IEFC

Illinois Economic and Fiscal Commission

MONTHLY REVENUE BRIEFING JULY 2002

http:/www.legis.state.il.us/commission/ecfisc/ecfisc_home.html

SENATE
Patrick D. Welch, Co-Chair
Miguel del Valle
Rickey R. Hendon
Chris Lauzen
Steven Rauschenberger

HOUSE
Terry R. Parke, Co-Chair
Mark H. Beaubien, Jr.
Judy Erwin
Frank J. Mautino
Richard Myers
Jeffrey M. Schoenberg

EXECUTIVE DIRECTOR
Dan R. Long

DEPUTY DIRECTOR
Trevor J. Clatfelter

INSIDE THIS ISSUE

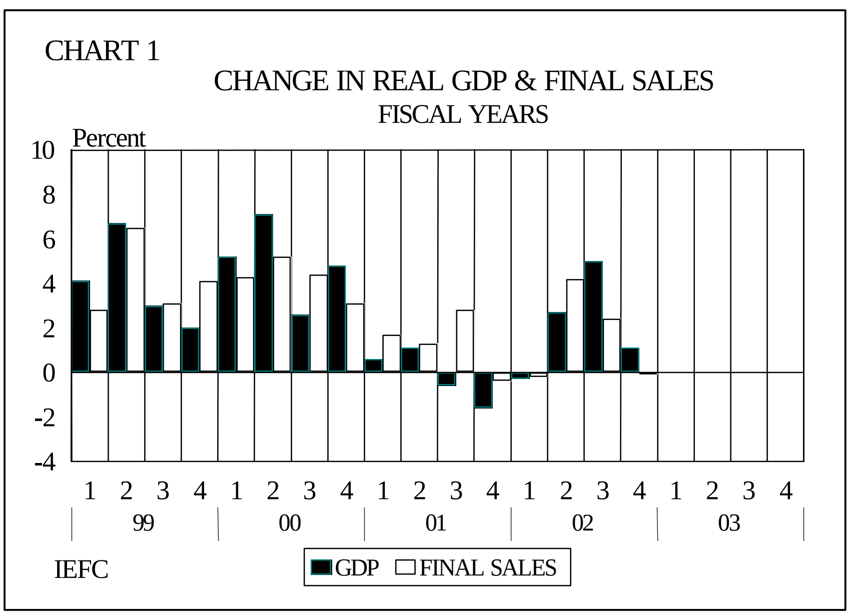
703 Stratton Ofc. Bldg.
Springfield, IL 62706

ECONOMY: Double Dip?

Edward H. Boss, Jr., Chief Economist

The economy continues to grow, albeit at a snails' pace, with the odds of another downturn low, but increasing. On Wednesday, the Commerce Department released its advance estimate of real gross domestic product (GDP) for the quarter ended in June. The latest data include the normal annual revisions to the national income accounts that extend back to 1999.

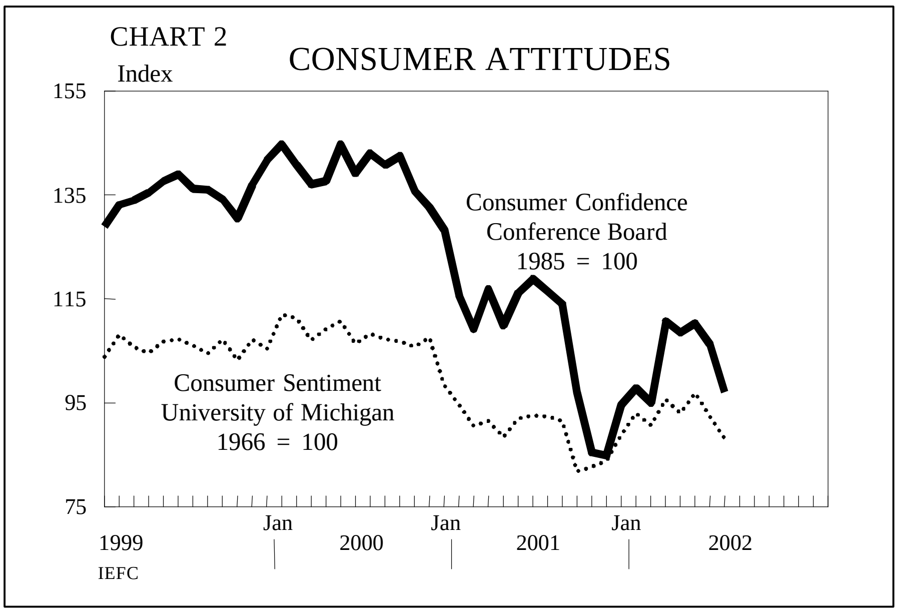
As depicted in Chart 1, the data now show that inflation-adjusted GDP grew at a meager annual rate of only 1.1% last quarter, down from a downwardly-revised 5.0% rate in the previous quarter. Moreover, GDP excluding the change in private inventories (final sales) decreased 0.1% in contrast to a 2.4% gain in the previous quarter.



