

Executive Summary . . .

General Fund receipts totaled \$2,035.7 million for the first quarter of fiscal year 2007 (FY07), increasing from FY06 by 3.6 percent. This represents \$70.0 million more than reported in the same period one year earlier. The Road Fund fell by 0.4 percent during the first quarter, and economic growth as measured by Kentucky personal income, was up by 5.5 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 2005 tax modernization. Sales and use tax revenues were up by 2.7 percent.

Individual income tax

receipts fell by 3.8 percent, reflecting higher refunds issued when compared to the previous year. Corpora-

tion income and license taxes posted sharp growth of 34.4 percent reflecting both the strength of the economy and the shift in revenues away from individual income taxes and into the corporation income tax for pass-through entities.

Coal severance taxes rose by 4.7 percent continuing their strong recent performance. Cigarette taxes, compared to last year when significant revenues were realized from the one-time floor stocks tax, were down by 21.3 percent in the first

quarter of FY07. Property taxes were 23.1 percent lower than a year earlier, affected by timing differences in collection of some accounts.

During the first quarter of FY07, lottery revenues grew by 10.8 percent compared to the first quarter of FY06. Reported growth in receipts for this quarter was affected by low dividends made by the Kentucky Lottery to the General Fund a year earlier. All other receipts combined for an increase of 23.9 percent.

Road Fund receipts were boosted by a recalculation of the motor fuels tax, which is tied to the wholesale price of motor fuels. For the first quarter, the Road Fund declined by 0.4 percent. Motor fuels taxes rose by 5.9 percent, while motor vehicle usage tax receipts fell by 7.6 percent as the continuing high oil prices deterred potential car buyers.

Weight distance tax revenues rose by 0.8 percent, and motor vehicle license tax revenues fell by 13.2 percent. Motor vehicle operators license tax rose by 24.2 percent due to an increase in drivers' license fees charged by the state.

The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 3.2 percent when compared to the same time period in FY06. Personal income also rose by a healthy 7.7 percent. Kentucky's economy as measured by personal income grew by 5.5 percent over the same period one year earlier.



Employment in the state grew by 1.0 percent as 18,200 jobs were added to the payroll during the first quarter.

The interim forecast for the General Fund expects revenues to rise by 3.3 percent over the final three quarters of FY07. Total revenues for the entire fiscal year are forecasted to reach \$8,656.7 million, which is \$278.9 million more than the official estimate approved by the Consensus Forecasting Group in December 2005 and modified by the 2006 Regular Session and Special Session of the General Assembly.

Among the major accounts, the outlook for the final three quarters of FY07 is for sales and use tax revenues to rise by 3.1 percent, the individual income tax to grow by 14.8 percent due to inclusion of income taxes paid by owners of pass-through entities, corporation income and license taxes to fall by 17.9 percent, and coal severance tax receipts to decrease by 3.6 percent.

The cigarette tax revenues are estimated to decline by 7.2 percent in the last three quarters of FY07. Property tax receipts will fall by 2.0 percent, and dividend payments

from the Lottery should decline by 10.7 percent. "Other" taxes and revenues will combine for an increase of 3.9 percent during the final three quarters due primarily to new taxes created on telecommunications services.

The interim outlook for the Road Fund anticipates an increase in revenues of 6.8 percent for the last three quarters of FY07. This is \$17.0 million below the official consensus revenue estimate of December 2005 as modified by the 2006 General Assembly. Motor fuels taxes will grow by 9.4 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to grow by 4.8 percent, and motor vehicle operators' license fees are projected to expand by 24.8 percent because of an increase in the fee.

The outlook for the national economy foresees real GDP growth of 2.5 percent over the remainder of FY07, and personal income growth should rise by 5.8 percent. In Kentucky, personal income is expected to rise by 5.4 percent, while employment should rise by 0.9 percent.

Revenue Receipts . . .

GENERAL FUND

General Fund receipts in the first quarter of FY07 totaled \$2,035.7 million compared to \$1,965.7 million in the first quarter of FY06, for a net gain of \$70.0 million and growth of 3.6 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. Otherwise, most of the changes in revenue were due to economic conditions, unless noted below in the specific tax section.

Table 1
Summary General Fund Receipts
First Quarter, FY07
(mil \$)

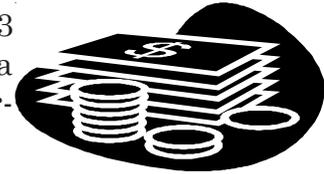
	FY07	FY06	Diff (\$)	Diff (%)
Sales and Use	703.8	685.5	18.3	2.7
Individual Income	737.8	766.8	-29.0	-3.8
Corp. Inc. & License	281.3	209.3	72.0	34.4
Coal Severance	54.8	52.3	2.5	4.7
Cigarette Taxes	41.7	53.0	-11.3	-21.3
Property	41.1	53.4	-12.3	-23.1
Lottery	41.0	37.0	4.0	10.8
Other	<u>134.2</u>	<u>108.3</u>	<u>25.9</u>	<u>23.9</u>
TOTAL	2,035.7	1,965.7	70.0	3.6

The **sales and use tax** had moderate growth of 2.7 percent in the first quarter of FY07. Receipts of \$703.8 million compare to the \$685.5 million collected in the first quarter of FY06.

Individual income tax receipts fell 3.8 percent in the first quarter of FY07. Receipts of \$737.8 million were \$29.0 million

less than was collected in the first quarter of the previous fiscal year due primarily to an increase in refunds paid.

