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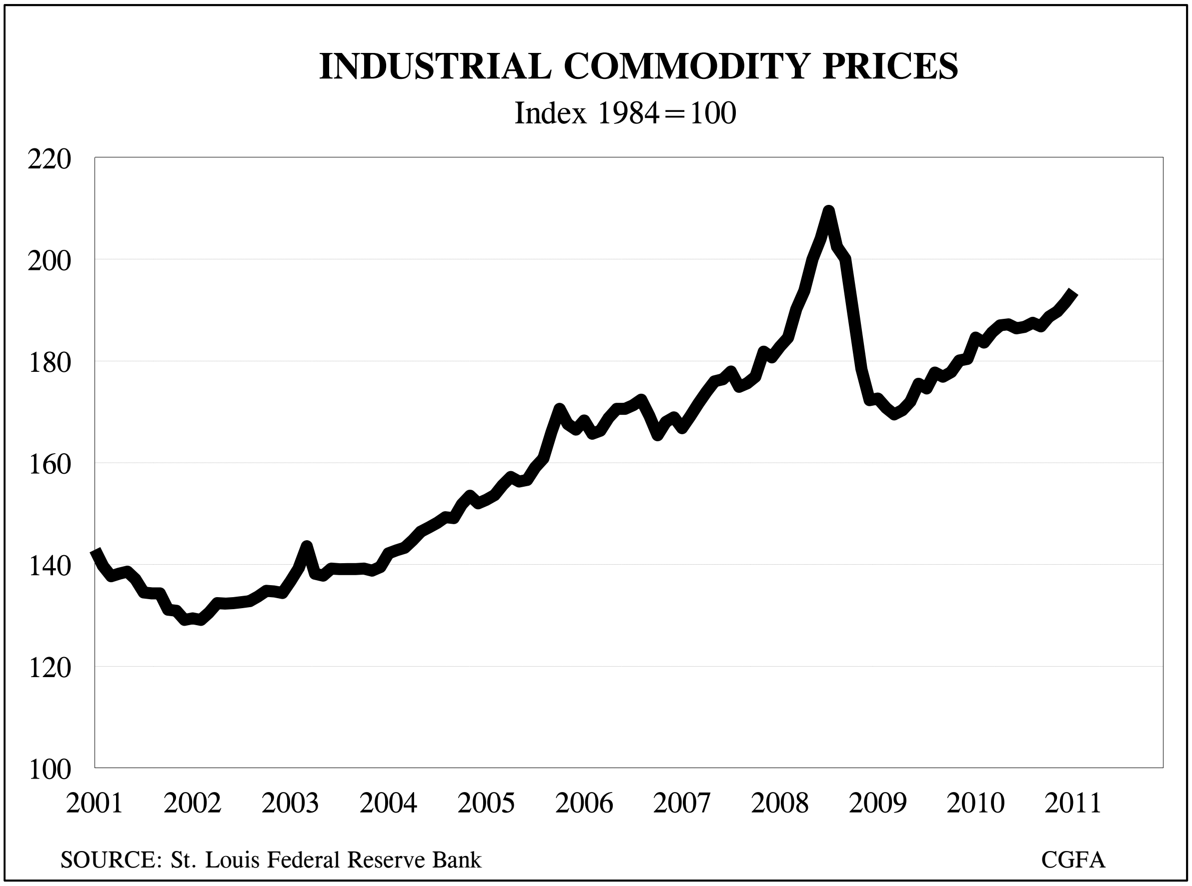
ECONOMY: Rebound in Commodity Prices

Edward H. Boss, Jr., Chief Economist

Commodity prices have been on the rise, raising concerns that this will lead to renewed inflation down the road. Even so, the increase in consumer prices in January remained acceptable with the overall index up a modest 1.6% from a year earlier and the core inflation rate, which excludes food and energy prices, up a mere 1.0%. Despite that, prices have risen in each of the past seven months with energy commodities and food accounting for more than two-thirds of the gain after recording little gain to small decreases in each of the previous six months.

There is every expectation that prices of food and energy commodities will continue to be a factor in lifting consumer prices in the months ahead. The national average price for regular gasoline rose to $3.18 a gallon in February, a 28-month high and $1.25 more than two years ago. Moreover, increasing unrest in the Middle East raises the possibility of supply disruptions that continue to drive up energy prices.

On the food front, the department of Agriculture notes that prices on most food commodities have risen sharply. For example, corn has risen from a 1990-1992 average of $2.30/bushel to $3.66/bushel in January 2010 to $4.82/bushel in December and a preliminary figure of $5.37/bushel in January 2011. Similarly, wheat prices last year rose from $4.90/bushel in January 2010 to $6.45/bushel by December with a preliminary price of $7.40/bushel this January. Meat and dairy products also have soared as feed prices rose and cattle numbers were pared. The rise in these commodity prices reflect not only increasing demand from rapidly emerging countries such as China and India, but reduced supplies due to drought in some areas and floods in others.



