Commission on Government Forecasting and Accountability

703 Stratton Ofc. Bldg., Springfield, IL 62706

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INSIDE THIS ISSUE

ECONOMY: Unscrambling Illinois Employment Picture

Edward H. Boss, Jr., Chief Economist

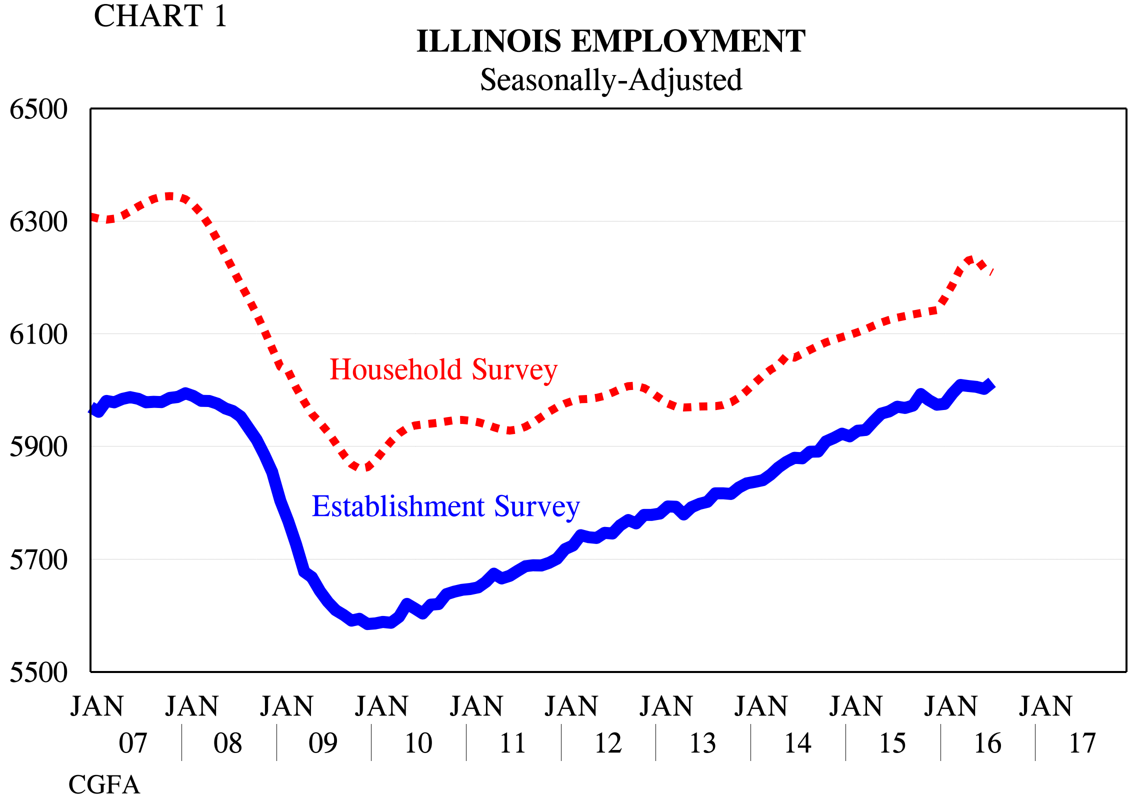
The burden of influencing economic activity in recent years has been placed almost solely upon the Federal Reserve's monetary policy stance through adjustments in the federal funds rate. Indeed, to simplify analysis, the Federal Reserve emphasizes labor market conditions with specified targets for the unemployment rate and inflation rate. The latest data on Illinois employment situation shows its unemployment rate fell to 5.8% in July, down for the third month in a row. Indeed, this would appear to be good news.

A clue to anticipated changes in Federal Reserve policy can be found in Fed Chairman Janet Yellen's speech to the central bank's annual Jackson Hole summit in Wyoming on August 26^{th}.

"Looking ahead, the FOMC *(Federal Open Market Committee)* expects moderate growth in real gross domestic product (GDP), additional strengthening in the labor market, and inflation rising to 2 percent over the next few years. Based on this economic outlook, the FOMC continues to anticipate that gradual increases in the federal funds rate will be appropriate over time to achieve and sustain employment and inflation near our objectives."

