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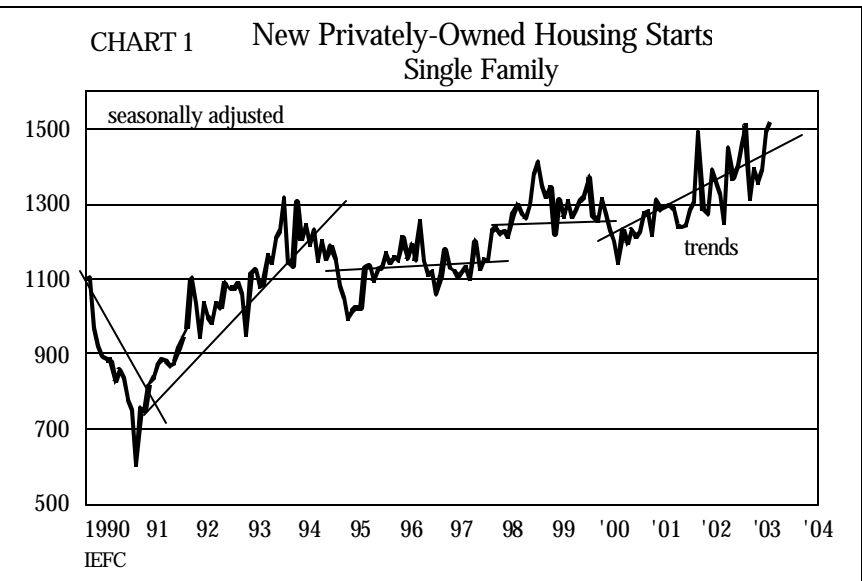
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ECONOMY: Is the Boom in Housing Over?

Edward H. Boss, Jr., Chief Economist

A major support to the fledgling economy has been the housing sector. Now, there are increasing prospects that this strength may be waning. This would remove one of the more dynamic sectors behind the continuing economic recovery.

As shown in Chart 1, new housing starts have been on a roll over the past few years, with single-family starts reaching a rate of 1,521,000 in July, up 1.9% from June. Building permits, although still up from a year earlier, however, declined last month. Building permits are a precursor to future housing activity, as a permit must be issued before construction activity can begin. While actual single-family permits in Illinois were up 19% in July from a year ago, they fell 3.7% from June levels.



A principal factor acting to slow the housing boom has been the reversal in mortgage interest rates. After reaching lows not seen for decades, mortgage interest rates have risen sharply in recent weeks. This is despite the Federal Reserve's efforts to keep short-term interest rates over which it has an influence at historically-

low levels. According to Fed statistics, the 30-year conventional mortgage interest rate rose to 6.28% in the week of August 22nd, up sharply from 5.23% as recently as June. Perhaps in response, it was reported that new mortgage applications fell 13% in the week ended August 22nd.

While there may be a last-minute rush to refinance for those who have put it off waiting for lower rates, a drop in refi's would reduce available cash to consumers. Indeed, reduced mortgage payments from lower-rate mortgages have served as a cushion to lack luster income gains and been a major support to continued gains in consumer spending which has been the mainstay of the economic expansion.

Of course another factor that has been a boom to housing is that it has been a good investment, particularly given the dismal performance of the stock market, at least until recently. Home prices in July were up a sharp 4.7% from June and 12% over July of last year, the biggest increase in 23 years. Similarly, in Illinois home sales were up 5.2% in July and 11.8% from a year ago, with the median cost of

an existing home reaching \$181,900 in Illinois in July, up 8.1% from a year earlier. At the same time, higher home prices and increasing financing costs are taking a greater share of income. Together with possible improving performance of alternative investment outlets, these developments may well put a damper on the future pace of housing activity, particularly should prices soften.

