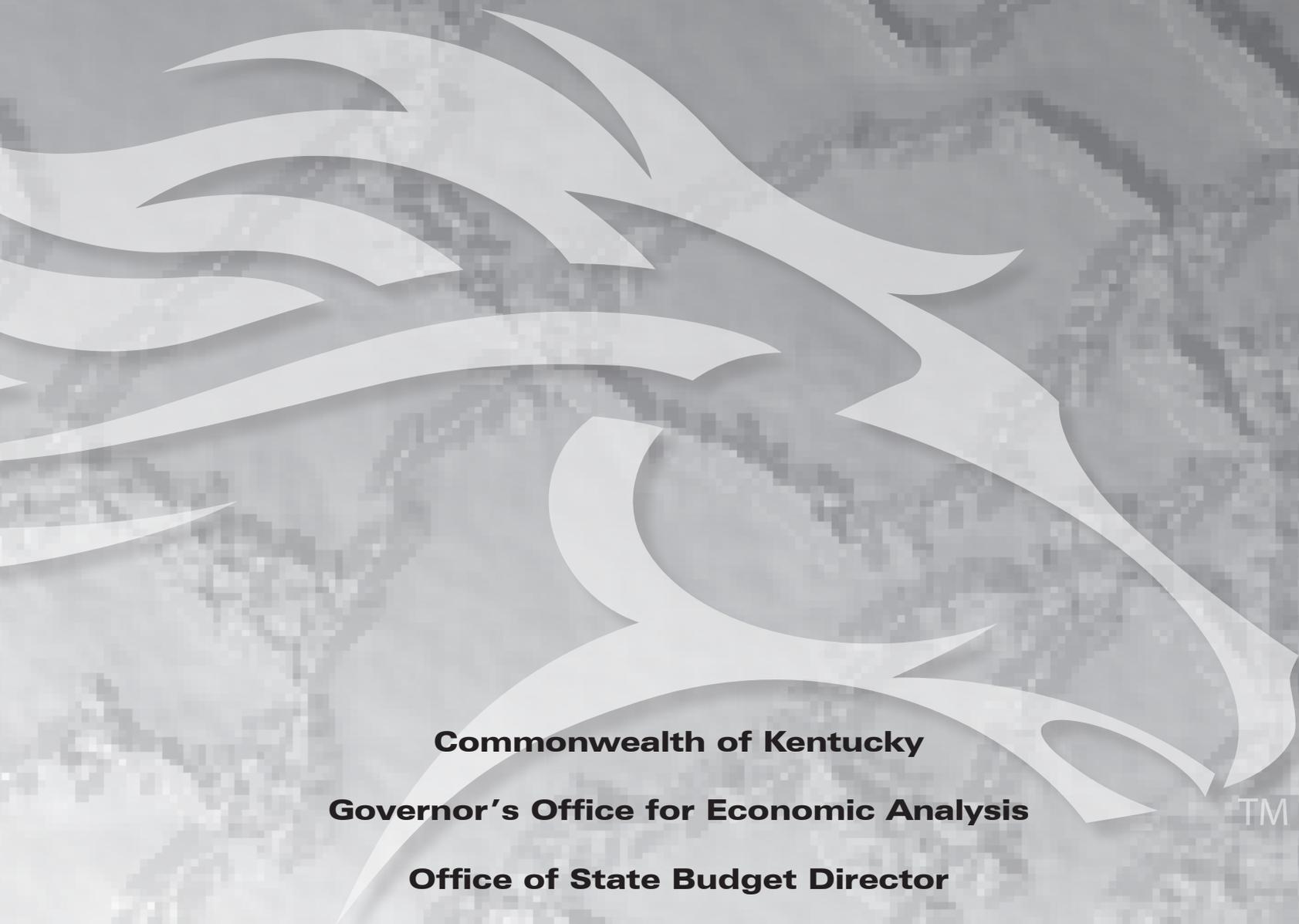


COMMONWEALTH OF KENTUCKY

Quarterly Economic & Revenue Report

Third Quarter Fiscal Year 2008



Commonwealth of Kentucky

Governor's Office for Economic Analysis

TM

Office of State Budget Director





Office of State Budget Director

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Steven L. Beshear
Governor

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Mary E. Lassiter
State Budget Director

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

April 30, 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 third quarter of Fiscal Year 2008 (FY08). It also includes an interim economic and revenue forecast for the final quarter of FY08 and the first two quarters of FY09.

General Fund receipts for the third quarter of FY08 totaled \$1.973 billion, an increase of 1.2 percent compared to the same period in FY07. Road Fund revenues totaled \$312.1 million, an increase of 3.2 percent from the third quarter of FY07.

The interim General Fund forecast for the final quarter of FY08 calls for an increase of 0.7 percent compared to the same period one year ago. The interim forecast for the Road Fund for the final quarter of FY08 is for growth of 1.7 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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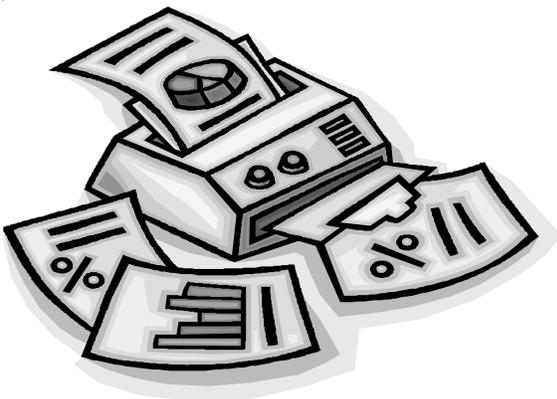
Executive Summary . . .

Quarterly Report - FY2008:3

General Fund receipts totaled \$1.973 billion in the third quarter of fiscal year 2008 (FY08), increasing from FY07 by 1.2 percent. This represents \$23.2 million more than reported in the same period one year earlier. The Road Fund grew by 3.2 percent during the third quarter, and economic growth as measured by Kentucky personal income was up by 4.1 percent.

Performance in the General Fund categories for the third quarter was affected not only by economic conditions but also by legislation enacted by the General Assembly in the 2006 special session. Sales and use tax revenues were up by 2.8 percent. Individual income tax receipts rose 10.8 percent, and combined corporation income tax and limited liability entity tax receipts were down 56.9 percent when compared to last year.

Coal severance taxes grew by 8.1 percent after slipping earlier in the fiscal year. Taxes on tobacco were up 8.6 percent in the third quarter of FY08. Property taxes were 11.0 percent lower than a year earlier, affected by timing differences in collection of some accounts.



During the third quarter of FY08, lottery revenues fell 4.0 percent compared to the third quarter of FY07. All other accounts in the General Fund combined for an increase of 8.2 percent.

Road Fund receipts were boosted by a recalculation of the statutory rate of motor fuels taxes, which is tied to the wholesale price of motor fuels. For the third quarter, the Road Fund grew by 3.2 percent. Motor fuels taxes rose by 6.1 percent, while motor vehicle usage taxes rose by only 0.2 percent.

