Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: OCTOBER 2015

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INSIDE THIS ISSUE

ECONOMY: Happy Holidays?

Edward H. Boss, Jr., Chief Economist

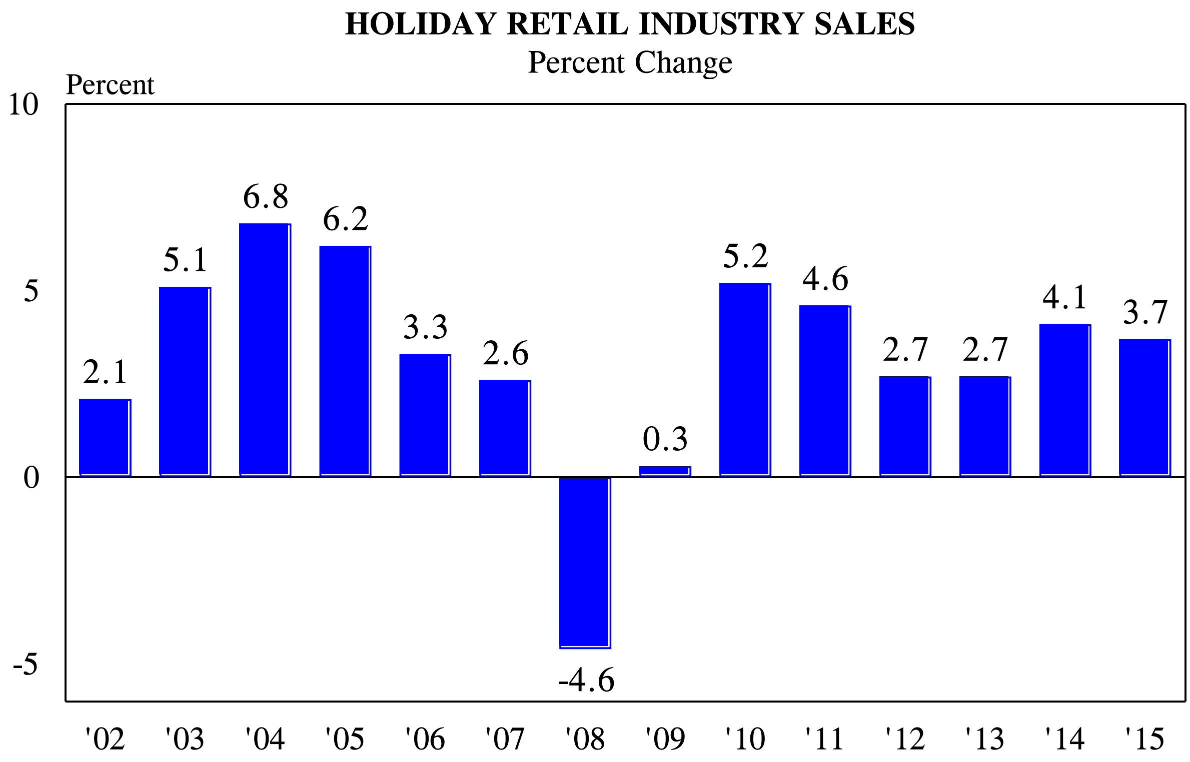
Concerns are being raised as to how strong retail sales will be as we enter the holiday season. Data released towards month end indicate a sharp moderation in economic growth from that seen in the second quarter. The advance release on real GDP slowed in the third quarter of the year and monthly business reports indicate a further loss of momentum. Real GDP rose at an annual rate of 1.5%, down from the 3.9% rate of the second quarter and for the year now shows average growth of 2%, the lower end of the 2% to 2.5% range which the economy has been stuck at since the recovery began in the middle of 2009.

For the first 9 months of the year retail sales rose 2.1% from the same period a year earlier, however, there was a sharp difference among the various categories. Auto and other vehicle sales rose 7.8%, and furniture and home furnishing stores rose 5.4% reflecting continued improvement in the housing sector. In contrast, sales at gas stations fell 19.7% as oil and gas prices plummeted while department store sales, excluding lease departments within department stores, dropped by 1.6%.

