Commonwealth of Kentucky

Quarterly Economic & Revenue Report

First Quarter Fiscal Year 2019

Governor's Office for Economic Analysis
Office of State Budget Director

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October 30, 2018

The Honorable Matthew G. Bevin
Governor
Commonwealth of Kentucky
State Capitol Building
Frankfort, KY 40601

Dear Governor Bevin:

The *Quarterly Economic and Revenue Report* summarizes Kentucky's revenue and economic conditions for the first quarter of Fiscal Year 2019 (FY19). It also includes an interim economic and revenue forecast for the final three quarters of FY19.

The Interim Outlook presents an unofficial staff estimate rather than an official revision to the enacted estimate. This is the first *Quarterly Report* that includes an estimate of FY19 in its entirety, complete with the fiscal impacts derived from HB 487 – the comprehensive tax bill that was passed in the 2018 Regular Session of the General Assembly.

Projected General Fund revenues are expected to close FY19 at $11,173.7 million – a total which is $24.5 million below the official budget estimate of $11,198.2 million. Total Road Fund revenues are forecasted to exceed the official forecast by $27.8 million.

General Fund receipts grew 4.5 percent in the first quarter of FY19 with revenues totaling $2,667.4 million compared to $2,553.6 million in the first quarter of FY18. The Road Fund continued its upward trend in the first quarter of FY19, growing 3.8 percent. Sales and use and cigarette tax collections continued to perform strongly while income taxes have been soft. This conforms to expectations following the 2018 tax reform measures adopted in HB 487 where consumption taxes were increased and income-based taxation was lowered through rate reductions.

We will continue to closely monitor economic and revenue trends in the Commonwealth between now and the next report.

Cordially,

John E. Chilton
State Budget Director

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EXECUTIVE SUMMARY

In accordance with KRS 48.400(2), the Office of State Budget Director (OSBD) has prepared this *Quarterly Economic and Revenue Report* for the first quarter of Fiscal Year 2019 (FY19). This report includes a synopsis of the current economic and fiscal conditions of the Commonwealth, as well as an outlook for the next three fiscal quarters.

The Interim Outlook presents an unofficial staff estimate rather than an official revision to the enacted estimate. This is the first *Quarterly Report* that includes an estimate of FY19 in its entirety, complete with the fiscal impacts derived from HB 487 – the comprehensive tax bill that was passed in the 2018 Regular Session of the General Assembly. The aggregate impact or score of HB 487 for FY19 was projected to be a positive impact on tax receipts of $192.3 million. With the first quarter of actual receipts collected, some of the impact from HB 487 has been absorbed into the various receipts accounts. In practice, it is very difficult to bifurcate the impacts of the economy versus the effects of the new tax law.

Projected General Fund revenues are expected to close FY19 at $11,173.7 million – a total which is $24.5 million below the official budget estimate of $11,198.2 million. Albeit small in magnitude, the $24.5 million anticipated shortfall comes on the heels of a $119.8 million revenue surplus in FY18. Total Road Fund revenues are forecasted to exceed the official forecast by $27.8 million.

Major points that will be discussed in this report include the following:

- General Fund receipts grew 4.5 percent in the first quarter of FY19 with revenues totaling $2,667.4 million compared to $2,553.6 million in the first quarter of FY18. Sales and use and cigarette tax collections continued to perform strongly while income taxes have been soft. This conforms to expectations following the 2018 tax reform measures adopted in HB 487 where consumption taxes were increased and income-based taxation was lowered through rate reductions.

- Real GDP rose by 2.9 percent in the first quarter of FY19. Real consumption, which grew by 2.8 percent, made up the majority of the gains in real GDP, while real investment was the fastest growing component with 5.4 percent growth. US personal income rose by 4.6 percent in the first quarter of FY19. Meanwhile, Kentucky personal income grew by 5.2 percent. Wages and salaries was the fastest growing component with 6.0 percent growth. Kentucky non-farm employment was modest with 1.0 percent growth. Other services employment was the fastest growing sector in Kentucky with 3.4 growth in the first quarter.

- The national outlook over the next three fiscal quarters is a forecast of improving GDP growth, continued modest gains in employment, and continued falling unemployment rates. Real GDP growth is forecasted to be 3.0 percent over the next three fiscal quarters, with continued support from the fiscal stimulus of tax cuts and elevated consumer and business sentiment. The overall unemployment rate is expected to continue to fall, reaching an average of 3.5 percent over the next three fiscal quarters, which represents a level of unemployment almost one percentage point below the non-accelerating inflation rate of unemployment (NAIRU).

- The Commonwealth entered the first quarter of FY19 on a positive note, sustaining its recent run of employment gains. Employment growth is projected to maintain at a steady pace through the remaining three quarters of FY19. Strength within the labor market has led to improvements in the labor force participation rate, but also in the personal income of Kentuckians. The improvements in personal income have spanned seven consecutive quarters and is anticipated to moderately increase over the next three quarters of FY19. Wages and salary earnings rose 6.0 percent in the first quarter of the new fiscal year.

- Individual income tax receipts are expected to decrease by 1.4 percent during FY19 following a first quarter decline of 0.7 percent. The individual income tax was heavily impacted by the effects of HB 498. There were also some one-time monies received in the second and third quarters of FY18 in the estimated payments account, which will affect the growth rate for FY19 receipts. Growth in sales and use tax receipts rebounded to 3.5 percent in FY18 following a disappointing year of 0.7 percent growth in FY17. Growth of 8.2 percent is expected in FY19. The high rate of expected growth is primarily attributable to the base broadening measures in the tax bill. HB 487 extended the sales and use tax to include the installation and maintenance of tangible property, as well as to certain services such as landscaping, small animal veterinary services, and extended warranty services.

- The Road Fund continued its upward trend in the first quarter of FY19, growing 3.8 percent. This builds on the 3.2 percent increase in the fourth quarter of FY18 and is the largest quarterly increase since the third quarter of FY17. Going forward, revenues will continue to increase; however, the rate of growth of the fund is expected to decline. Should that forecast come to fruition, the Road Fund would end the year above FY18 levels.

REVENUE RECEIPTS

GENERAL FUND
First Quarter, FY19

General Fund receipts in the first quarter of FY19 totaled $2,667.4 million compared to $2,553.6 million in the first quarter of FY18, for an increase of $113.9 million or 4.5 percent. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these major accounts is available in the Appendix. The first quarter of FY19 revealed growth in five major accounts and declines in four accounts.

The official General Fund revenue estimate for FY19 calls for revenue to grow 3.3 percent compared to FY18 actual receipts. General Fund revenues need to increase 3.0 percent for the remainder of the fiscal year to meet the official estimate.