Corporation income and license taxes posted strong growth of 34.4 percent during the first quarter of FY07. Receipts totaled \$281.3 million compared to the \$209.3 million received a year earlier. Corporation income tax collections made up virtually all receipts for the quarter due to the repeal of the license tax.



The **coal severance tax** continued its recent history of strong growth by climbing 4.7 percent in the first quarter. Coal prices have escalated sharply in tandem with other energy prices, and this has boosted severance tax revenues. Receipts of \$54.8 million compare to \$52.3 million collected in the first quarter of FY06.

Cigarette taxes fell sharply in the first quarter as an after effect of the one-time floor stocks tax which yielded over \$12 million in the first quarter of FY06. Receipts of \$41.7 million were 21.3 percent less 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, and the cigarette floor stocks tax. Excluding the floor stocks tax, which inflated FY06 receipts, revenue receipts increased 1.9 percent.

Property taxes were down by 23.1 percent in the first quarter of FY07 due almost entirely to differences in the timing of

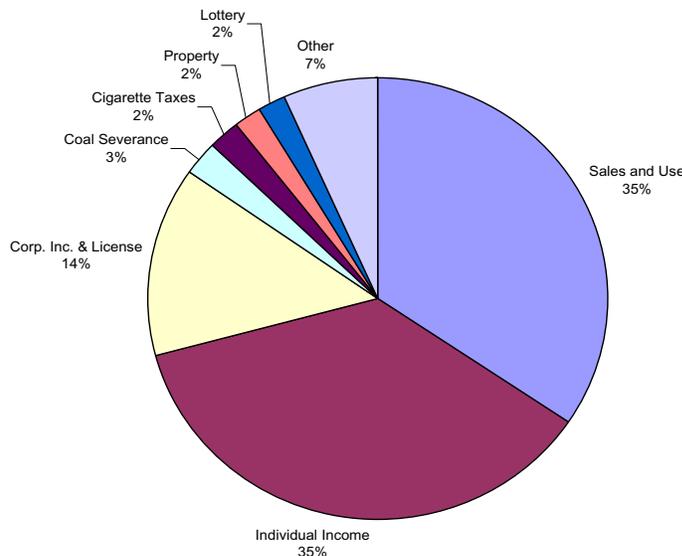
collections and the removal of telecommunications companies from the public service tax. Collections of \$41.1 million compare to \$53.4 million received in the first quarter of the prior fiscal year.

Lottery receipts increased by 10.8 percent in the first quarter of FY07 with revenues of \$41.0 million. Lottery revenues were affected by strong Powerball sales.

The **“other”** category represents the remaining accounts in the General Fund, and collections in this account increased 23.9 percent with receipts of \$134.2 million.

Figure 1 details the composition of first-quarter General Fund receipts by tax type. Seventy 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 the corporation license tax at 14 percent. “Other taxes” combine for the next-largest source, making up 7 percent of the General Fund. The major components in this category include inheritance taxes, insurance premium taxes, alcohol excise taxes, telecommunications taxes, and the natural gas severance tax. The coal severance tax accounted for three percent of the revenues. Property taxes, cigarette taxes, and the Lottery each made up two percent of the General Fund.

Figure 1
First Quarter, FY07
General Fund Receipts



ROAD FUND

The Road Fund fell by 0.4 percent in the first quarter of FY07. Receipts totaled \$303.3 million compared to the \$304.7 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.

Table 2
Summary Road Fund Receipts
First Quarter, FY07
(mil \$)

	<u>FY07</u>	<u>FY06</u>	<u>Diff</u> <u>(\$)</u>	<u>Diff</u> <u>(%)</u>
Motor Fuels	143.6	135.6	8.0	5.9
Motor Vehicle Usage	108.7	117.6	-8.9	-7.6
Weight Distance	21.8	21.6	0.2	0.8
Motor Vehicle License	14.2	16.4	-2.2	-13.2
Motor Vehicle Operators	4.0	3.3	0.7	24.2
Investment Income	3.2	0.7	2.5	336.3
Other	<u>7.9</u>	<u>9.5</u>	<u>-1.6</u>	<u>-16.5</u>
TOTAL	303.3	304.7	-1.4	-0.4

Motor fuels and motor fuels use tax receipts increased 5.9 percent during the first quarter of FY07. Receipts were \$143.6 million and compare to \$135.6 million collected during the first quarter of last year. Motor fuels tax revenues were affected by an increase in the motor fuels rate that was not in effect in the previous fiscal year.

Motor vehicle usage tax receipts fell by 7.6 percent during the first quarter. Receipts were \$108.7 million compared to \$117.6 million collected during the same period last year. Motor vehicle usage taxes were affected by poor sales of SUV's and trucks due to high gas prices.

Weight distance tax receipts of \$21.8 million grew by 0.8 percent over receipts of \$21.6 million during the first quarter of last year.

Motor vehicle license tax receipts fell by 13.2 percent during the first quarter of FY07. Receipts of \$14.2 million compare to \$16.4 million received during the first quarter of FY06.

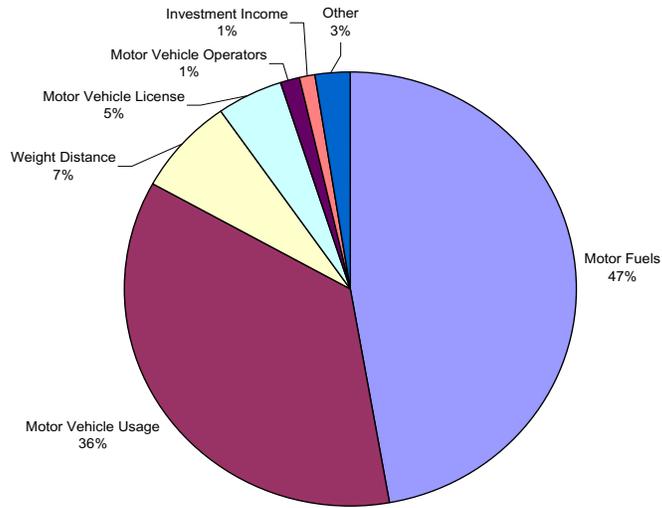
Motor vehicle operators' license fees grew by 24.2 percent due to an increase in registration fees. Collections of \$4.0 million in the first quarter of FY07 compare to \$3.3 million in the same period a year ago.