Motor vehicle license tax revenues fell by 1.8 percent, and motor vehicle operators' license tax receipts were down 5.9 percent from the third quarter of the previous fiscal year. The weight distance tax registered a decline of 2.0 percent. Investment income rose 39.1 percent due to higher Road Fund balances, and all other accounts in the Road Fund combined for a gain of 7.0 percent.

The U.S. economy as measured by real gross domestic product (GDP) is estimated to have contracted by 0.5 percent in the third quarter of FY08. U.S. personal income rose by 4.4 percent. By the same measure, Kentucky's economy grew by 4.1 percent over the same period one year earlier. Employment in the state grew by 0.9 percent as 17,600 jobs were added to the payroll during the third quarter.

The interim forecast for the General Fund expects revenues to rise by 0.7 percent in the final quarter of FY08. Total revenues for the entire fiscal year are forecasted to reach \$8.598 billion, which is \$38.0 million below the official revised revenue estimate including impacts of legislation enacted by the 2008 General Assembly.

Among the major accounts, the outlook for the final quarter of FY08 is for sales and use tax revenues to rise by 3.0 percent, individual income tax to grow by 12.8 percent, corporation income and limited liability entity taxes to decrease by 26.7 percent, and coal severance tax receipts to rise 6.6 percent.

Tobacco taxes are forecasted to rise by 1.5 percent in the fourth quarter of FY08, and property tax receipts will grow by 17.9 percent. Dividend payments from the lottery will fall by 1.6 percent. "Other" taxes and revenues will combine for a decline of 20.6 percent during the final quarter.

For the first two quarters of Fiscal Year 2009, General Fund receipts are forecasted to rise by 2.2 percent.

The interim outlook for the Road Fund anticipates an increase in revenues of 1.7 percent in the last quarter of FY08. This is \$2.0 million lower than the official consensus revenue estimate of January 2008. (No legislation affecting FY08 Road Fund revenues was enacted by the 2008 General Assembly.) Motor fuels taxes will grow by 8.4 percent

chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to fall by 7.5 percent, and motor vehicle license tax receipts are forecasted to rise 6.6 percent. Motor vehicle operators' license fees are projected to drop by 4.8 percent, and the weight distance tax will expand by 1.7 percent. Investment income will fall by 17.2 percent due to lower Road Fund balances, and all other accounts in the Road Fund will combine for growth of 2.9 percent.

During the first two quarters of FY09, Road Fund revenues should grow by 1.0 percent.

The outlook for the national economy foresees real Gross Domestic Product to shrink by 0.2 percent over the remainder of FY08, and personal income is expected to grow by 5.0 percent. Nonfarm employment should rise by 0.3 percent from the same period a year ago. In Kentucky, personal income is expected to rise by 4.8 percent, while employment should rise by 0.4 percent or 8,400 jobs. In the first two quarters of FY09, Kentucky personal income should grow by 4.0 percent, and employment growth should rise by 0.2 percent.

Revenue Receipts . . .

Quarterly Report - FY2008:3

GENERAL FUND

The third quarter of FY08 experienced weak but positive growth following a decrease in receipts during the previous quarter. Third-quarter growth rates were heavily influenced by decreases in the corporation income tax and property taxes. Receipts in the third quarter totaled \$1.973 billion compared to \$1.950 billion received in the third quarter of FY07. The resulting growth rate was 1.2 percent, and compares to a growth rate of 5.2 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.

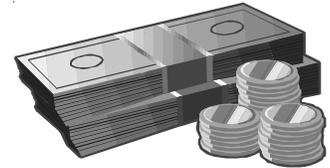
Table 1
Summary General Fund Receipts
Third Quarter, FY08
(mil \$)

	FY08	FY07	Diff (\$)	Diff (%)
Sales and Use	711.8	692.3	19.5	2.8
Individual Income	701.3	633.2	68.1	10.8
Corp. Inc. & LLET	52.1	120.9	-68.0	-56.9
Coal Severance	55.8	51.6	4.2	8.1
Tobacco Taxes	45.6	42.0	3.6	8.6
Property	139.7	156.9	-17.2	-11.0
Lottery	47.5	49.5	-2.0	-4.0
Other	<u>219.4</u>	<u>202.8</u>	<u>16.6</u>	<u>8.2</u>
TOTAL	1,973.2	1,950.0	23.2	1.2

Variations in the quarterly receipts are often affected by differences in the timing of payments in and out of revenue accounts. Timing differences affected receipts in both the property tax and the corporation income tax.

Total sales and use tax receipts for the quarter were \$711.8 million, compared to \$692.3 million in the third quarter of FY07. The result is a growth rate of 2.8 percent which is

better than the 1.1 percent growth for the third quarter of last year.



Individual income taxes posted receipts of \$701.3 million, compared to last year's quarterly total of \$633.2 million. The result was an increase of 10.8 percent, and compares to a 7.1 percent increase for the third quarter of last year. The increase in this revenue source is due largely to changes enacted in the 2006 Special Session of the General Assembly, which reassigned taxes paid by owners of pass-through business entities to the individual income tax.

Combined corporation income and limited liability entity tax receipts fell by 56.9 percent in the third quarter of the fiscal year. Revenues of \$52.1 million were less than half of the \$120.9 million collected a year earlier. The decline represents the shift in filing responsibility for owners of pass-through entities to the individual income tax due to the above-mentioned legislative change in 2006.

Coal severance tax revenue expanded by 8.1 percent in the third quarter, with total receipts of \$55.8 million. During the same period of FY07, receipts totaled \$51.6 million.

Taxes on tobacco products including cigarettes raised \$45.6 million in the third quarter of FY08 compared to \$42.0 million a year earlier. The result was growth of 8.6 percent.

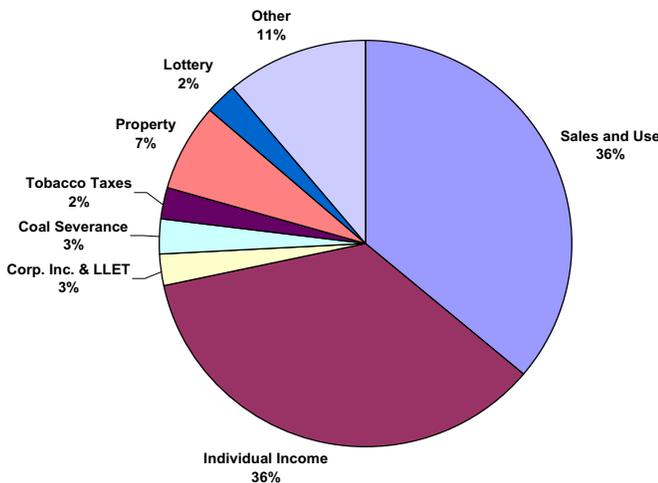
Third-quarter property tax receipts posted revenues that were 11.0 percent lower than in the third quarter of FY07. Fiscal year 2008

third-quarter receipts of \$139.7 million compare with \$156.9 million in the third quarter a year ago. The increase is largely the result of timing changes in the collection of the public service company property tax.