Some of the strongest areas of the economy have slowed. New home sales fell 11.5% in September, reaching the lowest level since November 2014. While existing home sales remain strong, speculation is rising that the market may be topping out. Slower job gains, reduced growth abroad and recently here, coupled with a strengthening U.S. dollar have cut into U.S. profit margins. Businesses with a global footprint are reacting by cutting back employment and expenditures. This is particularly noticeable among energy firms. In Illinois, new housing permits, a precursor to new housing starts, have softened since June.

In another area of strength, auto sales supported by a continued aging of existing cars on the road, estimated to reach

CHART 1



SOURCE: National Retail Federation CGFA

11.5 years, and the lengthening of the average auto loan and economic improvement sparked improved sales. However, slowdown in China's economy while many countries abroad are taking steps to stimulate stagnate economies have cut into U.S. auto sales abroad. While there is an apparent weakening in what have been strong sectors of the economy, there also is clear evidence where sectors already have deteriorated. Durable goods orders fell in September by 1.2% following an even bigger 3% decline in August dropping in four of the past six months. A category that centers on business investment fell 0.3% on top of a 1.6% drop the month before.

The entire manufacturing sector has been deteriorating over the past year and indeed some analysts are calling it a recession in manufacturing. The Institute of Supply Management Index of Manufacturing has been declining since August of last year, falling from 58.1 to 50.2 this September. (A number above 50 indicates expansion whereas a number below 50 represents contraction.) At the same time, the more volatile Chicago Manufacturing Index fell from a recent high of 66.2 in October of last year to 48.7 in September, actually contracting that month, before rising to 56.2 in October. Even so, this still left the index 15% lower than a year earlier. This is reflected in the latest data showing a decline of 6,300 manufacturing jobs in Illinois from a year earlier.

Despite the sharp slowdown in economic growth last quarter, much of which represented changes in inventories that were built in the previous quarter, buoying growth in the second quarter and then were liquidated in the past quarter reducing growth. Consumer spending slowed only modestly while disposable income and personal savings improved somewhat.

As the holidays approach expectations by the National Retail Association (NRF) are that retail sales in November and December will rise by 3.7% as shown in the Chart. This would be down from last year's 4.1% advance, in line with the average of the past 5 years, but below those seen a decade earlier.

While such a sales increase may seem optimistic given the decline in department store sales during the first 9 months of the year, it fails to notice the change in buying habits. The NRF projects that almost half of all sales will be on line and one in 5 may use their smart phones to purchase holiday gifts. Amazon already has said it would hire 100,000 workers to handle the load, FedEx expects sales from Thanksgiving through Christmas Eve to rise 12.4% and is hiring 55,000 seasonal workers while UPS will hire as many as 95,000. More offers of free sending of merchandise plus faster delivery of items often including Sundays have added to the attraction of on line purchasing. Soon other holiday forecast will be released and comparisons will be made. At this time, however, despite a slowdown in the pace of the economy it appears that holiday sales in 2015 may be good, if not exceptional.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	SEPT. 2015	AUG. 2015	SEPT. 2014
Unemployment Rate (Average)	5.4%	5.6%	6.4%
Annual Rate of Inflation (Chicago)	-3.6%	4.9%	-0.4%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (Sept.)	6,498.3	0.1%	-0.2%
Employment (thousands) (Sept.)	6,145.7	0.3%	0.8%
NonFarm Payroll Employment (Sept.)	5,909,200	-6,900	27,100
New Car & Truck Registration (Sept.)	59,1742	-4.9%	0.1%
Single Family Housing Permits (Sept.)	1,063	1.4%	9.0%
Total Exports ($ mil) (August)	5,068	1.1%	-8.3%
Chicago Purchasing Managers Index (Oct.)	56.2	15.4%	-15.1%

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

Illinois General Obligation Bond Downgrades

Lynnae Kapp, Senior Bond Analyst

On October 19, 2015, Fitch Ratings lowered the State of Illinois' General Obligation bonds rating from A- to BBB+ with a stable outlook. Fitch decided to downgrade the State due to the continuing budget stalemate which is causing the "*deterioration of the state's financial flexibility*." With the expiration of the income tax increase but spending at fiscal 2015 budget levels due to continuing appropriations, court orders and consent decrees, "*the budget gap has ballooned. As a result, the state finds itself with a current operating deficit, structural budget deficit, cash crunch that is now causing a delay in pension system contributions, and accumulation of accounts payable that approaches its highest level at the depth of the recession. As the fiscal year progresses, fewer options remain for closing the gap on a current year basis, pushing the potential solutions into fiscal 2017*". Fitch also points to the State's above average debt burden and unfunded pension liabilities as additional problems to be overcome, as well as lagging economic growth.

