

The U.S., Illinois and Metro Chicago Economic Outlook for 2015

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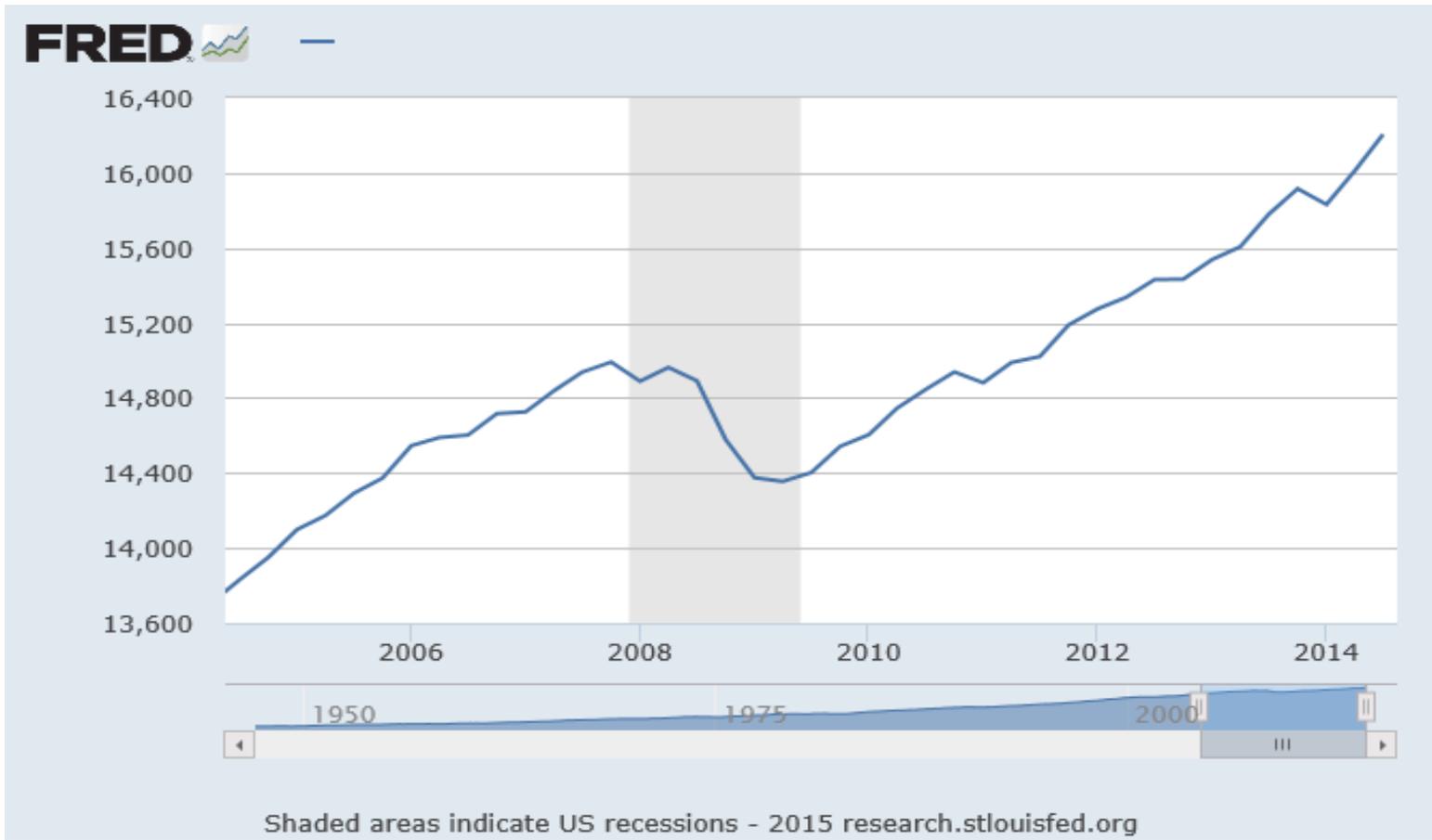
NIU

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Themes for 2015

- Other than the first quarter, 2014 was a strong year for the US economy. GDP growth was 4.6% in Q2 and 5.0% in Q3.
- Headlines have included a much improved labor market with almost 3 million net new jobs (best since 1999). Stock market continued gains adding \$1.1 trillion to US share prices.
- Oil price collapse—down more than 50%. Boost to middle and low-income households in particular. Gain to households is estimated at \$550 for the year.
- U.S. strength in contrast to world weakness
- Turning to evidence...