Investment income grew by 336.3 percent in the first quarter due to larger investible balances and higher yields on investments. Receipts of \$3.2 million compare to \$723,000 in the first quarter of FY06.

The remainder of the accounts in the Road Fund combined for a decrease of 16.5 percent. Receipts for the "Other" category totaled \$7.9 million during the first quarter, compared to \$9.5 million in the first quarter of FY06.

Figure 2 details the composition of Road Fund revenues by tax type in the first quarter of FY07. Motor fuels taxes and motor vehicle usage taxes comprised 83 percent of Road Fund revenues in the first quarter. The next-largest source of revenue was the weight distance tax with 7 percent, followed by motor vehicle license with 5 percent. The "other" category accounted for 3 percent, while motor vehicle operators' license fees and investment income each composed 1 percent.

Figure 2
First Quarter, FY07
Road Fund Receipts



The Economy . . .

Quarterly Economic & Revenue Report

First Quarter 2007

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. Growth in real GDP is typically reported as a seasonally adjusted annual rate that compares consecutive quarters. On that basis the growth in real output has slipped substantially. It is now estimated to have expanded by 2.4 percent (comparing April-June to July-September 2006) in contrast to growth of 4.2 percent a year ago. However, when the first quarter of FY07 is compared to the same quarter a year ago the situation is better: real GDP increased by 3.2 percent compared to 3.4 percent in FY06. For our analysis this is a more appropriate gauge because revenue estimates are typically compared to the same quarter of the previous fiscal year.

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 just 2.9 percent for the first quarter compared to 3.8 percent a year ago. The slowdown emanates from the sharp decline in the con-

sumption of motor vehicles and parts. This was *down* by 4.7 percent compared to a 5.2 percent increase a year ago. Even though purchases of other durable goods like furniture were markedly better than last year, the decline in automobile purchases was enough to suppress gains in these durable goods. Oil prices averaged \$73 per barrel in the first quarter, up \$10 from a year ago. 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.

Total investment comprises close to a fifth of real GDP and is usually sensitive to both interest rates and future expansion opportunities. Overall, the investment component of GDP showed strong gains, increasing 5.2 percent compared to 3.6 percent a year ago. Unlike the last five years when investment in computers and software was the strongest

performer, the gains this time are in commercial structures and other real estate.

Government spending constitutes 17 percent of GDP and was up 1.8 percent. With the nationwide improvement

in state revenues the greatest increase was in state government spending: up 2.3 percent compared to 0.5 percent last year.

Net exports are the fourth major component of real GDP. Over the last ten years the U.S. trade deficit—as net exports are called when they are negative—has continued to balloon:



from \$108.8 billion in the first quarter of FY97 to \$615.5 billion in FY07:1. During the first quarter net exports increased by 1.3 percent from a year ago. This is a substantial change from the recent past when net exports were increasing by 16 percent.

Industrial production rose by 4.5 percent in the first quarter, an improvement from the 1.4 percent increase in the same quarter a year ago. All major areas of production were up, especially the mining sector. With the increase in the price of crude oil and the subsequent rise in all energy products, production in the coal mining sector was up 6.3 percent.

The University of Michigan Consumer Sentiment Index for the first quarter averaged 83.6 compared to 87.5 a year ago. 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 any positive economic news associ-

ated with factors like increased productivity and factory capacity utilization. For over five years U.S. factory capacity utilization stayed well below eighty percent. Now, for three quarters in a row, the utilization has surged (81.1 percent in the first quarter) particularly because petroleum refineries are at full capacity, and uncompetitive plants in the auto sector have been shuttered.

Personal income, a measure of spending power, was \$11,051.2 billion in the first quarter, for increase of 7.7 percent over the previous year. This is remarkably strong growth even after factoring in CPI inflation. The robust income gain can be linked directly to increases in wage and salary income (up 7.7 percent), gains in dividend income (up 11.1 percent), and gains in interest income (up 9.1 percent). A rare alignment of all three components boosted total personal income growth to near historic highs. The strong gains in these components were counterbalanced by lower rates of increase in transfer payments (3.4 percent) and other labor income (6.2 percent).

Table 3
Summary US Economic Conditions
First Quarter* FY07

	<u>FY06:1</u>	<u>FY07:1</u>	<u>Percent*</u> <u>Change</u>
Real GDP (billion 2000 \$)	11,115.1	11,466.1	3.2
Personal Income (billion \$)	10,262.7	11,051.2	7.7
Consumer Price Index (percent change)	5.5	3.1	-
Industrial Production (percent change)	1.4	4.5	-
Civilian Labor Force (millions)	149.8	151.7	1.2
Total Nonfarm Employment (millions)	133.2	135.5	1.7
Manufacturing Employment (millions)	14.2	14.2	-0.1
Unemployment Rate (percent)	5.0	4.7	-

*Seasonally adjusted annual percent growth rate.

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

Data for FY07:1 are September 2006 estimates.

