Commission on Government Forecasting and Accountability

703 Stratton Ofc. Bldg., Springfield, IL 62706

MONTHLY BRIEFING FOR THE MONTH ENDED: JULY 2017

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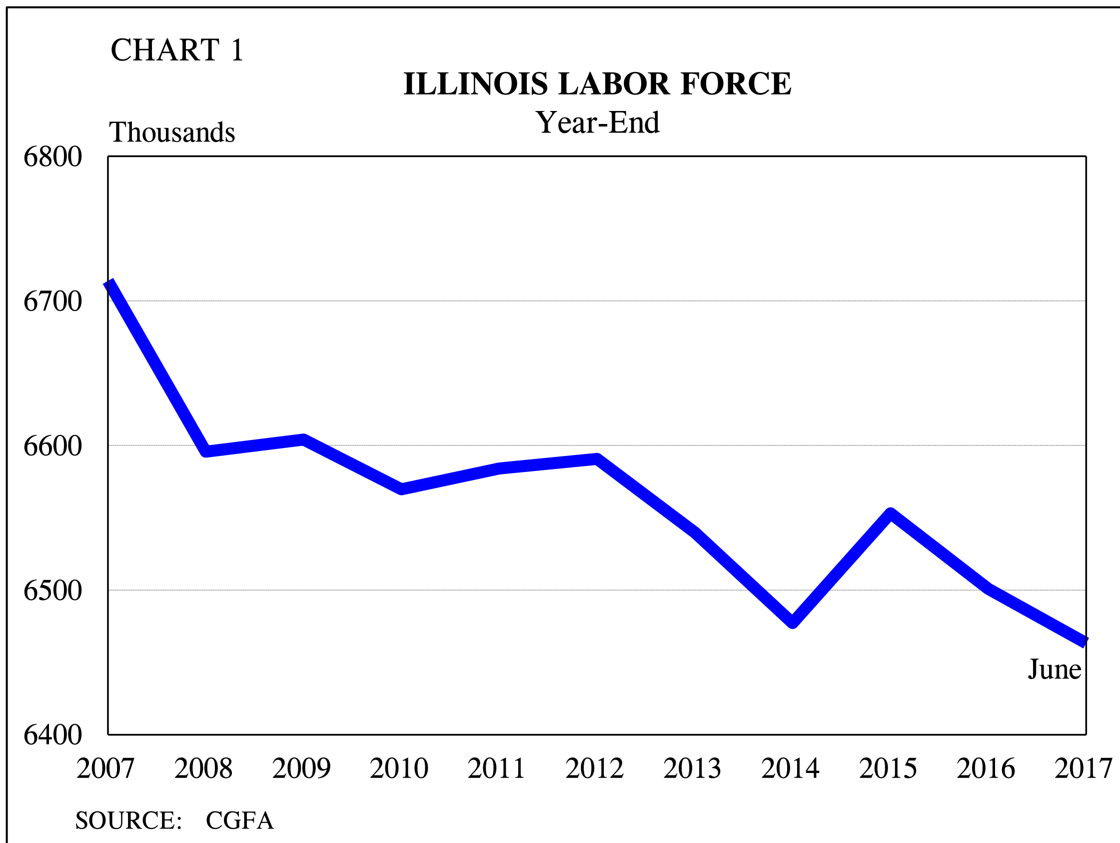
ECONOMY: Illinois facing shrinking labor force
Edward H. Boss, Jr., Chief Economist

The Chicago Tribune's Business section on July 21st had a headline column entitled "Illinois has more jobs but fewer workers." On the surface this seems incongruous but can be explained by noting that the labor force, employment, and unemployment rate are derived from one source, the Household Survey, while the jobs numbers used come from another, the Establishment Series. While over time the two employment sources generally trend in the same direction, there are times when employment figures between the two measures diverge. This is one of those times. For June, employment as measured by the Household Survey fell for the third consecutive month losing 24,700 for the month, down 0.4% from the previous month, and rose only 14,800, a modest 0.2%, from a year earlier. In contrast, the Establishment employment showed a gain of 8,600 jobs in June from the prior month and a gain of 54,000 jobs, or 0.9% from a year earlier.