While it is undoubtedly premature to write off the housing sector at this point, it may well be that the pace of activity will slow and that it will require other economic sectors to take up the slack. Fortunately it appears that the expansion is spreading to other sectors that had been lack luster. This is particularly true of business investment. Preliminary data on the second quarter GDP performance released on Thursday show that inflation-adjusted business spending rose at an 8% annual rate, the sharpest gain in three years and following declines in 9 out of the previous 10 quarters. It is imperative for this sector to improve if the employment picture is to brighten and the business expansion continue to improve.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>July 2003</u>	<u>June 2003</u>	<u>July 2002</u>
Unemployment Rate (Average)	6.5%	6.4%	6.6%
Annual Rate of Inflation (Chicago)	0.0%	4.6%	1.6%
	<u>LATEST</u>	<u>% CHANGE</u>	<u>% CHANGE</u>
	<u>MONTH</u>	<u>OVER PRIOR</u>	<u>OVER A</u>
		<u>MONTH</u>	<u>YEAR AGO</u>
Civilian Labor Force (thousands) (July)	6,431	0.4%	1.0%
Employment (thousands) (July)	6,016	0.3%	1.2%
New Car & Truck Registration (July)	56,117	-3.9%	-16.0%
Single Family Housing Permits (July)	4,372	-3.7%	19.0%
Total Exports (\$ mil) (June)	2,247	-4.2%	1.2%
Chicago Purchasing Managers Index (August)	58.9	5.4%	9.1%

REVENUE
Federal Receipts Cause August
Revenues to Jump

Jim Muschinske, Revenue Manager

August general revenue receipts, excluding Pension Contribution Fund transfers, jumped \$826 million. The increase was due entirely to higher federal sources. These resulted from an expected grant from the federal government and a temporary increase in the Medicaid matching rate, a concerted effort to pay down an accumulated backlog in Medicaid bills, and further reimbursements stemming from prior fiscal year activity. Absent those federal gains, other sources actually suffered an overall modest decline. If \$165 million in Pension Contribution Fund transfers are included, overall general funds revenues were up \$991 million. August had one less receiving day as compared to the same month of last year.

While overall receipts were up dramatically, only a couple of tax sources managed gains. Gross personal income tax receipts were up \$14 million. However, due to the higher refund percentage used in FY 2004, the net amount was a negative \$8 million. Insurance taxes and fees gained \$7 million for the month.

The other sources were either flat or suffered declines. Public utility taxes fell by \$19 million and inheritance tax receipts continued to fall, dropping by \$15 million. Sales tax revenue dipped by \$9 million and corporate franchise taxes gave back \$4 million. Gross corporate income tax receipts fell only \$2 million, but because of the higher

refund percentage, the net impact was a negative \$3 million. Liquor tax and interest on investments each lost \$2 million, while other sources were off by \$1 million.

Overall transfers rose \$37 million in August. The increase was attributed to lottery transfers that rose by \$4 million and from riverboat transfers and receipts that increased \$13 million as a result of the increased tax rates. In addition, miscellaneous other transfers rose by \$20 million due to "administrative chargebacks" which totaled a reported \$30 million. *[It should be noted that those chargebacks have already been rescinded and transferred back to the original fund. However, since the re-transfer took place in early September rather than August, those monies are still counted as August revenues].*

As part of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Illinois is scheduled to receive \$422 million in federal flexible grants as well as benefit from a 2.95% increase in our Medicaid matching rate. Together, those items are anticipated to total \$675 million. In August, Illinois received the first flexible grant installment of \$211 million. A second identical installment is anticipated around October 1, 2003. Illinois' matching rate will be increased for five quarters dating back to April 1, 2003. As part of an effort to pay overdue Medicaid provider bills, the Comptroller's Office spent approximately \$1.3 billion in August general revenue on Medicaid bills. That rate of spending at the higher match rate, coupled with the flexible grant and

timing reconciliation attributed to last fiscal year, accounted for the jump in federal receipts.

Year to Date

Through August, excluding revenues attributed to short-term borrowing and Budget Stabilization and Pension Contribution funds transfers, receipts are up \$557 million over the same period of last fiscal year. However, virtually all of that increase is attributed to the phenomenal growth in federal sources. Federal sources aside, for the most part base growth has been anemic.

While gross personal income tax is up \$28 million year to date, after factoring in the higher refund percentage, net receipts are down \$16 million. Similarly, gross corporate income tax is up \$1 million, but on a net basis is off \$2 million. Thus far, only insurance taxes and fees have shown a substantial gain, up \$6 million.

While recently-passed legislation decoupled the State from the federal phase-out of inheritance taxes, due to a natural lag in estate settlements, receipts are still on a declining trend, off \$25 million. Public utility taxes are down \$10 million, while sales tax receipts are off \$5 million, indicating that the weak economic recovery has yet to manifest itself into higher receipts.

