Commission on Government Forecasting and Accountability

703 Stratton Ofc. Bldg., Springfield, IL 62706

MONTHLY BRIEFING FOR THE MONTH ENDED: JULY 2014

http://cgfa.ilga.gov

INSIDE THIS ISSUE

LATEST PUBLICATIONS

2014 Update: Illinois National Rankings
FY 2015 Budget Summary

ECONOMY: More of the Same?

Edward H. Boss, Jr., Chief Economist

President Truman is cited as saying he was looking for a one-armed economist in response to economic advisors responding to his questions saying… "on the one hand" followed shortly thereafter by "but, on the other hand". Since then through the advent of computers, better data collection, econometrics and models, just-in-time inventory procedures, and the study of business cycles, progress has been made, although results in forecasting remain far from perfect.

The study of economics dates back at least to Ancient Greece. However, it was Adam Smith in 1776 who is referred to as the father of modern economics with his treatise *The Wealth of Nations*. In more recent times, institutions such as the National Bureau of Economic Research, created in 1920, was formed and claims 24 Nobel Prize winners and 13 past Chairman of the President's Council of Economic Advisors, which in part may be responsible for applying economic principals to managing business and serve as a basis for research. In 1959, in response to a growing business need for planning, the National Association of Business Economists, NABE, one of the member organizations of the Allied Social Sciences Association, was formed consisting of applied economists, strategists, academics and policy makers with its mission to provide leadership in the use and understanding of economics.

Progress from all these developments over the years perhaps may have had an impact as can be observed by the behavior of business cycles. From 1854-1919 there were 16 business cycles with periods of contraction lasting 21.6 months on average and expansions lasting only slightly longer at 26.6 months; from 1919-1945 there were 6 cycles with contractions lasting 18.2 months and expansions now almost twice as long at 35.0 months; while from 1945-2009 there were 11 cycles with average periods of contraction 11.1 months and periods of expansion of 58.4 months.

The current expansion was 5 years old in June of 2014, lasting 60 months thus far. Individual cycles, however, vary widely with contractions being as long as 65 months and as short as 6 months while expansions have been as short as 12 months and as long as 120 months. *(It should be pointed out that the shortest contraction and expansion periods occurred during the twin recessions in the early 1980s which some economists now consider a single cycle.)* Even so, it appears that over time economic expansions have lasted longer while periods of contraction have shortened. And, while there continue to be severe downturns from time to time, they too have not been as deleterious as earlier ones.

Real GDP has traded in a narrow range, roughly 2% to 2 1/2% since the recovery got underway, below that of earlier recoveries. After contracting 2.8% in 2009, the economy grew 2.5% in 2010; rose 1.6% in 2011; 2.3% in 2012; and 2.2% in 2013. With data released in late July, the advance report for the second quarter of 2014 showed real GDP rose at a seasonally adjusted 4.0%, with inventory accumulation comprising 1.66% of the growth. This followed a contraction of GDP of 2.1% in the first quarter for an annual rate of 1.9% for the first half of the year.

What is of particular interest during the current expansion is that even within sectors, conflicting messages are being sent as to the economic outlook. The largest component of GDP, about 67% to 70%, consists of consumer spending, and here diverse spending patterns appear. For example, total retail sales for the first half of 2014 rose 3.5% over the same period a year earlier, heavily concentrated in autos where the average age exceed 11 years. Motor vehicle and parts spending rose a strong 7.8%, but cut into spending for other items as wages remained stagnant. Excluding the auto and parts sector, non-auto retail sales were up a modest 2.6%, and with CPI inflation up 2% in June from a year earlier, little was gained in terms of real growth.