In assessing the basis of this analysis it's important to see where we are presently. Real GDP growth rose at an annual rate of 1% in the first half of this year. It will have to triple this pace in the second half of the year to average out to a 2% gain for the year that would approximate the 2.1% average growth for the years 2010 through 2015. Even so, this would still be the weakest recovery in the post WWII period. Inflation as measured by the consumer price index rose 0.8% in July from a year earlier and 2.2% when excluding volatile food and energy prices. The Fed prefers to look at personal consumption inflation. In the second quarter of this year the PCE rose 2.0% compared to 1.8% in the year earlier quarter, while excluding

CHART 1



food and energy, the index rose 1.8% in the second quarter which was the same in the year-ago quarter.

Judging labor market conditions require more analysis, however, than looking only at the unemployment rate. For example, while Illinois' unemployment rate fell in July, the data that is used to calculate the rate is from the Household Survey that measures both changes in employment and the size of the labor force. As shown in the chart and in the Indicator of Illinois Economic Activity table, while it is true that in the Household Survey employment rose, that was more than offset both this month and last by a larger decline in the labor force, thus causing reductions in the unemployment rate. Indeed last month's rate is unchanged from that of July 2015. Also, shown in the Chart and in the Indicator table is the Establishment survey that measures nonfarm payroll employment.

Both surveys have positives and negatives. The Household Survey is the larger of the two as it counts from a sample, all who did any work at all during the survey week for pay, those who worked in their own business, profession, or on their own farm or worked without pay at least 15 hours in a family business or farm. Also included as employed are those who are *temporarily* absent from work due to illness, bad weather, vacation, labor disputes or personal reasons. The sample survey is about 60,000 eligible households. In contrast, the Establishment Survey derives its data from private nonfarm businesses as well as federal, state, and local government entities. The Survey is among 146,000 businesses representing about 623,000 individual worksites and about one-third of all nonfarm payroll employees. Not only is this a more comprehensive survey, but since it goes to firms records, it is considered to be harder data. This is not to say there aren't problems. For example, most jobs originate from new businesses and it may be some time for these businesses to be included in the Establishment Survey. Thus, some suggest the trend of Household Survey may foreshadow events to come in the Establishment Survey. Perhaps a larger problem for the Establishment Survey is that it double counts employment numbers for those working two jobs. The latter impact may have become even greater recently as stagnant wages have sent many looking for another job while many part-time workers are having their hours cut by employers wanting to avoid offering health care under the ACA mandate, forcing them to look for additional employment elsewhere.

National payroll employment recouped all the jobs lost in the last recession that began at the end of 2007 within five years. In Illinois, payroll employment didn't recoup all the recession-lost jobs until early this year and Household employment has yet to achieve that. There are many other measures that influence the strength or weakness of the labor markets, the one most noticeable in this recovery is the low labor participation rate, the lowest since the late 1970s. While an aging population and retirements are factors behind the low participation rate, older workers are working longer and a major contributor is the large number of discouraged workers dropping out of the labor force. Indeed, if you include those marginally attached to the labor force and part-time for economic reasons, the U6 definition, and the national unemployment rate almost doubles its 4.9% rate to 9.7%.

Finally, after being relatively close at the end of 2007, Illinois unemployment rate has widened its gap not only with that of the nation, but particularly with the Midwest region. Latest data show the national unemployment rate at 4.9%, the Midwest at 4.5% and Illinois at 5.8%. A good part of the difference is in the manufacturing area. As the recovery got underway in mid-2009, Illinois also saw steady improvement in manufacturing jobs through the fall of 2012; however, it began to weaken. By July 2016 it had retreated to its lowest level since the spring of 2011. *(For a further discussion of Illinois manufacturing employment see the July Monthly Revenue Report.)* Thus, it appears that while employment may continue to rise in Illinois, the gap between Illinois, the nation, and the Midwest is likely to continue.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	July 2016	June 2016	July 2015
Unemployment Rate (Average)	5.8%	6.2%	5.8%
Annual Rate of Inflation (Chicago)	-0.1%	0.4%	-9.8%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (July)	6,592.1	-0.5%	1.3%
Employment (thousands) (July)	6,209.0	-0.1%	1.3%
NonFarm Payroll Employment (July)	6,013.9	11,600	43,200
New Car & Truck Registration (July)	52,300	-8.2%	-11.1%
Single Family Housing Permits (July)	898	-17.1%	-19.0%
Total Exports ($ mil) (June)	5,028.1	4.1%	-6.7%
Chicago Purchasing Managers Index (August)	51.5	-7.7%	-5.3%

