Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *JANUARY 2008*

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703 Stratton Ofc. Bldg.
Springfield, IL 62706

ECONOMY: What Lies Ahead?
Edward H. Boss, Jr., Chief Economist

The economy entered 2008 on a weak note, continuing the trend that developed in the final months of 2007. This sparked a large interest rate cut by the Federal Reserve at a pre-scheduled emergency meeting as well as an unprecedented quick response on a fiscal policy stimulus package by the Congress to avoid a recession. Indeed as mentioned last month, the odds of a recession had grown. **Global Insight** had given odds of a recession occurring a 40% chance early in January while in a forecast in late January, coming in a special report done for the Commission by **Moody's Economy.com,** raised the odds of recession to 60% according to their assessment.

The slowdown in the economy was shown in the latest report issued by the Commerce Department. In its advanced report on inflation-adjusted gross domestic product (GDP), the annual rate of increase slowed to a meager 0.6% annual rate in the final quarter of calendar 2007, down from 4.9% in the third quarter and 3.8% in the quarter before that. While GDP will be revised two more times as more detailed information becomes available, the advanced report showed growth that was about half that anticipated. Real consumer spending, which normally accounts for two-thirds of total spending, showed a 2% annual rate of increase, down from 2.8% in the previous quarter. The largest decline was again in residential, or housing, investment that fell at a 23.9% annual rate and subtracted 1.18% from GDP.

The weak GDP report was followed later in the day by the results of the latest Federal Reserve Open Market Committee Meeting, which lowered key monetary policy rates by one-half percent coming on top of a three-quarter's point decrease a few days earlier at the emergency meeting. Other data recently released have been mixed, but mainly disappointing.

Consumer confidence as measured by the Conference Board, after rising in November for the first time since last July, fell back to November's level in December. In contrast, durable goods orders rose at a sharp 5.2% rate in December, potentially boosting manufacturing output in the months ahead. The Chicago Purchasing Manager's Index weakened in January but still showed expansion. At the same time, housing continued to weaken. Sales of new single-family homes fell 4.7% in December and were 40.7% below December of a year earlier suggesting the housing correction continues. Finally, initial claims for unemployment, which had been trending lower in recent weeks, bounced up sharply at month's end.

Recent data suggest that the weakness in economic activity has yet to run its course. Whether or not this culminates into a full fledged recession or not is still uncertain, although in large part this may be a matter of semantics when it comes to the effect of the economy on state finances. The table below shows the latest **Global Insight** economic forecast expressed on a fiscal year basis made in January. The table reflects three years, FY 2007 – FY 2009, of below trend growth estimated for the U.S. economy, the weakest occurring in the upcoming fiscal year, following three years of growth that had been at or above its historical trend.

According to analysis done for the Commission by **Moody's Economy.com,** Illinois' economy closely mirrors the U.S. economy "*97% of the variations in the Illinois economy is related to variations in the national economy. This means that Illinois will most certainly succumb if the economy sinks into a recession—if it has not done so already.*" Indeed, the report goes on to point out that Illinois has trailed the national pace for the past decade and that its cyclical swings have been of greater amplitude in downswings. This suggests that Illinois will fare worse as the economy weakens, whether or not a recession occurs.

ECONOMIC FORECASTS - JANUARY 2008
($ Change from prior year levels)

