Commission on Government Forecasting and Accountability

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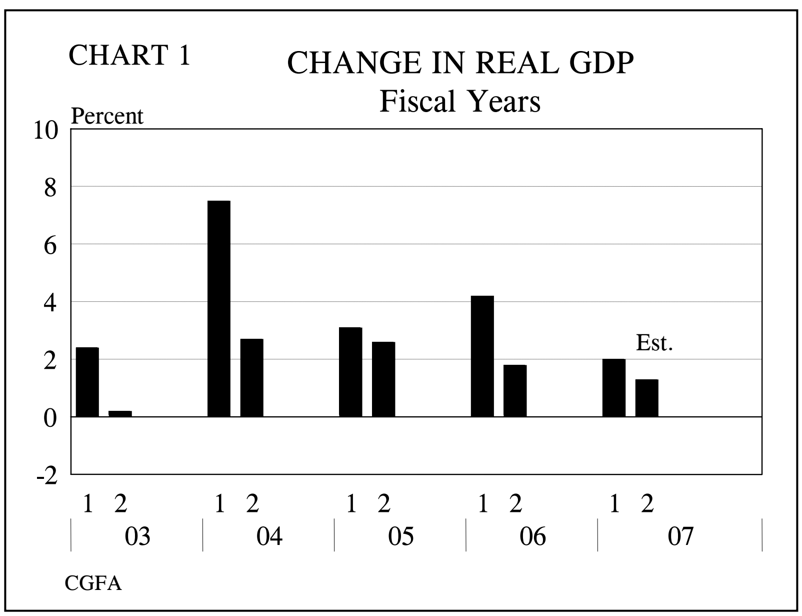
INSIDE THIS ISSUE

703 Stratton Ofc. Bldg.
Springfield, IL 62706

ECONOMY: Strength in Question

Edward H. Boss, Jr., Chief Economist

As the economy enters calendar 2007 and completes the first half of fiscal 2007, a weakening in the pace of economic activity is raising questions as to how long the current business expansion can be sustained. Analysts point out that the pace of activity already has slowed, growing at a modest 2% rate in the quarter ended in September with little evidence that any pickup occurred in the quarter just ended. Indeed, as shown in the Chart, the growth in the second fiscal quarter in each of the past four years failed to match the previous quarter's growth. Moreover, while last year's Holiday sales were strong, this year preliminary results were significantly less, although not entirely a surprise and in line with the projections of the National Federation of Retailers mentioned in last month's Revenue update.



The current business expansion began in November 2001, some 61 months ago, surpassing the average of 57 months of expansion in the ten cycles since 1945. While the length of expansions have varied widely, from as short as 12 months to as long as 120 months, there are other events that have surfaced which in the past have preceded the end of the expansion phase of the business cycle.

One of the most ominous is the inverted shape of the yield curve, or the existence of higher short-term interest rates than long-term interest rates. This situation comes about as the Federal Reserve progressively raises key short-term interest rates to a point where they raise above interest rates on longer-term securities in an attempt to slow demand and curtail upward price pressures. The Federal Reserve raised key short-term interest rates 17 times since the summer of 2004 with the federal funds rate raised to 5¼% from a low of 1%. As evidence of a slowing pace of economic activity emerged, the Federal Reserve held rates unchanged since their August meeting. Still, the yield curve is negatively sloped and concerns are that Federal Reserve once again may overstay its period of credit restraint leading to deleterious effects on the business expansion.

The decline in the housing market has been a major factor behind the slowdown. Moreover, as home prices decline further, this removes the fuel that allowed consumer spending to outpace real income gains. Similarly, lower levels of housing sales led to diminishing sales of household furnishings, carpets, etc. Finally, despite a surge in corporate profits, business spending has not been strengthening. Manufacturing in particular has weakened with both the Chicago area and national purchasing managers surveys contracting in November for the first time since the spring of 2003. The Chicago area index did rebound, however, in December. The common rule of thumb is that a recession occurs when there are two or more consecutive quarters of decline in real gross domestic product. In fact, only the NBER (National Bureau of Economic Research) dates recessions and that is based on its analysis of data that show a wide spread general decline in economic activity. For example, there were not two consecutive quarters of decline in the last recession, although latest revisions show small declines in GDP in 3Q 2000, 1Q 2001, and 3Q 2001.

