Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: DECEMBER 2015

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INSIDE THIS ISSUE

ECONOMY: The Die Is Cast

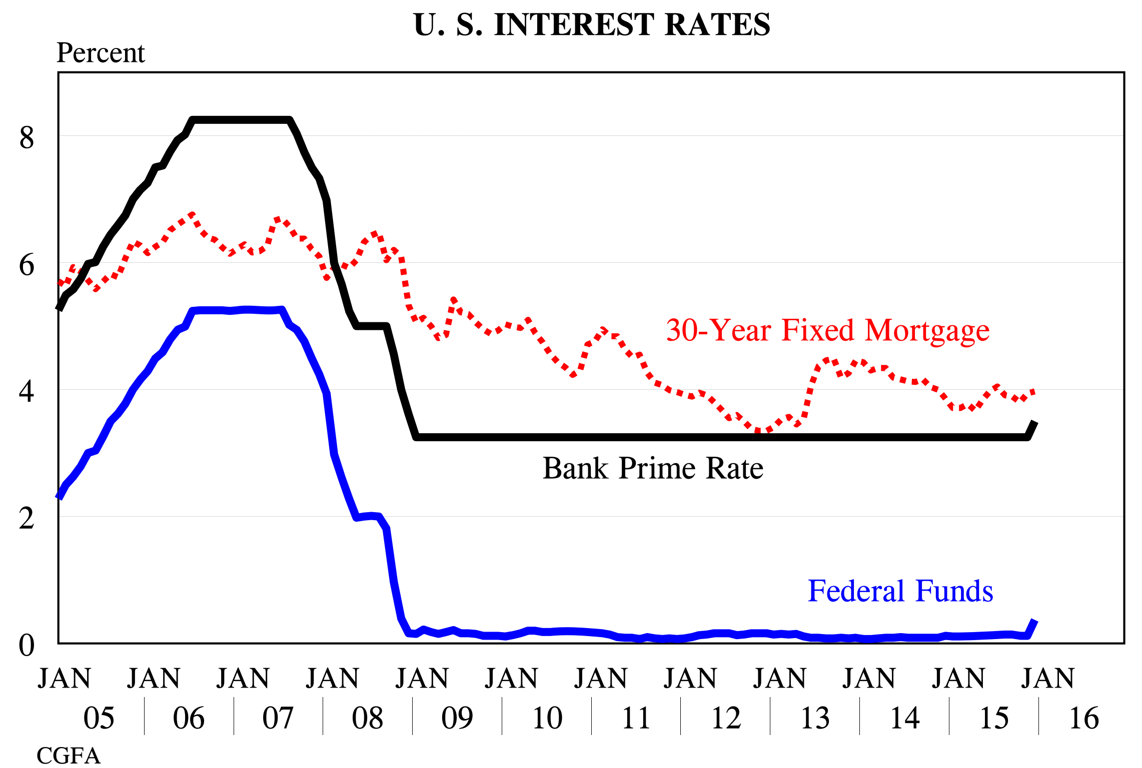
Edward H. Boss, Jr., Chief Economist

When the army under Julius Caesar crossed the Rubicon River in Italy, against the edict of the Roman Senate, he started a civil war that ultimately achieved his objective of becoming the ruler of Rome. Once crossed, there was no turning back. This brings to mind the recent action of the Federal Reserve which, despite warnings from the International Monetary Fund (IMF) that a rise in interest rates not only could damage an already fragile economic recovery but, if central banks didn't continue to keep interest rates low, could led to a world economic crash.

Despite these ominous warnings, as shown in the chart, the die was cast as the Federal Reserve raised the federal funds target rate into a range of ¼ to ½ percent in mid-December, after holding it in the narrow range of 0 to ¼ percent for more than 7 years. In response, other interest rates also edged upward. Moreover, the Federal Reserve stated that further gradual increases lie in the period ahead depending on the economic outlook as informed by incoming data. However it is unlikely that once starting to raise interest rates, it would reverse course. Indeed even as the IMF warned central banks not to raise interest rates, the G30group of experts that include former central bank governors felt that keeping interest rates low for a prolonged period would lead to a financial crisis as it would raise debt levels and encourage excessive risk taking. Indeed, many felt that a gradual return to market-driven interest rates already had been delayed for far too long.

