Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: SEPTEMBER 2013

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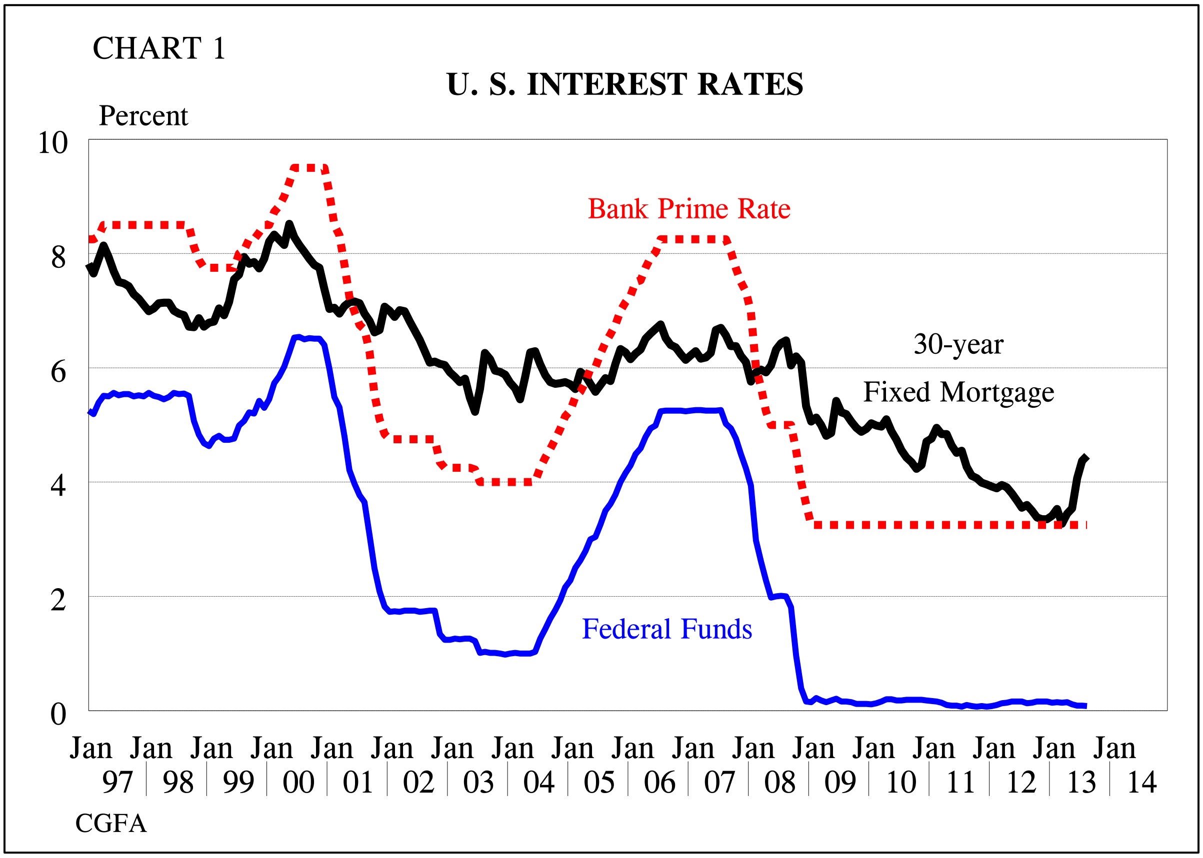
ECONOMY: Fed Responds to Slowing Pace of Expansion

Edward H. Boss, Jr., Chief Economist

The Federal Reserve shocked many market participants when it decided not to slow down its purchases of Treasury and agency mortgage-backed securities at its two-day Open Market Committee Meeting ended on September 18th. It was only at its previous meeting, held at the end of July, that the FOMC hinted for the first time that it was prepared to alter its pace of purchases to maintain appropriate policy accommodation. The markets interpreted that statement to mean that it would finally begin to taper the amount of such purchases, starting as soon as its September meeting. That did not occur as the Committee decided to continue to purchase at a pace of $40 billion per month of mortgage-backed securities and longer-term Treasury securities at a pace of $45 billion per month.

The failure to taper its asset purchases reflects the Committee's feelings that prospects for the outlooks of the economy and improvement in the labor market have diminished since the fall. The unemployment rate remains elevated. While edging down to 7.3% in August, it was due to a larger decline in the labor force that more than offset a drop in Household employment, continuing the trend toward a smaller and smaller labor force participation rate now at a 35-year low.