GDP—finally showing some bounce



Employment

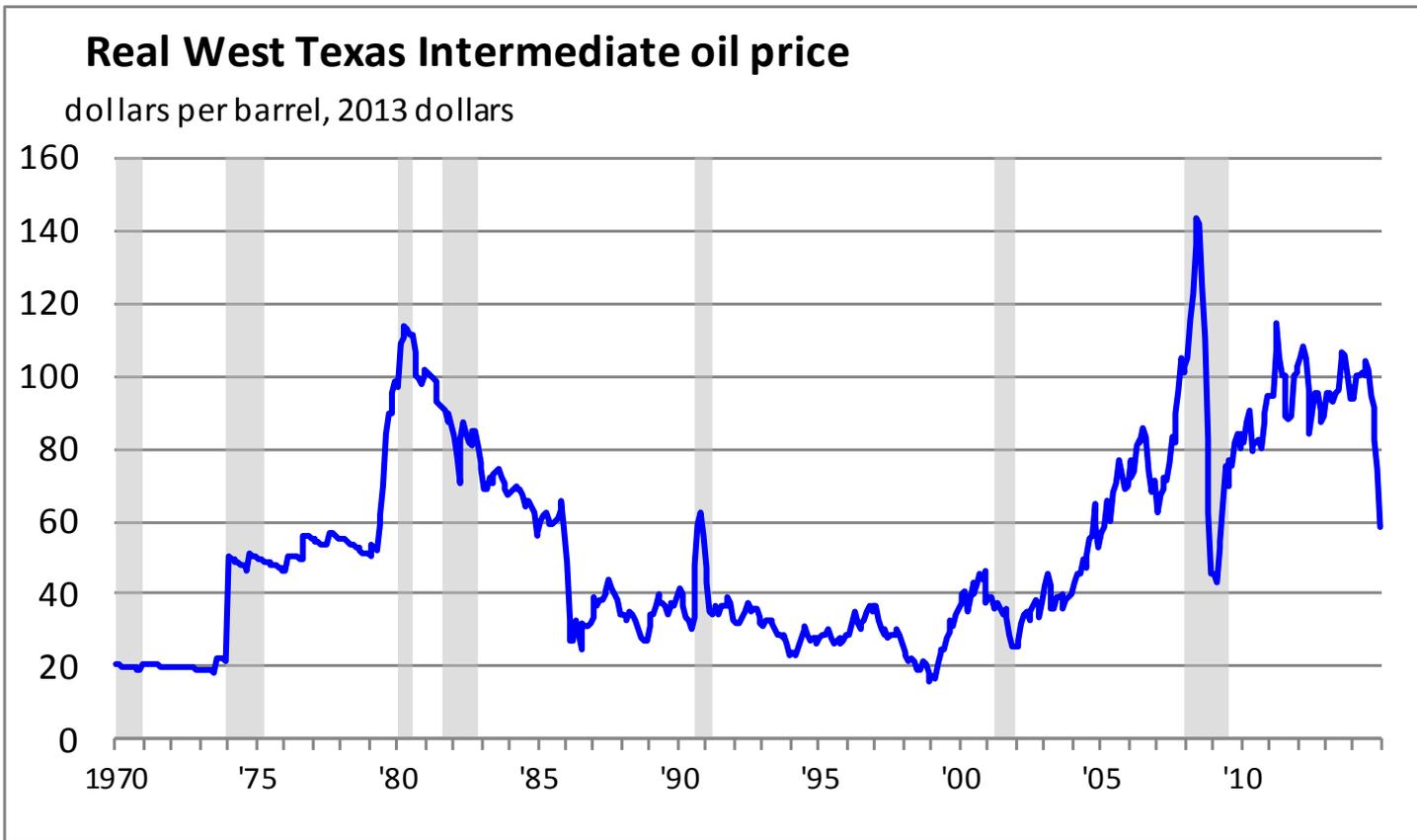
- 2014 gain was big



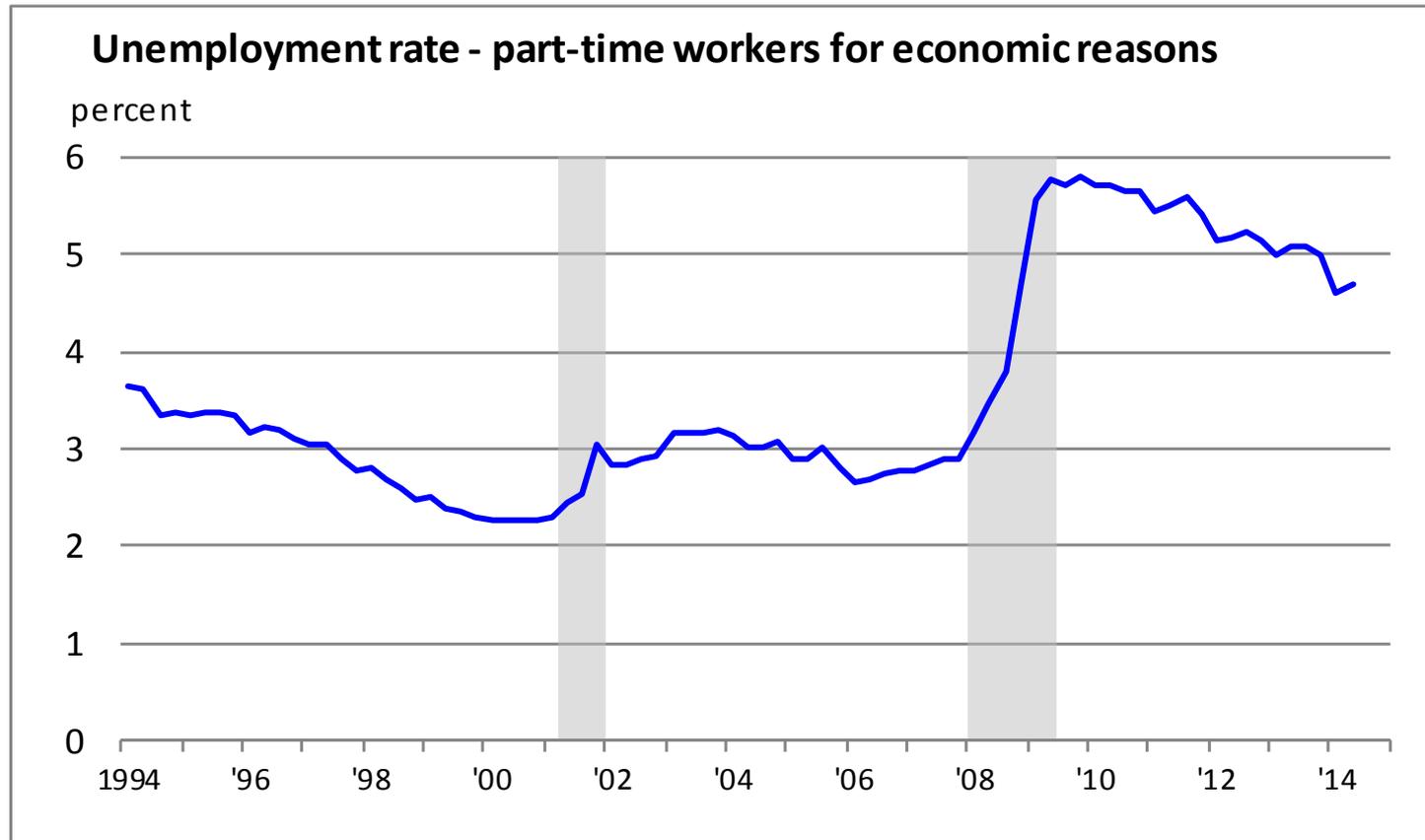