Table 1
Summary General Fund Receipts
$ millions

	FY19 Q1	FY18 Q1	Diff $	Diff %
Individual Income	1,115.9	1,123.3	-7.4	-0.7
Sales & Use	977.3	903.0	74.4	8.2
Corporate Income	145.8	153.6	-7.8	-5.1
Property	48.6	53.7	-5.1	-9.5
LLET	49.0	43.5	5.5	12.7
Lottery	56.5	55.0	1.5	2.7
Cigarettes	111.9	55.1	56.8	103.1
Coal Severance	20.0	25.3	-5.3	-21.1
Other	142.4	141.1	1.3	0.9
Total	**2,667.4**	**2,553.6**	**113.9**	**4.5**

Sales and use and cigarette tax collections continued to perform strongly while income taxes have been soft. This conforms to expectations following the 2018 tax reform measures adopted in HB 487 where consumption taxes were increased and income-based taxation was lowered through rate reductions.

Individual income tax receipts decreased 0.7 percent in the first quarter of FY19. Receipts of $1,115.9 million were $7.4 million less than was collected in the first quarter of the previous fiscal year. Withholding receipts were down 2.5 percent. On the other side, declaration receipts were up by 2.4 percent for the quarter.

The sales and use tax grew 8.2 percent in the first quarter of FY19. Receipts of $977.3 million compare to the $903.0 million collected in the first quarter of FY18.

Property taxes were down 9.5 percent in the first quarter of FY19 due to timing of collections in the tangible and public service company accounts. Collections of $48.6 million compare to $53.7 million received in the first quarter of the prior fiscal year. Corporation income tax posted a decrease of 5.1 percent, or $7.8 million, during the first quarter of FY19. Receipts totaled $145.8 million compared to the $153.6 million received a year earlier.

The limited liability entity tax (LLET) registered a $5.5 million increase in tax collections in the first quarter of FY19 when compared to FY18. Total collections in the current fiscal year totaled $49.0 million and compare to revenues of $43.5 million in the same period a year earlier.

The coal severance tax revenue continued to decline in the first quarter, with receipts down 21.1 percent. Collections of $20.0 million compare to the FY18 first quarter total of $25.3 million. Coal tax collections continued their weak performance for the last four quarters.

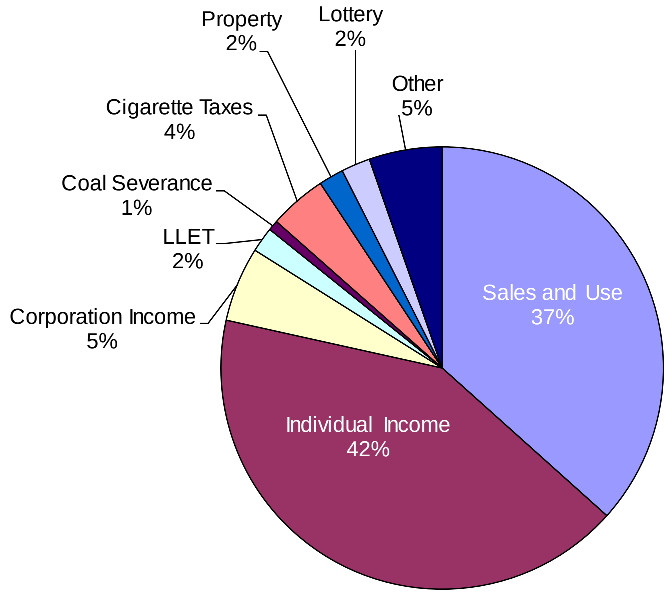
Cigarette taxes are up 103.1 percent in the first quarter with receipts of $111.9 million compare to $55.1 million in the fourth quarter of FY18. The increase coincides with the July 1 increase in the cigarette tax from $0.60 per pack to $1.10 per HB 487. The increase was boosted by the one-time collection of increased taxes on cigarettes in wholesaler inventories.

Lottery receipts increased 2.7 percent, or $1.5 million, in the first quarter of FY19 with revenues of $56.5 million compared to $55.0 million collected in the first quarter of FY18.

The "Other" category represents the remaining accounts in the General Fund, and collections in this account increased 0.9 percent with receipts of $142.4 million compared to $141.1 million collected in the first quarter of FY18.

Figure 1 details the composition of first quarter General Fund receipts by tax type. Seventy-nine percent of General Fund revenues were collected in the areas of the individual income and sales taxes. The next largest sources of revenue were corporation income taxes and the "Other" accounted for five percent each. The largest components in the "Other" category include insurance premium tax, bank franchise tax, telecommunications tax, beer wholesale tax, and inheritance tax. Cigarette taxes accounted for four percent. Lottery receipts, property, and LLET accounted for two percent each. Finally, coal severance taxes accounted for one percent.

Figure 1
Composition of First Quarter FY19
General Fund Revenues



ROAD FUND
First Quarter, FY19

Road Fund revenue is also outperforming estimates as receipts grew 3.8 percent in the first quarter of FY19. Receipts totaled $397.3 million compared to the $382.6 million received in the first quarter of the last fiscal year. The increase in quarterly collections is the strongest since the third quarter of FY17. The official Road Fund revenue estimate calls for a 0.3 percent decrease in receipts for the entire fiscal year FY19. Based on year-to-date collections, revenues can fall 1.7 percent for the remainder of the fiscal year to meet the estimate. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels tax receipts increased 1.2 percent during the first quarter of FY19. Receipts were $201.2 million and compare to $198.8 million collected during the first quarter of FY18.

Motor vehicle usage tax receipts of $133.1 million represent an increase of 4.9 percent compared to the $126.9 million collected in the first quarter of FY18. Vehicle usage tax collections fluctuate with the level of the vehicle sale transactions that occur in the Kentucky economy.

Table 2 Summary Road Fund Receipts $ millions				
	FY19 Q1	FY18 Q1	Diff $	Diff %
Motor Fuels	201.2	198.8	2.4	1.2
Motor Vehicle Usage	133.1	126.9	6.2	4.9
Motor Vehicle License	23.7	21.0	2.8	13.2
Motor Vehicle Operators	4.3	4.3	0.0	0.5
Weight Distance	21.2	20.8	0.4	2.0
Income on Investments	1.9	0.9	1.0	109.2
Other	11.8	10.0	1.8	18.4
Total	**397.3**	**382.6**	**14.7**	**3.8**

Motor vehicle license tax receipts increased 13.2 percent during the first quarter of FY19. Receipts of $23.7 million compare to $21.0 million received during the first quarter of FY18.