In part the shrinking participation rate reflects an aging of the work force with increased retirements. Adjusting for that factor, Larry Lindsey, director of the National Economic Council, recently pointed out the current unemployment rate would be about 9%. In Illinois the unemployment rate held at 9.2% in August, unchanged from July and second highest in the nation. Household employment fell 1.1% from a year ago and was at its lowest level in two years. Any adjustment applied for an aging workforce here would place the State's unemployment rate into double-digits.



The pace of economic growth also appears to have weakened with most forecasts projecting that real GDP grew below a 2% annual rate in the current quarter, less than the 2.5% recorded in the second quarter and for the fourth time in six quarters. Retail sales slowed in August despite strong auto sales, business fixed investment continued to advance although Global Insight, a forecasting service used by CGFA, projects the rate of gain slowed in the third quarter. In addition, the strong housing sector has been faced with higher mortgage interest rates while fiscal policy is restraining economic growth. As shown in the chart above, the contract rate on 30-year fixed rate conventional mortgages has been under upward pressure rising to an average of 4.46% in August, up more than a full percent from 3.35% at the end of 2012. The rise in mortgage interest rates and concerns this could dampen the housing recovery undoubtedly was another factor to cause the Fed to forestall the tapering of its purchases of mortgage-backed securities.

While the Fed is faced with a slowing in the economic activity and an elevated unemployment rate, it also is experiencing inflation that is below its 2% objective. In August the Consumer Price Index was up modest 1.5% from a year earlier and has been below 2% in eight of the past ten months. In the Fed's September press release it went on to state, "The Committee recognizes that inflation persistently below its 2% objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term. In judging when to moderate the pace of asset purchases, the Committee will, at its coming meetings, assess whether incoming information continues to support the Committee's expectation of ongoing improvement in the labor market conditions and inflation moving back to its long-run objective."

Many observers continue to expect that while a tapering in asset purchases did not start in September, it will begin before the end of the year prior to when a new Federal Reserve Chairman comes on board. Many would welcome a return to market determined interest rates. Quantitative easing was meant to provide a temporary assist to economic growth. In the long run, it can only lead to market distortions which can result in unintended consequences that may be even harder to correct.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	AUG. 2013	JULY 2013	AUG. 2012
Unemployment Rate (Average)	9.2%	9.2%	8.9%
Annual Rate of Inflation (Chicago)	0.8%	-2.6%	1.1%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (August)	6,525	-0.2%	-0.9%
Employment (thousands) (August)	5,923	-0.2%	-1.1%
New Car & Truck Registration (August)	57,595	10.5%	13.7%
Single Family Housing Permits (August)	1,039	3.1%	2.6%
Total Exports ($ mil) (July)	5,341	1.1%	-3.7%
Chicago Purchasing Managers Index (Sept.)	55.7	5.0%	9.4%

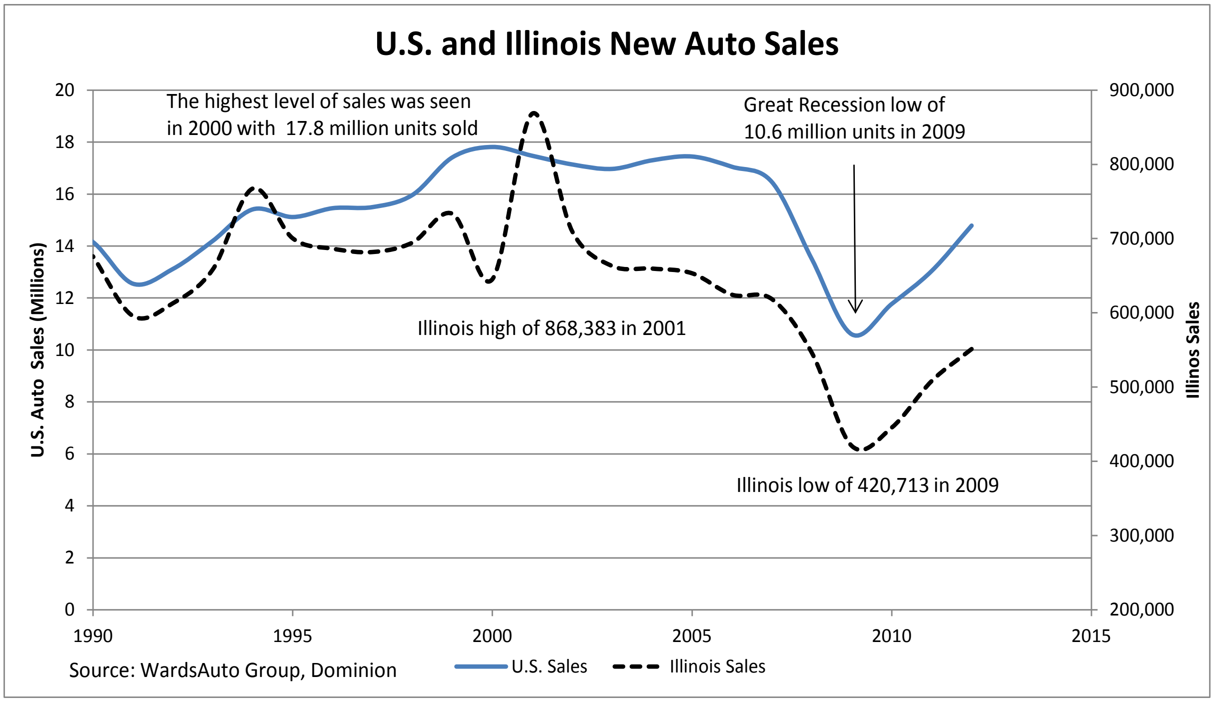
Auto Sales Returning to Pre-Recession Levels

