Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *SEPTEMBER 2009*

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ECONOMY: Monetary & Fiscal Policy in the Recovery

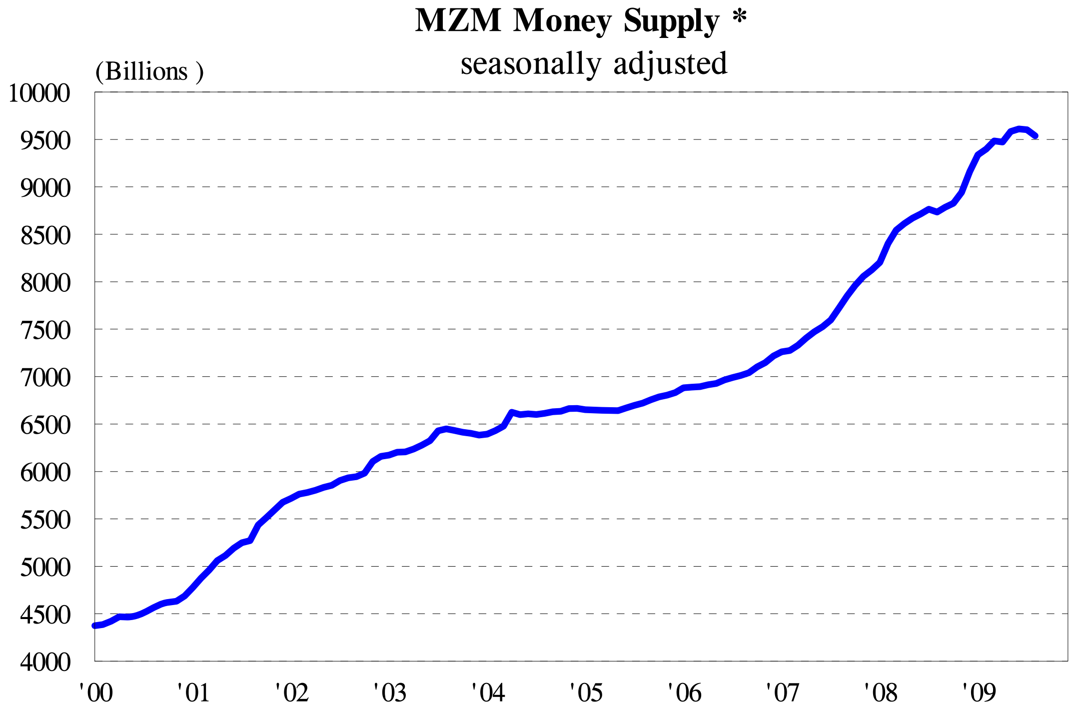
Edward H. Boss, Jr., Chief Economist

There is increasing evidence that the recession that began at the end of 2007 ended this summer and that the economy is now undergoing a recovery. The Conference Board, which produces the leading economic index (LEI), reported it rose for the fifth consecutive month in August and that the coincident economic indicator has stopped falling. The stock market, as measured by the Dow Jones Average, is generally an early indicator of an upcoming recovery and it has been rising since a bottom was reached back on March 9th. Even the often closed mouthed Federal Reserve in September stated that, "Information received since the Federal Open Market Committee met in August suggests that economic activity has picked up following its severe downturn."

The recession thus lasted around 18 or 19 months, a few months longer than the 16-month recessions in the 1970s and 1980s which previously had been the longest in the post World War II period. There is little argument that the many actions taken by the Federal Reserve in conjunction with the Treasury to stabilize the banking system and help to unfreeze the credit markets were beneficial to keeping the recession from spiraling further downward. At the same time, only modest gains can be directly attributed to the stimulus package as only a small percentage of the total had been spent and its major impact will be in the period ahead. Now that an economic recovery is in all likelihood under way, however, the role of both monetary and fiscal policy will have to be adjusted to new economic conditions.

The Federal Reserve stated that it would continue to employ a wide range of tools to provide economic recovery and to preserve price stability together with keeping low levels of the federal funds rate for an extended period. In addition, it will gradually slow its purchases of agency mortgage-backed

CHART 1



*M2 less small time deposits plus money market funds

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Source: Federal Reserve Bank of St. Louis

securities and agency debt and complete the $300 billion of Treasury securities it has been acquiring. As shown in the chart, growth in the money supply also had accelerated sharply during the recession.