Lottery receipts were \$47.5 million which were 4.0 percent lower than last year's third quarter total of \$49.5 million.

The "all other" category, which represents the remaining accounts of the General Fund, rose 8.2 percent in the third quarter. Third quarter receipts for FY08 were \$219.4 million and compare to \$202.8 million in FY07. Increases in the bank franchise tax, inheritance tax, and gains from the sale of NOx credits primarily contributed to the increase.

Figure 1
Third Quarter, FY08
General Fund Receipts



ROAD FUND

The Road Fund reported an increase of 3.2 percent in the third quarter of FY08. Receipts totaled \$312.1 million and compare to \$302.4 million from the third 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
Third Quarter, FY08
(mil \$)

	<u>FY08</u>	<u>FY07</u>	<u>Diff</u> <u>(\$)</u>	<u>Diff</u> <u>(%)</u>
Motor Fuels	136.9	129.0	7.9	6.1
Motor Vehicle Usage	99.6	99.4	0.2	0.2
Motor Vehicle License	28.7	29.3	-0.6	-1.8
Motor Vehicle Operators	3.7	3.9	-0.2	-5.9
Weight Distance	20.7	21.1	-0.4	-2.0
Investment Income	5.7	4.1	1.6	39.1
Other	<u>16.8</u>	<u>15.7</u>	<u>1.1</u>	<u>7.0</u>
TOTAL	312.1	302.4	9.7	3.2

Motor fuels tax receipts grew at a rate of 6.1 percent during the third quarter due to the formula-driven increase in the tax rate tied to the price of gasoline. Receipts were \$136.9 million and compare to \$129.0 million collected during the third quarter of last year.

Motor vehicle usage tax revenues rose a scant 0.2 percent in the third quarter. Receipts during the period totaled \$99.6 million compared to \$99.4 million collected during the same period last year.

Motor vehicle license tax receipts declined by 1.8 percent in the third quarter of FY08 to \$28.7 million.

Motor vehicle operators license tax receipts were \$3.7 million in the third quarter of FY08, down 5.9 percent from the third quarter of the previous year.

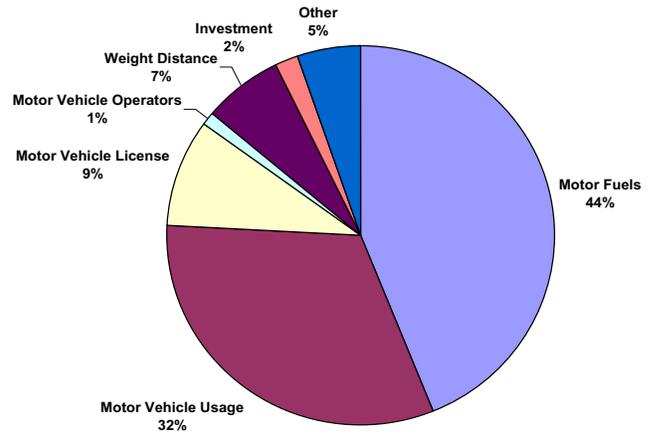
Weight distance tax receipts of \$20.7 million represent a 2.0 percent decrease from receipts of \$21.1 million during the third quarter of FY07.

Investment receipts of \$5.7 million were 39.1 percent higher than the total collected in the third quarter of FY07. Higher balances in the Road Fund are chiefly responsible.

The remainder of the accounts in the Road Fund combined for an increase of 7.0 percent from a year earlier. In the “other” category,

revenues of \$16.8 million compare to \$15.7 million in the third quarter of FY07. The largest gains were in departmental fees and other special fees, offsetting losses in toll income due to the termination of remaining tolls on Kentucky parkways.

Figure 2
Third Quarter, FY08
Road Fund Receipts



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The Economy . . .

Quarterly Report - FY2008:3

NATIONAL ECONOMY

The subprime mortgage crisis began to dampen economic growth in early FY08. As the year progressed the housing bubble became just one of the factors that threatened to send both the national and state economies into recession. The economy continued to take a battering in the third quarter as job growth slowed and inflation outpaced income gains. The falling dollar put added pressure on consumers by increasing the price of imported goods. Early in the third quarter the price of crude oil breached the \$100 per barrel mark, putting added strain on both consumers and businesses. During the third quarter the Federal Reserve lowered the federal funds rate from 4.25 percent to 2.25 percent in an aggressive attempt to bolster the flagging 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 slipped substantially. The economy has contracted by 0.5 percent (comparing January-to-March 2008 to October-to-December 2008) following tepid growth of 0.6 percent in the previous quarter. For this analysis the Governor's Office for Economic Analysis looks at growth



from a year ago to allow for comparison against revenue estimates. On that basis real GDP increased by 2.2 percent from 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. Real consumption (i.e. adjusted for inflation) was up 1.6 percent for the third quarter, just half the growth rate of 3.2 percent a year ago. Durable goods consumption fell by 0.2 percent. The drop was primarily from the 5.9 percent decline in the purchase of motor vehicle and parts. High fuel prices and the resulting drop in purchasing capacity discouraged consumers from making durable-goods purchases during the third quarter.

The purchase of nondurable goods also slowed from 3.2 percent in the third quarter of FY07 to 0.4 percent in the current third quarter. The slowdown in the purchase of goods was counterbalanced slightly by a 2.5 percent increase in the consumption of services during January to March FY08 compared to a 2.9 percent increase a year ago.

Total investment comprises close to a fifth of real GDP and is usually sensitive to both interest rates and future expansion opportunities. Falling interest rates have been unsuccessful in spurring investment because the very real possibility of a recession has engendered a wait-and-see attitude among investors. During the third quarter the investment component of



GDP *decreased* by 3.6 percent. Most of the decline was in residential fixed investment: down 23.0 percent compared to a decline of 16.5 percent a year ago.

Government spending constitutes 17 percent of GDP and was up 2.8 percent. The largest increase was in federal government spending on defense, up 6.0 percent compared to 1.3 percent a year ago. State and local government spending grew at the same rate as last year (1.9 percent) primarily because most state governments are required to balance their budgets. The weak U.S. economy and the historically low value of the dollar helped exports (up 9.4 percent) and severely crimped imports (up just 0.1 percent).

GOEA monitors industrial production because it is a measure of the output of heavy industries like mining and manufacturing. These industries continue to play a vital role in Kentucky's economy. Industrial production is a raw measure of output, comprised of only the final products. Total industrial production declined by 0.5 percent during the third quarter compared to a growth of 1.1 percent a year ago.

Personal income, which is a measure of spending power, was \$11,976.8 billion (annualized) in the third quarter of FY08, for a growth of 4.4 percent from a year ago. Inflation has been on the rise in response to an unprecedented surge in energy prices. The CPI inflation for the third quarter is estimated to be 4.6 percent compared to 3.7 percent a year ago.

The unemployment rate has increased from 4.5 percent in the third quarter of FY07 to 5.0 percent in the current third quarter. Non-farm employment posted a gain of just 0.6 percent. As expected the largest gains were in the relatively small natural resources and mining sector (up 4.9 percent), followed by a robust growth of 3.0 percent in the education and health services sector. Employment in manufacturing continued to decline with a loss of 2.0 percent.

