



Commission on Government Forecasting and Accountability

MONTHLY BRIEFING

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ECONOMY: Financial Rescue or Malaise?

Edward H. Boss, Jr., Chief Economist

The objective of this report is not to provide a critical examination of each aspect of any rescue bill that may evolve, but rather whether or not any plan if passed will achieve the objective of stabilizing the financial markets and keep the economy, already slowing sharply, from tail spinning further downward. At the heart of the problem are the huge widespread holdings of mortgage-backed securities and the inability to value their worth. After a long weekend, the Congressional agreement to a rescue plan to bail out the struggling financial markets failed with a surprise no vote on Monday. Despite dire fears of the consequences should the bailout plan fail, it was widely opposed by the majority of the public who apparently persevered.

There can be little doubt, however, that the financial markets are in disarray. The elimination in late September of the last two major investment banks – Morgan Stanley and Goldman Sachs – were granted permission to become bank holding companies in order to stay in business. This followed the collapse of Bear Sterns and its forced sale to JP Morgan Chase last March; the Treasury Department and the Federal Reserve's plan to prop up Fannie Mae and Freddie Mac; Bank of America's purchase of Countrywide Financial Company; the bankruptcy filing by investment bank Lehman Brothers; and the forced sale of investment bank Merrill Lynch to Bank of America. The Federal Reserve also had bailed out the insurance giant AIG by injecting up to \$85 billion. Allowing AIG to fail would have put at risk financial institutions all over the world.

In the U.S., thirteen commercial banks already have failed this year, including the largest on record to do so, and a fourteenth, the fourth largest bank, is in the process of being taken over. As a result of these events, the flow of

credit froze, curtailing loans for mortgages; new cars; to small business and, before the government stepped up to insure money market accounts, even business' ability to issue commercial paper to meet their short-term cash flow needs for such necessities as meeting payrolls. This had led to withdrawals of money market accounts that held a substantial amount of such high-grade short-term corporate paper.

As the stock market opened on Monday (September 29, 2008), and prior to voting on the bill by the House, the U.S. equity markets fell and pessimism was felt overseas as well. As Congress prepared to vote on the \$700 billion deal to purchase toxic mortgage-backed securities, the European Central Bank moved to inject more liquidity into the banking sector; Belgium's giant Fortis bank received a bailout from the government; and Britain nationalized lender Bradford and Bingley. With failure of the passage of the bill in the House, the Dow Jones industrial average fell by 777 points, the largest point drop in history. While the market improved, at least on Tuesday (September 30, 2008) morning on the basis that a new bailout proposal

was in the works, there is no assurance that even if a bill is approved, it will alleviate all the financial problems.

At least in the short-term, any way to isolate the toxic mortgage-backed securities should help to thaw the flow of credit. In the longer term it may take a stabilization of prices in the housing market to put a floor under the markets. In August, the median sales price of U.S. homes fell 9.5% to \$203,100, the largest drop on record since 1999 according to the National Association of Realtors. In another report issued by Standard & Poor's/Case-Shiller, home values in 20 cities fell a record 16.3% in July from a year earlier, the largest drop since its inception since 2000, while the 10 city index plunged 17.5%, its biggest drop in its 21 year history. Despite these reports on plunging home prices, it should be noted that the level of unsold home inventories is declining according to the National Association of Realtors while the pace of declines in prices in the 20-city index has slowed over the last three months. Thus, while the bottom in home prices may not have been reached, it appears that the rate of decline is abating.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

<u>INDICATORS</u>	<u>AUG. 2008</u>	<u>JULY 2008</u>	<u>AUG. 2007</u>
Unemployment Rate (Average)	7.3%	7.2%	5.2%
Annual Rate of Inflation (Chicago)	-8.2%	9.6%	4.9%
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	<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) (August)	6,727	-0.3%	0.1%
Employment (thousands) (August)	6,236	-0.4%	-2.1%
New Car & Truck Registration (August)	45,929	-13.9%	-34.2%
Single Family Housing Permits (August)	1,025	-19.7%	-55.0%
Total Exports (\$ mil) (July)	4,472	0.0%	9.6%
Chicago Purchasing Managers Index (Sept.)	56.7	-2.1%	5.4%