Finally, the revisions now display an economy with three consecutive quarters of declining real GDP (the third quarter of FY 2001 through the first quarter of FY 2002) instead of only one quarter before the revisions. Thus, those who follow the "rule of thumb" that a recession must have at least two consecutive quarters of negative GDP will be satisfied that the recession call made by the National Bureau of Economic Research last November was correct.

The lowered GDP data, while surprising, now depict an economic picture that shows somewhat less of a disconnect with what was happening to State revenues last fiscal year, not to mention the performance of the equity markets. In addition to the GDP data, other recently-released business reports were less vigorous than expected.

As illustrated in Chart 2, consumer attitudes, measured by either the Conference Board or University of Michigan, already depict a double dip pattern with data released this week. This is disturbing since it has been the continued strength in consumer spending, which accounts for two-thirds of GDP, that has kept the recession mild, if not as short as previously thought.



The Chicago Manufacturing Index released on Wednesday also saw a sharper-than-expected fall to its lowest level since January. This dampened hopes for a strong rebound in the manufacturing sector which has been the hardest hit sector of the economy. Even with the fall, however, the index of manufacturing activity in the Midwest showed its sixth straight month of expansion, following 18 months where the index had been below 50, indicating a contraction.

Despite the recent negative economic news, there are many positives which suggest that while odds of a double-dip recession are rising, they still remain low. The softer data imply the Federal Reserve may keep rates steady for longer than earlier anticipated. As a result, declining mortgage rates have renewed refinancing activity, reducing consumer mortgage payments and freeing up spendable cash. In addition, auto manufacturers have again reduced lending rates, in some cases to zero, to spur sales. And, while the unemployment rate is high and could rise further, it is a lagging indicator and reduced initial unemployment insurance claims portray underlying improvement in the employment picture. Finally, the equity market, while extremely volatile, has risen sharply from its recent lows and handled this week's weaker economic news well. Thus, while the pace of the economy will be watched closely in the months ahead, the odds still favor continued growth and at a somewhat faster pace than that which occurred last quarter.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	June 2002	May 2002	June 2001
Unemployment Rate (Average)	6.3%	6.3%	5.3%
Annual Rate of Inflation (Chicago)	4.6%	3.3%	1.6%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (June)	6,287	-0.4%	-1.0%
Employment (thousands) (June)	5,892	-0.4%	-2.0%
New Car & Truck Registration (June)	59,165	-27.0%	-8.6%
Single Family Housing Permits (June)	3,891	-10.5%	-1.1%
Total Exports ($ mil) (May)	2,714	0.7%	0.9%
Chicago Purchasing Managers Index (July)	51.5	-11.5%	35.5%

SHORT-TERM BORROWING

Lynnae Kapp, Bond Analyst

The $1.0 billion in Revenue Anticipation Certificates were sold July 16 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;
- $150 million into the Income Tax Refund Fund; and
- $150 million into the Long Term Care Provider Fund to pay medical providers for their medical assistance under the Public Aid Code.

State short-term debt may be incurred for two reasons—to resolve cash flow problems or to meet deficits caused by emergencies or failures of revenue. If the short-term debt is to be used only for cash flow purposes, up to

5% of the State's appropriations for that fiscal year may be incurred and must be repaid by the end of that fiscal year. If used for budget deficit, up to 15% of the State's appropriations for that fiscal year may be incurred and must be repaid within one year. The State has done similar cash flow short-term borrowing in the past from 1983 to 1996, ranging from $100 million to $900 million.

On January 15, 2003, $100 million dollars of the certificates will reach maturity and be paid. The amount of $300 million will be paid in each of the following months to retire the remaining certificates: April 15, May 15, and June 15. The certificates are federally tax-exempt, but not State tax-exempt. General Revenue funds will be transferred to the General Obligation Bond Retirement and Interest Fund to pay for the Revenue Anticipation Certificates.

Fitch Ratings, Standard & Poor's, and Moody's have given these certificates their highest short-term debt ratings of F1+, SP-1+ and MIG 1, respectively, reflecting strong and superior credit quality. Although the certificates are not full faith and credit obligations of the State, they are secured by required transfers of <u>any</u> FY 2003 revenues in the Treasury (not just general funds) to pay off the debt without legislative action. This allows for a 4.5 times coverage level of the debt.

