Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: SEPTEMBER 2014

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ECONOMY: Cutting the Apron Strings?

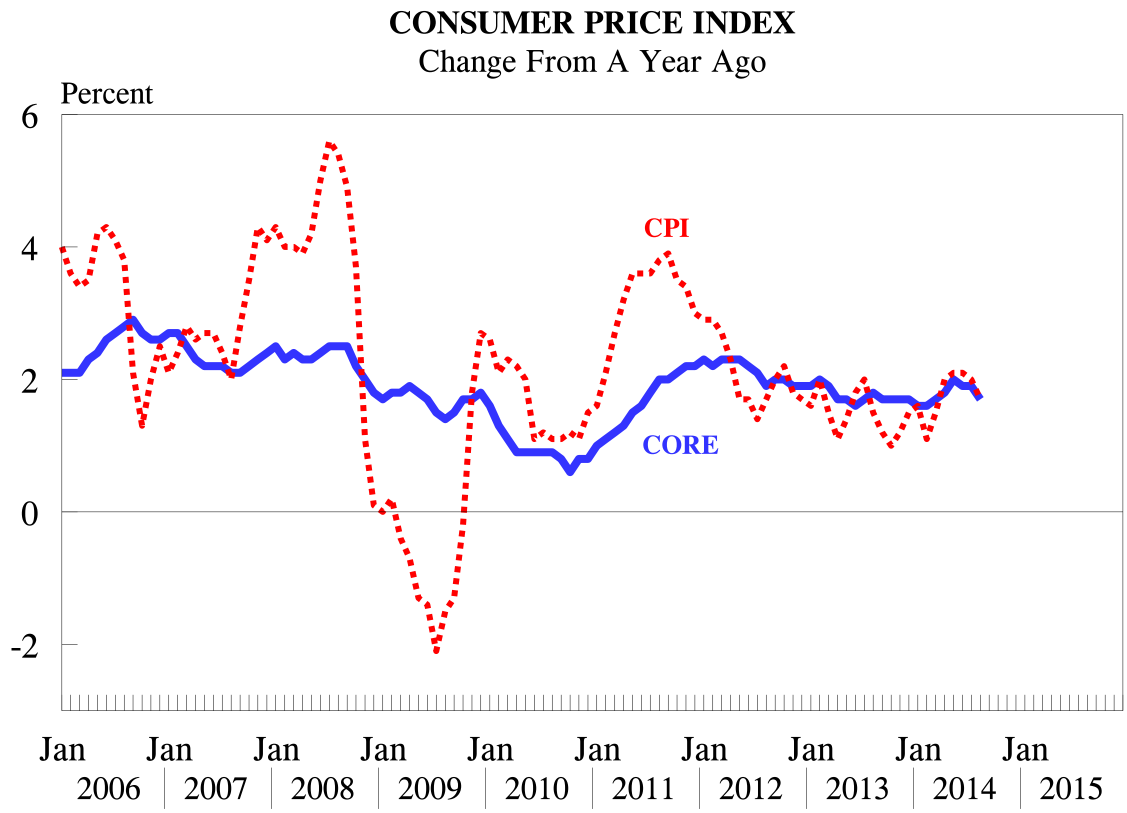
Edward H. Boss, Jr., Chief Economist

Much attention has centered on the actions of the Federal Reserve Board whose fate of the economy rests mainly in their hands. Indeed, with continued federal deficits adding to record levels of debt acting to constrain government spending, monetary policy has been relied upon to help improve economic growth in the current recovery, which is the weakest in the post WWII period, to improve labor market conditions, and keep inflation under control. Because of its importance, particular attention was paid to the minutes of the Fed's Open Market Committee released on September 17th.

While many market observers had expected that its stated course of action would be altered from its previous statements, that did not occur, rather it repeated…. "*that it likely will be appropriate to maintain its current target range for the federal funds rate for a* ***considerable*** *time* after the *asset purchase program ends, especially if projected inflation continues to run below the Committees 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored*." The reasons behind an anticipated change in policy was predicated on recent economic reports, especially on inflation.

Real economic growth, which actually had declined at a 2.1% annual rate in the first quarter of the year, rebounded in the second quarter increasing to 4.6% from a 4.2% annual rate initially reported. And, forecasts for the third quarter now anticipate real growth at 3% or more, breaking out of the 2% to 2.5 % range where it has been since the recovery began more than 5 years ago. Moreover, several monthly reports including those on retail sales, consumer confidence and both the manufacturing and non-manufacturing sectors have shown impressive gains. And, even while growth seems to have improved, inflation has continued modest.