- Above pre-recession peak



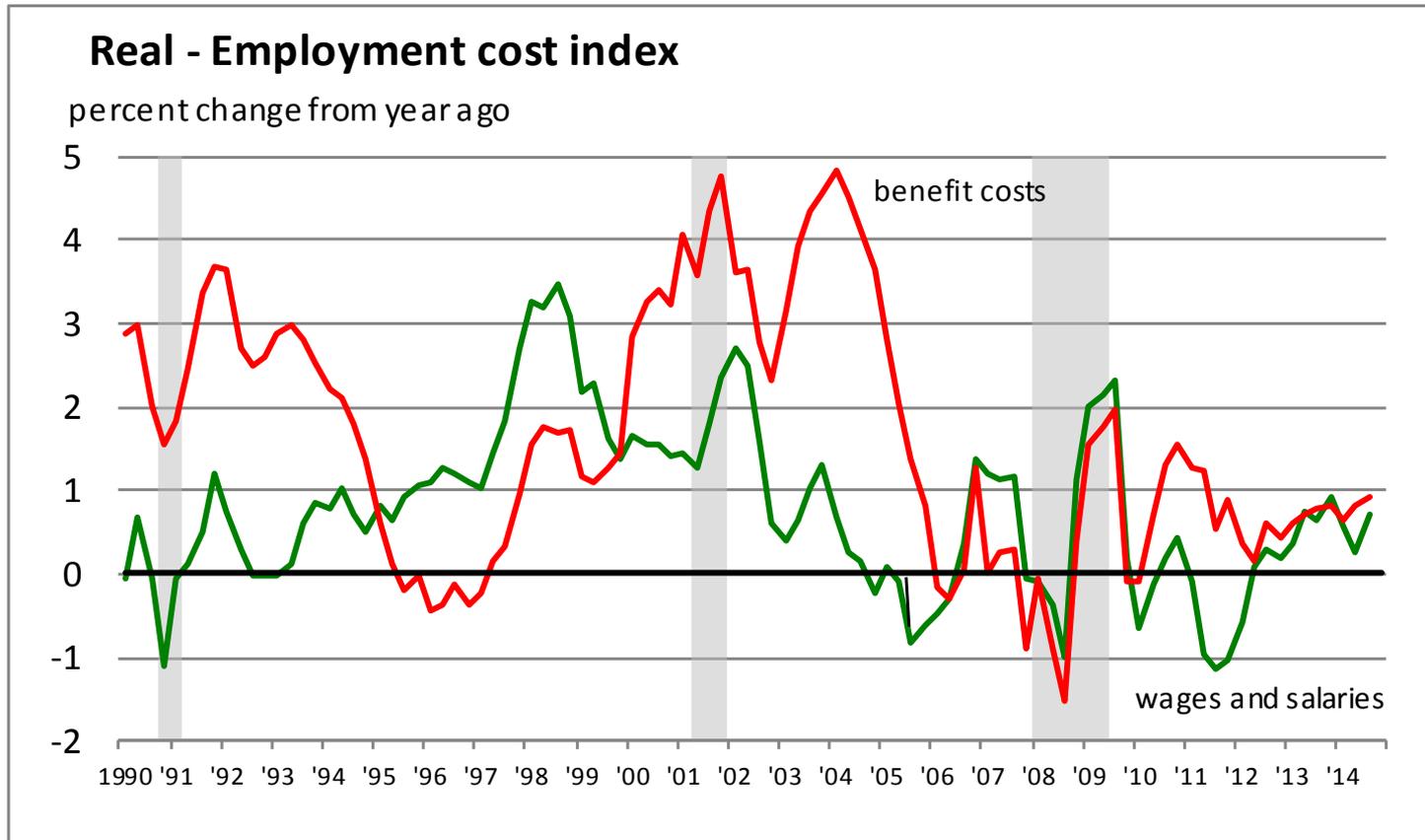
Adjusted for inflation, current oil prices are well below the levels that existed thirty years ago