The Federal Reserve feels that substantial slack in the economy will continue to dampen cost pressures with inflation remaining subdued for some time. Indeed, in the latest month the consumer price index (CPI) fell 1.5% from a year ago. Even so, that compared to a 2% decline in the previous 12-month comparison. As oil prices fell from their peak, comparisons with the year-earlier period lessen the impact of the earlier sharp rise in oil prices so that the CPI likely will turn positive in the months ahead. Moreover, as economic activity improves, the turnover or velocity of money will increase so that unless the money supply growth is restrained, rising prices would result. In the past, there had been a tendency for the Federal Reserve to overstay a period of credit ease for fear or weakening the economic recovery only to have a deal with inflationary pressures later. Indeed, this concern over inflation may be partially responsible for the sharp increase experienced in commodity prices, especially precious metals such as gold and silver, in recent months.

It is not only monetary policy that must change course as economic growth takes hold. Continued government spending with borrowed funds not only further weakens the U.S. dollar but also increases still further our dependence on foreign governments, primarily China, to buy this debt. Without continued purchases from abroad, interest rates would have to rise to sell this debt, threatening the economic recovery. As evidence of a recovery has been observed, however, it is important to note that cries for another government stimulus program have been muffled. At the same time, the President has called for reform of the health care system that would not increase the size of the federal deficit. While a final bill has yet to emerge, few feel this ambitious deficit neutral aspect will be met.

The economic recovery currently under way will be affected by the monetary and fiscal policy choices made. Flooding of liquidity, bank and corporate bailouts, and massive government spending programs that were employed to prevent a downward economic spiral are not likely to be the same prescription needed in the economic expansion phase of the business cycle that lies ahead. Both policies must show restraint. A fine line will have to be walked, however, in order not to undermine the fragile recovery currently under way and at the same time prevent renewed inflation and a growing national debt burden.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	AUG. 2009	JULY 2009	AUG. 2008
Unemployment Rate (Average)	10.0%	10.4%	6.7%
Annual Rate of Inflation (Chicago)	3.0%	-0.6%	-2.1%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (August)	6,595	-0.7%	-1.3%
Employment (thousands) (August)	5,937	-0.3%	-4.7%
New Car & Truck Registration (August)	41,235	-2.9%	-10.2%
Single Family Housing Permits (August)	767	-22.9%	-25.2%
Total Exports ($ mil) (July)	3,271	-2.4%	-26.8%
Chicago Purchasing Managers Index (Sept.)	46.1	-7.8%	-18.7%

REVENUE

Despite Strong Federal Receipts, Revenues Fall Again
Recovery Phase Slow to Manifest in Revenues

Jim Muschinske, Revenue Manager

A gain of $259 million in federal sources was not enough to offset losses in the economically related revenue sources as overall receipts fell $144 million in September. Despite the recession's end, personal and corporate income taxes as well as sales taxes continue to feel the bite of high unemployment, struggling corporate profits, and lackluster consumer sentiment. Unfortunately, as will be discussed later, early stages of the recovery phase are not expected to manifest in actual revenue improvement for a number of months. September had the same number of receipt days as last year.

For the month, gross personal income taxes fell $180 million or $163 million net of refunds, while gross corporate income dropped $93 million, or $77 million net of refunds. Sales tax continues to do poorly with receipts off $92 million. Other sources were down $8 million, interest earnings $4 million, and corporate franchise taxes by $1 million.

A few sources managed to post gains. Liquor taxes were up $12 million (presumably due to stock piling in anticipation of higher liquor tax rates), insurance taxes posted a $7 million increase, inheritance tax was up $4 million, and vehicle use tax eked out a $1 million gain.

Overall transfers suffered a $84 million drop in September. Other transfers fell $53 million, riverboat transfers were down $30 million, and lottery transfers dipped $1 million. As mentioned, Federal sources posted a sizable gain, up $259 million, due reimbursable spending.

