



Office of State Budget Director

Capitol Building, 700 Capitol Avenue
Frankfort, Kentucky 40601

(502) 564-2611 or (502) 564-7300
FAX: (502) 564-7022 or (502) 564-6684
Internet: osbd.ky.gov

Ernie Fletcher
Governor

Stanton L. Cave
State Budget Director

Governor's Office for Policy and Management
Governor's Office for Economic Analysis
Governor's Office for Policy Research

October 30, 2007

The Honorable Ernie Fletcher
Governor
Commonwealth of Kentucky
State Capitol Building
Frankfort, KY 40601

Dear Governor Fletcher:

The attached Quarterly Economic and Revenue Report summarizes the revenue and economic statistics for the first quarter of Fiscal Year 2008 (FY08). It also includes an interim economic and revenue forecast for the last three quarters of FY08.

General Fund receipts for the first quarter of FY08 totaled \$2.067 billion, an increase of 1.5 percent compared to the same period in FY07. Road Fund revenues totaled \$326.7 million, for an increase of 7.7 percent from the first quarter of FY07.

The interim General Fund forecast for the final three quarters of FY08 calls for an increase of 0.9 percent compared to the same period one year ago. The interim forecast for the Road Fund for the final three quarters of FY08 is for growth of 3.9 percent.

We will continue to monitor the economic and fiscal conditions of the Commonwealth and will keep you apprised of developments.

Sincerely,

A handwritten signature in black ink that reads "Stanton L. Cave".

Stanton L. Cave
State Budget Director

Attachment

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Executive Summary . . .

Quarterly Report - FY2008:1

General Fund receipts totaled \$2.067 billion for the first quarter of fiscal year 2008 (FY08), increasing from FY07 by 1.5 percent. This represents \$31.4 million more than reported in the same period one year earlier. The Road Fund grew by 7.7 percent during the first quarter, and economic growth as measured by Kentucky personal income, was up by 6.1 percent.

Performance in the General Fund categories for the first quarter was affected not only by economic conditions but also by changes in the treatment of taxes on limited liability business entities as mandated by the 2006 Extraordinary Session of the General Assembly. Sales and use tax revenues were up by 3.5 percent. Individual income tax receipts rose by 11.5 percent, reflecting the changes enacted by the General Assembly. Combined corporation income and limited liability entity taxes posted a sharp decline of 34.7 percent, reflecting the shift in revenues away from corporation income taxes and into the individual income tax for pass-through entities.

Coal severance taxes dipped by 2.4 percent continuing their downward drift. Tobacco taxes were up by 5.0 percent in the first quarter of FY08. Property taxes were 43.0 percent higher than a year earlier, affected by timing differences in collection of some accounts.

During the first quarter of FY08, lottery revenues grew by 1.2 percent compared to the first quarter of FY07. All other receipts combined for a decrease of 0.4 percent.

Road Fund receipts were boosted by a recalculation of the statutory rate of motor fuels taxes,

which are tied to the wholesale price of motor fuels. For the first quarter, the Road Fund grew by 7.7 percent. Motor fuels taxes rose by 11.6 percent, while motor vehicle usage tax receipts climbed by 1.4 percent.

Weight distance tax revenues rose by 1.2 percent, and motor vehicle license tax revenues grew by 30.3 percent. Motor vehicle operators' license tax slipped by 0.9 percent.

The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 2.2 percent from a year earlier in the first quarter of FY08. Personal income rose by a healthy 6.7 percent. Kentucky's economy as measured by personal income grew by 6.1 percent over the same period one year earlier. Employment in the state grew by 0.9 percent as 17,400 jobs were added to the payroll during the first quarter.

The interim forecast for the General Fund expects revenues to rise by 0.9 percent over the final three quarters of FY08. Total revenues for the entire fiscal year are forecasted to reach \$8.666 billion, a level that is \$98.8 million below budgeted levels.

Among the major accounts, the outlook for the final three quarters of FY08 is for sales and use tax revenues to rise by 2.1 percent, and for the individual income tax to grow by 10.1 percent due to inclusion of



income taxes paid by owners of pass-through entities. Corporation income tax receipts are expected to fall by 40.6 percent and coal severance tax receipts to decrease by 1.9 percent.

Tobacco tax revenues are estimated to grow by 9.6 percent in the last three quarters of FY08 in reaction to tax increases in the neighboring states of Indiana and Tennessee. Property tax receipts will fall by 2.9 percent, and dividend payments from the lottery should increase by 0.3 percent. "Other" taxes and revenues will combine for a decline of 6.3 percent during the final three quarters of the fiscal year.

The interim outlook for the Road Fund anticipates an increase in revenues of 3.9 percent for the last three quarters of FY08. This is \$23.3 million above budgeted levels. Motor fuels taxes will grow by 7.7 percent chiefly due to the higher rate on gasoline and other

motor fuels. Motor vehicle usage tax collections are expected to grow by 1.4 percent, and motor vehicle license taxes are projected to fall by 2.1 percent.

The outlook for the national economy foresees real GDP growth of 1.7 percent over the remainder of FY08, and personal income growth of 5.4 percent. In Kentucky, personal income is expected to rise by 5.2 percent, while employment should rise by 0.9 percent.



Revenue Receipts . . .

Quarterly Report - FY2008:1

GENERAL FUND

General Fund receipts in the first quarter of FY08 totaled \$2.067 billion compared to \$2.036 billion in the first quarter of FY07, for a net gain of \$31.4 million and growth of 1.5 percent. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these and other accounts is available in the Appendix. Changes in tax laws due to recent legislation had an impact on collections of certain taxes during the first quarter. The individual income tax and the corporation income tax continue to be affected by shifts in the reporting requirements. The first quarter was the first period in which receipts collected through the limited liability entity tax

\$703.8 million collected in the first quarter of FY07.

