



Commission on Government Forecasting and Accountability

MONTHLY BRIEFING

JULY 2011

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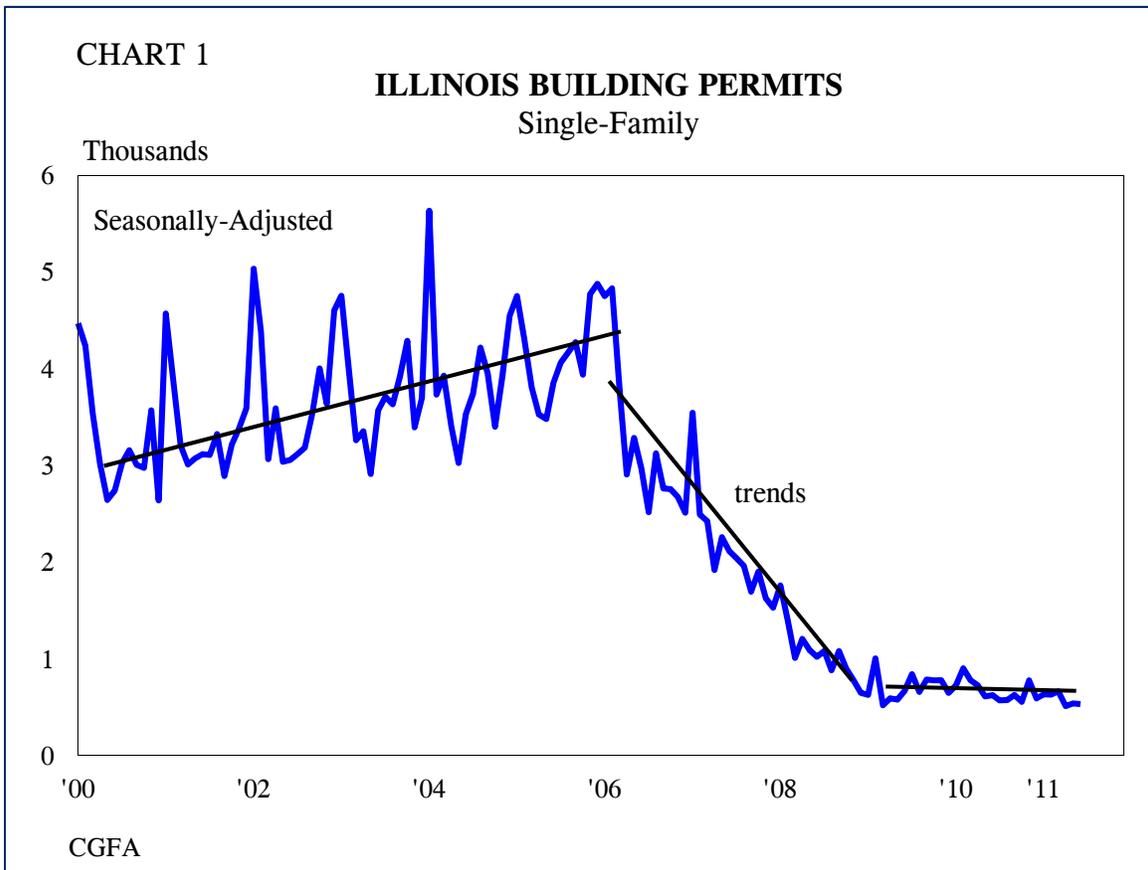
ECONOMY: Housing Remains in Severe Recession

Edward H. Boss, Jr., Chief Economist

The headlines were encouraging; “June housing starts at 6-month high, permits up” rang out from REUTER’s news service a few weeks ago, giving hope that the severely weakened housing sector at last may have reached bottom. Closer analysis, however, does not bear out the apparent improvement in this critical sector of the economy. Along with a rising unemployment rate over the past three months, housing has been a major element in the continuing depressed level of consumer sentiment, which as measured by the University of Michigan showed a preliminary reading of 63.8 in July, the lowest level since early 2009.

Housing, the employment situation, and consumer attitudes are intertwined. Housing is often the largest asset held by consumers and, unlike most of its history where prices or values have continued to rise, has fallen off sharply during the past recession and continued to weaken during the current recovery. This weakness has certainly had its effect on employment. Preliminary payroll data show that employment in the construction of residential buildings was 558,000 in July 2011, well off its recent peak of 1,022,000 recorded in July 2006 prior to the last recession. Indeed many economists project it will require a sustainable housing recovery before a more normal economic expansion and sustainable decline in the unemployment rate can be established.

An analysis of the latest housing data reveals that the strength in both housing starts and permits last month centered in multi-family units, in large part reflecting an increase in rental properties. Indeed, the rise in building permits, a precursor to new construction, showed that buildings with 5 or more units increased by 8.2% whereas those for single-family homes edged up a mere 0.2%. Indeed, with home



values severely depressed, foreclosures at record or near record levels, a large inventory of unsold properties and uncertainty over the future, the only demand seems to be for rentals. And, with rentals rising, home ownership has been on the decline falling to 66.5% in the first quarter of this year from a high of 69.4% in the second quarter of 2004. This decline in home ownership has occurred despite historically low mortgage interest rates for those who qualify.

