



Commission on Government Forecasting and Accountability

MONTHLY BRIEFING FOR THE MONTH ENDED: NOVEMBER 2012

<http://www.ilga.gov/commission/cgfa2006/home.aspx>

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ECONOMY: Many Challenges Ahead

Edward H. Boss, Jr., Chief Economist

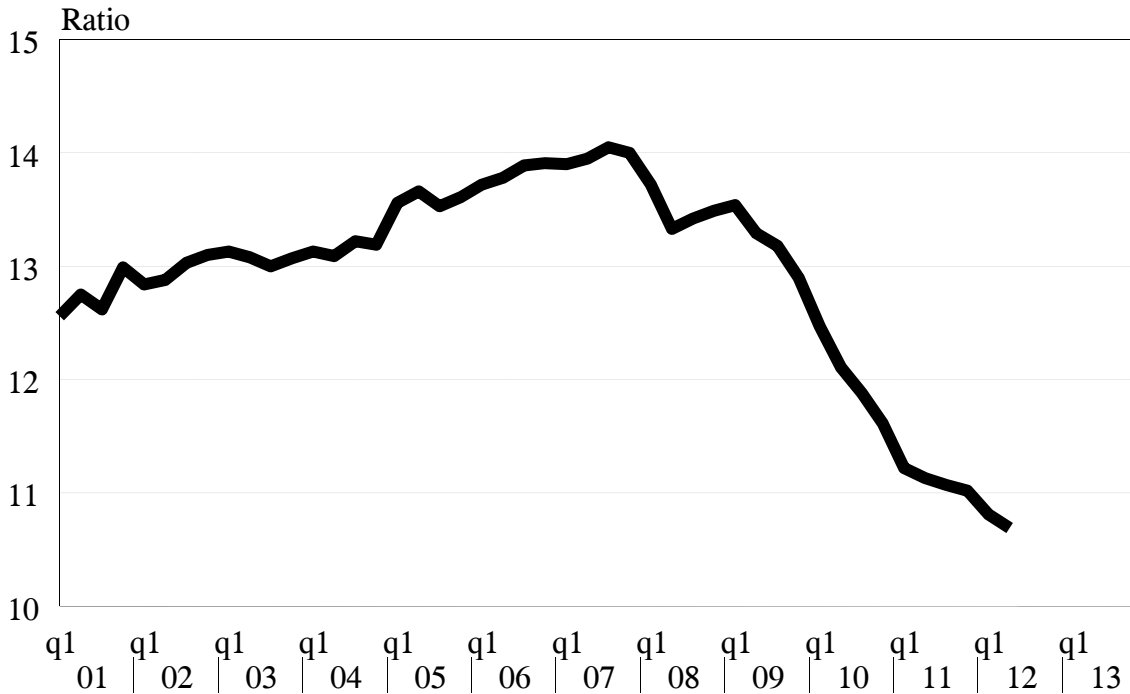
Even as some “green shoots” begin to appear, indicating that the economy is improving, there are events that not only could reverse that trend, but could even cause another recession. This happened coming out of the initial recovery from the Great Depression of late 1929 to the spring of 1933 only to decline again and it took the build-up to WWII finally to end the depression. Similarly, although to a much lesser extent, were the twin recessions in the early 1980s as an initial recovery from the 1980 recession quickly ended, followed by another recession in 1981.