Ben Varner, Revenue Analyst

Nationally, auto sales were up to 14.8 million in 2012. This was up from the Great Recession low of 10.6 million in 2009. The all-time high for car and truck sales was 17.8 million in 2000. According to Wards Auto, U.S. light-vehicle sales reached a 6-year high in August of 2013. August's seasonally adjusted annual rate (SAAR), a measure of vehicle unit sales that accounts for seasonal variation, equaled 16 million units per year which is the highest rating since November of 2007. Currently it is expected that 2013 sales will be 15.5 million or higher, which would be the highest amount of sales since 2007. While sales appear to be moving towards 16 million units per year, it remains to be seen how quickly sales will reach the 17 to 18 million units per year level which occurred from 1999 to 2006.

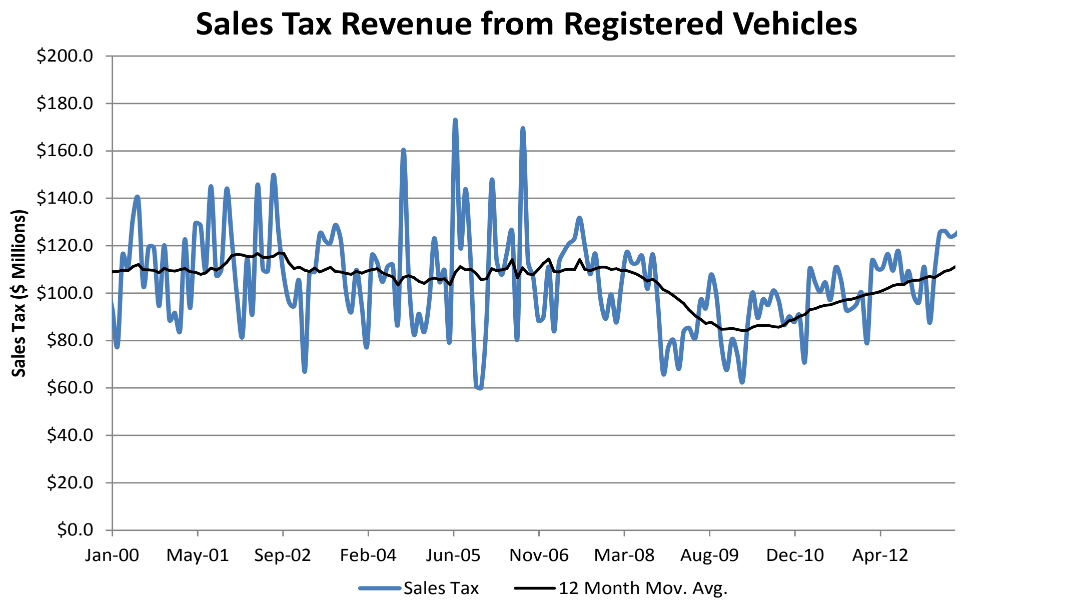
Illinois auto sales have generally followed a similar pattern as the U.S. market as a whole. Illinois saw its highest level of sales in 2001 at over 860,000 units sold. Sales tapered off through 2007 and then fell significantly in 2008 and 2009.