KENTUCKY ECONOMY

Kentucky's personal income is estimated to be \$135.1 billion for the third quarter of FY08, an increase of 4.1 percent from a year ago. U.S. personal income grew by 4.4 percent

Table 3
National Economic Indicators
Third Quarter, FY08

	<u>FY07:3</u>	<u>FY08:3</u>	<u>Percent Change</u>
Real GDP (billion 2000 \$)	11,412.6	11,661.2	2.2
Personal Income (billion \$)	11,469.2	11,976.8	4.4
Consumer Price Index (percentage change)	3.7	4.6	-
Industrial Production (percentage change)	1.1	-0.5	-
Civilian Labor Force (millions)	152.9	153.9	0.7
Nonfarm Employment (millions)	137.2	138.1	0.6
Manufacturing Employment (millions)	14.0	13.7	-2.0
Unemployment Rate (percent)	4.5	5.0	-

Sources: Global Insight, Inc. and U.S. Dept. of Commerce, Bureau of Economic Analysis
Data for FY08:3 are March 2008 estimates

during the same period. Wages and salary constitute a little over half of personal income. Income derived from wages and salaries is estimated to have grown by just 3.3 percent, slightly slower than the national average of 3.6 percent. Wages and salaries income is essentially the product of employment in each sector and wages per employee. The two sectors that account for Kentucky's sub-par growth are manufacturing and business services. Together these sectors account for about 27 percent of total wages and salaries.

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. Kentucky is estimated to have gained 17,600 jobs during the third quarter compared to a year ago. This growth of 0.9 percent is stronger than the national average of 0.7 percent, but there is evidence that employment is weakening further. During the first half of

FY08 nonfarm employment increased by 1.3 percent and then employment growth slowed to 0.9 percent in the third quarter. This was true for all employment categories in the third quarter, i.e. a marked slowdown compared to the first half of the year.

Manufacturing jobs in Kentucky continue to decline as companies restructure. During the first half of FY08 total manufacturing employment was down 2.0 percent. By the third quarter the situation had worsened with a decline of 2.3 percent, or a loss of 6,100 additional jobs.

The trade, transportation and utilities sector accounts for one-fifth of all employment in Kentucky. Growth slipped to 1.0 percent after increasing at an annual rate of 1.7 percent in the first half of FY08. In spite of the national slowdown in the housing market, Kentucky's construction employment increased by a heady 4.2 percent during the first half of the year and has now slowed to 2.7

Table 4
Selected Kentucky Economic Indicators
Third Quarter, FY08

	<u>FY07:3</u>	<u>FY08:3</u>	<u>Change</u>	<u>Percent Change</u>
Total Personal Income (\$ millions)	129,754	135,125	5,371	4.1
Wage & Salary Income (\$ millions)	70,471	72,828	2,357	3.3
Total Nonfarm Employment (thousands)	1,860.6	1,878.2	17.6	0.9
Contract Construction	83.5	85.8	2.3	2.7
Mining	22.6	22.8	0.3	1.2
Manufacturing	257.7	251.7	-6.1	-2.3
Trade, Transportation & Utilities	385.5	389.4	3.9	1.0
Information	29.7	30.3	0.6	2.1
Finance	92.8	94.4	1.6	1.7
Business Services	181.4	181.3	-0.1	-0.1
Educational and Health Services	240.1	242.7	2.6	1.1
Leisure and Hospitality Services	171.3	175.4	4.0	2.4
Other Services	75.4	76.8	1.4	1.8
Government	320.5	327.6	7.1	2.2

Note: Numbers may not add up due to rounding

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, GOEA, March 2008

percent. The current growth is not from building construction, but comes from heavy construction and specialty trade contractors.

A little over one-third of Kentucky's nonagricultural jobs are in the services sectors. The broad service-related industries are part of four newly categorized areas or super sectors.

These are business services, educational and health services, leisure and hospitality services, and other services. Overall employment was up just 1.3 percent in the service providing sectors. The largest gains were in leisure and hospitality services with an increase of 2.4 percent for an addition of 4,000 jobs.

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

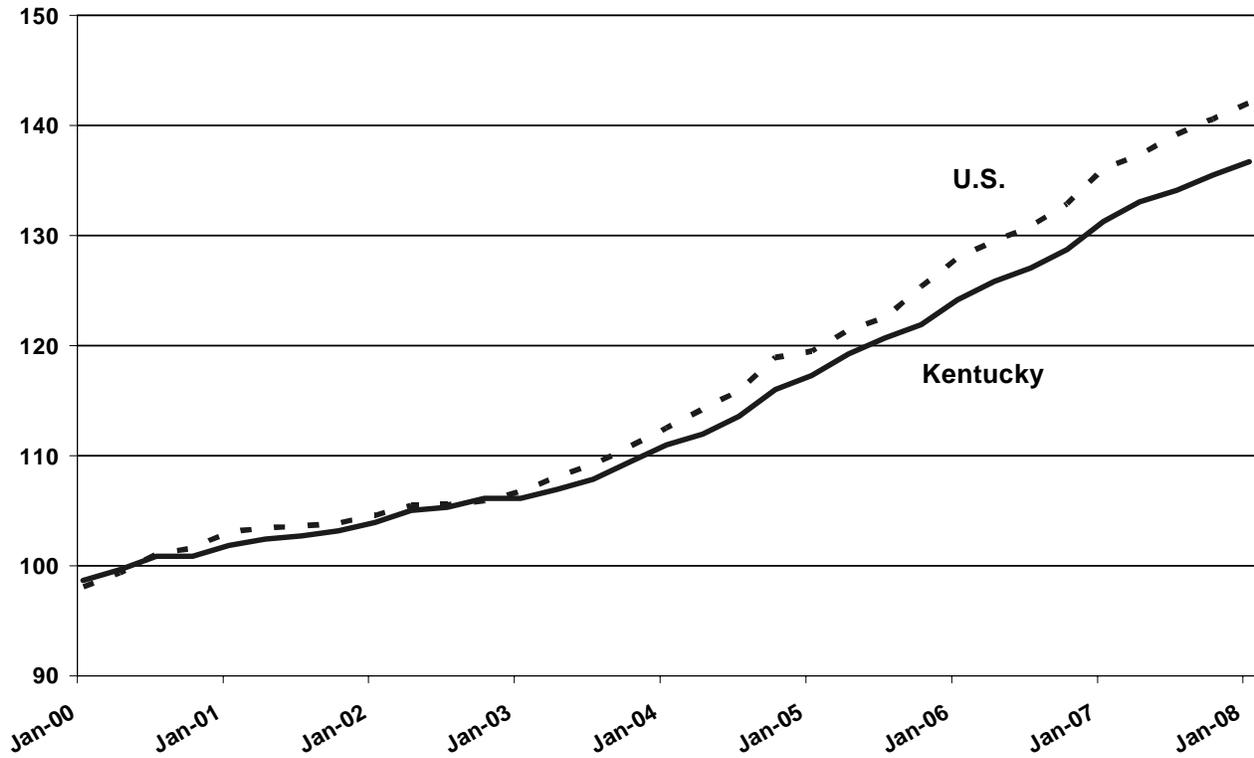
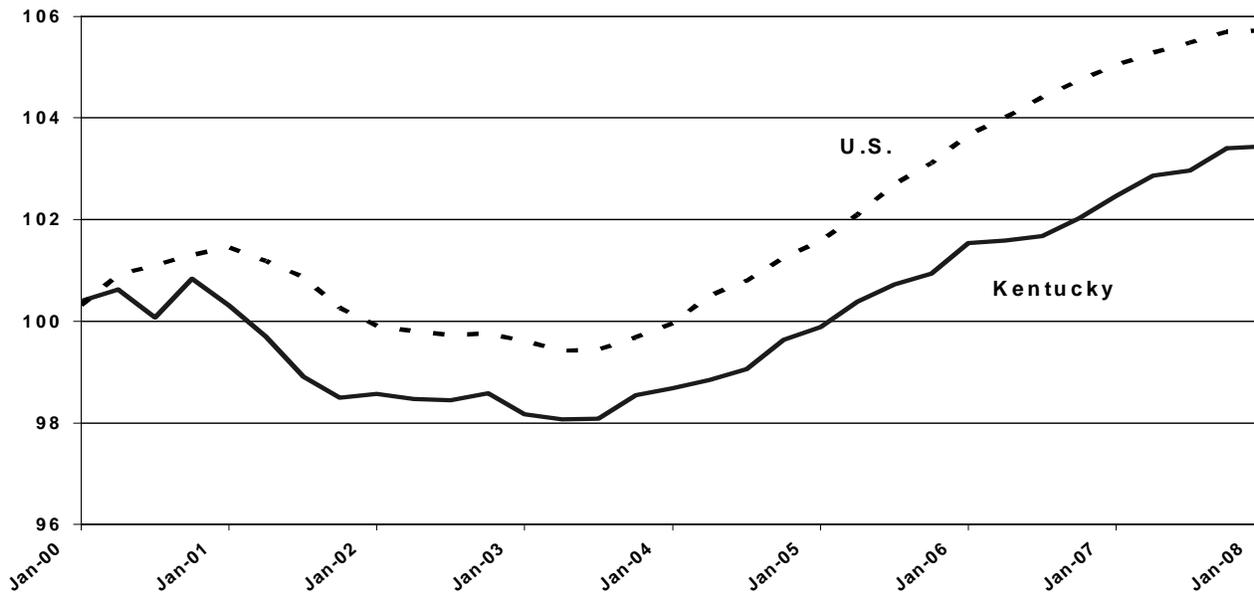