Individual income tax receipts grew 11.5 percent in the first quarter of FY08. Receipts of \$822.7 million were \$84.9 million more than was collected in the first quarter of the previous fiscal year due primarily to changes enacted during the 2006 special session.

Corporation income and limited liability entity taxes posted a decrease of 34.7 percent during the first quarter of FY08. Receipts totaled \$182.6 million compared to the \$279.6 million received a year earlier. Of this amount, the LLET contributed \$18.6 million.

Table 1
Summary General Fund Receipts
First Quarter, FY08
(mil \$)

	<u>FY08</u>	<u>FY07</u>	<u>Diff</u>	<u>Diff</u>
			<u>(\$)</u>	<u>(%)</u>
Sales and Use	728.2	703.8	24.4	3.5
Individual Income	822.7	737.8	84.9	11.5
Corp. Inc. & LLT	182.6	279.6	-97.0	-34.7
Coal Severance	53.4	54.8	-1.4	-2.4
Tobacco Taxes	46.1	43.9	2.2	5.0
Property	58.9	41.1	17.8	43.0
Lottery	41.5	41.0	0.5	1.2
Other	<u>133.7</u>	<u>134.2</u>	<u>-0.5</u>	<u>-0.4</u>
TOTAL	2,067.1	2,035.7	31.4	1.5

(LLET), created by the 2006 Extraordinary Session of the General Assembly, were reported separately. Otherwise, most of the changes in revenue were due to economic conditions, unless noted below in the specific tax section.

The **sales and use tax** had moderate growth of 3.5 percent in the first quarter of FY08. Receipts of \$728.2 million compare to the

The **coal severance tax** continued its recent trend of slowly decreasing by falling 2.4 percent in the first quarter. Coal prices have dipped slightly in recent months, thereby reducing the value of coal being severed in Kentucky. Receipts of \$53.4 million compare to \$54.8 million collected in the first quarter of FY07.

Tobacco taxes rose moderately in the first quarter, apparently due to recent cigarette tax increases enacted by Tennessee and Indiana. It is believed that residents of those states who live along their borders with Kentucky are taking advantage of lower cigarette prices here due to lower taxes, thereby boosting purchases of cigarettes in this state. Receipts of \$46.1 million were 5.0 percent more than collected one year earlier. Cigarette taxes included in the General Fund include the cigarette excise tax of 3-cents per pack, the 26-cent per pack surtax, taxes on

other tobacco products (e.g., cigars, pipe tobacco, chewing tobacco, and snuff) as well as cigarette rolling papers.

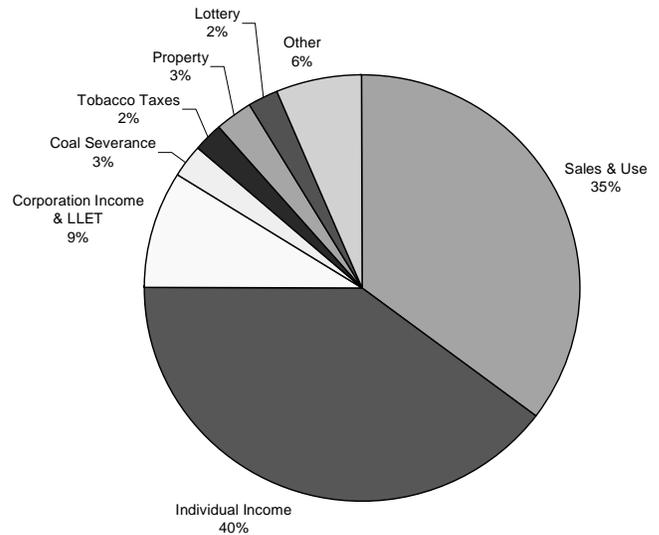
Property taxes were up by 43.0 percent in the first quarter of FY08 due almost entirely to differences in the timing of collections of the public service company property tax as well as omitted and delinquent taxes. Collections of \$58.9 million compare to \$41.1 million received in the first quarter of the prior fiscal year.

Lottery receipts increased by 1.2 percent in the first quarter of FY08 with revenues of \$41.5 million.

The **“other”** category represents the remaining accounts in the General Fund, and collections in this account decreased 0.4 percent with receipts of \$133.7 million.

Figure 1 details the composition of first-quarter General Fund receipts by tax type. Seventy-five percent of General Fund revenues were collected in the areas of the individual income tax and the sales tax. The next-largest source of revenue was the combination of the corporation income tax and LLET at nine percent. “Other taxes” combine for the next-largest source with a share of six percent. The major components in this category include inheritance taxes, insurance premium taxes, beer wholesale sales tax, telecommunications taxes, and the natural gas severance tax. The coal severance tax and the property tax each accounted for three percent of the revenues. Tobacco taxes and the lottery each made up two percent of the General Fund.

Figure 1
First Quarter, FY08
General Fund Receipts



ROAD FUND
First Quarter, FY08

The Road Fund grew by 7.7 percent in the first quarter of FY08. Receipts totaled \$326.7 million compared to the \$303.3 million received in the first quarter of the last fiscal year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels and motor fuels use tax receipts increased 11.6 percent during the first quarter of FY08. Receipts were \$160.2 million and compare to \$143.5 million collected during the first quarter of last year. Motor fuels tax revenues were affected by an increase in the motor fuels rate from that in effect in the previous fiscal year.

Motor vehicle usage tax receipts grew by 1.4 percent during the first quarter. Receipts were \$110.2 million compared to \$108.7 million collected during the same period last year.