The unemployment rate in the first quarter averaged 4.7 percent compared to 5.0 percent a year ago. Not only was the unemployment rate down, but total nonagricultural employment increased by a highly respectable 1.7 percent to 135.5 million jobs. Manufacturing employment continued to decline with a drop of 0.1 percent during the first quarter.

KENTUCKY ECONOMY

Kentucky's personal income is estimated to be \$125.5 billion for the first quarter of FY07, an increase of 5.5 percent from a year ago. U.S. personal income grew by 7.7 percent during the same period. Wages and salaries constitute a little over half of Kentucky personal income. Income derived from wages and salaries is estimated to have grown by 6.3 percent in FY07:1, slower than the national average of 7.7 percent. To some extent, the slower economic growth in Kentucky is a cause of

concern. However, in this particular quarter, the factors that have caused a surge nationally are in retrenchment. The overheated commercial and residential construction markets have begun to contract at the national level in recent months. By most historic measures Kentucky's personal income growth of 5.5 percent is quite respectable.

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. Nonagricultural employment in Kentucky is estimated to have increased by 18,200 jobs in the first quarter of FY07 compared to one year earlier, resulting in growth of 1.0 percent. Although employment growth has cooled recently in comparison to earlier quarters, the growth in the first quarter has been sufficient to help lower Kentucky's unemployment rate.

Table 4
Selected Kentucky Economic Indicators
First Quarter, FY07

	<u>FY06:1</u>	<u>FY07:1</u>	<u>Change</u>	<u>Percent Change</u>
Total Personal Income (\$ millions)	118,973	125,515	6,542	5.5
Wage & Salary Income (\$ millions)	65,019	69,109	4,090	6.3
Total Nonfarm Employment (thousands)	1,828.6	1,846.9	18.2	1.0
Contract Construction	84.7	86.7	2.0	2.4
Mining	21.8	23.9	2.0	9.3
Manufacturing	260.3	260.4	0.1	0.0
Trade, Transportation & Utilities	378.3	381.7	3.4	0.9
Information	29.5	29.2	-0.3	-0.9
Finance	87.9	89.7	1.8	2.1
Business Services	172.4	174.5	2.0	1.2
Educational Services	235.9	240.8	4.9	2.1
Leisure and Hospitality Services	165.4	169.1	3.7	2.2
Other Services	76.3	75.4	-0.9	-1.1
Government	316.1	315.5	-0.6	-0.2

Note: Numbers may not add up due to rounding.
Sources: U.S. Department of Commerce, Bureau of Economic Analysis, GOEA, September 2006

As a departure from the past, much of the employment growth in terms of numbers is from the Educational Services sector (up 2.1 percent with an increase of 4,900 jobs). The industries in this sector include both public and private colleges as well as training centers.

The Contract Construction sector (up 2.4 percent with an increase of 2,000 jobs) seems to have steadied in Kentucky as the market cools further. Unlike the national situation, the demand for commercial real estate has not driven up construction employment in Kentucky. The relative strength of construction is from the housing sector which continues to receive a boost from historically low mortgage rates. Business services constitute over eight percent of total nonfarm employment and include temporary help services. The growth of 1.2 percent in this sector is low by recent standards, and may be related to the downturn in manufacturing.

Employment in Leisure and Hospitality services was up 2.2 percent. Most of the gain was in accommodation and food

services industries. 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. The newly revised definition of manufacturing makes it the third-largest sector in the Kentucky economy after the Government sector and the Trade, Transportation, and Utilities sector. Manufacturing employment accounts for about 15 percent of all nonagricultural 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 flat with the addition of just 100 jobs.

The increased output in mining helped that sector to grow by 9.3 percent from a year ago. The demand for employment in coal mining is directly linked to the volatile energy market. As long as energy prices remain high, employment in mining is expected to keep increasing.