The larger in numbers of the two employment series is the Household series that surveys from a sample size of 60,000 reflecting the entire civilian noninstitutional population based on responses to questions on work and job search activities of each person 16 years of age and over classified as employed, unemployed, or not in the labor force. People are employed by this survey if they did any work for pay during the reference week; worked in their own business, profession, or on their farm; or worked without pay at least 15 hours in a family business or farm. Also counted are people that are temporarily absent from their job because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

The job numbers in the Establishment series cover nonfarm payroll employment. The data come directly from employment records of 634,000 individual worksites and,



therefore, is considered harder data than the survey method. Even so, this measure has some flaws. First, even though most jobs come from new small businesses, it takes some time before they would show up in the source data. Therefore, some observers look at the Household survey with its flaws as indicative of what eventually will show up in the Establishment series on nonfarm payroll employment. Second, there can be some double counting of jobs for those who have more than one job and show up twice. This double counting has undoubtedly increased given the government mandate to buy insurance if one worked for more than 30 hours, leading employers to cut hours and force many to get a second job.

In conclusion, while Illinois' unemployment rate has fallen to 4.7% in June from 5.9% a year earlier, as stated in Moody's Analytics independent report done for the Commission last January, "The state trails the nation in most metrics and political gridlock is imposing significant economic costs. The jobless rate has resumed its descent after rising late last year and into 2016, but much of the decline owes to a sharp drop in the labor force and population losses." Little has changed since. The chart shows the declining trend in Illinois labor force.

Illinois' unemployment rate compares poorly with the dynamic improvement in the Midwest. Of the 15 states comprising the Midwest, only 2 states, Kentucky and Ohio had a higher rate in June with rates of 5.1% and 5.0% respectively. Four states had unemployment rates in the 3.8%–4.7%

range with Illinois at the top of the range. Finally, the remaining 9 states had unemployment rates in a range of 2.3%–3.4%.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	JUNE 2017	MAY 2017	JUNE 2016
Unemployment Rate (Average)	4.7%	4.6%	5.9%
Annual Rate of Inflation (Chicago)	0.0%	0.2%	1.3%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (June)	6,463.3	-0.3%	-1.0%
Employment (thousands) (June)	6,160.9	-0.4%	0.2%
NonFarm Payroll Employment (June)	6,049,100	8,600	54,100
New Car & Truck Registration (June)	53,657	9.2%	-5.8%
Single Family Housing Permits (June)	1,125	6.3%	3.7%
Total Exports ($ mil) (May)	5,430.0	2.1%	8.0%
Chicago Purchasing Managers Index (July)	58.9	-10.3%	5.5%

* Due to monthly fluctuations, trend best shown by % change from a year ago

Credit Rating Agencies' Action after the State Passed a Budget

Lynnae Kapp, Senior Analyst

Throughout June of 2017, all three rating agencies threatened downgrades if the State didn't pass a budget for FY 2018. The budget-related bills––SB 6, SB 9 and SB 42––did not become law until July 6, 2017, after the General Assembly overrode the Governor's vetoes. By July 20, all three rating agencies had affirmed their current ratings on the State. Moody's and Fitch left the State's outlook as negative, while S&P has changed the State's outlook to stable.

Moody's [July 20, 2017]: "Moody's Investors Service has confirmed the State of Illinois' general obligation bond rating at Baa3, following passage of budget legislation that alleviates immediate liquidity pressures, moves the state closer to fiscal balance and should keep pension and other fixed costs at manageable levels at least in the near term. The rating confirmation, which also applies to state debt linked to the GO (and listed at the end of this section), ends a review for possible

downgrade that began July 5. Debt outstanding for all affected securities totals about $32 billion, though not all the non-GO issues have a Moody's rating. The state's outlook is negative.