Rapid growths in resource-intensive emerging economies like China and India and continued economic recovery, albeit at a less than desired rate, in the U.S. and other developed countries also have increased the demand for industrial commodities resulting in upward price pressure. As shown in the above chart, in the past year these prices were up 14% in February 2011 from a recent low in March 2009. Everything from cotton to copper has seen prices rise sharply not to mention precious metal prices that have soared. Gold prices have jumped from the $300/ounce level in the early 2000s to $1,385 recently and even have hit $1,400/ounce at times. Silver has seen its highest level in 30 years, rising from the $8.50/ounce level to $32/ounce or more recently.

It is not only rising demand and reduced supplies, however, that has caused commodity prices to rise. Some fear that excessive government spending to stimulate economic activity, rising levels of debt, and a monetary policy that has kept interest rates at extremely low levels for a prolonged period will lead to currency value depreciation. As such, investment in real assets in the form of commodities and precious metals could well do a better job of maintaining their value. Also, because it is unknown as to how government policies will work out and what their effect will be on the economy, there is an element of speculation built into the price structure.

It should be pointed out, however, that a sharp rise in commodity prices does not necessarily translate into a similar spike in consumer prices. For example, again looking at the attached chart, the sharp rise in commodity prices from late 2006 to a peak in July 2008, a gain of 26%, did not lead to a similar rise in consumer prices. While overall consumer prices fluctuated widely during that period there was no discernable trend and the recession that began at the end of 2007 caused these prices actually to decline into 2009. At the same time, the core rate of inflation, viewed by many analysts as a more reliable inflation indicator, held relatively stable in the 2% to 2.5% range from late 2006 to 2008 before also trending lower into 2009. Thus while commodity prices are an input affecting consumer prices, they are one of many factors that ultimately will determine future inflation.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	JAN. 2011	DEC. 2010	JAN. 2010
Unemployment Rate (Average)	*%	*%	*%
Annual Rate of Inflation (Chicago)	7.9%	4.0%	1.5%

Illinois Employment Data Delayed Due To Benchmarking

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (JAN.)	*	*%	*%
Employment (thousands) (JAN.)	*	*%	*%
New Car & Truck Registration (JAN.)	41,550	12.2%	19.3%
Single Family Housing Permits (JAN.)	291	-18.0%	-12.6%
Total Exports ($ mil) (DEC.)	4,482	4.3%	22.8%
Chicago Purchasing Managers Index (FEB)	71.2	3.5%	13.7%

REVENUE

Despite Tax Increase, February Revenues Record Small Gains as Federal Sources Fall

Jim Muschinske, Revenue Manager

Overall revenues grew $16 million in February as a comparatively weak month for federal sources virtually erased all other gains. Growth associated with the recently passed income tax increase was offset by a $336 million fall in federal source receipts. Due to the Blizzard closure, there was one less receipting day in February compared to the same month last year.

Gross personal income tax grew $303 million, or $283 million net of transfers. While the increase can be attributed to higher tax rates, February was somewhat less than what would have been expected given the increase, fueling speculation that a lagged effect on withholding may result in a higher than previously considered final payment reconciliation in Spring 2012. Sales tax continued to perform well, posting $52 million in gains. Other sources grew by $22 million and the cigarette tax by $1 million.

As expected, inheritance tax continues to fall, down $11 million for the month. Despite reinstatement of the estate tax for calendar 2011 and thereafter per P.A. 96-1496, an approximate ten month lag from date of death to estate settlement will result in continued weakness through the remainder of FY 2011 and into the first third of next fiscal year before receipts will return to earlier levels. Liquor tax dropped $7 million, while corporate franchise dipped $1 million. Despite a rise in the tax rate, gross corporate income tax receipts fell $1 million, or flat net of refunds. Due to timing of corporate income tax payments, they have yet to reflect the tax increase.

Overall transfers in February were up $13 million. While both lottery and riverboat transfers were unchanged, other sources grew by $13 million. As mentioned, federal sources plunged $336 million due to a comparatively high month last fiscal year.

Year to Date

Excluding short-term borrowing, tobacco settlement bond proceeds, and Budget Stabilization Fund transfers, general funds revenues are up $997 million through February. However, that increase takes into account approximately $419 million in net revenues classified as related to tax amnesty. Some of this, however, is money that has been accelerated from the current fiscal year as well as from future fiscal years. In addition, year to date totals include approximately $354 million in interfund borrowing. Obviously, if both of those items were excluded, growth would be much more modest.