Motor vehicle operators' license fees totaled $4.3 million, a 0.5 percent increase compared to the level observed a year ago.

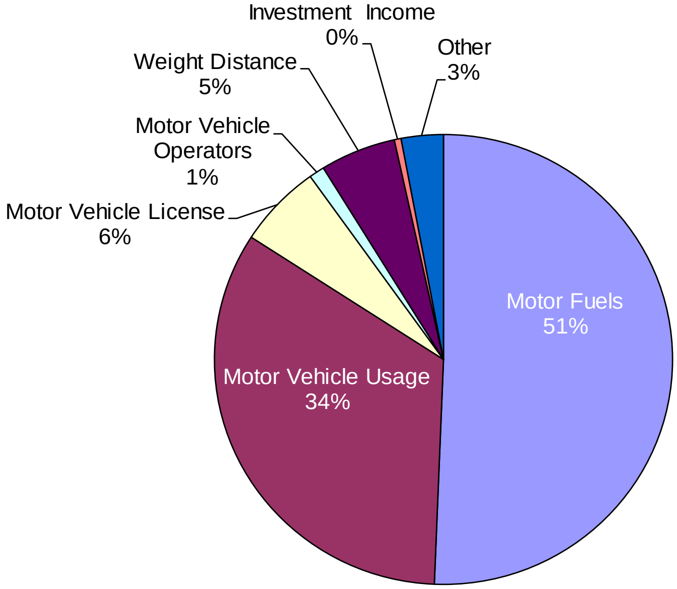
Weight distance tax receipts totaled $21.2 million, an increase of 2.0 percent from the first quarter of last year. The weight distance tax has some significance as a leading indicator of economic activity, as it is a rough proxy for goods in transit over Kentucky highways.

Income on investment receipts of $1.9 million compared to $0.9 million in the first quarter of FY18.

The remainder of the accounts in the Road Fund combined for an increase of 18.4 percent. Receipts for the "Other" category totaled $11.8 million during the first quarter, compared to $10.0 million in the first quarter of FY18.

Figure 2 details the composition of Road Fund revenues by tax type in the first quarter of FY19. Motor fuels taxes and the motor vehicle usage tax accounted for 85 percent of Road Fund revenues in the first quarter. The next-largest source of revenue was motor vehicle license tax for six percent followed by weight distance taxes with five percent. The "Other" category accounted for three percent and motor vehicle operators accounted for one percent. Income on investment accounted for a negligible amount of the total Road Fund receipts.

Figure 2
Composition of First Quarter FY19
Road Fund Revenues



THE ECONOMY
FIRST QUARTER FY19

NATIONAL ECONOMY

Real gross domestic product (real GDP) grew by 2.9 percent in the first quarter of FY19. Growth is above average both in comparison to recent history and relative to other expansion periods. Average adjacent-quarter growth since the end of the last recession has been 0.6 percent. Adjacent-quarter growth in the fourth quarter of FY18 was 1.0 percent and 0.7 percent in the first quarter of FY19. Growth has been above the average for five of the last six quarters. This is the eighteenth consecutive quarter of positive growth for real GDP. The majority of the real GDP growth during this quarter came from consumption and investment.

Real consumption grew by 2.8 percent in the first quarter of FY19. Real consumption has risen on an adjacent-quarter basis in every quarter but one since the end of the 2007 recession. That declining quarter occurred in the second quarter of FY10, shortly after the recession ended. Average adjacent-quarter growth since the end of the 2007 recession is 0.6 percent. Real consumption adjacent-quarter growth during the last four quarters has been strong; growing 1.0, 0.1, 0.9, and 0.7 percent, respectively. Real consumption made up 69.3 percent of real GDP during the first quarter of FY19.

Real investment grew by 5.4 percent in the first quarter of FY19. Adjacent-quarter growth has been erratic for the last five months with growth rates of 2.1, 0.2, 2.3, 0.1, and 2.7 percent respectively. The average growth during that time was 1.5 percent. So while erratic, it is still significantly better than the growth between the first quarter of FY16 and the first quarter of FY17, where growth declined for five consecutive quarters. Adjacent-quarter growth rates during that time were -0.3, -1.5, -0.5, -0.3, and -0.1 percent, respectively. Despite these recent short-term trends, real investment has done extremely well following the 2007 recession. Since the end of the recession, real investment has grown a net 82.8 percent. This is by far the best performing component during that time. Exports were the next best performing component, gaining a net 44.7 percent.

Real investment has grown in relative terms, as well as absolute terms. In the quarter following the end of the 2007 recession, real investment made up 12.3 percent of real GDP. In the first quarter of FY19, real investment made up 18.3 percent of real GDP. Exports and imports also gained some ground in their shares of real GDP, but not by as much as real investment. Real investment is the sum of gross private fixed investment and the change in private inventories. Gross private fixed investment consists of purchases of fixed assets by businesses and the construction of new housing for households.

Table 3
Summary of US Economic Series
First Quarter FY19 & FY18

	First Quarter			
	FY19	**FY18**	**Chg**	**% Chg**
Real GDP	18,651.2	18,120.8	530.3	2.9
Real Consumption	12,932.7	12,584.9	347.8	2.8
Real Investment	3,413.8	3,239.8	174.0	5.4
Real Govt. Expenditures	3,196.3	3,121.8	74.5	2.4
Real Exports	2,561.7	2,456.1	105.7	4.3
Real Imports	3,484.1	3,302.0	182.1	5.5
CPI all goods (% chg)	2.7	2.0	NA	NA
CPI Food (% chg)	1.5	1.1	NA	NA
CPI Energy (% chg)	8.6	6.7	NA	NA
CPI Core (% chg)	2.3	1.7	NA	NA
Industrial Production Index (% chg)	5.0	1.3	NA	NA
Working Population[1]	258.1	255.4	2.7	1.1
Civilian Labor Force[2]	162.5	161.3	1.3	0.8
Employed[3]	156.2	154.2	2.1	1.3
Unemployed[4]	6.3	7.1	-0.8	-11.3
Not in Labor Force[5]	95.5	94.1	1.5	1.5
Labor Force Participation Rate[6] (%)	62.8	62.9	NA	NA
Unemployment Rate (%)	3.8	4.3	NA	NA

Real government expenditures grew by 2.4 percent in the first quarter of FY19. Real government expenditures have followed four different trajectories since the end of the 2007 recession. In the first of these four periods, between fourth quarter of FY10 and the fourth quarter of FY14, real government expenditures contracted, as they normally do during an expansion period. In the second period, between the fourth quarter of FY14 and the fourth quarter of FY16, real government expenditures rose just as steadily as they contracted in the period before. In the third period, from the fourth quarter of FY16 to the first quarter of FY18, real government expenditures were flat. In the fourth period, from the first quarter of FY18 to the first quarter of FY19, real government expenditures are rising again. In the last four quarters, real government expenditure adjacent-quarter growth rates were 0.6, 0.4, 0.6, and 0.8 percent respectively. Real government expenditures made up 17.1 percent of real GDP in the first quarter of FY19.

