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January 31, 2008

The Honorable Steven L. Beshear
Governor
Commonwealth of Kentucky
State Capitol Building
Frankfort, KY 40601

Dear Governor Beshear:

The attached Quarterly Economic and Revenue Report summarizes the revenue and economic statistics for the second quarter of Fiscal Year 2008 (FY08). It also includes an interim economic and revenue forecast for the final two quarters of FY08 and the first quarter of FY09.

General Fund receipts for the first quarter of FY08 totaled \$2,176.2 million, a decrease of 2.1 percent compared to the same period in FY07. Road Fund revenues totaled \$300.6 million, an increase of 5.6 percent from the second quarter of FY07.

The interim General Fund forecast for the final two quarters of FY08 calls for an increase of 1.5 percent compared to the same period one year ago. The interim forecast for the Road Fund for the final two quarters of FY08 is for growth of 2.7 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 cursive script that reads "Mary E. Lassiter".

Mary E. Lassiter
State Budget Director

Attachment

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Executive Summary . . .

Quarterly Report - FY2008:2

General Fund receipts totaled \$2.176 billion in the second quarter of fiscal year 2008 (FY08), decreasing 2.1 percent from FY07. This represents \$47.4 million less than reported in the same period one year earlier. The Road Fund rose by 5.6 percent in the second quarter, and economic growth in Kentucky, measured by personal income, was up by 5.9 percent.

Performance in the General Fund categories for the second quarter was affected not only by economic conditions but also by continuing effects of tax legislation passed in 2005 and 2006. Sales and use tax revenues were up by 1.8 percent. Individual income tax receipts rose by 5.0 percent, reflecting growth due to tax changes enacted in the 2006 special legislation session. Corporation income and limited liability entity tax (LLET) revenues were down sharply, falling by 47.1 percent also largely as a result of legislated changes.

Coal severance taxes rose by 1.5 percent after declining in the first quarter. Tobacco tax receipts fell by 3.5 percent in the second quarter of FY08. Property taxes were 2.3 percent lower than a year earlier, affected by timing differences in some accounts. During the second quarter, lottery revenues rose 6.6 percent compared to the second quarter of FY07. All other receipts combined for growth of 15.0 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 second quarter, the Road Fund grew by 5.6 percent. Motor fuels taxes and motor fuel use and surtaxes rose 8.2 percent, while motor vehicle usage tax receipts were up by 4.4 percent. Weight distance tax revenues fell by 1.0 percent, and motor vehicle license tax receipts were down by 0.3 percent. Motor vehicle operators license receipts fell by 4.2 percent, and investment receipts were up sharply due to higher Road Fund balances.

The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 2.6 percent in the second quarter of FY08. Personal income rose by 6.0 percent during the same period. Kentucky's economy as measured by personal income grew by 5.9 percent over the same period one year earlier. Employment in the state grew by 0.7 percent as 13,200 jobs were added to the payroll during the second quarter.

The interim forecast for the General Fund expects revenue to rise by 1.5 percent over the final two quarters of FY08. Total revenues for the entire fiscal year are forecasted to reach \$8.621 billion, which is slightly lower than the official consensus revenue estimate prepared on January 16, 2008, by the Consensus Forecasting Group.



Among the major accounts, the outlook for the next two quarters of FY08 is for sales and use tax revenues to rise by 2.1 percent, and the individual income tax is forecasted to rise by 13.3 percent due to changes enacted in HB 1 of the 2006 Extraordinary Session of the Kentucky General Assembly. The corporation income tax and LLET are expected to decline by a combined 28.6 percent due to the same legislation. Coal severance tax revenues are forecasted to rise by 2.0 percent, and tobacco taxes should rise by 1.9 percent.

Property taxes are estimated to decline by 3.7 percent in the final two quarters of FY08. Dividend payments from the Kentucky Lottery are expected to sag by 2.9 percent. All other revenues will combine for a decrease of 8.3 percent. For the first quarter of FY09, General Fund receipts are forecasted to rise by 2.1 percent.

The interim outlook for the Road Fund anticipates an increase in revenues of 2.7

percent over the final six months of FY08. This is identical to the official consensus revenue estimate of January 16, 2008. Motor fuels taxes will grow by 7.2 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to decrease by 2.4 percent, and motor vehicle license taxes should expand by 3.9 percent. For the first quarter of FY09, the Road Fund should grow by 0.9 percent.

The outlook for the national economy foresees real GDP growth of 0.7 percent over the remainder of FY08, and personal income growth of 4.3 percent over the same period. In Kentucky, personal income is expected to rise by 4.1 percent, while employment should grow by 0.5 percent or 9,000 jobs. In the first quarter of FY09, Kentucky personal income should continue to grow by 4.0 percent, and employment growth will be 0.8 percent.

Revenue Receipts . . .

Quarterly Report - FY2008:2

GENERAL FUND

The second quarter of FY08 experienced a reversal of fortune with a 2.1 percent decline in revenue following first quarter growth of 1.5 percent. FY08 growth was depressed by corporation income tax receipts. Individual income and “other” receipts helped offset the corporate losses. Receipts in the second quarter totaled \$2.176 billion compared to \$2.224 billion received in the second quarter of FY07. The resulting growth rate was -2.1 percent, and compares to a growth rate of 1.6 percent for the same quarter last year. 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.

