



Commission on Government Forecasting and Accountability

MONTHLY BRIEFING

AUGUST 2011

<http://www.ilga.gov/commission/cgfa2006/home.aspx>

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ECONOMY: Soft Patch or Recession?

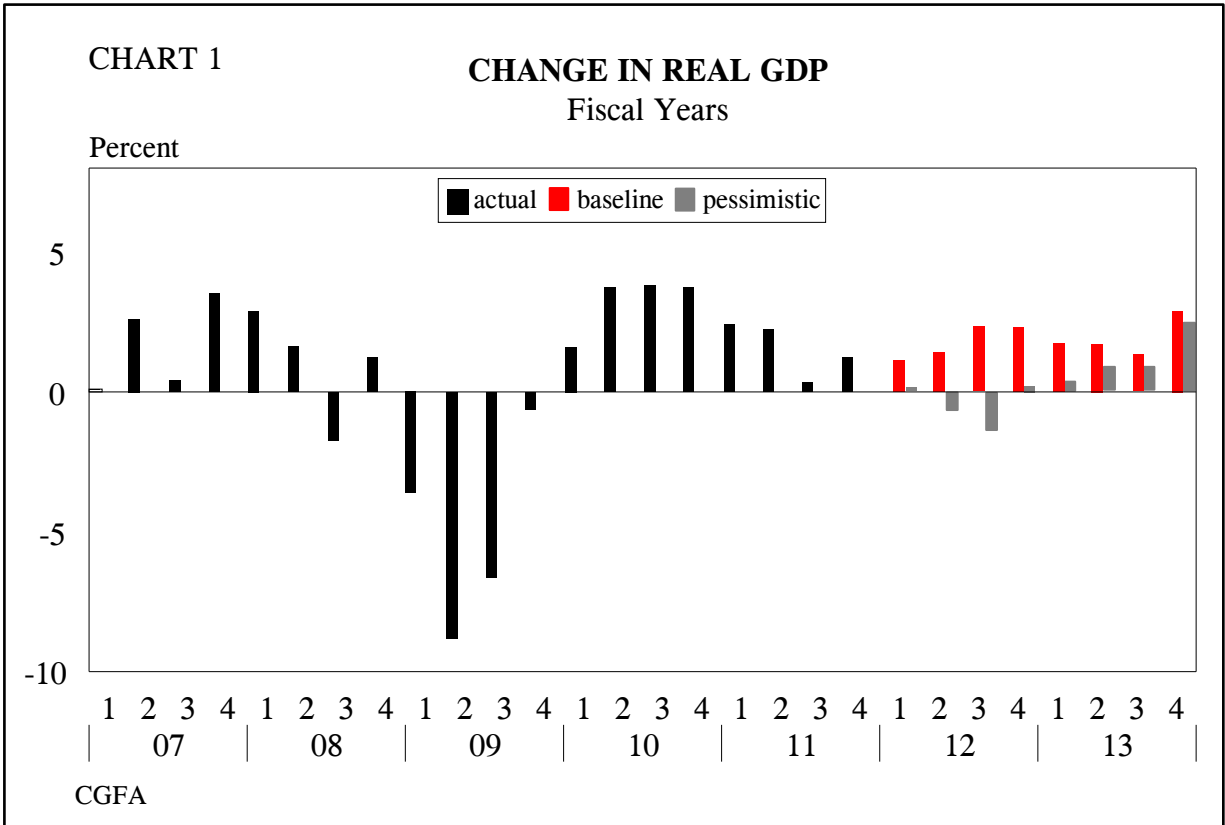
Edward H. Boss, Jr., Chief Economist

Revised historical data on the U.S. economy, a recent rash of weak business data, and turmoil in the Euro Zone are causing analysts to take a new look at their economic forecasts. Most have, or are in the process of, revising their forecasts for growth downward, raising speculation as to whether the economy is merely experiencing a soft patch or is on the verge of falling into another recession.

Each July, the Commerce Department releases its revision of the national income accounts based on more complete data, this year starting from 2003, although the most notable revisions were from 2008 through the first quarter of 2011. Two major conclusions can be drawn from the revised data. First the recession that began at the end of 2007 and ended in June 2009 not only was the longest post WWII recession, but also it was much deeper than originally thought. Second the pace of recovery, now more than two years old, was weaker than originally reported, particularly in the first quarter of this year when real GDP growth, which had been reported as 1.9% was reduced to a mere 0.4%.

Preliminary estimates of real GDP for the second quarter showed a modest improvement, growing at an annual rate of 1.0%, although with the exception of the previous quarter was the slowest in 2 years. Moreover, the largest spending component, personal consumption expenditures rose at only a 0.4% annual rate last quarter, down from a 2.1% rate in the first quarter. The acceleration in real GDP was due to a deceleration in imports, an upturn in federal government spending, and an improvement in nonresidential or business fixed investment.

