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703 Stratton Ofc. Bldg.
Springfield, IL 62706

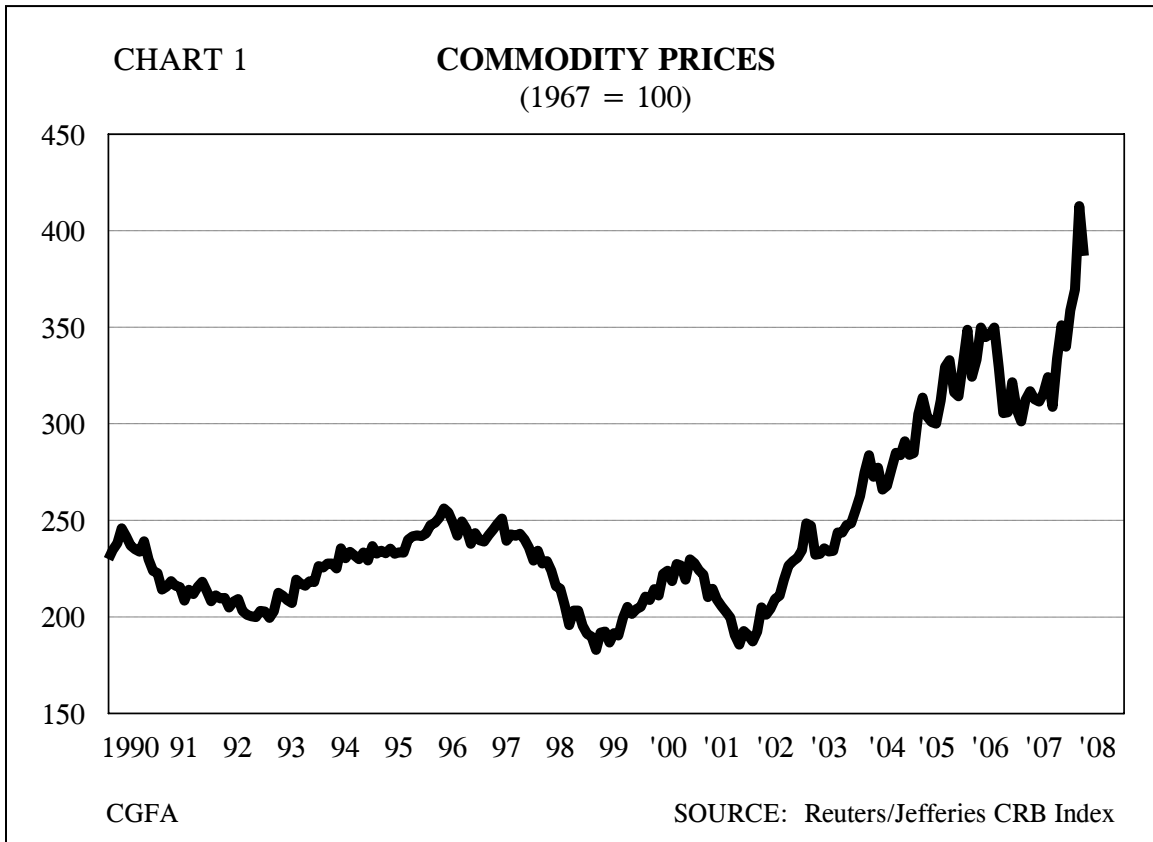
ECONOMY: Commodities, the Next Bubble?

Edward H. Boss, Jr., Chief Economist

As the credit crisis appears to be stabilizing, signs are emerging that the housing sector may be bottoming, and expectations are rising that fiscal and monetary policies will either ward off a recession or at the least make it shallow and short. Analysts are beginning to ponder if another bubble may be forming. Soon, if not already, attention will be focused on other areas of the economy that appear to be out of sync with historical relationships. A key candidate for a bubble is the soaring increase in basic commodity prices in the past five to six years (see Chart 1 on the next page).