FY 2009 Fund Sweeps

Lynnae Kapp, Bond Analyst

Fund sweeps may occur if the Governor signs SB 790, which passed both houses of the General Assembly on September 23, 2008. This legislation would put in statute the transfer of \$221.3 million from specific funds to a newly created FY 2009 Budget Relief Fund. Amounts may be expended from the Fund only pursuant to specific authorization by appropriation. These appropriations were made in SB 1103, which passed both Houses, and appropriates funds to various agencies that are to be in addition to any other appropriations in FY 2009 for the stated purposes. The appropriations will go to programs and personnel cut at State Agencies, including the Department of Human

Services, the Department on Aging, the Department of Children and Family Services, the Department of Public Health, the Department of Healthcare and Family Services for programs for Mental Illness, Developmental Disabilities, Drug Addiction, and medical research. Funding would also be restored to the Department of Natural Resources and the Historic Preservation Agency for personnel and to keep parks and historic sites from closing. Other funding restored was for cuts to agency budgets such as the Attorney General's Office and several Legislative Commissions. The following list details the fund sweeps in SB 790 to the FY 2009 Budget Relief Fund if it were to become law.

FY09 FUND SWEEPS (SB 0790)		
No.	Fund	Statutory Amount
0014	Food and Drug Safety	\$250,000
0016	Teacher Certificate Fee Revolving	\$250,000
0018	Transportation Regulatory	\$500,000
0021	Financial Institution	\$2,000,000
0022	General Professions Dedicated	\$5,000,000
0031	Drivers Education	\$1,000,000
0039	State Boating Act	\$500,000
0040	State Parks	\$250,000
0041	Wildlife & Fish	\$5,000,000
0050	Mental Health	\$5,000,000
0054	State Pensions	\$5,000,000
0057	IL State Pharmacy Disciplinary	\$250,000
0059	Pubic Utility	\$5,000,000
0069	Natural Heritage Endowment Trust	\$250,000
0074	EPA Special State Projects Trust	\$1,000,000
0078	Solid Waste Management	\$2,000,000
0089	Subtitle D Management	\$250,000
0093	IL State Medical Disciplinary	\$5,000,000
0151	Registered CPAs' Admin & Disciplinary	\$500,000
0163	Weights and Measures	\$1,000,000
0179	Injured Workers' Benefit	\$500,000
0193	Local Gov't. Health Insurance Reserve	\$1,000,000
0195	IPTIP Administrative Trust	\$250,000
0205	IL Farmer & Agri-Business Loan Guarantee	\$1,000,000
0207	Pollution Control Board State Trust	\$250,000
0215	Capitol Development Board Revolving	\$250,000
0218	Professions Indirect Cost	\$2,000,000
0222	State Police DUI	\$250,000
0224	Asbestos Abatement	\$2,000,000
0238	IL Health Facilities Planning	\$1,000,000
0245	Fair and Exposition	\$500,000
0251	Dept. of Labor Special State Trust	\$250,000
0257	Abandoned Mined Lands Reclamation Set Aside	\$5,000,000
0258	Nursing Dedicated & Professional	\$2,000,000
0259	Optometric Licensing & Disciplinary Board	\$200,000
0260	Fish & Wildlife Endowment	\$500,000
0261	Underground Resources Conservation Enforcement Trust	\$200,000
0265	State Rail Freight Loan Repayment	\$2,000,000
0281	IL Tax Increment	\$250,000
0285	Long Term Care Monitor/Receiver	\$1,000,000
0286	IL Affordable Housing Trust	\$2,000,000
0288	Community Water Supply Lab	\$200,000
0290	Fertilizer Control	\$250,000
0294	Used Tire Management	\$1,000,000
0301	Working Capital Revolving	\$500,000
0303	State Garage Revolving	\$1,000,000
0304	Statistical Services Revolving	\$2,000,000
0310	Tax Recovery	\$250,000
0312	Communications Revolving	\$1,000,000
0314	Facilities Management Revolving	\$1,000,000

