IEFC

Illinois Economic and Fiscal Commission

MONTHLY REVENUE BRIEFING MAY 2003

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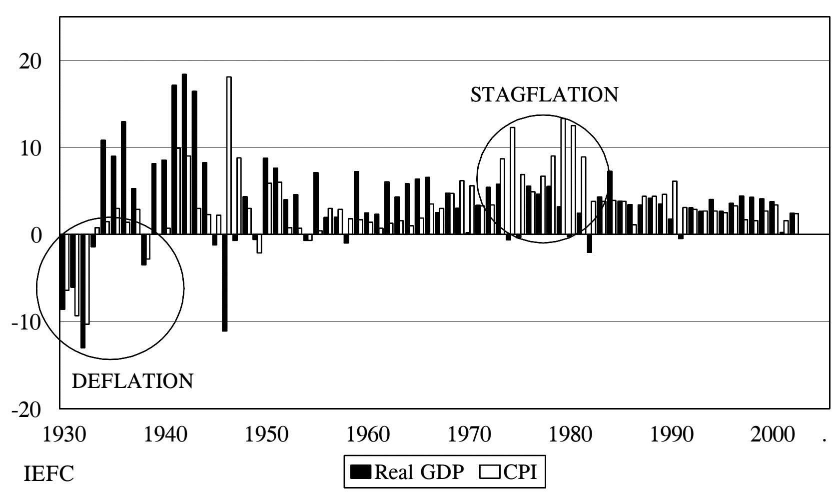
ECONOMY: The Dreaded "**D**" Word
Edward H. Boss, Jr., Chief Economist

No, it's not depression, it's fear of ***deflation*** that has captured the imagination of financial analysts, not to mention policymakers in recent months. Deflation is generally defined as a prolonged period of declining prices. It can be either a good or bad event. Good deflation is when growth rises faster than prices and productivity is strong so that profits increase. This is somewhat true in China today. Bad deflation was experienced here in the late 1920s and 1930s and in Japan today. It is where prices decline and economic growth deteriorates.

As shown in Chart 1, in the late 1920s and early 1930s consumer prices, as measured by the CPI, were in decline and there was an accompanying collapse in the economy with real GDP falling sharply. A following upturn in economic activity in 1934 through 1937 brought with it hopes that the depression was over, only to be thwarted by the economy contracting again in 1938. It wasn't until the buildup and finally U.S. entrance into World War II that the deflationary period came to an end and the economy improved.

CHART 1

CHANGE IN REAL GDP & CPI



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Currently, prices as measured by the CPI are up a modest 2.2% over the past 12-months, but only the apparel group shows an actual decline. The core rate, which excludes the volatile food and energy sectors, is up a more modest 1.5% over the past year. The fear is that if aggregate corporate and personal income weaken at the same time as prices, that it will lead to more cuts in production, prices, and income – a vicious cycle.

Many point to conditions in Japan where, after being the economic miracle of the 1980s, growth faltered sharply. From 1992-2002, the average GDP growth rate in Japan was a modest 0.7%. The economy hit its third recession in the past decade in the summer of 2001, accompanied by rising unemployment and persistent deflation. Some improvement occurred last year, but prospects are slowing again this year.

While prices in Japan are falling, inflation has slowed to below 1% in Germany and concerns are this trend could follow in the U.S., U.K. and Canada. Indeed, Federal Reserve Chairman Greenspan addressed this deflationary concern in recent Congressional testimony. He stated that the Fed is ready and able to do whatever is necessary to guard against the remote possibility that a weak economy will trigger a debilitating bout of falling prices.

The current concerns over deflation are in marked contrast to the late 1970s and early 1980s when soaring prices led to slowing economic activity. This so-called period of stagflation – stagnant growth accompanied by rapid price increases – became the major concern of policymakers and it took the twin recessions of the 1980s to break the upward pressure on prices at the time. (See Chart).

Price changes and economic activity have a major impact on State financial conditions. Weakening economic activity not only increase State needs through such services as unemployment compensation, Medicaid, and other social services, but reduced income from wages, salaries, and profits eat into revenues. Similarly, slowing or lower prices cut into revenue gains as sales taxes are expressed as a percentage of total prices paid.