During this first period, the declines in real government expenditures occurred largely in national defense, non-Medicaid grants to states and aid to foreign governments. During the second period, the increases occurred largely in Social Security, Medicare and Medicaid. During the third period, Medicare grew by 6.3 percent, the fastest among all categories. This high growth was offset by many small declines across several other expenditure categories. In the fourth period, the fastest growth occurred mostly in interest on the debt, aid to foreign governments, and national defense. As noted in the last report, the fastest growing accounts since the end of the recession are Medicare, Medicaid, Social Security, and the interest on the debt. Each of these has grown by over 40 percent since the end of the recession.

Table 4
US Federal Outlays
$ billions, AR

	First Quarter			
	FY19	**FY18**	**Chg**	**% Chg**
Federal Outlays excl. Gross Investment	4,494.9	4,250.9	244.0	5.7
Social Security	978.1	929.8	48.3	5.2
Medicare	737.0	699.6	37.5	5.4
National Defense	630.8	592.3	38.5	6.5
Interest on Debt	542.3	467.0	75.3	16.1
Medicaid	394.9	381.5	13.4	3.5
Non-Medicaid Grants to S&L Govts	188.5	185.8	2.6	1.4
Subsidies	59.4	62.5	-3.0	-4.9
Aid to Foreign Governments	53.0	48.6	4.4	9.1

Real exports grew by 4.3 percent in the first quarter of FY19. Adjacent-quarter growth in the first quarter of FY19 is -0.4 percent. This comes on the heels of strong growth for the previous six quarters. Adjacent-quarter growth during the previous six quarters was 1.2, 0.9, 0.9, 1.6, 0.9, and 2.2 percent respectively. This follows a two year period during calendar 2014 and 2015 when exports were nearly flat. Real exports made up 13.7 percent of real GDP in the first quarter of FY19.

Real imports grew by 5.5 percent in the first quarter of FY19. Growth on an adjacent-quarter basis, has been strong in eight of the last nine quarters. Persistent and strong personal income is the main driver of this increase. As American's disposable income increases, their demand for imported goods goes up as well. Real imports made up 18.7 percent* of real GDP in the first quarter of FY19. *Real imports are a deduction from real GDP.

US personal income rose by 4.6 percent in the first quarter of FY19. Dividends, interest and rent, wages and salaries, and proprietor's income rose sharply in the first quarter. Growth in the income components is far more evenly distributed than the recent past. In the last seven quarters, US personal income grew by a net 8.1 percent. During the previous seven quarters (from third quarter of FY15 to the second quarter of FY17) US personal income grew by 5.7 percent. Growth rates in the components were very different between these two periods. During the last seven quarters, proprietor's income has grown by a net 10.5 percent. During the previous seven quarters, proprietor's income grew by a net 0.5 percent.

Over the last 17 years (which encompasses three different Presidential administrations), wages and salaries and transfers income have changed considerably. In 2001, wages and salaries income made up 55.4 percent of total personal income. In the first quarter of FY19, wages and salaries income made up 50.4 percent of total personal income. In 2001, transfers income made up 12.9 percent of total personal income. In the first quarter of FY19, transfers income made up 16.9 percent of total personal income. It is common for transfer payments to rise during and immediately following recessions. It is also common for transfer payments income to contract during expansion periods.

This pattern has been broken during the expansion period following the 2007 recession. Transfers income share rose from 15.6 percent to 18.8 percent during and immediately following the 2007 recession. By the second quarter of FY13, transfer payments income declined to 16.6 percent share of personal income. Transfer payments fluctuated considerably over the next four years, slowly trending upwards to 17.2 percent by the end of the Obama administration. Over the next seven quarters, the share of transfer payments income has declined from 17.2 percent to 16.9 percent. The share of wages and salaries income in the last seven quarters rose from 50.2 percent to 50.4 percent.

US non-farm employment increased by 1.7 percent in the first quarter of FY19. Quarterly growth has been very stable over the last three years. Adjacent-quarter growth in the first quarter of FY19 was 0.4 percent. Adjacent-quarter growth was 0.4 percent in 10 of the last 13 quarters and the range was between 0.3 and 0.5 percent each quarter.

The fastest growing sector in the first quarter of FY19 was mining employment, which grew by 6.6 percent. The weakest sector in the first quarter was information services employment, which declined by 0.6 percent. In an absolute sense, business services employment was the strongest sector, gaining a net half million jobs between the first quarter of FY18 and the first quarter of FY19.

In the first quarter of FY19, the working population increased by 1.1 percent. On an adjacent-quarter basis the working population increased by 0.2 percent, which was the sixth consecutive quarter of increases. The labor force increased by 0.8 percent in the first quarter of FY19. The labor force is made up of two groups of people, the employed and the unemployed. The employed group grew by 1.3 percent in the first quarter of FY19 and the unemployed declined by 11.3 percent. The decrease in the unemployed group has sped up in recent quarters. The number of unemployed peaked in the third quarter of FY10 with 15.9 million unemployed. This number contracted over the next six years by an average of 1.9 percent per quarter. However, over the last six quarters, the number of unemployed have declined on average 3.0 percent per quarter.

KENTUCKY ECONOMY

Kentucky personal income grew by 5.2 percent in the first quarter of FY19. Kentucky personal income has increased on an adjacent–quarter basis for 19 consecutive quarters. All five contributing income components experienced solid to strong growth this quarter. Wages and salaries income was the fastest growing contributing component, growing 6.0 percent. Meanwhile, income from transfer receipts was the slowest growing component which grew 4.2 percent. Wages and salaries income made up 51.3 percent of total personal income in the first quarter of FY19.