The jump in housing starts in June should not be considered a new trend; one month's data does not a trend make, indeed the market, particularly for single-family homes remains severely depressed. Centering in on Illinois, and looking at building permits issued for the construction of new single-family homes, Chart 1 shows no change in the trend of

permits for more than the last three years. Indeed the level in June was a mere 680 down from a high of 4,906 in June of 2005.

On a somewhat similar note, data from the Illinois Association of Realtors, which had shown increases in the median prices of homes in Chicago, recently revised downward its figures for the past seven months due to a computer glitch. Thus, the median price of single-family homes in May originally reported at \$144,937 is now being reported as \$135,000. Similarly the median priced Chicago condominium in May originally was reported as \$299,000, but is now reported \$50,000 lower at \$249,900. And the median price on all city of Chicago sales in May was lowered from \$238,450 to \$190,000. Statewide both home sales and median prices rose in June from May but were down 16.3% and 11.7% respectively from a year earlier.

While many await a turnaround in housing to help strengthen the struggling pace of the economic expansion, there is little evidence that any significant improvement is on the horizon. Moreover, the recent soft patch in

the economy may well delay any such evidence. At best, it can be hoped that we may at least have seen the end of the sharp deterioration that has been so evident for so long in this very important sector.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>June 2011</u>	<u>May 2011</u>	<u>June 2010</u>
Unemployment Rate (Average)	9.2%	8.9%	10.3%
Annual Rate of Inflation (Chicago)	0.4%	7.3%	3.8%
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (June)	6,596	0.0%	-0.3%
Employment (thousands) (June)	5,993	-0.3%	0.7%
New Car & Truck Registration (June)	48,453	7.4%	34.3%
Single Family Housing Permits (June)	680	-6.3%	-14.9%
Total Exports (\$ mil) (May)	5,624	2.6%	35.0%
Chicago Purchasing Managers Index (July)	58.8	-3.7%	-5.6%

REVENUE

FY 2012 Revenues Start Higher Despite Falloff in Federal Sources

Jim Muschinske, Revenue Manager

Excluding Budget Stabilization Fund transfers, July revenues rose \$185 million to begin the fiscal year. Gains in income taxes related to January's rate increase coupled with a good month for sales and a strong month for transfers were more than enough to offset a significant drop in federal sources. July had one less receipting day as compared to the same month of last year.

For the month, personal income tax receipts led the gainers as gross receipts grew \$439 million, or \$401 million net of refunds. Gross corporate income tax rose \$15 million, or \$12 million net of refunds. Both source

increases were due principally to the tax increase. Sale tax started strong for the year, as receipts gained \$64 million. Other sources grew \$3 million, liquor taxes \$1 million, and corporate franchise \$1 million.

Inheritance tax continued its expected fall off, dropping \$22 million. Public utility taxes declined \$7 million, while interest earnings dipped \$1 million.

Overall transfers grew \$137 million. The gain was due primarily to an increase of \$134 million in other transfers that was fueled by the release of long protested liquor taxes [approximately \$140 million] that were trans-

ferred from the Protest Fund to the Capitol Projects Fund and then ultimately to the General Revenue Fund to meet statutory transfer requirements. Finally, as mentioned, federal sources plunged \$403 million as reimbursable spending slowed substantially after June's spending push.

FY 2012 Revenues—Full-year of Tax Increase Enough to Offset Expected Falloff in Federal Sources

The table on page 6 presents the Commission's updated revenue forecast of FY 2012. As shown, base FY 2012 revenues are expected to be \$33.937 billion, a gain of \$3.449 billion. Obviously, the large increase reflects the annualization of the January 2011 income tax hike along with related timing issues that will have a positive impact on next spring's final payments. In addition, the estimates take into account the actual performance of FY 2011 along with slightly lower growth assumptions that were used previously in the March 2011 estimates. Also included are new federal sources figures that reflect significant lower appropriation levels.

Economic Sources

While a full year of the higher personal income tax rate will significantly boost receipts, so too will a timing element valued at over \$500 million related to the mid-year implementation of the new rate. Those items, combined with a modest base growth estimate of approximately 2.1%, cause gross personal income tax to grow an estimated \$4.696 billion, or \$4.285 billion net of refunds. In the case of corporate income tax, a full year of the higher tax rate as well as suspension of the net operating loss deduction

coupled with base growth expected to be over 7%, are expected to result in gross receipts rising \$597 million, or \$520 million net of refunds. It should be noted that the estimates of personal and corporate income tax have been decreased a net \$600 million [approximately 46% personal and 54% corporate] due to federal depreciation provisions that the State elected not to decouple from. The impact of last year's tax amnesty program also has been incorporated into the estimates of income tax. Base sale taxes, after experiencing higher than expected growth in FY 2011, is expected to return to more modest levels of approximately 2.5%. However, the accelerated effects of the FY 2011 tax amnesty program will result in sales tax only growing \$7 million in FY 2012.