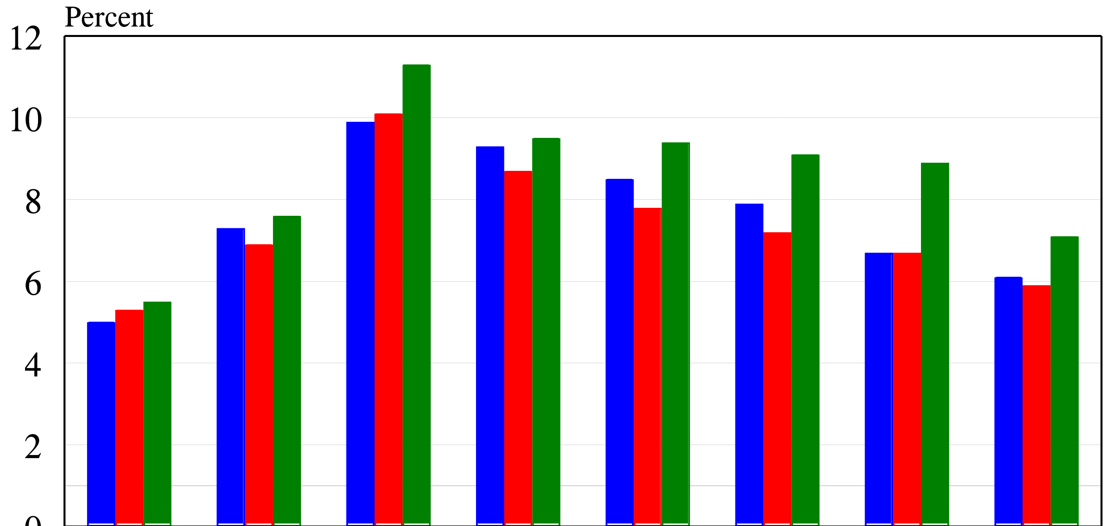
Housing recovered from its collapse during the recession with prices reaching new highs, but still faces problems with experiences varying widely by area. According to Trulia, a real estate listing and research site, “sales and prices of non-distressed homes are back to normal, while foreclosures are ebbing and fewer homeowners are behind on their mortgage payments.” In looking ahead, however, the firm expects some increase in mortgage rates, and while mortgages will be easier to secure, home affordability will decline and fewer people will own homes. Commenting on prices, SP/Case Shiller says home prices slowed in May and actually inched down seasonally. Since then, pending home sales and new home sales have weakened and thus they are expecting slower improvement in the housing market in the year ahead.

Despite record profits, business spending remains restrained due to a myriad of uncertainties while huge deficits are holding back government spending both at the federal and local level. At the same time, despite great reductions in unemployment rates, the detail behind the data paint a less rosy picture and there remain large divergences among regions. As shown in the following chart, from the end of 2009 to the end of June 2014, the U.S. unemployment rate dropped from 9.9% to 6.1%; the rate in the Midwest from 10.1% to 5.9%; and in Illinois from 11.3% to 7.1%. These sharp declines far exceed any forecast, given a continued sluggish recovery.

CHART 1

COMPARATIVE UNEMPLOYMENT RATES

Year-End



	2007	2008	2009	2010	2011	2012	2013	June 2014
U.S.	5	7.3	9.9	9.3	8.5	7.9	6.7	6.1
Midwest	5.3	6.9	10.1	8.7	7.8	7.2	6.7	5.9
Illinois	5.5	7.6	11.3	9.5	9.4	9.1	8.9	7.1

While there was little difference in unemployment rates between these groups at the end of 2007 when the recession began, gaps developed, particularly with Illinois. By last year and June of this year, the Midwest pretty much mirrored the national rate, in fact even falling below 6% last month. This in part reflected a turnaround in manufacturing employment in the "rust belt". Manufacturing employment on a year-over-year basis in the U.S. declined for 67 consecutive months between February 2005 and October 2010. Since then it increased each month and in June was 1.1% higher than a year earlier. In contrast, Illinois continues to loose manufacturing jobs which fell 11,500 in the past year, or 2%.

When looking at last month's sharp drop in Illinois unemployment rate to 7.1%, which was the lowest since rate since October 2008, it came about with only a modest 0.1 % increase in employment but a large decline of 0.3% in the size of the labor force.