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

	FY08	FY07	Diff (\$)	Diff (%)
Sales and Use	718.0	705.2	12.8	1.8
Individual Income	797.9	760.3	37.7	5.0
Corp. Inc. & LLET	126.3	238.8	-112.6	-47.1
Coal Severance	57.5	56.6	0.8	1.5
Tobacco Taxes	43.5	45.1	-1.6	-3.5
Property	245.4	251.1	-5.7	-2.3
Lottery	50.8	47.6	3.1	6.6
Other	<u>136.9</u>	<u>119.0</u>	<u>17.9</u>	<u>15.0</u>
TOTAL	2,176.2	2,223.7	-47.4	-2.1

Variations in the quarterly receipts are often affected by differences in the timing of payments into revenue accounts. While timing differences were not as prevalent as in the past, property tax receipts continue to record fluctuations because of these differences.

Total sales and use tax receipts for the quarter were \$718.0 million, compared to \$705.2 million in the second quarter of FY07. The result is a growth rate of 1.8 percent which fails to match the 3.2 percent growth for the second quarter of last year.

Individual income tax posted receipts of \$797.9 million, compared to last year’s second-quarter receipts of \$760.3 million. The resulting growth rate was 5.0 percent, and compares to a growth rate of 1.7 percent for the second quarter of last year. Growth in this revenue source is due to changes in law that now require certain limited-liability entities to file under this tax rather than the corporation income tax.

Combined corporation income and limited liability entity tax (LLET) receipts were down sharply in the second quarter of the fiscal year. Revenues of \$126.3 million were 47.1 percent lower than year-earlier figures of \$238.8 million. The fall in corporation income tax revenues is the mirror effect of the shift in reporting among limited liability entities. Limited liability entity tax receipts totaled \$18.4 million in the second quarter. There were no LLET receipts in the same quarter of Fiscal Year 2007.

Coal severance tax revenue growth returned in the second quarter, with receipts up by 1.5 percent. Collections of \$57.5 million compare to the FY07 second quarter total of \$56.6 million. Tax receipts in the second quarter of FY07 rose by 6.6 percent.

Receipts from tobacco taxes of \$43.5 million in the second quarter of FY08 failed to match last year's total of \$45.1 million. The \$1.6 million decrease amounted to a 3.5 percent decrease.

Second-quarter property tax receipts were 2.3 percent less than the second quarter of FY07. Fiscal year 2008 second-quarter receipts of \$245.4 million compare with \$251.1 million from the second quarter of FY07.

Lottery receipts were \$50.8 million which was 6.6 percent higher than last year's second-quarter total of \$47.6 million.

The "all other" category, which represents the remaining accounts of the General Fund, rose 15.0 percent in the second quarter. Second-quarter receipts for FY08 were \$136.9 million and compare to \$119.0 million in FY07.

ROAD FUND

The Road Fund reported an increase of 5.6 percent in the second quarter of FY08. Receipts totaled \$300.6 million and compare to \$284.6 million from the second quarter of last year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

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

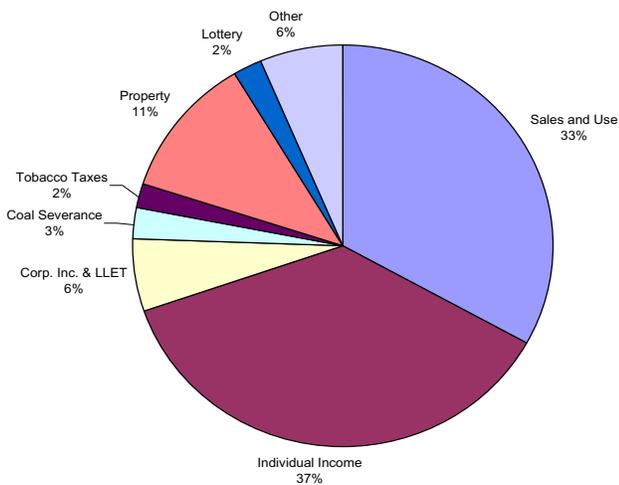
	FY08	FY07	Diff (\$)	Diff (%)
Motor Fuels	151.5	139.9	11.6	8.3
Motor Vehicle Usage	94.4	90.4	4.0	4.4
Motor Vehicle License	17.3	17.3	0.0	-0.3
Motor Vehicle Operators	3.8	4.0	-0.2	-4.2
Weight Distance	21.3	21.5	-0.2	-1.0
Investment Income	4.5	3.8	0.8	20.7
Other	<u>7.9</u>	<u>7.7</u>	<u>0.2</u>	<u>2.8</u>
TOTAL	300.6	284.6	16.1	5.6

Motor fuels tax receipts grew at a rate of 8.3 percent during the second quarter due to the formula-driven increase in the tax rate tied to the price of gasoline. Receipts were \$151.5 million and compare to \$139.9 million collected during the second quarter of last year.

Motor vehicle usage tax grew in the second quarter, with receipts increasing by 4.4 percent. Receipts during the second quarter of FY08 totaled \$94.4 million and compare to \$90.4 million collected during the same period last year.

Motor vehicle license tax receipts decreased 0.3 percent in the second quarter of FY08 to \$17.3 million.

Figure 1
Second Quarter, FY08
General Fund Receipts



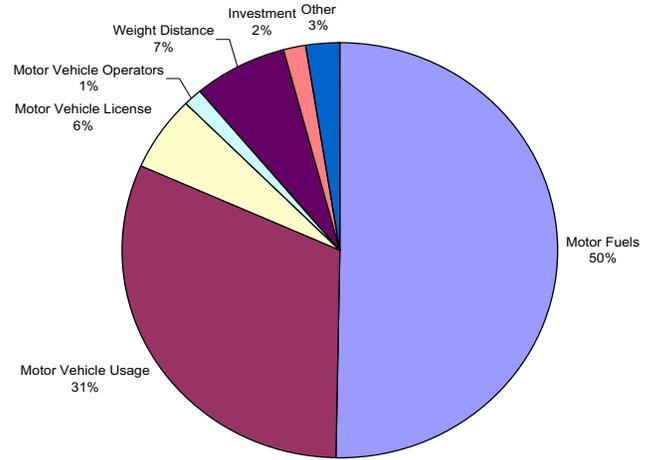
Motor vehicle operators license receipts were \$3.8 million in the second quarter of FY08, a decrease of 4.2 percent.