Despite concerns over the weakening growth in the pace of economic activity, the odds favor a soft landing of the economy and not a recession. There was an increase in gift cards during the holidays, which should uplift consumer spending early in the new year. In addition, consumer confidence as measured by the Conference Board showed a surprisingly strong increase in December while the stock market set new record highs. Both new and existing home sales increased in November and the backlog of unsold homes overhanging the market was reduced. The 4-week average level of unemployment claims fell, breaking out of a rising trend and, finally, the rise in the Chicago manufacturing index suggests some improvement in business spending. Even so, the economy remains vulnerable to any shocks to the system such as a significant increase in oil prices, the Federal Reserve over-staying its period of credit firmness, or any one of several external World developments.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	NOV. 2006	OCT. 2006	NOV. 2005
Unemployment Rate (Average)	4.1%	4.1%	5.2%
Annual Rate of Inflation (Chicago)	2.4%	-12.6%	0.3%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (November)	6,645	-2.8%	2.5%
Employment (thousands) (November)	6,375	-2.1%	3.8%
New Car & Truck Registration (November)	N/A	N/A%	N/A%
Single Family Housing Permits (November)	2,267	-27.1%	-44.0%
Total Exports ($ mil) (October)	3,825	7.5%	16.3%
Chicago Purchasing Managers Index (December)	52.4	5.0%	-13.8%

REVENUE
Receipts Close 2006 on Mixed Note
Jim Muschinske, Revenue Manager

Revenues for December were again mixed, although overall receipts fell $72 million due to continued lower federal sources. While corporate income tax and sales tax performed well, income tax receipts took a breather from its otherwise strong year to date performance. December had one less receipting day than last fiscal year.

Sales tax receipts posted a $44 million gain for the month and gross corporate income taxes rose $20 million, or $23 million net of refunds. Interest income continued to fare well as evidenced by its advance of $6 million. Vehicle use tax managed to eke out a $1 million gain.

A number of sources experienced declines in December. Other sources fell $20 million while public utility taxes were off by $16 million. Inheritance tax posted a loss of $9 million and even gross personal income tax eased with a drop of $8 million, or $7 million net of refunds. Cigarette tax dipped by $4 million due to a change in the tax distribution.

Overall transfers fell by $14 million in December. Riverboat transfers fell $10 million, while lottery and other transfers each fell $2 million. As mentioned earlier, federal sources experienced another down month as receipts were down $76 million.

Year to Date

Due to the large November fall-off in federal sources, overall receipts to the general funds are down $74 million through the first half of the fiscal year. However, that total is very misleading as most of the economically related sources continue to perform very well. In fact, the falloff in federal sources aside, other receipts are up a very respectable $596 million.

Gross personal income taxes are up $258 million, or $233 million net of refunds. Sales tax receipts are up $154 million, while gross corporate income taxes advanced by $127 million, or $122 million net of refunds. Interest income is ahead by $38 million and inheritance tax receipts are up $15 million. All other sources experiencing gains added an additional $5 million.

As expected, the Cook County IGT is down $27 million, while due to a change in tax distribution, cigarette taxes are off by $25 million. Other sources are behind by $20 million and public utility taxes are down $11 million.

Overall transfers are up by $112 million. While other transfers are up $165 million due mostly to a large July transfer from the Refund Fund as well as chargeback activity, a $59 million falloff in lottery transfers served to offset some of those gains. Finally, federal sources are down $670 million due to less reimbursable spending related to last year's $1 billion in short-term borrowing.

GENERAL FUNDS RECEIPTS: DECEMBER

FY 2007 vs. FY 2006
($ million)

