Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: MARCH 2014

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INSIDE THIS ISSUE

LATEST PUBLICATIONS

- February 2014: Inmate Population Redistribution / 98th GA – SR 358
- FY 2014 State of IL Economic Forecast Report Prepared for CGFA by Moody's/ Economy.com
- Property Taxes in IL: March 2014 Update
- Liabilities of State Employees Group Insurance Program FY 2015
- Segal Actuarial Cost Study: PA 98-0599 (SB 1)
- 3-Year Budget Forecast: FY 2015-FY 2017
- FY 2015 GAAP Report

ECONOMY: Spring Forward?

Edward H. Boss, Jr., Chief Economist

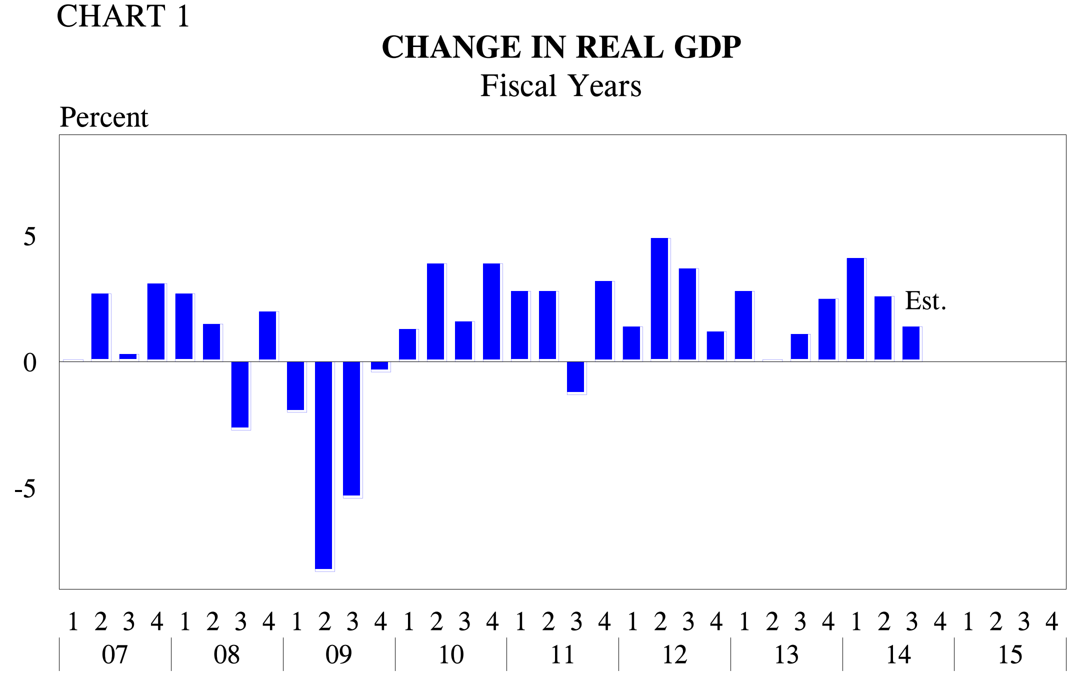
As spring officially began on March 20th and clocks were turned ahead one hour, it was only the calendar that seemed to realize the seasons had changed. Snow continued to fall well into the month, temperatures remained well below normal, and many areas of the country recorded one of the worst winters on record. There is no doubt that weather was a factor in a dramatic slowing in the pace of economic activity.

After rising at a 4.1% annual rate in the third quarter of 2013, the advance report for the final quarter of the year showed real GDP rising at a 3.2% rate only to be revised lower to 2.6% in the final report. This brought the full year growth in real GDP to 1.9%, almost a full percent lower than the 2.8% reached in 2012 and close to the 1.8% rate in 2011. As illustrated in the chart, the latest estimate by Global Insight has real GDP slowing further in the quarter just ended, rising at an estimated 1.4% annual rate. It takes consistent growth of 2.5% to 3% to significantly improve the employment situation.

The current economic recovery will be 5 years by mid-2014, and remains the weakest recovery in the post WWII period. And, while there is no close correlation between expansions and their length, at 5 years, the current expansion already will be longer than the average of the 11 recoveries following WWII, with 7 of the 11 being shorter in length.

As winter continued to sweep across a major portion of the country well into March, it was reflected in softening business reports. A major sector affected was housing. Seasonally adjusted privately-owned single family units in February were 10.6% lower than a year earlier while new building permits, a precursor to starts, were 2.0% below that of a year earlier. The major question now is whether these short falls can be recouped in the months ahead as the wicked

CHART 1



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weather factor is removed, or whether something more fundamental exists that will continue to dampen growth.