Weight distance tax receipts of \$21.3 million represent a 1.0 percent decrease compared to receipts of \$21.5 million during the second quarter of FY07.

Investment receipts of \$4.5 were up 20.7 percent over the total collected in the second quarter of FY07.

The remainder of the accounts in the Road Fund combined for an increase of 2.8 percent from a year earlier. In the “all other” category, revenues of \$7.9 million compare to \$7.7 million in the second quarter of FY07.

Figure 2
Second Quarter, FY08
Road Fund Receipts



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The Economy . . .

Quarterly Report - FY2008:2

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 is typically reported as a seasonally adjusted annual rate that compares consecutive quarters. On that basis real output has slowed considerably. It is estimated to be 1.1 percent (comparing July-September 2007 to October-December 2007) in contrast to 2.1 percent a year ago. When real GDP growth is compared to the same quarter a year ago, the second quarter output for FY08 increased by 2.6 percent –identical to the increase a year ago in FY07. For analysis here this is a more appropriate gauge because revenue estimates are typically compared to the same quarter a year ago. If there is a single indicator that captures the economic slowdown, it is the change in industrial production. The U.S. industrial production index declined by 2.0 percent during the second quarter after having contracted by 1.5 percent 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. The dramatic rise in oil prices combined with the subprime lending fiasco caused consumer confidence to suffer and consumption to fall. The five-

year average growth for real consumption is 3.5 percent. The economic slowdown caused consumers to be cautious, and real consumption grew by just 2.7 percent compared to 3.4 percent a year ago. The purchase of motor vehicles and parts slowed drastically (only 1.3 percent growth compared to 4.6 percent a year ago). Purchase of nondurable goods increased by 1.9 percent compared to 3.6 percent a year ago. Oil prices averaged \$90.88 per barrel in the second quarter, up \$30 from a year ago. In the short run it is difficult for consumers to adjust to the dramatic spike in oil prices by reducing energy consumption. The net effect is usually a slight reduction in the consumption of other commodities, and a sharp drop 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 ninth straight quarter—down 3.1 percent compared to a decline of 3.6 percent a year ago. Given the problems arising from subprime lending and the overbuilt housing market it is not surprising that residential fixed investment component was down for the eleventh straight quarter.

Government spending constitutes 17 percent of GDP and was up 2.8 percent in the second quarter. With the surge in defense outlay the greatest increase was in defense spending (up 4.1 percent). State government spending was up just 2.6 percent as a consequence of the slowing economy.

The final component of GDP is net exports, the difference between exports and imports. The dollar declined by 10.1 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 7.9 percent.

The University of Michigan Consumer Sentiment Index slid from 92.5 in October-December 2006 to 77.5 a year later. The slide in consumer confidence is related to the sharp increase in crude oil prices and the resulting hike in the price of gasoline at the pump.

Personal income, a measure of spending power, was \$11,867.6 billion in the second quarter, for increase of 6.0 percent over the previous year. The seemingly strong growth during an economic slowdown is due

to the surge in inflation. CPI inflation soared to 4.0 percent during the second quarter after averaging 1.9 percent a year earlier.

The unemployment rate in the second quarter averaged 4.7 percent, a little higher than a year ago. Total nonfarm employment increased by 1.1 percent to 138.4 million jobs. Manufacturing employment continued to decline with a drop of 1.4 percent during the second quarter.

KENTUCKY ECONOMY

Kentucky's personal income is estimated to be \$134.8 billion for the second quarter of FY08, an increase of 5.9 percent from a year ago. U.S. personal income grew by 6.0 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

Table 3
National Economic Indicators
Second Quarter, FY08

	<u>FY07:2</u>	<u>FY08:2</u>	<u>Percent Change</u>
Real GDP (billion 2000 \$)	11,395.5	11,686.9	2.6
Personal Income (billion \$)	11,200.2	11,867.6	6.0
Consumer Price Index (percentage change)	1.9	4.0	-
Industrial Production (percentage change)	-1.5	-2.0	-
Civilian Labor Force (millions)	152.4	153.7	0.8
Nonfarm Employment (millions)	137.0	138.4	1.1
Manufacturing Employment (millions)	14.1	14.0	-1.4
Unemployment Rate (percent)	4.5	4.7	-

Sources: Global Insight, Inc., and U.S. Dept. of Commerce, Bureau of Economic Analysis. Data for FY08:2 are January 2008 estimates, based on a 5:4 blend of Control and Pessimistic scenarios.

grown by 5.3 percent in FY08:2. Both personal income and wage and salary income have been driven up largely by a spike in inflation.

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. Nonfarm employment in Kentucky is estimated to have increased by 13,200 jobs in the second quarter of FY08 compared to one year earlier, resulting in a growth of 0.7 percent. The current growth rate is almost half of the average growth rate in the period 2002-2006. It clearly indicates that the national slowdown has had an impact on the Kentucky economy.

The largest gain in employment is in mining (up 3.2 percent for an increase of 700 jobs). In terms of the total number the jobs the biggest gain is in the educational services sector (up 1.9 percent with an increase of 4,500 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 1.4 percent with an increase of 1,200 jobs) is growing in spite of the 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 1.7 percent.

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 trade, transportation, and utilities. 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 second quarter manufacturing was down 1.6 percent with a loss of 4,200 jobs.