Year to Date

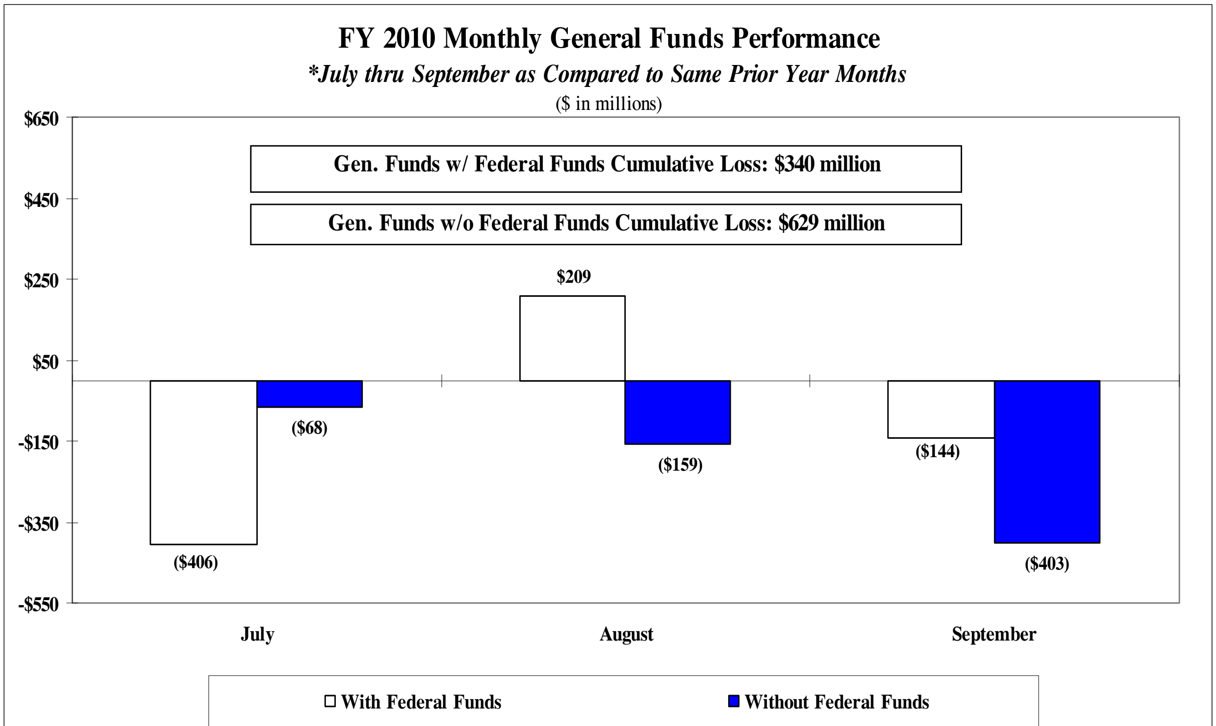
Through the first quarter of the fiscal year, overall base revenues are down $340 million. Despite being in the early stages of a recovery, the larger economically related sources such as income and sales continue to reel from the recession's grip. As mentioned earlier, it will be some time before improvement in receipts can be expected.

Through September, gross personal income tax is down $278 million, or $251 million net of refunds. Sales tax is down a stunning $244 million reflecting a very cautious consumer while gross corporate income tax is off $113 million, or $93 million net of refunds. All remaining sources contributed a net drop of $45 million.

Even with the July fund sweeps, overall transfers are up a scant $4 million. After enjoying two consecutive months of significant growth due to reimbursable spending, federal sources are up $289 million.

