Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *JULY 2010*

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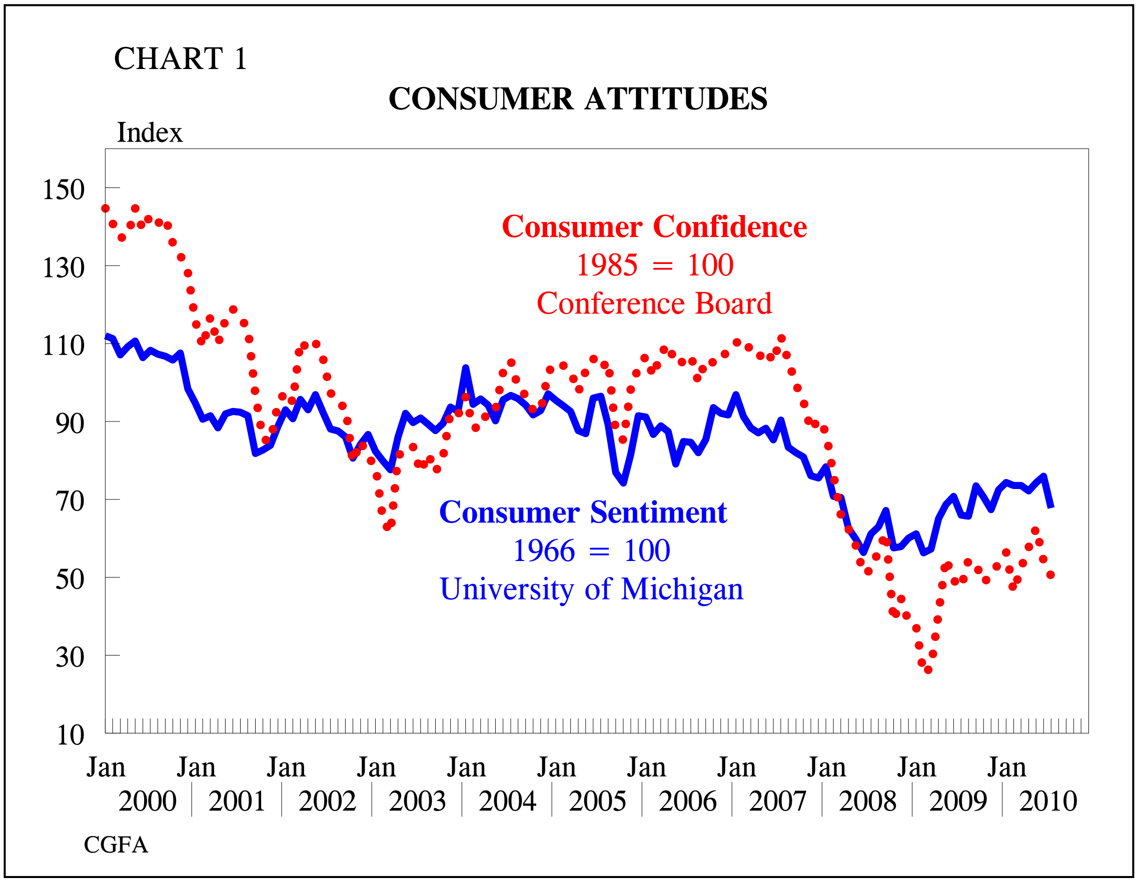
ECONOMY: Soft Patch or Double Dip Recession?

Edward H. Boss, Jr., Chief Economist

A significant slowdown in some key economic measures in recent months have raised speculation that the economy has either reached a soft patch in an otherwise continuing economic recovery or is on the verge of returning into recession. The official determiner of recessions and recovery is the NBER (the National Bureau of Economic Research) and it has never classified a recession as a double dip. However, there have been times of relatively short periods of recovery between recessions, the most noticeable being the twin recessions that occurred in the early 1980s. The Iranian revolution at that time sharply increased the price of oil. In order to stem the inflation that followed, the Federal Reserve dramatically raised interest rates. As a result of these events, a short recession that began in 1980 was followed by a brief period of growth only to return to a recession that proved to be deep in 1981.

Unlike that previous period of recurring recessions, the factors behind the recent pause in the pace of the economic recovery are not related to price movements or policy actions to correct their trend. Indeed there is as much concern today about deflation as inflation. Instead, the policy controversy is whether more government stimulus is needed to spark increased economic activity or whether austerity measures, like taken in several European countries, should be taken to reduce burgeoning debt positions that among other things threaten their currency.