Table 4
Selected Kentucky Economic Indicators
Second Quarter, FY08

	<u>FY07:2</u>	<u>FY08:2</u>	<u>Change</u>	<u>Percent Change</u>
Total Personal Income (\$ millions)	127,196	134,752	7,556	5.9%
Wage & Salary Income (\$ millions)	69,240	72,939	3,699	5.3%
Total Nonfarm Employment	1,847.0	1,860.2	13.2	0.7%
Contract Construction	83.4	84.5	1.2	1.4%
Mining	23.3	24.0	0.7	3.2%
Manufacturing	260.7	256.5	-4.2	-1.6%
Trade, Transportation & Utilities	379.2	380.6	1.4	0.4%
Information	29.6	29.7	0.2	0.6%
Finance	90.9	91.7	0.7	0.8%
Business Services	178.9	182.7	3.8	2.1%
Educational and Health Services	238.4	243.0	4.5	1.9%
Leisure and Hospitality Services	167.9	170.7	2.8	1.7%
Other Services	75.6	76.1	0.5	0.6%
Government	319.1	320.6	1.5	0.5%

Note: Numbers may not add up due to rounding.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, and GOEA forecast.
 Data for FY08:2 are January 2008 estimates, based on a 5:4 blend of Control and Pessimistic scenarios.

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

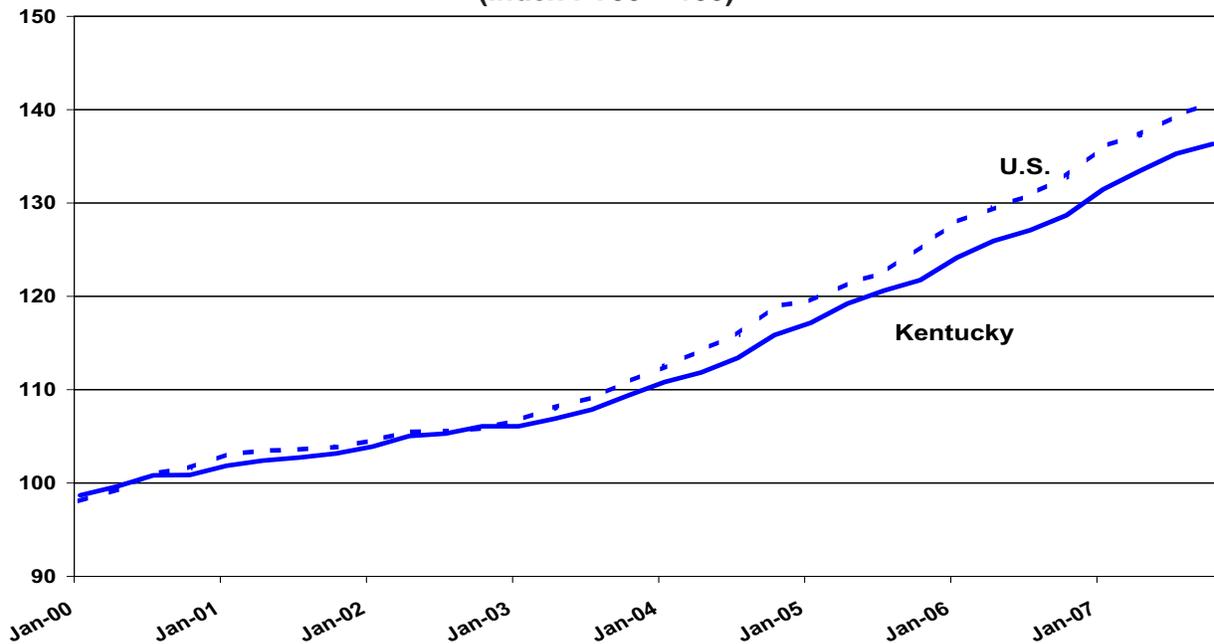
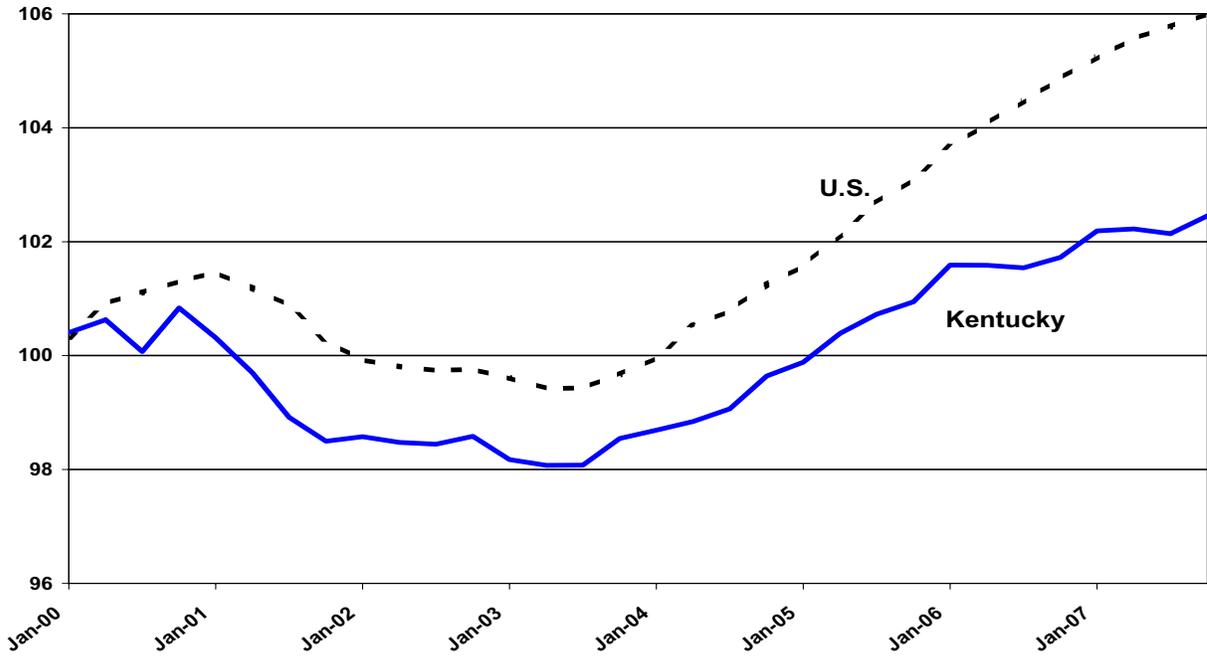


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



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Interim Outlook . . .