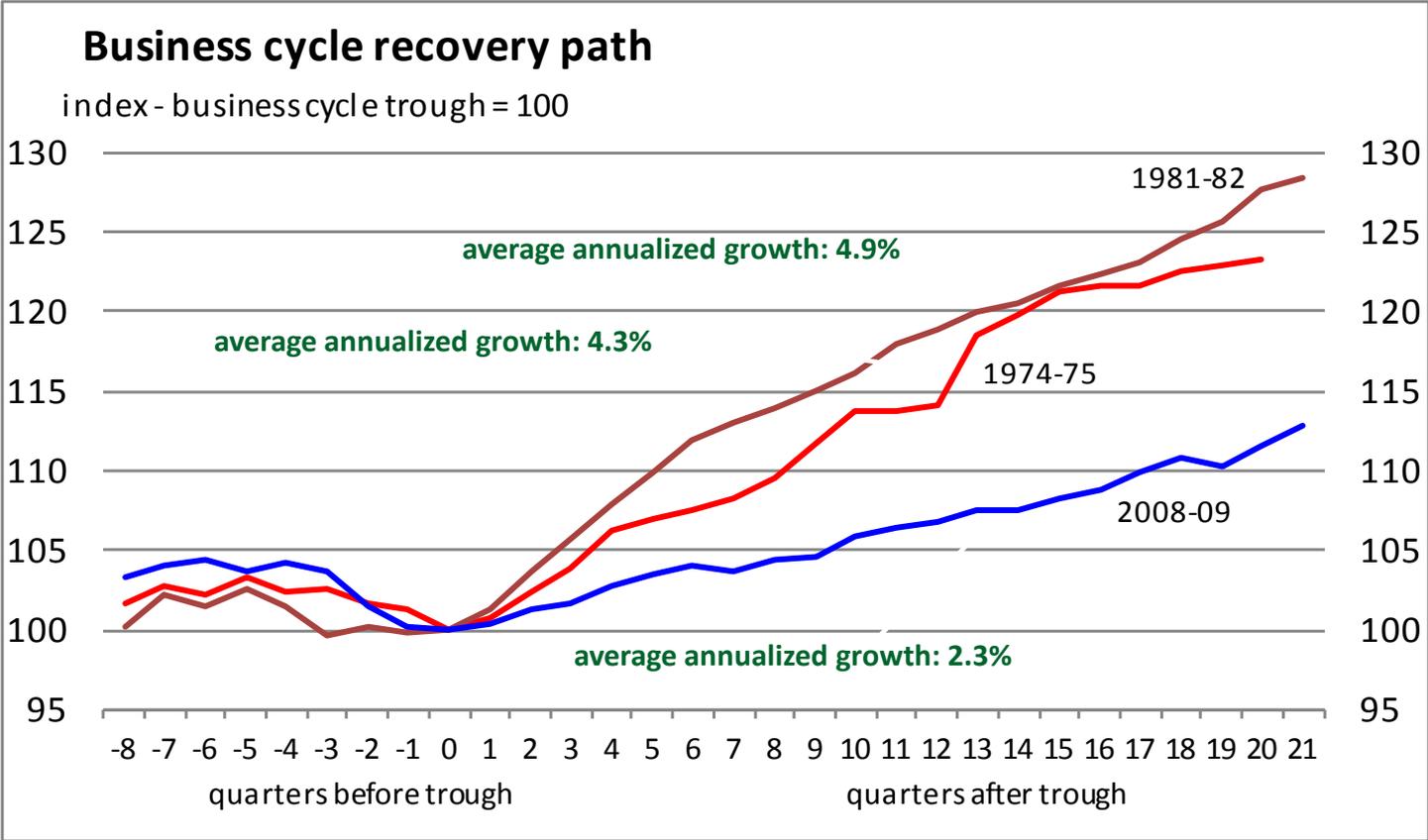
Employees working part time for economic reasons remains elevated