As illustrated in Chart 1 commodity prices, as measured by Reuters/Jefferies CRB Index, has doubled between January 2002 and January 2008 and have risen further on average in the past two months. If the U.S. economy is already in recession, as some economists believe, or even about to enter one, the recent performance of commodity prices would be at variance with that which occurred in similar periods. For example, in each of the last two recessions, which began in 1990 and 2001 respectively, commodity prices showed declines. Indeed, the prolonged period of soft commodity and consumer prices in the early 2000s even brought up concerns of deflation, or a general decline in prices usually associated only with periods of sustained economic weakness.

The Reuters/Jefferies CRB Index is comprised of 19 commodities, each weighed by its importance. The measure includes oil and related products (crude oil, natural gas, heating oil, and unleaded gasoline); metals (aluminum, copper, nickel and precious metals, gold and silver); agricultural products (corn, soybeans, wheat, cotton, sugar, cocoa, coffee and orange juice); and meats (live cattle and



lean hogs). A major factor in the divergence of commodity prices this time verses similar periods in the past can be attributed to the relative weights, or importance, given to its components. There can be little doubt that the major factor is the surge in oil prices that has occurred. Crude oil prices have a weight of 23%, unleaded gas 5%, and heating oil 5%. Thus, soaring oil prices directly impact a third of the entire index.

Furthermore, there are indirect effects from soaring oil prices. For example, with a fifth of corn being turned into ethanol to increase energy supplies, corn with a weight of 6% has

seen its price rise and as more land is turned to corn planting rather than soybeans, also with a weight of 6%, soybean prices have risen.

Another indirect effect of rising oil prices has to do with the sharp drop in the foreign exchange value of the dollar as the price of oil is always expressed in U.S. dollars. Thus as the value of the dollar drops, it has a greater impact on increasing U.S. oil prices than in many other countries where a weaker dollar helps to offset the upward price pressure on their oil purchases. Finally, one cannot rule out the role of speculation, always the air that inflates the bubble in the first place.

Higher energy prices are already affecting usage. The American Petroleum Institute reports that fuel demand in the first quarter of this year was 1.4% below year-ago levels with total imports of crude oil and refined products down 3.5% from a year earlier. Prices however were higher, in part due to a declining dollar but also concern over supply disruptions because of events in the Middle East and other areas as well as speculation. Oil reached

a record \$120 per barrel before edging modestly lower. Precious metal prices, particularly gold, also declined from a recent high of over \$1000 per ounce to under \$890 per ounce currently. While many uncertainties remain, the weak U.S. economy coupled with a weakening in both Europe and Asia may act to subdue demand for basic commodities further. Should these trends continue, the dollar might well strengthen taking pressure off basic commodity prices, quickly deflating a possible bubble.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

<u>INDICATORS</u>	<u>March 2008</u>	<u>February 2008</u>	<u>March 2007</u>
Unemployment Rate (Average)	5.5%	5.5%	4.6%
Annual Rate of Inflation (Chicago)	11.6%	4.4%	4.5%
—————			
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (March)	6,809	0.1%	2.4%
Employment (thousands) (March)	6,437	0.1%	1.5%
New Car & Truck Registration (March)	42,737	-4.8%	-14.3%
Single Family Housing Permits (March)	1,107	35.2%	-58.2%
Total Exports (\$ mil) (February)	4,118	2.9%	19.8%
Chicago Purchasing Managers Index (April)	48.3	0.2%	-8.7%

Short-Term Borrowing
Lynnae Kapp, Bond Analyst

In April 2008, the State sold General Obligation Certificates in the amount of \$1.2 billion to supplement the Hospital Provider Assessment Program and other health care funds. The State will pay off \$900 million of the Certificates in May

and \$300 million in June, and pay approximately \$3.5 million in interest. Federal reimbursements would give the State an additional \$465 million for hospitals, \$80 for the General Revenue Fund and \$50 million to other State healthcare funds. This would be the last year of the three-year program which has allowed the State to capture additional Federal Medicaid reimbursements.