Weight distance tax receipts of \$22.1 million grew by 1.2 percent over receipts of \$21.8 million during the first quarter of last year.

Motor vehicle license tax receipts grew by 30.3 percent during the first quarter of FY08. Receipts of \$18.5 million compare to \$14.2 million received during the first quarter of FY07. Revenues from this tax have experienced extreme volatility recently, and the current trend appears to extend this feature.

Motor vehicle operators' license fees slipped by 0.9 percent compared to the level observed a year ago. Although rounded figures of \$4.0 million in both years would imply no change, receipts in the first quarter of FY08 were actually about \$38,000 below the level received last year.

Investment income grew by 6.3 percent in the first quarter due to larger investible balances. Receipts of \$3.4 million compare to \$3.2 in the first quarter of FY07.

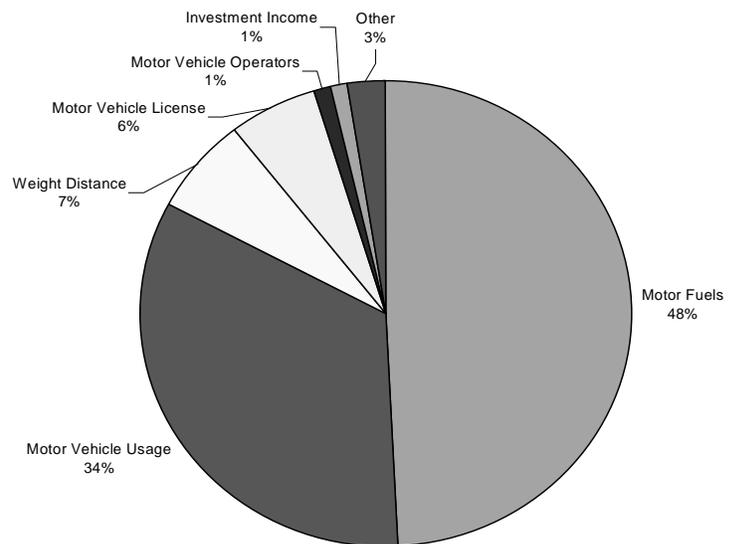
The remainder of the accounts in the Road Fund combined for an increase of 5.1 percent. Receipts for the "Other" category totaled \$8.3 million during the first quarter, compared to \$7.9 million in the first quarter of FY07.

Figure 2 details the composition of Road Fund revenues by tax type in the first quarter of FY08. Motor fuels taxes and motor vehicle usage taxes comprised 82 percent of Road Fund revenues in the first quarter. The next-largest source of revenue was the weight distance tax with seven percent, followed by motor vehicle license with five percent. The "other" category accounted for three percent, while motor vehicle operators' license fees and investment income composed one percent each.

Table 2
Summary Road Fund Receipts
First Quarter, FY08
(mil \$)

	FY08	FY07	Diff (\$)	Diff (%)
Motor Fuels	160.2	143.5	16.7	11.6
Motor Vehicle Usage	110.2	108.7	1.5	1.4
Weight Distance	22.1	21.8	0.3	1.2
Motor Vehicle License	18.5	14.2	4.3	30.3
Motor Vehicle Operators	4.0	4.0	0.0	-0.9
Investment Income	3.4	3.2	0.2	6.3
Other	<u>8.3</u>	<u>7.9</u>	<u>0.4</u>	<u>5.1</u>
TOTAL	326.7	303.3	23.4	7.7

Figure 2
First Quarter, FY08
Road Fund Receipts



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The Economy . . .

Quarterly Report - FY2008:1

NATIONAL ECONOMY

The broadest measure of economic performance is real gross domestic product (GDP), an inflation-adjusted measure of the total output of goods and services produced in the United States. Real GDP growth is typically reported as a seasonally adjusted annual rate that compares consecutive quarters. On that basis growth in real output has strengthened considerably, rising by 2.3 percent (comparing April-June to July-September 2007) in contrast to 1.1 percent a year ago. However, when the first quarter output for FY08 is compared to the same quarter a year ago the situation is reversed: real GDP increased by 2.2 percent compared to 2.4 percent in FY07. For analyzing revenue growth this is a more appropriate gauge because revenues are typically compared to the same quarter a year ago.

There are four broad components of the economy that drive overall growth: consumption, investment, government spending, and net exports. Consumption is by far the largest component, accounting for about 70 percent of the total. Though consumption adjusted for inflation grew slightly faster in the first quarter (up 2.9 percent compared to 2.7 percent a year ago), it was still considerably lower than the 3.5 percent growth rate that had been the norm until recently. As a result of pent-up demand, the purchase of motor vehicles and parts accelerated in the first quarter, rising 3.1 percent compared to a decline of 6.6 percent a year ago. The consumption of nondurable goods increased by 2.4 percent

compared to 3.7 percent a year ago. Oil prices averaged \$72.68 per barrel in the first quarter, up \$2 from a year ago. Despite the higher cost of oil, in the short-run it is difficult for consumers to drastically reduce their spending on energy. The net effect is usually a slight reduction in the consumption of other commodities, accompanied by a decline in the savings rate.

Total investment comprises close to a fifth of real GDP and is usually sensitive to both interest rates and future expansion opportunities. The investment component of GDP declined for the fourth straight quarter—down 5.3 percent compared to an increase of 3.4 percent a year ago. Given the problems arising from subprime lending and the overbuilt housing market it is not surprising that residential fixed investment was down for the sixth straight quarter.

Government spending constitutes 17 percent of GDP and was up 2.2 percent, led by a surge in defense outlays (up 3.8 percent). The improvement in state revenues caused state government spending to go up by 2.3 percent.