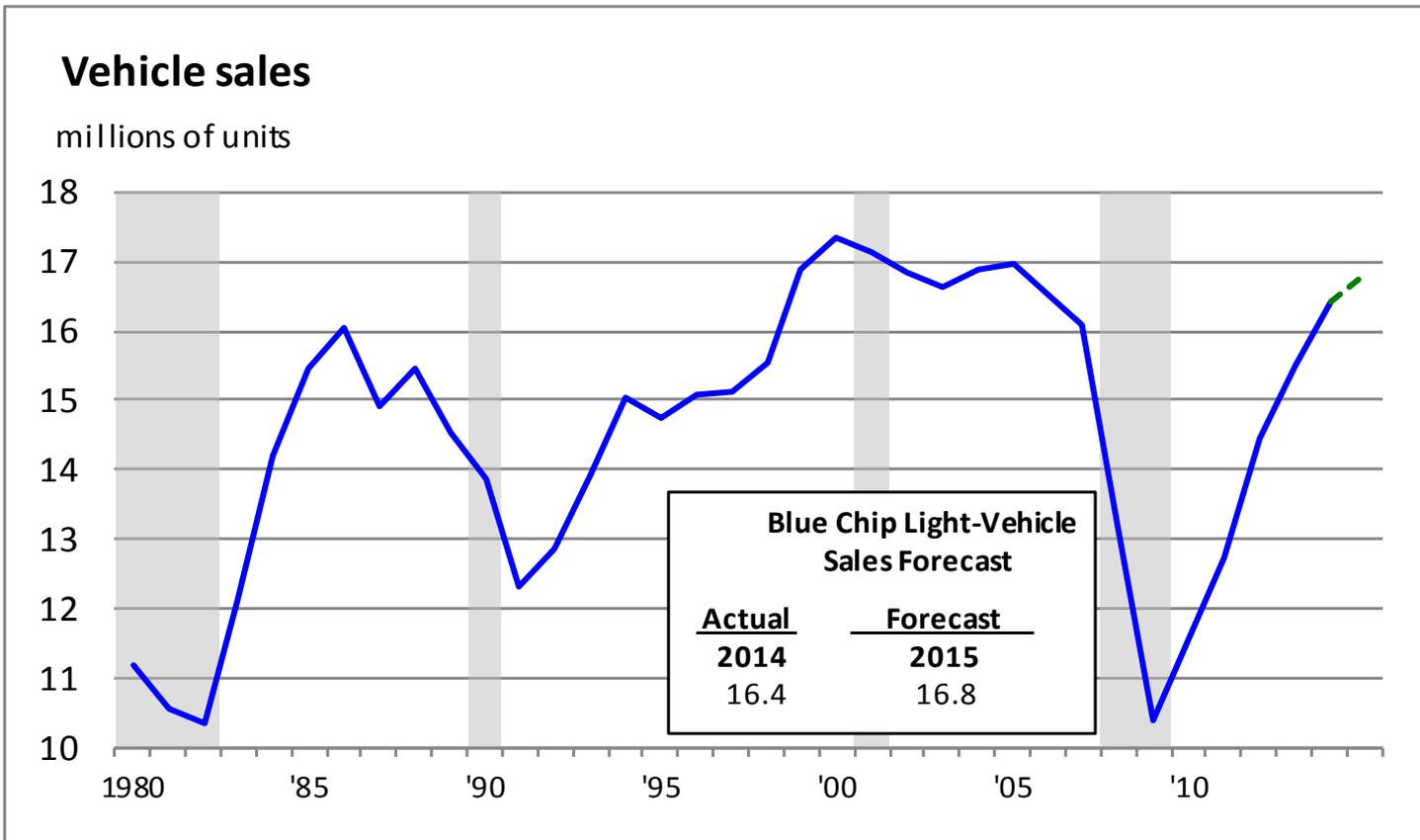
Wages and benefit cost increases remain low



The path of the current recovery is restrained compared with past deep recession recovery cycles



After rising by 13% in 2012, vehicle sales rose 7% in 2013 and are forecast to rise around 6% this year and around 2% next year



Other positive indicators

- US consumer confidence in December was 92.6, highest since February 2008. Boost to retail sales, another string year for car sales (2014 auto sales were highest since 2002)
- Manufacturing ISM still strong at 55.5 in December despite concerns about foreign markets and impact of low energy prices on sales to mining operations
- Housing, while slowing in the rate of gain, Case-Schiller price index was up 4.4% (10 city) and 4.5% (20 city) through October (y over y). However, some expectation that better job gains and consumer confidence will lead to stronger increases in the November and December numbers. However, still a long way from the peak—national prices are still down 16% to 17% from peak and are hovering at 2004 levels.