The goal of monetary policy is "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Oftentimes, however, employing measures to achieve one of these goals may be in conflict with achieving others. Also, what may be good policy in the long run may be disruptive to the markets in the short turn and vise versa. Thus, the Fed must walk a tight rope over time to balance its objectives.

Currently, with assurances from the Fed, it has the ability to further stimulate the economy and has not run out of monetary ammunition. At the same time, increased government spending and further tax reductions should provide stimulus from the federal government. These factors, when coupled with the end of hostilities in Iraq, hopefully will be sufficient to raise confidence, increase spending, and remove the threat of a deflationary spiral that could lead to weakening economic conditions.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	April 2003	March 2003	April 2002
Unemployment Rate (Average)	6.3%	6.6%	6.5%
Annual Rate of Inflation (Chicago)	-9.1%	4.6%	1.4%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (April)	6,375	-0.3%	-0.2%
Employment (thousands) (April)	5,975	0.0%	0.0%
New Car & Truck Registration (April)	52,506	-3.2%	-18.1%
Single Family Housing Permits (April)	4,252	19.4%	-6.6%
Total Exports ($ mil) (March)	2,276	14.3%	1.7%
Chicago Purchasing Managers Index (May)	52.2	9.7%	-14.1%

SHORT-TERM BORROWING

Lynnae Kapp, Bond Analyst

In May 2003, the State issued $1.5 billion in General Obligation Certificates to pay off overdue bills. The distribution of the proceeds were as follows:

- $700 million to the general funds for Medicaid,
- $50 million to the Long Term Care Provider Fund to pay medical providers of long term care,
- $475 million for corporate and personal income tax refunds, and
- $275 million to the general funds to make State Aid Payments to K-12 school districts.

The notes were sold in May of 2003 and are to be paid back within a year during FY 2004. The repayment schedule is as follows:

Maturity Date	Principal Paid	Rate of Interest
January 15, 2004	$300 million	2.0%
March 15, 2004	$250 million	1.5%
April 15, 2004	$450 million	2.0%
May 15, 2004	$500 million	1.5%
Source: Official Statement Addendum, May 20, 2003		

This is referred to as "across fiscal year" short-term borrowing used for a deficit due to emergencies or failures of revenues. Up to 15% of the State's appropriations for the fiscal year may be incurred and must be repaid within one year.

The State can also borrow within a fiscal year if the short-term debt is to be used for cash flow purposes. Up to 5% of the State's appropriations for the fiscal year may be incurred and must be repaid by the end of that fiscal year. At the beginning of FY 2003, $1.0 Billion in federally tax-exempt Revenue Anticipation Certificates were sold (July 16, 2002) at an interest rate of 1.43% to meet the cash flow problems of the State. The proceeds from this sale were available July 23 and disbursed as follows:

- $700 million into the general funds to relieve general cash flow pressures and to provide for the payment of appropriated amounts for medical assistance under the Illinois Public Aid Code- to be paid back from the General Revenue Fund.
- $150 million into the Income Tax Refund Fund-to be paid back from this fund.

- $150 million into the Long Term Care Provider Fund to pay medical providers for their medical assistance under the Public Aid Code - to be paid back from this fund.

Of the $2.5 billion in combined short-term borrowing sales in FY 2003, the General Revenue Fund will have received $1.675 billion to assist with cash flow.

REVENUE

Revenues Jump as Federal Receipts Rebound

Jim Muschinske, Revenue Manager

Overall general funds revenue rose $248 million in May as receipts from federal sources and transfers increased significantly. Absent those areas, State tax sources showed modest improvement even though May had one less receipting day than in the previous year.

Due to the timing of receipts, the Cook County intergovernmental transfer was up $44 million for the month. Gross personal income tax managed to gain $22 million ($18 million net of refunds), while other sources produced $14 million in gains. Other advancers included: sales tax receipts $11 million; corporate franchise taxes $2 million; gross corporate income taxes $2 million ($0 net of refunds); and insurance taxes $1 million.