Review of First Quarter Revenues

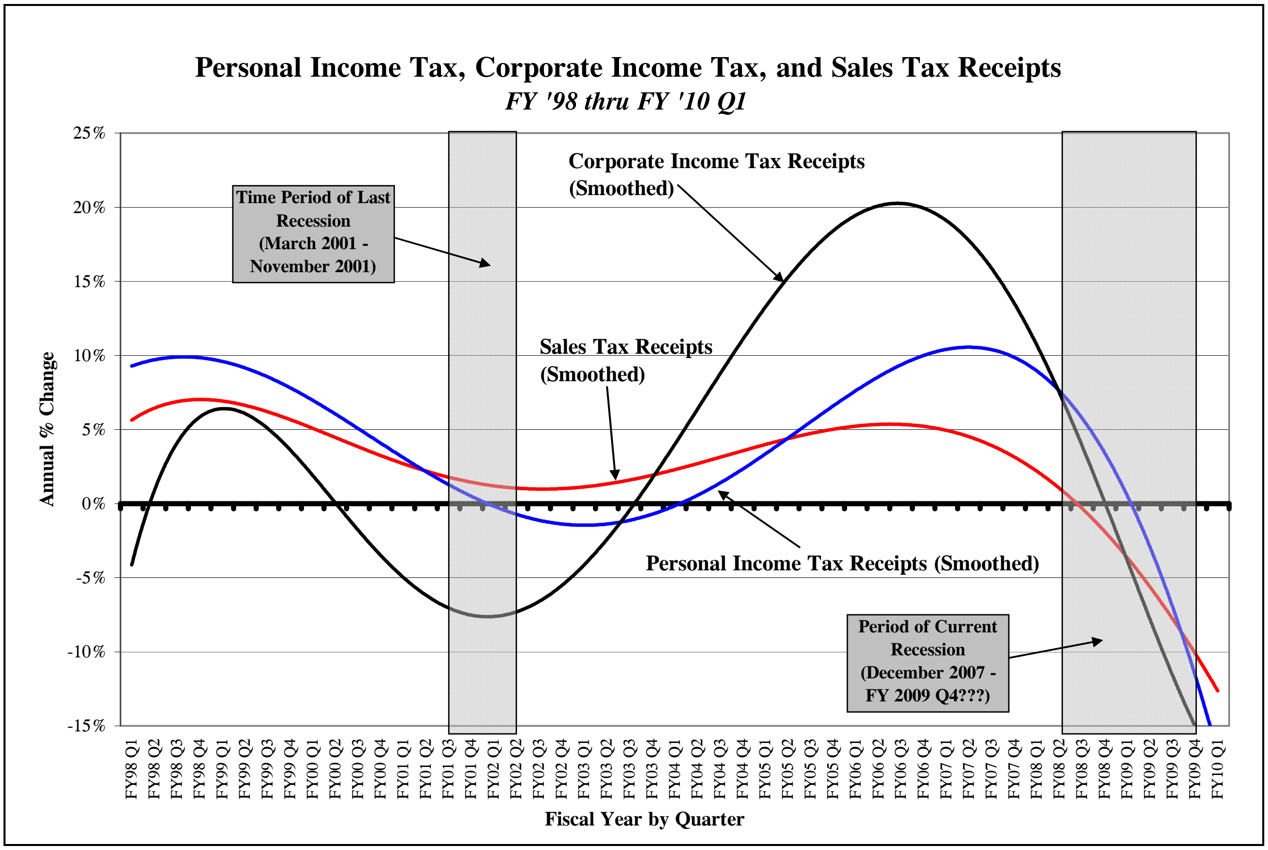
As shown, through the first quarter of FY 2010, overall base revenues are down $340 million. The decline is primarily attributed to continued weakness in the economically related areas such as income and sales taxes. While declines were expected early in the fiscal year, the magnitude of the falloffs are somewhat unsettling and serve as a reminder that despite being in a recovery phase, revenues should not be expected to abruptly improve. If $289 million in gains from federal sources are excluded, the falloff grows to a much more alarming $629 million.



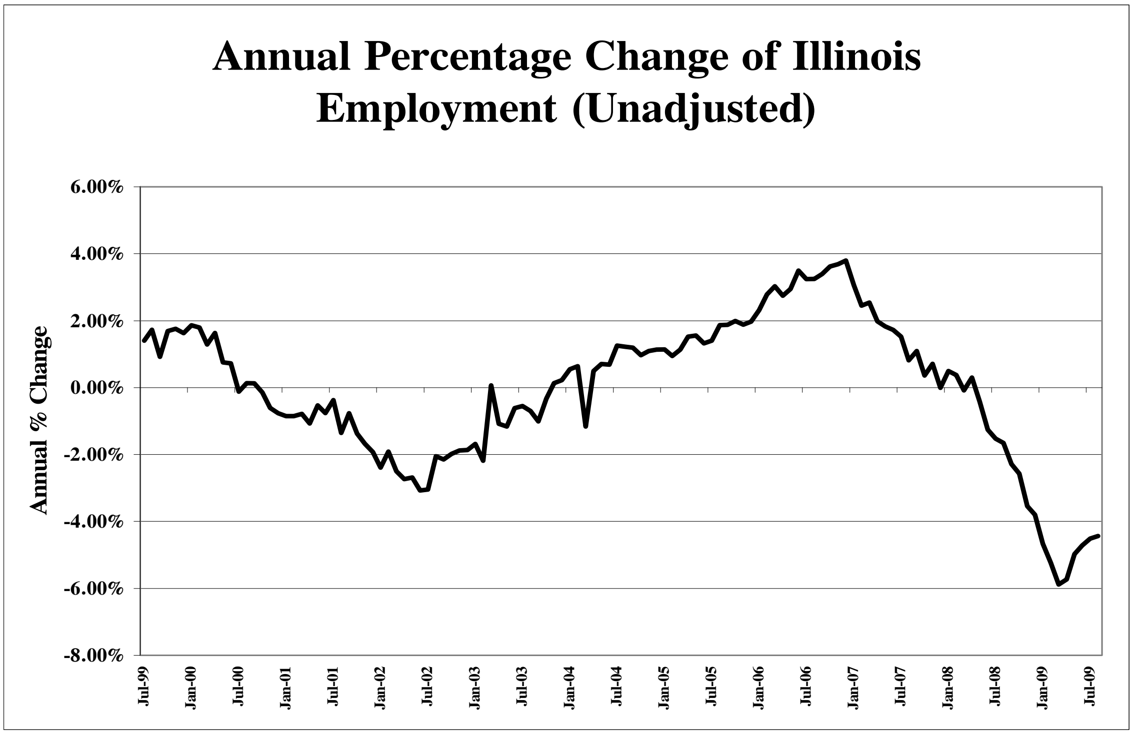
*Figures exclude short-term borrowing and Budget Stabilization Fund transfers.