Revenue Sources	DEC. FY 2007	DEC. FY 2006	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$689	$697	($8)	-1.1%
Corporate Income Tax (regular)	289	269	$20	7.4%
Sales Taxes	638	594	$44	7.4%
Public Utility Taxes (regular)	96	112	($16)	-14.3%
Cigarette Tax	29	33	($4)	-12.1%
Liquor Gallonage Taxes	17	17	$0	0.0%
Vehicle Use Tax	2	1	$1	100.0%
Inheritance Tax (Gross)	18	27	($9)	-33.3%
Insurance Taxes and Fees	63	63	$0	0.0%
Corporate Franchise Tax & Fees	13	13	$0	0.0%
Interest on State Funds & Investments	17	11	$6	54.5%
Cook County IGT	0	0	$0	N/A
Other Sources	22	42	($20)	-47.6%
Subtotal	$1,893	$1,879	$14	0.7%
Transfers				
Lottery	43	45	($2)	-4.4%
Riverboat transfers & receipts	60	70	($10)	-14.3%
Other	18	20	($2)	-10.0%
Total State Sources	$2,014	$2,014	$0	0.0%
Federal Sources	$330	$406	($76)	-18.7%
Total Federal & State Sources	$2,344	$2,420	($76)	-3.1%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($67)	($68)	$1	-1.5%
Corporate Income Tax	($51)	(54)	$3	-5.6%
Subtotal General Funds	$2,226	$2,298	($72)	-3.1%
Short-Term Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$2,226	$2,298	($72)	-3.1%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Jan-07

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2007 vs. FY 2006

($ million)

Revenue Sources	FY 2007	FY 2006	CHANGE FROM FY 2006	% CHANGE
State Taxes				
Personal Income Tax	$4,194	$3,936	$258	6.6%
Corporate Income Tax (regular)	820	693	$127	18.3%
Sales Taxes	3,695	3,541	$154	4.3%
Public Utility Taxes (regular)	530	541	($11)	-2.0%
Cigarette Tax	175	200	($25)	-12.5%
Liquor Gallonage Taxes	80	79	$1	1.3%
Vehicle Use Tax	17	17	$0	0.0%
Inheritance Tax (Gross)	149	134	$15	11.2%
Insurance Taxes and Fees	147	147	$0	0.0%
Corporate Franchise Tax & Fees	96	92	$4	4.3%
Interest on State Funds & Investments	103	65	$38	58.5%
Cook County IGT	62	89	($27)	-30.3%
Other Sources	185	205	($20)	-9.8%
Subtotal	$10,253	$9,739	$514	5.3%
Transfers				
Lottery	271	330	($59)	-17.9%
Riverboat transfers & receipts	355	349	$6	1.7%
Other	358	193	$165	85.5%
Total State Sources	$11,237	$10,611	$626	5.9%
Federal Sources	$2,161	$2,831	($670)	-23.7%
Total Federal & State Sources	$13,398	$13,442	($44)	-0.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($409)	($384)	($25)	6.5%
Corporate Income Tax	($144)	($139)	($5)	3.6%
Subtotal General Funds	$12,845	$12,919	($74)	-0.6%
Short-Term Borrowing	$0	$1,000	($1,000)	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	N/A
Total General Funds	$13,121	$14,195	($1,074)	-7.6%

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

CGFA 2-Jan-07

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2007 ESTIMATE vs. FY 2006 ACTUAL

($ million)

Revenue Sources	Nov-06 ESTIMATE FY 2007	FYTD 2007	AMOUNT NEEDED FY 2007 EST.	FYTD 2006	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$10,116	$4,194	$5,922	$3,936	$290	5.1%
Corporate Income Tax (regular)	1,938	820	$1,118	693	$27	2.5%
Sales Taxes	7,345	3,695	$3,650	3,541	$99	2.8%
Public Utility Taxes (regular)	1,074	530	$544	541	$11	2.1%
Cigarette Tax	350	175	$175	200	($25)	-12.5%
Liquor Gallonage Taxes	153	80	$73	79	$0	0.0%
Vehicle Use Tax	34	17	$17	17	$0	0.0%
Inheritance Tax (Gross)	277	149	$128	134	($10)	-7.2%
Insurance Taxes and Fees	320	147	$173	147	$3	1.8%
Corporate Franchise Tax & Fees	190	96	$94	92	$5	5.6%
Interest on State Funds & Investments	185	103	$82	65	($6)	-6.8%
Cook County IGT	309	62	$247	89	($14)	-5.4%
Other Sources	440	185	$255	205	$19	8.1%
Subtotal	$22,731	$10,253	$12,478	$9,739	$399	3.3%
Transfers						
Lottery	630	271	$359	330	$19	5.6%
Riverboat transfers & receipts	700	355	$345	349	$5	1.5%
Other	841	358	$483	193	($70)	-12.7%
Total State Sources	$24,902	$11,237	$13,665	$10,611	$353	2.7%
Federal Sources	$4,803	$2,161	$2,642	$2,831	$748	39.5%
Total Federal & State Sources	$29,705	$13,398	$16,307	$13,442	$1,101	7.2%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($986)	($409)	($577)	($384)	($28)	5.1%
Corporate Income Tax	(339)	($144)	($195)	(139)	$22	-10.1%
Subtotal General Funds	$28,380	$12,845	$15,535	$12,919	$1,095	7.6%
Short-Term Borrowing	$0	$0	$0	$1,000	$0	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	$276	$0	N/A
Total General Funds	$28,656	$13,121	$15,535	$14,195	$1,095	7.6%