As for the State's fiscal operations, Fitch points to the "recent period of successful financial operations through fiscal 2001…(The) State addressed the $1.2 billion projected fiscal 2003 budget shortfall without resorting to deficit financing…(and) potential emergency revenue measures remain available", including $750 million authorized for tobacco securitization and the ability to sell a 10th riverboat license.

Moody's rating was influenced by "the state's strong cash monitoring and control procedures, and prior track record of successful short-term borrowing in the early and mid-1990s' period of financial strain in the state's General Funds. In addition, the state's long-term credit position is sound, based on its diversified and growing economy, above-average resident wealth levels, moderate debt burden, and good system of financial controls notwithstanding low reserves and a significant variance in revenues from the budget forecast in fiscal 2002."

REVENUE

July Revenues Jump Due to Borrowing and Transfers

Jim Muschinske, Revenue Manager

A number of one-time items took place during the first month of FY 2003, which significantly increased July revenues. For the month, overall receipts grew by $1.376 billion. However, most of that growth was the result of short-term borrowing as well as transfers from the Budget Stabilization Fund and other funds. Federal sources also performed exceptionally well due to reimbursable spending made possible by the borrowing. Excluding short-term borrowing, one-time transfers, and federal source receipts, revenue growth was much more modest, growing by approximately $64 million. In fact, even that amount was aided by one more receipting day this July than in the prior year, as well as minor changes in certain tax allocations (retention of 0.4% of the State portion of sales tax previously distributed to local governments as well as the General Fund now receiving 25% of the real estate transfer tax).

As discussed earlier in this month's briefing, of the $1 billion in short-term borrowing, $700 million was deposited into the General Revenue Fund. In addition, similar to last year, $226 million was transferred from the Budget Stabilization Fund to the General Revenue Fund to further assist in relieving current cash flow pressures. The resulting spending on backlogged Medicaid bills and subsequent federal reimbursement was the reason for the significant increase in federal sources which were up $229 million for the month.

Those actions aside, base revenue growth was much tamer. However, after six months of consecutive decline to end FY 2002, any gain is a welcome change. Sales tax led the State tax sources as receipts grew by $16 million. Public utility tax revenue added a gain of $14 million, while gross personal income tax rose $10 million. Both gross corporate income tax and inheritance tax advanced $6 million in July. Other sources added $5 million, corporate franchise taxes $2 million, and liquor taxes $1 million. A $12 million decline in interest earnings was the only source experiencing a year-over-year decline in July.

Overall transfers were up $179 million for the month, although most of that increase was the result of approximately $157 million in one-time transfers from other special State funds. Lottery transfers did manage to gain $14 million in July, while transfers from the Gaming Fund contributed an increase of $10 million.

Revisions to the FY 2003 Estimate

As in years past, the table entitled "General Funds Growth Needed to Meet Estimate" shows the Commission's latest estimate. As shown, the FY 2003 general funds estimate, excluding short-term borrowing proceeds as well as Budget Stabilization Fund transfers, totals $24.178 billion. The estimate reflects anticipated growth of $800 million or 3.4% over the prior year. Revisions to the estimate have been made to reflect actual FY 2002 base figures as well as other factors including higher income tax refund percentages, federal source estimates based on final appropriation levels, higher intergovernmental transfers, and lower Build Illinois general reserve account transfers.

In addition to these items, the revised forecast incorporates those tax changes made during the final weeks of the Spring 2002 legislative session and effective during FY 2003. In total, those changes will increase general funds revenues by over $500 million more than what they otherwise would have been, indicating that base revenue growth is forecast to be rather tepid in FY 2003, particularly during the first half of the fiscal year. The June 2002 monthly briefing explained what the various tax changes were, but a quick listing follows:

- One-time transfers totaling $165 million from a number of funds into the General Revenue Fund;
- Decoupling from the federal depreciation provision that will retain $161 million in net income tax revenue;
- Increasing and restructuring the riverboat gaming taxes that will generate $142 million for transfer to the general funds;
- Reallocation of 0.4% of sales tax collections (photo processing exemption) that will result in $25 million more in general revenues; and
- Reallocation of the existing real estate transfer tax that will result in $15 million more in general revenues

While not a direct impact on general funds revenues, the cigarette tax was also increased and will result in approximately $230 million more in revenues, of which $15 million in FY 2003 will be deposited into the School Infrastructure Fund, with the remainder being deposited into the Long Term Care Provider Fund.