Currently on the positive side, there are encouraging signs that the long precipitous decline in housing is over. Existing home sales rose 2.1% in October and were up 10.9% from a year earlier, while the median price was up 11.1% and the inventory of homes for sale declined. This has sparked improved activity. Housing starts rose in October and were 28% ahead of a year-earlier while permits, a precursor to starts, were up 30%. Also encouraging has been the de-leveraging of the consumer, the largest spending sector in the economy. As illustrated in the chart, the household debt service ratio (DSR), which is the ratio of debt payments on outstanding mortgages and consumer debt to personal income, the consumer is better able to handle debt now and may feel freer to spend. When this is coupled with rising consumer sentiment that hit 82.7 in November, its highest level since August of 2007, it could provide a powerful force to continued economic growth

It's not only the consumer, however, whose financial position has improved. Businesses have cut costs, greatly increased profits, and built up large cash balances. Even many states have improved their fiscal positions. This is illustrated by a survey done by International Strategy &

CHART 1

HOUSEHOLD DEBT SERVICE TO DISPOSABLE INCOME



SOURCE: Federal Reserve Board

Investment, where the index of state receipts has risen, averaging above 50 this year, sharply higher than the all-time low of 9 recorded in mid 2009 when the current recovery got under way, although still well below the previous highs of around 80 in July 2006.

The biggest threat to these positive developments can be tied to the outcome of the fiscal cliff --a combination of expiring tax cuts and across-the-board government spending cuts-- scheduled to become effective December 31, 2012. These draconian

measures if not addressed, would cut the budget deficit by \$503 billion through next September and cause a recession with the economy shrinking by 0.5% and the unemployment rate rising up to 9.1% by next fall according to the non-partisan CBO (Congressional Budget Office). Other analyses concur. The rating agency Fitch agrees that going over the fiscal cliff would cause a recession and it estimates that the unemployment rate would rise above 10%. The fiscal cliff originally came about because it was thought to be so onerous that policymakers would have to take action to reign in the deficit to avoid it.

Most attention has been on raising taxes on the “wealthy” which even if passed would barely put a dent in the deficit. At the same time if all tax rates revert to their earlier higher levels, it would put a significant damper on economic activity. Much less attention is given to reducing spending, half of which is designated in defense, leading Secretary of Defense Panetta to respond, “The impacts of these cuts would be devastating for the department.” Moreover, hoped for spending declines from ending the wars in Iraq and Afghanistan may not materialize as hoped. The Middle East is in turmoil, Israel, our major ally in the Middle East, is in a shaky cease fire with Gaza even as Egypt is in flux, Iran gets closer to developing a nuclear bomb, which we have pledged would not be allowed, and al-Qaida related terrorist groups have been on the rise attacking U.S. interests abroad, in one incident killing our Ambassador and three military personnel.

And, there have been no specifics given on how to contain entitlement programs; the largest contributor to deficit increases and, given changing demographics, may have shortened lives in their current forms. Despite trying to reign in spending, however, some are advocating increased spending under the guise they are investments in the future. Even so, investments are supposed to provide a return, whereas some of the recent past investments have not met this criterion, raising questions whether or not this is the time to pursue a large spending expansion in this area. Outside the U.S., Europe remains in recession, the leadership of China has changed, and the Federal Reserve has about exhausted its ability to assist in solving the economic problems without fiscal policy actions being taken. While the consensus still expect the economy to continue to grow, albeit at a slower than normal recovery pace, this could quickly change if the challenges that lie ahead are not resolved and quickly.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY			
<u>INDICATORS</u>	<u>OCT. 2012</u>	<u>SEPT. 2012</u>	<u>OCT. 2011</u>
Unemployment Rate (Average)	8.8%	8.8%	10.0%
Annual Rate of Inflation (Chicago)	-2.0%	3.4%	1.7%
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (October)	6,627	0.6%	0.7%
Employment (thousands) (October)	6,045	0.7%	2.0%
New Car & Truck Registration (October)	48,807	1.8%	19.1%
Single Family Housing Permits (October)	995	23.0%	35.5%
Total Exports (\$ mil) (September)	5,617	0.0%	0.2%
Chicago Purchasing Managers Index (Nov.)	50.4	1.0%	-19.3%

HMO Contract Awarded
Anthony Bolton, Revenue Analyst

The Department of Healthcare and Family Services announced on November 15 that an award had been made for supplemental fully-insured HMO coverage for participants in the State Employees Group Insurance Program, Local Government Health Plan, Teachers Retirement Insurance Program, and the College Insurance Program. This contract comes after a lengthy period of temporary emergency contracts while a final contract was developed. The new contract takes effect January 2013 and continues through June 2016 with options for 5 renewal years.