CGFA 2-Jan-07

GENERAL FUNDS PERFORMANCE TO DATE
GOVERNOR'S OFFICE OF MANANGEMENT AND BUDGET

FY 2007 ESTIMATE vs. FY 2006 ACTUALS

($ million)

Revenue Sources	GOMB JUNE-06 Estimate FY 2007	FYTD 2007	AMOUNT NEEDED FY 2007 Est.	FYTD 2006	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$9,844	$4,194	$5,650	$3,936	$18	0.3%
Corporate Income Tax (regular)	2,074	820	$1,254	693	$163	14.9%
Sales Taxes	7,280	3,695	$3,585	3,541	$34	1.0%
Public Utility Taxes (regular)	1,090	530	$560	541	$27	5.1%
Cigarette Tax	350	175	$175	200	($25)	-12.5%
Liquor Gallonage Taxes	152	80	$72	79	($1)	-1.4%
Vehicle Use Tax	35	17	$18	17	$1	5.9%
Inheritance Tax (Gross)	255	149	$106	134	($32)	-23.2%
Insurance Taxes and Fees	322	147	$175	147	$5	2.9%
Corporate Franchise Tax & Fees	196	96	$100	92	$11	12.4%
Interest on State Funds & Investments	143	103	$40	65	($48)	-54.5%
Cook County IGT	309	62	$247	89	($14)	-5.4%
Other Sources	505	185	$320	205	$84	35.6%
Subtotal	$22,555	$10,253	$12,302	$9,739	$223	1.8%
Transfers						
Lottery	670	271	$399	330	$59	17.4%
Gaming Fund Transfer	692	355	$337	349	($3)	-0.9%
Other	933	358	$575	193	$22	4.0%
Total State Sources	$24,850	$11,237	$13,613	$10,611	$301	2.3%
Federal Sources	$4,803	$2,161	$2,642	$2,831	$748	39.5%
Total Federal & State Sources	$29,653	$13,398	$16,255	$13,442	$1,049	6.9%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($960)	($409)	($551)	($384)	($2)	0.4%
Corporate Income Tax	(363)	(144)	($219)	(139)	($2)	0.9%
Subtotal General Funds	$28,330	$12,845	$15,485	$12,919	$1,045	7.2%
Short-Term Borrowing	$0	$0	$0	$1,000	$0	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	$276	$0	N/A
Total General Funds	$28,606	$13,121	$15,485	$14,195	$1,045	7.2%
CGFA						2-Jan-07

PENSIONS
Chicago Transit Authority Pension Funding Projections

Gregg Scott, Pension Analyst

The Retirement Plan for the Chicago Transit Authority Employees covered a total of 19,628 participants on January 1, 2005. This total included 10,751 active participants, 7,211 retirees, 905 disabled and 761 survivors.

The active participants have an average age of 44.2 years with 10.4 years of average service and receive an average annual salary of $53,426. The employee annuitants have an average age of 66.3 years with an average annual benefit of $22,512. The disability annuitants have an average age of 60.0 years and an average annual benefit of $12,453. Finally, surviving spouses have an average age of 75 years and receive an average annual benefit of $8,130.

The funding status of the CTA Pension Fund is measured as a ratio of the total value of the pension fund assets to the actuarial present value of the total benefits earned to date by the plan participants. This is referred to as the plan's funding ratio. On January 1, 2005, the Chicago Transit Authority Plan had a funding ratio of 39.4%, as shown in Table #1 below. This calculation was based upon $1.4 billion in total assets and $3.5 billion in accrued liabilities. For 2004, the total actuarial value of Plan assets was $1.6 billion with $3.3 billion in total actuarial accrued Plan liabilities, with a funding ratio of 48.5%.