Indeed, the labor force participation rate continues at its lowest level since 1978. Moreover, while the U.S. has finally replaced all the jobs lost during the last recession, more are part-time. Illinois has yet to reach that mark as it never replaced all the jobs lost in the previous recession before the last one began. In conclusion, while most economists do not foresee a new recession on the horizon, neither do they see any near-term breakout from the pace of advance seen in recent years. Moreover, the same divergent trends within sectors of the economy are likely to remain.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	JUNE 2014	MAY 2014	JUNE 2013
Unemployment Rate (Average)	7.1%	7.5%	9.2%
Annual Rate of Inflation (Chicago)	4.5%	-1.2%	2.0%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (June)	6,529	-0.3%	-0.2%
Employment (thousands) (June)	6,551	0.1%	-2.0%
New Car & Truck Registration (June)	61,494	-0.4%	9.6%
Single Family Housing Permits (June)	963	-6.2%	4.4%
Total Exports ($ mil) (May)	5,836	1.9%	3.2%
Chicago Purchasing Managers Index (July)	52.6	-15.9%	0.5%

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

REVENUE

FY 2015 Begins Mixed As One-Time Revenues Help Monthly Total

Jim Muschinske, Revenue Manager

Overall base revenues grew $184 million in July. While both personal and corporate income taxes dipped slightly, sales tax performed quite well. A surprisingly big month for inheritance tax receipts as well as a one-time boost of approximately $110 million from court settlements related to pharmaceutical company[ies] via the Attorney General's Office. July had the same number of receipting days as the prior year.

Other sources jumped $128 million, although the majority of that gain was related to the aforementioned one-time $110 million court settlement proceeds. Sales tax started the new fiscal year in similar fashion to how the last ended, as receipts continued their strong performance by growing $39 million. Inheritance tax jumped $24 million, although its success is believed to be one-time in nature. Insurance taxes added $4 million in gains, while corporate franchise taxes and interest earnings each managed a $1 million increase.

Both personal and corporate income taxes experienced declines, albeit minor, to begin the fiscal year. Gross personal income tax dipped $7 million, or $12 million net of refunds. Gross corporate income taxes were off $5 million. Public utility also dropped in July, falling $7 million.

Overall transfers rose $13 million in July. Riverboat transfers grew $1 million while other transfers added $12 million. Federal sources declined slightly for the month, falling $2 million.

GENERAL FUNDS RECEIPTS: JULY ***FY 2015 vs. FY 2014*** ***($ million)***				
Revenue Sources	**July FY 2015**	**July FY 2014**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$1,203	$1,210	($7)	-0.6%
Corporate Income Tax (regular)	80	85	($5)	-5.9%
Sales Taxes	696	657	$39	5.9%
Public Utility Taxes (regular)	79	86	($7)	-8.1%
Cigarette Tax	30	30	$0	0.0%
Liquor Gallonage Taxes	17	17	$0	0.0%
Vehicle Use Tax	3	3	$0	0.0%
Inheritance Tax (Gross)	36	12	$24	200.0%
Insurance Taxes and Fees	6	2	$4	200.0%
Corporate Franchise Tax & Fees	14	13	$1	7.7%
Interest on State Funds & Investments	2	1	$1	100.0%
Cook County IGT	0	0	$0	N/A
Other Sources	164	36	$128	355.6%
Subtotal	$2,330	$2,152	$178	8.3%
Transfers				
Lottery	40	40	$0	0.0%
Riverboat transfers & receipts	17	16	$1	6.3%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Other	79	67	$12	17.9%
Total State Sources	$2,466	$2,275	$191	8.4%
Federal Sources	$301	$303	($2)	-0.7%
Total Federal & State Sources	$2,767	$2,578	$189	7.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($120)	($115)	($5)	4.3%
Corporate Income Tax	($11)	(11)	$0	0.0%
Subtotal General Funds	$2,636	$2,452	$184	7.5%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund	$0	$50	($50)	N/A
Budget Stabilization Fund Transfer	$275	$275	$0	N/A
Total General Funds	$2,911	$2,777	$134	4.8%
CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding				1-Aug-14