



Commission on Government Forecasting and Accountability

MONTHLY BRIEFING FOR THE MONTH ENDED: MAY 2012

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ECONOMY: Soft Patch Confirmed, What Now?

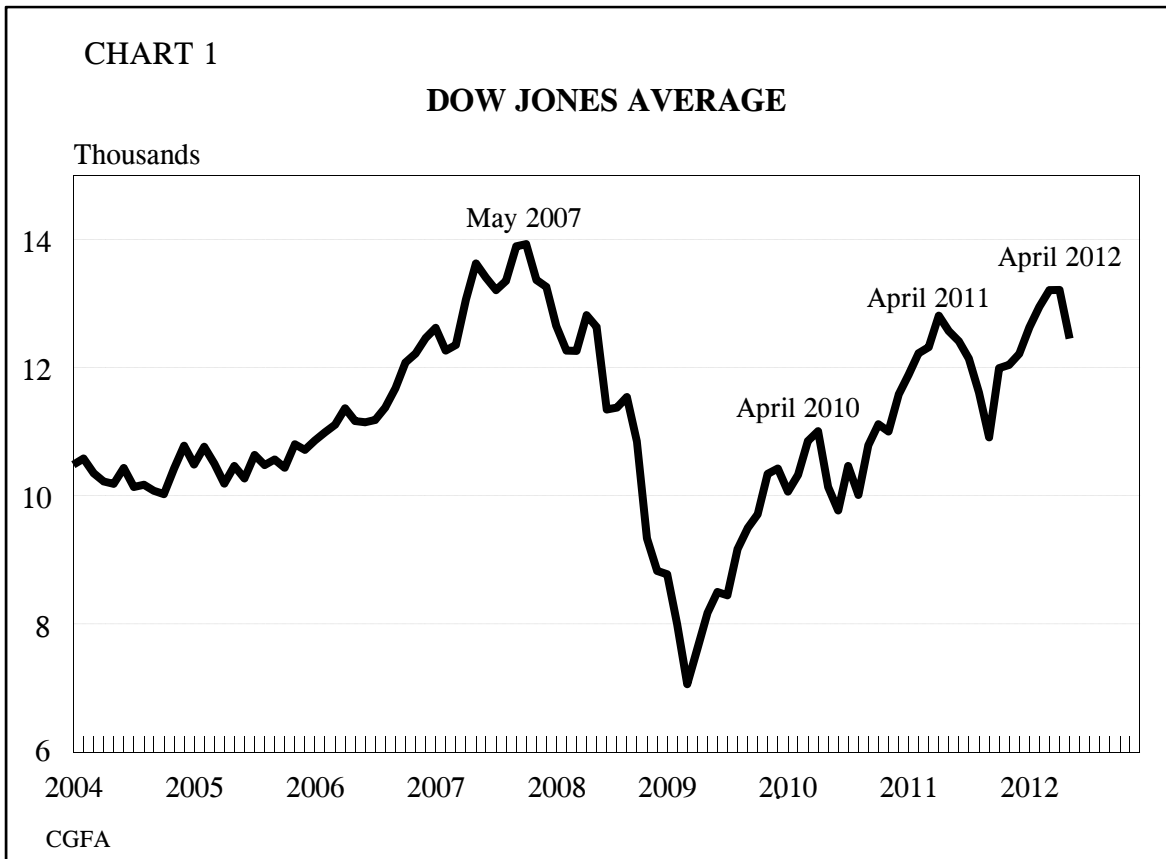
Edward H. Boss, Jr., Chief Economist

Last month this section of the Monthly Revenue Briefing suggested the economy may have hit another “soft patch”, repeating the pattern that occurred in both the spring of 2010 and 2011. Since then several business reports seem to confirm that supposition.

In measuring the largest spending component of GDP growth- the consumer- retail sales barely grew in April from the previous month and slowed its increase on a year-over-year basis. Claims for unemployment insurance, which had fallen over the winter months, started climbing in April; the service sector of the economy also slipped in April, and the Conference Board’s Index of Leading Economic Indicators- designed to show where the economy is headed in coming months- slipped in April falling 0.1% after rising 0.3% in March.

In addition to these domestic factors, renewed financial stresses in the Euro Zone present another set of uncertainties that can have negative effects on the pace of the U.S. economic advance in the months ahead. For example, one of the stronger components to U.S. growth have been net exports, but with many countries in Europe, which account for about 20% of U.S. exports, in or near recession and growth in China slowing, demand for U.S. products will undoubtedly soften. In addition, with the Euro falling in relation to the U.S. dollar, strengthening the dollar’s value, it has reduced U.S. price competitiveness, raising the cost of goods, even as demand for them is weakening.