The final component of GDP is net exports: the difference between exports and imports. The dollar declined by 10.0 percent against the exchange rate of major U.S. trading partners. This automatically made imports more expensive causing real imports to increase by just 1.4 percent. The weaker dollar also made U.S. goods relatively cheap for foreign buyers and pushed real exports up by 7.8 percent.

Industrial production was up by 1.5 percent, after a vigorous 5.1 percent increase in the same quarter a year ago. Output in coal min-

ing was down 3.6 percent in contrast to a 3.7 percent increase a year ago.

The University of Michigan Consumer Sentiment Index has been going down for the last four quarters. It has declined from a high of 92.5 in October-December 2006 to 85.6 during the July-September 2007 period. The slide in consumer confidence was related to the steady increase in crude oil prices and the resulting hike in the price of gasoline at the pump. In the minds of consumers this clearly overshadowed the positive economic news about increased productivity and factory capacity utilization.

Personal income, a measure of spending power, was \$11,769.5 billion in the first quarter, for increase of 6.7 percent over the previous year. This is remarkably strong growth even after factoring in inflation. The robust income gain can be linked directly to increases in wage and salary income (up 7.2 percent), and dividends, interest and rent (up 7.8 percent).

The unemployment rate in the first quarter averaged 4.7 percent, the same as a year ago. Total nonfarm employment increased by a highly respectable 1.3 percent to 138.2 million jobs. Manufacturing employment continued to decline with a drop of 1.1 percent during the first quarter.

STATE ECONOMY

Kentucky's personal income is estimated to be \$133.3 billion for the first quarter of FY08, an increase of 6.1 percent from a year ago. U.S. personal income grew by 6.7 percent during the same period. Wages and salaries constitute a little over half of personal income. Income derived from wages and salaries is estimated to have grown by 6.6 percent in FY08:1, slightly slower than the national average of 7.2 percent.

Employment data is commonly used to gauge the strength of the state's economy, primarily because of its timely availability and its impact on consumer spending and confidence.

Table 3
Summary US Economic Indicators
First Quarter* FY08

	FY07:1	FY08:1	Percent Change
Real GDP (billion 2000 \$)	11,336.7	11,589.3	2.2
Personal Income (billion \$)	11,030.9	11,769.5	6.7
Consumer Price Index (percent change)	3.4	2.3	-
Industrial Production (percent change)	5.1	1.5	-
Civilian Labor Force (millions)	151.7	153.4	1.1
Total Nonfarm Employment (millions)	136.4	138.2	1.3
Manufacturing Employment (millions)	14.2	14.1	-1.1
Unemployment Rate (percent)	4.7	4.7	-

*Seasonally adjusted annual percent growth rate.

Sources: Global Insight, Inc., and U.S. Department of Commerce, BEA.

Data for FY08:1 are September 2007 estimates.

Nonfarm employment in Kentucky is estimated to have increased by 17,400 jobs in the first quarter of FY08 compared to one year earlier, resulting in a growth of 0.9 percent. Over a longer time period, Kentucky's job growth has averaged 1.4 percent annually, or approximately 25,000 new jobs. But, given that productivity rates have increased substantially, and there is excess production capacity in China and East Asia, the approximately one percent increase may be the new norm.

The largest gain in employment is from the Educational Services sector (up 2.0 percent with an increase of 4,700 jobs). The industries in this sector include both public and private colleges as well as training centers. It

seems reasonable that given the nature of the changing economy, especially the pronounced shift in manufacturing employment, workers would tend to drop out of the labor force for training in new fields of employment, thus increasing employment in Educational Services.

The Contract Construction sector (up 2.9 percent with an increase of 2,400 jobs) is growing in spite of the national woes associated with residential housing. The relative strength of construction employment is from the demand for specialty trade contractors. This includes pouring concrete, site preparation, plumbing, painting, and electrical work. Nationally, however, employment in construction is down 1.1 percent.

Table 4
Selected Kentucky Economic Indicators
First Quarter, FY08

	<u>FY07:1</u>	<u>FY08:1</u>	<u>Chg</u>	<u>% Chg</u>
Total Personal Income (\$ billions)	125.6	133.3	7.7	6.1
Wage & Salary Income (\$ billions)	67.9	72.4	4.5	6.6
Total Nonfarm Employment (thousands)	1,843.7	1,861.1	17.4	0.9
Contract Construction	82.1	84.5	2.4	2.9
Mining	23.0	23.4	0.4	1.6
Manufacturing	260.0	257.9	-2.1	-0.8
Trade, Transportation & Utilities	379.1	381.9	2.8	0.7
Information	29.6	30.2	0.6	1.9
Finance	90.6	92.2	1.7	1.8
Business Services	178.6	182.0	3.4	1.9
Educational Services	238.1	242.8	4.7	2.0
Leisure and Hospitality Services	167.1	171.3	4.2	2.5
Other Services	75.8	76.1	0.3	0.3
Government	319.7	319.0	-0.7	-0.2

Note: Numbers may not add up due to rounding.
Sources: U.S. Department of Commerce, BEA,
GOEA's Macromodel of Kentucky Forecast, September 2007

Leisure and Hospitality services were up 2.5 percent. Most of the gain was in the area of accommodation and food services. The arts and entertainment portion of this category showed a slight decline.

Historically the focus of Kentucky's economy has been on the manufacturing sector. It is the third largest sector in the Kentucky economy after Government and the Trade,

Transportation, and Utilities sector. Manufacturing employment accounts for about 15 percent of all nonfarm employment in Kentucky compared to 11 percent nationally. Over the last four years manufacturing employment declined sharply due to both the relocation of production facilities abroad and increased domestic productivity. During the first quarter manufacturing was down 0.8 percent with a loss of 2,100 jobs.