Through February, and fueled by the recent tax change, gross personal income tax is up $511 million, or $525 million net of refunds. Sales tax receipts are up $387 million, although a large proportion of that gain is likely due to the acceleration effects of the tax amnesty. Gross corporate income tax is up $296 million, or $217 million net of refunds. Again, those gains are primarily related to the tax amnesty.

Overall transfers are up $266 million for the year, principally due to $354 million in interfund borrowing that is somewhat offset by a loss of $36 million in riverboat transfers. Federal sources, after falling again in February, are now down $400 million for the year.

GENERAL FUNDS RECEIPTS: FEBRUARY FY 2011 vs. FY 2010 ($ million)				
Revenue Sources	**Feb. FY 2011**	**Feb. FY 2010**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$965	$662	$303	45.8%
Corporate Income Tax (regular)	37	38	($1)	-2.6%
Sales Taxes	483	431	$52	12.1%
Public Utility Taxes (regular)	92	92	$0	0.0%
Cigarette Tax	30	29	$1	3.4%
Liquor Gallonage Taxes	8	15	($7)	-46.7%
Vehicle Use Tax	2	2	$0	0.0%
Inheritance Tax (Gross)	1	12	($11)	-91.7%
Insurance Taxes and Fees	14	14	$0	0.0%
Corporate Franchise Tax & Fees	15	16	($1)	-6.3%
Interest on State Funds & Investments	2	2	$0	0.0%
Cook County IGT	94	94	$0	0.0%
Other Sources	47	25	$22	88.0%
Subtotal	$1,790	$1,432	$358	25.0%
Transfers				
Lottery	38	38	$0	0.0%
Riverboat transfers & receipts	21	21	$0	0.0%
Proceeds from Sale of 10th license	0	0	$0	N/A
Other	14	1	$13	1300.0%
Total State Sources	$1,863	$1,492	$371	24.9%
Federal Sources	$258	$594	($336)	-56.6%
Total Federal & State Sources	$2,121	$2,086	$35	1.7%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($84)	($64)	($20)	31.3%
Corporate Income Tax	($6)	(7)	$1	-14.3%
Subtotal General Funds	$2,031	$2,015	$16	0.8%
Short-Term Borrowing	$0	$0	$0	N/A
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,031	$2,015	$16	0.8%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				2-Mar-11

GENERAL FUNDS RECEIPTS: YEAR TO DATE
FY 2011 vs. FY 2010
($ million)

Revenue Sources	FY 2011	FY 2010	CHANGE FROM FY 2010	% CHANGE
State Taxes				
Personal Income Tax	$6,431	$5,920	$511	8.6%
Corporate Income Tax (regular)	1,045	749	$296	39.5%
Sales Taxes	4,556	4,169	$387	9.3%
Public Utility Taxes (regular)	723	701	$22	3.1%
Cigarette Tax	236	234	$2	0.9%
Liquor Gallonage Taxes	108	110	($2)	-1.8%
Vehicle Use Tax	19	19	$0	0.0%
Inheritance Tax (Gross)	117	143	($26)	-18.2%
Insurance Taxes and Fees	163	174	($11)	-6.3%
Corporate Franchise Tax & Fees	140	138	$2	1.4%
Interest on State Funds & Investments	22	18	$4	22.2%
Cook County IGT	150	150	$0	0.0%
Other Sources	265	254	$11	4.3%
Subtotal	$13,975	$12,779	$1,196	9.4%
Transfers				
Lottery	381	377	$4	1.1%
Riverboat transfers & receipts	242	278	($36)	-12.9%
Proceeds from Sale of 10th license	0	0	$0	N/A
Other	785	487	$298	61.2%
Total State Sources	$15,383	$13,921	$1,462	10.5%
Federal Sources	$3,692	$4,092	($400)	-9.8%
Total Federal & State Sources	$19,075	$18,013	$1,062	5.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($563)	($577)	$14	-2.4%
Corporate Income Tax	($210)	($131)	($79)	60.3%
Subtotal General Funds	$18,302	$17,305	$997	5.8%
Short-Term Borrowing	$1,300	$1,250	$50	4.0%
Tobacco Liquidation Proceeds	$1,250	$0	$1,250	N/A
Pension Contribution Fund Transfer	$0	$835	($835)	N/A
Budget Stabilization Fund Transfer	$235	$666	($431)	-64.7%
Total General Funds	$21,087	$20,056	$1,031	5.1%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.
CGFA 2-Mar-11

PENSIONS

Current Financial Condition of the State-Funded Retirement Systems

Dan Hankiewicz, Pension Manager

Based upon the actuarial value of assets, the total unfunded liabilities of the State systems totaled $75.7 billion on June 30, 2010, led by the Teachers' Retirement System (TRS) whose unfunded liabilities amounted to $39.9 billion. As the largest of the State systems, TRS accounts for over half of the total assets and liabilities of the five State systems combined. Table 1 below provides a summary of the financial condition of each of the five State retirement systems, showing their respective liabilities and assets as well as their accumulated unfunded liabilities and funded ratios.