Table 5
Personal Income
$ billions, SAAR

	Q1			
	FY19	**FY18**	**$ Diff**	**% Diff**
United States				
Personal Income	17,675	16,895	780	4.6
Social Insurance	1,372	1,306	66	5.0
Residence Adjustments	0	0	0	NA
Dividends, Interest and Rents	3,536	3,347	189	5.6
Transfer Receipts	2,986	2,875	110	3.8
Wages & Salaries	8,905	8,507	398	4.7
Supplements to W&S	2,030	1,965	65	3.3
Proprietor's Income	1,590	1,507	83	5.5
Kentucky				
Personal Income	184	175	9	5.2
Social Insurance	16	15	1	6.5
Residence Adjustments	-2	-2	0	7.2
Dividends, Interest and Rents	29	27	1	4.4
Transfer Receipts	44	42	2	4.2
Wages & Salaries	95	89	5	6.0
Supplements to W&S	24	23	1	5.1
Proprietor's Income	11	10	1	6.1

Transfer receipts income made up 24.0 percent of total personal income in the first quarter of FY19. In 2001, transfer receipts income made up 17.4 percent of total personal income. Most of that increase in share occurred following the 2007 recession. Typically, during the expansion that follows a recession, transfer receipts and transfer receipts' share declines back to pre-recession levels. However, this did not happen following the 2007 recession. Instead, transfer receipts share rose to a peak of 25.0 percent in the third quarter of FY10 and contracted slightly to 23.1 percent over the next two years. Then transfers began to grow again. By the third quarter of FY15, transfer receipts share was back to 25.0 percent. Over the next three years, transfer receipts grew in nominal terms, but receded slowly on a share basis, as total income grew faster than transfer receipts. Transfer receipts are those "payments by business and government to persons for which no current services are performed."[1] This includes, but is not limited to Social Security payments, Medicaid payments, Medicare payments, unemployment insurance payments, veteran's benefits, and housing subsidy payments.

Kentucky non-farm employment grew by 1.0 percent in the first quarter of FY19. This is the eighth consecutive quarter that growth has been at one percent or lower. Other services employment was the fastest growing employment sector in the first quarter of FY19. Other services employment grew by 3.4 percent in the first quarter of FY19. On an adjacent-quarter basis, other services employment grew 1.5 percent in the first quarter. Adjacent-quarter growth has been above 0.9 percent in three of the last four quarters. The 2007 recession hurt other services employment significantly. Not only did the recession cut deep into other services employment, but the quarterly losses continued for 23 additional quarters after the recession had officially ended. Other services growth has been positive now for 12 of the last 14 quarters. Industries classified in the 'other services' employment sector are those services industries not specifically provided for elsewhere and include machinery repair, dry-cleaning and laundry services, personal care services, pet care services and dating services.

[1]NIPA Handbook definition, BEA, November 2017, P.15.

Table 6
Summary of US & KY Employment
First Quarter FY19 & FY18

	US Q1 (millions)			KY Q1 (thousands)		
	FY19	**FY18**	**% Chg**	**FY19**	**FY18**	**% Chg**
Non-farm Employment	149.4	146.9	1.7	1,940.7	1,921.9	1.0
Goods-producing	20.8	20.1	3.3	342.1	337.4	1.4
Construction	7.3	7.0	4.3	77.4	77.5	-0.2
Mining	0.7	0.7	6.6	10.4	10.4	0.2
Manufacturing	12.8	12.5	2.6	254.4	249.5	1.9
Service-providing	106.3	104.5	1.7	1,283.1	1,268.0	1.2
Trade, Transportation & Utilities	27.8	27.5	1.2	410.2	402.3	2.0
Information	2.8	2.8	-0.6	21.9	22.7	-3.3
Finance	8.6	8.5	1.2	93.6	93.1	0.5
Business Services	21.1	20.5	2.6	217.9	214.7	1.5
Educational Services	23.7	23.3	1.9	272.9	272.5	0.1
Leisure and Hospitality Services	16.4	16.1	1.9	198.6	196.9	0.9
Other Services	5.9	5.8	1.6	68.0	65.8	3.4
Government	22.3	22.3	0.0	315.4	316.6	-0.4

INTERIM OUTLOOK

GENERAL FUND

The revenue forecasts presented in Table 7 and Table 8 were prepared using the September 2018 "control scenario" economic forecast from both IHS Markit and the Kentucky MAK model. The FY19 estimates presented below highlight the final three fiscal quarters of the year. Projected General Fund revenues are shown in Table 7. As the table indicates, General Fund growth is projected to be 2.7 percent for the final three quarters of FY19. When coupled with first quarter growth of 4.5 percent, FY19 is expected to close at $11,173.7 million – a total which is $24.5 million below the official budget estimate of $11,198.2 million.

Table 7
General Fund Interim Forecast
$ millions

	FY19						FY19	
	Q1		Q2, Q3, & Q4		Full Year		Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Individual Income	1,115.9	-0.7	3,421.8	-1.7	4,537.7	-1.4	4,531.2	6.5
Sales & Use	977.3	8.2	2,925.3	8.2	3,902.6	8.2	3,907.6	-5.0
Corporate Income	145.8	-5.1	350.6	-2.0	496.4	-2.9	573.0	-76.6
Property	48.6	-9.5	580.1	2.2	628.7	1.2	620.7	8.0
LLET	49.0	12.7	182.1	-6.4	231.1	-3.0	200.2	30.9
Lottery	56.5	2.7	195.7	-1.2	252.2	-0.3	249.0	3.2
Cigarettes	111.9	103.1	226.9	44.8	338.8	59.9	337.9	0.9
Coal Severance	20.0	-21.1	56.7	-11.9	76.6	-14.5	77.9	-1.3
Other	142.4	0.9	567.2	0.8	709.6	0.8	700.7	8.9
General Fund	**2,667.4**	**4.5**	**8,506.3**	**2.7**	**11,173.7**	**3.1**	**11,198.2**	**-24.5**

The Interim Outlook represents an unofficial staff estimate prepared in accordance with KRS 48.400 (2). It is the first such update that includes an estimate of FY19 in its entirety, complete with the fiscal impacts derived from HB 487 – the comprehensive tax bill that was passed in the 2018 Regular Session of the General Assembly. The aggregate impact or score of HB 487 for FY19 was projected to be positive $192.3 million. Therefore, the growth rates presented in Table 7 incorporate normal economic activity plus the impacts associated with the tax bill. With the first quarter of actual data in the books, some of the impact from HB 487 has been absorbed into the various receipts accounts.

In practice, it is very difficult to bifurcate the impacts of the economy versus the effects of the new tax law.

Individual income tax receipts are expected to decrease by 1.4 percent during FY19 following a first-quarter decline of 0.7 percent. The individual income tax was heavily impacted by the effects of HB 498. There were also some one-time monies received in the second and third quarters of FY18 in the estimated payments account, which will affect the growth rate for FY19 receipts.

The full FY19 impact of HB 487 is a reduction of $118.3 million. A share of that impact will occur in the final three quarters of FY19. The withholding component of the individual income tax was profoundly impacted by the rate reduction elements of the tax bill. Withholding tables were adjusted in May 2018, following the passage of HB 487. The lower withholding amounts through the first quarter of FY19 support the expected decline in the individual income tax.