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

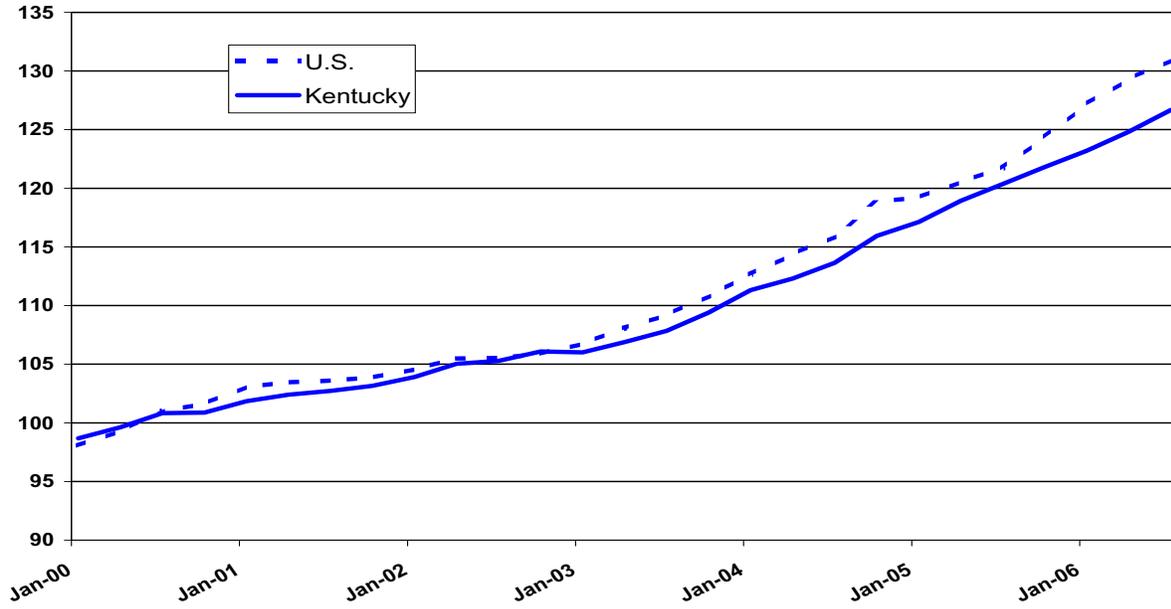
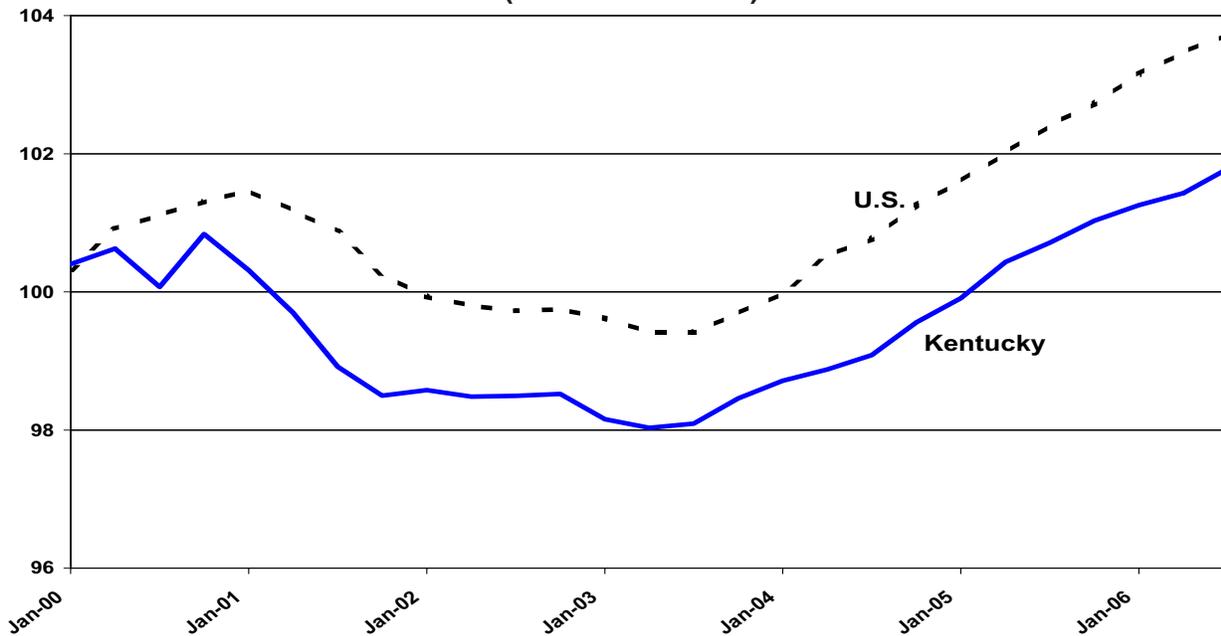


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



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Interim Outlook . . .

GENERAL FUND

Projected General Fund revenues for the next three quarters are shown in Table 5 below. General Fund revenues were \$2,035.7 million in the first quarter of FY07, a growth rate of 3.6 percent from the same period a year ago. Revenues grew moderately reflecting a cooling economy. First-quarter growth was strongest in the volatile corporation income tax, which was responding to strong corporate profits.

Anticipated revenues for the last three quarters of FY07 are \$6,621.0 million, corresponding to a growth rate of 3.3 percent from the previous fiscal year. Revenue declines are expected to be posted in most major accounts except for the sales tax and the individual income tax. 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 revenue estimate including changes made by the 2006 Regular Session and Special Session of the General Assembly anticipates General Fund revenues of \$8,377.9 million for FY07. For purposes of comparison, the fiscal impact of HB1 passed by the 2006 Special Session (-\$13.2 million) is included in the official estimate. The interim forecast as shown in Table 6 on page 14 predicts that revenues will be \$8,656.7 million, an increase of \$278.9 million. Higher receipts than forecasted for FY06 combined with a moderate economic outlook have led to expectations of greater revenues for FY07.

Total sales and use tax receipts for the first quarter of FY07 were \$703.8 million, representing an increase of 2.7 percent from the

Table 5
General Fund Interim Estimate
(million dollars)

	FY07 Quarter 1		FY07 Quarters 2,3, & 4		FY07 Full Year	
	Actual	%Chg	Estimate	%Chg	Estimate	%Chg
Sales & Use	703.8	2.7	2,128.1	3.1	2,831.9	3.0
Individual Income	737.8	-3.8	2,471.3	14.8	3,209.1	10.0
Corporation Inc. & Lic.	281.3	34.4	686.3	-17.9	967.6	-7.4
Coal Severance	54.8	4.7	166.0	-3.6	220.8	-1.6
Cigarette (inc. flr stocks tax)	41.7	-21.8	121.5	-7.2	163.2	-8.3
Property	41.1	-23.1	440.1	-2.0	481.2	-4.2
Lottery	41.0	10.8	136.6	-10.7	177.6	-6.5
Other	<u>134.2</u>	<u>24.1</u>	<u>471.1</u>	<u>3.9</u>	<u>605.3</u>	<u>6.6</u>
Total General Fund	2,035.7	3.6	6,621.0	3.3	8,656.7	3.4

same period a year ago. The projected rate of growth for the remaining three quarters of FY07 is 3.1 percent. Total sales and use tax receipts for FY07 are estimated to be \$2,831.9 million, or \$53.7 million above the official estimate.