No.	Fund	Statutory Amount
0317	Professional Services	\$2,000,000
0332	Workers' Compensation Revolving	\$1,000,000
0339	IL Community College Board Contracts & Grants	\$250,000
0340	Public Health Lab Services Revolving	\$500,000
0341	Provider Inquiry Trust	\$250,000
0342	Audit Expense	\$3,250,000
0344	Care Provider Fund for Persons w/ a Developmental Disability	\$1,000,000
0353	State Pheasant	\$250,000
0356	Law Enforcement Camera Grant	\$800,000
0357	Child Labor & Day and Temporary Labor Services Enforcement	\$500,000
0360	Lead Poisoning, Screening, Prevention, and Abatement	\$250,000
0365	Health & Human Services Medicaid Trust	\$5,000,000
0369	Feed Control	\$250,000
0371	Innovations in Long-term Care Quality Demonstration Grants	\$1,000,000
0372	Plumbing Licensure & Program	\$750,000
0380	Corporate Franchise Tax Refund	\$200,000
0384	Tax Compliance and Admin	\$250,000
0386	Appraisal Administration	\$250,000
0390	IL Habitat Endowment Trust	\$2,000,000
0391	IL Habitat	\$1,000,000
0397	Trauma Center	\$2,000,000
0421	Public Aid Recoveries Trust	\$3,000,000
0422	Alternate Fuels Fund	\$2,000,000
0452	IL Tourism Tax	\$250,000
0502	Early Intervention Services Revolving	\$1,000,000
0514	State Asset Forfeiture	\$1,000,000
0520	Federal Asset Forfeiture	\$500,000
0523	Dept. of Corrections Reimbursement & Education	\$1,500,000
0524	Health Facility Plan Review	\$500,000
0537	State Offender DNA ID System	\$250,000
0538	IL Historic Sites	\$250,000
0546	Public Pension Regulation	\$250,000
0548	Drycleaner Environmental Response Trust	\$2,000,000
0549	IL Charity Bureau	\$200,000
0564	Renewable Energy Resources Trust	\$5,000,000
0569	School Technology Revolving Loan	\$500,000
0571	Energy Efficiency Trust	\$1,000,000
0574	Off-Highway Vehicle Trails	\$250,000
0576	Pesticide Control	\$500,000
0600	AG Whistleblower Reward & Protection	\$8,250,000
0611	Fund For Illinois' Future	\$10,000,000
0613	Wireless Carrier Reimbursement	\$5,000,000
0617	CDB Contributory Trust	\$2,000,000
0621	International Tourism	\$5,000,000
0629	Real Estate Recovery	\$250,000
0632	Horse Racing	\$250,000
0635	Death Certificate Surcharge	\$500,000
0637	State Police Wireless Service Emergency	\$1,000,000
0641	Auction Regulation Administration	\$500,000
0643	Auction Recovery	\$200,000
0690	DHS Private Resources	\$500,000