REAL (2000$)	FY 2004 Actual	FY 2005 Actual	FY 2006 Actual	FY 2007 Actual	FY 2008 Estimated	FY 2009 Estimated
Gross Domestic Product	3.8	3.1	3.2	2.1	2.5	2.0
Personal Consumption	3.6	3.3	3.1	3.0	2.4	2.1
Durable	7.7	5.3	3.6	4.5	3.1	2.1
Nondurable	4.0	3.3	3.6	3.2	1.8	2.1
Services	2.6	3.0	2.8	2.6	2.5	2.1
Fixed Investment	7.9	8.1	5.0	-3.2	-3.7	-1.6
Exports	3.4	8.9	7.4	7.9	11.8	8.5
Imports	10.1	7.5	6.3	2.4	1.4	3.4
Government	2.0	0.8	1.4	1.7	2.9	1.1
Federal	7.0	2.9	1.8	1.5	4.5	1.1
State & Local	0.0	-0.2	1.0	1.8	2.3	1.0
OTHER MEASURES						
Personal Income (Current $)	4.8	6.5	6.2	6.3	5.6	4.7
Personal Consumption (Current $)	5.9	6.2	6.4	5.5	5.1	3.8
Before Tax Profits (Current $)	20.7	17.5	9.6	8.8	1.0	-0.6
Consumer Prices	2.2	3.0	3.8	2.6	3.0	1.5
Unemployment Rate (Average)	5.8	5.3	4.8	4.6	4.8	5.2

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	DEC. 2007	NOV. 2007	DEC. 2006
Unemployment Rate (Average)	5.5%	5.2%	4.0%
Annual Rate of Inflation (Chicago)	-4.1%	6.5%	4.7%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (December)	6,795	0.1%	1.7%
Employment (thousands) (December)	6,423	-0.2%	0.2%
New Car & Truck Registration (December)	43,499	18.5%	12.4%
Single Family Housing Permits (December)	915	-33.7%	-39.0%
Total Exports ($ mil) (November)	4,121	-8.9%	10.7%
Chicago Purchasing Managers Index (January)	51.5	-9.0%	5.3%

REVENUE
January Revenues Dip – Monthly Results Mixed

Jim Muschinske, Revenue Manager

Overall receipts in January fell $10 million. Despite a few revenue sources posting solid gains for the month, a large drop in federal sources erased all gains. The falloff would have been much greater except finalizing of the FY 2008 BIMP aided January's receipts by approximately $105 million due to lowered income tax refund percentage per P.A. 95-707. In effect, until SB 783 became law on January 11th, last year's refund percentages were being utilized. Once final, an adjustment was made to the refund fund for the previous six plus months. January had the same number of receipting days as last year.

Despite an overall loss in monthly revenue, a number of sources fared quite well. Gross personal income taxes continued to perform nicely in January, with receipts up $91 million. And, with the resulting adjustment for the refund percentage change, the net increase for the month was $200 million. Similarly, gross corporate income tax increased by $18 million, but that gain rose to $32 million on a net of refund basis. As expected, insurance taxes and fees posted a large gain this month, up $31 million, due to timing of receipts. Public utility taxes grew by $26 million, although virtually all of that gain was due to a corrected electronically submitted payment. Evidently, back in the October/November period, a taxpayer mistakenly coded their payment as sales tax rather than public utility tax, and a corrective adjustment subsequently was made in January. Inheritance tax grew by $6 million, liquor taxes by $5 million, and corporate franchise by $2 million.

A few sources did experience declines for the month. Sales tax fell $28 million, although most of that decline was related to the aforementioned corrected receipting with public utility taxes. Essentially, sales tax was flat again for the month. Other sources declined by $11 million, the Cook County IGT by $9 million, and interest earnings by $3 million.