Figure 3
Personal Income: KY vs. U.S.
(Index FY00 = 100)

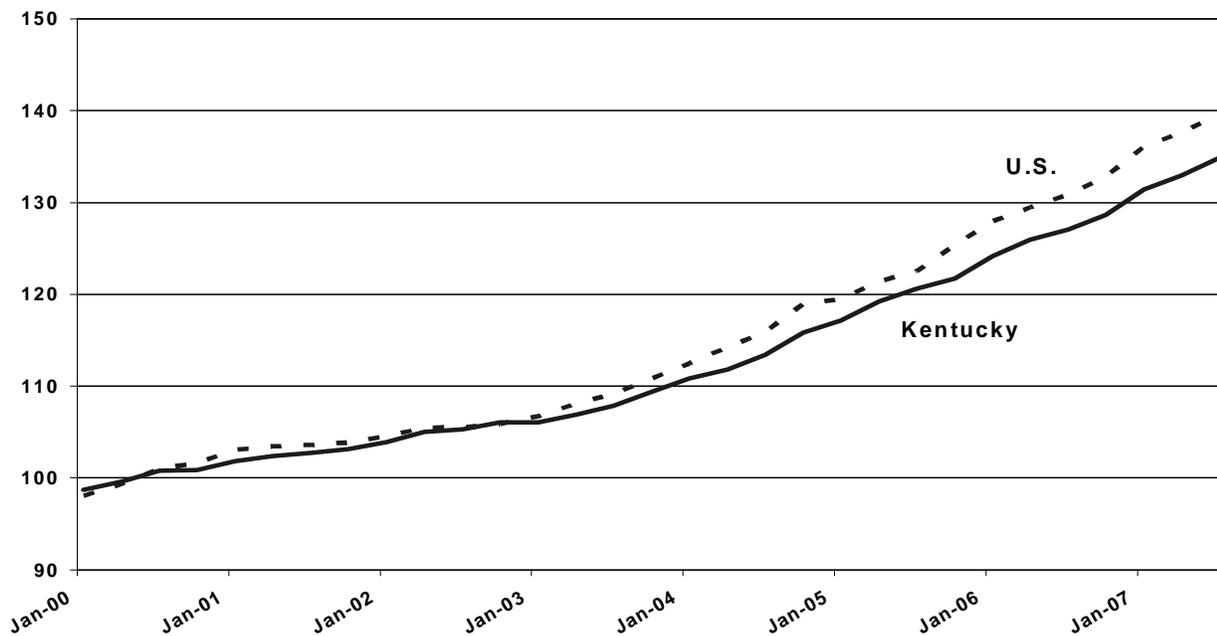
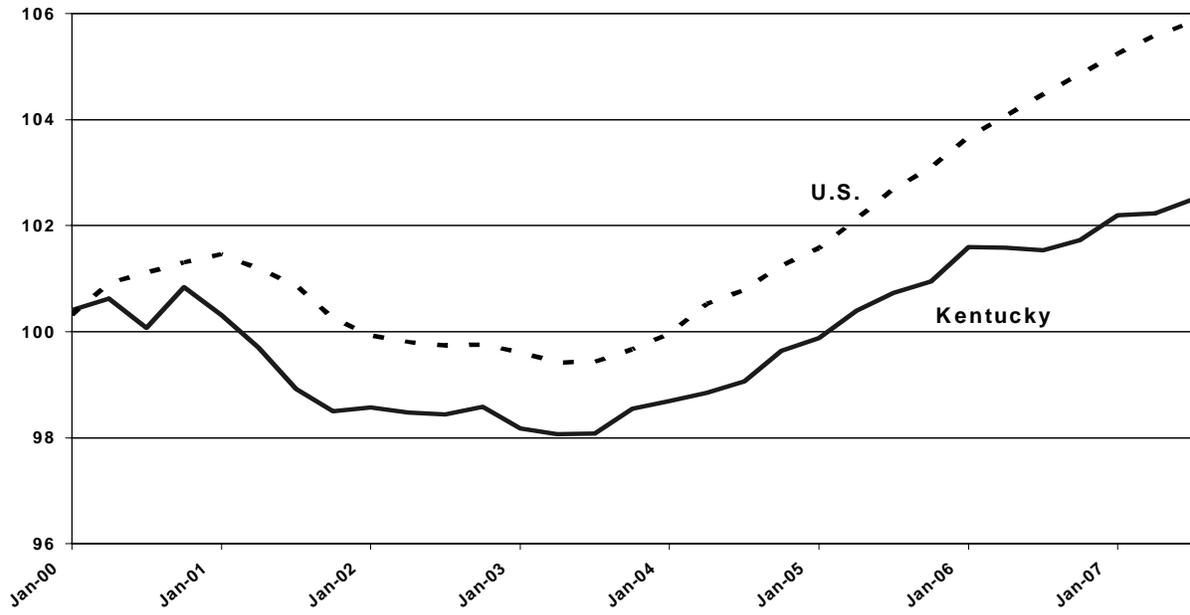


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



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Interim Outlook . . .

Quarterly Report - FY2008:1

Projected General Fund revenues for the next three quarters are shown in Table 5 below. General Fund revenues were \$2.067 billion in the first quarter of FY08, a growth rate of 1.5 percent from the same period a year ago. Revenues grew slowly reflecting a cooling economy. First-quarter growth was strongest in the individual income tax and the property tax, for different reasons as explained earlier in this report.

Anticipated revenues for the last three quarters of FY08 are \$6.599 billion, corresponding to a growth rate of 0.9 percent from the previous fiscal year. Revenue performance among the major accounts is expected to vary from weak growth to actual declines. Growth in the individual income tax as well as the corporation income tax will be affected by the changes enacted by the 2006 Special Session of the Kentucky General Assembly.