No.	Fund	Statutory Amount
0702	Assisted Living & Shared Housing Regulatory	\$100,000
0705	State Police Whistleblower Reward and Protection	\$2,000,000
0728	Drug Rebate	\$3,000,000
0731	IL Clean Water	\$5,000,000
0733	Tobacco Settlement Recovery	\$3,000,000
0738	Alternative Compliance Market Account	\$200,000
0739	Group Workers' Comp Pool Insolvency	\$250,000
0740	Medicaid Buy-In Program Revolving	\$500,000
0746	Home Inspector Admin	\$500,000
0757	Child Support Administrative	\$1,000,000
0763	Tourism Promotion	\$5,000,000
0764	Pet Population Control	\$250,000
0796	Nuclear Safety Emergency Preparedness	\$3,000,000
0776	Presidential Library and Museum Operating	\$500,000
0808	Medical Special Purpose Trust	\$500,000
0821	Dram Shop	\$500,000
0823	IL State Dental Disciplinary	\$1,000,000
0828	Hazardous Waste	\$1,000,000
0845	Environmental Protection Trust	\$250,000
0850	Real Estate License Admin *	\$5,000,000
0858	Land Reclamation	\$250,000
0879	Traffic & Criminal Conviction Surcharge	\$1,000,000
0884	DNR Special Projects	\$500,000
0896	Public Health Special State Projects	\$3,000,000
0900	Petroleum Violation	\$1,000,000
0905	IL Forestry Development	\$500,000
0906	State Police Services	\$6,000,000
0907	Health Insurance Reserve	\$5,000,000
0920	Metabolic Screening & Treatment	\$500,000
0921	DHS Recoveries Trust	\$1,000,000
0922	Insurance Producer Administration	\$3,000,000
0936	Rail Freight Loan Repayment	\$1,000,000
0942	Low-Level Radioactive Waste Facility Development & Operation	\$250,000
0944	Environ Protection Permit and Inspect	\$1,500,000
0951	Narcotics Profit Forfeiture	\$250,000
0953	State Migratory Waterfowl Stamp	\$500,000
0954	IL State Podiatric Disciplinary	\$200,000
0962	Park & Conservation	\$2,000,000
0969	Local Tourism	\$5,000,000
0973	Build IL Capital Revolving Loan	\$2,000,000
0975	Large Business Attraction	\$500,000
0993	Public Infrastructure Construction Loan Revolving	\$1,000,000
0994	IL Agricultural Loan Guarantee	\$2,000,000
0997	Insurance Financial Regulation	\$5,000,000
	Total	\$221,250,000

REVENUE
September Revenues Rise Due to Federal Sources;
Other Sources Mixed

Jim Muschinske, Revenue Manager

September revenues increased \$267 million as reimbursable spending caused federal sources to rise \$146 million. A good month for transfers also contributed to the monthly gain. In addition, two extra receipting days in September facilitated the advance.

Despite an overall increase, only a few sources experienced gains for the month. Gross personal income taxes grew by \$69 million, or \$63 million net of refunds. Sales tax receipts rose by \$40 million, while public utility taxes gained \$7 million.

The remaining sources were either flat or suffered declines in September. Corporate franchise taxes fell \$16 million as the result of a large month experienced last year that resulted from merger activity. Interest earnings continued their expected decline, dropping \$6 million. A number of sources each experienced a \$1 million decline for the month--liquor taxes, vehicle use tax, inheritance tax, and insurance taxes.

Overall transfers grew by \$52 million as a \$62 million increase in other transfers more than offset a \$5 million decline in both lottery and riverboat transfers. As mentioned, federal sources jumped \$146 million in September.

**Despite September Uptick, Revenues
Concerns Remain**

Through the first quarter of FY 2009, overall base revenues are down \$38 million. In July's monthly briefing, a

number of items were highlighted that will serve to restrict revenue growth in FY 2009 [i.e. increased refund percentage, lower miscellaneous transfers, reduced Cook County IGT, less from riverboat transfers, returns from interest income, no expected growth from federal sources]. Those items, when combined with a weak economy, which may be unable to avoid a recession, paint a less than rosy revenue picture.

The most closely related economic sources shows subdued performance. Gross personal income tax is up 3.7% or \$86 million [\$78 million net of refunds]. Sales tax is up 2.6% or \$47 million, while gross corporate income tax is up 1.5% or \$6 million [\$5 million net of refunds]. While rates of growth are close to expectations, worsening economic conditions suggest that even these modest rates of growth will struggle to be maintained over the remainder of the fiscal year.

Other transfers are down \$70 million due to certain transfers enjoyed last year that will not be repeated in FY 2009. In addition, riverboat transfers continue depressed and are down \$40 million, whereas even the lottery is running \$15 million behind last year. Not surprisingly, interest income is down, as the \$31 million decline can be attributed to lower rates of return as well as investable balances. Finally, federal sources are off by \$57 million and, based on appropriation levels is not expected to rebound much over the remainder of the year.