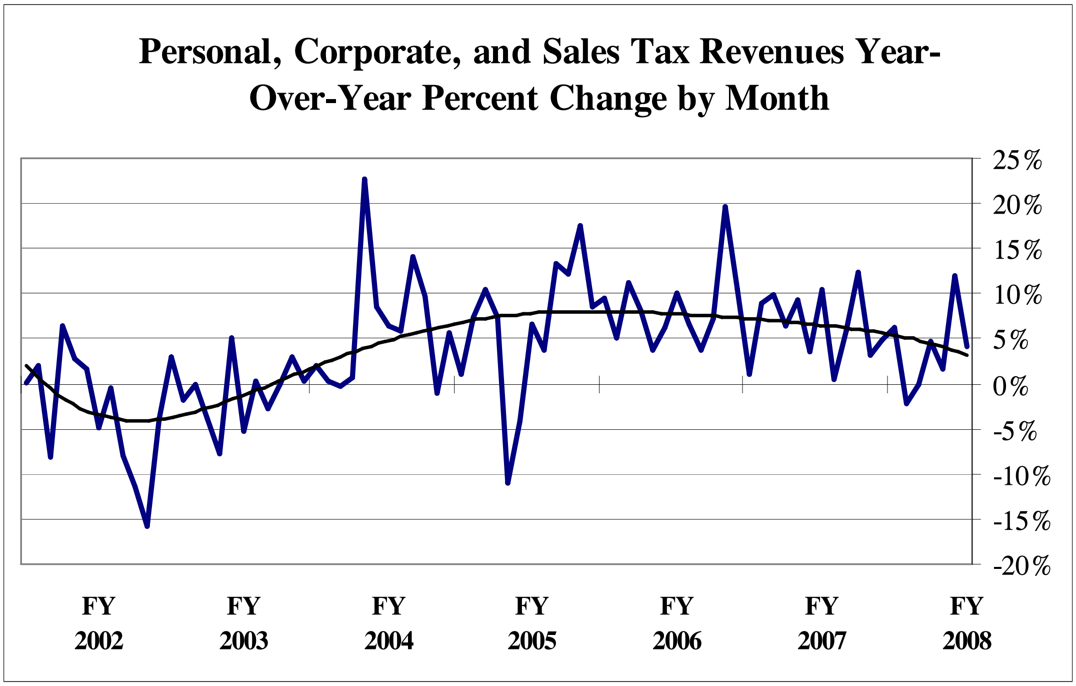
Overall transfers fell by $50 million in January. While lottery transfers rose by $7 million, those gains were offset by a $2 million decline in riverboat transfers and a $55 million falloff in all other transfers. Finally, the unusually large amount of reimbursable spending undertaken in January 2007 resulted in a comparatively large falloff this year, as federal receipts dropped by $211 million.

Year to Date

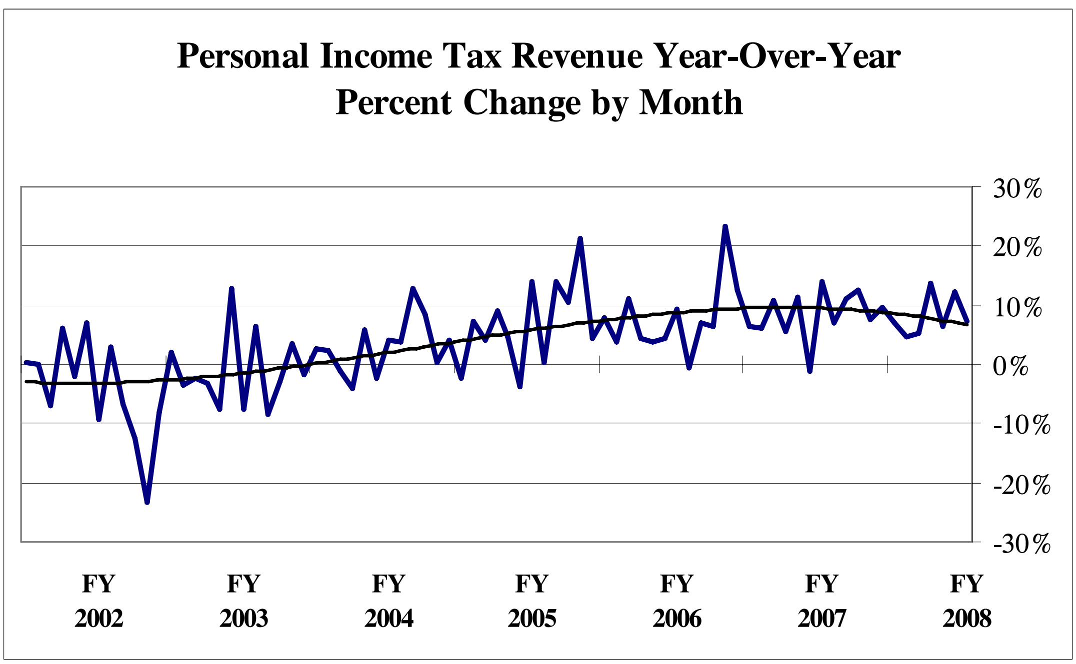
Through the first seven months of the fiscal year, overall base receipts were up $564 million. While receipt performance has been mixed, one area that continues to fare well is gross personal income tax receipts. Through January, receipts are up $428 million, or $504 million on a net of refund basis. While this revenue source continues to be fueled by gains in withholding and estimated payments, concerns remain that upcoming final payments and later estimated payments will reflect the slowed economy. Conversely, weakness in corporate income tax continues with gross receipts down $26 million, or $4 million on a net of refund basis. Also underperforming is the sales tax, as receipts are only up $3 million. Some positive news continues to come from the strength of inheritance tax—up $57 million, corporate franchise tax $22 million, and interest earnings $12 million. However, while lottery and riverboat transfers are up $42 million and $13 million, respectively, other transfers more than erased those gains and are down $111 million. Finally, after beginning the fiscal year on an up note, the recent drop off in federal sources has receipts running slightly behind last year—off a modest $5 million.