The official revised revenue estimate determined by the Consensus Forecasting Group in January 2007 anticipates General Fund revenues of \$8.902 billion for FY08. This interim estimate forecasts that revenues will be \$236 million less than estimated at that time. The revenue estimate on which the FY07-FY08 biennial budget was enacted called for \$8.765 billion for FY08. The interim forecast as shown in Table 5 predicts that revenues will be \$8.666 billion, a level that is of \$98.8 million below budgeted levels. A weakening economic outlook and lower limited liability entity tax (LLET) revenues than anticipated earlier have led to expectations of lower revenues for FY08.

Total sales and use tax receipts for the first quarter of FY08 were \$728.2 million, representing an increase of 3.5 percent from the same period a year ago. The projected rate of

Table 5
General Fund Interim Estimate
(million dollars)

	FY08		FY08		FY08	
	Quarter 1		Quarters 2, 3, & 4		Full Year	
	Actual	%Chg	Estimate	%Chg	Estimate	%Chg
Sales & Use	728.2	3.5	2,158.2	2.1	2,886.4	2.4
Individual Income	822.7	11.5	2,537.5	10.1	3,360.2	10.5
Corporation Income	164.0	-41.3	420.9	-40.6	584.9	-40.8
Limited Liability Entity	18.6	n/a	106.4	n/a	125.0	n/a
Coal Severance	53.4	-2.6	164.0	-1.9	217.4	-2.1
Tobacco Taxes	46.1	5.0	146.3	9.6	192.4	8.5
Property	58.9	43.3	438.1	-2.9	497.0	0.9
Lottery	41.5	1.2	146.0	0.3	187.5	0.5
Other	<u>133.7</u>	<u>0.0</u>	<u>481.9</u>	<u>-6.3</u>	<u>615.6</u>	<u>-5.0</u>
Total General Fund	2,067.1	1.5	6,599.3	0.9	8,666.4	1.1

growth for the remaining three quarters of FY08 is 2.1 percent. Total sales and use tax receipts for FY08 are estimated to be \$2.886 billion.

The interim forecast for the individual income tax calls for a rise of 10.1 percent for the remainder of FY08, amounting to collections of \$2.538 billion in the final nine months. The individual income tax grew by 11.5 percent in the first quarter of FY08, and growth is expected to remain near that level in the remainder of the fiscal year as the changes enacted in 2006 continue to result in revenues shifting from the corporation income tax to the individual income tax. For the entire fiscal year, individual income tax revenues are projected to grow by 10.5 percent.

The outlook for corporation income tax projects a decrease of 40.6 percent in the final three quarters of FY08, representing collections of \$420.9 million. These anticipated collections will bring the FY08 total to \$584.9 million, a decrease of 40.8 percent from FY07. Revenues in FY08 are affected by changes to the corporation income tax as described above. In addition, receipts are expected to decline as a result of a reduction in the top marginal corporation income tax rate from 7 percent to 6 percent, effective January 1, 2007.

The limited liability entity tax was created by the 2006 Special Session of the General Assembly as replacement to the alternative minimum calculation (AMC) that was enacted as part of HB 272 (2005). This tax became effective in 2007, and receipts under it have been tracked separately since July 2007. Collections for the first quarter of FY08 totaled \$18.6 million, and for the next three fiscal quarters this tax is forecasted to yield \$106.4 million.

The coal severance tax dipped slightly in the first quarter, and the forecast is that coal prices will drift downward slightly over the remainder of the fiscal year. As a result, revenue from this source is projected to drop by 1.9 percent for the remaining three quarters. Overall for the fiscal year, coal severance tax receipts are expected to fall by 2.1 percent.

Tobacco taxes grew when compared to a year earlier. Kentucky sales rose in response to cigarette tax increases in the neighboring states of Tennessee and Indiana. The outlook for the remaining nine months of the fiscal year is for \$146.3 million in revenue, with a corresponding growth of 9.6 percent. For the entire fiscal year, receipts are forecasted to rise by 8.5 percent and yield \$192.4 million in revenue.

Property tax revenues totaled \$58.9 million in the first quarter of FY08, representing a growth rate of 43.3 percent from a year earlier. Receipts in property tax are sensitive to timing of payments, and in the first quarter payments of Public Service Company (PSC) property taxes grew sharply in relation to the previous year. It is expected that the remaining three quarters of FY08 will yield total property tax revenues of \$438.1 million, for a decline of 2.9 percent from the previous year. The removal of taxes on most remaining forms of intangible property and the removal of telecommunications companies from the PSC property tax will contribute to the slow growth. For the entire fiscal year property taxes should rise by 0.9 percent.

Lottery revenues grew by 1.2 percent in the first quarter of FY08. In the next three quarters, lottery revenues are expected to rise by 0.3 percent as revenue boosts received

last year due to high Powerball sales are not expected to be repeated. For the entire fiscal year, lottery receipts should grow by 0.5 percent.

The “other” category contains estimates for several of the smaller revenue sources not otherwise classified. The final three quarters of FY08 should experience shrinkage of 6.3 percent. The decrease is anticipated due to several factors: natural gas severance tax revenue is expected to fall, abandoned property receipts will not be as large as in the previous year, and investment income will also be lower than in the year before.

ROAD FUND

Road Fund revenues over the three-quarter horizon are forecasted to grow by 3.9 percent as shown on Table 6 below. This represents a decrease of \$3.6 million from the January 2007 official revised revenue estimate, but is \$23.3 million above the budgeted level for FY08.