“While budget passage alleviates immediate threats to the state's credit, long-term challenges remain. The outsized net pension burden...will keep growing in coming years, despite certain reforms included in the budget legislation. Reducing and containing the backlog over the long term will likely depend on repeated operating surpluses, which the state has not produced in recent memory.

“The confirmation action also applies to several other types of debt linked to the state's credit: sales tax-backed Build Illinois bonds, which were confirmed at Baa3; the Metropolitan Pier and Exposition Authority's McCormick Place convention center bonds, confirmed at Ba1; and the state's Civic Center program bonds, also confirmed at Ba1. The rating on the state's Build Illinois sales-tax bonds is capped at the government's GO rating, based on the sales tax revenues' lack of sufficient protection from general state operating needs. Both the Metropolitan Pier and the Civic Center program bonds are a notch below the state's GO based on the need for annual legislative appropriation of payments.

“The negative outlook is based on the implementation risks in the enacted budget (such as the potential failure to realize expense reductions or revenue increases anticipated under the enacted budget), expectations of continued pension liability growth and potential vulnerability to national economic downturns or other external factors.

“Factors that Could Lead to an Upgrade:

- Implementation of a realistic plan to provide long-term funding for pension obligations,
- Progress in reducing payment backlog and adoption of legal framework to prevent renewed build-up of unpaid bills,
- Enactment of recurring fiscal measures that support expectation of sustainable, structural balance.

“Factors that Could Lead to a Downgrade:

- Structural imbalance that leads to renewed build-up of unpaid bills following issuance of debt to pay down backlog,
- Efforts to obtain near-term fiscal relief by reducing pension contributions,
- Political paralysis that results in failure to provide for timely payment of subject-to-appropriation debt,
- Difficulty managing the impacts of an economic downturn, a reduction in federal Medicaid funding or other unexpected adverse event.”

Fitch Ratings [July 17, 2017]: “The affirmation of Illinois' ratings follows the passage of a fiscal 2018 budget that incorporates a permanent increase in taxes to more closely align revenues with spending and that should significantly reduce the near-term liquidity stress that had threatened the state's investment-grade rating. The

state's financial resilience has been materially weakened by the two-year period in which it spent far in excess of tax revenues while accumulating an extraordinary level of budgetary liabilities, adding to the strain presented by the state's unfunded retiree benefit liabilities and rising contribution burden. These factors result in a rating well below the level that the state's solid economic base and still substantial independent legal ability to control its budget would support.

"The Negative Outlook reflects the uncertainties related to successful implementation of the budget, particularly given the contentious political environment in the state. These risks include reducing the accounts payable backlog in the near term, including by coming to market with bonds that were authorized in the budget; completing the sale of a state building assumed in the budget; meeting revenue targets in a slow growth environment; and achieving near-term pension contribution savings, partly at the expense of worsening the state's long-term liability picture.

"RATING SENSITIVITIES - MEETING BUDGET ASSUMPTIONS:
An inability to meet the assumptions incorporated in the fiscal 2018 budget that results in failure to reduce budgetary liabilities and materially improve the state's stressed liquidity environment would lead to a downgrade. Specific risks to successful implementation include pension contributions above the level assumed in the budget, a failure to take significant steps to reduce the accounts payable backlog including by issuing bonds, a return to political gridlock specifically related to school funding, and a significantly slower growth revenue environment.

"ONGOING BUDGETARY BALANCE: Stabilization of the rating is sensitive to the state's ability to maintain budgetary balance over multiple years, indicating more sustainable fiscal management. Upward rating momentum is unlikely until the state more comprehensively addresses its accumulated liabilities."