Two insurance vendors, Health Alliance Medical Plan and Coventry Health Care of Illinois (formerly Personal Care) had submitted bids for this particular contract, and both vendors were awarded contracts. The total awarded amount (including renewal options) is approximately \$6.94 billion. The amount breaks down into an award of \$6.291 billion for Health Alliance and \$649 million for Coventry. This award covers fully-insured HMO service in all four regions (all counties except Cook, Lake, McHenry, Kane, DuPage and Kendall) covered by the RFP.

REVENUE

November Revenues Mixed – Overall Flat

Jim Muschinske, Revenue Manager

Overall base revenues dropped by \$6 million in November as revenue performance varied by line. While the larger economic sources performed decently, those gains were erased by a down month for federal sources and a variety of smaller revenue lines. Also contributing to the minor monthly drop was one less receipting day in November.

Gross personal income tax revenues rose \$75 million, or \$56 million net of refunds. Sales tax managed a \$8 million advance, while gross corporate income tax grew \$7 million, or \$8 million net of refunds. Cigarette taxes

grew \$7 million, making up for some of the shortfall related to the stockpiling effect that took place prior to the June tax increase. Liquor taxes eked out a \$2 million gain in November.

Inheritance taxes dropped \$42 million as a function of timing related to tax changes that went into effect January 2011 [and which were accompanied with an approximate ten month timing delay]. Those changes resulted in large receipts last November, which led to the large monthly drop this fiscal year. Public utility taxes fell by \$16 million, insurance taxes and fees \$3 million, interest income \$2 million, and vehicle use tax \$1 million.

Overall transfers grew \$5 million for the month. Riverboat transfers posted strong gains of \$19 million, and Lottery transfers grew \$4 million. Other transfers fell \$18 million in November. Federal sources suffered its second monthly decline for the fiscal year, falling \$42 million.

Year to Date

Through the first five months of FY 2013, overall base revenues grew \$530 million. Gross personal income taxes were up \$342 million, or \$250 million net of refunds. Gross corporate income taxes increased \$188 million, or \$186 million net of refunds. Due to lagged timing of receipts related to a prior tax change, inheritance tax was up \$86 million. All other tax sources totaled a net gain of \$4 million.

Overall transfers were down \$257 million. The falloff was due to the one-time \$73 million sale of the 10th license last year, as well as timing related to last year's settlement of protested liquor taxes. Federal sources, after experiencing a very weak beginning to last fiscal year, managed to post a \$261 million gain through November.

Updated FY 2013 and Preliminary FY 2014 Outlook

On November 15th, the Commission provided testimony to the House Revenue Committee as part of the discussion regarding HJR 45. At that time, CGFA presented an update on FY 2013 revenues, as well as a preliminary outlook for FY 2014. While a copy of the material presented can be found on the Commission's website, the following pages provide a brief summary of the revenue items discussed.

CGFA and GOMB FY 2013 Estimates

The table below demonstrates the differences between CGFA's revised FY 2013 estimate and GOMB's latest official statement published in September 2013. As shown, in total, the two agencies are very close with CGFA being slightly higher than GOMB by \$52 million.

While CGFA is somewhat higher than GOMB in estimates of the State taxes including the larger economic

sources, CGFA is lower than the GOMB in the estimate of federal sources. At this point of the fiscal year, CGFA is not yet comfortable assuming that reimbursable spending will be at the level required in order to meet the GOMB forecast.

It should also be noted that neither forecast presented here includes \$264 million in transfers related to the FY 2013 Backlog Payment Fund as those monies are not viewed as true additional revenue.