Illinois sales totaled just over 420,000 units in 2009 which was less than half the 2001 level. Sales have rebounded to over 550,000 units in 2012 and are expected to continue to increase in 2013. Through July, Illinois sales were up 7.5% which would equate to over 590,000 units sold if continued through the second half of the year.



The increase in auto sales has contributed to an increase in sales tax receipts for the state. Through August, general funds sales tax revenue was up 9.0%, or just over $107 million. Approximately a quarter of this increase can be attributed to auto sales. Looking at data from the States ST-556 form which reports sales transactions for vehicles, watercraft, aircraft, and mobile homes, sales tax revenue is up over $24 million so far this year. Sales tax related to vehicles makes up approximately 95% of the sales tax received from transactions recorded through the ST-556 form. The $24 million increase equates to growth over 10.6%. Due to time needed to prepare the data from the ST-556 report it is unknown how much the auto sector contributed to the approximate $140 million increase year-to-date in general funds sales tax revenue through September.

For the five months from April through August of 2013, sales tax related to vehicle registrations has averaged growth of over 11% compared to the same time in 2012. If this level of growth were to continue throughout the fiscal year, the State would see growth of approximately $140 million in sales tax growth from the auto sector alone. Expecting this kind of growth to continue throughout the year may be wishful thinking at this point but does show how well this sector has performed in recent months.



Data from ST-556 report which includes vehicles, watercraft, aircraft, trailers, and mobile homes sold at retail in Illinois. Approximately 95% of the sales tax revenue reported is from vehicle transactions.
Source: Illinois Dept. of Revenue

Medicare Advantage Award

Anthony Bolton, Revenue Analyst

On October 1, 2013, the Department of Central Management Services announced the award of four contracts for the provision of services under a RFP for Medicare plans. The four contracts will be awarded to Aetna Life Insurance Company, Humana Health Plan, Humana Benefit Plan, and United Healthcare. These awards all contain Medicare Advantage-style plans with Prescription Drug components. The awards are expected to provide health insurance services for Medicare-eligible retirees and dependents and total approximately $4.2 billion over the course of the contracts (October 2013 through December 2016).

Aetna Life Insurance Company will receive a contract for approximately $220 million through the end of 2016 to provide a Medicare Advantage-Prescription Drug HMO plan for its service area. Humana Health Plan will receive a contract for approximately $296 million through the end of 2016 to provide a Medicare Advantage-Prescription Drug HMO plan for its service area. Humana Benefit Plan will receive a contract for approximately $13 million through the end of 2016 to provide a Medicare Advantage-Prescription Drug HMO plan for Livingston and Knox counties. Finally, United Healthcare will receive a contract for approximately $3.66 billion through the end of 2016 to provide a Medicare Advantage- Prescription Drug PPO plan. All these plans will have options for up to seven one-year renewals after the initial contract period of October 15, 2013 through December 31, 2016.

REVENUE

September Revenues Post Gains – Income and Sales Taxes Have Good Month

Jim Muschinske, Revenue Manager

Overall base revenues grew $255 million in September. Both personal and corporate income taxes performed quite well, and sales tax receipts were able to maintain positive momentum. Gains from those larger economically-tied sources were more than enough to offset a weaker month for federal sources. The overall monthly gain was aided by one more receipting day as compared to the same month last year.

For the month, gross personal income tax receipts were up $149 million, or $138 million net of refunds. Gross corporate income taxes grew $87 million, or $78 million net of refunds. Other sources jumped $76 million due to approximately $72 million in settlement proceeds [$54 million via Attorney General's Office and $18 million via Healthcare and Family Services]. Sales tax continues to surprise by gaining $32 million. Insurance taxes jumped $19 million, on what could end up being a timing issue. Corporate franchise tax grew $4 million, while interest income gained $2 million.

A couple sources experienced declines for the month. Public utility taxes fell $9 million while inheritance tax dropped $7 million.

Overall transfers grew a modest $3 million in September. Other transfers were up $7 million and lottery transfers gained $1 million. Those gains were partially offset by a $5 million decline in riverboat transfers. Federal sources experienced a rather weak month, falling $76 million.