Fitch also lowered the ratings of bonds from related entities relying on State appropriations from BBB+ to BBB. These include:

--City of Chicago motor fuel tax revenue bonds

--Illinois Sports Facilities Authority, sports facilities bonds (state tax supported)

--Metropolitan Pier & Exposition Authority McCormick Place expansion project bonds

A few days later, Moody's downgraded the State's GO bonds to the same level (Baa1) with a negative outlook. *"The downgrades reflect weakening of the state's financial position during 2015 and our expectation that an ongoing budget stalemate will lead to further deterioration. Structural budget imbalance, accounts payable, and other fiscal metrics are back-tracking, despite a favorable economic climate, leaving the state more vulnerable to the next economic downturn, barring unexpectedly strong and swift corrective actions. Any recurring measures ultimately enacted for the fiscal year that began July 1 will have a short time in which to offset the state's approximately \$6 billion (or 16%) general fund deficit caused in part by recent income tax cuts. Payment deferrals could drive the state's balance of unpaid bills higher than the levels seen in late 2012, when the backlog approached \$10 billion. Additionally, the partisan gridlock evident this year is impeding efforts to address the state's unfunded liabilities for pensions and retiree health benefits."*

In relation to this downgrade, Moody's also lowered the ratings for Build Illinois Bonds down one level to Baa1 and the State's Civic Center bonds and the Metropolitan Pier and Exposition Authority expansion bonds one level to

Baa2. Moody's has in the past rated states in the triple B category--Alaska, California, Louisiana, Massachusetts, and Michigan—prior to the revised ratings calibrations that occurred in the Spring of 2010 [*Illinois Credit Stung Again*, The Bond Buyer, October 22, 2015].

On October 26, Moody's downgraded six of the State's nine public universities due to the reliance on State appropriations among other problems the universities may be dealing with:

- Eastern Illinois University, Governors State University and Western Illinois University were each downgraded two levels to Baa3 which is just above speculative grade.
- Northeastern Illinois University was dropped one notch from Baa1 to Baa2.
- Northern Illinois University and Southern Illinois University were dropped one level from A3 to Baa1.

Standard and Poor's Ratings Services currently rates Illinois General Obligation bonds at A- but on the credit watch list with negative implications.

See the following chart for a history of the State of Illinois' General Obligation Bond ratings.

TABLE 14 ILLINOIS' GENERAL OBLIGATION RATINGS HISTORY

Date of	*Fitch*		*S&P*		*Moody's*	
Rating Action	***Rating***	***up/down***	***Rating***	***up/down***	***Rating***	***up/down***
October 2015	*BBB+*	↓1x			*Baa1*	↓1x
June 2013	*A-*	↓1x			*A3*	↓1x
Jan 2013			*A-*	↓1x		
Aug 2012			*A*	↓1x		
Jan 2012					*A2*	↓1x
Jun 2010	*A*	↓1x			*A1*	↓1x
Mar-Apr 2010	*A-/A+ recal*	↓1x/↑2x			*Aa3 recal*	↑2x
Dec 2009			*A+*	↓1x	*A2*	↓1x
Mar-Jul 2009	*A*	↓2x	*AA-*	↓1x	*A1*	↓1x
Dec 2008	*AA-*	↓1x				
May 2003	*AA*	↓1x			*Aa3*	↓1x
Jun 2000	*AA+*	↑1x				
Jun 1998					*Aa2*	↑1x
Jul 1997			*AA*	↑1x		
Feb 1997					*Aa3*	↑1x
Sep 1996	*AA*	*initial rating*				
Feb 1995					*A1*	↓2x
Aug 1992			*AA-*	↓1x	*Aa*	↓1x
Aug-Sep 1991			*AA*	↓1x	*Aa1*	↓2x
Mar 1983			*AA+*	↓2x		
Feb 1979			*AAA*	*initial rating*		
1973					*AAA*	*initial rating*

Note: "recal" means recalibration, when Fitch and Moody's revised their ratings on municipal bonds to match global/corporate ratings. These are not considered upgrades.