HISTORY OF SHORT TERM BORROWING			
Date Issued	Amount (millions)	Purpose	Date Retired
June-July 1983	\$200	To maintain adequate cash balances caused by revenue shortfalls	May 1984
February 1987	\$100	To improve the cash position of the General Funds	February 1988*
August 1991	\$185	For cash flow purposes	June 1992
February 1992	\$500	To pay Medicaid providers through the Medicaid Developmentally Disabled Provider Participation Fee, Medicaid Long-Term Care Provider Participation Fee, and Hospital Services Trust Funds	October 1992*
August 1992	\$600	To improve the payment cycle to Medicaid service providers	May 1993
October 1992	\$300	For cash flow purposes	June 1993
August 1993	\$900	For cash flow to pay Medicaid service providers through the Hospital Provider Fund	June 1994
August 1994	\$687	To pay Medicaid service providers through the Long-Term Care and Hospital Provider Funds	June 1995
August 1995	\$500	To GRF for cash flow and payment to Medicaid service providers through the Long-Term Care Provider Fund and Hospital Provider Fund	June 1996
July 2002	\$1,000	For Cash Flow; payments for medical assistance; to medical providers for long-term care; to pay Income Tax Refunds	June 2003
May 2003	\$1,500	For Cash Flow; payments for medical assistance; to medical providers for long-term care; for Income Tax Refunds; for State Aid to K-12 school districts	May 2004*
June 2004	\$850	For Medicaid service providers and the Children's Health Insurance Program	October 2004*
March 2005	\$765	For Cash Flow; for payments to Medicaid Service Providers through the Hospital Provider Fund.	June 2005
November 2005	\$1,000	For Cash Flow; for payments for Medicaid and the Children's Health Insurance Program.	June 2006
February 2007	\$900	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	June 2007
September 2007	\$1,200	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	November 2007
April 2008	\$1,200	For the Hospital Provider Assessment Tax Program; health care related funds; General Revenue Fund liquidity.	June 2008

Source: Office of Management & Budget
*Across fiscal year borrowing

REVENUE

April Revenues Jump Due to Personal Income Tax and Federal Sources -- Remaining Months Expected to Struggle

Jim Muschinske, Revenue Manager

Overall base receipts increased \$389 million in April, excluding \$1.2 billion in short-term borrowing, reversing what had been a disappointing March. April rebounded with a flourish with exceptionally strong performances from personal income tax as well as federal sources. An extra receipting day likely was key in the monthly jump in receipts.

Gross personal income tax experienced a jump of \$288 million, or \$294 net of refunds. Preliminary analysis indicates that the large increase primarily was due to higher automatic extension payments [Form IL-505I sometimes called "estimated final payments"]. Basically, these payments are made by taxpayers who are unable to file their individual income tax return [IL-1040] by the due date. It provides them a means of calculating and remitting their tentative tax liability on or before the original due date of the return. It still is unclear what impact the increase in extension payments means for future receipts. In addition, the monthly increase in receipts likely was assisted by timing related to when withholding payments are due [withholding which otherwise would have been remitted in May might have been booked in April simply due to calendar dates]. The impact of that timing could, therefore, reduce the withholding portion of May

receipts. Further analysis of the individual components [withholding, final, and estimated] will need to be conducted.

Timing also seems to have been the reason for a large increase in public utility taxes as receipts grew \$57 million. Public utility taxes are usually received in the middle of the week. The extra receipting day in April significantly contributed to the monthly increase [as did the fact that last year was a fairly low month]. It's anticipated that receipts in May will fall due to the same mid-week receipt timing issue. Due to a sales tax allocation issue experienced last year in March and April, sales tax receipts grew \$33 million for the month. Once the value related to last year's allocation change is accounted for, base sales taxes were likely flat again. Inheritance tax continued to excel with receipts up \$9 million, while other sources eked out a \$1 million gain.

Gross corporate income tax receipts were down \$23 million, or \$10 million net of refunds. The Cook County IGT declined \$11 million for the month, while insurance taxes and fees dropped by \$6 million.