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



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Interim Outlook . . .

Quarterly Report - FY2008:3

GENERAL FUND

Projected General Fund revenues for the next three quarters are shown in Table 5. The interim forecast incorporates the fiscal impact of legislation enacted by the 2008 General Assembly. General Fund revenues were \$6.217 billion in the first three quarters of FY08, a growth rate of 0.1 percent from the same period a year ago. General Fund revenues are anticipated to total \$2.382 billion in the fourth quarter of FY08, yielding a growth rate of 0.7 percent. For the entire fiscal year, total General Fund collections are expected to grow 0.3 percent, with total revenues of \$8.598 billion. Compared to the official revenue estimates including changes from the 2008 legislative session, General Fund revenues are projected to be \$38.0 million lower in FY08 as shown in Table 6.

Anticipated revenues for the first two quarters of FY09 are \$4.338 billion, corresponding to a growth rate of 2.2 percent from the previous fiscal year. Growth is expected to be strongest in the coal severance tax.

Total sales and use tax receipts for the first three quarters of FY08 were \$2.158 billion, representing an increase of 2.7 percent from the same period a year ago. The projected rate of growth for the remaining quarter is 3.0 percent. Total sales and use tax receipts for the fiscal year are forecast to be \$2.896 billion, a decrease of \$1.9 million from the official estimate. In the first two quarters of FY09, the sales and use tax will grow 1.9 percent.

The interim forecast for the individual income tax calls for an increase of 12.8 percent

Table 5
General Fund: Interim Estimate
(millions of dollars)
April 2008

	FY08		FY08		FY08		FY09	
	Quarters 1, 2, & 3		Quarter 4		Full Year		Quarters 1 & 2	
	Actual	% Chg Yr Ago	Est	% Chg Yr Ago	Interim Est	% Chg Yr Ago	Est	% Chg Yr Ago
Sales & Use	2,158.0	2.7	737.7	3.0	2,895.7	2.8	1,473.9	1.9
Individual Income	2,321.9	8.9	1,027.1	12.8	3,349.0	10.1	1,657.6	2.3
Corporation Inc. & LLET	360.9	-44.4	255.7	-26.7	616.6	-38.2	320.1	3.7
Coal Severance	166.7	2.3	62.9	6.6	229.6	3.4	122.9	10.8
Tobacco Taxes	135.1	8.3	47.1	1.5	182.2	6.5	92.3	3.0
Property	443.9	-1.1	51.3	17.9	495.2	0.5	304.2	0.0
Lottery	139.8	1.2	47.7	-1.6	187.5	0.5	97.7	5.9
Other	<u>490.2</u>	<u>8.2</u>	<u>152.3</u>	<u>-20.6</u>	<u>642.5</u>	<u>-0.4</u>	<u>269.1</u>	<u>-0.6</u>
GENERAL FUND	6,216.5	0.1	2,381.8	0.7	8,598.3	0.3	4,337.8	2.2

for the remainder of FY08, amounting to \$1.027 billion in the final quarter of the fiscal year. The individual income tax rose by 8.9 percent in the first three quarters of FY08. Growth in the final quarter is expected to be boosted by a reassignment of income taxes paid by limited liability pass-through entities from the corporation income tax to the individual income tax. For the entire year, individual income tax revenues are forecasted to grow by 10.1 percent. Compared to the official estimate, individual income tax receipts are forecasted to be \$21.0 million lower in FY08. For the first half of FY09, individual income tax receipts are expected to rise by 2.3 percent to \$1.658 billion.

The outlook for the combined corporation income tax and limited liability entity tax is for a decrease of 26.7 percent in the final three months of FY08, representing collections of \$255.7 million. These anticipated collections will bring the FY08 total to \$616.6 million. Corporation income tax revenues will experience the mirror effect of the shift in reporting requirements for limited liability pass-through entities. Combined corpora-

tion income and limited liability entity tax revenues are forecasted to be \$27.9 million lower than the official consensus forecast. Corporation income and limited liability entity tax revenues are expected to rise by 3.7 percent in the first six months of FY09.

Growth in the coal severance tax was modest in the first three quarters of FY08, with receipts up by 2.3 percent compared to the same period a year earlier. Expectations are that growth will accelerate in this revenue source, with a gain of 6.6 percent compared to the fourth quarter of last year. Total FY08 collections will be \$229.6 million, an increase of \$5.9 million from the official estimate. In the first two quarters of FY09, coal severance tax receipts will continue to grow, rising by 10.8 percent to \$122.9 million.

