Commission on Government Forecasting and Accountability

MONTHLY BRIEFING *NOVEMBER 2011*

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ECONOMY: De-leveraging

Edward H. Boss, Jr., Chief Economist

After running up debt by consumers, business, and governments in the past decade or more, the economy is experiencing a period of de-leveraging -- reducing debt relative to income. After a surge in consumer credit expansion over the past decade, there has been a sharp contraction resulting in delinquencies, bankruptcies, and record levels of mortgage defaults, all made worse by the credit crisis that led to the great recession that began at the end of 2007. Recently, however, there are signs that consumer finances are improving and that the related balance sheet stresses are easing.

A recent report by the Federal Reserve shows that consumer debt is down 8% from a peak reached in the third quarter of 2008 and that the sharp reductions in revolving, or credit card, debt has begun to level off. This is important since consumer spending generally accounts for two-thirds or more of total spending in the U.S. economy. Indeed, the healing in consumer balance sheets seem to be helping the retail sector where sales have risen in each of the past five months.

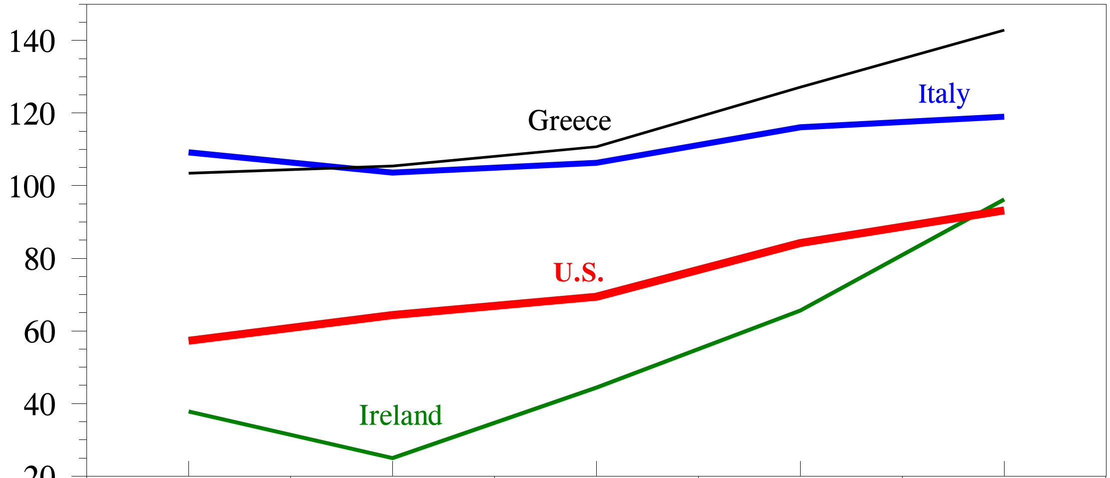
While consumers have improved their balance sheets, corporations have done an even better job. Corporations appear to be flush with cash, have not increased leverage, and bank capital levels are at record high levels in the U.S. Moreover, technical conditions seem quite supportive for the issuance of corporate bonds that appear to provide an investment-grade safe haven, offering less volatility than stocks, while offering higher interest rates than cash or governments. At the same time, the uncertain economic, political, and regulatory environments are likely to keep corporations conservative in handling their balance sheets, thus reducing chances for any spike in defaults.

CHART 1

GOVERNMENT DEBT TO GDP

Ratio

Percent



	2000	2007	2008	2009	2010
U.S.	57.3	64.4	69.4	84.2	93.2
Greece	103.4	105.4	110.7	127.1	142.8
Italy	109.2	103.6	106.3	116.1	119
Ireland	37.8	25	44.4	65.6	96.2

CGFA

The debt situation in the 17 countries comprising the Euro Zone has shown less progress in reducing over-leveraged positions. Government debt relative to the size of the country as measured by Gross Domestic Product (GDP) has soared in many of these countries, particularly in Southern Europe. As illustrated in the accompanied chart, Ireland was an early concern, mainly because of the acceleration of the debt to GDP ratio. Even more critical was the situation in Greece where the debt to GDP ratio is at an astounding 142%.

