Commission on Government Forecasting and Accountability

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703 Stratton Ofc. Bldg.
Springfield, IL 62706

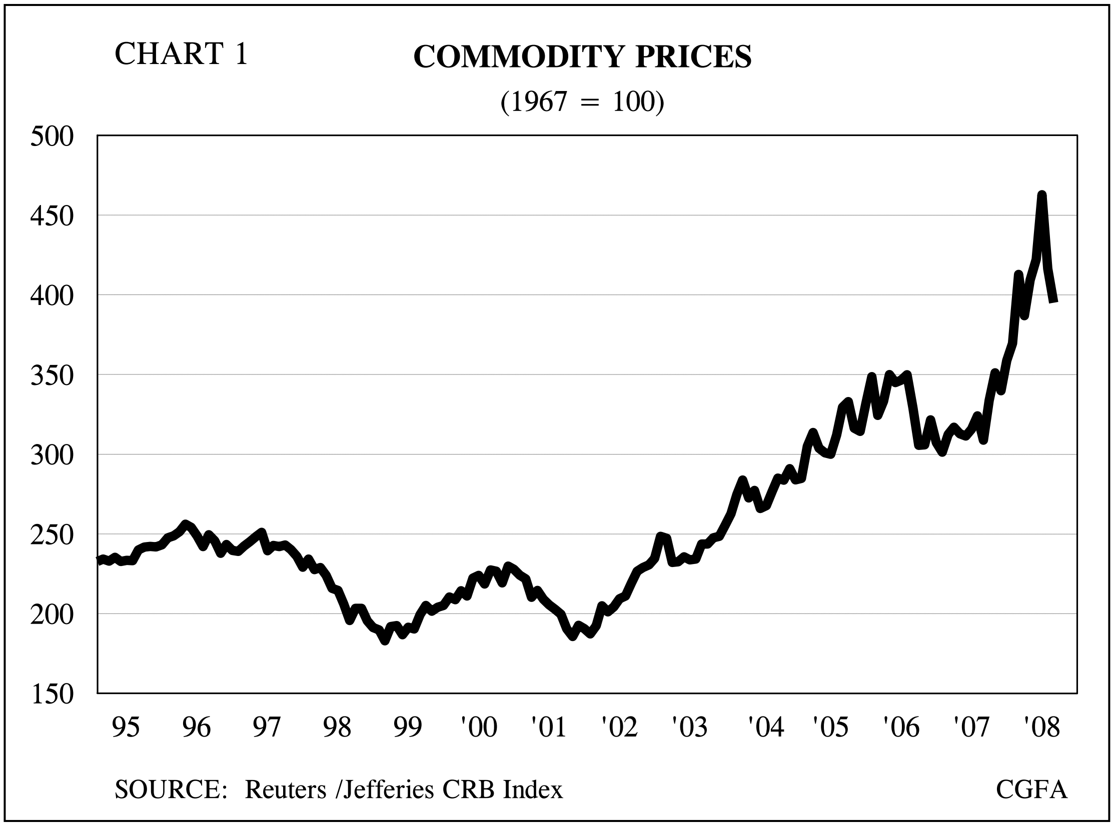
ECONOMY: Commodities Bubble Revisited

Edward H. Boss, Jr., Chief Economist

Last April the ***Monthly Briefing*** raised speculation that *"another bubble may be forming...a key candidate... is the soaring increase in basic commodity prices."* In recent weeks the sharp decline in these prices suggests that this bursting of a bubble indeed may be under way. This is illustrated in the Chart 1 on the next page that shows monthly movements in the Reuters/Jefferies CRB Index. The index is comprised of prices on 19 commodities, each weighted by its importance. The measure includes oil and related products (crude oil, natural gas, heating oil, and unleaded gasoline); metals (aluminum, copper, nickel and precious metals (gold and silver); agricultural products (corn, soybeans, wheat, cotton, sugar, cocoa, coffee and orange juice); and meats (live cattle and lean hogs).

Recent readings of the CRB have brought the index down from a level of 462.7 (1967=100) at the end of June to 395.0 by August 25th. A large part of the falloff in the index can be attributed to a decline in energy prices from record levels. The falloff of $30 a barrel in the price of oil from a high of $146 a barrel in early July to $116 a barrel on August 26th had an important impact. Crude oil prices have a weight of 23%, unleaded gas 5%, and heating oil 5%, so together they account for fully a third of the index.