Sales and use tax receipts rebounded to 3.5 percent in FY18 following a disappointing year of 0.7 percent growth in FY17. Growth of 8.2 percent is expected in FY19. The high rate of expected growth is attributable to the base broadening measures in the tax bill. HB 487 extended the sales and use tax to installation and maintenance of tangible property, as well as to certain services such as landscaping, small animal veterinary services, and extended warranty services. The full-year impact of the expansion of the sales tax is $208.2 million. An appropriate share of that impact was added to the forecast shown in Table 7.

Property tax revenues are expected to increase by 2.2 percent over the forecasting horizon, yielding annual growth of 1.2 percent following a first quarter setback of 9.5 percent. The state rate on real property will remain at 12.2 cents per $100 in valuation for property assessed as of January 1, 2018. Many areas of the state continue to linger from the effects of the housing recession, so the state rate has remained at 12.2 cents since valuation year 2008, an unprecedented run of 11 consecutive years without a rate decline. The relatively weak growth expected in the property tax is primarily attributable the public service account as well as the tangible property account. Both of these categories fared above average in FY18 and are expected to revert back to more historical patterns in FY19. Property taxes were not affected by the most recent tax reform, so no additions or subtractions were indicated for these accounts.

The corporation income tax and the LLET are now estimated in aggregate due to the inability to separate the receipts in a meaningful manner. Business taxes were also affected by the changes in HB 487. The progressive rate structure was replaced with a flat rate of 5.0 percent, which represents a tax cut for most businesses. Rate cuts were coupled with some base broadening and an update to the IRC effective January 1, 2018 – partially mitigating the negative fiscal impact of the rate reduction. Due in part to the estimated tax law effect in FY19 of -$27.6 million, the combined amount of corporation taxes is expected to decline nearly 3.0 percent in FY19. While business profits remain positive, the outlook calls for more muted profit growth than was reported in earlier estimates of the corporation taxes.

Coal severance receipts fell 10.8 percent in FY18 but managed to exceed the official estimate by $1.1 million. Coal severance receipts have fallen from an all-time high of $298.3 million in FY12 to an all-time low of $89.6 million in FY18. This interim estimate calls for a further decline in coal severance tax receipts of 14.5 percent in FY19, including a first quarter setback of 21.1 percent. The coal severance tax was unaffected by the provisions of HB 487 so no exogenous changes were applied to the forecast.

Cigarette tax receipts in FY19 will be profoundly impacted by the change in the rate of taxation. HB 487 raised the tax on each pack of cigarettes from 60 cents to $1.10, with an associated tax impact of $128.6 million for FY19. A floor stocks tax of 50 cents per pack was also added to inventories to prevent hoarding prior to the July 1 tax increase. The effect of the tax increase and floor stocks tax are projected to increase 59.9 percent in FY19. The downward trend in smoking is expected to continue beyond the forecasting horizon. Therefore, the revenue increase expected in FY19 is likely to be a high watermark for cigarette tax receipts going forward – absent any further changes to the rate of taxation.

Lottery dividends exceeded the FY18 estimate by $10.0 million, largely due to strength in the online games and solid growth in the instant ticket marketplace. As with any revenue source, unusually high growth in the base period creates a higher bar to clear for the projections in the following years. While the dividend schedule for the remainder of FY19 has not yet been released, minor improvement is expected vis-à-vis the official estimate of $249.0 million. Lottery collections are projected to be $252.2 million in FY19.

The "Other" category contains dozens of smaller accounts, which make up the remainder of the General Fund. Insurance premiums tax, bank franchise and telecommunications tax are the three largest accounts in the "Other" category. The "Other" category of taxes is expected to rise 0.8 percent during FY19, a rate of growth slightly under the 2.0 percent increase in FY18. Each account was re-examined after FY18 and the proper adjustments were made to calibrate the models. The "Other" accounts totaled $703.7 million in FY18. "Other" collections are estimated to be $709.6 million in FY19, $8.9 million greater than the official estimate.

ROAD FUND

Road Fund revenues continued to gain strength in the first quarter of FY19, growing 3.8 percent. This builds on the 3.2 percent increase in the fourth quarter of FY18 and is the largest quarterly increase since the third quarter of FY17. Growth in the quarter was largely the result of increases in motor vehicle usage tax collections but motor fuels revenues also performed well in the period.

Going forward, the rate of growth of the fund is expected to decline but it is anticipated that the Road Fund will end the year above FY18 levels. Total revenues are projected to exceed the official forecast by $27.8 million as shown in Table 8. Motor fuels taxes grew 1.2 percent in the first three months of the year but are forecasted to increase 0.8 percent over the remainder of the year as the price of gasoline increases. Motor vehicle usage tax receipts also rose in the first quarter, growing 4.9 percent. That rate of growth is expected to abate over the final nine months of FY18 as tariffs raise the price of vehicles. All of the remaining Road Fund accounts - motor vehicle operators, motor vehicle license, weight distance, investment and “Other” receipts all posted solid growth in the first three months of the fiscal year. However, forecasted values for these accounts are expected to slow from their current rates over the remainder of the year and even be negative for three of the accounts.

Table 8
Road Fund Interim Forecast
$ millions

	FY19						FY19	
	Q1		Q2, Q3, & Q4		Full Year		Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Motor Fuels	201.2	1.2	570.6	0.8	771.8	0.9	759.2	12.6
Motor Vehicle Usage	133.1	4.9	370.0	1.0	503.1	2.0	494.0	9.1
Motor Vehicle License	23.7	13.2	91.7	-0.2	115.4	2.3	116.5	-1.1
Motor Vehicle Operators	4.3	0.5	12.6	0.7	16.9	0.6	16.7	0.2
Weight Distance	21.2	2.0	61.9	1.6	83.1	1.7	82.1	1.0
Income on Investments	1.9	109.2	1.9	-1.7	3.8	33.9	3.1	0.7
Other	11.8	18.4	28.4	-1.3	40.2	3.8	35.0	5.2
Road Fund	**397.3**	**3.8**	**1,137.0**	**0.8**	**1,534.3**	**1.5**	**1,506.6**	**27.8**

To estimate the growth of all other components of the Road Fund, officials of the Kentucky Transportation Cabinet and staff of the Governor’s Office for Economic Analysis assessed recent growth patterns as well as administrative and statutory factors to formulate the projections. Motor vehicle license taxes are forecasted to decrease 0.2 percent in the final three quarters of FY19. Motor vehicle operators’ licenses are projected to grow 0.7 percent in the remainder of the fiscal year. Weight distance tax revenue is expected to grow 1.6 percent for the remainder of the fiscal year. Investment income is expected to decline 1.7 percent over the next three quarters. All other revenues combined are projected to decline 1.3 percent during the last nine months of FY19.