Despite an overall monthly increase, a few revenue sources experienced a decline in revenue. Inheritance tax fell $15 million, while interest earnings fell $4 million. Public utility tax revenues slipped $2 million and the vehicle use tax dipped $1 million.

May was a very good month for transfers as they rose $48 million. Other transfers rose $42 million due to an anticipated large transfer while Lottery transfers contributed $6 million in gains. Gaming Fund transfers, however, were flat for May. As mentioned earlier, federal sources enjoyed a strong month as receipts rose $132 million due in large part to reimbursable spending made possible by the short-term borrowing in May (see earlier section).

Year to Date

With only one month remaining in FY 2003, overall general revenue receipts (excluding short-term borrowing and Budget Stabilization Fund transfers) are down $24 million or 0.1%.

Gross personal income tax revenues are down $95 million ($116 million net of refunds) while inheritance taxes are off $80 million. Interest earnings have declined $69 million and public utility taxes have given up $54 million. Gross corporate income taxes are down $37 million ($63 million net of refunds) while other sources experiencing declines total an additional $14 million.

Relatively few sources have experienced yearly gains thus far in FY 2003. Other sources are up $113 million for the year, however, all of that gain will be more than lost in June as the anticipated Build Illinois general reserve account transfer will be approximately $250 million less than last year. The Cook County intergovernmental transfer is up $110 million due to changes in the agreement. Insurance taxes and fees have continued to perform well for most of the year and are up $35 million thus far, while liquor receipts have managed to contribute a modest $2 million gain.

Through May, overall transfers are up $229 million. Gaming Fund transfers are up $90 million, which reflects the restructured gaming taxes and fees, while other transfers are $169 million higher as a result of one-time interfund transfers. Lottery transfers are down $30 million thus far in FY 2003. Despite the surge in May, Federal sources are off $117 million.

In order to reach the Commission's latest estimate, presented in May 2003, overall revenues must decline $401 million over the remaining month. As described earlier, over $250 million of that decline is expected from a significant reduction in June's Build Illinois reserve transfer.

GENERAL FUNDS RECEIPTS: MAY

FY 2003 vs. FY 2002
($ million)

Revenue Sources	**MAY FY 2003**	**MAY FY 2002**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$685	$663	$22	3.3%
Corporate Income Tax (regular)	35	33	$2	6.1%
Sales Taxes	521	510	$11	2.2%
Public Utility Taxes (regular)	87	89	($2)	-2.2%
Cigarette Tax	33	33	$0	0.0%
Liquor Gallonage Taxes	11	11	$0	0.0%
Vehicle Use Tax	3	4	($1)	-25.0%
Inheritance Tax (Gross)	15	30	($15)	-50.0%
Insurance Taxes and Fees	2	1	$1	100.0%
Corporate Franchise Tax & Fees	15	13	$2	15.4%
Interest on State Funds & Investments	4	8	($4)	-50.0%
Cook County IGT	44	0	$44	N/A
Other Sources	27	13	$14	107.7%
Subtotal	$1,482	$1,408	$74	5.3%
Transfers				
Lottery	42	36	$6	16.7%
Gaming Fund Transfer	40	40	$0	0.0%
Other	62	20	$42	210.0%
Total State Sources	$1,626	$1,504	$122	8.1%
Federal Sources	$608	$476	$132	27.7%
Total Federal & State Sources	$2,234	$1,980	$254	12.8%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($55)	($51)	($4)	7.8%
Corporate Income Tax	($9)	(7)	($2)	28.6%
Subtotal General Funds	$2,170	$1,922	$248	12.9%
Short-Term Borrowing	$975	$0	$975	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$3,145	$1,922	$1,223	63.6%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Jun-03

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2003 vs. FY 2002

($ million)