Through August, overall transfers are up \$84 million. While lottery transfers are down \$9 million, that decline was more than offset by a \$22 million increase in riverboat transfers and receipts as the result of the increased wagering and admission tax. In addition, other transfers are up \$71 million. Finally, as explained earlier, federal sources were up significantly, \$525 million.

FY 2004 Revenue Estimate

On September 5th the Commission will be presenting an updated FY 2004 revenue forecast that includes base FY 2003 figures, as well as incorporates numerous legislative changes enacted during the last session as well as the federal relief stemming from the previously discussed JGTRRA.

In total, the FY 2004 forecast, is estimated to be \$27.352 billion, which reflects growth of \$2.365 billion over the previous fiscal year. The forecast is comprised of a base estimate of \$22.812 billion (which is only \$26 million higher than the comparable FY 2003 base), Budget Stabilization Fund transfers of \$226 million, plus adjustments totaling \$4.314 billion. For a more detailed explanation of the forecast, please see the Commission's publication "Economic and Revenue Update FY 2003 – FY 2004". A brief summary is shown on page 5 with more detail available in the table on page 8.

Total General Revenue

Base FY 2003 Actuals	\$22,786
Short-term Borrowing	\$1,675
Budget Stabilization Transfer	\$226
Pension Contribution Fund Transfer	\$300
Total FY 2003	\$24,987

		<u>Change</u>
IEFC Base FY 2004 Estimate	\$22,812	\$26
Short-term Borrowing	\$0	-\$1,675
Budget Stabilization Transfer	\$226	\$0
Adjustments (State & Federal)	\$4,314	\$4,014
Total FY 2004	\$27,352	\$2,365

GENERAL FUNDS RECEIPTS: AUGUST

FY 2004 vs. FY 2003
(\$ million)

Revenue Sources	AUGUST FY 2004	AUGUST FY 2003	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$573	\$559	\$14	2.5%
Corporate Income Tax (regular)	12	14	(\$2)	-14.3%
Sales Taxes	516	525	(\$9)	-1.7%
Public Utility Taxes (regular)	65	84	(\$19)	-22.6%
Cigarette Tax	33	33	\$0	0.0%
Liquor Gallonage Taxes	8	10	(\$2)	-20.0%
Vehicle Use Tax	3	3	\$0	0.0%
Inheritance Tax (Gross)	13	28	(\$15)	-53.6%
Insurance Taxes and Fees	14	7	\$7	100.0%
Corporate Franchise Tax & Fees	9	13	(\$4)	-30.8%
Interest on State Funds & Investments	6	8	(\$2)	-25.0%
Cook County IGT	0	0	\$0	N/A
Other Sources	16	17	(\$1)	-5.9%
Subtotal	\$1,268	\$1,301	(\$33)	-2.5%
Transfers				
Lottery	39	35	\$4	11.4%
Riverboat transfers & receipts	63	50	\$13	26.0%
Other	41	21	\$20	95.2%
Total State Sources	\$1,411	\$1,407	\$4	0.3%
Federal Sources	\$1,090	\$245	\$845	344.9%
Total Federal & State Sources	\$2,501	\$1,652	\$849	51.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$67)	(\$45)	(\$22)	48.9%
Corporate Income Tax	(\$4)	(3)	(\$1)	33.3%
Subtotal General Funds	\$2,430	\$1,604	\$826	51.5%
Short-Term Borrowing	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$0	\$0	\$0	N/A
Pension Contribution Fund Transfer	\$165	\$0	\$165	N/A
Total General Funds	\$2,595	\$1,604	\$991	61.8%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding

4-Sep-03

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2004 vs. FY 2003

(\$ million)