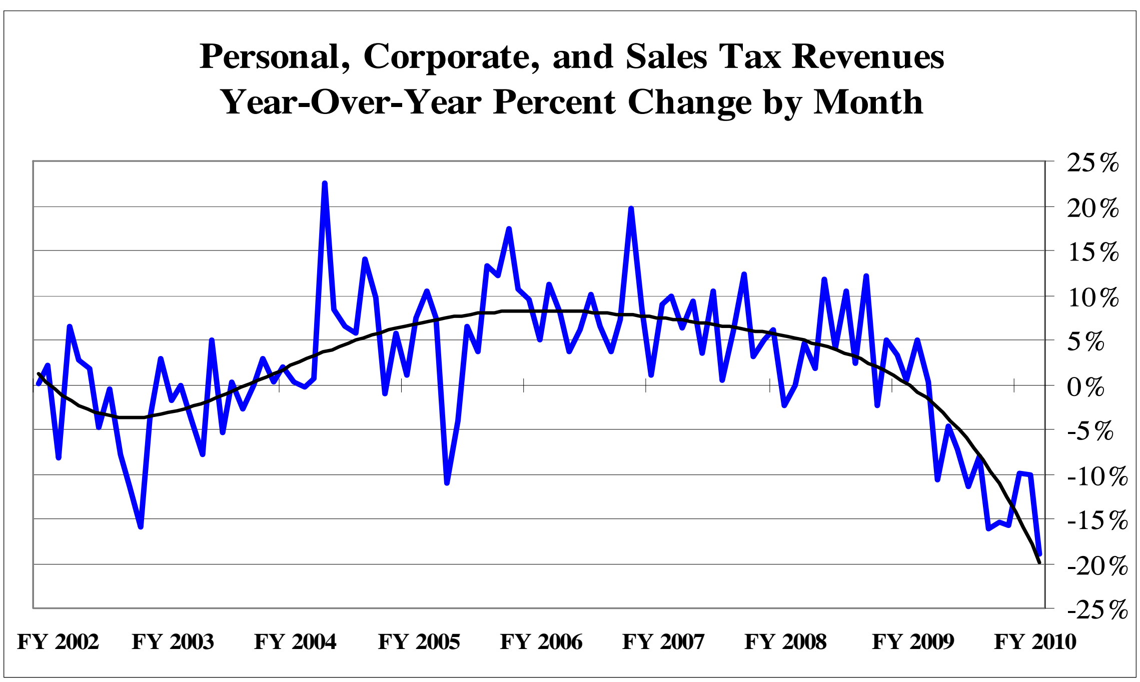
Recovery Phase Likely Slow to Manifest in Revenue Growth

As evidenced by the last recession in 2001, it took approximately four quarters before the recovery phase manifested in actual receipt improvement for personal income tax and sales tax. Given the latest employment figures, there is little reason to anticipate a dramatic turn around.