Quarterly Report - FY2008:2

GENERAL FUND

Projected General Fund revenues for the next three quarters are shown in Table 5. General Fund revenues were \$4.243 billion in the first two quarters of FY08, a decline of 0.4 percent from the same period a year earlier. Revenues stalled due to slower economic growth related to the subprime mortgage crisis and its impact on housing construction and the real estate market. The drop was most pronounced in the corporation income tax, which also declined as a result of statutory changes enacted by HB 1 of the 2006 Extraordinary Session.

Anticipated revenues are \$4.377 billion, with a corresponding growth rate of 1.5 percent. Some major accounts like the corporation income tax, property taxes, and the lottery are forecasted to decline.

Projected revenues for the last two quarters of FY08 vary from the January 16,

2008 consensus revenue estimate due to differences in the sales and use tax forecast. The consensus estimate projects total FY08 receipts of \$8.633 billion, which is \$12.4 million above this interim forecast.

Sales and use tax receipts for the first two quarters of FY08 totaled \$1.446 billion, representing a growth rate of 2.6 percent from a year ago. The projected rate of growth for the remaining two quarters of FY08 is 2.1 percent. Sales and use tax receipts for the first quarter of FY09 are forecasted to grow 3.4 percent to \$753.0 million.

The interim forecast for the individual income tax calls for a rise of 13.3 percent for the remainder of FY08, amounting to collections of \$1.749 billion in the final six months. The individual income tax rose by 8.2 percent in the first two quarters of the fiscal year, boosted by a change in report-

Table 5
General Fund: Interim Forecast
(millions of dollars)
January 2008

	FY08		FY08		FY08		FY09	
	Quarters 1 & 2		Quarters 3 & 4		Full Year		Quarter 1	
	Actual	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago
Sales & Use	1,446.2	2.6	1,438.9	2.1	2,885.1	2.4	753.0	3.4
Individual Income	1,620.6	8.2	1,749.4	13.3	3,370.0	10.8	848.0	3.1
Corporation Income & LLET	308.8	-40.4	335.7	-28.6	644.5	-34.8	176.3	-3.5
Coal Severance	110.9	-0.4	112.8	2.0	223.7	0.8	54.7	2.4
Tobacco	89.6	0.7	90.1	1.9	179.7	1.3	45.3	-1.7
Property	304.2	4.1	192.8	-3.7	497.0	0.9	61.2	3.9
Lottery	92.3	4.2	95.2	-2.9	187.5	0.5	42.0	1.2
Other	<u>270.7</u>	7.2	362.4	-8.3	<u>633.1</u>	-2.3	<u>129.6</u>	-3.1
General Fund	4,243.3	-0.4	4,377.3	1.5	8,620.6	0.5	2,110.1	2.1

ing requirements for limited-liability pass-through entities. For the entire fiscal year, individual income tax receipts are projected to rise by 10.8 percent. Collections in the first quarter of FY09 should reach \$848.0 million or 3.1 percent over collections in the same period of the previous year.

The outlook for the corporation income and limited liability entity taxes is for a decrease of 28.6 percent in the final two quarters of FY08, representing collections of \$335.7 million. These anticipated collections will bring the FY08 total to \$644.5 million, a decline of 34.8 percent from FY07. The same statutory changes that have led to increases in individual income tax revenues will work to depress corporation income tax receipts. Revenue from the limited liability entity tax will offset some of the losses. In the first quarter of FY09, the continuing decline of 3.5 percent is linked to the outlook for U.S. corporate profits.

The coal severance tax dipped modestly in the first two quarters of FY07, but the forecast is for growth to resume in the final half of the fiscal year. Receipts in this account are expected to rise by 2.0 percent in the final two quarters, reflecting recent increases in coal prices. Collections in this account will rise by 2.4 percent in the first quarter of FY09.

Taxes on cigarettes and other tobacco products rose by 0.7 percent in the first two quarters of FY08. The outlook for the remaining six months of the fiscal year is for \$90.1 million in revenue, with a corresponding growth rate of 1.9 percent. For the first quarter of FY09, receipts are

forecasted to decline by 1.7 percent when compared to the first quarter of the current fiscal year.

Property tax revenues totaled \$304.2 million in the first two quarters of FY08, representing growth of 4.1 percent from a year earlier. Receipts in property taxes are sensitive to timing of payments in the second quarter. It is expected that in the second half of the fiscal year, receipts will fall by 3.7 percent. Overall for the fiscal year, property taxes are expected to grow by 0.9 percent. Property taxes in the first quarter of FY09 will grow by 3.9 percent.

Lottery revenues grew by 4.2 percent in the first half of FY08. In the next two quarters, lottery revenues are expected to decline by 2.9 percent when compared to a year ago due to a difference in the timing of dividend payments to the state. For the first quarter of FY09, lottery revenues should grow by 1.2 percent.