The interim forecast for the individual income tax calls for a rise of 14.8 percent for the remainder of FY07, amounting to collections of \$2,471.3 million in the final nine months. The individual income tax fell by 3.8 percent in the first quarter of FY07, but growth is expected to return in the remainder of the fiscal year as the changes from the enactment of *JOBS for Kentucky* have now been incorporated into the base, and future growth will reflect more closely actual economic growth. Another factor leading to increased growth is the passage of HB 1 in the Special Session of the 2006 General Assembly, which resulted in taxes paid on income earned by pass-through entities (s-corporations, limited liability companies, limited liability partnerships, etc.) being shifted from the corporation income tax to the individual income tax effective January 1, 2007. For the entire fiscal year, individual income tax revenues are projected to grow by 10.0 percent.

The outlook for corporation income and license taxes projects a decrease of 17.9 percent in the final three quarters of FY07, representing collections of \$686.3 million. These anticipated collections will bring the FY07 total to \$967.6 million, a decrease of 7.4 percent from FY06. Revenues in FY07 are affected by changes to the corporation income tax as described above, and the repeal of the corporate license tax. In addition, measures that will reduce revenues include a reduction in the top marginal corporation income tax rate from 7 percent to 6 percent, effective January 1, 2007.

The coal severance tax continued its growth in the first quarter, and the forecast is that coal prices have peaked and will moderate slightly over the remainder of the fiscal year. As a result, revenue from this source is projected to drop by 3.6 percent for the remaining three quarters. Overall for the fiscal year, coal severance tax receipts are expected to fall by 1.6 percent.

Cigarette taxes declined when compared to a year earlier, when significant revenues were realized from the one-time floor stocks tax. The floor stocks tax was payable in three monthly installments with July and August being the two months of the previous fiscal year to receive payments. In the first quarter, cigarette tax collections totaled \$41.7 million. The outlook for the remaining nine months of the fiscal year is for \$121.5 million in revenue, with a corresponding decline of 7.2 percent. (This drop is somewhat artificial when compared to the previous fiscal year, when the tax on other tobacco products was not reported separately from the cigarette tax as is currently done.) For the entire fiscal year, receipts are forecasted to slip by 8.3 percent and yield \$163.2 million in revenue.

Table 6
FY07 Interim General Fund Revenue Forecast
Compared to Official Estimate
(mil \$)

	Interim Estimate	Official Estimate	Dif
Sales & Use	2,831.9	2,778.2	53.7
Individual Income	3,209.1	3,161.1	48.0
Corp Inc. & Lic.	967.6	759.3	208.3
Coal Severance	220.8	217.1	3.7
Cigarette (inc. flr stocks tax)	163.2	170.9	-7.7
Property	481.2	475.5	5.7
Lottery	177.6	165.5	12.1
Other	<u>605.3</u>	<u>650.2</u>	<u>-44.9</u>
General Fund	8,656.7	8,377.9	278.9

Property tax revenues totaled \$41.1 million in the first quarter of FY07, representing a decline of 23.1 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 lagged in relation to the previous year. It is expected that the remaining three quarters of FY07 will yield total property tax revenues of \$440.1 million, for a decline of 2.0 percent from the previous year. The removal from the PSC property tax of telecommunications companies contributes to the decline. For the entire fiscal year property taxes should decline by 4.2 percent.

Lottery revenues grew by 10.8 percent in the first quarter of FY07. The increase was the result of more favorable ticket sales. In the next three quarters, Lottery revenues are expected to fall by 10.7 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 fall by 6.5 percent.

The “other” category contains estimates for several of the smaller revenue sources

not otherwise classified. The final three quarters of FY07 should experience growth of 3.9 percent. The growth is anticipated due to several measures: the creation of new taxes by the 2005 General Assembly including a tax on other tobacco products, a telecommunications excise tax, and a telecommunications gross receipts tax; and redirecting abandoned property receipts to the General Fund.

ROAD FUND

Road Fund revenues over the three-quarter horizon are forecasted to grow by 6.8 percent as shown on Table 7 below. This represents a decrease of \$17.0 million from the official revenue estimates including legislation enacted by the 2006 Kentucky General Assembly.

Motor fuels tax receipts are forecasted to grow by 9.4 percent in the last three quarters of FY07. This is principally due to falling gas prices which will increase consumption.

Motor vehicle usage tax collections are expected to rise by 4.8 percent in the final three quarters of FY07. Receipts in the first quarter declined by 7.6 percent.

**Table 7
Road Fund Interim Estimate
(million dollars)**

	FY07 Quarter 1		FY07 Quarters 2,3, & 4		FY07 Full Year	
	Actual	%Chg	Estimate	%Chg	Estimate	%Chg
Motor Fuels & MF Use/Surtax	143.6	5.9	429.6	9.4	572.9	8.4
Motor Vehicle Usage & Rental	108.7	-7.6	291.3	4.8	399.7	1.0
Motor Vehicle License	14.2	-13.4	77.5	0.0	91.7	-2.3
Motor Vehicle Operators	4.0	21.2	14.1	24.8	18.1	24.0
Weight Distance Tax/Surtax	21.8	0.9	65.8	3.3	87.6	2.7
Investment	3.2	357.1	9.1	59.6	12.3	92.2
Other	7.8	-15.8	31.6	-1.3	39.4	-4.6
Road Fund	303.3	-0.4	919.0	6.8	1,221.7	4.8

Growth is expected to return, partially boosted by legislated changes in the treatment of the motor vehicle usage tax.

