Commission on Government Forecasting and Accountability

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MONTHLY BRIEFING FOR THE MONTH ENDED: OCTOBER 2018

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Higher Levels of Inflation

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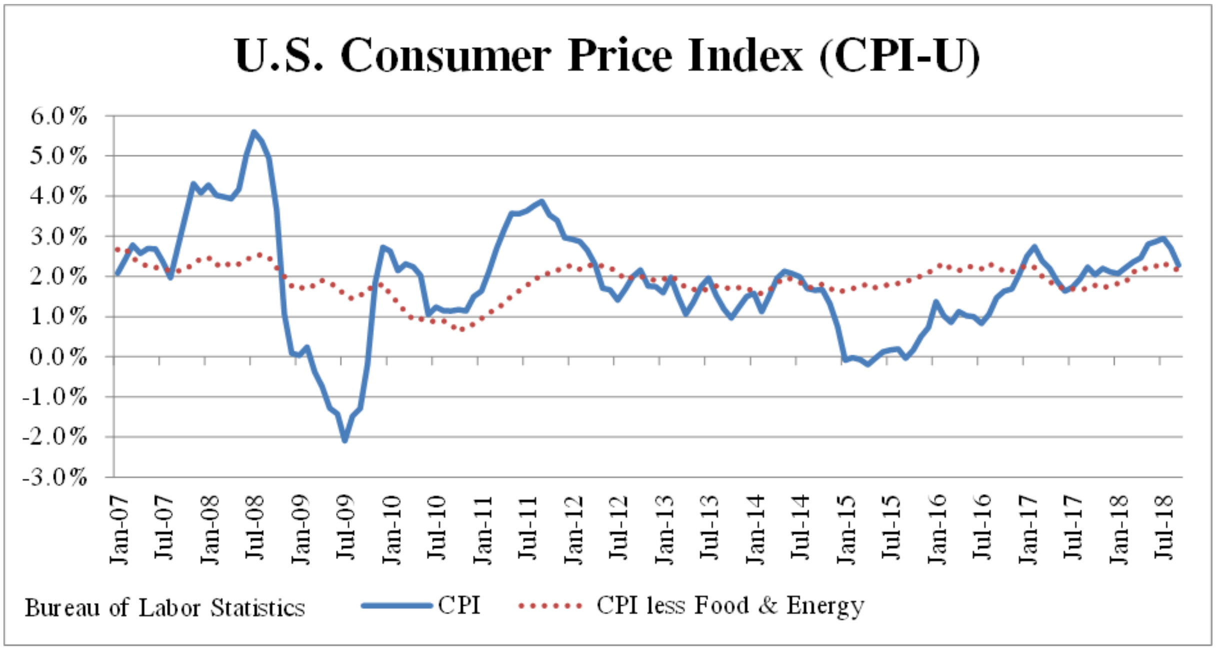
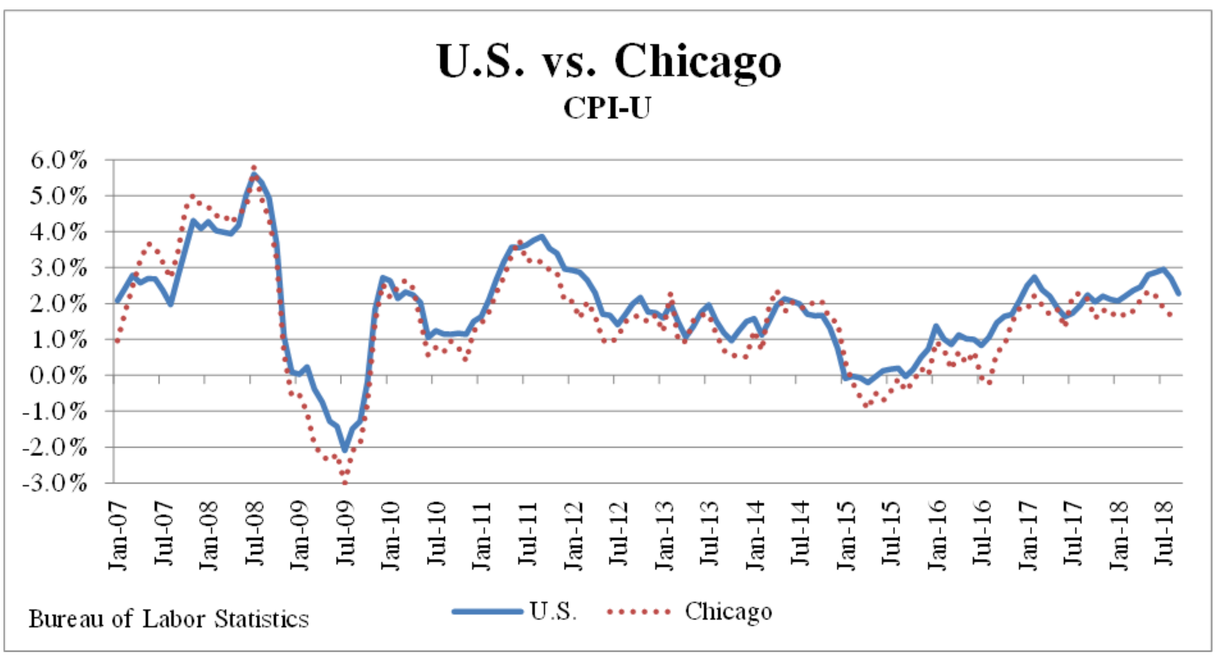
The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. It is a monthly measurement of U.S. prices for most household goods and services. It reports inflation (rising prices) and deflation (falling prices.) The CPI market basket is developed from detailed expenditure information provided by families and individuals on what they actually bought.