The “other” category contains estimates for the remaining accounts in the General Fund. During the last two quarters of FY08 this category should experience a decline of 8.3 percent. Receipts in this category will decline by 3.1 percent in the first quarter of FY09, with receipts totaling \$129.6 million.

ROAD FUND

Road Fund revenues are forecasted to grow by 2.7 percent over the final six months of FY08 and 0.9 percent in the first quarter of FY09 as shown in Table 6. This forecast is identical to the official revenue estimate as approved by the Consensus Forecasting Group on January 16, 2008.

Motor fuels tax receipts are forecasted to grow by 7.2 percent in the last two quarters of FY08. The increase is principally due to the higher gasoline prices and their effect on the statutory motor fuels tax rate. Growth in this account will continue into FY09 with receipts in the first quarter totaling \$164.7 million.

Motor vehicle usage tax collections are expected to fall by 2.4 percent in the final two quarters of FY08. Receipts in the first two quarters were up 2.8 percent from a year earlier. Growth is expected to flag as declining automobile sales will impact receipts in the upcoming months. Collections in the first quarter of FY09 will decline by 2.2 percent.

To estimate the growth of all other components of the Road Fund, The Governor's Office for Economic Analysis assessed

recent growth patterns as well as administrative and statutory factors. Weight distance tax revenue should rise by a slight 0.2 percent for the remainder of FY08 and decline by 2.3 percent in the first quarter of FY09. Motor vehicle license taxes are forecasted to rise by 3.9 percent in the final two quarters of FY08 and grow by 18.4 percent in the first quarter of FY09. Motor vehicle operators' license fees are forecasted to decline by 2.6 percent in the second half of FY08. Receipts in the first quarter of FY09 should be lower by 5.0 percent. Investment income should fall by 14.1 percent in the final two quarters due to lower balances in the Road Fund, and the declines should continue into the first quarter of FY09 with a loss of 47.1 percent. All other revenues should combine for a growth of 6.6 percent in the final two quarters of the current fiscal year, and decline by 2.4 percent in the first quarter of FY09.

Table 6
Road Fund: Interim Forecast
(millions of dollars)
January 2008

	FY08		FY08		FY08		FY09	
	Quarters 1 & 2		Quarters 3 & 4		Full Year		First Quarter	
	Actual	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago
Motor Fuels	311.7	9.9	300.0	7.2	611.7	8.6	164.7	2.8
Motor Vehicle Usage	204.5	2.8	207.2	-2.4	411.7	0.1	107.8	-2.2
Motor Vehicle License	35.8	13.3	72.8	3.9	108.6	6.8	21.9	18.4
Motor Vehicle Operators	7.8	-2.5	7.6	-2.6	15.4	-2.5	3.8	-5.0
Weight Distance	43.3	0.0	42.2	0.2	85.5	0.1	21.6	-2.3
Investment	7.9	14.5	7.9	-14.1	15.8	-1.9	1.8	-47.1
Other	16.3	5.2	17.8	6.6	34.1	5.9	8.1	-2.4
Road Fund	627.3	6.7	655.5	2.7	1,282.8	4.6	329.7	0.9

ECONOMY

The economic outlook presented here is for the three-quarter period from January to September 2008. In terms of fiscal years this period is the second half of FY08 (quarters 3 and 4) and the first quarter of FY09. The economic outlook is identical to the one the Consensus Forecasting Group used in arriving at their forecast this month. Both the national and state forecast are based on a 5:4 weighted average of Global Insight's Control and Pessimistic scenarios.

National Economy

During the second half of FY08 real GDP is expected to grow by 0.7 percent from a year ago. Growth is expected to continue along the same slow path, averaging 0.6 percent in the first quarter of FY09. Employment in nonfarm industries is expected to be at near-recession posting gains of just 0.3 percent in the remainder of the fiscal year, and will remain unchanged FY09:Q1.

Typically the consumption component of GDP is the major factor in sustaining growth. But as more and more consumers face the prospect of foreclosures and a decline in property value, there is a marked decline in aggregate demand. During the last two quarters of FY08 real consumption expenditures are projected to increase by 1.7 percent compared to 3.0 percent a year ago. The demand for durable goods is expected to increase by just 1.0 percent compared to a 4.7 percent increase in the previous year. The consumption pattern is expected to worsen slightly in the first quarter of FY09. Overall consumption growth is expected to be up 1.6 percent, and the demand for durable goods is expected to

soften further. The relatively slow growth in the consumption of durable goods is tied to the fortunes of the automobile industry. Real consumption of motor vehicles is forecasted to register a decline of 5.5 percent in the second half of FY08.

The overall investment component is expected to decline by 4.3 percent in the second half of FY08 and by 7.1 percent in the first quarter of FY09. The weak investment activity is due almost entirely to the housing sector. Investment in residential structures is forecasted to decline by 28.4 percent in the final six months of FY08 and by 25.7 percent during the first quarter of FY09. Business-critical areas like investment in equipment and software will, however, continue to show slight increases.

State Economy

The dominance of the goods-producing sector in the state economy is expected to be responsible for slow growth in Kentucky. During the final two quarters of FY08 personal income is estimated to increase by 4.1 percent compared to a 4.3 percent increase nationally. The slow growth is expected to continue into the first quarter of FY09. Income from wages and salaries is expected to grow even slower due to the poor outlook for the traditionally high-wage manufacturing sector.

During the second half of FY08 total non-farm employment in Kentucky is expected to increase by 0.5 percent from a year ago. The slight increase in growth seen in the first quarter of FY09 (up 0.8 percent) has more to do with comparison with a weak quarter a year earlier than with any actual strengthening of the economy

Employment in goods-producing industries has declined dramatically in Kentucky in response to productivity gains and the shift of some manufacturing facilities abroad. During the second half of FY08 employment in goods-producing industries is forecasted to be down 0.3 percent followed by a similar decline in the first quarter of FY09. In spite of strong growth in mining the overall decline in the goods sector is because of a sharp drop in manufacturing employment.