Revenue Sources	FY 2004	FY 2003	CHANGE FROM FY 2002	% CHANGE
State Taxes				
Personal Income Tax	\$1,123	\$1,095	\$28	2.6%
Corporate Income Tax (regular)	50	49	\$1	2.0%
Sales Taxes	1,049	1,054	(\$5)	-0.5%
Public Utility Taxes (regular)	150	160	(\$10)	-6.3%
Cigarette Tax	67	67	\$0	0.0%
Liquor Gallonage Taxes	23	22	\$1	4.5%
Vehicle Use Tax	7	6	\$1	16.7%
Inheritance Tax (Gross)	30	55	(\$25)	-45.5%
Insurance Taxes and Fees	15	9	\$6	66.7%
Corporate Franchise Tax & Fees	21	21	\$0	0.0%
Interest on State Funds & Investments	15	14	\$1	7.1%
Cook County IGT	54	54	\$0	0.0%
Other Sources	30	33	(\$3)	-9.1%
Subtotal	\$2,634	\$2,639	(\$5)	-0.2%
Transfers				
Lottery	70	79	(\$9)	-11.4%
Riverboat transfers & receipts	122	100	\$22	22.0%
Other	266	195	\$71	36.4%
Total State Sources	\$3,092	\$3,013	\$79	2.6%
Federal Sources	\$1,256	\$731	\$525	71.8%
Total Federal & State Sources	\$4,348	\$3,744	\$604	16.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$131)	(\$87)	(\$44)	50.6%
Corporate Income Tax	(\$16)	(\$13)	(\$3)	23.1%
Subtotal General Funds	\$4,201	\$3,644	\$557	15.3%
Short-Term Borrowing	\$0	\$700	(\$700)	N/A
Budget Stabilization Fund Transfer	\$226	\$226	\$0	0.0%
Pension Contribution Fund Transfer	\$368	\$0	\$368	N/A
Total General Funds	\$4,795	\$4,570	\$225	4.9%

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

IEFC

4-Sep-03

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE
FY 2004 ESTIMATE vs. FY 2003 ACTUAL
(\$ million)

Revenue Sources	Sept-05 ESTIMATE FY 2004	FYTD 2004	AMOUNT NEEDED FY 2004 EST.	FYTD 2003	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	\$8,220	\$1,123	\$7,097	\$1,095	\$213	3.1%
Corporate Income Tax (regular)	1,095	50	\$1,045	49	\$83	8.6%
Sales Taxes	6,265	1,049	\$5,216	1,054	\$211	4.2%
Public Utility Taxes (regular)	1,000	150	\$850	160	\$4	0.5%
Cigarette Tax	400	67	\$333	67	\$0	0.0%
Liquor Gallonage Taxes	125	23	\$102	22	\$1	1.0%
Vehicle Use Tax	35	7	\$28	6	\$0	0.0%
Inheritance Tax (Gross)	225	30	\$195	55	\$13	7.1%
Insurance Taxes and Fees	332	15	\$317	9	\$13	4.3%
Corporate Franchise Tax & Fees	150	21	\$129	21	\$8	6.6%
Interest on State Funds & Investments	75	15	\$60	14	\$8	15.4%
Cook County IGT	400	54	\$346	54	\$45	15.0%
Other Sources	1,403	30	\$1,373	33	\$1,057	334.5%
Subtotal	\$19,725	\$2,634	\$17,091	\$2,639	\$1,656	10.7%
Transfers						
Lottery	540	70	\$470	79	\$9	2.0%
Riverboat transfers & receipts	717	122	\$595	100	\$141	31.1%
Other	915	266	\$649	195	\$255	64.7%
Total State Sources	\$21,897	\$3,092	\$18,805	\$3,013	\$2,061	12.3%
Federal Sources	\$4,950	\$1,256	\$3,694	\$731	\$485	15.1%
Total Federal & State Sources	\$26,847	\$4,348	\$22,499	\$3,744	\$2,546	12.8%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$965)	(\$131)	(\$834)	(\$87)	(\$283)	51.4%
Corporate Income Tax	(356)	(16)	(\$340)	(13)	(\$80)	30.8%
Subtotal General Funds	\$25,526	\$4,201	\$21,325	\$3,644	\$2,183	11.4%
Short-Term Borrowing	\$0	\$0	\$0	\$700	(\$975)	N/A
Budget Stabilization Fund Transfer	\$226	\$226	\$0	\$226	\$0	N/A
Proceeds from Pension Obligation Bonds	\$1,600	\$368	\$1,232	\$0	\$932	N/A
Total General Funds	\$27,352	\$4,795	\$22,557	\$4,570	\$2,140	10.5%