Table #1

Chicago Transit Authority Pension Fund
Financial Condition as of January 1, 2005

Active Participants	
Number	10,751
Average Annual Salary	$53,426
Retirees	
Number	7,211
Average Age	66.3
Average Annual Benefit	$22,512
Assets ($ millions)	$1,382.3
Accrued Liabilities ($ millions)	$3,510.6
Funded Ratio	39.4%

There were two primary causes for the decrease in funding ratio between 2004 and 2005. The largest cause was a shortfall in contributions. The collective bargaining agreement between the Chicago Transit Authority and the Amalgamated Transit Workers' Union requires an annual contribution of 3% of payroll by the employees and 6% of payroll by the CTA. This 9% total contribution fell far short of matching the 16.7% contribution necessary to meet the plan's Normal Cost plus interest.

The second primary cause of the 2005 funding ratio decline was lower-than-anticipated investment income. The return on the actuarial value of assets for 2005 was 1.4% and was significantly less than the 9.0% actuarially assumed rate. This shortfall caused the total asset value to be $113.47 million less than expected. The actuarial value of assets method used by the Chicago Transit Authority recognizes the 9% assumed rate of return fully each year, whether it is actually achieved or not. Any differences between actual returns and the 9% assumed rate of return are recognized over a 5-year period at a rate of 20% per year. This five-year smoothing method serves to eliminate the effects of annual market volatility. Accordingly, the actuarial value of assets will tend to be less than market value during periods when market returns exceed the actuarially assumed rate of return. Conversely, periods when actual returns are lower than the assumed rate will result in the actuarial value of assets being greater than the market value of assets. As of January 1, 2005, the actuarial value of assets was $97.6 million greater than the market value of assets due to several prior years of investment returns below expectations. The January 1, 2005 funding ratio would be reduced to 36.6% if assets were calculated at market value.

All of the aforementioned figures include the liability for the costs of healthcare premium reimbursement earned as of January 1, 2005 by all retirees and active employees. As of January 1, 2005, the total healthcare premium reimbursement earned by all retirees and survivors totaled $826.6 million. The corresponding figure for all active employees equaled $392.9 million. Therefore, a total of $1.2 billion for healthcare premium reimbursement costs was included in the $3.5 billion total actuarial liabilities of the pension fund, as shown in Table #2 below. If all of the costs for healthcare premium reimbursement were eliminated from the pension fund, the total actuarial liabilities would be reduced to $2.3 billion. Using the January 1, 2005 actuarial value of assets, i.e. $1.4 billion, this adjustment in liabilities would result in a 60.3% funded ratio with no healthcare premium reimbursement costs.

Table #2 Chicago Transit Authority Pension Fund Breakdown of Healthcare and Pension Liabilities - January 1, 2005 ($ in Thousands)	Pension	Healthcare	Total
Actuarial Accrued Liabilities	$2,291,162	$1,219,457	$3,510,619
Actuarial Value of Assets	902,117	480,147	1,382,264
Unfunded Actuarial Liability	$1,389,045	$739,310	$2,128,355

P.A. 94-0839, which became effective on June 6, 2006, established a 50-year funding plan for the CTA pension fund. The Act stipulates that for fiscal years 2009 through 2058, the minimum employer contribution to the pension fund must be an amount determined to be sufficient to bring the total assets of the retirement system up to 90% of its total actuarial liabilities by the end of fiscal year 2058. The employer contribution shall be calculated each year as a level percentage of payroll over the years remaining to and including fiscal year 2058. Beginning in fiscal year 2059, the minimum CTA contribution for each fiscal year shall be the amount needed to maintain a 90% funding ratio. Additionally, the Act requires the CTA pension fund to remove contributions and liabilities relating to healthcare beginning on January 1, 2009.