FY 2013 GENERAL FUNDS REVENUE COMPARISON: CGFA vs. GOMB			
(\$ Millions)			
Revenue Sources	FY 2013 CGFA Nov-12	FY 2013 GOMB Sept-12	\$ Difference
State Taxes			
Personal Income Tax	\$17,025	\$16,923	\$102
Corporate Income Tax	\$3,161	\$2,966	\$195
Sales Taxes	\$7,340	\$7,335	\$5
Public Utility (regular)	\$1,055	\$1,101	(\$46)
Cigarette Tax	\$355	\$355	\$0
Liquor Gallonage Taxes	\$164	\$163	\$1
Vehicle Use Tax	\$30	\$29	\$1
Inheritance Tax (gross)	\$255	\$242	\$13
Insurance Taxes & Fees	\$345	\$285	\$60
Corporate Franchise Tax & Fees	\$195	\$203	(\$8)
Interest on State Funds & Investments	\$20	\$20	\$0
Cook County Intergovernmental Transfer	\$244	\$244	\$0
<u>Other Sources</u>	<u>\$402</u>	<u>\$405</u>	<u>(\$3)</u>
Subtotal	\$30,591	\$30,271	\$320
Transfers			
Lottery	\$656	\$649	\$7
Riverboat transfers and receipts	\$357	\$350	\$7
Proceeds from sale of 10th license	\$10	\$10	\$0
<u>Other*</u>	<u>\$740</u>	<u>\$689</u>	<u>\$51</u>
Total State Sources	\$32,354	\$31,969	\$385
Federal Sources	\$3,935	\$4,231	(\$296)
Total Federal & State Sources	\$36,289	\$36,200	\$89
Nongeneral Funds Distribution:			
Refund Fund			
Personal Income Tax [9.75%]	(\$1,660)	(\$1,650)	(\$10)
Corporate Income Tax [14.0%]	(\$443)	(\$416)	(\$27)
Subtotal General Funds	\$34,186	\$34,134	\$52
NOTE: Totals exclude Budget Stabilization transfers, and other cash flow transfers.			
CGFA			
*Other transfers do not include \$264 million from the FY'13 Backlog Payment Fund			

A Look Ahead To FY 2014

While CGFA’s first official estimate for FY 2014 will not be presented until February/March of 2013, interest is already building around out-year expectations. Unfortunately, most views are that FY 2014 will be saddled with continued struggles related to employment gains and overall tepid economic performance.

- In terms of income taxes, at this early juncture, base personal income taxes are expected to post 2.3% growth, and base corporate income taxes are expected to be flat. Fortunately, due to year-over-year impacts of federal bonus depreciation, both growth rates will be adjusted positively, thereby able to eke out somewhat higher gains than base growth.
- Sales tax is expected to continue to struggle, likely in the neighborhood

of 2%. In the very near future, decisions at the federal level related to the “fiscal cliff” could impact on consumer confidence so it’s difficult to commit to a growth rate at this early stage.

- Very little growth can be expected from non-economic sources as well as transfers.
- Federal sources are dependent on reimbursable spending which are in turn dependent on appropriations as well as available resources. At this time, federal sources are assumed to be flat for the upcoming fiscal year – although that assumption will likely change once spending priorities are made.

As shown in the table below, at this early stage, general revenues in FY 2014 are expected to grow just over \$767 million, or 2.2%.

Preliminary CGFA FY 2014 Estimates			
General Funds	FY 2013	FY 2014	
\$millions	Nov-12	Nov-12	Change
State Sources	\$28,488	\$29,218	\$730
Transfers	\$1,763	\$1,800	\$37
Federal Sources	\$3,935	\$3,935	\$0
Total	\$34,186	\$34,953	\$767

GENERAL FUNDS RECEIPTS: NOVEMBER

FY 2013 vs. FY 2012

(\$ million)