Overall transfers fell \$107 million in April. While lottery transfers gained \$10 million, riverboat transfers declined \$5 million and other transfers fell \$112 million due to last year's fund sweeps. Federal sources reversed the previous month's decline by jumping \$121 million due to an exceptionally strong month for reimbursable spending.

Year to Date

Through April, overall base receipts were up \$953 million. While receipt performance had been mixed, one area that had continued to fare well is gross personal income tax receipts. Through April, receipts were up \$771 million, or \$879 million on a net of refund basis. While receipts could very well drop over the remainder of the year due to timing as well as economic slowing, a strong year for personal income tax served to bolster what otherwise would be a year void of meaningful growth.

Despite an up tick in April due to last year's allocation issue, sales tax continued to disappoint with little prospect for a reversal of fortune, as receipts continue to plod along and are up just \$67 million for the year [with an estimated \$50 million of that gain owed to allocation issues]. Some positive news continued to come from the strength of the inheritance tax -- up \$101 million.

While lottery transfers were up \$40 million, other transfers more than erased those gains and were down \$244 million due to lack of fund sweeps and charge-backs. Finally, despite the recent surge in federal sources, receipts are running behind last year—off \$37 million.

Despite the April respite from overall disappointing revenue performance, the remaining months are not anticipated to be very favorable for a number of reasons:

- **Timing of personal income receipts may have benefited April's total, but perhaps at the expense of May.**
- **Corporate income tax is not expected to demonstrate any growth in the remaining months, and could in fact suffer declines.**
- **Sales tax receipts, which benefited from last year's allocation issues in the preceding two months, are expected to continue to struggle over the remainder of the year.**
- **Public utility taxes jumped appreciably in April due to timing. That same reason will work against receipts over the remaining two months.**
- **Riverboat transfers in the final month will be significantly less this year as the "hold harmless" provision no longer will supply a last minute surge [\$67 million last June].**
- **Lack of chargeback activity will result in a significant drop off in other transfers [\$73 million in June of last year].**

GENERAL FUNDS RECEIPTS: APRIL

FY 2008 vs. FY 2007
(\$ million)

<u>Revenue Sources</u>	<u>April FY 2008</u>	<u>April FY 2007</u>	<u>\$ CHANGE</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$1,702	\$1,414	\$288	20.4%
Corporate Income Tax (regular)	461	484	(\$23)	-4.8%
Sales Taxes	586	553	\$33	6.0%
Public Utility Taxes (regular)	134	77	\$57	74.0%
Cigarette Tax	29	29	\$0	0.0%
Liquor Gallonage Taxes	11	13	(\$2)	-15.4%
Vehicle Use Tax	3	3	\$0	0.0%
Inheritance Tax (Gross)	31	22	\$9	40.9%
Insurance Taxes and Fees	36	42	(\$6)	-14.3%
Corporate Franchise Tax & Fees	25	15	\$10	66.7%
Interest on State Funds & Investments	17	17	\$0	0.0%
Cook County IGT	15	26	(\$11)	-42.3%
Other Sources	39	38	\$1	2.6%
Subtotal	\$3,089	\$2,733	\$356	13.0%
Transfers				
Lottery	60	50	\$10	20.0%
Riverboat transfers & receipts	35	40	(\$5)	-12.5%
Other	70	182	(\$112)	-61.5%
Total State Sources	\$3,254	\$3,005	\$249	8.3%
Federal Sources	\$510	\$389	\$121	31.1%
Total Federal & State Sources	\$3,764	\$3,394	\$370	10.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$132)	(\$138)	\$6	-4.3%
Corporate Income Tax	(\$72)	(85)	\$13	-15.3%
Subtotal General Funds	\$3,560	\$3,171	\$389	12.3%
Short-Term Borrowing	\$1,200	\$0	\$1,200	N/A
Hopital Provider Fund (cash flow transfer)	\$0	\$167	(\$167)	N/A
Budget Stabilization Fund Transfer	\$0	\$0	\$0	N/A
Total General Funds	\$4,760	\$3,338	\$1,422	42.6%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				1-May-08