In light of the funding requirements set forth in P.A. 94-0839, the Commission's actuary has performed a cost study for the Chicago Transit Authority retirement system utilizing membership data obtained from the pension fund's January 1, 2005 actuarial report. The results of the cost study are shown in Chart #3 below. The actuary's projections do not include any costs for healthcare premium reimbursements after January 1, 2009. These projections assumed that the retiree healthcare plan would be transferred out of the pension plan as of January 1, 2009 and no healthcare benefits would be paid from the pension fund assets thereafter. The existing employee/employer contribution rates totaling 9% of payroll were assumed to continue through December 31, 2008. From January 1, 2009 through December 31, 2059, a total annual contribution rate equaling 27.67% of payroll was used in all calculations. The actuary assumed the employee contribution rate would continue at 3% of payroll, and the employer contribution rate would be increased to 24.67% of payroll.

Table #3

CTA Retirement Plan

CGFA Funding Projection based on Funding Plan Specified in Public Act 94-0839*

($ in Millions)

Fiscal Year	Accrued Liability	Assets	Unfunded Liability	Funded Ratio	Payroll	Employee Contributions	Employer Contributions	Employer Contributions As a % of Payroll
2006	$2,354.1	$1,199.1	$1,155.1	50.9%	$575.8	$17.3	$34.5	6.00%
2007	2,416.8	1,090.4	1,326.5	45.1%	588.6	17.7	35.3	6.00%
2008	2,482.9	962.2	1,520.6	38.8%	602.0	18.1	36.1	6.00%
2009	2,553.1	813.4	1,739.7	31.9%	616.2	18.5	152.0	24.67%
2010	2,627.6	846.0	1,781.6	32.2%	630.5	18.9	155.5	24.67%
2011	2,706.5	880.7	1,825.8	32.5%	645.2	19.4	159.2	24.67%
2012	2,789.7	917.5	1,872.2	32.9%	660.0	19.8	162.8	24.67%
2013	2,876.9	956.0	1,920.9	33.2%	674.0	20.2	166.2	24.67%
2014	2,968.2	995.7	1,972.5	33.5%	688.6	20.7	169.8	24.67%
2015	3,063.0	1,036.2	2,026.8	33.8%	703.3	21.1	173.5	24.67%
2016	3,160.5	1,076.7	2,083.8	34.1%	717.3	21.5	176.9	24.67%
2017	3,259.9	1,116.0	2,143.9	34.2%	731.0	21.9	180.3	24.67%
2018	3,361.0	1,153.6	2,207.4	34.3%	745.6	22.4	183.9	24.67%
2019	3,463.8	1,189.5	2,274.3	34.3%	761.0	22.8	187.7	24.67%
2020	3,568.1	1,223.3	2,344.8	34.3%	776.9	23.3	191.6	24.67%
2021	3,672.1	1,253.5	2,418.6	34.1%	792.6	23.8	195.5	24.67%
2022	3,775.0	1,279.0	2,496.0	33.9%	809.0	24.3	199.5	24.67%
2023	3,877.2	1,299.8	2,577.4	33.5%	826.9	24.8	204.0	24.67%
2024	3,976.9	1,314.7	2,662.1	33.1%	845.1	25.4	208.5	24.67%
2025	4,073.7	1,323.0	2,750.7	32.5%	864.8	25.9	213.3	24.67%
2026	4,167.1	1,324.2	2,842.9	31.8%	886.5	26.6	218.7	24.67%
2027	4,254.5	1,316.5	2,938.0	30.9%	908.1	27.2	224.0	24.67%
2028	4,333.4	1,297.6	3,035.8	29.9%	930.4	27.9	229.5	24.67%
2029	4,403.1	1,266.6	3,136.4	28.8%	955.8	28.7	235.8	24.67%
2030	4,465.6	1,225.5	3,240.1	27.4%	986.4	29.6	243.3	24.67%
2035	4,739.5	954.9	3,784.6	20.1%	1,212.5	36.4	299.1	24.67%
2040	5,135.1	839.1	4,296.0	16.3%	1,579.6	47.4	389.6	24.67%
2045	5,842.2	1,246.7	4,595.4	21.3%	2,108.2	63.2	520.0	24.67%
2050	7,038.6	2,656.0	4,382.6	37.7%	2,791.5	83.7	688.5	24.67%
2055	8,866.7	5,643.3	3,223.4	63.6%	3,615.6	108.5	891.8	24.67%
2059	10,771.7	9,694.5	1,077.2	90.0%	4,417.5	132.5	1,089.6	24.67%

* Health Care benefits not paid from pension fund after 1/1/09