What to watch for in 2015

- **Do wage gains finally become meaningful?** This will broaden the base of the recovery away from just people with assets. Also, 21 states raised the minimum wage on January 1...estimated to pump \$1.5 billion into the U.S. economy
- **International developments**—Japan is struggling (2 straight decline quarters), Europe isn't much better (2015 forecast fro 1.3% growth) and China is a question mark with growth slowing to 7%. International demand may be hard to come by.
- **Watching the Fed**—desire to normalize, but the question is when and how much. Particularly important will be inflation...will it finally hit the 2% target
- **Infrastructure spending? Construction spending?**

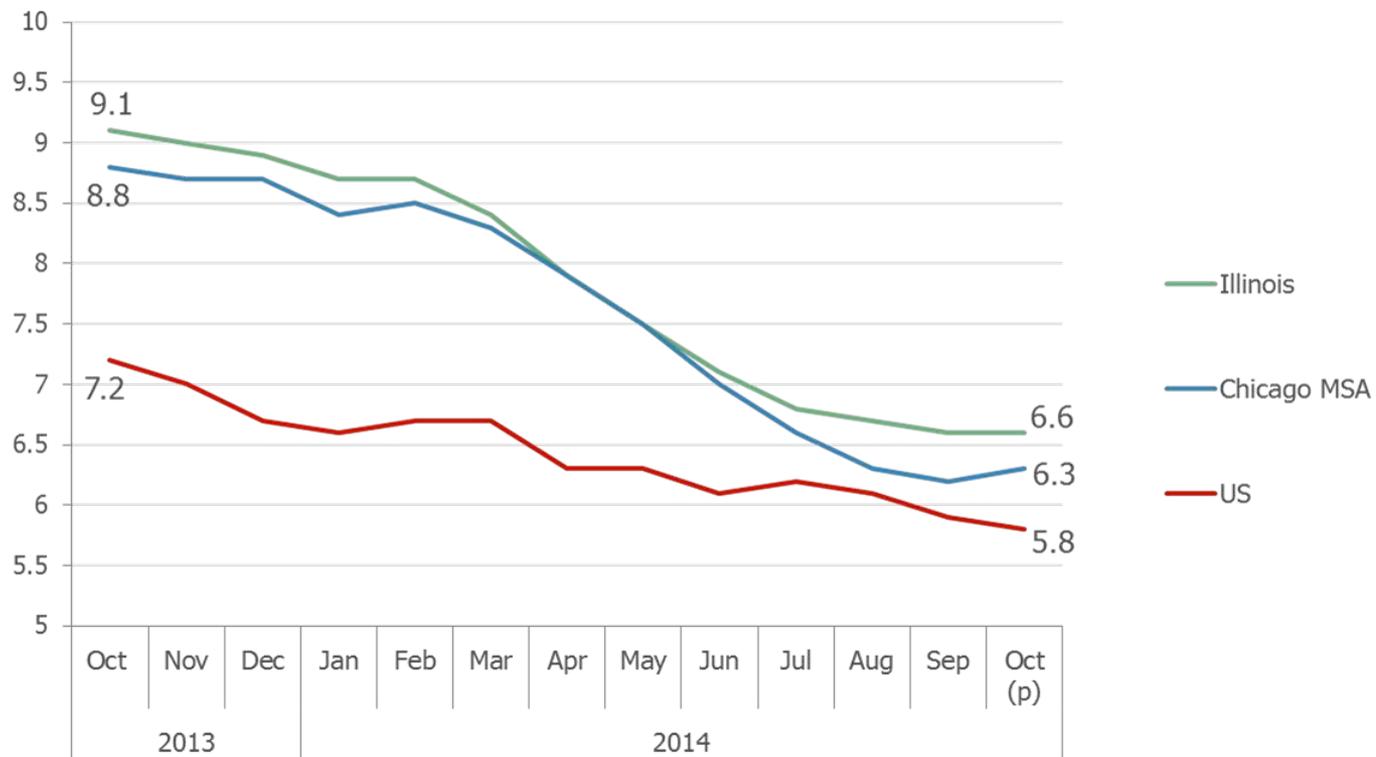
The Current Forecast

- Last FOMC (December, 2014) central tendency projection for **GDP growth in 2014 is 2.0% to 2.4%**. 2015 projection is **2.6% to 3.0%**, the 2016 projection is **2.5 to 3.0**. **Long-run 2.0% to 2.3%**. However, growth for last 3 quarters would be 3.4%.
- inflation appears contained. CPI and core have seen either declines or minimal growth, although gas/food prices might cause a blip. FOMC forecast has **PCE at 1.2% to 1.3% (2014) and 1.0% to 1.6% (2015) and 1.7% to 2.0%**. **Long-run estimate is at 2%**
- FOMC forecast has **unemployment at 5.8% (2014), 5.2% to 5.3% (2015) and 5.0% to 5.2% (2016)**. **Long-run—5.2% to 5.5%**
- QE3 and low Fed Funds rate—taper concluded in 2014 and Fed funds rate has remained unchanged at essentially zero. Changes in policy will be data driven.

Big drop in Unemployment for Illinois and Chicago MSA in 2014

Local and National Unemployment Rates

October 2013 - October 2014, seasonally adjusted



Indicators of Illinois Improvement

	Latest Month	% Change Year Over Year
Civilian Labor Force	6,531,000	-0.1
Employment	6,102,000	2.6
New Car & Truck Registrations	55,004	9.7
Single Family House Permits	1,158	5.2
Total Exports	\$5.6 billion	1.2

Chicago shows broad based improvement

- **The Chicago (city) economy has expanded by an estimated 12,445 private-sector jobs since September 2013**, mostly attributed to professional and business services (+7,067), transportation and warehousing (+3,770), and education and health services (+2,078) sectors.
- **Venture capital investment** in the metro area increased to \$210.2M during the third quarter of 2014, a 42.2% improvement over the same time period last year.
- **Residential building permits** in the city increased to 4,522 units in September 2014, a 49.8% improvement compared to the same time period last year.
- **Passenger volume for O'Hare and Midway Airports grew** by 187,537 people, a 2.5% YOY change since September 2013.