More recent business reports continue to display discouraging results. The initial reading on Consumer Sentiment from the University of Michigan released on August 12th shows



continued concern and uncertainty. The index dropped a sharp 8.8 points to 54.9 and has fallen nearly 20 points in three months. Adding to restraint on spending has been the sharp swings in the stock market leading to significantly lower levels in recent weeks as well as to further weakness in the housing market. The Census Bureau reported on August 16th that privately owned housing permits fell 3.2% from June; privately owned housing starts fell 1.5%, and single-family housing starts dropped 4.9% from the previous month. Even business spending both in the manufacturing and service sectors, which had been strengthening during the recovery, has weakened significantly as measured by the Institute of Supply Management.

In addition to the downwardly revised GDP growth and weak business reports

in the U.S., conditions in the Euro Zone appear even more tenuous. Economic growth in the 17 countries that use the euro dropped to 0.2% in the second quarter compared to 0.8% measured quarter to quarter in the first quarter. Perhaps even more important was the sharp slowdown in the major European engines of growth -- Germany and France. Germany's growth sagged to 0.1% in the second quarter against 1.3% in the first quarter while it stagnated in France. These two countries are the major backers of the euro zone's bailout fund, limiting their ability to help crises stricken countries and may intensify the sovereign debt crisis they have been working on to quell.

All these factors provide the basis for downward adjustments to U.S. economic growth prospects. Chart 1

illustrates the latest economic forecast for U.S. growth on a fiscal year basis in August provided by the Commission's forecasting service, Global Insight. The chart shows real GDP growth on a quarterly annual rate basis through fiscal 2013. The chart shows both the baseline, or most likely outcome, and a pessimistic alternative. (The service also provided an optimistic alternative, but was omitted as its odds of occurring has been falling and currently is only 10%.) It is important to note that the odds of the baseline coming about has fallen to 50% from 60% as recently as May while odds of the pessimistic solution occurring has doubled between May and August from 20% to 40%.

In conclusion, while the odds are that the current soft patch gets softer, its

falling over the edge into a double dip recession has diminished. The baseline forecast indicates that growth in FY 2012 would slow to 1.4% from 2.6% in FY 2011 and improves only modestly to 2.0% in FY 2013. The pessimistic forecast has two consecutive quarters of decline and even slower growth. It does suggest the possibility of two consecutive quarters of decline in real growth, although that alone is not necessarily a recession. A recession depends not only on the length of decline but also how widespread it is. According to the National Bureau of Economic Research, the official determinate of business cycles, a recession is "*a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale-retail trade*".

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>JULY 2011</u>	<u>JUNE 2011</u>	<u>JULY 2010</u>
Unemployment Rate (Average)	9.5%	9.1%	10.1%
Annual Rate of Inflation (Chicago)	-4.9%	0.5%	3.2%
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (July)	6,587.9	-0.1%	-0.6%
Employment (thousands) (July)	5,960.2	-0.5%	0.0%
New Car & Truck Registration (July)	42,426	-12.4%	11.3%
Single Family Housing Permits (July)	626	-7.9%	-7.2%
Total Exports (\$ mil) (June)	5,531	-1.6%	26.6%
Chicago Purchasing Managers Index (August)	56.5	-3.9%	-0.3%

REVENUE

August Revenues Up Despite Federal Source Falloff

Jim Muschinske, Revenue Manager

August revenues rose \$223 million despite a poor month for federal reimbursements. Personal and corporate income taxes jumped due to higher tax rates as compared to last year, while sales tax continues to perform quite well even as most economic measures indicate consumer weakness. Also contributing to the monthly gain was an expected \$73 million remaining payment related to the 10th riverboat license bid. August had one more receipting day as compared to the same month of last year.

For the month, personal income tax receipts led the gainers as gross receipts grew \$464 million, or \$424 million net of refunds. Sales tax continues to fare well as receipts grew \$63 million for the month. Public utility managed to post growth of \$27 million, while gross corporate income tax rose \$26 million, or \$22 million net of refunds. Other sources increased \$3 million, insurance taxes \$2 million, and liquor taxes \$1 million.

Inheritance tax continued its expected fall off, dropping \$29 million. Corporate franchise taxes dipped \$2 million, while interest income dropped \$1 million.

Overall transfers declined \$23 million in August. While proceeds from the 10th riverboat license bid resulted in an expected \$73 million payment, that gain was more than wiped out by a falloff of \$12 million in regular riverboat transfers, a dip of \$4 million from

lottery transfers, and a \$80 million decline in other transfers related to last year's interfund borrowing activity. Finally, as mentioned, federal sources plunged \$264 million as reimbursable spending slowed substantially.