GENERAL FUNDS RECEIPTS: SEPTEMBER

FY 2009 vs. FY 2008

(\$ million)

Revenue Sources	Sept. FY 2009	Sept. FY 2008	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$996	\$927	\$69	7.4%
Corporate Income Tax (regular)	316	334	(\$18)	-5.4%
Sales Taxes	621	581	\$40	6.9%
Public Utility Taxes (regular)	82	75	\$7	9.3%
Cigarette Tax	29	29	\$0	0.0%
Liquor Gallonage Taxes	13	14	(\$1)	-7.1%
Vehicle Use Tax	2	3	(\$1)	-33.3%
Inheritance Tax (Gross)	13	14	(\$1)	-7.1%
Insurance Taxes and Fees	55	56	(\$1)	-1.8%
Corporate Franchise Tax & Fees	22	38	(\$16)	-42.1%
Interest on State Funds & Investments	8	14	(\$6)	-42.9%
Cook County IGT	0	0	\$0	N/A
Other Sources	26	26	\$0	0.0%
Subtotal	\$2,183	\$2,111	\$72	3.4%
Transfers				
Lottery	52	57	(\$5)	-8.8%
Riverboat transfers & receipts	55	60	(\$5)	-8.3%
Other	75	13	\$62	476.9%
Total State Sources	\$2,365	\$2,241	\$124	5.5%
Federal Sources	\$359	\$213	\$146	68.5%
Total Federal & State Sources	\$2,724	\$2,454	\$270	11.0%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$97)	(\$91)	(\$6)	6.6%
Corporate Income Tax	(\$55)	(\$58)	\$3	-5.2%
Subtotal General Funds	\$2,572	\$2,305	\$267	11.6%
Short-Term Borrowing	\$0	\$1,200	(\$1,200)	N/A
Hopital Provider Fund (cash flow transfer)	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$0	\$0	\$0	N/A
Total General Funds	\$2,572	\$3,505	(\$933)	-26.6%

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

2-Oct-08

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2009 vs. FY 2008

(\$ million)

<u>Revenue Sources</u>	<u>FY 2009</u>	<u>FY 2008</u>	<u>CHANGE FROM FY 2008</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$2,382	\$2,296	\$86	3.7%
Corporate Income Tax (regular)	405	399	\$6	1.5%
Sales Taxes	1,851	1,804	\$47	2.6%
Public Utility Taxes (regular)	277	258	\$19	7.4%
Cigarette Tax	88	88	\$0	0.0%
Liquor Gallonage Taxes	42	42	\$0	0.0%
Vehicle Use Tax	8	10	(\$2)	-20.0%
Inheritance Tax (Gross)	71	70	\$1	1.4%
Insurance Taxes and Fees	78	81	(\$3)	-3.7%
Corporate Franchise Tax & Fees	49	67	(\$18)	-26.9%
Interest on State Funds & Investments	24	55	(\$31)	-56.4%
Cook County IGT	13	15	(\$2)	-13.3%
Other Sources	97	102	(\$5)	-4.9%
Subtotal	\$5,385	\$5,287	\$98	1.9%
Transfers				
Lottery	133	148	(\$15)	-10.1%
Riverboat transfers & receipts	135	175	(\$40)	-22.9%
Other	130	145	(\$15)	-10.3%
Total State Sources	\$5,783	\$5,755	\$28	0.5%
Federal Sources				
Total Federal & State Sources	\$1,304	\$1,361	(\$57)	-4.2%
Total Federal & State Sources	\$7,087	\$7,116	(\$29)	-0.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$232)	(\$224)	(\$8)	3.6%
Corporate Income Tax	(\$71)	(\$70)	(\$1)	1.4%
Subtotal General Funds	\$6,784	\$6,822	(\$38)	-0.6%
Short-Term Borrowing	\$0	\$1,200	(\$1,200)	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	\$7,060	\$8,298	(\$1,238)	-14.9%
SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
CGFA				2-Oct-08