Certainly, the prolonged period of easy money with low yields, while stimulating demand, had negative effects on other segments of the economy. While the Federal Reserve supplanted market forces by buying up securities to keep interest rates low through a series of quantitative easing

CHART 1



maneuvers, it encouraged spenders at the cost of savers. As examples, lower mortgage rates sparked a rebound in housing activity while easing rates on auto loans coupled with extended periods to pay sparked a boom in auto sales to replace an aging fleet. In contrast, many of those on a fixed income found that their returns on safe investments like CD's, savings accounts, and social security increases saw their returns eliminated or severely reduced. Those still working found that their pension funds were falling well below that estimated by actuaries in more normal times causing shortfalls in the funds needed to meet continuing and future pension obligations.

The timing of the Federal Reserve interest rate hike reflects progress on reaching the economic goals it had set for itself. The unemployment rate held at 5% in the latest two months, half that of the 10% peak reached in October 2009 shortly after the beginning of the recovery. Even the more inclusive U6 rate, which includes those marginally attached and those working part time for economic reasons, fell below 10% in the past two months, reaching single digits for the first time since May 2008. At the same time, inflation remains low with consumer prices excluding the volatile food and energy prices at 2% and overall consumer prices either unchanged or declining all year. It is the missed target on inflation that appears to be of more concern to the Fed.

Supply and demand are considered the backbone of a market economy and how prices are determined. Rising employment with declining unemployment, some improvement in compensation, sharply lower inflation highlighted by plunging gasoline prices, and attractive interest rates have sparked an increase in consumer demand. At the same time, supply may be weakening: business spending has moderated reflected in weakening corporate profits; the Purchasing Managers Index of Manufacturing contracted in November for the first time in three years, and the Chicago Index went on to fall in December to reach its lowest level since August 2009.

The result of these trends are reflected in weak manufacturing employment with U.S. industrial production declining in the past four months as capacity utilization rates continued to ease. Indeed, many feel that manufacturing already is in recession. Moreover, any reform of corporate taxes appears on hold. At the same time, the expanding service sector slowed during the past three months and remains below that of a year earlier.

The effects of changes in both fiscal and monetary policy can operate with significant lags. Some analysts point out that at times in the past the effects have begun at a time when they were either not needed or may even have had to be reversed. Even so, with fiscal policy restrained by record levels of debt and lack of an agreement on long-term budget solutions, it has been monetary policy that has been relied upon. And, given the severity of the past recession it appeared stronger action than was taken in the past was needed and appears at least to have been met with some degree success.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	NOV. 2015	OCT. 2015	NOV. 2014
Unemployment Rate (Average)	5.7%	5.4%	6.2%
Annual Rate of Inflation (Chicago)	0.2%	-5.2%	0.2%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (November)	6,540.6	0.3%	0.4%
Employment (thousands) (November)	6,168.9	0.0%	0.9%
NonFarm Payroll Employment (November)	5,927,200	400	35,700
New Car & Truck Registration (November)	43,808	-21.2%	12.3%
Single Family Housing Permits (November)	825	-19.0%	20.0%
Total Exports ($ mil) (October)	5,502	5.4%	-8.0%
Chicago Purchasing Managers Index (Dec.)	42.9	-11.9%	-26.4%

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

REVENUE

December Receipts Down

Jim Muschinske, Revenue Manager

Overall base revenues fell $484 million in December. Comparatively lower personal income tax rates again resulted in a drop from that source, although receipts actually performed marginally better than expected. Unfortunately, corporate income taxes, even when taking the comparatively lower tax rate into account, were weaker than expected. In addition, sales taxes posted a modest loss, as did federal reimbursements. One less receipting day in December also likely contributed to the monthly decline.

Due to the lower income tax rates effective January 2015, gross personal income tax receipts fell $263 million, or $233 million net of refunds. An additional $27 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 $287 million. Gross corporate income taxes sunk by $162 million in December, or $143 million net of refunds. It is still too early to know if the higher than expected drop is related to timing of receipts, or is a harbinger of future weakness which will further manifest in final payments.

A few other sources also suffered declines in December. Inheritance taxes were off $8 million, other sources $6 million, and insurance taxes $5 million.

A few sources managed to post gains for the month. Corporate franchise taxes increased $4 million, while public utility taxes, cigarette taxes, vehicle use tax, and interest income each eked out $1 million gains.

Overall transfers fell $16 million in December. Lottery transfers fell $12 million, while riverboat transfers dipped $4 million. As mentioned, federal sources experienced a weaker month, falling $13 million.

Year To Date

Through the first half of the fiscal year, base receipts are down $1.812 billion. The vast majority of the drop reflects comparatively lower income tax rates.