Perhaps the clearest sign indicating an economic soft patch, however, is simply shown by the performance of the stock market. Indeed the stock market is considered a leading



economic indicator. The problem is it is not definitive, that is while it systematically leads an economic downturn, it also can give off false signals. A common saying among economists is that the stock market has correctly predicted 11 of the past 7 recessions.

A look at the attached chart illustrates this pattern. Simply looking at the Dow Jones Industrial Average, the index peaked in April 2010, April 2011, and April 2012 followed by declines. In both 2010 and 2011, the market resumed an upward course and, while there were fears of a double-dip recession at those times, the period was followed by slow growth but no recession. In contrast, the stock average peaked around the same time in May 2007, but this time was followed by

a sharp and prolonged decline that foreshadowed the longest recession in at least the post WWII period.

Which course the economy takes following the recent peak in the stock market may well depend not only by events in the Euro Zone but also policy decisions made at home. As mentioned last month, “The courts have yet to announce its decision on Obama care; the reduction in payroll taxes and extension of lower tax rates and expanded credits and deductions are set to expire at the end of the year, and additional savings of more than \$1 trillion are required by the Budget Control Act.” How these as well as the implications of a myriad of new regulations are resolved may well determine which course the economy takes.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	<u>April 2012</u>	<u>March 2012</u>	<u>April 2011</u>
Unemployment Rate (Average)	8.7%	8.8%	9.5%
Annual Rate of Inflation (Chicago)	0.4%	14.9%	1.7%
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	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (April)	6,592	0.1%	0.6%
Employment (thousands) (April)	6,020	0.2%	1.5%
New Car & Truck Registration (March)	42,164	24.1%	-2.2%
Single Family Housing Permits (April)	729	-12.9%	11.8%
Total Exports (\$ mil) (March)	6,180	5.5%	7.7%
Chicago Purchasing Managers Index (May)	52.7	-6.2%	-6.9%



May 2012 Bond Sales

Lynnae Kapp, Senior Bond Analyst

In May 2012, the State sold \$425 million in Build Illinois bonds getting a true interest cost of 3.566%. Bond proceeds will be used for projects under the State's multi-year \$31 billion capital plan. The State also sold \$1.798 billion in General Obligation Refunding bonds with a true interest cost of 3.35% and a net present value savings of \$157 million. New project G.O. Bond sales for FY 2012 have reached \$1.375 billion while Build Illinois Bond sales have reached \$725 million.

In January 2012, the three rating agencies gave their analysis on where the State stands. Fitch reaffirmed it's A rating with a stable outlook, while Standard & Poor's reaffirmed their ratings of an A+ with a negative outlook. Moody's downgraded Illinois' G.O. Bond rating from A1 to A2 and

gave the State a stable outlook. They also downgraded the State's Build Illinois Bonds from A1 to A2, the Metropolitan Pier & Exposition Authority's Bonds and State Civic Center Bonds from A2 to A3. Moody's also put the State's public universities on watch for possible downgrades due to their receipt of State funding, payments of which have been consistently late. As of the May bond sales, all three rating agencies reaffirmed their ratings for the State's General Obligation rating, but gave the following commentary.

***S&P (May 2012):** The negative outlook reflects the state's large accumulated deficit and improved but still elusive structural budget balance despite significant revenue enhancement for the current financial plan period. The*

accumulated deficit continues to pressure Illinois' overall financial condition and liquidity, in our view. If the state does not implement meaningful changes to further align revenue and spending and address its accumulated deficit (accounts payable and general fund liabilities) for fiscal 2013, we could lower the rating this year. The outlook also reflects ongoing weakness in the state's pension funds and lack of action to meaningfully address the liability. A downgrade could also be triggered if pension funding levels continue to deteriorate and the state makes no credible progress in addressing the liability. Furthermore, we could also lower the rating by more than one notch if there is no progress on structural budget solutions and if Illinois does not address the significant pension liabilities and associated cost pressure. As with all states, Standard & Poor's will continue to monitor the federal consolidation efforts stemming from the Budget Control Act and, once these are identified, will evaluate their effect on the state's finances and officials' response to these revenue reductions. If solutions are implemented to address Illinois' significant pension liability and revenues and expenditures are successfully aligned for fiscal 2013, thereby stabilizing the state's finances, we could revise the outlook to stable. We do not believe there is upside potential to the rating in the next year given the range of budget and liability challenges Illinois faces.