FY 2008 Revenue Outlook Update—Concerns Mount With Slowing Economy

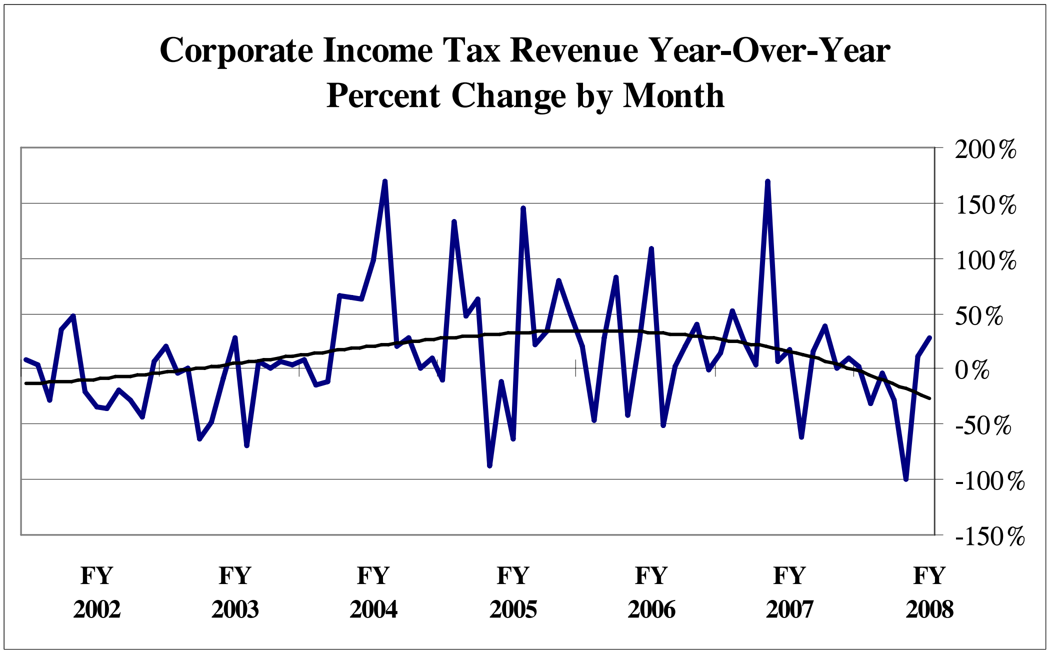
In its September 2007 monthly briefing, the Commission raised concerns regarding certain areas of revenue performance, particularly those of sales tax and corporate income taxes. In addition, it was stated that, *"With this heightened state of [economic] uncertainty, it would not be surprising to see revenues struggle in FY 2008"*. Unfortunately, the outlook has turned more onerous as we head into the second half of the fiscal year. As shown, the following chart illustrates how sources most closely tied to the economy have performed thus far. Based on a year over year percent change basis, a slowing trend continues to advance in the combined monthly revenues of personal, corporate, and sales taxes.