In the area of housing, some upward increase in mortgage interest rates and higher prices seemed to have tempered interest from investors. At the same time, the affordability index for first time home buyers has decreased, limiting access to some potential purchasers. Finally, pending home sales now have fallen for eight straight months at a time when short sales and foreclosures are lessening, limiting the supply on the market. These factors could temper any spring housing rebound.

Consumer spending is by far the largest contributor to GDP and its ability to show renewed vigor as the weather improves may be limited. For example, real hourly earnings rose 1.5% in February from a year earlier, but when combined with a 1.5% decrease in the average workweek with more part time workers, resulted in real weekly earnings being unchanged from a year earlier. Some of the buoyancy also appears to have left the stock market. These suggest any rebound in spending may be limited.

Other than the weather, there are several risks to any sustained resurgence in the pace of economic activity. On the policy front, monetary policy appears to continue to reduce its asset purchases at a specified pace, unwinding its quantitative easing program and putting some upward pressure on all but the targeted federal funds interest rate. Fiscal policy proposals plan spending gains in many areas, although cutting defense spending reduces armed forces to their lowest level prior to WWII.

At the same time Russia's incursion into the Crimea and its troop buildups in areas bordering Russia create great uncertainty. The U.S. has imposed limited sanctions and threatens to increase them should Russia go further. Any Russian retaliation through limiting energy availability not only would weaken much of Western Europe but would have repercussions in the U.S. as well. And, Russia is not the only geopolitical issue, there remains China's territorial dispute with Japan, the war in Syria, the Iran situation and the entire Middle East and Korea.

Despite all the possible factors that could slow the pace of economic activity in the period ahead, much of the country is anxiously awaiting spring, raising spirits. This may be reflected by the recent increase in Consumer Confidence released by the Conference Board for March. The index reached 82.3, its highest level in six years. Thus, despite the doom and gloom experienced last winter, spring could spark an increase in economic activity. Whether this would be sustainable given the fundamentals, however, is still in question.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	FEB. 2014	JAN. 2014	FEB. 2013
Unemployment Rate (Average)	8.7%	8.7%	9.2%
Annual Rate of Inflation (Chicago)	0.5%	6.3%	0.7%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (February)	6,568	0.2%	-0.1%
Employment (thousands) (February)	5,999	0.2%	0.4%
New Car & Truck Registration (February)	36,467	-21.7%	-2.1%
Single Family Housing Permits (February)	488	43.9%	4.0%
Total Exports ($ mil) (January)	5,532	-4.4%	18.2%
Chicago Purchasing Managers Index (March)	55.9	-6.5%	6.6%

* Due to monthly fluctuations, trend best shown by % change from a year ago.

MARCH 2014 BOND SALE

Lynnae Kapp, Senior Analyst

Taxable Build Illinois bonds, sold in March 2014, totaled $402 million. The State had seven bids on the competitive sale and received a true interest cost (TIC) of 4.2706%. Although spreads to a comparable Treasury interest rate have narrowed since the State's last taxable Build Illinois bond sale in May 2013, interest rates have increased.

Tax-exempt General Obligation bonds sold in February 2014 equaled $1.025 billion. With over $5.5 billion in orders from about 109 investors, the State was able to re-price the bond twice, to the State's benefit. The true interest cost on the sale was 4.06%, a savings of approximately $60 million over the 25-year life of the bond compared to the rate the State received on a similar issue in June 2013, based on statements from State officials.

In December, Illinois sold $350 million of taxable General Obligation Bonds. The True Interest Cost was 5.40%, with a spread over Treasuries of 251 basis points. This spread is 59 basis points lower than an identical sale in April of 2013. The Governor's Office of Management and Budget attributes the smaller spread to the passage of SB 1 affecting pension reform. This smaller spread will save the State over $20 million over the life of the bonds.

The State sold $600 million of Build Illinois refunding bonds in June 2013. The sale received a 2.70% true interest cost, and gave the State approximately 9% in present value savings equaling $55 million. The refunding also freed up $30 million - $40 million of reserves that will no longer be required.

Illinois also sold $1.3 billion of General Obligation bonds at the end of June 2013. This occurred after four days of massive sell-offs of bonds in the market. Illinois' G.O. bonds "received more than $9 billion in bids from 145 investors…and it was able to pare between 6 to 14 basis points off yields on some maturities after lowering some by as much as 10 basis points from preliminary marketing levels" ["Buyers Devour Illinois GOs As Market Rallies Back From Selloff", The Bond Buyer, June 26, 2013]. Even though the State was able to somewhat lower the yields of the bonds, the Governor stated that the ratings downgrades cost the State an additional $130 million in debt service over the 25-year maturity of the bonds.

