by $35,012, or 0.1 percent, from the same month of 2017.
Revenue

FROM PAGE 6

Other collections, consisting of about 60 different sources including use taxes, along with taxes on fuel, tobacco, and alcoholic beverages, produced $168.6 million during the month. That is $18.9 million, or 12.7 percent, more than last September.

Twelve month collections

Gross revenue totals $12.5 billion from the past 12 months. That is $1.4 billion, or 12.4 percent, more than collections from the previous 12 months.

Gross income taxes generated $4.4 billion for the period, reflecting an increase of $394.4 million, or 10 percent, from the prior 12 months.

Individual income tax collections total $3.9 billion, up by $303.5 million, or 8.5 percent, from the prior 12 months. Corporate collections are $494.4 million for the period, an increase of $90.9 million, or 22.5 percent, over the previous period.

Sales taxes for the 12 months generated $4.8 billion, an increase of $455.2 million, or 10.5 percent, from the prior period.

Oil and gas gross production tax collections brought in $810.1 million during the 12 months, up by $325.4 million, or 67.1 percent, from the previous period.

Motor vehicle collections total $774.6 million for the period. This is an increase of $18.5 million, or 2.5 percent, from the trailing period.

Other sources generated $1.8 billion, up by $190 million, or 11.6 percent, from the previous year.

About Gross Receipts to the Treasury

The Office of the State Treasurer has issued the monthly Gross Receipts to the Treasury report since March 2011 to provide a timely and broad view of the state’s macro economy.

It is released in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

The General Revenue Fund receives less than half of the state’s gross receipts with the remainder paid in rebates and refunds, remitted to cities and counties, and placed into off-the-top earmarks to other state funds.

State unemployment rate drops to 3.7 percent in August

Oklahoma’s seasonally adjusted unemployment rate of 3.7 percent in August is down by one-tenth of a percentage point from July. The U.S. jobless rate of 3.9 percent is unchanged from the prior month, according to figures released by the Oklahoma Employment Security Commission.

Since August 2017, the number of working Oklahomans has risen by 33,920, while the number of those listed as unemployed has dropped by 6,772.
Economic Indicators

Unemployment Rate
January 1980 – August 2018

Gross Receipts vs. Oil & Gas Employment
January 2008 – September 2018

Leading Economic Index
January 2001 – July 2018

Oklahoma Stock Index
Top capitalized state companies
January 2009 – September 2018

Oklahoma Oil Prices & Active Rigs
January 2011 – September 2018

Oklahoma Natural Gas Prices & Active Rigs
January 2011 – September 2018