Agency Ratings Comparison

Fitch/S&P	Moody's
AAA+	Aaa1(Aaa)
AAA	Aaa2
AAA-	Aaa3
AA+	Aa1
AA	Aa2
AA-	Aa3
A+	A1
A	A2
A-	A3
BBB+	Baa1
BBB	Baa2
BBB-	Baa3
BB+	Ba1
BB	Ba2
BB-	Ba3
B+	B1
B	B2
B-	B3
CCC+	Caa1
CCC	Caa2
CCC-	Caa3
CC+	Ca1
CC	Ca2
CC-	Ca3
C+	C1
C	C2
C-	C3

REVENUE

October Revenues Follow Suit As Monthly Receipts Reflect Lower Income Tax Rates

Jim Muschinske, Revenue Manager

Overall base revenues fell $319 million in October. Comparatively lower income tax rates, related income tax diversions to the education and human service related funds account for the decline. The month had one less number of receipting days than last fiscal year.

Due to the lower income tax rates effective January 2015, gross personal income tax receipts fell $298 million, or $265 million net of refunds. An additional $42 million was directed from the general funds to both the Fund for Advancement of Education as well the Commitment to Human Services Fund. As result, net personal income tax receipts were lower by $349 million. Gross corporate income tax also fell due to reduced rates, with gross receipts off $21 million, or $19 net of refunds. Corporate franchise taxes fell $7 million, other sources declined $4 million, cigarette taxes dipped $1 million, and vehicle use tax also fell $1 million.

A few sources, however, did manage to record gains for the month. Inheritance taxes had an unusually strong month as receipts grew $38 million, insurance taxes advanced $5 million, sales taxes managed $3 million in gains, interest income grew $2 million, and liquor taxes eked out a $1 million increase.

Overall transfers grew $9 million in October. Lottery transfers were up $13 million, while riverboat transfers dipped $4 million. All other transfers were the same as the prior year. Federal sources posted a modest $4 million increase for the month.

Year To Date

Through the first third of the fiscal year, base receipts are down $1.306 billion. The drop reflects comparatively lower income tax rates as well as the one-time nature of some pharmaceutical court settlements recovered by the Attorney General's Office last fiscal year.

Gross personal income taxes are down $997 million, $886 million net of refunds, or $1.176 billion when the diversions to the education and human service funds are included. Gross corporate income taxes fell behind last year's receipting by $176 million, or $159 million net of refunds. Other sources are down $122 million, reflecting the aforementioned court settlement proceeds received last fiscal year in a similar amount. Public utility taxes are off $25 million, corporate franchise tax by $2 million, and interest income by $1 million.

A small number of sources posted gains as inheritance tax receipts are up $30 million on the strength of the most recent month, insurance taxes are $5 million ahead of last year's pace, liquor taxes are up a modest $2 million, and the vehicle use tax has grown $1 million.

Overall transfers are up by $66 million and despite its continued weakness, federal sources are up $55 million so far this fiscal year.

GENERAL FUNDS RECEIPTS: OCTOBER

FY 2016 vs. FY 2015

($ million)

Revenue Sources	Oct. FY 2016	Oct. FY 2015	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,081	$1,379	($298)	-21.6%
Corporate Income Tax (regular)	107	128	($21)	-16.4%
Sales Taxes	701	698	$3	0.4%
Public Utility Taxes (regular)	72	72	$0	0.0%
Cigarette Tax	29	30	($1)	-3.3%
Liquor Gallonage Taxes	14	13	$1	7.7%
Vehicle Use Tax	2	3	($1)	-33.3%
Inheritance Tax	60	22	$38	172.7%
Insurance Taxes and Fees	6	1	$5	500.0%
Corporate Franchise Tax & Fees	13	20	($7)	-35.0%
Interest on State Funds & Investments	3	1	$2	200.0%
Cook County IGT	0	0	$0	N/A
Other Sources	26	30	($4)	-13.3%
Subtotal	$2,114	$2,397	($283)	-11.8%
Transfers				
Lottery	72	59	$13	22.0%
Riverboat transfers & receipts	22	26	($4)	-15.4%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Fund sweeps	0	0	$0	N/A
Other	37	37	$0	0.0%
Total State Sources	$2,245	$2,519	($274)	-10.9%
Federal Sources	$165	$161	$4	2.5%
Total Federal & State Sources	$2,410	$2,680	($270)	-10.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($105)	($138)	$33	-23.9%
Corporate Income Tax	($16)	(18)	$2	-11.1%
Fund for Advancement of Education	($42)	0	($42)	N/A
Commitment to Human Services Fund	($42)	0	($42)	N/A
Subtotal General Funds	$2,205	$2,524	($319)	-12.6%
Short-Term Borrowing	$0	$0	$0	N/A
Interfund Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,205	$2,524	($319)	-12.6%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 3-Nov-15