S&P Global Ratings [July 12, 2017]: "S&P Global Ratings affirmed its 'BBB-' rating on Illinois' general obligation (GO) bond...[and] affirmed its 'AA-' rating on Illinois' Build Illinois sales tax revenue bonds and removed the rating from CreditWatch where it was placed with negative implications...We also affirmed our 'BB+' ratings on the state's appropriation-backed debt, which includes Chicago's outstanding motor fuel tax (MFT) revenue bonds. Finally, we affirmed our 'BB-' ratings on the state's moral obligation-backed debt. At the same time, we removed the ratings from CreditWatch, where they had been placed with negative implications on June 1. The outlook on all the debt ratings is stable. We have removed the ratings from CreditWatch because we no longer believe the state is at risk of experiencing a liquidity crisis in the near term as it was before.

"The rating affirmations and stable outlook reflect that following Illinois' enactment of a fiscal 2018 budget, which required a bipartisan vote of the

General Assembly to override the governor's veto, the odds of its GO credit rating falling to below investment grade within the next year has substantially diminished. As it is a U.S. state imbued with extensive and constitutionally protected sovereignty over its fiscal policy, its protracted budget impasse came to represent an extraordinary threat to its credit quality. Through a combination of spending cuts and tax increases, the budget package brings the state's revenue and expenditure base much closer to structural alignment and reduces the near-term uncertainty that had come to characterize its financial operations. Crucially, budget enactment also reasserts state authority over its finances while simultaneously helping preserve and strengthen the adequacy of its resources to reliably cover its priority obligations.

"On its own, the passage of a budget—among the most basic of lawmakers' governing responsibilities—does not alleviate the pressure on Illinois' credit quality related to its weak liability profile. Furthermore, the state will almost certainly suffer an extended fiscal hangover from the impasse, not least from its record level of unpaid bills, which will be a drain on its future resources. Revenue spent on servicing and retiring the roughly $15 billion in unpaid bills is unavailable for contribution to the state's severely underfunded pension systems or to fund state services. It also crowds out fiscal capacity the state might otherwise use to accommodate a reduction in tax rates. Similarly, the state has incurred an immeasurable but undoubtedly steep opportunity cost throughout the impasse in terms of foregone pension reforms or investment in its higher education institutions. From a credit perspective, there is also a disconcerting lack of consensus among state officials on the way forward. Nevertheless, despite being fractured and delayed, passage of the budget represents an affirmation of lawmakers' collective willingness to prioritize the state's fundamental claims-paying ability at an investment-grade level.

"While the budget does not comprehensively address the state's burdensome pension liabilities—no individual budget could—it does move the state's annual revenue and expenditure baselines toward alignment. And in our view, balanced fiscal operations are for Illinois a necessary precondition to improving its prospects for longer term solvency. Still, it is largely because of the bill backlog, poorly funded pension systems, and ongoing political dysfunction that the state's rating is well below that of peer-comparison states with similar economic profiles."

ILLINOIS' GENERAL OBLIGIATION RATINGS HISTORY						
Date of	*Fitch*		*S&P*		*Moody's*	
Rating Action	*Rating*	*up/down*	*Rating*	*up/down*	*Rating*	*up/down*
June 2017			*BBB-*	↓1x	*Baa3*	↓1x
February 2017	*BBB*	↓1x				
September 2016			*BBB*	↓1x		
June 2016			*BBB+*	↓1x	*Baa2*	↓1x
October 2015	*BBB+*	↓1x			*Baa1*	↓1x
June 2013	*A-*	↓1x			*A3*	↓1x
Jan 2013			*A-*	↓1x		
Aug 2012			*A*	↓1x		
Jan 2012					*A2*	↓1x
Jun 2010	*A*	↓1x			*A1*	↓1x
Mar-Apr 2010	*A-/A+ recal*	↓1x/↑2x			*Aa3 recal*	↑2x
Dec 2009			*A+*	↓1x	*A2*	↓1x
Mar-Jul 2009	*A*	↓2x	*AA-*	↓1x	*A1*	↓1x
Dec 2008	*AA-*	↓1x				
May 2003	*AA*	↓1x			*Aa3*	↓1x
Jun 2000	*AA+*	↑1x				
Jun 1998					*Aa2*	↑1x
Jul 1997			*AA*	↑1x		
Feb 1997					*Aa3*	↑1x
Sep 1996	*AA*	*initial rating*				
Feb 1995					*A1*	↓1x
Aug 1992			*AA-*	↓1x	*Aa**	↓1x
Aug-Sep 1991			*AA*	↓1x	*Aa1*	↓1x
Mar 1983			*AA+*	↓1x		
Feb 1979			*AAA*	*initial rating*		
1973					*AAA*	*initial rating*