While not yet official, most economists estimate the recession that began in December 2007 ended by the summer of 2009, making it some 18 or 19 months in length and the longest in the post WWII period. This in turn would mark the current recovery period one year in length as substantiated by real GDP growth in each of the past four quarters. The main drag on the pace of growth in the past year has come from



its most important sector, the consumer that accounts for from sixty-seven to seventy percent of total spending. This is reflected not only by the continuing weakness in housing but by the trend of retail sales, which had been gathering strength in the first quarter reaching a peak in March, only to decline in each of the following three months.

The weakening in the consumer sector can be illustrated by the recent sharp decline in measures of Consumer Sentiment, as measured by the University of Michigan, and Consumer Confidence, as measured by The Conference Board. As shown in the accompanying chart, the Conference Board Index fell to 50.4 in July, the lowest level since February while the University of Michigan index plunged from 76.0 to 67.8, reaching its lowest level since November last year. The hesitation in the pace of economic activity also was reflected in the latest release of the Federal Reserve's beige book, which indicated the pace of economic activity either slowed or held steady in many parts of the country last quarter. This was substantiated in the newly-released advance report on real GDP for the second quarter that showed the annual rate of growth slowed from an upwardly revised annual rate of 3.7% in the first quarter to 2.4% in the quarter ended June with the consumer sector slowing to a 1.6% gain from 1.9%. Moreover this choppy condition may continue as reflected in the performance of the leading economic indicators that now have fallen in two of the past three months.

Whether or not the economy has hit a soft patch or a more serious slowdown leading to another recession may well depend on policy actions taken. Those favoring more government stimulus must face critics that point to previous stimulative measures that did little to stem the deterioration in the job market while vastly increasing government debt. At the same time, failure to extend at least some of the Bush tax cuts that expire at year end in order to reduce the government debt burden on future generations will greatly increase taxes across the board, further dampening the ability of consumers to spend. According to the Global Insight forecasting service used by the Commission, chances for "W" or double dip recession are still small although they have been raised to a 20% chance of occurrence from 15%. The most likely outcome at this time appears to be that another near-term recession can be avoided but that economic activity will continue to lag well behind the experience of earlier recovery periods. Thus, recovering the jobs lost during the last recession may take years to accomplish.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	JUNE 2010	MAY 2010	JUNE 2009
Unemployment Rate (Average)	10.4%	10.8%	10.3%
Annual Rate of Inflation (Chicago)	-4.5%	0.3%	0.6%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (June)	6,660	-0.5%	0.6%
Employment (thousands) (June)	5,966	-0.1%	-0.5%
New Car & Truck Registration (June)	N/A	N/A	N/A
Single Family Housing Permits (June)	79.9	-3.0%	-6.7%
Total Exports ($ mil) (May)	4,165	3.2%	25.0%
Chicago Purchasing Managers Index (July)	62.3	5.4%	43.5%

REVENUE

July Revenues Up on Strength of Federal Sources – Weakness Still Widespread

Jim Muschinske, Revenue Manager

Excluding $1.3 billion in short-term borrowing, July revenues increased $107 million. The increase was due to a comparatively strong month for federal sources. Absent $182 million in gains from federal reimbursements, virtually all other revenue sources faltered to begin the new fiscal year. July had one less receipting day compared to the same month last year.

For the month, most revenue sources experienced losses. Other sources experienced the largest decline, falling $21 million. Public utility taxes dropped $12 million, while gross personal income tax dipped $7 million, but were flat once a lower refund percentage is factored in. Sales tax receipts were off by $4 million, insurance taxes $3 million, interest income $3 million, and corporate franchise taxes $2 million.

Only a couple of sources experienced growth in July. Gross corporate income taxes were up $7 million, or $6 million net of refunds, while inheritance tax grew by $6 million.

Overall transfers in July were down $42 million. Other transfers were down by $33 million, riverboat transfers off by $5 million, and lottery transfers lower by $4 million. As mentioned earlier, federal sources increased $182 million fueled by spending made possible by the short-term borrowing.

Short-Term Borrowing

Lynnae Kapp, Bond Analyst

Illinois sold $1.3 billion in General Obligation Certificates in July under Section 9d of the Illinois State Constitution, "to meet deficits caused by emergencies or failures of revenue". The State will make payments in April, May and June of 2011 and pay approximately $17 million in interest. The State received $9 million in premium from the competitive bond sale, that was deposited into the General Obligation Bond Retirement and Interest Fund, which will go towards paying debt service on the borrowing.