In the case of Ireland, there was some double counting of debt which when corrected slightly lowered this level. In Greece, the newly appointed Prime Minister reiterated his determination to implement all budget measures demanded by the European Union and IMF and the EU said it stood ready to help. Actions taken by both, which are relatively small countries, seem to have forestalled default in these countries, at least in the short run. More concerning is the threat of a major country default, particularly Italy, where a bail out would be huge. In response, Italy also has replaced its Prime Minister who promises to get the nation's fiscal house in order and make the Italian economy more competitive. Even so, with increased prospects for Europe to enter another recession, it will be difficult to lower the debt to GDP ratios even under more restrictive fiscal restraint.

Fears are the debt problems in Europe could be a contagion on the U.S. as the global world economies become more and more intertwined. This could be true for a number of reasons including lower corporate profits and, not the least of which is that Europe accounts for about 20% of U.S. exports. Weakening exports would put a damper on U.S. growth that recently was revised down in the third quarter from 2.5% to 2% with most forecasters seeing even slower growth early next year. Indeed, Global Insight, the Commission's forecasting service, maintains that the odds that the U.S. could experience another recession at 40%. Even if a recession is avoided here, growth will not be strong enough to reduce the unemployment rate by any significant amount next year.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	OCT. 2011	SEPT. 2011	OCT. 2010
Unemployment Rate (Average)	10.1%	10.0%	9.6%
Annual Rate of Inflation (Chicago)	-2.3%	1.8%	2.9%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (October)	6,627	0.1%	-0.4%
Employment (thousands) (October)	5,958	0.0%	-0.9%
New Car & Truck Registration (October)	40,951	-10.7%	16.3%
Single Family Housing Permits (October)	734	14.0%	16.5%
Total Exports ($ mil) (September)	5,607	1.1%	33.8%
Chicago Purchasing Managers Index (Nov.)	62.6	7.2%	0.1%

$300 Million Build Illinois Bond Sale

Lynnae Kapp, Senior Bond Analyst

The Governor's Office of Management closed on a $300 million Build Illinois Bond sale on November 4, 2011. The Bonds were sold competitively and had a True Interest Cost of 4.066%. Of the $12 million premium received from the bond sale, $9 million was deposited in the Debt Service Reserve Fund; $2.6 million will go to projects and the remainder to costs of issuance. Bond proceeds will be used for projects under the State's multi-year $31 billion capital plan. The Bonds, backed by Illinois Sales Tax revenues, received ratings of AAA from Standard and Poor's and AA+ from Fitch Ratings.

REVENUE

November Revenue Growth Stalls as Expected Due to Impact of 2010 Tax Amnesty Program

Jim Muschinske, Revenue Manager

Despite higher income tax rates compared to last November, overall monthly revenues dipped $18 million. While federal sources again suffered a significant drop, the main contributor to the lack of growth was the impact of last year's tax amnesty program that accounted for approximately $401 million of last November's revenues. As stated many times by CGFA, the vast majority of those tax amnesty revenues should not have been viewed as "new" revenues, but rather an acceleration of tax revenue that ultimately would have been collected later in FY 2011 or in subsequent fiscal years [i.e. FY'12]. November had one extra receipting day compared to last year.

For the month, gross corporate income taxes fell $243 million, or $177 million net of refunds. The drop was directly related to the timing of tax amnesty. Last November, approximately $244 million gross, or $178 million net, of tax amnesty was classified as corporate income tax. Sales taxes also suffered on a comparative basis as monthly receipts dropped $73 million. Again, the falloff was due to tax amnesty, as November 2010 receipts included approximately $122 million classified as such.

Personal income tax receipts did achieve growth, albeit somewhat lower than has been experienced, as gross receipts were up $389 million, or $355 million net of refunds. The impact of tax amnesty was not significant in this case, as only $35 million gross [$32 million net] was classified as amnesty monies last November. In examining the monthly data, it appears that the timing related to the November/ December 2010 receipt period also contributed to the weaker gains this month. It is believed that December will generate gains more in line with recent experience once this timing issue is eliminated.

As expected, inheritance tax receipts jumped as a consequence of tax changes which went into effect January 2011, up $41 million. Due to an approximate nine or ten month lag in estate settlements, receipts only now are experiencing growth. Public utility taxes were up $5 million, corporate franchise $4 million, interest income $4 million, other sources $3 million, and insurance taxes $2 million.