Fitch Ratings (April 19, 2012):
Trigger(s) for negative rating action -

Deterioration in the state's financial position, as evidenced by excessive use of non-recurring revenues or additional payment deferrals in the budget, could lead to negative rating action. Also, pushing up against the expiration of temporary tax increases in fiscal 2015 without a solution in place would put extreme pressure on the budget and likely lead to a rating action.

Trigger(s) for Positive Rating Action - A return to balanced general fund operations with limited use of non-recurring budget solutions and implementation of a comprehensive approach to reducing the accounts payable backlog that does not significantly exacerbate the state's already high debt position.

Moody's (April 17, 2012): Illinois' general obligation bond rating was lowered to A2 from A1 on January 6 because of the state's failure last year to implement solutions to its largest credit challenges: severe pension underfunding and chronic bill-payment delays. It remains to be seen whether the state has the political will to impose new pension reforms and other measures that restore fiscal strength in the near term. The stable outlook acknowledges an ability to reach consensus on difficult decisions, such as temporary tax increases enacted early in 2011 that allowed Illinois to end reliance on deficit bonds to finance annual pension contributions. Sovereign revenue and spending powers, as well as state legal provisions giving payment of G.O. debt service priority over other expenditures, also help support Illinois' stable outlook.

ILLINOIS GENERAL OBLIGATION BOND RATINGS										
RATING	July	June	June	May	Dec	Mar-July	Dec	Mar-Apr	June	January
AGENCIES	1997	1998	2000	2003	2008	2009	2009	2010	2010	2012
Fitch Ratings	AA	AA	AA+	AA	AA-	A	A	A-/A+*	A	A
Standard & Poor's	AA	AA	AA	AA	AA	AA-	A+	A+	A+	A+
Moody's	Aa3	Aa2	Aa2	Aa3	Aa3	A1	A2	A2/Aa3*	A1	A2

*Fitch and Moody's recalibrated their Municipal Bond ratings to be on a scale with their global ratings, thereby moving Illinois up to A+ and Aa3, respectively. These are NOT considered upgrades.

BUILD ILLINOIS BOND RATINGS						
Rating	Apr/July	Oct	Dec	Mar-Apr	June	January
Agencies	2009	2009	2009	2010*	2010	2012
Fitch Ratings	AA	AA	AA	AA+	AA+	AA+
Standard & Poor's	AAA	AAA	AAA	AAA	AAA	AAA
Moody's	Aa3	A1	A2	Aa3	A1	A2

*Fitch and Moody's Recalibration.

REVENUE

May Revenues Rise As Federal Sources Grow

Jim Muschinske, Revenue Manager

Overall base revenues grew \$474 million in May. The significant growth was largely due to federal sources. After struggling for most of the year, a significant increase in reimbursable spending resulted in higher receipts. In addition, the economic related sources also performed favorably. May had one extra receipting day when compared to last year.

Gross personal income tax revenues rose \$103 million or \$94 million net of refunds. Gross corporate income tax again performed well—up \$45 million or \$37 million net of refunds. Sales tax continues to surpass expectations, growing \$28 million in May. As expected, inheritance tax

receipts jumped as a consequence of tax changes that went into effect January 2011, up \$17 million. Other sources grew \$5 million, insurance taxes and fees increased \$4 million, corporate franchise taxes were up \$2 million, interest earnings posted \$2 million in gains, and vehicle use tax eked out a \$1 million advance.

In contrast public utility taxes dropped \$12 million in May, while cigarette taxes dipped \$1 million.

Overall transfers increased \$3 million in May as lottery, riverboat, and other transfers each posted \$1 million in monthly gains. After consistently posting significant declines month after

month, federal sources posted a robust gain of \$294 million, again reflecting higher reimbursable spending.

Year to Date

Through May, absent short-term borrowing, tobacco settlement proceeds, Pension Contribution Fund transfers and Budget Stabilization Fund transfers, base general funds revenues are up \$3.072 billion. The increase has been 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 resulting 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 ended].

To date, gross personal income taxes are up \$4.609 billion, or \$4.206 billion net of refunds. Gross corporate income taxes are up \$625 million, or \$543 million net of refunds. Sales taxes increased \$374 million, while all other revenue sources declined \$5 million.