To estimate the growth of all other components of the Road Fund, 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 remain flat in the final three quarters of FY07. Motor vehicle operators' licenses are projected to rise by 24.8 percent in the

remainder of the fiscal year due to a statutory change in drivers' license fees from \$8 to \$20. Weight distance tax revenue should improve by 3.3 percent for the remainder of the fiscal year. Investment income should grow by 59.6 percent due to higher fund balances. All other revenues should combine for a decrease of 1.3 percent during the last nine months of FY07. The decline is partially due to the removal of tolls from the Natcher and Audubon Parkways ordered by the Governor, effective in November 2006.

Table 8
FY07 Interim Road Fund Revenue Forecast
Compared to Official Estimate
(mil \$)

	Interim Estimate	Official Estimate	Dif
Motor Fuels & MF Use/Surtax	572.7	563.3	9.4
Motor Vehicle Usage & Rental	399.4	425.6	-26.2
Motor Vehicle License	91.7	92.2	-0.5
Motor Vehicle Operators	18.1	17.4	0.7
Weight Distance Tax/Surtax	87.6	87.4	0.2
Investment	12.3	9.0	3.3
Other	<u>39.3</u>	<u>43.8</u>	<u>-4.5</u>
Road Fund	1,221.7	1,238.7	-17.0

NATIONAL ECONOMY

Real GDP is expected to show a gain of 2.5 percent from a year ago during the three quarters that comprise the October-to-June period of FY07. This is considerably lower than the 3.5 percent growth experienced during the same period in FY06. Employment in nonfarm industries is forecasted to slow with a gain of 1.1 percent compared to a 1.5 percent increase in the same period last year. Employment in mining will continue to grow rapidly (7.7 percent) fueled by high energy prices. However, mining job gains have little impact on overall employment since mining comprises just 0.5 percent of nonfarm employment. Among the large sectors, business services are expected to expand by 2.3 percent and leisure and hospitality by 2.0 percent. Manufacturing employment is forecasted to be up by 0.5 percent. Higher interest rates are expected to cause a 0.4 percent decline in construction employment.

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, the strong dollar, and state government budget woes which have counterbalanced federal government spending. During the next three quarters of FY07 consumption is expected to increase by 2.8 percent compared to 3.1 percent a year ago. Consumption of durable goods is expected to soften substantially from 4.2 percent a year ago to 1.9 percent. The dampening is related to continued slowdown in the purchase of motor vehicles and parts (down 1.3 percent) as well as furniture (from 12.7 percent a year ago to 4.8 percent).

The increase in interest rates is expected to drive down all investment activity from residential and commercial construction to manufacturing investments. Investments are expected to *decline* by 0.7 percent compared to an increase of 6.8 percent a year ago.

U.S. personal income is forecasted to increase by 5.8 percent compared to a more robust 6.2 percent a year ago. In spite of

Table 9
U.S. Economic Outlook for FY07
Quarters 2, 3, & 4

	FY06	FY07	Percent* Change
Real GDP (billion 2000 \$)	11,292.6	11,573.4	2.5
Personal Income (billion \$)	10,702.0	11,326.1	5.8
Consumer Price Index (1992-94=100)	199.7	205.9	3.1
Industrial Production (2002=100)	110.9	114.4	3.2
Civilian Labor Force (millions)	150.5	152.5	1.3
Total Nonfarm Employment (millions)	134.7	136.1	1.1
Manufacturing Employment (millions)	14.2	14.3	0.5
Unemployment Rate (percent)	4.8	4.9	-

*Seasonally adjusted annual rate.

Sources: Global Insight, and U.S. Department of Commerce, BEA.
Data for FY07 are September 2006 estimates.

higher energy prices inflation is expected to be kept in check from increased productivity to 3.1 percent.

KENTUCKY ECONOMY

The impact of the national recovery will be felt in the state economy. In contrast to the national economy, in Kentucky the goods-producing sector should experience growth slightly higher than the total average for all nonagricultural industries. Personal income is estimated to increase by 5.4 percent during the October-to-June FY07 period compared to a 5.8 percent increase nationally.

Kentucky's nonagricultural employment is expected to grow slowly during the final three quarters of FY07 with a gain of 0.9 percent. In percentage terms most of the job growth is anticipated to come from the goods-producing sectors which includes mining, construction and manufacturing. These sectors account for one-fifth of all

Kentucky employment. The combined growth in goods-producing sectors is estimated at 1.1 percent resulting in 4,200 new jobs. The service-providing industries are forecasted to expand by 0.9 percent with the creation of 9,400 jobs. Employment in government—including federal, state, and local—is anticipated to rise by 1.1 percent.

Among the separate sectors, during the next three quarters the outlook for the coal mining industry continues to be promising. Employment is expected to increase by a robust 9.3 percent. This is followed by educational services with an increase of 2.1 percent. The construction industry is expected to weaken substantially. Even though 30-year mortgage rates are expected to average 6.3 percent for FY07 construction activity is expected to dampen following the frenetic building spree of the last three years. Manufacturing employment is expected to post a gain of 0.6 percent although the sector has weakened substantially in the area of durable goods, especially in motor vehicles and parts.