Service-providing industries are forecasted to do better during the second half of FY08

with an addition of 7,700 jobs. The overall growth rate during the first quarter of FY09 is expected to be 1.3 percent. The slow growth is a result of the drag from manufacturing. As total wage and salary income growth slows it is expected to dampen consumer demand and hence employment in wholesale and retail trade. However, as the national economy strengthens and there is a further drop in the federal funds rate, the demand for business services is expected to rise. Educational and health services and other services are also expected to see strong gains in the first quarter of FY09.

**Table 71
Economic Outlook: Second Half of FY08**

	FY07 Q3 & Q4	FY08 Q3 & Q4	Percent Change
United States			
Real GDP (billion 2000 \$)	11,672.9	11,750.1	0.7%
Personal Income (billion \$)	11,807.1	12,316.6	4.3%
Consumer Price Index (1992-94=100)	209.1	213.3	2.0%
Industrial Production (2002=100)	110.4	112.9	2.3%
Nonfarm Employment (millions)	138.3	138.6	0.3%
Manufacturing Employment (millions)	14.0	13.7	-2.2%
Unemployment Rate (percent)	4.5	5.1	-
Kentucky			
Personal Income (mil\$)	134,231	139,765	4.1%
Wage & Salary Income (mil\$)	72,641	75,312	3.7%
Nonfarm Employment ('000)	1,855.8	1,864.8	0.5%
Goods producing ('000)	365.5	364.4	-0.3%
Service Providing ('000)	1,172.0	1,179.7	0.7%

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA.
Data for FY08 are January 2008 estimates based on a 5:4 blend of Control and Pessimistic scenarios.

Table 7.2
Economic Outlook: First Quarter of FY09

	FY08	FY09	Percent
	<u>Q1</u>	<u>Q1</u>	<u>Change</u>
United States			
Real GDP (billion 2000 \$)	11,658.9	11,726.7	0.6%
Personal Income (billion \$)	11,746.7	12,256.6	4.3%
Consumer Price Index (1992-94=100)	208.0	213.0	2.4%
Industrial Production (2002=100)	114.2	114.2	0.0%
Nonfarm Employment (millions)	138.1	138.6	0.3%
Manufacturing Employment (millions)	14.0	13.7	-1.9%
Unemployment Rate (percent)	4.6	5.3	-
Kentucky			
Personal Income (million \$)	133,710	139,119	4.0%
Wage & Salary Income (million \$)	72,343	74,973	3.6%
Nonfarm Employment ('000)	1,854.5	1,869.4	0.8%
Goods producing ('000)	364.2	363.0	-0.3%
Service Providing ('000)	1,170.3	1,185.0	1.3%

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA.
 Data for FY08-FY09 are January 2008 estimates based on a 5:4 blend of
 Control and Pessimistic scenarios.