Transfers

Overall transfers are anticipated to fall a net \$344 million. While a gain is expected from Lottery and riverboat related transfers, a significant drop off in other transfers due to last year's \$496 million of interfund borrowing will cause a significant year over year decline.

Federal Sources

Medicaid spending was a focus of the General Assembly and the Governor during the appropriation process. While provider rates have not yet been changed, the decision to extend the payment cycle essentially translates into less reimbursable spending and subsequent federal source receipts. Couple the lower spending with a return to a lower match rate on what spending does take place, and federal sources are expected to fall \$1.036 billion from last year's levels.

GENERAL FUNDS RECEIPTS: JULY

FY 2012 vs. FY 2011

(\$ million)

Revenue Sources	July FY 2012	July FY 2011	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$1,087	\$648	\$439	67.7%
Corporate Income Tax (regular)	62	47	\$15	31.9%
Sales Taxes	606	542	\$64	11.8%
Public Utility Taxes (regular)	81	88	(\$7)	-8.0%
Cigarette Tax	29	29	\$0	0.0%
Liquor Gallonage Taxes	18	17	\$1	5.9%
Vehicle Use Tax	2	3	(\$1)	-33.3%
Inheritance Tax (Gross)	2	24	(\$22)	-91.7%
Insurance Taxes and Fees	4	4	\$0	0.0%
Corporate Franchise Tax & Fees	13	12	\$1	8.3%
Interest on State Funds & Investments	0	1	(\$1)	-100.0%
Cook County IGT	0	0	\$0	N/A
Other Sources	36	33	\$3	9.1%
Subtotal	\$1,940	\$1,448	\$492	34.0%
Transfers				
Lottery	41	43	(\$2)	-4.7%
Riverboat transfers & receipts	35	30	\$5	16.7%
Proceeds from Sale of 10th license	0	0	\$0	N/A
Other	233	99	\$134	135.4%
Total State Sources	\$2,249	\$1,620	\$629	38.8%
Federal Sources	\$150	\$553	(\$403)	-72.9%
Total Federal & State Sources	\$2,399	\$2,173	\$226	10.4%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$95)	(\$57)	(\$38)	66.7%
Corporate Income Tax	(\$11)	(8)	(\$3)	37.5%
Subtotal General Funds	\$2,293	\$2,108	\$185	8.8%
Short-Term Borrowing	\$0	\$1,300	(\$1,300)	N/A
Tobacco Liquidation Proceeds	\$0	\$0	\$0	N/A
Pension Contribution Fund Transfer	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$275	\$0	\$275	N/A
Total General Funds	\$2,568	\$3,408	(\$840)	-24.6%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				1-Aug-11

CGFA FY 2012 Estimates July-11 vs. FY 2011 Actuals

(millions)

	FY'12 CGFA July-11	FY 2011 Actuals	\$ Difference
Revenue Sources			
State Taxes			
Personal Income Tax	\$16,997	\$12,301	\$4,696
Corporate Income Tax	\$2,874	\$2,277	\$597
Sales Taxes	\$6,840	\$6,833	\$7
Public Utility (regular)	\$1,111	\$1,147	(\$36)
Cigarette Tax	\$355	\$355	\$0
Liquor Gallonage Taxes	\$157	\$157	\$0
Vehicle Use Tax	\$30	\$30	\$0
Inheritance Tax (gross)	\$188	\$122	\$66
Insurance Taxes & Fees	\$320	\$317	\$3
Corporate Franchise Tax & Fees	\$208	\$207	\$1
Interest on State Funds & Investments	\$30	\$28	\$2
Cook County Intergovernmental Transfer	\$244	\$244	\$0
<u>Other Sources</u>	<u>\$385</u>	<u>\$404</u>	<u>(\$19)</u>
Subtotal	\$29,739	\$24,422	\$5,317
Transfers			
Lottery	\$645	\$632	\$13
Riverboat transfers and receipts	\$324	\$324	\$0
Proceeds from sale of 10th license	\$75	\$0	\$75
<u>Other</u>	<u>\$794</u>	<u>\$1,226</u>	<u>(\$432)</u>
Total State Sources	\$31,577	\$26,604	\$4,973
Federal Sources	\$4,350	\$5,386	(\$1,036)
Total Federal & State Sources	\$35,927	\$31,990	\$3,937
Nongeneral Funds Distribution:			
Refund Fund			
Personal Income Tax [8.75%]	(\$1,487)	(\$1,076)	(\$411)
Corporate Income Tax [12.5%]	(\$503)	(\$426)	(\$77)
Subtotal General Funds	\$33,937	\$30,488	\$3,449
NOTE: Totals exclude Budget Stabilization transfers, and other cash flow transfers.			
CGFA			