Overall transfers are down \$302 million, primarily as a result of \$496 million of interfund borrowing that took place last fiscal year. Other transfers are \$396 million lower, while regular riverboat transfers are up \$14 million [the final payment of \$73 million is related to the sale of the 10th license]. Lottery transfers are up \$7 million for the year. Despite a positive April and May, Federal source receipts have shown a significant drop in FY 2012, falling \$1.744 billion due to lower reimbursable spending as well as reduced reimbursement rates previously enjoyed under ARRA.

GENERAL FUNDS RECEIPTS: MAY**FY 2012 vs. FY 2011**

(\$ million)

Revenue Sources	May FY 2012	May FY 2011	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$1,400	\$1,297	\$103	7.9%
Corporate Income Tax (regular)	144	99	\$45	45.5%
Sales Taxes	596	568	\$28	4.9%
Public Utility Taxes (regular)	73	85	(\$12)	-14.1%
Cigarette Tax	29	30	(\$1)	-3.3%
Liquor Gallonage Taxes	12	12	\$0	0.0%
Vehicle Use Tax	3	2	\$1	50.0%
Inheritance Tax (Gross)	19	2	\$17	850.0%
Insurance Taxes and Fees	5	1	\$4	400.0%
Corporate Franchise Tax & Fees	17	15	\$2	13.3%
Interest on State Funds & Investments	3	1	\$2	200.0%
Cook County IGT	94	94	\$0	0.0%
Other Sources	32	27	\$5	18.5%
Subtotal	\$2,427	\$2,233	\$194	8.7%
Transfers				
Lottery	59	58	\$1	1.7%
Riverboat transfers & receipts	22	21	\$1	4.8%
Proceeds from Sale of 10th license	0	0	\$0	N/A
Other	70	69	\$1	1.4%
Total State Sources	\$2,578	\$2,381	\$197	8.3%
Federal Sources	\$458	\$164	\$294	179.3%
Total Federal & State Sources	\$3,036	\$2,545	\$491	19.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$123)	(\$114)	(\$9)	7.9%
Corporate Income Tax	(\$25)	(17)	(\$8)	47.1%
Subtotal General Funds	\$2,888	\$2,414	\$474	19.6%
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	\$2,888	\$2,414	\$474	19.6%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				4-Jun-12

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2012 vs. FY 2011
(\$ million)

<u>Revenue Sources</u>	<u>FY 2012</u>	<u>FY 2011</u>	<u>CHANGE FROM FY 2011</u>	<u>% CHANGE</u>
State Taxes				
Personal Income Tax	\$15,514	\$10,905	\$4,609	42.3%
Corporate Income Tax (regular)	2,498	1,873	\$625	33.4%
Sales Taxes	6,599	6,225	\$374	6.0%
Public Utility Taxes (regular)	932	1,046	(\$114)	-10.9%
Cigarette Tax	324	325	(\$1)	-0.3%
Liquor Gallonage Taxes	149	144	\$5	3.5%
Vehicle Use Tax	26	27	(\$1)	-3.7%
Inheritance Tax (Gross)	214	121	\$93	76.9%
Insurance Taxes and Fees	281	255	\$26	10.2%
Corporate Franchise Tax & Fees	180	191	(\$11)	-5.8%
Interest on State Funds & Investments	20	28	(\$8)	-28.6%
Cook County IGT	244	244	\$0	0.0%
Other Sources	366	360	\$6	1.7%
Subtotal	\$27,347	\$21,744	\$5,603	25.8%
Transfers				
Lottery	572	565	\$7	1.2%
Riverboat transfers & receipts	313	299	\$14	4.7%
Proceeds from Sale of 10th license	73	0	\$73	N/A
Other	729	1,125	(\$396)	-35.2%
Total State Sources	\$29,034	\$23,733	\$5,301	22.3%
Federal Sources				
Total Federal & State Sources	\$3,092	\$4,836	(\$1,744)	-36.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$1,357)	(\$954)	(\$403)	42.2%
Corporate Income Tax	(\$437)	(\$355)	(\$82)	23.1%
Subtotal General Funds	\$30,332	\$27,260	\$3,072	11.3%
Short-Term Borrowing	\$0	\$1,300	(\$1,300)	N/A
Tobacco Liquidation Proceeds	\$0	\$1,250	(\$1,250)	N/A
Pension Contribution Fund Transfer	\$0	\$224	(\$224)	N/A
Budget Stabilization Fund Transfer	\$275	\$335	(\$60)	-17.9%
Total General Funds	\$30,607	\$30,369	\$238	0.8%

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

CGFA

4-Jun-12