Recent Bond Sales

DATE	BOND SALE TYPE	AMOUNT	TAXABLE v. TAX-EXEMPT	NEGOTIATED v. COMPETITIVE SALE	TRUE INTEREST COST	S&P	FITCH	MOODY'S
Apr-13	GO Series A bonds	$450 million	tax-exempt	competitive	3.92%	A-	A	A2
Apr-13	GO Series B bonds	$350 million	taxable	competitive	4.97%			
May-13	BI bonds	$300 million	taxable	competitive	3.29%	AAA	AA+	A2
Jun-13	BI Refunding bonds	$604 million	tax-exempt	negotiated	2.70%	AAA	AA+	A3
Jun-13	GO bonds	$1.3 billion	tax-exempt	negotiated	5.04%	A-	A-	A3
Dec-14	GO bonds	$350 million	taxable	competitive	5.40%	A-	A-	A3
Feb-14	GO bonds	$1.025 billion	tax-exempt	negotiated	4.06%	A-	A-	A3
Mar-14	BI bonds	$402 million	taxable	competitive	4.27%	AAA	AA+	A3

REVENUE

Third Quarter Ends on Positive Performance – Uncertainty Looms in April

Jim Muschinske, Revenue Manager

Overall base revenues grew $254 million in March. The larger economically related sources of income and sales taxes fared quite well. A one-time deposit of approximately $59 million from a prior year overpayment to SERS fueled other sources. There was the same number of processing days in March as last year.

Gross personal income tax receipts grew $90 million, or $85 million net of refunds. Gross corporate income taxes gained $20 million, or $21 million net of refunds. Both sales tax receipts as well as public utility tax revenues each added $18 million to the monthly advance. As mentioned, the category of "other sources" jumped, gaining $56 million, but due solely to the one-time $59 million in prior year overpayment to SERS. Cigarette tax eked out a $1 million increase, as did inheritance tax as well as corporate franchise taxes.

Only two revenue sources experienced declines in March, albeit minor ones. Insurance taxes dipped $2 million, and vehicle use tax declined by $1 million.

Overall transfers grew $34 million in March. As expected, gaming transfers made up for lack of activity last month, and were up $21 million. Other transfers gained $12 million, while lottery transfers managed to post a $1 million gain. Federal sources experienced a comparatively good month, growing $22 million in March.

Year to Date

Through three-fourths of FY 2014, base general funds are up $1.264 billion compared to last fiscal year. Much of that growth can be attributed to the one-time surge in transfers related to the refund fund [$397 million]. Despite the occasional pause, the larger economically-related sources performed fairly well.

Gross personal income taxes are up $513 million, or $495 million net of refunds. Sales tax receipts have done quite well, up $221 million to date. Gross corporate income tax is up a strong $185 million, or $174 million net of refunds. Other sources are up $128 million for the year, although all of that increase can be attributed to September's receipt of one-time court settlement proceeds as well as March's one-time overpayment returned from SERS.

Despite the performance of the larger sources, a couple of smaller revenue lines suffered declines worth noting. The Cook County IGT is off $30 million, and inheritance tax is down $31 million.

Through March, overall transfers are up $452 million. Nearly all of those gains stem from the one-time $397 million transfer from the Income Tax Refund Fund. Federal sources are down $146 million thus far, reflecting lower reimbursable spending.

What Will April Bring?

Readers of the monthly briefings will remember the "April Surprise" that occurred in 2013. A record month for income tax receipts and federal sources caused revenues to leap $1.521 billion that month.

To recap, in 2013, strong final and estimated payments stemmed from actions taken by taxpayers in efforts to minimize the tax consequences of the higher 2013 federal tax rates. Individuals shifted revenues they would have routinely booked in 2013 and later, into the end of tax year 2012, thereby reducing the effect of higher tax rates. Nationally, it was reported that many wealthy individuals sold investments, even businesses and homes, to avoid higher taxes. If able, some partnerships also distributed monies prior to the higher taxes. On the corporate side, businesses made sure bonus payments were done in 2012 rather than in 2013, also a number of companies were said to have accelerated income and dividends into 2012. The net action of all of those types of transactions caused a "bubble" of income tax receipts.

In addition, the surge of income taxes coupled with the Comptroller's efforts to pay down the Medicaid backlog, translated into the record month for federal sources in April 2013 as receipts totaled a massive $1.025 billion.

But that was then—what will be the consequence on this April's receipts? That uncertainty was paramount in CGFA's decision to delay revising its personal income tax receipt estimate in February. Despite a year removed, questions remain as to the exact nature of last year's phenomenal growth: true "one-time" revenues, increased base growth, simply an acceleration of future revenues, or the most likely scenario of a mixture of the three.