TABLE 1

Summary of Financial Condition
State Retirement Systems Combined
Assets at Actuarial Value / With Asset Smoothing
Public Act 96-0043
FY 2010
($ in Millions)

System	Accrued Liability	Actuarial Assets	Unfunded Liability	Funded Ratio
TRS	$77,293.2	$37,439.1	$39,854.1	48.4%
SERS	$29,309.5	$10,961.5	$18,347.9	37.4%
SURS	$30,120.4	$13,966.6	$16,153.8	46.4%
JRS	$1,819.4	$619.9	$1,199.5	34.1%
GARS	$251.8	$66.2	$185.6	26.3%
TOTAL	$138,794.3	$63,053.4	$75,740.9	45.4%

A much more realistic valuation of the true financial position of the various retirement systems would be based upon the MARKET value of the assets, as shown in Table 2 on the following page. Based upon this more realistic value of assets, the total unfunded liabilities of the State systems totaled $85.6 billion on June 30, 2010. The Teachers' Retirement System (TRS), whose unfunded liabilities amounted to $45.9 billion, again represents over 50% of the combined total unfunded balance. Table 2 below, provides a summary of the financial condition of each of the five State retirement systems, showing their respective liabilities and assets as well as their accumulated unfunded liabilities and funded ratios.

TABLE 2

Summary of Financial Condition State Retirement Systems Combined Assets at Market Value / Without Asset Smoothing FY 2010 ($ in Millions)				
System	Accrued Liability	Net Assets	Unfunded Liability	Funded Ratio
TRS	$77,293.2	$31,323.8	$45,969.4	40.5%
SERS	$29,309.5	$9,201.8	$20,107.6	31.4%
SURS	$30,120.4	$12,121.5	$17,998.9	40.2%
JRS	$1,819.4	$523.3	$1,296.2	28.8%
GARS	$251.8	$54.7	$197.1	21.7%
TOTAL	$138,794.3	$53,225.1	$85,569.2	38.3%

The funded ratios for each of the five State retirement systems may be compared to the aggregate funded ratio of 38.3% for the five systems combined. Although the Judges' Retirement System and the General Assembly Retirement System have the poorest funded ratios, these two systems are much smaller and their unfunded liabilities are thus more manageable than the three larger systems.

Impact of Interest Rate Assumption Changes

The interest rate assumptions for three of the five state retirement systems have changed as of June 30, 2010. The retirement systems affected are the State Employees, State Universities, and Judges Retirement Systems. Previously, the interest rate assumption for both the State Employees' Retirement System and the State Universities Retirement System was 8.50%; the interest rate assumption for the Judges' Retirement System was 8.00%.

The interest rate assumption for the State Employees' Retirement System and the State Universities Retirement System has been changed to 7.75%; the interest rate assumption for the Judges' Retirement System has been changed to 7.00%. The Teachers Retirement System and the General Assembly Retirement System have not changed their respective interest rate assumptions.

Since the system's actuaries now assume that all three systems will earn less investment income going forward, the amount of State contributions to each of the three systems will increase substantially. As shown in Table 3 below, the Commission's actuary estimates that the State will be required to contribute an additional $19.8 billion to SERS, SURS, and JRS between FY 2012 – FY 2045 as a result of the interest rate change. The retirement systems have certified an FY 2012 State contribution of $4.9 billion. The Commission's actuary estimates that the FY 2012 certified contribution is $205.5 million higher as a result of the interest rate assumption change.

TABLE 3

CoGFA Projections of Increase in Contributions
Due to Change in Interest Rate Assumption
FY 2010 - 2045
($ in millions)

System	Contributions Using Old Interest Rate Assumption	Contributions Using New Interest Rate Assumption	Increase in Contributions Due to Interest Rate	Present Value of Increase in Contributions
SERS	$82,281.1	$95,338.2	$13,057.1	$3,251.9
SURS	$62,656.4	$69,018.2	$6,361.8	$1,522.0
JRS	$4,647.6	$5,047.0	$399.4	$83.9
ALL COMBINED	**$149,585.1**	**$169,403.4**	**$19,818.3**	**$4,857.8**