Revenue Sources	Nov. FY 2013	Nov. FY 2012	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$1,174	\$1,099	\$75	6.8%
Corporate Income Tax (regular)	50	43	\$7	16.3%
Sales Taxes	610	602	\$8	1.3%
Public Utility Taxes (regular)	71	87	(\$16)	-18.4%
Cigarette Tax	36	29	\$7	24.1%
Liquor Gallonage Taxes	15	13	\$2	15.4%
Vehicle Use Tax	2	3	(\$1)	-33.3%
Inheritance Tax (Gross)	14	42	(\$28)	-66.7%
Insurance Taxes and Fees	0	3	(\$3)	N/A
Corporate Franchise Tax & Fees	19	19	\$0	0.0%
Interest on State Funds & Investments	4	6	(\$2)	-33.3%
Cook County IGT	56	56	\$0	0.0%
Other Sources	28	28	\$0	0.0%
Subtotal	\$2,079	\$2,030	\$49	2.4%
Transfers				
Lottery	59	55	\$4	7.3%
Riverboat transfers & receipts	47	28	\$19	67.9%
Proceeds from Sale of 10th license	0	0	\$0	N/A
Other	28	46	(\$18)	-39.1%
Total State Sources	\$2,213	\$2,159	\$54	2.5%
Federal Sources	\$175	\$217	(\$42)	-19.4%
Total Federal & State Sources	\$2,388	\$2,376	\$12	0.5%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$115)	(\$96)	(\$19)	19.8%
Corporate Income Tax	(\$7)	(8)	\$1	-12.5%
Subtotal General Funds	\$2,266	\$2,272	(\$6)	-0.3%
Short-Term Borrowing	\$0	\$0	\$0	N/A
FY'13 Backlog Payment Fund	\$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	\$2,266	\$2,272	(\$6)	-0.3%

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

3-Dec-12

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2013 vs. FY 2012

(\$ million)

Revenue Sources	FY 2013	FY 2012	CHANGE FROM FY 2012	% CHANGE
State Taxes				
Personal Income Tax	\$6,238	\$5,896	\$342	5.8%
Corporate Income Tax (regular)	883	695	\$188	27.1%
Sales Taxes	3,039	3,020	\$19	0.6%
Public Utility Taxes (regular)	401	426	(\$25)	-5.9%
Cigarette Tax	145	147	(\$2)	-1.4%
Liquor Gallonage Taxes	71	69	\$2	2.9%
Vehicle Use Tax	12	13	(\$1)	-7.7%
Inheritance Tax (Gross)	135	49	\$86	N/A
Insurance Taxes and Fees	89	86	\$3	3.5%
Corporate Franchise Tax & Fees	93	87	\$6	6.9%
Interest on State Funds & Investments	7	10	(\$3)	-30.0%
Cook County IGT	56	56	\$0	0.0%
Other Sources	155	150	\$5	3.3%
Subtotal	\$11,324	\$10,704	\$620	5.8%
Transfers				
Lottery	245	239	\$6	2.5%
Riverboat transfers & receipts	187	154	\$33	21.4%
Proceeds from Sale of 10th license	0	73	(\$73)	N/A
Other	205	428	(\$223)	-52.1%
Total State Sources	\$11,961	\$11,598	\$363	3.1%
Federal Sources	\$1,395	\$1,134	\$261	23.0%
Total Federal & State Sources	\$13,356	\$12,732	\$624	4.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$608)	(\$516)	(\$92)	17.8%
Corporate Income Tax	(\$124)	(\$122)	(\$2)	1.6%
Subtotal General Funds	\$12,624	\$12,094	\$530	4.4%
Short-Term Borrowing	\$0	\$0	\$0	N/A
FY'13 Backlog Payment Fund Transfer	\$264	\$0	\$264	N/A
Tobacco Liquidation Proceeds	\$0	\$0	\$0	N/A
Pension Contribution Fund Transfer	\$0	\$0	\$0	N/A
Budget Stabilization Fund Transfer	\$275	\$275	\$0	0.0%
Total General Funds	\$13,163	\$12,369	\$794	6.4%

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

CGFA

3-Dec-12