In the first three quarters of FY08, taxes on tobacco (cigarettes and other tobacco products) totaled \$135.1 million, registering growth of 8.3 percent when compared to the same period one year earlier. The outlook for the remaining three months of the fiscal year is for \$47.1 million in revenue with growth of 1.5 percent when compared to the same period of FY07. Overall for the fiscal year, tobacco tax receipts are forecasted to rise by 6.5 percent to \$182.2 million. Tobacco tax receipts are forecasted to rise by 3.0 percent in the first half of FY09.

Property tax revenues totaled \$443.9 million in the first three quarters of FY08, representing a decline of 1.1 percent from a year earlier. It is expected that in the final quarter of FY08, property tax revenues will rise by 17.9 percent to \$51.3 million. Total property tax receipts for FY08 are estimated to be \$495.2 million, a rise of 0.5 percent. In the first two quarters of FY09, property tax receipts will be flat compared to the previous fiscal year.

Table 6
FY08 Interim General Fund Revenue Estimate
Compared to Official Estimate
(millions of dollars)

	Interim FY08 Estimate	Adjusted CFG* FY08 Estimate	Difference FY08 Estimate
Sales & Use	2,895.7	2,897.6	-1.9
Individual Income	3,349.0	3,370.0	-21.0
Corporation Inc & LLET	616.6	644.5	-27.9
Coal Severance	229.6	223.7	5.9
Tobacco	182.2	179.7	2.5
Property	495.2	497.0	-1.8
Lottery	187.5	187.5	0.0
Other	<u>642.5</u>	<u>636.4</u>	<u>6.1</u>
GENERAL FUND	8,598.3	8,636.3	-38.0

*The fiscal impact of the 2008 Legislative session has been included in both the Interim and the CFG data. This includes action to shorten the dormancy period for abandoned traveler's checks, and an adjustment to the tax interest rate. The sum of these is expected to add \$3.3 million to FY08 receipts.

Lottery revenues rose by 1.2 percent in the first nine months of FY08. In the final quarter, lottery revenues are expected to fall by 1.6 percent to \$47.7 million. For the entire fiscal year, lottery receipts are forecasted to be \$187.5 million. Lottery receipts are expected to rise 5.9 percent in the first six months of FY09.

The “other” category contains estimates for several of the smaller revenue sources not listed separately in the summary tables. For the first nine months of FY08, receipts in this category rose by 8.2 percent compared to the prior year. During the last quarter of FY08 this category should experience a decline of 20.6 percent, bringing total fiscal year receipts to \$642.5 million. Declines in abandoned property receipts are largely responsible for the expected decrease. Total FY08 receipts are expected to be \$6.1 million above

the official revenue estimate. For the first half of FY09, “other” revenues should decrease by 0.6 percent.

ROAD FUND

Road Fund revenues are forecasted to grow by 1.7 percent over the final three months of FY08 and 1.0 percent in the first two quarters of FY09 as shown in Table 7. This forecast is \$2.0 million lower than the official revised consensus revenue estimate as shown in Table 8.

Motor fuels tax receipts grew by 8.4 percent in the first three quarters of FY08 to \$456.9 million. This is principally due to a change in the statutory rate of the motor fuels tax tied to the price of gasoline. Growth in this account will continue at 8.4 percent into the final quarter of the fiscal year with receipts

Table 7
Road Fund: Interim Forecast
 (millions of dollars)
 April 2008

	FY08		FY08		FY08		FY09	
	Quarters 1, 2 & 3		Quarter 4		Full Year		Quarters 1 & 2	
	Actual	% Chg Yr Ago	Interim Est	% Chg Yr Ago	Interim Est	% Chg Yr Ago	Interim Est	% Chg Yr Ago
Motor Fuels	456.9	8.4	154.0	8.4	610.9	8.4	324.2	4.0
Motor Vehicle Usage	304.1	1.9	104.4	-7.5	408.5	-0.7	198.4	-3.0
Motor Vehicle License	64.6	6.2	43.5	6.6	108.1	6.3	39.9	11.3
Motor Vehicle Operators	11.5	-3.6	3.7	-4.8	15.2	-3.9	7.9	1.1
Weight Distance	64.0	-0.6	21.4	1.7	85.4	0.0	43.1	-0.5
Investment	13.6	23.5	4.2	-17.2	17.8	10.6	3.3	-58.2
Other	<u>24.7</u>	<u>10.8</u>	<u>10.2</u>	<u>2.9</u>	<u>34.9</u>	8.3	<u>16.9</u>	<u>4.5</u>
ROAD FUND	939.4	5.5	341.4	1.7	1,280.8	4.5	633.6	1.0

of \$154.0 million. Motor fuels tax receipts are expected to lag the official revenue estimate by \$0.8 million.

Motor vehicle usage tax collections rose by 1.9 percent to \$304.1 million in the first nine months of the fiscal year but are expected to fall by 7.5 percent in the final quarter of FY08. Total FY08 collections are forecasted to be \$408.5 million, \$3.2 million below the official estimate. Collections in this account

are expected to continue declining in the first half of FY09 due to the softening sales of motor vehicles.

To estimate all other components of the Road Fund, the staff of the Governor's Office for Economic Analysis assessed recent growth patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to increase by 6.6 percent in the final quarter of FY08 and rise by 11.3 percent in the first half of FY09. Motor vehicle operators' licenses are projected to fall by 4.8 percent in the remainder of the fiscal year, but growth will resume at 1.1 percent in the first six months of FY09. Weight distance tax revenue should expand by 1.7 percent for the remainder of this fiscal year, but decrease by 0.5 percent in the first two quarters of the next fiscal year. Investment income should fall by 17.2 percent due to lower fund balances in the remainder of FY08, and continue to decrease at a rate of 58.2 percent in the following two quarters. All other revenues should combine for growth of 2.9 percent in the last quarter of FY08, and will grow by 4.5 percent in the first half of FY09.

Table 8
FY08 Interim Road Fund Revenue Estimate
Compared to Official Estimate
April 2008
(millions of dollars)

	<u>Interim</u> <u>Estimate</u>	<u>Official</u> <u>Estimate</u>	<u>Difference</u>
Motor Fuels	610.9	611.7	-0.8
Motor Vehicle Usage	408.5	411.7	-3.2
Motor Vehicle License	108.1	108.6	-0.5
Motor Vehicle Operators	15.2	15.4	-0.2
Weight Distance	85.4	85.5	-0.1
Investment	17.8	15.8	2.0
Other	<u>34.9</u>	<u>34.1</u>	<u>0.8</u>
ROAD FUND	1,280.8	1,282.8	-2.0

ECONOMIC OUTLOOK: Interim Forecast

The economic outlook presented here is for the three-quarter period from April to December 2008. In terms of fiscal years this period encompasses the final quarter of FY08 (April to June 2008) and the first half of FY09. The national outlook is based on Global Insight's March 2008 forecast, and the Kentucky outlook is from GOEA's March 2008 forecast.