Oil was not the only sector to decline, however, as gold prices fell from a high of $1,011 an ounce in mid March to $822 by late August while silver dropped from a high of $20 an ounce to $13.62 during the same time period and other metals also came off their earlier peak prices. Even agricultural prices, which earlier had jumped due to continuing usage for ethanol production only to be hit by major flood conditions, came off their highs as the Department of Agriculture's estimates of output were not as



dire as had been expected. As a result, corn prices dropped from a high of $7.60 a bushel in early July to $5.80 by late August, although prices were still up almost 30% from a year earlier.

If the U.S. economy is in recession, about to enter one, or even in a prolonged period of slow growth, which encompass the forecast range of most economists, then the softening in commodity prices would be expected and in line with previous such periods. However, until recently, many market participants had believed that the U.S. experience would not reduce such prices as soaring growth in China and India as well as continued growth in Europe would more than offset any softening in the U.S. economy. Recent evidence suggests they may well be wrong in their assessment.

As pointed out by ISI (International Strategy & Investment), real GDP in the U.K. was zero in the second quarter, the weakest in 16 years, the Euro zone and Japan's GDPs were negative that quarter, and the Emerging Market economies were likely to follow suit as suggested by their stock markets. Indeed, the economic slowing abroad was a major factor in strengthening the foreign exchange value of the U.S. dollar that in turn helped to lower world oil prices that are priced in dollars. In addition, higher gasoline prices in the U.S. reduced demand while fears of energy supply disruptions in Europe that could weaken their economies even further, arose due to the Russian invasion of Georgia that threatened the pipeline that runs through that independent nation.

The most likely outlook is that the recent downturn in commodity prices will continue in the months ahead, reversing the skyrocketing pace seen, particularly over the past year. This is not to say, however, that the level of prices will return to those seen earlier in the decade. The further softening in these basic prices is predicated on the weakening in the U.S. economy, in Europe, and Asia and a reduced pace of advance in both China and India, particularly as energy subsidies are removed. The path to lower prices, however, may not be smooth. Threatening disruption of oil and gas production during the hurricane season, as well as possible fall out from the Russian invasion and other possible events could at least temporarily cause a reversal of the recent downward trend in commodity prices.

INDICATOR OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	JULY 2008	JUNE 2008	JULY 2007
Unemployment Rate (Average)	7.3%	6.8%	5.1%
Annual Rate of Inflation (Chicago)	9.5%	4.5%	5.8%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (July)	6,755	-0.3%	0.6%
Employment (thousands) (July)	6,264	-0.8%	-1.6%
New Car & Truck Registration (July)	53,360	-1.8%	-1.3%
Single Family Housing Permits (July)	1,277	-1.9%	-47.1%
Total Exports ($ mil) (June)	4,474	-7.1%	5.3%
Chicago Purchasing Managers Index (August)	57.9	14.0%	7.6%

REVENUE

August Revenues Plunge Due to Weak Federal Sources and Transfers

Jim Muschinske, Revenue Manager

August revenues dropped $457 million as a significant slowing in reimbursable spending caused federal sources to plummet $338 million. A poor month for transfers also contributed to the drop off. August had two less receipting days than the same month one year earlier, which added to the decline.

Most of the revenue sources either experienced declines in August or were flat when compared to last fiscal year. Public utility taxes fell $30 million, in part due to receipt timing. Gross personal income tax declined by $18 million, or $17 million net of refunds. Both interest earnings and other sources each fell $9 million, while inheritance tax slowed by $6 million. Corporate franchise taxes dipped $2 million and vehicle use tax by $1 million.

Only a few sources posted gains for the month. Gross corporate income taxes grew $19 million, or $12 million net of refunds. Sales tax managed to post a $4 million gain, while insurance taxes eked out a $2 million advance.

Overall transfers were down $63 million. Riverboat transfers dropped $45 million, lottery $12 million, and other transfers by $6 million. After surging in July, federal sources plunged by $338 million, reflecting a slowing in reimbursable spending.

Early Revenues Continue to Reflect Concerns

Through August, overall base revenues are down $305 million, with most of that decline related to federal sources [$204 million]. Spending on reimbursable programs such as Medicaid has been erratic over the first two months. While down on a year to date basis, current appropriation levels would indicate that receipts should approximate last year's levels by the end of the fiscal year. In last month's briefing, a number of items were highlighted that will serve to restrict revenue growth in FY 2009. Those items, when combined with a slowed economy already have been felt early in the new fiscal year.