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	Second Quarter FY 2008	Second Quarter FY 2007	%	Year-To-Date FY 2008	Year-To-Date FY 2007	%
			Change			Change
TOTAL GENERAL FUND	2,176,219,588	2,223,651,510	-2.1%	\$4,243,331,177	\$4,259,389,619	-0.4%
Tax Receipts	2,086,358,555	2,142,266,982	-2.6%	\$4,083,751,820	\$4,108,963,542	-0.6%
Sales and Gross Receipts	819,932,657	799,436,590	2.6%	\$1,660,666,221	\$1,615,904,287	2.8%
Beer Consumption	1,601,136	1,499,062	6.8%	3,443,065	3,290,413	4.6%
Beer Wholesale	11,886,463	10,901,798	9.0%	26,081,766	24,111,457	8.2%
Cigarette	41,196,626	43,026,113	-4.3%	84,970,466	84,727,463	0.3%
Distilled Spirits Case Sales	25,653	24,822	3.3%	51,025	48,808	4.5%
Distilled Spirits Consumption	2,565,972	2,559,757	0.2%	5,129,975	5,014,278	2.3%
Distilled Spirits Wholesale	6,643,104	6,442,249	3.1%	12,979,184	12,363,604	5.0%
Insurance Premium	16,943,483	10,333,741	64.0%	41,001,026	39,131,024	4.8%
Pari-Mutuel	1,411,780	1,481,352	-4.7%	2,121,562	2,220,635	-4.5%
Race Track Admission	24,764	66,435	-62.7%	177,415	184,208	-3.7%
Sales and Use	717,998,725	705,161,669	1.8%	1,446,206,256	1,408,984,762	2.6%
Wine Consumption	606,770	615,173	-1.4%	1,158,432	1,145,268	1.1%
Wine Wholesale	3,129,886	2,967,363	5.5%	5,790,165	5,500,616	5.3%
Telecommunications Tax	13,616,512	12,255,490	11.1%	26,942,344	24,896,915	8.2%
OTP	2,281,784	2,101,568	8.6%	4,613,541	4,284,837	7.7%
License and Privilege	93,381,614	72,913,874	28.1%	\$181,166,109	\$143,912,014	25.9%
Alc. Bev. License Suspension	114,400	156,381	-26.8%	433,170	257,381	68.3%
Coal Severance	57,470,985	56,622,015	1.5%	110,903,103	111,385,164	-0.4%
Corporation License	1,832,883	3,008,873	-39.1%	3,735,164	4,696,543	-20.5%
Corporation Organization	97,643	13,006	650.7%	185,700	54,406	241.3%
Occupational Licenses	22,174	41,053	-46.0%	62,769	71,562	-12.3%
Oil Production	2,345,236	1,251,928	87.3%	4,384,853	3,110,696	41.0%
Race Track License	3,210	115,200	-97.2%	189,785	275,700	-31.2%
Bank Franchise Tax	(180,810)	156,733	-215.4%	(226,658)	(61,094)	---
Driver License Fees	137,055	147,302	-7.0%	313,970	308,564	1.8%
Minerals Severance	5,350,767	4,600,255	16.3%	9,928,116	8,771,374	13.2%
Natural Gas Severance	7,783,202	6,801,127	14.4%	14,249,899	15,041,718	-5.3%
Limited Liability Entity	18,404,870	0	---	37,006,239	0	---
Income	905,779,716	999,073,807	-9.3%	\$1,892,464,419	\$2,016,553,373	-6.2%
Corporation	107,855,997	238,818,741	-54.8%	271,828,161	518,457,673	-47.6%
Individual	797,923,719	760,255,066	5.0%	1,620,636,258	1,498,095,700	8.2%
Property	\$245,394,830	\$251,054,831	-2.3%	\$304,214,424	\$292,176,080	4.1%
Building & Loan Association	0	1,599	-100.0%	93,832	425,552	-78.0%
General - Real	149,422,381	148,722,854	0.5%	149,998,530	149,007,816	0.7%
General - Tangible	86,005,978	81,100,935	6.0%	112,270,144	104,071,490	7.9%
Omitted & Delinquent	(9,071,570)	9,358,910	---	10,485,846	21,056,879	-50.2%
Public Service	18,684,404	11,326,339	65.0%	30,848,895	17,054,611	80.9%
Other	353,637	544,195	-35.0%	517,178	559,732	-7.6%
Inheritance	\$12,583,156	\$11,165,909	12.7%	\$26,644,818	\$23,403,116	13.9%
Miscellaneous	\$9,286,581	\$8,621,970	7.7%	\$18,595,829	\$17,014,671	9.3%
Legal Process	5,984,126	5,698,604	5.0%	12,537,454	12,484,687	0.4%
T. V. A. In Lieu Payments	3,302,455	2,923,366	13.0%	6,058,375	4,525,485	33.9%
Other	0	0	---	0	4,499	-100.0%
Nontax Receipts	\$86,555,375	\$80,651,093	7.3%	\$154,532,449	\$142,542,330	8.4%
Departmental Fees	7,040,744	5,919,002	19.0%	14,393,044	12,576,700	14.4%
PSC Assessment Fee	71,598	22,580	217.1%	10,601,255	12,281,406	-13.7%
Fines & Forfeitures	6,788,052	7,284,872	-6.8%	14,404,055	13,946,821	3.3%
Interest on Investments	377,122	330,567	14.1%	813,751	691,854	17.6%
Lottery	50,761,591	47,625,113	6.6%	92,261,591	88,625,113	4.1%
Sale of NOx Credits	0	112,000	-100.0%	0	199,500	-100.0%
Miscellaneous	21,516,268	19,356,958	11.2%	22,058,753	14,220,937	55.1%
Redeposit of State Funds	\$3,305,658	\$733,435	350.7%	\$5,046,908	\$7,883,748	-36.0%

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	Second Quarter FY 2008	Second Quarter FY 2007	% Change	Year-To-Date FY 2008	Year-To-Date FY 2007	% Change
TOTAL ROAD FUND	\$300,612,035	\$284,553,276	5.6%	\$627,267,597	\$587,890,919	6.7%
Tax Receipts-	\$290,965,340	\$274,921,383	5.8%	\$607,820,067	\$569,100,169	6.8%
Sales and Gross Receipts	\$245,829,909	\$230,318,491	6.7%	\$516,219,870	\$482,567,444	7.0%
Motor Fuels Taxes	143,614,421	133,949,388	7.2%	293,512,144	\$270,353,042	8.6%
Motor Fuels Use & Surtax	7,796,587	5,922,550	31.6%	18,045,373	\$13,037,296	38.4%
Truck Trip Permits (fuel)	58,920	73,580	-19.9%	127,760	\$153,220	-16.6%
Motor Vehicle Usage	94,359,981	90,372,974	4.4%	204,534,593	\$199,023,886	2.8%
License and Privilege	\$45,135,431	\$44,602,892	1.2%	\$91,600,196	\$86,532,725	5.9%
Motor Vehicles	17,294,082	17,342,963	-0.3%	35,836,236	\$31,575,239	13.5%
Motor Vehicle Operators	3,811,165	3,980,108	-4.2%	7,817,867	\$8,024,545	-2.6%
Weight Distance	21,263,281	21,488,185	-1.0%	43,322,010	\$43,283,809	0.1%
Truck Decal Fees	14,417	26,738	-46.1%	50,469	\$70,051	-28.0%
Other Special Fees	2,752,486	1,764,898	56.0%	4,573,614	\$3,579,082	27.8%
Nontax Receipts	\$9,586,377	\$9,814,149	-2.3%	\$19,326,988	\$18,611,528	3.8%
Departmental Fees	4,535,680	4,542,559	-0.2%	10,305,084	\$8,196,243	25.7%
In Lieu of Traffic Fines	274,154	253,849	8.0%	567,723	\$564,398	0.6%
Highway Tolls	0	1,103,966	-100.0%	0	\$2,687,722	-100.0%
Investment Income	4,540,966	3,762,180	20.7%	7,900,220	\$6,920,967	14.1%
Miscellaneous	235,577	151,595	55.4%	553,961	\$242,198	128.7%
Redeposit of State Funds	\$60,318	(\$182,257)	---	\$120,543	\$179,222	-32.7%