As in FY 2002, FY 2003 will also utilize $226 million in Budget Stabilization Fund transfers to the General Revenue Fund to meet cash flow needs. These funds must be repaid by the end of the fiscal year. In addition to this transfer, the State has recently short-term borrowed $1 billion ($700 million to the General Fund) to aid in the alleviation of cash flow pressures. The short-term borrowing also will be repaid by the end of the fiscal year.

The Commission's revised FY 2003 estimate of $24.178 billion is $207 million lower than the Bureau of the Budget's latest projection of $24.385 billion published in their July 2002 Quarterly Financial Report.

GENERAL FUNDS RECEIPTS: JULY

FY 2003 vs. FY 2002
($ million)

Revenue Sources	JULY FY 2003	JULY FY 2002	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$536	$526	$10	1.9%
Corporate Income Tax (regular)	35	29	$6	20.7%
Sales Taxes	529	513	$16	3.1%
Public Utility Taxes (regular)	76	62	$14	22.6%
Cigarette Tax	33	33	$0	0.0%
Liquor Gallonage Taxes	11	10	$1	10.0%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax (Gross)	28	22	$6	27.3%
Insurance Taxes and Fees	2	2	$0	0.0%
Corporate Franchise Tax & Fees	9	7	$2	28.6%
Interest on State Funds & Investments	6	18	($12)	-66.7%
Cook County IGT	54	54	$0	0.0%
Other Sources	16	11	$5	45.5%
Subtotal	$1,338	$1,290	$48	3.7%
Transfers				
Lottery	44	30	$14	46.7%
Gaming Fund Transfer	50	40	$10	25.0%
Other	174	19	$155	815.8%
Total State Sources	$1,606	$1,379	$227	16.5%
Federal Sources	$486	$257	$229	89.1%
Total Federal & State Sources	$2,092	$1,636	$456	27.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($43)	($40)	($3)	7.5%
Corporate Income Tax	(9)	(6)	($3)	50.0%
Subtotal General Funds	$2,040	$1,590	$450	28.3%
Short-Term Borrowing	**$700**	**$0**	**$700**	**N/A**
Budget Stabilization Fund Transfer	**$226**	**$0**	**$226**	**N/A**
Total General Funds	$2,966	$1,590	$1,376	86.5%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Aug-02

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2003 ESTIMATE vs. FY 2002 ACTUAL

($ million)

Revenue Sources	July-02 ESTIMATE FY 2003	FYTD 2003	AMOUNT NEEDED FY 2003 EST.	FYTD 2002	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$8,405	$536	$7,869	$526	$309	4.1%
Corporate Income Tax (regular)	1,126	35	$1,091	29	$77	7.6%
Sales Taxes	6,365	529	$5,836	513	$298	5.4%
Public Utility Taxes (regular)	1,165	76	$1,089	62	$47	4.5%
Cigarette Tax	400	33	$367	33	$0	0.0%
Liquor Gallonage Taxes	125	11	$114	10	$2	1.8%
Vehicle Use Tax	39	3	$36	3	$1	2.9%
Inheritance Tax (Gross)	270	28	$242	22	($65)	-21.2%
Insurance Taxes and Fees	280	2	$278	2	$8	3.0%
Corporate Franchise Tax & Fees	169	9	$160	7	$8	5.3%
Interest on State Funds & Investments	160	6	$154	18	$36	30.5%
Cook County IGT	395	54	$341	54	$150	78.5%
Other Sources	320	16	$304	11	($197)	-39.3%
Subtotal	$19,219	$1,338	$17,881	$1,290	$674	3.9%
Transfers						
Lottery	585	44	$541	30	$16	3.0%
Gaming Fund Transfer	625	50	$575	40	$145	33.7%
Other	650	174	$476	19	$42	9.7%
Total State Sources	$21,079	$1,606	$19,473	$1,379	$877	4.7%
Federal Sources	$4,075	$486	$3,589	$257	($412)	-10.3%
Total Federal & State Sources	$25,154	$2,092	$23,062	$1,636	$465	2.1%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($672)	($43)	($629)	($40)	($54)	9.4%
Corporate Income Tax	(304)	(9)	($295)	(6)	($61)	26.1%
Subtotal General Funds	$24,178	$2,040	$22,138	$1,590	$350	1.6%
Short-Term Borrowing	$700	$700	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$226	$226	$0	$0	($226)	N/A
Total General Funds	$25,104	$2,966	$22,138	$1,590	$124	0.6%
IEFC						1-Aug-02