CHART 1



CGFA

As shown in the above chart, the consumer price index in August rose a modest 1.7% from a year earlier, both on all items as well as on a core basis, which exclude food and energy prices. Moreover, the trend in recent months has been softening as prices on all items rose 0.3% from May to June, 0.1% in June to July, and declined 0.2% from July through August. In part this reflects reduced energy prices which, during the same three-month periods, went from a 1.6% increase, to a 0.3% decline, to a drop of 2.6% in August. Because monetary policy's effect on the economy can lag for as much as 18 months, often times in the past it has pursued a credit easing policy for too long, acting to reignite inflation which, once out of the bottle, is difficult to reign in again. This happened in the 1980s where interest rates were set free to sky rocket in order to slow money growth which led to back-to-back recessions before double-digit price increases that developed were eventually contained.

The latest Fed minutes did recognize the overall improvements and continued to unwind its program of easing in October by further reducing its purchases of mortgage-backed securities to $5 billion per month from $10 billion and its purchases of Treasury securities to $10 billion per month from $15 billion. It also stated that if incoming information supports improvement in labor market conditions and inflation, it will end its current program of asset purchases at its next meeting, thus cutting the apron strings of its program of Quantitative Easing. It should be pointed out that the Open Market's policy action was not unanimous. Richard Fischer "believed that the continuing strengthening of the real economy, improved outlook for labor utilization and general price stability, and continued signs of financial market excess, will likely warrant an earlier reduction in monetary accommodation than suggested by the Committees' forward guidance" and voted no. Similarly, Charles Plosser also voted against the policy action citing that the use of the phrase "considerable time after the asset program ends" is too time dependent and does not reflect the economic progress that has been made toward the Committee's goals.

At this time, monetary policy is being employed as a major tool to help lift economic growth, improve conditions in the labor market, while keeping inflation in check. Some feel that, given the historical lag of monetary policy actions on the economy, to continue the current level of credit accommodation with basically a zero interest rate target for a prolonged period, even after the quantitative easing program is ended, risks inflation down the road. Others feel that, despite surpassing the Fed's initial unemployment rate and inflation rate targets, there remains significant under-utilization of labor resources with the lowest labor force participation rate since the late 1970s, a slowdown in the housing recovery, and a myriad of exogenous factors that have surfaced, which increase uncertainty, that to tighten now would risk the economic improvement recently seen. Only time will tell whether the gradual unwinding of credit accommodation is successful or if the monetary authorities waited too long, requiring corrective action with possible deleterious results in the future.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS *	AUG. 2014	JULY 2014	AUG. 2013
Unemployment Rate (Average)	6.7%	6.8%	9.2%
Annual Rate of Inflation (Chicago)	0.6%	-4.4%	1.9%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (August)	6,493	-0.2%	-0.7%
Employment (thousands) (August)	6,060	-0.1%	2.0%
New Car & Truck Registration (August)	55,230	-12.0%	-4.1%
Single Family Housing Permits (August)	970	-2.4%	-6.6%
Total Exports ($ mil) (July)	5,494	-5.1%	2.8%
Chicago Purchasing Managers Index (Sept.)	60.5	-5.9%	8.6%

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

REVENUE
SEPTEMBER REVENUES MIXED AS WEAKER FEDERAL SOURCES OFFSET GAINS ELSEWHERE

Jim Muschinske, Revenue Manager

Overall base revenues declined $95 million in September. Another extremely weak month for federal source reimbursements was the root cause even as the majority of the revenue sources posted gains. September had one extra receipting day as compared with the same month one year prior.

Despite the overall monthly drop, gross personal income taxes fared quite well, growing $103 million, or $86 million net of refunds. Sales tax also performed nicely, jumping $47 million. Public utility taxes increased by $13 million. Inheritance tax receipts posted a gain of $7 million, insurance taxes grew $5 million, corporate franchise taxes were up $2 million, and interest earnings eked out a $1 million gain.

Only a couple tax sources declined for the month. Gross corporate income taxes fell $59 million, or $55 million net of refunds. And, other sources dropped $67 million related to court settlement proceeds which occurred last September.

Overall transfers were unchanged in September. While riverboat transfers dropped $3 million, that falloff was offset by a $1 million increase in lottery transfers and a $2 million increase in other transfers. As mentioned, it was another poor month for federal sources as receipts dropped $135 million, reflecting reimbursable spending at this time primarily taking place from non-general funds.

Year to Date

Through the first quarter of the fiscal year, overall base revenues are down $374 million. However, much of that decline was expected and is due to the scheduled lower Refund Fund transfer into GRF. In addition, weaker federal sources to begin the year have significantly contributed to the fall off. The economically related sources are mixed as both personal income taxes and sales have performed well while corporate income taxes have weakened.