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

REVENUE

August Revenues Up Modestly on Mixed Results

Jim Muschinske, Revenue Manager

Overall base revenues increased $84 million in August as results were mixed among the various revenue sources. August benefited from two extra receipting days.

Gross personal income taxes increased $71 million, $49 million net of refunds, or $53 million after including the distributions to the Fund for Advancement of Education and the Commitment to Human Services Fund. Sales tax managed to post an $11 million gain, while public utility taxes grew $10 million. Cigarette tax made up for the previous month by adding $5 million, other sources grew $4 million, insurance taxes increased $2 million, and interest income managed to grow $1 million.

A few sources did experience declines for the month. Gross corporate income taxes fell by $31 million, or $26 million net of refunds. [It should be mentioned that since the IDoR's recent ledger conversion, some historic receipt patterns have changed. In particular, corporate income tax has behaved erratically. It is unknown at this time if this is temporary or will persist into future months]. Inheritance tax receipts declined $7 million, while liquor taxes fell $2 million, and corporate franchise taxes dipped $1 million.

Transfers into the general funds declined by $63 million in August. The decline was due to last year's $77 million transfer from the Refund Fund—which will not recur in FY 2017. The lottery transfer grew $3 million, while other transfers increased by $13 million. Riverboat transfers fell by $2 million. Federal sources posted a decent gain of $97 million, however, this compared to a dismal month for federal reimbursements experienced last year.

Year To Date

Through August, base receipts are down $26 million, reflecting a rather inconsistent revenue picture early in FY 2017. While both personal and corporate income taxes have somewhat disappointed, sales tax receipts at least posted respectable early returns.

As mentioned earlier, gross corporate income taxes have deviated from usual receipt patterns and are off $67 million, or $57 million net of refunds. Gross personal income tax is virtually flat, although dipping slightly with a $6 million decline. A higher refund percentage in FY 2017 does increase the falloff to a larger $18 million year to date. Despite the early performance of income taxes, sales taxes managed to grow in line with modest expectations as receipts are ahead of last year's tepid pace by $43 million.

Overall transfers are down $72 million at this point of the young fiscal year. As stated earlier, this year is without a transfer from the Refund Fund which added $77 million last August. While the lottery transfer is ahead of last year pace by $18 million, other transfers are down $9 million and riverboat transfers are off $4 million.

Despite federal sources growing $91 million thus far, average monthly performance would have to increase over the remainder of the fiscal year even to hit the Commission's very modest projection.

AUGUST
FY 2017 vs. FY 2016
($ million)

Revenue Sources	August FY 2017	August FY 2016	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,054	$983	$71	7.2%
Corporate Income Tax (regular)	14	45	($31)	-68.9%
Sales Taxes	700	689	$11	1.6%
Public Utility Taxes (regular)	78	68	$10	14.7%
Cigarette Tax	34	29	$5	17.2%
Liquor Gallonage Taxes	12	14	($2)	-14.3%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax	11	18	($7)	-38.9%
Insurance Taxes and Fees	23	21	$2	9.5%
Corporate Franchise Tax & Fees	13	14	($1)	-7.1%
Interest on State Funds & Investments	2	1	$1	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	32	28	$4	14.3%
Subtotal	$1,976	$1,913	$63	3.3%
Transfers				
Lottery	32	29	$3	10.3%
Riverboat transfers & receipts	34	36	($2)	-5.6%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	77	($77)	N/A
Fund sweeps	0	0	$0	N/A
Other	97	84	$13	15.5%
Total State Sources	$2,139	$2,139	$0	0.0%
Federal Sources	$144	$47	$97	206.4%
Total Federal & State Sources	$2,283	$2,186	$97	4.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($118)	($96)	($22)	22.9%
Corporate Income Tax	($2)	(7)	$5	-71.4%
Fund for Advancement of Education	($28)	(30)	$2	-6.7%
Commitment to Human Services Fund	($28)	(30)	$2	-6.7%
Subtotal General Funds	$2,107	$2,023	$84	4.2%
Short-Term Borrowing	$0	$0	$0	N/A
Interfund Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$125	($125)	N/A
Total General Funds	$2,107	$2,148	($41)	-1.9%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Sep-16