Revenue Sources	FY 2003	FY 2002	CHANGE FROM FY 2002	% CHANGE
State Taxes				
Personal Income Tax	$7,294	$7,389	($95)	-1.3%
Corporate Income Tax (regular)	855	892	($37)	-4.1%
Sales Taxes	5,536	5,538	($2)	0.0%
Public Utility Taxes (regular)	953	1,007	($54)	-5.4%
Cigarette Tax	366	366	$0	0.0%
Liquor Gallonage Taxes	113	111	$2	1.8%
Vehicle Use Tax	31	34	($3)	-8.8%
Inheritance Tax (Gross)	220	300	($80)	-26.7%
Insurance Taxes and Fees	252	217	$35	16.1%
Corporate Franchise Tax & Fees	132	141	($9)	-6.4%
Interest on State Funds & Investments	60	129	($69)	-53.5%
Cook County IGT	332	222	$110	49.5%
Other Sources	285	172	$113	65.7%
Subtotal	$16,429	$16,518	($89)	-0.5%
Transfers				
Lottery	469	499	($30)	-6.0%
Gaming Fund Transfer	510	420	$90	21.4%
Other	541	372	$169	45.4%
Total State Sources	$17,949	$17,809	$140	0.8%
Federal Sources	$3,671	$3,788	($117)	-3.1%
Total Federal & State Sources	$21,620	$21,597	$23	0.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($583)	($562)	($21)	3.7%
Corporate Income Tax	($231)	($205)	($26)	12.7%
Subtotal General Funds	$20,806	$20,830	($24)	-0.1%
Short-Term Borrowing	$1,675	$0	$1,675	N/A
Budget Stabilization Fund Transfer	$226	$226	$0	0.0%
Total General Funds	$22,707	$21,056	$1,651	7.8%

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

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GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2003 ESTIMATE vs. FY 2002 ACTUAL

($ million)

Revenue Sources	*May-03 ESTIMATE FY 2003	FYTD 2003	AMOUNT NEEDED FY 2003 EST.	FYTD 2002	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$7,950	$7,294	$656	$7,389	($41)	-5.9%
Corporate Income Tax (regular)	985	855	$130	892	($21)	-13.9%
Sales Taxes	6,025	5,536	$489	5,538	($24)	-4.7%
Public Utility Taxes (regular)	1,025	953	$72	1,007	($25)	-25.8%
Cigarette Tax	400	366	$34	366	$0	0.0%
Liquor Gallonage Taxes	125	113	$12	111	$0	0.0%
Vehicle Use Tax	35	31	$4	34	$0	0.0%
Inheritance Tax (Gross)	250	220	$30	300	$1	3.4%
Insurance Taxes and Fees	310	252	$58	217	$3	5.5%
Corporate Franchise Tax & Fees	145	132	$13	141	($5)	-27.8%
Interest on State Funds & Investments	65	60	$5	129	($1)	-16.7%
Cook County IGT	385	332	$53	222	$30	130.4%
Other Sources	357	285	$72	172	($268)	-78.8%
Subtotal	$18,057	$16,429	$1,628	$16,518	($351)	-17.7%
Transfers						
Lottery	534	469	$65	499	$9	16.1%
Gaming Fund Transfer	580	510	$70	420	$20	40.0%
Other	610	541	$69	372	($13)	-15.9%
Total State Sources	$19,781	$17,949	$1,832	$17,809	($335)	-15.5%
Federal Sources	$4,075	$3,671	$404	$3,788	($66)	-14.0%
Total Federal & State Sources	$23,856	$21,620	$2,236	$21,597	($401)	-15.2%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($636)	($583)	($53)	($562)	$0	0.0%
Corporate Income Tax	(266)	(231)	($35)	(205)	$0	0.0%
Subtotal General Funds	$22,954	$20,806	$2,148	$20,830	($401)	-15.7%
Short-Term Borrowing	$1,675	$1,675	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$226	$226	$0	$226	$0	N/A
Proceeds from Pension Obligation Bonds	$300	$0	$300	$0	$300	N/A
Total General Funds	$25,155	$22,707	$2,448	$21,056	($101)	-4.0%

****The May estimate reflects actual short-term borrowing proceeds rather than preliminary figures used earler. In addition, $144 million in proposed deficit reduction measures (interfund transfers) has been removed per SB 1903 leaving only the proceeds from the sale of Pension obligation bonds as deficit reduction revenues in FY 2003.***

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