Other transfers are down $75 million due to certain transfers enjoyed last year that will not be repeated in FY 2009. In addition, riverboat transfers continue to struggle and are down $35 million, whereas even the lottery is running $11 million behind last year. Not surprisingly, interest income is down, as the $25 million decline can be attributed to lower rates of return as well as lower investable balances.

The most closely related economic sources shows varied performance. Gross corporate income tax is up $24 million, or $19 million net of refunds. However, the vast majority of corporate income tax has yet to be receipted, and this early performance is expected to take a downward turn. Sales tax continues to be lifeless, posting only a gain of $8 million.

GENERAL FUNDS RECEIPTS: AUGUST

FY 2009 vs. FY 2008

($ million)

Revenue Sources	August FY 2009	August FY 2008	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$691	$709	($18)	-2.5%
Corporate Income Tax (regular)	35	16	$19	118.8%
Sales Taxes	601	597	$4	0.7%
Public Utility Taxes (regular)	82	112	($30)	-26.8%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	13	13	$0	0.0%
Vehicle Use Tax	3	4	($1)	-25.0%
Inheritance Tax (Gross)	31	37	($6)	-16.2%
Insurance Taxes and Fees	20	18	$2	11.1%
Corporate Franchise Tax & Fees	13	15	($2)	-13.3%
Interest on State Funds & Investments	9	18	($9)	-50.0%
Cook County IGT	0	0	$0	N/A
Other Sources	30	39	($9)	-23.1%
Subtotal	$1,557	$1,607	($50)	-3.1%
Transfers				
Lottery	35	47	($12)	-25.5%
Riverboat transfers & receipts	30	75	($45)	-60.0%
Other	25	31	($6)	-19.4%
Total State Sources	$1,647	$1,760	($113)	-6.4%
Federal Sources	$236	$574	($338)	-58.9%
Total Federal & State Sources	$1,883	$2,334	($451)	-19.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($68)	($69)	$1	-1.4%
Corporate Income Tax	($10)	(3)	($7)	233.3%
Subtotal General Funds	$1,805	$2,262	($457)	-20.2%
Short-Term Borrowing	$0	$0	$0	N/A
Hopital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$276	($276)	N/A
Total General Funds	$1,805	$2,538	($733)	-28.9%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 3-Sep-08

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2009 vs. FY 2008

($ million)

Revenue Sources	FY 2009	FY 2008	CHANGE FROM FY 2008	% CHANGE
State Taxes				
Personal Income Tax	$1,386	$1,369	$17	1.2%
Corporate Income Tax (regular)	89	65	$24	36.9%
Sales Taxes	1,231	1,223	$8	0.7%
Public Utility Taxes (regular)	195	183	$12	6.6%
Cigarette Tax	58	58	$0	0.0%
Liquor Gallonage Taxes	29	28	$1	3.6%
Vehicle Use Tax	6	7	($1)	-14.3%
Inheritance Tax (Gross)	58	56	$2	3.6%
Insurance Taxes and Fees	23	26	($3)	-11.5%
Corporate Franchise Tax & Fees	27	29	($2)	-6.9%
Interest on State Funds & Investments	16	41	($25)	-61.0%
Cook County IGT	13	15	($2)	-13.3%
Other Sources	71	76	($5)	-6.6%
Subtotal	$3,202	$3,176	$26	0.8%
Transfers				
Lottery	81	92	($11)	-12.0%
Riverboat transfers & receipts	80	115	($35)	-30.4%
Other	56	131	($75)	-57.3%
Total State Sources	$3,419	$3,514	($95)	-2.7%
Federal Sources	$944	$1,148	($204)	-17.8%
Total Federal & State Sources	$4,363	$4,662	($299)	-6.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($135)	($134)	($1)	0.7%
Corporate Income Tax	($16)	($11)	($5)	45.5%
Subtotal General Funds	$4,212	$4,517	($305)	-6.8%
Short-Term Borrowing	$0	$0	$0	N/A
Hospital Provider Fund (cash flow transfer)	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	0.0%
Total General Funds	$4,488	$4,793	($305)	-6.4%

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

CGFA 3-Sep-08