Year to Date

Through the first two months of the fiscal year, absent short-term borrowing and Budget Stabilization Fund transfers, base general funds revenues are up \$409 million. The increase is fueled by comparatively higher income tax receipts stemming from the January 2011 rate increases, as well as continued strong sales tax receipts. Those items along with higher transfers were enough to offset a significant drop off in federal sources.

To date, gross personal income taxes are up \$904 million, or \$825 million net of refunds. Sales taxes have increased \$128 million, while gross corporate income taxes are up \$41 million, or \$34 million net of refunds. All other revenue sources net a decline of \$24 million mainly due to the expected falloff in inheritance tax receipts.

Overall transfers are up \$114 million due in large part to the recent payment related to the operation of the 10th riverboat per bid agreement. And as mentioned, those gains have in large part been erased by a drop of \$668 million in federal source receipts related to reimbursable spending as well as lower federal match.

GENERAL FUNDS RECEIPTS: AUGUST

FY 2012 vs. FY 2011

(\$ million)

<u>Revenue Sources</u>	<u>August FY 2012</u>	<u>August FY 2011</u>	<u>\$ CHANGE</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$1,144	\$680	\$464	68.2%
Corporate Income Tax (regular)	54	28	\$26	92.9%
Sales Taxes	601	538	\$63	11.7%
Public Utility Taxes (regular)	97	70	\$27	38.6%
Cigarette Tax	29	29	\$0	0.0%
Liquor Gallonage Taxes	12	11	\$1	9.1%
Vehicle Use Tax	3	3	\$0	0.0%
Inheritance Tax (Gross)	1	30	(\$29)	-96.7%
Insurance Taxes and Fees	14	12	\$2	16.7%
Corporate Franchise Tax & Fees	13	15	(\$2)	-13.3%
Interest on State Funds & Investments	0	1	(\$1)	-100.0%
Cook County IGT	0	0	\$0	N/A
Other Sources	32	29	\$3	10.3%
Subtotal	\$2,000	\$1,446	\$554	38.3%
Transfers				
Lottery	35	39	(\$4)	-10.3%
Riverboat transfers & receipts	18	30	(\$12)	-40.0%
Proceeds from Sale of 10th license	73	0	\$73	N/A
Other	47	127	(\$80)	-63.0%
Total State Sources	\$2,173	\$1,642	\$531	32.3%
Federal Sources	\$135	\$399	(\$264)	-66.2%
Total Federal & State Sources	\$2,308	\$2,041	\$267	13.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$100)	(\$60)	(\$40)	66.7%
Corporate Income Tax	(\$9)	(5)	(\$4)	80.0%
Subtotal General Funds	\$2,199	\$1,976	\$223	11.3%
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	\$2,199	\$1,976	\$223	11.3%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				1-Sep-11

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2012 vs. FY 2011

(\$ million)

<u>Revenue Sources</u>	<u>FY 2012</u>	<u>FY 2011</u>	<u>CHANGE FROM FY 2011</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$2,232	\$1,328	\$904	68.1%
Corporate Income Tax (regular)	116	75	\$41	54.7%
Sales Taxes	1,207	1,079	\$128	11.9%
Public Utility Taxes (regular)	178	158	\$20	12.7%
Cigarette Tax	59	58	\$1	1.7%
Liquor Gallonage Taxes	29	29	\$0	0.0%
Vehicle Use Tax	6	5	\$1	20.0%
Inheritance Tax (Gross)	1	53	(\$52)	-98.1%
Insurance Taxes and Fees	18	16	\$2	12.5%
Corporate Franchise Tax & Fees	26	28	(\$2)	-7.1%
Interest on State Funds & Investments	1	1	\$0	0.0%
Cook County IGT	0	0	\$0	N/A
Other Sources	68	62	\$6	9.7%
Subtotal	\$3,941	\$2,892	\$1,049	36.3%
Transfers				
Lottery	76	82	(\$6)	-7.3%
Riverboat transfers & receipts	53	60	(\$7)	-11.7%
Proceeds from Sale of 10th license	73	0	\$73	N/A
Other	280	226	\$54	23.9%
Total State Sources	\$4,423	\$3,260	\$1,163	35.7%
Federal Sources				
Total Federal & State Sources	\$284	\$952	(\$668)	-70.2%
Total Federal & State Sources	\$4,707	\$4,212	\$495	11.8%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$195)	(\$116)	(\$79)	68.1%
Corporate Income Tax	(\$20)	(\$13)	(\$7)	53.8%
Subtotal General Funds	\$4,492	\$4,083	\$409	10.0%
Short-Term Borrowing	\$0	\$1,300	(\$1,300)	-100.0%
Tobacco Liquidation Proceeds	\$0	\$0	\$0	N/A
Pension Contribution Fund Transfer	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$275	\$0	\$275	N/A
Total General Funds	\$4,767	\$5,383	(\$616)	

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

CGFA

2-Sep-11