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2008 vs. FY 2007
(\$ million)

<u>Revenue Sources</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>CHANGE FROM FY 2007</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$9,174	\$8,403	\$771	9.2%
Corporate Income Tax (regular)	1,786	1,752	\$34	1.9%
Sales Taxes	5,996	5,929	\$67	1.1%
Public Utility Taxes (regular)	987	924	\$63	6.8%
Cigarette Tax	292	292	\$0	0.0%
Liquor Gallonage Taxes	132	130	\$2	1.5%
Vehicle Use Tax	27	27	\$0	0.0%
Inheritance Tax (Gross)	321	220	\$101	45.9%
Insurance Taxes and Fees	233	245	(\$12)	-4.9%
Corporate Franchise Tax & Fees	191	162	\$29	17.9%
Interest on State Funds & Investments	171	171	\$0	0.0%
Cook County IGT	208	204	\$4	2.0%
Other Sources	346	343	\$3	0.9%
<i>Subtotal</i>	\$19,864	\$18,802	\$1,062	5.6%
Transfers				
Lottery	537	497	\$40	8.0%
Riverboat transfers & receipts	489	495	(\$6)	-1.2%
Other	442	686	(\$244)	-35.6%
<i>Total State Sources</i>	\$21,332	\$20,480	\$852	4.2%
Federal Sources				
<i>Total Federal & State Sources</i>	\$3,973	\$4,010	(\$37)	-0.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$711)	(\$819)	\$108	-13.2%
Corporate Income Tax	(\$277)	(\$307)	\$30	-9.8%
<i>Subtotal General Funds</i>	\$24,317	\$23,364	\$953	4.1%
Short-Term Borrowing	\$2,400	\$900	\$1,500	166.7%
Hospital Provider Fund (cash flow transfer)	\$300	\$456	(\$156)	-34.2%
Budget Stabilization Fund Transfer	\$276	\$276	\$0	0.0%
<i>Total General Funds</i>	\$27,293	\$24,996	\$2,297	9.2%
SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.				
CGFA				1-May-08

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2008 ESTIMATE vs. FY 2007 ACTUAL

(\$ million)

<u>Revenue Sources</u>	Mar-08 ESTIMATE FY 2008	FYTD 2008	AMOUNT NEEDED FY 2008 EST.	FYTD 2007	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	\$11,100	\$9,174	\$1,926	\$8,403	(\$95)	-4.7%
Corporate Income Tax (regular)	2,153	1,786	\$367	1,752	(\$2)	-0.5%
Sales Taxes	7,156	5,996	\$1,160	5,929	(\$47)	-3.9%
Public Utility Taxes (regular)	1,140	987	\$153	924	(\$54)	-26.1%
Cigarette Tax	350	292	\$58	292	\$0	0.0%
Liquor Gallonage Taxes	160	132	\$28	130	\$2	7.7%
Vehicle Use Tax	33	27	\$6	27	\$0	0.0%
Inheritance Tax (Gross)	360	321	\$39	220	(\$5)	-11.4%
Insurance Taxes and Fees	325	233	\$92	245	\$27	41.5%
Corporate Franchise Tax & Fees	220	191	\$29	162	(\$2)	-6.5%
Interest on State Funds & Investments	185	171	\$14	171	(\$19)	-57.6%
Cook County IGT	302	208	\$94	204	(\$9)	-8.7%
Other Sources	453	346	\$107	343	\$1	0.9%
Subtotal	\$23,937	\$19,864	\$4,073	\$18,802	(\$203)	-4.7%
Transfers						
Lottery	675	537	\$138	497	\$13	10.4%
Riverboat transfers & receipts	625	489	\$136	495	(\$54)	-28.4%
Other	598	442	\$156	686	(\$97)	-38.3%
Total State Sources	\$25,835	\$21,332	\$4,503	\$20,480	(\$341)	-7.0%
Federal Sources	\$4,804	\$3,973	\$831	\$4,010	\$138	19.9%
Total Federal & State Sources	\$30,639	\$25,305	\$5,334	\$24,490	(\$203)	-3.7%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$860)	(\$711)	(\$149)	(\$819)	\$48	-24.4%
Corporate Income Tax	(334)	(\$277)	(\$57)	(307)	\$7	-10.9%
Subtotal General Funds	\$29,445	\$24,317	\$5,128	\$23,364	(\$148)	-2.8%
Short-Term Borrowing	\$1,200	\$2,400	(\$1,200)	\$900	(\$1,200)	N/A
Hospital Provider Fund (cash flow transfer)	\$300	\$300	\$0	\$456	\$0	N/A
Budget Stabilization Fund Transfer	\$276	\$276	\$0	\$276	\$0	N/A
Total General Funds	\$31,221	\$27,293	\$3,928	\$24,996	(\$1,348)	-25.5%
CGFA estimate updated to reflect actual short-term borrowing						
						1-May-08