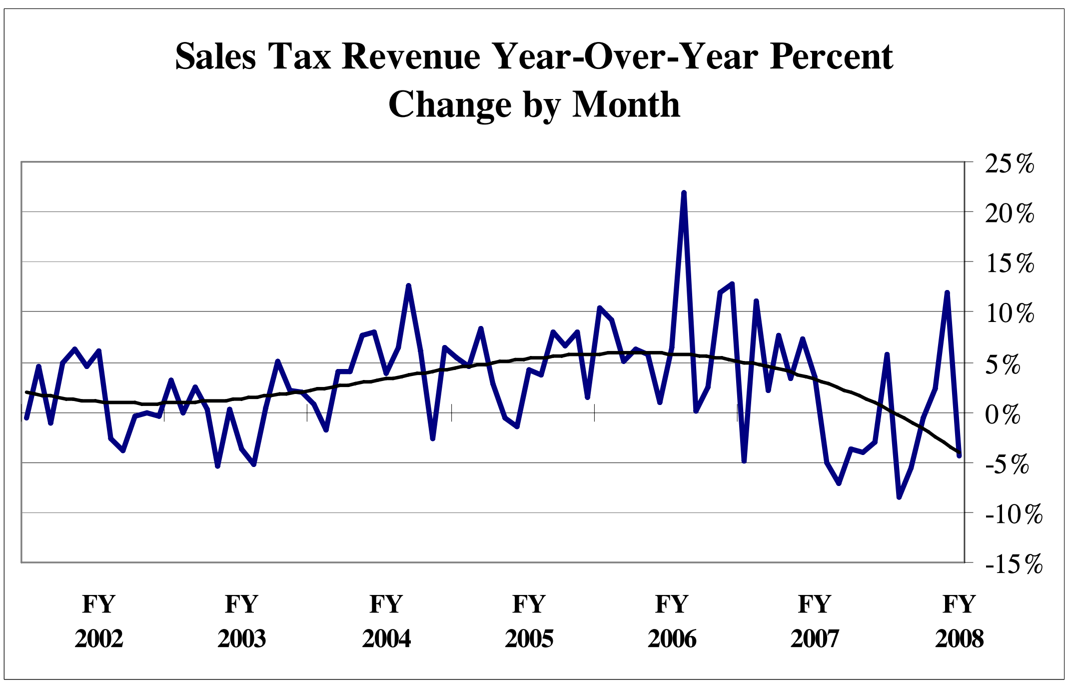
To reiterate, while gross personal income tax has continued to post above average gains, a markedly more fragile employment picture will likely begin to impact receipts heading forward. Since much of the year to date strength has come from estimated payments, concern is growing that a significant reduction in growth will occur in the spring once final payments are made. On the plus side, gains thus far have been significant, so even if the slowdown is worse than expected, enough "cushion" may have been built up to still post a healthy gain in FY 2008.



News is not as good for corporate income tax receipts. While the year to date decline in gross receipts may be somewhat low due to timing and/or processing changes, the outlook for the remainder of the year, and for that matter, for quite some time to come, is not good. The latest economic forecast calls for essentially no growth in before tax profits continuing through next fiscal year. As a result, it would seem unrealistic to think that corporate income tax receipts over the remainder of FY 2008 would do anything but continue to struggle.