In June and July of 2018, the CPI for all urban consumers (CPI-U) which represents approximately 93% of the total U.S. population reached a 6-year high. The year-over-year percentage change in the non-seasonally adjusted CPI was 2.9% in the U.S. This was the highest level since February of 2012. Inflation has been steadily growing since the beginning of 2015. The increase in inflation in June and July was associated with increases in shelter costs (rent or owner's equivalent rent of primary residence) which accounts for approximately 1/3 of the basket of goods measured by the CPI. Shelter costs were up 3.4% in June and 3.5% in July. Increases in energy and transportation prices also added to the growth in inflation.

While inflation as measured by the CPI-U is higher compared to recent years, especially when compared to levels in 2015 and 2016, overall inflation is not that high particularly when food and energy costs are removed. The CPI-U with food and energy costs removed has been consistently around 2% since about July of 2011. In July of 2011, the CPI-U less food and energy rose to 1.8% after almost a year at or below 1.1%. Since then, the CPI-U less food and energy has averaged 1.9% with the highest month being 2.4% in July of 2018 and the lowest months being 1.6% in January and February of 2015. The table below shows the growth in the CPI-U since 2015 and the stability of consumer prices when food and energy costs are removed.





As compared to the U.S., the Illinois economy did not see as high of a level of inflation over the summer. Inflation reached a high of 2.3% in May of 2018 in the Chicago-Naperville-Elgin region. In recent years, the Chicago area has consistently had lower levels of inflation when compared to the country as a whole. Since the beginning of 2015, the Chicago area has averaged 0.5% less inflation as measured by the CPI-U than the U.S. In the 45 months since January of 2015, Chicago has only seen five months in which its monthly CPI-U estimate was higher than the U.S. The persistent lower level of inflation in Chicago since 2015 is illustrated in the graph which shows CPI-U results for both the U.S. and Chicago. Similar, to the U.S., the volatility of the CPI is reduced in Chicago when food and energy prices are removed. While the U.S. averaged 1.9% growth in the CPI-U less food and energy since 2011, Chicago averaged only 1.5%. This difference of 0.4% is similar to the 0.5% difference seen in the CPI-U for all items.

Looking Ahead

It is likely that the moderately increased level of inflation will continue into the near future. Examining what 29 different groups which make economic forecasts think will happen, the average growth estimate for consumer prices was 2.5% in 2018 and 2.3% in 2019. This is above the 1.9% average seen in the U.S. since 2011.

Another indicator which may point to continued higher consumer prices is the Producer Price Index (PPI). The PPI measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. The PPI measures inflation and deflation at the wholesale level of the economy. The PPI has been at a somewhat elevated level since the beginning of 2017. In July of 2018, the PPI peaked at 5.8%. This is the highest level it has been since December of 2011. While not absolute, current high PPI results could be a signal for continued higher levels for the CPI moving forward.