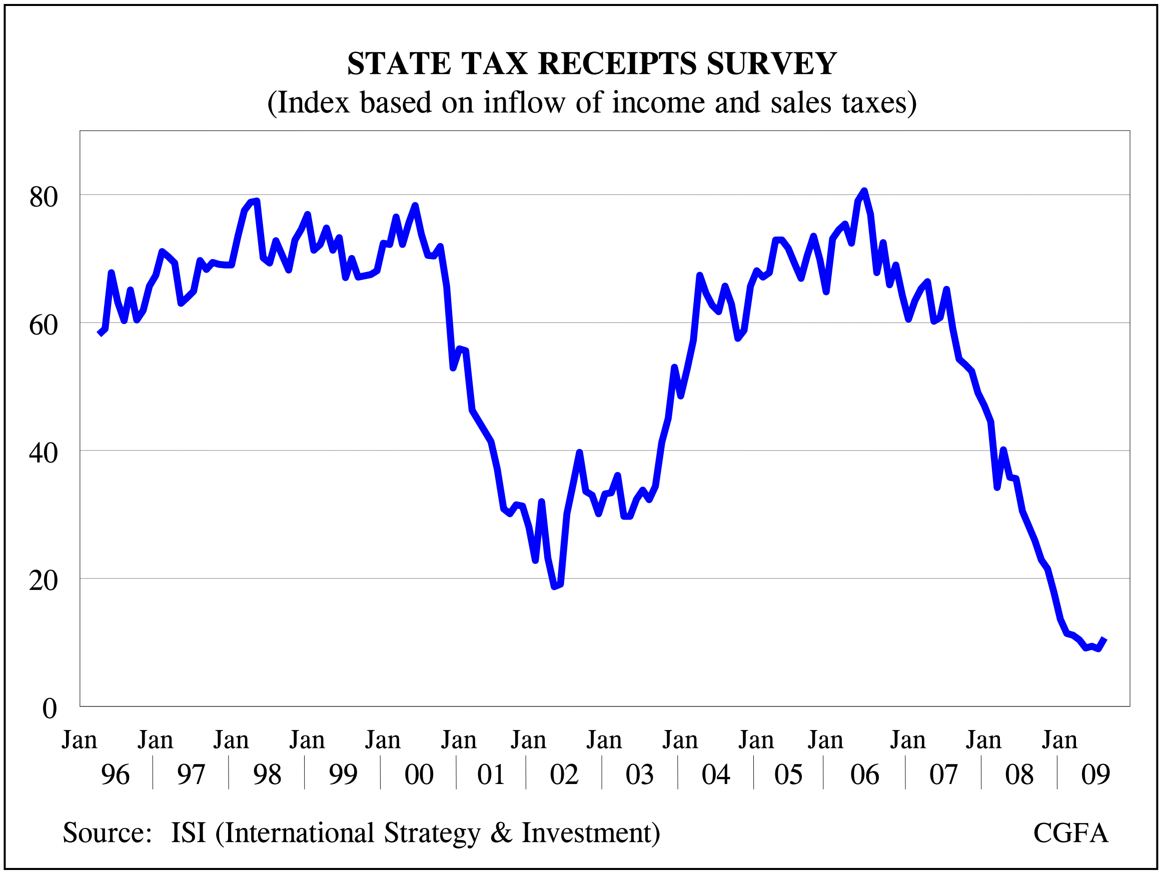


The following chart demonstrates that the employment picture, while still in negative territory, appears to have bottomed out. Again, however, it will take some time before improving economic conditions will translate into a more positive revenue picture. As shown in the bottom chart, the current trends of income and sales taxes will be difficult to turn around and are not expected to suddenly reverse course. At best, gradual improvement in the rate of loss can be hoped for by fiscal year end.





Illinois is not suffering alone as evidenced in the latest ISI State Tax Receipt Survey. The survey is based upon data from 16 states—including Illinois—that have diverse geographic and population characteristics. The index for overall receipts for August was at 10.7 up from July's reading of 9.0, which was an all time low since the index measure began. While Illinois mirrors the national pattern, it often lags the general trend and, therefore, poor revenue inflows from economic sources can be expected to continue well into the fiscal year even as an economic recovery gets underway. Even so, hopefully a bottom is being reached.