GENERAL FUNDS GROWTH NEEDED TO MEET GOMB ESTIMATE

FY 2008 ESTIMATE vs. FY 2007 ACTUAL

(\$ million)

<u>Revenue Sources</u>	Feb-08 ESTIMATE FY 2008	FYTD 2008	AMOUNT NEEDED FY 2008 EST.	FYTD 2007	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	\$11,136	\$9,174	\$1,962	\$8,403	(\$59)	-2.9%
Corporate Income Tax (regular)	2,121	1,786	\$335	1,752	(\$34)	-9.2%
Sales Taxes	7,172	5,996	\$1,176	5,929	(\$31)	-2.6%
Public Utility Taxes (regular)	1,111	987	\$124	924	(\$83)	-40.1%
Cigarette Tax	350	292	\$58	292	\$0	0.0%
Liquor Gallonage Taxes	159	132	\$27	130	\$1	3.8%
Vehicle Use Tax	30	27	\$3	27	(\$3)	-50.0%
Inheritance Tax (Gross)	315	321	(\$6)	220	(\$50)	-113.6%
Insurance Taxes and Fees	320	233	\$87	245	\$22	33.8%
Corporate Franchise Tax & Fees	215	191	\$24	162	(\$7)	-22.6%
Interest on State Funds & Investments	204	171	\$33	171	\$0	0.0%
Cook County IGT	302	208	\$94	204	(\$9)	-8.7%
Other Sources	502	346	\$156	343	\$50	47.2%
Subtotal	\$23,937	\$19,864	\$4,073	\$18,802	(\$203)	-4.7%
Transfers						
Lottery	657	537	\$120	497	(\$5)	-4.0%
Riverboat transfers & receipts	636	489	\$147	495	(\$43)	-22.6%
Other	678	442	\$236	686	(\$17)	-6.7%
Total State Sources	\$25,908	\$21,332	\$4,576	\$20,480	(\$268)	-5.5%
Federal Sources	\$4,804	\$3,973	\$831	\$4,010	\$138	19.9%
Total Federal & State Sources	\$30,712	\$25,305	\$5,407	\$24,490	(\$130)	-2.3%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$863)	(\$711)	(\$152)	(\$819)	\$45	-22.8%
Corporate Income Tax	(329)	(\$277)	(\$52)	(307)	\$12	-18.8%
Subtotal General Funds	\$29,520	\$24,317	\$5,203	\$23,364	(\$73)	-1.4%
Short-Term Borrowing	\$1,200	\$2,400	(\$1,200)	\$900	(\$1,200)	N/A
Hospital Provider Fund (cash flow transfer)	\$300	\$300	\$0	\$456	\$0	N/A
Budget Stabilization Fund Transfer	\$276	\$276	\$0	\$276	\$0	N/A
Total General Funds	\$31,296	\$27,293	\$4,003	\$24,996	(\$1,273)	-24.1%
CGFA estimate updated to reflect actual short-term borrowing						
						1-May-08