Note: "recal" means recalibration, when Fitch and Moody's revised their ratings on municipal bonds to match global/corporate ratings. These are not considered upgrades.

***Moody's rating of Aa was before that level had modifiers of Aa2 and Aa3, so it was considered one level in between AA1 and A1**

S&P also reviewed the ratings of State Universities [July 24, 2017]: "While we view the passing of the fiscal 2018 budget and associated funding positively, as it provides more funding than that of the stop-gap funds provided in fiscal 2016 and 2017, we note that the state's plan cuts support for universities by 10% below fiscal 2015 levels. In addition to operating appropriations, the state budget includes funding for its student aid program, the Monetary Award Program (MAP), for both fiscal 2017 and 2018. Total MAP funding will reach more than $400 million in fiscal 2018, after two years of universities covering MAP funding to students in an effort to offset the temporary lapse in payments from the state, resulting in compressed liquidity levels.

"In our opinion, the full impact of the new budget--and the end of the state budget impasse on the universities' operations, finances, enrollment, and overall performance--cannot be immediately determined. Given the universities' reliance on state funds to support operations, the timing of funding distributions to these institutions will be pertinent. It is our understanding that the majority of the fiscal 2017 MAP funding has already been distributed to the universities and that the fiscal 2017 Education Assistance Fund operating appropriations will be provided by the end of July 2017. We view the timely dispersal of funds to the universities as imperative for liquidity purposes and a key credit factor."

RATINGS RAISED AND REMOVED FROM CREDITWATCH

UNIVERSITY	FROM	TO
Southern Illinois University	BB/Watch Negative	BB+/Stable
Governors State University	BB/Watch Negative	BB+/Stable
Northeastern Illinois University	B/Watch Negative	B+/Stable
Eastern Illinois University	B/Watch Negative	B+/Stable

RATINGS AFFIRMED AND REMOVED FROM CREDITWATCH

UNIVERSITY	FROM	TO
University of Illinois	A-/Watch Negative	A-/Stable
Illinois State University	A-/Watch Negative	A-/Stable
Western Illinois University	BB-/Watch Negative	BB-/Positive

REVENUE

JULY RECEIPT GROWTH REFLECTS HIGHER INCOME TAX RATES AND OTHER CHANGES

Jim Muschinske, Revenue Manager

Overall general funds revenues increased $235 million to begin FY 2018. In addition to beginning to reflect the recently enacted higher income tax rates per P.A. 100-22, receipts include the Fund for Advancement of Education and Commitment to Human Services Fund in the definition of general funds per P.A. 100-23. Previously, the funds, which receive monies from the income tax via a distribution formula, were considered non-general funds and removed from net income taxes. Also reflected are requisite amounts from net income taxes that are now being directly deposited into the Local Government Distributive Fund rather than flowing through the previous distribution process [less 10% of LGDF funds which remain in the GRF in FY 2018]. Similarly, a small portion of monthly sales tax receipts will be directly receipted into various transportation funds, rather than deposited into the GRF and subsequently disbursed.