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2016 vs. FY 2015

($ million)

Revenue Sources	**FY 2016**	**FY 2015**	**CHANGE FROM FY 2015**	**% CHANGE**
State Taxes				
Personal Income Tax	$4,471	$5,468	($997)	-18.2%
Corporate Income Tax (regular)	609	785	($176)	-22.4%
Sales Taxes	2,753	2,733	$20	0.7%
Public Utility Taxes (regular)	283	308	($25)	-8.1%
Cigarette Tax	118	118	$0	0.0%
Liquor Gallonage Taxes	59	57	$2	3.5%
Vehicle Use Tax	13	12	$1	8.3%
Inheritance Tax	136	106	$30	28.3%
Insurance Taxes and Fees	98	93	$5	5.4%
Corporate Franchise Tax & Fees	71	73	($2)	-2.7%
Interest on State Funds & Investments	7	8	($1)	-12.5%
Cook County IGT	0	0	$0	N/A
Other Sources	133	255	($122)	-47.8%
Subtotal	$8,751	$10,016	($1,265)	-12.6%
Transfers				
Lottery	208	204	$4	2.0%
Riverboat transfers & receipts	103	112	($9)	-8.0%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	77	63	$14	22.2%
Fund sweeps	0	0	$0	N/A
Other	239	182	$57	31.3%
Total State Sources	$9,378	$10,577	($1,199)	-11.3%
Federal Sources	$718	$663	$55	8.3%
Total Federal & State Sources	$10,096	$11,240	($1,144)	-10.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($436)	($547)	$111	-20.3%
Corporate Income Tax	($93)	($110)	$17	-15.5%
Fund for Advancement of Education	($145)	$0	($145)	N/A
Commitment to Human Services Fund	($145)	$0	($145)	N/A
Subtotal General Funds	$9,277	$10,583	($1,306)	-12.3%
Short-Term Borrowing	$0	$0	$0	N/A
Interfund Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$125	$275	($150)	-54.5%
Total General Funds	$9,402	$10,858	($1,456)	-13.4%

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

CGFA 3-Nov-15

SEGIP Status Update

Anthony Bolton, Revenue Analyst

As Illinois continues operations without an enacted budget, the State Employee Group Insurance Program (SEGIP) has built up significant claims to be paid out. As of the end of October, approximately $2.05 billion in claims are being held by the state from various insurers, organizations, and companies. Of this total, the largest portion is approximately $1.08 billion of Managed Care claims. The second largest line, Prescription, OAP, and Mental Health claims, totals $598 million. The third largest portion of the overall claims hold comes from CIGNA, which has $291 million in claims currently held by the state. Concurrently, the estimated time for claims to be held is 360 days for Managed Care, 293 days for CIGNA, and 271-357 days for Prescriptions/OAPs/Mental Health. This information and other pertinent data is displayed on the chart below.

2015 Claims Hold Data for SEGIP

	October
Total Claims Hold	$2,048,971,682
Total Estimated Length of Claims Hold	Varies, 140-370 Days
CIGNA - PPO (and Member)	$291,156,089
Length of Claims Hold - PPO	293
CIGNA - Non-PPO	$21,017,903
Length of Claims Hold - Non-PPO	370
Total Managed Care Claims Hold	
HMO/ASC/Med Adv Claims Hold	$1,077,553,990
Length of Claims Hold	360
Other Self-Insured Claims Held: Rx, OAP, Mental Health	$598,104,349
Length of Claims Hold	Rx=357, OAP=271
Dental Claims Hold - PPO and Premier	$39,061,433
Length of Dental Claims Hold - PPO & Premier	140
Dental - Non-PPO	$22,077,918
Length of Dental Claims Hold - Non-PPO	231