Overall transfers declined $59 million. While lottery transfers grew $9 million, other transfers declined $52 million and riverboat transfers fell $16 million. Finally, as mentioned, federal sources dropped $122 million reflecting reimbursable spending as well as a lower rate of reimbursement when compared to last year.

Year to Date

Through the first five months of the fiscal year, absent short-term borrowing and Budget Stabilization Fund transfers, base general funds revenues are up $1.035 billion. Despite the brief interruption related to the above mentioned tax amnesty timing issue, the increase continues to be fueled by comparatively higher income tax receipts stemming from the January 2011 rate increases as well as continued strong sales tax receipts. Those items have been more than enough to overcome a significant falloff in federal sources that resulted from less reimbursable spending as well as a return to a lower federal matching rate [under ARRA, states enjoyed approximately two years of higher reimbursable match—that has now ended].

To date, gross personal income taxes are up $2.343 billion, or $2.138 billion net of refunds. Gross corporate income taxes are up $15 million, or $35 million net of refunds. Sales taxes have increased $196 million, while all other revenue sources displayed a decline of $54 million mainly due to the expected falloff in inheritance tax receipts.

Overall transfers are down $161 million, primarily as the result of $338 million of interfund borrowing that took place last fiscal year through November. Other transfers are down $228 million, and regular riverboat transfers are off $9 million [the final payment of $73 million is related to the sale of the 10th license]. Lottery transfers are up a scant $3 million for the year. Federal source receipts suffered a significant drop falling $1.119 billion due to lower reimbursable spending as well as lower reimbursement rates previously enjoyed under ARRA.

GENERAL FUNDS RECEIPTS: NOVEMBER

FY 2012 vs. FY 2011

($ million)

Revenue Sources	Nov. FY 2012	Nov. FY 2011	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,099	$710	$389	54.8%
Corporate Income Tax (regular)	43	286	($243)	-85.0%
Sales Taxes	602	675	($73)	-10.8%
Public Utility Taxes (regular)	87	82	$5	6.1%
Cigarette Tax	29	30	($1)	-3.3%
Liquor Gallonage Taxes	13	13	$0	0.0%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax (Gross)	42	1	$41	N/A
Insurance Taxes and Fees	3	1	$2	200.0%
Corporate Franchise Tax & Fees	19	15	$4	26.7%
Interest on State Funds & Investments	6	2	$4	200.0%
Cook County IGT	56	56	$0	0.0%
Other Sources	28	25	$3	12.0%
Subtotal	$2,030	$1,899	$131	6.9%
Transfers				
Lottery	55	46	$9	19.6%
Riverboat transfers & receipts	28	44	($16)	-36.4%
Proceeds from Sale of 10th license	0	0	$0	N/A
Other	46	98	($52)	-53.1%
Total State Sources	$2,159	$2,087	$72	3.4%
Federal Sources	$217	$339	($122)	-36.0%
Total Federal & State Sources	$2,376	$2,426	($50)	-2.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($96)	($62)	($34)	54.8%
Corporate Income Tax	($8)	(74)	$66	-89.2%
Subtotal General Funds	$2,272	$2,290	($18)	-0.8%
Short-Term Borrowing	$0	$0	$0	N/A
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,272	$2,290	($18)	-0.8%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Dec-11

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2012 vs. FY 2011

($ million)