Sales tax receipts continue to reflect weakness in the consumer sector. With the exception of an anticipated up tick in March, related to an allocation issue experienced last year, consumer activity is likely to continue to be weak for the foreseeable future.



A few bright spots have come from the smaller revenue sources such as inheritance tax, corporate franchise tax, and interest income—all of which have demonstrated significant growth. However, due to their relative size, even large percent changes do not generate major windfalls.

While the FY 2008 budget was implemented with the hopes of recording approximately $1.6 billion in revenue growth--actual performance through January, teamed with a slowing economy, point to revenues falling well short of those expectations. While the Commission will be providing an official estimate at a scheduled March 5th meeting, receipts to date coupled with an anticipated slowing in personal income tax growth could result in overall growth struggling even to reach $1 billion.

FY 2009 Revenue Picture - Pain or Gain?

Unfortunately, the current state of economic uncertainty serves to temper growth expectations for FY 2009. Latest economic forecasts indicate that real personal income as well as personal consumption is forecast to continue to slow in the upcoming fiscal year, while corporate profits are expected to struggle again. Furthermore, the unemployment rate, which has moved significantly higher in recent months, is expected to continue to climb.

As a result, growth rates of the economically related sources are likely to fall well below historic averages.

- Personal income tax, while holding up quite well over the first part of the current fiscal year, is expected to slow eventually and continue below average into FY 2009.

- Corporate income tax has historically been one of the most volatile revenue sources, illustrated by double digit swings in seven out of the last ten fiscal years (two of those negative). Given the latest corporate profit outlook, achieving any growth absent last years "loophole" changes [P.A. 95-233], will prove difficult.

- Sales tax revenues have disappointed for quite some time now, virtually all of last year and well into this fiscal year. While it may end somewhat improved from this year, it's unlikely that growth will be significantly higher next year.

- A few revenue areas that are enjoying a good FY 2008 may very well return losses next year. For example, inheritance tax has performed unexpectedly strong thus far based on large settlement activity. Inheritance tax receipts are very volatile and, therefore, it will be difficult to duplicate a similar performance. Rates of return have begun to decline, signaling a potential drop in interest earnings. The Cook County Intergovernmental transfer is expected to continue to erode in the near term. And finally, absent legislative action, certain fund transfers are not expected to be repeated at similar levels in the future, i.e. income tax refund transfers and hospital assessment program transfers.

Given the current uncertain status of the economy the revenue picture for FY 2009 is far from clear. However, it would

appear that limited base growth is the best that can be hoped for. Unfortunately, appetites for expanded health care, education, capital needs, and other worthy programs continue to build. Add to that the continued pension funding pressure, bills incurred but unable to be paid, and the resulting budgetary difficulties continue to build without any signs of slowing. Again, the Commission plans on presenting its official FY 2009 forecast at a scheduled March 5th meeting.

GENERAL FUNDS RECEIPTS: JANUARY

FY 2008 vs. FY 2007
($ million)

Revenue Sources	Jan. FY 2008	Jan. FY 2007	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,352	$1,261	$91	7.2%
Corporate Income Tax (regular)	86	68	$18	26.5%
Sales Taxes	622	650	($28)	-4.3%
Public Utility Taxes (regular)	141	115	$26	22.6%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	18	13	$5	38.5%
Vehicle Use Tax	2	2	$0	0.0%
Inheritance Tax (Gross)	21	15	$6	40.0%
Insurance Taxes and Fees	39	8	$31	387.5%
Corporate Franchise Tax & Fees	17	15	$2	13.3%
Interest on State Funds & Investments	13	16	($3)	-18.8%
Cook County IGT	13	22	($9)	N/A
Other Sources	53	64	($11)	-17.2%
Subtotal	$2,406	$2,278	$128	5.6%
Transfers				
Lottery	65	58	$7	12.1%
Riverboat transfers & receipts	43	45	($2)	-4.4%
Other	24	79	($55)	-69.6%
Total State Sources	$2,538	$2,460	$78	3.2%
Federal Sources	$432	$643	($211)	-32.8%
Total Federal & State Sources	$2,970	$3,103	($133)	-4.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($14)	($123)	$109	-88.6%
Corporate Income Tax	$2	(12)	$14	-116.7%
Subtotal General Funds	$2,958	$2,968	($10)	-0.3%
Short-Term Borrowing	$0	$0	$0	N/A
Hopital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,958	$2,968	($10)	-0.3%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 5-Feb-08