Year to Date

Through the first quarter of FY 2014, base general funds rose $700 million. Much of that growth can be attributed to the one-time surge in transfers related to the refund fund [$397 million]. However, at the quarter pole, the larger economically-related sources have fared quite well. Gross personal income tax is up by $215 million, or $205 million net of refunds. Sales tax continues to surprise in its performance, up $139 million to date. And a strong close to the quarter finds gross corporate income taxes up $81 million, or $75 million net of refunds. The $72 million in September settlement proceeds have boosted what would have otherwise been a flat period for other sources. Cigarette taxes are up $20 million due to the stockpiling effect of last fiscal year. Insurance taxes are up $20 million, but that could be due to receipt timing.

Only a couple of sources suffered year to date declines to begin the fiscal year. Inheritance tax is down $48 million, although the falloff was expected as is attributed to an earlier tax change which resulted in an exceptionally large July in 2012. And, public utility tax is down a modest $6 million.

Through September, overall transfers are up $408 million. However, virtually all of those gains stem from the one-time $397 million transfer from the Income Tax Refund Fund. Federal sources are down $184 million thus far, reflecting lower reimbursable spending.

GENERAL FUNDS RECEIPTS: SEPTEMBER
FY 2014 vs. FY 2013
($ million)

Revenue Sources	Sept. FY 2014	Sept. FY 2013	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,576	$1,427	$149	10.4%
Corporate Income Tax (regular)	585	498	$87	17.5%
Sales Taxes	633	601	$32	5.3%
Public Utility Taxes (regular)	70	79	($9)	-11.4%
Cigarette Tax	29	34	($5)	-14.7%
Liquor Gallonage Taxes	14	14	$0	0.0%
Vehicle Use Tax	2	2	$0	0.0%
Inheritance Tax (Gross)	12	19	($7)	-36.8%
Insurance Taxes and Fees	63	44	$19	43.2%
Corporate Franchise Tax & Fees	21	17	$4	23.5%
Interest on State Funds & Investments	2	0	$2	N/A
Cook County IGT	0	0	$0	N/A
Other Sources	98	22	$76	345.5%
Subtotal	$3,105	$2,757	$348	12.6%
Transfers				
Lottery	56	55	$1	1.8%
Riverboat transfers & receipts	46	51	($5)	-9.8%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Other	32	25	$7	28.0%
Total State Sources	$3,239	$2,888	$351	12.2%
Federal Sources	$255	$331	($76)	-23.0%
Total Federal & State Sources	$3,494	$3,219	$275	8.5%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($150)	($139)	($11)	7.9%
Corporate Income Tax	($78)	(69)	($9)	13.0%
Subtotal General Funds	$3,266	$3,011	$255	8.5%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund	$0	$264	($264)	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$3,266	$3,275	($9)	-0.3%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Oct-13

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2014 vs. FY 2013

($ million)

Revenue Sources	FY 2014	FY 2013	CHANGE FROM FY 2013	% CHANGE
State Taxes				
Personal Income Tax	$3,987	$3,772	$215	5.7%
Corporate Income Tax (regular)	734	653	$81	12.4%
Sales Taxes	1,939	1,800	$139	7.7%
Public Utility Taxes (regular)	239	245	($6)	-2.4%
Cigarette Tax	88	68	$20	29.4%
Liquor Gallonage Taxes	43	43	$0	0.0%
Vehicle Use Tax	8	8	$0	0.0%
Inheritance Tax (Gross)	46	94	($48)	-51.1%
Insurance Taxes and Fees	86	66	$20	30.3%
Corporate Franchise Tax & Fees	52	49	$3	6.1%
Interest on State Funds & Investments	4	3	$1	33.3%
Cook County IGT	0	0	$0	N/A
Other Sources	167	95	$72	75.8%
Subtotal	$7,393	$6,896	$497	7.2%
Transfers				
Lottery	143	140	$3	2.1%
Riverboat transfers & receipts	108	113	($5)	-4.4%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	397	0	$397	N/A
Other	136	128	$8	6.3%
Total State Sources	$8,177	$7,277	$900	12.4%
Federal Sources	$732	$916	($184)	-20.1%
Total Federal & State Sources	$8,909	$8,193	$716	8.7%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($378)	($368)	($10)	2.7%
Corporate Income Tax	($98)	($92)	($6)	6.5%
Subtotal General Funds	$8,433	$7,733	$700	9.1%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund Transfer	$50	$264	($214)	N/A
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$275	$275	$0	0.0%
Total General Funds	$8,758	$8,272	$486	5.9%

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

CGFA 1-Oct-13