NATIONAL OUTLOOK

As we enter the second quarter of the FY19, the national outlook over the next three fiscal quarters is a forecast of improving GDP growth, continued modest gains in employment, and continued falling unemployment rates. Real GDP growth is forecasted to be 3.0 percent over the next three fiscal quarters, with continued support from the fiscal stimulus of tax cuts and elevated consumer and business sentiment. The overall unemployment rate is expected to continue to fall, reaching an average of 3.5 percent over the next three fiscal quarters, which represents a level of unemployment almost one percentage point below the non-accelerating inflation rate of unemployment (NAIRU).

One area of strong growth in real GDP over the next three fiscal quarters is real investment. Driven by business investment, as businesses increase investments in plant and equipment, real investment is expected to increase by 6.8 percent over the remainder of the fiscal year. Recent increases in oil prices have encouraged increased spending on energy related drilling structures, and incentives in the Tax Cuts and Jobs Act have reinforced the increases in equipment and intellectual property expenditures.

The Trump administration enacted a second round of tariffs on approximately $200 billion in goods imported from China. The tariffs represent an initial 10 percent levy, which will rise to 25 percent on January 1, 2019. The tariffs were levied on a variety of goods that are mostly intermediate goods and materials used by US businesses as inputs to production. The remaining goods subject to the new tariffs are split between capital goods and consumer goods. Overall, the tariffs are expected to generate about $70 billion in customs duties, and the new tariffs will increase the effective rate on all non-petroleum goods to 5.1 percent by the first calendar quarter of 2019, the highest rate since the Carter administration.

Tariffs wars can have serious implications for the industries involved in the tariffs. The effect on the overall economy is theoretically ambiguous. That is, there will be some positive effects from the increased domestic production in protected industries. And there will be negative effects from the decreased production on domestic industries where foreign tariffs affect exports. Some industries will be winners and others will be losers. More importantly, the tariffs result in resources being used in places which are not efficient. If Chinese steel is cheaper than US steel, then US steel workers and capital would be better used in some other endeavor. Moreover, if Kentucky bourbon is taxed in the Chinese market, then Kentucky bourbon suffers. If the Chinese market for bourbon is significant, then bourbon sellers in the US could go out of business. So even if the tariff wars are temporary, their effects can be long-lasting.

The Federal Open Market Committee (FOMC), as expected, raised the federal funds rate by 25 basis points at their September meeting to maintain a target rate of between 2.0-2.25 percent. In addition to raising the benchmark interest rate, the FOMC defended the committee's gradual approach to raising interest rates, as the committee attempts to allow the current economic expansion to continue in a sustainable fashion, while avoiding having the PCE inflation target exceed 2 percent. The FOMC will likely continue to raise interest rates until the target funds rate reaches 3.5 percent by the end of calendar 2020. The yield on 10-year Treasury issuances have increased by over 70 basis points this calendar year, and the current forecast has 10 Treasuries achieving 3.5 percent by 2020. As a result, the Treasury yield curve will continue to flatten, as short- and intermediate-term rates rise by more than long-term rates, and the equity markets may falter in an environment of bond yields increasing at a rate that exceeds expectations.

Table 9
US Economic Outlook
Quarters 2, 3, & 4

	Q2, Q3, & Q4			Full Year	
	FY19	FY18	% Chg	FY19	% Chg
Real GDP	18,908.5	18,354.1	3.0	18,844.2	3.0
Real Consumption	13,093.0	12,756.8	2.6	13,053.0	2.7
Real Investment	3,519.8	3,297.1	6.8	3,493.3	6.4
Real Govt. Expenditures	3,239.0	3,154.3	2.7	3,228.3	2.6
Real Exports	2,618.4	2,528.9	3.5	2,604.2	3.7
Real Imports	3,601.5	3,410.7	5.6	3,572.1	5.6
CPI all goods (% chg)	2.5	2.3	NA	2.6	NA
CPI Food (% chg)	1.9	1.4	NA	1.8	NA
CPI Energy (% chg)	5.7	8.2	NA	6.4	NA
CPI Core (% chg)	2.3	2.0	NA	2.3	NA
Industrial Production Index (% chg)	3.1	3.3	NA	3.6	NA
Unemployment Rate (%)	3.5	4.0	NA	3.6	NA

KENTUCKY OUTLOOK

The Commonwealth entered the first quarter of FY19 on a positive note, continuing its recent run of employment gains. Employment growth is projected to maintain a steady pace through the remaining three quarters of FY19. Kentucky's seasonally adjusted unemployment rate remained low at 4.4 percent for August 2018, according to the Local Area Unemployment Statistics published by the Bureau of Labor Statistics. A slight upswing in the unemployment rate has recently been observed, beginning its uptick in May of 2018. Kentucky's labor force has climbed to a new high of 2,071,442 workers in August 2018. The labor force count consists of individuals who are actively employed, as well as those unemployed who are seeking work. The August 2018 record surpasses the prior November 2012 labor force peak by 1,296 workers.

The improvement in personal income has spanned seven consecutive quarters and anticipated to moderately increase over the next three quarters of FY19. Wages and salary earnings rose 6.0 percent in the first quarter of the new fiscal year. The flipside to increased earnings is the challenge that employers face regarding employee retention and recruiting as the labor market tightens in response to a sustained low rate of unemployment.

Drilling down by sector, projected growth is anticipated for non-farm employment over the forecast horizon. Looking ahead at the final three quarters of FY19, growth is expected for the goods-producing sector, continuing its reign as the bright spot in Kentucky's economic outlook. Construction and manufacturing supersectors constitute the largest portion of percent change of employment with projected growth of 2.6 percent and 3.1 percent, respectively.

The business services supersector is anticipated to gain an additional 6,900 jobs over the next three quarters, accounting for the most significant employment gain within the service-providing sector. On the opposite end of the spectrum, fewer jobs continue to beset the information supersector with flat or declining growth dating back to the first quarter of FY18. Information services employment is expected to lose 600 jobs for the final three quarters of FY19. The main components of this sector include software publishing, traditional broadcasting industries and those exclusive to the internet, telecommunications industries, web search portals, and data processing industries. Automation, offshoring, the collapse of traditional media, as well as self-service features have attributed to the decline of jobs in information.

Lastly, government jobs are expected to grow an additional 800 positions or 0.2 percent over the forecast horizon. While some sector outlooks are rosier than others, collectively Kentucky's non-farm employment is expected to make substantial progress in the months to come.