NATIONAL ECONOMY

During the final quarter of FY08 the economy is expected to contract by 0.2 percent at an annualized rate. Based on comparison from a year ago, however, real output is expected to post a gain of 1.2 percent. Despite the efforts of the Federal Reserve and Congress, the dismal outlook for the housing market is unlikely to change during the next nine months. Nonfarm employment is expected to increase by just 0.3 percent during the final quarter of FY08.

In the first half of FY09 real GDP growth is expected to be 0.8 percent compared to a year ago. On a seasonally adjusted annual basis real GDP is forecasted to grow by 2.5 percent and 1.9 percent for the first two quarters of the next fiscal year. The gains are in response to a firming of energy prices and improvements in productivity. Employment in nonfarm industries is forecasted to be flat during the first half of FY09 compared to a 1.0 percent increase a year ago. The outlook for manufacturing is expected to worsen as employment declines by 2.9 percent compared to a decrease of 2.1 percent a year ago.

The consumption component of GDP has typically been the major factor in sustaining growth. During the last quarter of FY08 durable goods consumption is expected to decline by a hefty 9.2 percent as consumers continue to allocate more of their budget to energy. Crude oil prices are expected to average \$96 per barrel compared to \$65 per barrel a year ago. During the first half of the next fiscal year overall consumption is expected to increase by 1.3 percent, though the decline in the demand for durable goods will continue. There is some relief in the energy market as prices retreat and crude oil averages \$86 per barrel.

There has been a noticeable decline in overall investment due to the crisis in the housing market. The outlook is for a continuation of that trend. During the fourth quarter investment is expected to decline by 28.8 percent followed by a decline of 8.7 percent in the first half of FY09.

Table 9
Economic Outlook: Fourth Quarter of FY08

	FY07 Q4	FY08 Q4	Percent Change
United States			
Real GDP (billion 2000 \$)	11,520.1	11,656.2	1.2
Personal Income (billion \$)	11,577.3	12,158.2	5.0
Consumer Price Index (percent)	4.6	1.3	-
Industrial Production (percent)	3.5	-1.2	-
Nonfarm Employment (millions)	137.5	137.9	0.3
Manufacturing Employment (millions)	14.0	13.7	-2.0
Unemployment Rate (percent)	4.5	5.3	-
Kentucky			
Personal Income (million \$)	131,547	137,821	4.8
Wage & Salary Income (million \$)	71,452	73,396	2.7
Nonfarm Employment ('000)	1,867.8	1,876.2	0.4
Goods producing ('000)	365.2	358.1	-1.9
Service Providing ('000)	1,180.1	1,190.2	0.9
Government ('000)	316.4	320.6	1.3

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA
Data for FY08 are March 2008 estimates

The weak dollar has caused a surge in exports and at the same time put a damper on imports. The low federal funds rate has caused more foreign investors to convert their assets into euros causing the dollar to weaken substantially this year. The trade-weighted exchange rate is forecasted to drop by 11.3 percent in the fourth quarter and an additional 5.8 percent in the first half of FY09. U.S. exports are forecasted to show gains of 9.1 percent in FY08:4, and then 7.3 percent in the first half of FY09. The corresponding import numbers are declines of 0.3 percent and 0.2 percent.

The unemployment rate is expected to average 5.3 percent in the fourth quarter and then increase slightly to 5.6 percent during the first half of FY09.

STATE ECONOMY

Kentucky's economy started to decelerate in the second half of FY08. In the final quarter of FY08 personal income is expected to increase by 4.8 percent compared to a 5.0 percent increase nationally. During the first half of FY09 personal income is forecasted to weaken further with a gain of just 4.0 percent while the national average is forecasted to be 3.9 percent. The marginally higher growth in Kentucky is primarily from a slight boost in income from the mining sector.

The job market showed steady recovery in FY07 and then slowed down substantially in much of FY08. During the first three quarters of FY08 total nonfarm employment in Kentucky was up by 1.2 percent. The current

Table 10
Economic Outlook: First Half of FY09

	FY08 Q1 & Q2	FY09 Q1 & Q2	Percent Change
United States			
Real GDP (billion 2000 \$)	11,668.0	11,757.0	0.8
Personal Income (billion \$)	11,794.3	12,252.1	3.9
Consumer Price Index (percent)	3.2	2.7	-
Industrial Production (percent)	1.7	0.5	-
Nonfarm Employment (millions)	137.9	138.0	0.0
Manufacturing Employment (millions)	13.8	13.4	-2.9
Unemployment Rate (percent)	4.8	5.6	-
Kentucky			
Personal Income (million \$)	133,262	138,622	4.0
Wage & Salary Income (million \$)	71,694	74,451	3.8
Nonfarm Employment ('000)	1,873.5	1,877.1	0.2
Goods producing ('000)	361.6	355.8	-1.6
Service Providing ('000)	1,184.5	1,194.0	0.8
Government ('000)	319.4	321.9	0.8

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA
Data for FY08-FY09 are March 2008 estimates

economic crisis has been exacerbated by high energy costs and the consequent decrease in demand for durable goods as well as certain services. Nonfarm employment growth is forecasted to increase by 0.4 percent in the final quarter of the year, followed by further weakening in the first half of FY09 with an increase of just 0.2 percent.

With the exception of mining—which constitutes only one percent of total employment—the goods-producing industries have been the hardest hit in the current economic downturn. An increase in exports from the lower dollar has not been enough to turn this sector around.

During the fourth quarter of FY08 employment in the goods-producing sector is expected to decline by 1.9 percent in contrast to the 1.3 percent decline in the previous quarter. During the first half of FY09 employment in the goods producing sector is expected to register a drop of 1.6 percent compared to 0.7 percent in the previous year.

Service-providing industries constitute a little over 60 percent of total nonfarm employment and are expected to fare a little better than the goods-producing sectors. In the final quarter of FY08 service-related employment is forecasted to increase by 0.9 percent followed by a 0.8 percent increase in the first half of FY09.