For presentation purposes and to better reflect underlying performance, the Commission has elected to continue to show gross personal, gross corporate and unadjusted sales tax receipts in similar format to our traditional presentation. Then, similar to how we have historically adjusted for the income tax refunds, direct receipts related to the aforementioned changes will be removed from the general funds total. And, in the instance of FAE and CHSF, those monies will remain in general funds rather than subtracted per P.A. 100-23. See following table.

Gross personal income tax receipts increased $137 million to begin the new fiscal year. Growth primarily reflects higher tax rates that went into effect on July 6th [retroactive to July 1]. As a result, there is an expected initial "ramp up" period before the higher rates are fully integrated into receipt patterns as withholding tables must be adjusted and the natural lag period between employee pay periods and collections/tax receipts are eliminated. Gross corporate income taxes advanced by $39 million, partially reflecting the higher tax rates. However, in the case of corporate income taxes, due to the volatile nature of last year's receipt patterns attributed to the IDoR's newly implemented accounting system and subsequent reconciliations, it will be difficult to discern impacts of the rate increase versus timing impacts of last year's accounting system adjustments. Overall sales taxes increased by $29 million, or $13 million once the new direct receipt diversion to the public transportation fund(s) is factored in.

A number of lesser sources were either flat or generated smaller absolute gains. Insurance taxes posted a $8 million increase, cigarette taxes grew $5 million, public utility taxes as well as corporate franchise taxes each increased $3 million, and both liquor taxes and interest earnings contributed $2 million in growth. The only revenue source to suffer a loss to begin the fiscal year was inheritance tax, as receipts dropped $6 million.

Overall transfers posted a loss of $3 million in July as a $10 million gain in riverboat transfers and a $1 million advance in other transfers more than offset by a drop of $14 million in lottery transfers. Federal sources, after suffering yet another poor performance in FY 2017, managed a modest $14 million increase to begin the new fiscal year. Expectations for significantly higher federal reimbursements for FY 2018 are contingent on efforts made to reduce the Medicaid bill backlog.

JULY

FY 2018 vs. FY 2017

($ million)

Revenue Sources	**July FY 2018**	**July FY 2017**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$1,074	$937	$137	14.6%
Corporate Income Tax (regular)	69	30	$39	130.0%
Sales Taxes	737	708	$29	4.1%
Public Utility Taxes (regular)	66	63	$3	4.8%
Cigarette Tax	30	25	$5	20.0%
Liquor Gallonage Taxes	19	17	$2	11.8%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax	23	29	($6)	-20.7%
Insurance Taxes and Fees	16	8	$8	100.0%
Corporate Franchise Tax & Fees	14	11	$3	27.3%
Interest on State Funds & Investments	4	2	$2	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	41	41	$0	0.0%
Subtotal	$2,096	$1,874	$222	11.8%
Transfers				
Lottery	53	67	($14)	-20.9%
Riverboat transfers & receipts	29	19	$10	52.6%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Fund sweeps	0	0	$0	N/A
Other	44	43	$1	2.3%
Total State Sources	$2,222	$2,003	$219	10.9%
Federal Sources	$353	$339	$14	4.1%
Total Federal & State Sources	$2,575	$2,342	$233	9.9%
Nongeneral Funds Distributions/Direct Receipts:				
Refund Fund				
Personal Income Tax	($105)	($95)	($10)	10.5%
Corporate Income Tax	($12)	(5)	($7)	140.0%
Fund for Advancement of Education	$0	(46)	$46	-100.0%
Commitment to Human Services Fund	$0	(46)	$46	-100.0%
LGDF--Direct from PIT	($53)	0	($53)	N/A
LGDF--Direct from CIT	($4)	0	($4)	N/A
Downstate Pub/Trans--Direct from Sales	($16)	0	($16)	N/A
Subtotal General Funds	$2,385	$2,150	$235	10.9%
Short-Term Borrowing	$0	$0	$0	N/A
Interfund Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,385	$2,150	$235	10.9%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Aug-17