Finally, the expectation for a continued higher level of inflation can be seen in the actions taken by the Federal Reserve. The Federal Reserve has a mandate to ensure maximum employment, stable prices, and moderate long-term interest rates through the use of monetary policy. While the economy has neared full employment, the Federal Reserve has raised the federal funds rate numerous times in the recent past to fight inflation. The federal funds rate is the interest rate at which depository institutions trade federal funds (balances held at Federal Reserve Banks) with each other overnight. The federal funds target rate is set by the Federal Reserve through the use of open market operations. Since December of 2016, the Federal Reserve has raised the federal funds rate seven times from a target range of 0.25% - 0.50% to its current level of between 2.00%-2.25%. The most recent interest rate raise was done on September 27, 2018. Both the Chairmen and the Vice Chairman of the Federal Reserve have recently indicated that they believe further gradual adjustment in the federal fund rate will be needed in the future.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS*	LATEST MONTH	PRIOR MONTH	A YEAR AGO
Unemployment Rate (Average) (Sept.)	4.1%	4.1%	5.0%
Inflation in Chicago (12-month percent change) (Sept.)	1.6%	1.7%	2.1%

	LATEST MONTH	CHANGE OVER PRIOR MONTH	CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (Sept.)	6,478.2	0.0%	-0.3%
Employment (thousands) (Sept.)	6,211.4	0.0%	0.6%
Nonfarm Payroll Employment (Sept.)	6,124,900	2,800	50,300
New Car & Truck Registration (Sept.)	47,071	-17.3%	-3.2%
Single Family Housing Permits (Sept.)	849	-21.6%	-14.5%
Total Exports ($ mil) (Aug.)	5,440.4	3.3%	-3.1%
Chicago Purchasing Managers Index (Oct.)	58.4	-3.3%	-11.8%

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

October 2018 Build Illinois Bond Sales and Downgrade

Lynnae Kapp, Senior Analyst

Illinois competitively sold $250 million of Build Illinois bonds in three series in October of 2018 for capital projects. Debt service for Series A will be paid from sales tax revenues, and debt service for both Series B and Series C will be paid with revenues from both sales taxes and the Capital Projects Fund. The October 2018 Series A tax-exempt bonds of $115 million had 10 bids and received a true interest cost of 4.16%. The October 2018 Series B tax-exempt bonds of $125 million received a 4.27% true interest cost from the winner out of 11 bids. The October 2018 Series C taxable bonds of $10 million had four bids and received a true interest cost of 4.09%. "The yields landed on par with current trading levels. Build Illinois bonds in the seven to 12 year range have traded recently between 75 basis points to 85 bps over the AAA benchmark…While the spreads have widened since the 2016 sale, they remain attractive compared to the 180 bp spread trading levels of the state's 10-year general obligation bond." [*Spread penalty on Build Illinois sales tax bonds reflects downgrades*, The Bond Buyer, October 17, 2018]

BUILD ILLINOIS BOND RATINGS

Rating Agencies	Apr/July 2009	Oct 2009	Dec 2009	Mar-Apr 2010*	June 2010	Jan 2012	June 2013	Oct 2015	Jun 2016	Jun 2017	May 2018	Oct 2018
Fitch Ratings	AA	AA	AA	AA+	AA+	AA+	AA+	AA+	AA+	AA+	A-	A-
Standard & Poor's	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AA-	AA-	BBB
Moody's	Aa3	A1	A2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Baa3	Baa3
Kroll												AA+

STATE-ISSUED BOND SALES

DATE	BOND SALE TYPE	AMOUNT	TAXABLE v. TAX-EXEMPT	NEGOTIATED v. COMPETITIVE SALE	TRUE INTEREST COST	FITCH	S&P	MOODY'S	Kroll
FY 2016									
Jan-16	General Obligation bonds	$480 million	tax-exempt	competitive	3.999%	BBB+	A-	Baa1	
Jun-16	General Obligation bonds	$550 million	tax-exempt	competitive	3.743%	BBB+	BBB+	Baa2	
FY 2017									
Sep-16	Build IL 2016A	$150 million	tax-exempt	competitive	2.442%	AA+	AAA	Baa2	
	Build IL 2016B	$60 million	taxable						
	Build IL 2016C Refunding	$152 million	tax-exempt						
	Build IL 2016D Refunding	$187 million	tax-exempt						
Oct-16	General Obligation Refunding	$1.3 billion	tax-exempt	negotiated	3.7616% Discount Rate	BBB+	BBB	Baa2	
Nov-16	General Obligation bonds	$480 million	tax-exempt	competitive	4.245%	BBB+	BBB	Baa2	
FY 2018									
Nov-17	General Obligation 2017A/B/C	$1.5 billion	tax-exempt	competitive	combined 3.46%	BBB	BBB-	Baa3	
Nov-17	General Obligation 2017D	$4.5 billion	tax-exempt	negotiated	3.55%	BBB	BBB-	Baa3	
Dec-17	General Obligation 2018A & B	$750 million	tax-exempt	competitive	combined 4.29%	BBB	BBB-	Baa3	
May-18	General Obligation 2018A & B	$500 million	tax-exempt	competitive	combined 4.72%	BBB	BBB-	Baa3	
FY 2019									
Sep-18	General Obligation Refunding Series A & B	$966 million	tax-exempt	negotiated	combined 4.19%	BBB	BBB-	Baa3	
Oct-18	Build IL October 2018 A	$115 million	tax-exempt	competitive	4.16%	A-	BBB		AA+
Oct-18	Build IL October 2018 A	$125 million	tax-exempt	competitive	4.27%	A-	BBB		AA+
Oct-18	Build IL October 2018 A	$10 million	taxable	competitive	4.09%	A-	BBB		AA+