Table 10
Kentucky Economic Outlook for FY07
Quarters 2, 3, & 4

	FY06	FY07	Percent* Change
Total Personal Income (\$ millions)	121,877	128,424	5.4
Wage & Salary Income (\$ millions)	66,926	70,407	5.2
Total Nonfarm Employment (thousands)	1,838.3	1,855.2	0.9
Contract Construction	85.8	86.4	0.7
Mining	22.7	24.8	9.3
Manufacturing	262.3	263.8	0.6
Trade, Transportation & Utilities	380.2	380.4	0.0
Information	29.3	29.2	-0.2
Finance	88.4	89.3	1.0
Business Services	173.9	175.3	0.8
Educational Services	237.9	243.0	2.1
Leisure and Hospitality Services	167.8	170.1	1.3
Other Services	76.3	76.0	-0.4
Government	313.7	317.0	1.1

* Seasonally adjusted rate from a year ago.
Source: GOEA, September 2006

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	<u>First Quarter</u> 2006 - 2007	<u>First Quarter</u> 2005 - 2006	% Change
TOTAL GENERAL FUND	2,035,738,110	1,965,737,395	3.6%
Tax Receipts	1,966,535,298	1,907,344,153	3.1%
Sales and Gross Receipts	816,467,697	792,685,901	3.0%
Beer Consumption	1,791,350	1,501,640	19.3%
Beer Wholesale	13,209,659	10,394,423	27.1%
Cigarette	41,701,350	40,926,592	1.9%
Cigarette Floor Stock	0	12,110,939	-100.0%
Distilled Spirits Case Sales	23,986	17,632	36.0%
Distilled Spirits Consumption	2,454,522	1,973,910	24.3%
Distilled Spirits Wholesale	5,921,355	4,563,845	29.7%
Insurance Premium	28,797,283	32,247,913	-10.7%
Pari-Mutuel	739,283	902,130	-18.1%
Race Track Admission	117,774	128,061	-8.0%
Sales and Use	703,823,093	685,484,466	2.7%
Wine Consumption	530,095	390,530	35.7%
Wine Wholesale	2,533,253	1,771,093	43.0%
Telecommunications Tax	12,641,426	0	---
Other Tobacco Products	2,183,268	272,728	700.5%
License and Privilege	70,836,879	79,787,880	-11.2%
Alc. Bev. License Suspension	101,000	46,400	117.7%
Coal Severance	54,763,148	52,319,160	4.7%
Corporation License	1,687,671	14,925,796	-88.7%
Corporation Organization	41,400	68,200	-39.3%
Occupational Licenses	30,509	26,285	16.1%
Oil Production	1,858,768	1,609,065	15.5%
Race Track License	160,500	161,350	-0.5%
Bank Franchise Tax	(217,827)	(189,622)	---
Driver License Fees	0	161,814	-100.0%
Minerals Severance	4,171,119	4,232,587	-1.5%
Natural Gas Severance	8,240,592	6,426,845	28.2%
Income	1,017,479,565	961,195,126	5.9%
Corporation	279,638,932	194,368,013	43.9%
Individual	737,840,634	766,827,113	-3.8%
Property	\$41,121,249	\$53,439,676	-23.1%
Bank Deposits	0	0	---
Building & Loan Association	423,953	168,529	151.6%
Distilled Spirits	7,135	74,184	---
General - Intangible	8,047	5,765	39.6%
General - Real	284,962	344,656	-17.3%
General - Tangible	22,970,554	22,402,585	2.5%
Omitted & Delinquent	11,697,970	8,037,930	45.5%
Public Service	5,728,272	22,405,909	-74.4%
Other	355	117	204.0%
Inheritance	\$12,237,207	\$11,216,202	9.1%
Miscellaneous	\$8,392,700	\$9,019,369	-6.9%
Legal Process	6,786,083	6,816,915	-0.5%
T. V. A. In Lieu Payments	1,602,119	2,181,146	-26.5%
Other	4,499	21,308	-78.9%
Nontax Receipts	\$61,891,237	\$56,511,143	9.5%
Departmental Fees	6,657,698	5,535,995	20.3%
PSC Assessment Fee	12,258,825	8,367,263	---
Fines & Forfeitures	6,661,948	6,608,006	0.8%
Interest on Investments	361,287	235,151	53.6%
Lottery	41,000,000	37,000,000	10.8%
Sale of NOx Credits	87,500	136,000	-35.7%
Miscellaneous	(5,136,022)	(1,371,271)	---
Redeposit of State Funds	\$7,311,574	\$1,882,099	288.5%

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	<u>First Quarter</u> 2006 - 2007	<u>First Quarter</u> 2005 - 2006	% Change
TOTAL ROAD FUND	\$303,337,643	\$304,684,105	-0.4%
Tax Receipts-	\$294,178,786	\$296,799,824	-0.9%
Sales and Gross Receipts	\$252,248,952	\$253,192,423	-0.4%
Motor Fuels Taxes	136,403,655	130,255,075	4.7%
Motor Fuels Use & Surtax	7,114,746	5,235,418	35.9%
Truck Trip Permits (fuel)	79,640	92,440	-13.8%
Motor Vehicle Usage	108,650,912	117,609,489	-7.6%
License and Privilege	\$41,929,833	\$43,607,401	-3.8%
Motor Vehicles	14,232,275	16,390,608	-13.2%
Motor Vehicle Operators	4,044,437	3,257,331	24.2%
Weight Distance	21,795,624	21,628,265	0.8%
Truck Decal Fees	43,313	44,219	-2.0%
Other Special Fees	1,814,184	2,286,978	-20.7%
Nontax Receipts	\$8,797,379	\$7,025,895	25.2%
Departmental Fees	3,653,684	4,234,352	-13.7%
In Lieu of Traffic Fines	310,549	333,281	-6.8%
Highway Tolls	1,583,756	1,589,008	-0.3%
Investment Income	3,158,787	723,912	336.3%
Miscellaneous	90,603	145,343	-37.7%
Inter-Agency Motor Pool	\$0	\$0	---
Motor Carrier Taxes - Undistributed	\$0	\$0	---
Redeposit of State Funds	\$361,479	\$858,386	-57.9%