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APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	Third Quarter FY 2008	Third Quarter FY 2007	%	Year-To-Date FY 2008	Year-To-Date FY 2007	%
			Chg			Chg
TOTAL GENERAL FUND	\$1,973,167,233	\$1,949,990,682	1.2	\$6,216,498,410	\$6,209,380,301	0.1
Tax Receipts	\$1,899,483,341	\$1,879,670,858	1.1	\$5,983,235,161	\$5,988,634,400	-0.1
Sales and Gross Receipts	\$845,711,924	\$818,956,621	3.3	\$2,506,378,145	\$2,434,860,908	2.9
Beer Consumption	1,404,030	1,391,215	0.9	4,847,095	4,681,627	3.5
Beer Wholesale	10,779,909	9,931,890	8.5	36,861,675	34,043,348	8.3
Cigarette	43,558,952	39,930,400	9.1	128,529,418	124,657,862	3.1
Distilled Spirits Case Sales	27,266	25,100	8.6	78,290	73,908	5.9
Distilled Spirits Consumption	2,675,827	2,516,172	6.3	7,805,802	7,530,450	3.7
Distilled Spirits Wholesale	6,979,729	6,355,260	9.8	19,958,913	18,718,863	6.6
Insurance Premium	48,101,459	46,866,408	2.6	89,102,485	85,997,432	3.6
Pari-Mutuel	519,812	531,972	-2.3	2,641,374	2,752,608	-4.0
Race Track Admission	3,660	6,154	-40.5	181,075	190,362	-4.9
Sales and Use	711,797,499	692,283,797	2.8	2,158,003,755	2,101,268,559	2.7
Wine Consumption	626,774	597,384	4.9	1,785,206	1,742,652	2.4
Wine Wholesale	3,247,807	2,958,437	9.8	9,037,972	8,459,053	6.8
Telecommunications Tax	13,976,992	13,532,641	3.3	40,919,336	38,429,556	6.5
OTP	2,012,207	2,029,791	-0.9%	6,625,749	6,314,628	4.9
License and Privilege	\$152,822,281	\$132,097,588	15.7	\$333,988,390	\$276,009,602	21.0
Alc. Bev. License Suspension	217,140	195,180	11.3	650,310	452,561	43.7
Coal Severance	55,818,093	51,635,185	8.1	166,721,196	163,020,348	2.3
Corporation License	(1,540,951)	4,671,059	—	2,194,213	9,367,603	-76.6
Corporation Organization	50,491	19,182	163.2	236,191	73,588	221.0
Occupational Licenses	26,685	39,966	-33.2	89,454	111,528	-19.8
Oil Production	2,426,616	1,389,983	74.6	6,811,470	4,500,679	51.3
Race Track License	4,725	7,975	-40.8	194,510	283,675	-31.4
Bank Franchise Tax	70,519,371	63,327,091	11.4	70,292,713	63,265,997	11.1
Driver License Fees	150,516	143,649	4.8	464,486	452,213	2.7
Minerals Severance	2,731,016	2,357,086	15.9	12,659,132	11,128,461	13.8
Natural Gas Severance	8,789,153	8,311,231	5.8	23,039,052	23,352,950	-1.3
Limited Liability Entity	13,629,426	0	—	50,635,665	0	—
Income	\$739,760,215	\$754,099,184	-1.9	\$2,632,224,634	\$2,770,652,557	-5.0
Corporation	38,453,588	120,894,206	-68.2	310,281,749	639,351,879	-51.5
Individual	701,306,627	633,204,977	10.8	2,321,942,885	2,131,300,677	8.9
Property	\$139,662,313	\$156,863,215	-11.0	\$443,876,736	\$449,039,295	-1.1
Building & Loan Association	141,669	37,973	273.1	235,501	463,526	-49.2
General - Real	78,934,693	70,618,656	11.8	228,933,223	219,626,472	4.2
General - Tangible	48,465,360	57,857,571	-16.2	160,735,503	161,929,061	-0.7
Omitted & Delinquent	8,381,603	5,246,500	59.8	18,867,448	26,303,380	-28.3
Public Service	3,217,079	22,598,716	-85.8	34,065,974	39,653,327	-14.1
Other	521,910	503,797	3.6	1,039,087	1,063,530	-2.3
Inheritance	\$12,532,279	\$8,761,438	43.0	\$39,177,097	\$32,164,555	21.8
Miscellaneous	\$8,994,330	\$8,892,847	1.1	\$27,590,159	\$25,907,518	6.5
Legal Process	5,806,277	6,074,690	-4.4	18,343,730	18,559,377	-1.2
T. V. A. In Lieu Payments	3,165,484	2,755,921	14.9	9,223,859	7,281,406	26.7
Other	22,569	62,237	-63.7	22,569	66,735	-66.2
Nontax Receipts	\$72,028,383	\$66,551,883	8.2	\$226,560,832	\$209,094,213	8.4
Departmental Fees	8,233,075	6,833,336	20.5	22,626,119	19,410,036	16.6
PSC Assessment Fee	70,288	16,106	336.4	10,671,543	12,297,512	-13.2
Fines & Forfeitures	7,017,212	5,632,048	24.6	21,421,267	19,578,869	9.4
Interest on Investments	297,158	369,355	-19.5	1,110,908	1,061,209	4.7
Lottery	47,500,000	49,500,000	-4.0	139,761,591	138,125,113	1.2
Sale of NOx Credits	9,535,600	412,100	2213.9	9,535,600	611,600	1459.1
Miscellaneous	(624,950)	3,788,938	—	21,433,803	18,009,875	19.0
Redeposit of State Funds	\$1,655,510	\$3,767,906	-56.1	\$6,702,418	\$11,651,654	-42.5

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	<u>Third Quarter</u> <u>FY 2008</u>	<u>Third Quarter</u> <u>FY 2007</u>	<u>%</u> <u>Chg</u>	<u>Year-To-Date</u> <u>FY 2008</u>	<u>Year-To-Date</u> <u>FY 2007</u>	<u>%</u> <u>Chg</u>
TOTAL ROAD FUND	\$312,126,351	\$302,400,941	3.2	\$939,393,949	\$890,291,860	5.5
Tax Receipts-	\$300,159,206	\$293,528,221	2.3	\$907,979,273	\$862,628,390	5.3
Sales and Gross Receipts	\$244,859,309	\$237,317,216	3.2	\$761,079,180	\$719,884,660	5.7
Motor Fuels Taxes	136,884,638	129,031,644	6.1	430,396,782	399,384,686	7.8
Motor Fuels Use & Surtax	8,303,214	8,846,602	-6.1	26,348,588	21,883,898	20.4
Truck Trip Permits (fuel)	71,440	76,160	-6.2	199,200	229,380	-13.2
Motor Vehicle Usage	99,600,017	99,362,810	0.2	304,134,610	298,386,696	1.9
License and Privilege	\$55,299,897	\$56,211,005	-1.6	\$146,900,093	\$142,743,730	2.9
Motor Vehicles	28,717,421	29,253,304	-1.8	64,553,657	60,828,542	6.1
Motor Vehicle Operators	3,657,741	3,887,768	-5.9	11,475,607	11,912,313	-3.7
Weight Distance	20,678,657	21,105,642	-2.0	64,000,667	64,389,451	-0.6
Truck Decal Fees	9,889	72,083	-86.3	60,358	142,134	-57.5
Other Special Fees	2,236,189	1,892,208	18.2	6,809,804	5,471,290	24.5
Nontax Receipts	\$10,618,576	\$8,744,903	21.4	\$29,945,563	\$27,356,431	9.5
Departmental Fees	4,499,147	3,145,946	43.0	14,804,231	11,342,189	30.5
In Lieu of Traffic Fines	280,459	300,960	-6.8	848,182	865,358	-2.0
Highway Tolls	0	1,029,486	-100.0	0	3,717,208	-100.0
Investment Income	5,682,583	4,084,476	39.1	13,582,803	11,005,443	23.4
Miscellaneous	156,386	184,034	-15.0	710,348	426,232	66.7
Redeposit of State Funds	\$1,348,569	\$127,818	955.1	\$1,469,113	\$307,039	378.5