Motor fuels tax receipts are forecasted to grow by 7.7 percent in the last three quarters of FY08. This is principally due to a change

in forecasted gasoline prices and their effect on the statutory rate of the motor fuels tax. Gasoline prices have averaged higher than in the previous fiscal year; the resulting tax rate will be higher than a year ago as well.

Motor vehicle usage tax collections are expected to rise by 1.4 percent in the final three quarters of FY08. Receipts in the first quarter grew by 1.4 percent. Growth is expected to be partially boosted by changes in the treatment of the motor vehicle usage tax.

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 together assessed recent growth patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to decline by 2.1 percent in the final three quarters of FY08. Motor vehicle operators’ licenses are projected to rise by 0.8 percent in the remainder of the fiscal year. Weight distance tax revenue should improve by 1.6 percent for the remainder of the fiscal year. Investment income should fall by 17.8 percent due to lower fund balances. All other revenues should combine for a growth of 10.0 percent during the last nine months of FY08.

Table 6
Road Fund Interim Estimate
(million dollars)

	FY08 Quarter 1		FY08 Quarters 2,3, & 4		FY08 Full Year	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg
Motor Fuels	160.2	11.6	452.1	7.7	612.3	8.7
Motor Vehicle Usage	110.2	1.4	306.9	1.4	417.1	1.3
Motor Vehicle License	18.5	30.3	85.7	-2.1	104.2	2.5
Motor Vehicle Operators	4.0	0.0	11.9	0.8	15.9	0.6
Weight Distance	22.1	1.4	64.6	1.6	86.7	1.5
Investment	3.4	6.3	10.6	-17.8	14.0	-13.0
Other	8.3	4.6	26.7	10.0	35.0	8.7
Road Fund	326.7	7.7	958.5	3.9	1,285.2	4.8

NATIONAL ECONOMY

Final Three Quarters of FY08

In the three quarters that comprise the October-to-June period of FY08, real GDP is expected to show a gain of 1.7 percent from a year ago. This is about par with the unremarkable 1.5 percent growth experienced during the same period in FY07. Employment growth in nonfarm industries is forecasted to slow considerably to 0.7 percent compared to a 1.6 percent increase in the same period last year. Fueled by energy prices, employment in mining will continue to grow rapidly (2.3 percent) though much slower than the 7.1 percent growth a year ago. However, mining job gains have little impact on overall U.S. employment since mining comprises just 0.5 percent of nonfarm employment. Among the large sectors, leisure and hospitality services are expected to register a gain of 3.1 percent and educational services should grow by 2.5 percent. Manufacturing employment is forecasted to decline by 0.7 percent. The drag of the subprime lending disaster will be felt in the construction market with employment declining by 4.1 percent.

Over the last three years consumption has played a greater role in real GDP as the other components—investment, net exports, and government spending—have been hit by overcapacity, and state government budget woes which have counterbalanced federal government spending. During the next three quarters of FY08 consumption is expected to increase by 2.3 percent compared to 2.7 percent a year ago. Consumption of durable goods is expected to soften substantially from 4.1 percent a year ago to 1.8 percent. The dampening is related to a renewed slowdown in the purchase of motor vehicles and parts (1.2 percent) as well as furniture (from 6.8 percent a year ago to 2.2 percent).

In spite of relatively low interest rates the investment climate will continue to be unfavorable because of the lackluster near-term outlook for the economy. Overall investment activity is expected to be down 3.2 percent, and residential investments are expected to dip 18.6 percent.

U.S. personal income is forecasted to increase by 5.4 percent compared to a more robust 6.2 percent a year ago. In spite of higher energy

Table 7
U.S. Economic Outlook for FY08
Quarters 2, 3, & 4

	FY07	FY08	Percent* Change
Real GDP (billion 2000 \$)	11,444.0	11,638.6	1.7
Personal Income (billion \$)	11,424.8	12,040.0	5.4
Consumer Price Index (1992-94=100)	204.4	209.6	2.5
Industrial Production (2002=100)	112.4	113.8	1.2
Civilian Labor Force (millions)	152.7	154.1	0.9
Total Nonfarm Employment (millions)	137.4	138.5	0.7
Manufacturing Employment (millions)	14.1	14.0	-0.7
Unemployment Rate (percent)	4.5	4.9	-

* Seasonally adjusted annual rate.

Sources: Global Insight, and U.S. Department of Commerce, BEA.

Data for FY08 are September 2007 estimates.

prices (oil at \$74.60 per barrel) increased productivity is expected to keep inflation in check at 2.5 percent.

STATE ECONOMY

Final Three Quarters of FY08

The impact of the national slowdown will percolate to the state economy. Personal income is estimated to increase by 5.2 percent during the October-to-June FY08 period compared to a 5.7 percent increase during the same period a year ago.

Kentucky's nonfarm employment is expected to grow by 0.9 percent during the final three quarters of FY08. The goods-producing sectors account for one-fifth of all employment and the expected growth rate is only 0.1 per-

cent. Manufacturing employment is projected to decline by 0.3 percent and construction by 0.2 percent. Mining is the only industry in the goods-producing category expected to show a gain in employment.

The service-providing industries account for about 65 percent of employment and are forecasted to expand by 1.2 percent with the creation of 14,200 jobs. The strongest growth in this category is in the leisure and hospitality services industry (up 2.7 percent), followed by educational services (up 2.0 percent). With the slowdown in the economy, employment in business services is expected to rise by only 0.5 percent. Employment in government—including federal, state, and local—is also anticipated to rise by 0.5 percent.