Other than Finance, recovery is pretty broad-based

YOY job growth by industry, City, Sep-2014

Professional and Bus. Services 2.6% 7,067

Transportation & Utilities 5.2% 3,770

Educational & Health Services 0.9% 2,078

Construction 4.8% 1,377

Wholesale trade 2.2% 1,021

Information 1.6% 541

Other Services 0.1% 52

Natural Resources & Mining -9.1% -24

Retail Trade 0.0% -40

Government 0.0% -83

Manufacturing -0.4% -283

Leisure and Hospitality -0.5% -648

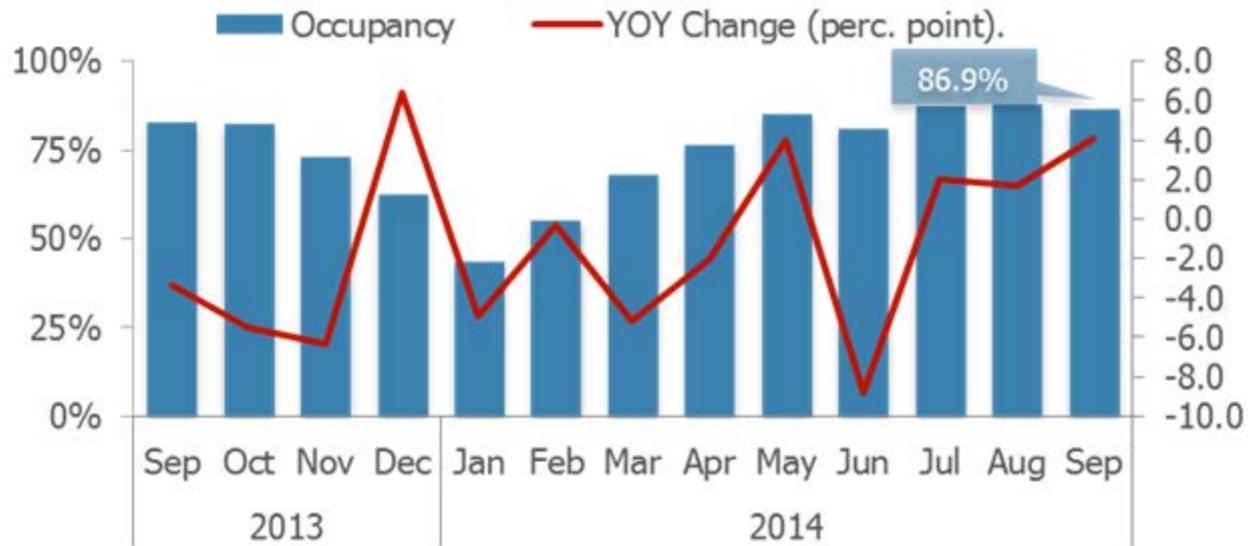
Financial Activities -1.9% -2,468

Other indicators of Chicago vitality

- Since 2011, 27 companies have chosen to locate headquarters in Chicago. 31 Fortune 500 firms in MSA and 8 in Chicago

Hotel Occupancy

- Not much room at the inn means pricing power



What is the fiscal challenge for Illinois?

- Unpaid Bills—state routinely defers payment to contractors and other governments
- “Off-balance sheet” liabilities—pensions & OPEB
- Roll-back of the income tax rate increase--\$4 billion hit to state treasury
- Difficulty in making this up through budget cuts—20% across the board reduction?

What can the state do?

- Cut the budget
- Shift costs onto local governments—already thinking of doing this with pensions
- Pension reform—is it legal?
- Revenue enhancements—expand sales tax to personal services, tax retirement income?

How about Chicago?

- First premise—Cities are the economic engines of state (and national economies). Chicago is 72% of Illinois economy. Economic growth needs cities with strong fiscal positions. As cities go, so go state economies.
- Cities also often have narrower tax bases to solve fiscal problems so adjustment can be harder.
- Sometimes state action exacerbates the problem—in Illinois a history of the state granting pension expansions without paying for them. Also reductions in state aid after the last recession.
- Case study Chicago...