What we do know at this point is that personal income tax receipts through March have performed quite well. The withholding component (which typically represents approximately 80% of total personal income tax receipts), seems to have weathered a slowdown during the winter and has returned to anticipated modest levels. Estimated payments through March actually have exceeded expectations, but it is the uncertainty about final payments that leaves the narrative unwritten for the spring tax season.

Questions remain regarding corporate income tax receipts as well. With a final payment surge over 51% last April, despite the success this fiscal year, its unlikely similar levels will be met. However, a positive observation is that March is also a fairly large month for final corporate income tax receipts, and revenues were able to return a gain of approximately 4%.

In addition, last April's income tax success fueled record reimbursable spending and resulting federal source receipting. Since federal receipts are trending at even lower levels than last fiscal year going into this crucial month, it would seem probable that a significant falloff in April's federal receipting can be anticipated.

To wrap up, despite occurring nearly a year ago, the "April Surprise" of 2013 carries with it considerable uncertainty. How revenues will ultimately be characterized in FY 2014 will largely be shaped by what occurs in the coming month.

GENERAL FUNDS RECEIPTS: MARCH
FY 2014 vs. FY 2013
($ million)

Revenue Sources	March FY 2014	March FY 2013	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,595	$1,505	$90	6.0%
Corporate Income Tax (regular)	645	625	$20	3.2%
Sales Taxes	587	569	$18	3.2%
Public Utility Taxes (regular)	114	96	$18	18.8%
Cigarette Tax	30	29	$1	3.4%
Liquor Gallonage Taxes	11	11	$0	0.0%
Vehicle Use Tax	2	3	($1)	-33.3%
Inheritance Tax (Gross)	17	16	$1	6.3%
Insurance Taxes and Fees	33	35	($2)	-5.7%
Corporate Franchise Tax & Fees	16	15	$1	6.7%
Interest on State Funds & Investments	2	2	$0	0.0%
Cook County IGT	0	0	$0	N/A
Other Sources	93	37	$56	151.4%
Subtotal	$3,145	$2,943	$202	6.9%
Transfers				
Lottery	67	66	$1	1.5%
Riverboat transfers & receipts	33	12	$21	175.0%
Proceeds from Sale of 10th license	10	10	$0	0.0%
Refund Fund transfer	0	0	$0	N/A
Other	81	69	$12	17.4%
Total State Sources	$3,336	$3,100	$236	7.6%
Federal Sources	$320	$298	$22	7.4%
Total Federal & State Sources	$3,656	$3,398	$258	7.6%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($152)	($147)	($5)	3.4%
Corporate Income Tax	($86)	(87)	$1	-1.1%
Subtotal General Funds	$3,418	$3,164	$254	8.0%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$3,418	$3,164	$254	8.0%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Apr-14

GENERAL FUNDS RECEIPTS: YEAR TO DATE FY 2014 vs. FY 2013 ($ million)				
Revenue Sources	**FY 2014**	**FY 2013**	**CHANGE FROM FY 2013**	**% CHANGE**
State Taxes				
Personal Income Tax	$12,906	$12,393	$513	4.1%
Corporate Income Tax (regular)	2,392	2,207	$185	8.4%
Sales Taxes	5,675	5,454	$221	4.1%
Public Utility Taxes (regular)	774	765	$9	1.2%
Cigarette Tax	265	265	$0	0.0%
Liquor Gallonage Taxes	125	125	$0	0.0%
Vehicle Use Tax	20	20	$0	0.0%
Inheritance Tax (Gross)	185	216	($31)	-14.4%
Insurance Taxes and Fees	207	213	($6)	-2.8%
Corporate Franchise Tax & Fees	159	159	$0	0.0%
Interest on State Funds & Investments	14	16	($2)	-12.5%
Cook County IGT	120	150	($30)	-20.0%
Other Sources	429	301	$128	42.5%
Subtotal	$23,271	$22,284	$987	4.4%
Transfers				
Lottery	470	462	$8	1.7%
Riverboat transfers & receipts	274	275	($1)	-0.4%
Proceeds from Sale of 10th license	10	15	($5)	-33.3%
Refund Fund transfer	397	0	$397	N/A
Other	453	400	$53	13.3%
Total State Sources	$24,875	$23,436	$1,439	6.1%
Federal Sources	$2,612	$2,758	($146)	-5.3%
Total Federal & State Sources	$27,487	$26,194	$1,293	4.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($1,226)	($1,208)	($18)	1.5%
Corporate Income Tax	($320)	($309)	($11)	3.6%
Subtotal General Funds	$25,941	$24,677	$1,264	5.1%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund Transfer	$50	$264	($214)	N/A
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$275	$275	$0	0.0%
Total General Funds	$26,266	$25,216	$1,050	4.2%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.
CGFA 1-Apr-14