Revenue Sources	FY 2012	FY 2011	CHANGE FROM FY 2011	% CHANGE
State Taxes				
Personal Income Tax	$5,896	$3,553	$2,343	65.9%
Corporate Income Tax (regular)	695	680	$15	2.2%
Sales Taxes	3,020	2,824	$196	6.9%
Public Utility Taxes (regular)	426	430	($4)	-0.9%
Cigarette Tax	147	148	($1)	-0.7%
Liquor Gallonage Taxes	69	67	$2	3.0%
Vehicle Use Tax	13	13	$0	0.0%
Inheritance Tax (Gross)	49	108	($59)	-54.6%
Insurance Taxes and Fees	86	86	$0	0.0%
Corporate Franchise Tax & Fees	87	89	($2)	-2.2%
Interest on State Funds & Investments	10	10	$0	0.0%
Cook County IGT	56	56	$0	N/A
Other Sources	150	140	$10	7.1%
Subtotal	$10,704	$8,204	$2,500	30.5%
Transfers				
Lottery	239	236	$3	1.3%
Riverboat transfers & receipts	154	163	($9)	-5.5%
Proceeds from Sale of 10th license	73	0	$73	N/A
Other	428	656	($228)	-34.8%
Total State Sources	$11,598	$9,259	$2,339	25.3%
Federal Sources	$1,134	$2,253	($1,119)	-49.7%
Total Federal & State Sources	$12,732	$11,512	$1,220	10.6%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($516)	($311)	($205)	65.9%
Corporate Income Tax	($122)	($142)	$20	-14.1%
Subtotal General Funds	$12,094	$11,059	$1,035	9.4%
Short-Term Borrowing	$0	$1,300	($1,300)	-100.0%
Tobacco Liquidation Proceeds	$0	$0	$0	N/A
Pension Contribution Fund Transfer	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$275	$0	$275	N/A
Total General Funds	$12,369	$12,359	$10	

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

CGFA 2-Dec-11

PENSIONS
State Retirement Systems
Gregg Scott, Pension Analyst

The information in the following chart was received by CGFA from each of the 5 State of Illinois retirement systems. These numbers were calculated using the actuarial methods and assumptions chosen as most appropriate by the individual systems. As of this date, these are the latest and best numbers to use for each of the systems for the Fiscal Years listed in the chart column headings.

Summary of Certified Amounts
State Retirement Systems Combined
($ in Millions)

System	FY 2012 Cerified Amounts	FY 2013 Certified Amounts	FY 2013 System Projections
TRS	$2,406.5	$2,703.5	$2,655.2
SERS	$1,450.8	$1,659.6	$1,541.4
SURS	$980.5	$1,402.8	$1,057.7
JRS	$63.6	$88.2	$67.7
GARS	$10.5	$14.2	$11.3
TOTAL	$4,911.9	$5,868.3	$5,333.3

The information in the following chart was received by CGFA from each of the 5 State of Illinois retirement systems for the specified date. The results shown represent the financial condition of each system WITHOUT asset smoothing. For FY2010 the Total Unfunded Balance using this method was $85.57 Billion. Therefore, the FY2011 Total Unfunded balance of $83.08 Billion represents a decline of $2.49 Billion.

Summary of Financial Condition
State Retirement Systems Combined
Assets at Market Value / **Without Asset Smoothing**
FY 2011
($ in Millions)

System	Accrued Liability	Net Assets	Unfunded Liability	Funded Ratio
TRS	$81,299.7	$37,471.3	$43,828.4	46.1%
SERS	$31,395.0	$10,970.8	$20,424.2	34.9%
SURS	$31,514.3	$14,274.0	$17,240.3	45.3%
JRS	$1,952.5	$606.0	$1,346.5	31.0%
GARS	$298.4	$60.4	$238.0	20.2%
TOTAL	$146,459.9	$63,382.5	$83,077.4	43.3%

The information in the following chart was received by CGFA from each of the 5 State of Illinois retirement systems for the specified date. The results shown represent the financial condition of each system WITH assets smoothing. For FY2010 the Total Unfunded Balance using this method was $75.74 Billion. Therefore, the FY2011 Total Unfunded balance of $82.91 Billion represents an increase of $7.17 Billion.

Summary of Financial Condition
State Retirement Systems Combined
Assets at Actuarial Value / **With Asset Smoothing**
Public Act 96-0043
FY 2011
($ in Millions)

System	Accrued Liability	Actuarial Assets	Unfunded Liability	Funded Ratio
TRS	$81,299.7	$37,769.8	$43,529.9	46.5%
SERS	$31,395.0	$11,159.8	$20,235.2	35.5%
SURS	$31,514.3	$13,945.7	$17,568.6	44.3%
JRS	$1,952.5	$614.6	$1,337.9	31.5%
GARS	$298.4	$63.2	$235.2	21.2%
TOTAL	$146,459.9	$63,553.1	$82,906.8	43.4%