Dimensions of the Problem—Pension Unfunded Actuarial Accrued Liability Per Capita

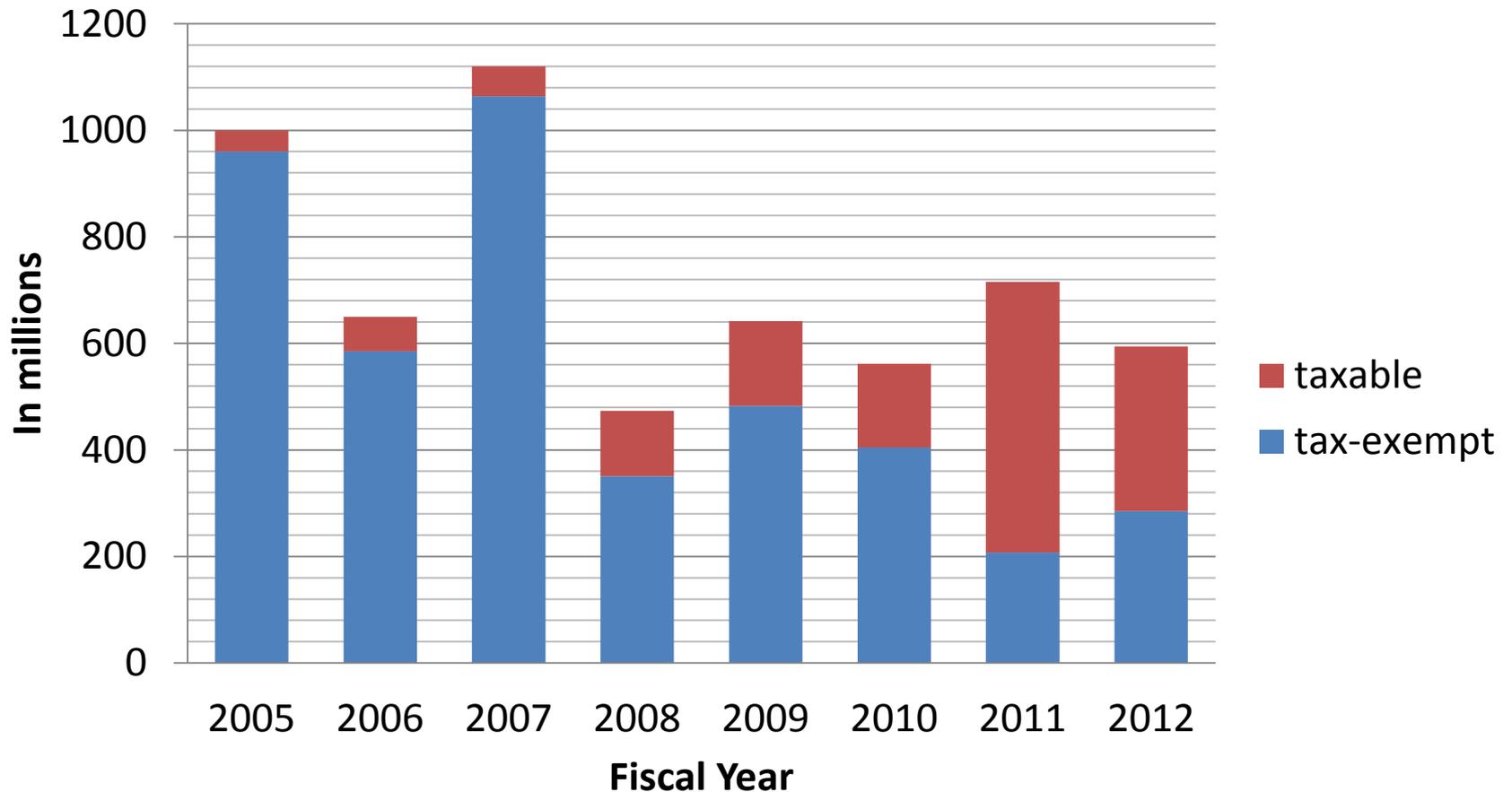
(Morningstar Municipal Credit Research, January, 2014)

City	Direct Liability	Total Liability (includes overlapping governments)
Washington	-\$409	-\$409
Indianapolis	\$1,011	\$3,426
Detroit	\$911	\$3,758
Los Angeles	\$1,895	\$6,426
New York	\$8,726	\$9,842
Chicago	\$7,149	\$18,596

Debt Issuance

- Outstanding debt on General Obligation Bonds has risen from \$2.96 billion in 1995 to \$14 billion in 2012
- In 2012, 60% of the city's debt payment went to cover interest vs 26% in 1995. Debt service comprises 12% of the city budget (which represents 63% of Chicago's property tax collection)
- Between 2000 and 2012, less than 1/3rd of bond proceeds went to capital projects

A further problem—use of taxable bonds (Chicago Annual Bond Issuance)



Can Chicago solve its own problem?

- The immediate issue is coming up with an additional \$590 million for the 2015 pension contribution (as mandated by state law). CPS needs \$400 million.
- Crain's (January 20, 2014) reports that if Chicago was going to make the pension payment using property taxes (and not reduce current spending levels) property tax rates would need to increase 71.6%. The largest recent increase in property taxes in a major city was in Atlanta in 2009—36%. If Chicago increased property taxes by 36% it would still have to reduce spending by \$293 million in 2015.

Summary

- 2014 was a solid year for the US economy. Much better job market, strong industry performance and good stock market
- 2015 appears to carry significant momentum. Big issue is whether US strength is enough to offset global weakness.
- Illinois and Chicago economies showed significant gains in 2014. The big cloud over the state is still fiscal issues.