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2008 vs. FY 2007

($ million)

Revenue Sources	FY 2008	FY 2007	CHANGE FROM FY 2007	% CHANGE
State Taxes				
Personal Income Tax	$5,883	$5,455	$428	7.8%
Corporate Income Tax (regular)	861	887	($26)	-2.9%
Sales Taxes	4,348	4,345	$3	0.1%
Public Utility Taxes (regular)	655	645	$10	1.6%
Cigarette Tax	204	204	$0	0.0%
Liquor Gallonage Taxes	100	93	$7	7.5%
Vehicle Use Tax	20	20	$0	0.0%
Inheritance Tax (Gross)	221	164	$57	34.8%
Insurance Taxes and Fees	153	155	($2)	-1.3%
Corporate Franchise Tax & Fees	133	111	$22	19.8%
Interest on State Funds & Investments	131	119	$12	10.1%
Cook County IGT	99	84	$15	17.9%
Other Sources	249	248	$1	0.4%
Subtotal	$13,057	$12,530	$527	4.2%
Transfers				
Lottery	372	330	$42	12.7%
Riverboat transfers & receipts	413	400	$13	3.3%
Other	325	436	($111)	-25.5%
Total State Sources	$14,167	$13,696	$471	3.4%
Federal Sources	$2,799	$2,804	($5)	-0.2%
Total Federal & State Sources	$16,966	$16,500	$466	2.8%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($456)	($532)	$76	-14.3%
Corporate Income Tax	($133)	($155)	$22	-14.2%
Subtotal General Funds	$16,377	$15,813	$564	3.6%
Short-Term Borrowing	$1,200	$0	$1,200	N/A
Hospital Provider Fund (cash flow transfer)	$300	$0	$300	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	0.0%
Total General Funds	$18,153	$16,089	$2,064	12.8%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.

CGFA 5-Feb-08

PENSION

Pension Reforms Contained in CTA Bailout Bill

Dan Hankiewicz, Pension Manager

Public Act 95-0708, the long-anticipated metropolitan transit bailout bill, became effective on January 18th, 2008, upon certification by the governor of the General Assembly's acceptance of his amendatory veto. Several important reforms were made to the Chicago Transit Authority pension fund, as summarized below:

Management Structure

Prior to the enactment of P.A. 95-0708, the committee responsible for the governance and administration of the CTA Pension Fund was known as the Retirement Allowance Committee. The Act abolished this committee and replaced it with an 11 member Board of Trustees. Five members shall be appointed by the Chicago Transit Board; three members shall be appointed by the labor organization representing the highest number of CTA participants; one member shall be appointed by the labor organization representing the second-largest number of CTA participants, and one member shall be appointed by the employees not represented by a labor organization representing the highest or second-highest number of CTA participants. The final member shall be a professional fiduciary who has experience in pension plan collective bargaining, and shall be selected by the Regional Transportation Authority Board of Directors.

Investment Authority

P.A. 95-0708 stipulates that the Board of Trustees may cause retirement plan funds to be invested in any type of investment permitted for the investment of moneys held by any of the State pension or retirement systems, any unit of local government or school district, or any agency or instrumentality thereof. The Act states that the board may, by a vote of at least two-thirds of the trustees, place retirement plan funds under the investment management of the Illinois State Board of Investment.