GENERAL FUNDS RECEIPTS: SEPTEMBER

FY 2010 vs. FY 2009

($ million)

Revenue Sources	Sept. FY 2010	Sept. FY 2009	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$816	$996	($180)	-18.1%
Corporate Income Tax (regular)	223	316	($93)	-29.4%
Sales Taxes	529	621	($92)	-14.8%
Public Utility Taxes (regular)	84	82	$2	2.4%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	25	13	$12	92.3%
Vehicle Use Tax	3	2	$1	50.0%
Inheritance Tax (Gross)	17	13	$4	30.8%
Insurance Taxes and Fees	62	55	$7	12.7%
Corporate Franchise Tax & Fees	21	22	($1)	-4.5%
Interest on State Funds & Investments	4	8	($4)	-50.0%
Cook County IGT	0	0	$0	N/A
Other Sources	18	26	($8)	-30.8%
Subtotal	$1,831	$2,183	($352)	-16.1%
Transfers				
Lottery	51	52	($1)	-1.9%
Riverboat transfers & receipts	25	55	($30)	-54.5%
Other	22	75	($53)	-70.7%
Total State Sources	$1,929	$2,365	($436)	-18.4%
Federal Sources	$618	$359	$259	72.1%
Total Federal & State Sources	$2,547	$2,724	($177)	-6.5%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($80)	($97)	$17	-17.5%
Corporate Income Tax	($39)	(55)	$16	-29.1%
Subtotal General Funds	$2,428	$2,572	($144)	-5.6%
Short-Term Borrowing	$0	$0	$0	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	$2,428	$2,572	($144)	-5.6%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Oct-09

GENERAL FUNDS RECEIPTS: YEAR TO DATE FY 2010 vs. FY 2009 ($ million)				
Revenue Sources	**FY 2010**	**FY 2009**	**CHANGE FROM FY 2009**	**% CHANGE**
State Taxes				
Personal Income Tax	$2,104	$2,382	($278)	-11.7%
Corporate Income Tax (regular)	292	405	($113)	-27.9%
Sales Taxes	1,607	1,851	($244)	-13.2%
Public Utility Taxes (regular)	251	277	($26)	-9.4%
Cigarette Tax	88	88	$0	0.0%
Liquor Gallonage Taxes	55	42	$13	31.0%
Vehicle Use Tax	8	8	$0	0.0%
Inheritance Tax (Gross)	56	71	($15)	-21.1%
Insurance Taxes and Fees	86	78	$8	10.3%
Corporate Franchise Tax & Fees	49	49	$0	0.0%
Interest on State Funds & Investments	11	24	($13)	-54.2%
Cook County IGT	0	13	($13)	-100.0%
Other Sources	98	97	$1	1.0%
Subtotal	$4,705	$5,385	($680)	-12.6%
Transfers				
Lottery	128	133	($5)	-3.8%
Riverboat transfers & receipts	100	135	($35)	-25.9%
Other	174	130	$44	33.8%
Total State Sources	$5,107	$5,783	($676)	-11.7%
Federal Sources	$1,593	$1,304	$289	22.2%
Total Federal & State Sources	$6,700	$7,087	($387)	-5.5%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($205)	($232)	$27	-11.6%
Corporate Income Tax	($51)	($71)	$20	-28.2%
Subtotal General Funds	$6,444	$6,784	($340)	-5.0%
Short-Term Borrowing	$1,250	$0	$1,250	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	$7,970	$7,060	$910	12.9%

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

CGFA 1-Oct-09

$400 Million General Obligation Bond Sale

Lynnae Kapp, Bond Analyst

The State sold $400 million in General Obligation Bonds on September 18, 2009. The bonds were sold for new projects and divided up as follows among the following bond purposes:

Capital Facilities	$25,500,000
Transportation A—Highways	$337,000,000
Transportation B—Mass Transit & Airport	$15,000,000
Anti-Pollution	$2,500,000
Coal and Energy Development	$20,000,000

It is understood that these bonds would not be funded by the new capital plan revenue sources. The first $300 million in bonds from this sale would be paid for from the Road Fund. The remaining $100 million in projects will be paid for from traditional bond revenue sources, mainly the General Revenue Fund.

The State plans on a refunding sale of approximately $2 billion for General Obligation and Build Illinois bonds this fall, and will sell $3.466 billion of 5-year Pension Notes at some time during FY 2010. Illinois has suffered downgrades from all three rating agencies in 2009. Current bond ratings are AA- from Standard & Poor's, A from Fitch, and A1 from Moody's.