Gross personal income taxes are down $1.458 billion, $1.295 billion net of refunds, or $1.705 billion when the diversions to the education and human service funds are included. Gross corporate income taxes are behind last year's receipting by $338 million, or $302 million net of refunds. Other sources are $129 million lower, reflecting one-time court settlement proceeds received last fiscal year. Public utility taxes are off $29 million and interest income by $1 million.

A small number of sources posted gains as inheritance tax receipts are up $36 million, corporate franchise taxes $9 million, vehicle use $2 million and liquor tax $1 million.

Overall transfers are up by $61 million, and federal sources are ahead of last year's slow pace by $238 million.

With the first half of FY 2016 completed, a few observations regarding revenues can be offered. The performance of the large economic related sources is mixed. While the largest source, personal income tax, has performed somewhat stronger than expected over the first six months, the same cannot be said for corporate income tax and sales tax which have failed to meet even modest expectations.

For the most part, the other much smaller revenue sources have performed as expected. Federal sources have done decently thus far, but the lack of a true FY 2016 budget as well as on going cashflow issues makes predicting second half reimbursable spending levels difficult.

DECEMBER
FY 2016 vs. FY 2015
($ million)

Revenue Sources	Dec. FY 2016	Dec. FY 2015	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,407	$1,670	($263)	-15.7%
Corporate Income Tax (regular)	324	486	($162)	-33.3%
Sales Taxes	742	756	($14)	-1.9%
Public Utility Taxes (regular)	85	84	$1	1.2%
Cigarette Tax	31	30	$1	3.3%
Liquor Gallonage Taxes	14	14	$0	0.0%
Vehicle Use Tax	3	2	$1	50.0%
Inheritance Tax	29	37	($8)	-21.6%
Insurance Taxes and Fees	61	66	($5)	-7.6%
Corporate Franchise Tax & Fees	20	16	$4	25.0%
Interest on State Funds & Investments	2	1	$1	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	24	30	($6)	-20.0%
Subtotal	$2,742	$3,192	($450)	-14.1%
Transfers				
Lottery	53	65	($12)	-18.5%
Riverboat transfers & receipts	24	28	($4)	-14.3%
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	40	40	$0	0.0%
Total State Sources	$2,859	$3,325	($466)	-14.0%
Federal Sources	$219	$232	($13)	-5.6%
Total Federal & State Sources	$3,078	$3,557	($479)	-13.5%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($137)	($167)	$30	-18.0%
Corporate Income Tax	($49)	(68)	$19	-27.9%
Fund for Advancement of Education	($27)	0	($27)	N/A
Commitment to Human Services Fund	($27)	0	($27)	N/A
Subtotal General Funds	$2,838	$3,322	($484)	-14.6%
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	$2,838	$3,322	($484)	-14.6%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 5-Jan-16

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	$6,768	$8,226	($1,458)	-17.7%
Corporate Income Tax (regular)	975	1,313	($338)	-25.7%
Sales Taxes	4,143	4,136	$7	0.2%
Public Utility Taxes (regular)	431	460	($29)	-6.3%
Cigarette Tax	177	177	$0	0.0%
Liquor Gallonage Taxes	86	85	$1	1.2%
Vehicle Use Tax	18	16	$2	12.5%
Inheritance Tax	192	156	$36	23.1%
Insurance Taxes and Fees	161	161	$0	0.0%
Corporate Franchise Tax & Fees	111	102	$9	8.8%
Interest on State Funds & Investments	10	11	($1)	-9.1%
Cook County IGT	56	56	$0	0.0%
Other Sources	187	316	($129)	-40.8%
Subtotal	$13,315	$15,215	($1,900)	-12.5%
Transfers				
Lottery	312	306	$6	2.0%
Riverboat transfers & receipts	171	181	($10)	-5.5%
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	313	262	$51	19.5%
Total State Sources	$14,188	$16,027	($1,839)	-11.5%
Federal Sources	$1,296	$1,058	$238	22.5%
Total Federal & State Sources	$15,484	$17,085	($1,601)	-9.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($660)	($823)	$163	-19.8%
Corporate Income Tax	($148)	($184)	$36	-19.6%
Fund for Advancement of Education	($205)	$0	($205)	N/A
Commitment to Human Services Fund	($205)	$0	($205)	N/A
Subtotal General Funds	$14,266	$16,078	($1,812)	-11.3%
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	$14,391	$16,353	($1,962)	-12.0%

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

CGFA 5-Jan-16