To date, gross personal income taxes are up $102 million, or $72 million net of refunds. Sales tax receipts are ahead of last year's pace by $95 million, while other sources are up $59 million. Inheritance tax has added $38 million, insurance taxes $6 million, interest income $3 million, liquor taxes $1 million, and vehicle use $1 million.

Gross corporate income taxes are down $78 million through September, or $72 million net of refunds. And public utility taxes are off by $3 million.

Overall transfers are down $345 million due to the much lower Refund transfer which accounts for $334 million of that falloff. Riverboat transfers are down $22 million, but other transfers have posted a $9 million gain while lottery transfers eked out a $2 million increase. Federal sources are down $229 million thus far in the fiscal year, reflecting lower GRF reimbursable spending through the first quarter. At some point it is assumed that the bulk of reimbursable spending will transition back to GRF, resulting in improved federal source receipting.

GENERAL FUNDS RECEIPTS: SEPTEMBER
FY 2015 vs. FY 2014
($ million)

Revenue Sources	Sept. FY 2015	Sept. FY 2014	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$1,679	$1,576	$103	6.5%
Corporate Income Tax (regular)	526	585	($59)	-10.1%
Sales Taxes	680	633	$47	7.4%
Public Utility Taxes (regular)	83	70	$13	18.6%
Cigarette Tax	29	29	$0	0.0%
Liquor Gallonage Taxes	14	14	$0	0.0%
Vehicle Use Tax	3	2	$1	50.0%
Inheritance Tax (Gross)	19	12	$7	58.3%
Insurance Taxes and Fees	68	63	$5	7.9%
Corporate Franchise Tax & Fees	23	21	$2	9.5%
Interest on State Funds & Investments	3	2	$1	50.0%
Cook County IGT	0	0	$0	N/A
Other Sources	31	98	($67)	-68.4%
Subtotal	$3,158	$3,105	$53	1.7%
Transfers				
Lottery	57	56	$1	1.8%
Riverboat transfers & receipts	43	46	($3)	-6.5%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	0	0	$0	N/A
Other	34	32	$2	6.3%
Total State Sources	$3,292	$3,239	$53	1.6%
Federal Sources	$120	$255	($135)	-52.9%
Total Federal & State Sources	$3,412	$3,494	($82)	-2.3%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($167)	($150)	($17)	11.3%
Corporate Income Tax	($74)	(78)	$4	-5.1%
Subtotal General Funds	$3,171	$3,266	($95)	-2.9%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$0	$0	$0	N/A
Total General Funds	$3,171	$3,266	($95)	-2.9%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Oct-14

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2015 vs. FY 2014

($ million)

Revenue Sources	FY 2015	FY 2014	CHANGE FROM FY 2014	% CHANGE
State Taxes				
Personal Income Tax	$4,089	$3,987	$102	2.6%
Corporate Income Tax (regular)	656	734	($78)	-10.6%
Sales Taxes	2,034	1,939	$95	4.9%
Public Utility Taxes (regular)	236	239	($3)	-1.3%
Cigarette Tax	88	88	$0	0.0%
Liquor Gallonage Taxes	44	43	$1	2.3%
Vehicle Use Tax	9	8	$1	12.5%
Inheritance Tax (Gross)	84	46	$38	82.6%
Insurance Taxes and Fees	92	86	$6	7.0%
Corporate Franchise Tax & Fees	52	52	$0	0.0%
Interest on State Funds & Investments	7	4	$3	75.0%
Cook County IGT	0	0	$0	N/A
Other Sources	226	167	$59	35.3%
Subtotal	$7,617	$7,393	$224	3.0%
Transfers				
Lottery	145	143	$2	1.4%
Riverboat transfers & receipts	86	108	($22)	-20.4%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	63	397	($334)	N/A
Other	145	136	$9	6.6%
Total State Sources	$8,056	$8,177	($121)	-1.5%
Federal Sources	$503	$732	($229)	-31.3%
Total Federal & State Sources	$8,559	$8,909	($350)	-3.9%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($408)	($378)	($30)	7.9%
Corporate Income Tax	($92)	($98)	$6	-6.1%
Subtotal General Funds	$8,059	$8,433	($374)	-4.4%
Short-Term Borrowing	$0	$0	$0	N/A
FY'13/14 Backlog Payment Fund Transfer	$0	$50	($50)	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	$8,334	$8,758	($424)	-4.8%

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

CGFA 1-Oct-14