The State did not request a rating for this bond sale from Moody's, but received the State's first rating from Kroll Bond Rating Agency of AA+ with a stable outlook.

In June 2017, during the State of Illinois' budget impasse, Standard & Poor's downgraded the State's Build Illinois bonds three levels from AAA to AA-, after it began to tie them to the State's general obligation bonds.

On October 30, 2018, S&P lowered the Build Illinois Bond rating five more levels to BBB, based on changes they have made to their rating's criteria for priority-lien tax revenue debt. S&P stated, "Offsetting these strengths, in our view, is the state's general credit quality (general obligation [GO] rating BBB-/Stable). To date, the Build Illinois bond program's authorizing legislation has restricted its use to financing capital and infrastructure projects. While this remained the case even throughout the state's two-year budget impasse, future legislatures could enact laws broadening the program's allowable uses. In our view, the inability to prohibit future lawmakers from taking such action, combined with the state's unresolved fiscal imbalances, links the credit quality of the Build Illinois sales tax revenue bonds to the state's general creditworthiness. Therefore, the rating on the Build Illinois bonds is constrained from going higher unless we raise the state GO rating."

In May 2018, Fitch downgraded Illinois' Build Illinois bonds five levels from AA+ down to A-. Fitch decided that due to the flow of sales tax revenues to general operations after Build Illinois debt requirements and the State's ability to transfer excess sales tax revenues to the general fund at the end of the fiscal year, the Build Illinois bond ratings should be tied to the State's general obligation rating.

REVENUE: PERSONAL INCOME AND SALES TAXES DO WELL IN OCTOBER AS OVERALL TRANSFERS WEAKEN

Jim Muschinske, Revenue Manager

Excluding $204 million in interfund borrowing last October, as well as $500 million related to the Treasurer's Investment transfers per P.A. 100-1107, base revenues grew $205 million this October. A good month for personal income tax and sales taxes were partially offset by a comparatively weaker month in overall transfers. Federal sources, while disappointing on an absolute basis, did manage to contribute to the monthly gain as last year's monthly receipts were even weaker. The month had one more receipting day compared to the prior year.

October's $500 million was the second month to see activity related to SB 2858 [P.A. 100-1107] which allows the Treasurer's Office to invest in the state's unpaid receivables. The new law allows up to $2 billion of state funds not immediately needed for current expenses to be utilized to address the state's overdue bill backlog.

As mentioned, the larger economically-related revenue sources performed well with gross personal income taxes growing $145 million, or $122 million on a net basis. Sales taxes rose $71 million on a gross basis, or $60 million net of the direct distributions to transportation funds. Other sources increased $14 million, while inheritance tax rose by $13 million. Insurance taxes contributed a gain of $6 million, corporate income taxes $4 million, interest earnings $4 million, corporate franchise taxes $1 million, and public utility taxes $1 million. Only one tax source experienced a monthly decline as cigarette taxes dipped by $5 million in October.

Overall transfers erased some of the above gains with monthly totals down $51 million. While October benefited from an additional $127 million transfer from the Income Tax Refund Fund, those gains were more than eliminated by timing associated with last year's $81 million of fund sweeps, as well as a decline of $83 million in other miscellaneous transfers. In addition, Lottery transfers were down $12 million, while riverboat transfers dipped $2 million. Federal sources managed to post gains of $34 million, however, that increase was due to an even weaker October of last fiscal year.

Year To Date

Excluding $354 million in interfund borrowing last fiscal year, and the $700 million related to the Treasurer's Investments this fiscal year, the first third of FY 2019 show general funds ahead of last year by $595 million. Gross personal income tax is up by $878 million, or $737 million net. Gross sales tax receipts are up by $154 million, or $136 million net. Gross corporate income taxes are up by $138 million, or $119 million net. All other tax sources combined added $69 million to the year-to-date gain.

Overall transfers increased $61 million through October. Federal sources are down by $527 million, as on a comparative basis last year was particularly strong.