GENERAL FUNDS RECEIPTS: YEAR TO DATE
FY 2017 vs. FY 2016
($ million)

Revenue Sources	FY 2017	FY 2016	CHANGE FROM FY 2016	% CHANGE
State Taxes				
Personal Income Tax	$1,991	$1,997	($6)	-0.3%
Corporate Income Tax (regular)	44	111	($67)	-60.4%
Sales Taxes	1,408	1,365	$43	3.2%
Public Utility Taxes (regular)	140	132	$8	6.1%
Cigarette Tax	59	59	$0	0.0%
Liquor Gallonage Taxes	30	31	($1)	-3.2%
Vehicle Use Tax	5	6	($1)	-16.7%
Inheritance Tax	40	46	($6)	-13.0%
Insurance Taxes and Fees	31	31	$0	0.0%
Corporate Franchise Tax & Fees	24	30	($6)	-20.0%
Interest on State Funds & Investments	4	2	$2	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	74	77	($3)	-3.9%
Subtotal	$3,850	$3,887	($37)	-1.0%
Transfers				
Lottery	98	80	$18	22.5%
Riverboat transfers & receipts	53	57	($4)	-7.0%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	77	($77)	-100.0%
Fund sweeps	0	0	$0	N/A
Other	141	150	($9)	-6.0%
Total State Sources	$4,142	$4,251	($109)	-2.6%
Federal Sources	$483	$392	$91	23.2%
Total Federal & State Sources	$4,625	$4,643	($18)	-0.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($213)	($195)	($18)	9.2%
Corporate Income Tax	($7)	($17)	$10	-58.8%
Fund for Advancement of Education	($74)	($74)	$0	N/A
Commitment to Human Services Fund	($74)	($74)	$0	N/A
Subtotal General Funds	$4,257	$4,283	($26)	-0.6%
Short-Term Borrowing	$0	$0	$0	N/A
Interfund Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$125	($125)	-100.0%
Total General Funds	$4,257	$4,408	($151)	-3.4%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.
CGFA 2-Sep-16

PENSIONS
Summary of Governor Rauner's Amendatory Veto of SB 440
Jerry Lazzara, Pension Analyst

SB 440 proposes a multitude of changes for the Chicago Police and Chicago Fire Pension Funds. The bill would:

1. Expand eligibility for death benefits and refunds for Tier 2 employees.

2. Salary deductions for present employees and future entrants will contribute to the Funds for Tier 2 monthly retirement annuity, in addition to age and service annuity and widow's annuity.

3. Increase the the COLA for retirees born between 1955 and 1965 by 1.5%.

4. Adjust the minimum widow's annuity so that it is no less than 125% of the Federal Poverty Level.

5. Surviving spouses shall be deemed qualified to receive a Tier 2 suviving spouse's annuity in lieu of the standard widow's annuity.

6. Surviving children shall be deemed qualified to receive a Tier 2 child's annuity in lieu of the standard child's annuity.

7. Surviving parents shall be deemed qualified to receive a Tier 2 parent's annuity in lieu of the standard parent's annuity.

<u>Governor Rauner's Amendatory Veto</u>

On Friday, August 26, 2016, Governor Bruce Rauner issued an amendatory veto of Senate Bill 440. In his veto message, Governor Rauner stated that the City of Chicago and its pension systems opposed SB 440, due to the 1.5% COLA increase for retirees born between 1955 and 1965. He states that although this increase is anticipated, the City pension systems calculate their financial obligations with regards to current law, so this adjustment is not accounted for. Gov. Rauner expressed his hope that SB 440 will be considered in the context of broader pension reform. The veto message does not detail the specifics of the reforms that are being sought, but notwithstanding the amendatory veto, the governor expressed support for many of the changes contained in SB 440.