Table 10
Kentucky Economic Outlook
Quarters 2, 3, & 4

	Q2, Q3, & Q4			Full Year	
	FY19	**FY18**	**% Chg**	**FY19**	**% Chg**
Personal Income ($ millions)	188,994.9	179,829.7	5.1	187,843.6	5.1
Wages and Salaries ($ millions)	96,823.1	92,008.5	5.2	96,282.4	5.4
Non-farm Employment (thousands)	1,953.6	1,926.2	1.4	1,950.3	1.3
Goods-producing	346.1	336.3	2.9	345.1	2.5
Construction	78.4	76.4	2.6	78.1	1.9
Mining	10.5	10.4	1.0	10.4	0.8
Manufacturing	257.2	249.6	3.1	256.5	2.8
Service-providing	1,291.7	1,274.9	1.3	1,289.6	1.3
Trade, Transportation & Utilities	411.9	408.7	0.8	411.5	1.1
Information	21.8	22.4	-2.7	21.8	-2.9
Finance	94.2	93.1	1.1	94.0	1.0
Business Services	221.9	215.0	3.2	220.9	2.8
Educational Services	274.1	272.1	0.7	273.8	0.6
Leisure and Hospitality Services	200.2	196.3	2.0	199.8	1.7
Other Services	67.6	67.2	0.6	67.7	1.3
Government	315.8	315.0	0.2	315.7	0.1

APPENDIX

General Fund and Road Fund Revenue Receipts

First Quarter FY19

KENTUCKY STATE GOVERNMENT – GENERAL FUND REVENUE

	First Quarter FY 2019	First Quarter FY 2018	% Change
TOTAL GENERAL FUND	**$2,667,429,897**	**$2,553,562,721**	**4.5%**
Tax Receipts	$2,588,126,004	$2,480,757,948	4.3%
Sales and Gross Receipts	**$1,179,620,655**	**$1,055,029,875**	**11.8%**
Beer Consumption	1,745,641	1,779,571	-1.9%
Beer Wholesale	16,286,176	17,104,433	-4.8%
Cigarette	90,764,122	55,107,667	64.7%
Distilled Spirits Case Sales	33,745	38,149	-11.5%
Distilled Spirits Consumption	3,664,372	3,542,671	3.4%
Distilled Spirits Wholesale	11,605,781	10,822,379	7.2%
Insurance Premium	30,114,759	35,967,495	-16.3%
Pari-Mutuel	1,486,032	1,229,876	20.8%
Race Track Admission	86,338	99,059	-12.8%
Sales and Use	977,331,613	902,963,933	8.2%
Wine Consumption	769,553	744,884	3.3%
Wine Wholesale	4,049,866	4,070,336	-0.5%
Telecommunications Tax	14,403,829	15,775,132	-8.7%
Other Tobacco Products	6,119,283	5,785,274	5.8%
Floor Stock Tax	21,159,545	(982)	---
License and Privilege	**($341,732)**	**($366,514)**	**---**
Alc. Bev. License Suspension	111,250	133,850	-16.9%
Corporation License	44,657	10,897	309.8%
Corporation Organization	9,505	12,375	-23.2%
Occupational Licenses	31,020	36,866	-15.9%
Race Track License	95,000	100,075	-5.1%
Bank Franchise Tax	(805,226)	(844,729)	---
Driver License Fees	172,062	184,153	-6.6%
Natural Resources	**$29,258,307**	**$33,689,669**	**-13.2%**
Coal Severance	19,954,372	25,287,648	-21.1%
Oil Production	1,727,422	1,148,457	50.4%
Minerals Severance	5,004,077	5,537,595	-9.6%
Natural Gas Severance	2,572,435	1,715,968	49.9%
Income	**$1,310,726,340**	**$1,320,407,472**	**-0.7%**
Corporation	145,816,242	153,636,467	-5.1%
Individual	1,115,938,449	1,123,303,844	-0.7%
Limited Liability Entity	48,971,649	43,467,161	12.7%
Property	**$48,573,747**	**$53,652,955**	**-9.5%**
Building & Loan Association	257,579	10,684	2310.9%
General - Real	54,344	(722,930)	---
General - Tangible	32,831,714	32,707,411	0.4%
Omitted & Delinquent	4,943,932	4,802,857	2.9%
Public Service	10,481,690	16,848,628	-37.8%
Other	4,488	6,304	-28.8%
Inheritance Tax	**$13,594,894**	**$12,654,997**	**7.4%**
Miscellaneous	**$6,693,793**	**$5,689,495**	**17.7%**
Legal Process	4,058,097	3,181,960	27.5%
T. V. A. In Lieu Payments	2,631,901	2,490,216	5.7%
Other	3,795	17,319	-78.1%
Nontax Receipts	$78,592,656	$72,756,394	8.0%
Departmental Fees	3,649,937	3,294,134	10.8%
PSC Assessment Fee	15,689,168	15,812,583	-0.8%
Fines & Forfeitures	6,394,100	4,423,027	44.6%
Income on Investments	(1,444,874)	(1,136,549)	---
Lottery	56,500,000	55,000,000	2.7%
Miscellaneous	(2,195,674)	(4,636,802)	---
Redeposit of State Funds	**$711,236**	**$48,379**	**1370.1%**

KENTUCKY STATE GOVERNMENT – ROAD FUND REVENUE

	First Quarter FY 2019	First Quarter FY 2018	% Change
TOTAL ROAD FUND	$397,284,793	$382,626,355	3.8%
Tax Receipts-	$389,353,673	$377,668,339	3.1%
Sales and Gross Receipts	$334,302,285	$325,673,733	2.6%
Motor Fuels Taxes	201,176,590	198,766,262	1.2%
Motor Vehicle Usage	133,125,695	126,907,471	4.9%
License and Privilege	$55,051,388	$51,994,606	5.9%
Motor Vehicles	23,726,370	20,959,918	13.2%
Motor Vehicle Operators	4,327,187	4,304,703	0.5%
Weight Distance	21,226,226	20,818,053	2.0%
Truck Decal Fees	16,739	16,593	0.9%
Other Special Fees	5,754,867	5,895,339	-2.4%
Nontax Receipts	$7,659,452	$4,679,216	63.7%
Departmental Fees	4,802,627	3,510,180	36.8%
In Lieu of Traffic Fines	92,633	87,850	5.4%
Income on Investments	1,907,089	911,660	109.2%
Miscellaneous	857,103	169,526	405.6%
Redeposit of State Funds	$271,667	$278,800	-2.6%