Benefit Eligibility

All individuals who were participants in the fund prior to the effective date of the Act shall automatically be members of the new retirement fund, and shall continue receiving the same benefits. For all CTA employees hired on or after the effective date, the following terms, conditions and provisions with respect to retirement shall be applicable: full retirement benefits at age 64 with 25 years of continuous service, or a reduced retirement benefit at age 55 with 10 years of continuous service.

Contribution Rates

Beginning January 1, 2009, all participating employees shall contribute 6% of compensation, and the CTA shall contribute 12% of compensation to the Plan. For the period ending December 31, 2040, the amount of debt service on any pension obligation bonds will be treated as a credit against the CTA contribution to the Plan, up to a limit of 6% of compensation.

Contribution Increases

P.A. 95-0708 makes the following contribution changes: if the funded ratio of the CTA pension fund is projected to fall below 60% for any year before 2040, the Board of Trustees will calculate as a level percentage of payroll the amount of increased contributions necessary to eliminate the shortfall within 10 years. These additional contributions will be required for each year prior to 2040 with one-third of the increase coming from increased employee contributions and two-thirds coming from increased employer contributions, in excess of normal contribution rates. For the period beginning 2040, the minimum contribution to the retirement Plan for each fiscal year shall be an amount sufficient to increase the funded ratio to 90% by the end of 2059. Participating employees will be responsible for one-third of the required additional contribution and the CTA will be responsible for two-thirds of the required additional contribution. Beginning in 2060, the required total contributions will be the amount necessary to keep the funded ratio at 90% each year, and the contribution shall be funded two-thirds by the CTA and one-third by the participating employees.

Health Care Trust

P.A. 95-0708 provides the CTA shall take all lawful actions necessary to separate the funding of retiree health benefits from the funding for the pension plan no later than July 1, 2009. A Retiree Health Care Trust shall be established 90 days after the effective date for the purpose of providing retirement health care benefits. The Act also states that the Retiree Health Care Trust shall assume sole responsibility for providing health care benefits to eligible retirees and their dependants and survivors no later than July 1, 2009.

Health Care Trust Board of Trustees

The Trust shall be governed and administered by a Board of Trustees consisting of 7 members. Three members shall be appointed by the Chicago Transit Board; one member shall be appointed by the labor organization representing the highest number of CTA participants; one member shall be appointed by the labor organization representing the second-largest number of CTA participants; and one member shall be appointed by the employees not represented by a labor organization representing the highest or second-highest number of CTA participants. The final member shall be a professional fiduciary who has experience in collectively bargained employee pension health plans, and shall be selected by the Regional Transportation Authority Board of Directors. The Act stipulates that the health care trust will not offer any health insurance plan which provides for more than 90% coverage for in-network services or 70% coverage for out-of-network services after any deductible has been paid.

Health Care Trust Contributions and Investment

Contributions into the Trust will come from employee contributions totaling no less than 3% of compensation. The Board of Trustees will also have the discretion to require contributions from retirees, dependants and survivors based upon their years of service, levels of coverage or Medicare eligibility, provided that the total of these contributions do not exceed 45% of the total benefit costs. Funds in the Trust may be invested in the same manner as retirement plan moneys. In order to be eligible for retiree health care benefits, the retiree must be at least 55 years of age, retire with 10 or more years of service, and satisfy any other rules that the board may establish.

Bond Issuance

The CTA is authorized to issue $1.3 billion in new bonds for the pension system. After payment of the costs of issuance and necessary deposits related to debt service, the net proceeds of approximately $1.1 billion will be deposited into the Retirement Plan for Chicago Transit Authority Employees. In addition, the CTA is authorized to issue $639.7 million in new bonds for healthcare funding. After payment of the costs of issuance and necessary deposits related to debt service, the bond sale net proceeds of approximately $528.8 million will be deposited into the Retiree Health Care Trust.