Table 8
Kentucky Economic Outlook for FY08
Quarters 2, 3, & 4

	FY07	FY08	Percent* Change
Total Personal Income (\$ millions)	129,522	136,218	5.2
Wage & Salary Income (\$ millions)	70,271	73,710	4.9
Total Nonfarm Employment (thousands)	1,838.3	1,855.2	0.9
Contract Construction	83.6	83.5	-0.2
Mining	23.1	24.4	5.7
Manufacturing	259.2	258.5	-0.3
Trade, Transportation & Utilities	380.1	383.5	0.9
Information	30.0	30.1	0.5
Finance	91.6	90.7	-1.0
Business Services	180.5	181.3	0.5
Educational Services	240.4	245.1	2.0
Leisure and Hospitality Services	169.6	174.1	2.7
Other Services	76.1	77.5	1.8
Government	318.6	320.3	0.5

*Seasonally adjusted rate from a year ago.

Source: GOEA's Macromodel of Kentucky, September 2007.

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APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	First Quarter FY 2008	First Quarter FY 2007	% Change
TOTAL GENERAL FUND	2,067,111,590	2,035,738,110	1.5%
Tax Receipts	1,997,393,265	1,966,696,560	1.6%
Sales and Gross Receipts	840,733,564	816,467,697	3.0%
Beer Consumption	1,841,929	1,791,350	2.8%
Beer Wholesale	14,195,303	13,209,659	7.5%
Cigarette	43,773,840	41,701,350	5.0%
Distilled Spirits Case Sales	25,372	23,986	5.8%
Distilled Spirits Consumption	2,564,003	2,454,522	4.5%
Distilled Spirits Wholesale	6,336,080	5,921,355	7.0%
Insurance Premium	24,057,543	28,797,283	-16.5%
Pari-Mutuel	709,782	739,283	-4.0%
Race Track Admission	152,651	117,774	29.6%
Sales and Use	728,207,530	703,823,093	3.5%
Wine Consumption	551,662	530,095	4.1%
Wine Wholesale	2,660,279	2,533,253	5.0%
Telecommunications Tax	13,325,831	12,641,426	5.4%
Other Tobacco Products	2,331,758	2,183,268	6.8%
License and Privilege	87,784,495	70,998,141	23.6%
Alc. Bev. License Suspension	318,770	101,000	215.6%
Coal Severance	53,432,118	54,763,148	-2.4%
Corporation License	1,902,281	1,687,671	12.7%
Corporation Organization	88,057	41,400	112.7%
Occupational Licenses	40,595	30,509	33.1%
Oil Production	2,039,617	1,858,768	9.7%
Race Track License	186,575	160,500	16.2%
Bank Franchise Tax	(45,848)	(217,827)	---
Driver License Fees	176,915	161,262	9.7%
Minerals Severance	4,577,349	4,171,119	9.7%
Natural Gas Severance	6,466,697	8,240,592	-21.5%
Limited Liability Entity	18,601,369	0	---
Income	986,684,703	1,017,479,565	-3.0%
Corporation	163,972,164	279,638,932	-41.4%
Individual	822,712,539	737,840,634	11.5%
Property	\$58,819,593	\$41,121,249	43.0%
Building & Loan Association	93,832	423,953	-77.9%
General - Real	576,149	284,962	102.2%
General - Tangible	26,264,166	22,970,554	14.3%
Omitted & Delinquent	19,557,415	11,697,970	67.2%
Public Service	12,164,491	5,728,272	112.4%
Other	163,541	15,537	952.6%
Inheritance	\$14,061,662	\$12,237,207	14.9%
Miscellaneous	\$9,309,248	\$8,392,700	10.9%
Legal Process	6,553,328	6,786,083	-3.4%
T. V. A. In Lieu Payments	2,755,921	1,602,119	72.0%
Other	0	4,499	-100.0%
Nontax Receipts	\$67,977,075	\$61,891,237	9.8%
Departmental Fees	7,352,300	6,657,698	10.4%
PSC Assessment Fee	10,529,657	12,258,825	---
Fines & Forfeitures	7,616,003	6,661,948	14.3%
Interest on Investments	436,629	361,287	20.9%
Lottery	41,500,000	41,000,000	1.2%
Sale of NOx Credits	0	87,500	-100.0%
Miscellaneous	542,485	(5,136,022)	---
Redeposit of State Funds	\$1,741,250	\$7,150,312	-75.6%

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	<u>First Quarter FY 2008</u>	<u>First Quarter FY 2007</u>	<u>% Change</u>
TOTAL ROAD FUND	\$326,655,562	\$303,337,643	7.7%
Tax Receipts-	\$316,854,726	\$294,178,786	7.7%
Sales and Gross Receipts	\$270,389,961	\$252,248,952	7.2%
Motor Fuels Taxes	149,897,723	136,403,655	9.9%
Motor Fuels Use & Surtax	10,248,786	7,114,746	44.0%
Truck Trip Permits (fuel)	68,840	79,640	-13.6%
Motor Vehicle Usage	110,174,612	108,650,912	1.4%
License and Privilege	\$46,464,765	\$41,929,833	10.8%
Motor Vehicles	18,542,154	14,232,275	30.3%
Motor Vehicle Operators	4,006,702	4,044,437	-0.9%
Weight Distance	22,058,728	21,795,624	1.2%
Truck Decal Fees	36,052	43,313	-16.8%
Other Special Fees	1,821,129	1,814,184	0.4%
Nontax Receipts	\$9,740,611	\$8,797,379	10.7%
Departmental Fees	5,769,404	3,653,684	57.9%
In Lieu of Traffic Fines	293,569	310,549	-5.5%
Highway Tolls	0	1,583,756	-100.0%
Investment Income	3,359,254	3,158,787	6.3%
Miscellaneous	318,384	90,603	251.4%
Redeposit of State Funds	\$60,225	\$361,479	-83.3%