GENERAL FUNDS RECEIPTS: JULY

FY 2011 vs. FY 2010

($ million)

Revenue Sources	July FY 2011	July FY 2010	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$648	$655	($7)	-1.1%
Corporate Income Tax (regular)	47	40	$7	17.5%
Sales Taxes	542	546	($4)	-0.7%
Public Utility Taxes (regular)	88	100	($12)	-12.0%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	17	17	$0	0.0%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax (Gross)	24	18	$6	33.3%
Insurance Taxes and Fees	4	7	($3)	-42.9%
Corporate Franchise Tax & Fees	12	14	($2)	-14.3%
Interest on State Funds & Investments	1	4	($3)	-75.0%
Cook County IGT	0	0	$0	N/A
Other Sources	33	54	($21)	-38.9%
Subtotal	$1,448	$1,487	($39)	-2.6%
Transfers				
Lottery	43	47	($4)	-8.5%
Riverboat transfers & receipts	30	35	($5)	-14.3%
Proceeds from Sale of 10th license	0	0	$0	N/A
Other	99	132	($33)	-25.0%
Total State Sources	$1,620	$1,701	($81)	-4.8%
Federal Sources	$553	$371	$182	49.1%
Total Federal & State Sources	$2,173	$2,072	$101	4.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($57)	($64)	$7	-10.9%
Corporate Income Tax	($8)	(7)	($1)	14.3%
Subtotal General Funds	$2,108	$2,001	$107	5.3%
Short-Term Borrowing	$1,300	$0	$1,300	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$276	($276)	N/A
Total General Funds	$3,408	$2,277	$1,131	49.7%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 3-Aug-10

CGFA Analyzes New Benefit Increase

Dan Hankiewicz, Pension Manager

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P.A. 94-0004, which became effective on June 1, 2005, requires that all new benefit increases under the State Employees' Retirement System article of the Pension Code "must identify and provide for payment to the System of additional funding at least sufficient to fund the resulting annual increase in cost to the System as it accrues" (40 ILCS 5/14-152.1). The Act goes on to state that the Commission on Government Forecasting and Accountability must analyze whether adequate additional funding has been provided for the new benefit increase, after which the Commission must report its findings to the Public Pension Division of the Department of Insurance.

Pursuant to P.A. 94-0004, Commission staff requested an actuarial analysis of P.A. 94-0612 from SERS' consulting actuary, Gabriel, Roder, Smith & Co. P.A. 94-0612 took effect on August 18, 2005. The Act allowed members of SERS to establish service credit for up to 8 years during which the member was employed by the Visually Handicapped Managers of Illinois in a vending program operated under a contractual agreement with the Department of Rehabilitation Services or its successor agency. According to the actuarial analysis, two members purchased service credit under P.A. 94-0612. In both cases, the increase in the present value of future benefits exceeded the amounts that the members contributed to purchase the service credit. Therefore, the Commission determined that adequate additional funding has not been provided for this benefit increase. On July 7th, the commission forwarded its findings along with the accompanying actuarial study to the Public Pension Division of the Department of Insurance.

Under P.A. 94-0004, a new benefit increase created by a Public Act that does not include adequate additional funding is null and void. If the Public Pension Division determines that a new benefit increase has been insufficiently funded, it is required to notify the Governor and the State Comptroller. In the absence of corrective action by the General Assembly, the new benefit increase shall expire at the end of the fiscal year in which the certification has been made. If the new benefit increase provided by P.A. 94-0612 is allowed to expire, the benefit increase will continue to apply to persons who applied and qualified for the affected benefit while the new benefit increase was in effect, however the new benefit increase will not apply to any other person, including a person who would otherwise qualify for the benefit but did not apply while the new benefit increase was in effect.

The Commission has requested actuarial studies on the following Public Acts from the 95th General Assembly:

P.A. 95-0583 – Allowed members of SERS to purchase service credit for up to 2 years spent on authorize leave of absence, provided that during the leave the member represented or was employed as an officer of a statewide labor organization that represents members of SERS.

P.A. 95-0483 – Allowed members of SERS to purchase up to 4 years of military service credit.

P.A. 95-0652 – Allowed members of SERS to purchase service credit for up to 2 years of employment as a Government Public Service Intern.

P.A. 95-0530 – Provided for the transfer of service credit as a police officer from various systems under the Pension Code to SERS.