OCTOBER

FY 2019 vs. FY 2018

($ million)

Revenue Sources	**Oct. FY 2019**	**Oct. FY 2018**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$1,612	$1,467	$145	9.9%
Corporate Income Tax (regular)	84	80	$4	5.0%
Sales Taxes	736	665	$71	10.7%
Public Utility Taxes (regular)	65	64	$1	1.6%
Cigarette Tax	24	29	($5)	-17.2%
Liquor Gallonage Taxes	13	13	$0	0.0%
Vehicle Use Tax	3	2	$1	50.0%
Inheritance Tax	41	28	$13	46.4%
Insurance Taxes and Fees	6	0	$6	N/A
Corporate Franchise Tax & Fees	20	18	$2	11.1%
Interest on State Funds & Investments	9	5	$4	80.0%
Cook County IGT	0	0	$0	N/A
Other Sources	43	29	$14	48.3%
Subtotal	$2,656	$2,400	$256	10.7%
Transfers				
Lottery	51	63	($12)	-19.0%
Riverboat transfers & receipts	33	35	($2)	-5.7%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	127	0	$127	N/A
Fund sweeps	0	81	($81)	N/A
Other	72	155	($83)	-53.5%
Total State Sources	$2,939	$2,734	$205	7.5%
Federal Sources	$88	$54	$34	63.0%
Total Federal & State Sources	$3,027	$2,788	$239	8.6%
Nongeneral Funds Distributions/Direct Receipts:				
Refund Fund				
Personal Income Tax	($156)	($144)	($12)	8.3%
Corporate Income Tax	($13)	(14)	$1	-7.1%
LGDF--Direct from PIT	($84)	(73)	($11)	15.1%
LGDF--Direct from CIT	($5)	(4)	($1)	25.0%
Downstate Pub/Trans--Direct from Sales	($45)	(34)	($11)	32.4%
Subtotal General Funds	$2,724	$2,519	$205	8.1%
Treasurer's Investments	$500	$0	$500	N/A
Interfund Borrowing	$0	$204	($204)	N/A
Income Tax Bond Fund Transfer	$0	$0	$0	N/A
Transfer to Commitment Human Services	$0	$0	$0	N/A
Total General Funds	$3,224	$2,723	$501	18.4%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Nov-18

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2019 vs. FY 2018

($ million)

Revenue Sources	**FY 2019**	**FY 2018**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$6,340	$5,462	$878	16.1%
Corporate Income Tax (regular)	755	617	$138	22.4%
Sales Taxes	2,948	2,794	$154	5.5%
Public Utility Taxes (regular)	252	277	($25)	-9.0%
Cigarette Tax	117	117	$0	0.0%
Liquor Gallonage Taxes	59	59	$0	0.0%
Vehicle Use Tax	11	10	$1	10.0%
Inheritance Tax	130	102	$28	27.5%
Insurance Taxes and Fees	113	113	$0	0.0%
Corporate Franchise Tax & Fees	78	70	$8	11.4%
Interest on State Funds & Investments	36	17	$19	111.8%
Cook County IGT	0	0	$0	N/A
Other Sources	173	135	$38	28.1%
Subtotal	$11,012	$9,773	$1,239	12.7%
Transfers				
Lottery	207	216	($9)	-4.2%
Riverboat transfers & receipts	107	113	($6)	-5.3%
Proceeds from Sale of 10th license	0	0	$0	N/A
Refund Fund transfer	327	0	$327	N/A
Fund sweeps	0	207	($207)	N/A
Other	240	284	($44)	-15.5%
Total State Sources	$11,893	$10,593	$1,300	12.3%
Federal Sources	$706	$1,233	($527)	-42.7%
Total Federal & State Sources	$12,599	$11,826	$773	6.5%
Nongeneral Funds Distributions/Direct Receipts:				
Refund Fund				
Personal Income Tax	($615)	($535)	($80)	15.0%
Corporate Income Tax	($117)	(108)	($9)	8.3%
LGDF--Direct from PIT	($330)	(269)	($61)	22.7%
LGDF--Direct from CIT	($41)	(31)	($10)	32.3%
Downstate Pub/Trans--Direct from Sales	($101)	(83)	($18)	21.7%
Subtotal General Funds	$11,395	$10,800	$595	5.5%
Treasurer's Investments	$700	$0	$700	N/A
Interfund Borrowing	$0	$354	($354)	N/A
Income Tax Bond Fund Transfer	$0	$0	$0	N/A
Transfer to Commitment Human Services	$0	$0	$0	N/A
Total General Funds	$12,095	$11,154	$941	8.4%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 2-Nov-18