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Ernie Fletcher
Governor

April 30, 2007

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

Dear Governor Fletcher:

The attached Quarterly Economic and Revenue Report summarizes the revenue and economic statistics for the third quarter of Fiscal Year 2007 (FY07). It also includes an interim economic and revenue forecast for the final quarter of FY07 and the first two quarters of FY08.

General Fund receipts for the third quarter of FY07 totaled \$1,950.0 million, an increase of 5.2 percent compared to the same period in FY06. Road Fund revenues totaled \$302.4 million, for an increase of 6.9 percent from the third quarter of FY06.

The interim General Fund forecast for the final quarter of FY07 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 FY07 is for growth of 4.5 percent. For the first half of FY08, General Fund revenues should rise by 3.7 percent and Road Fund receipts are expected to rise by 3.2 percent.

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

Sincerely,


Bradford L. Cowgill
State Budget Director

Attachment

TABLE OF CONTENTS

3	Executive Summary
5	Revenue Receipts - Third Quarter 2007
5	General Fund
6	Road Fund
9	The Economy
9	National Economy
10	Kentucky Economy
13	Interim Outlook
13	General Fund
15	Road Fund
18	National Economy
19	State Economy
21	Appendix: Third Quarter Receipts

Executive Summary . . .

Quarterly Economic & Revenue Report

Third Quarter 2007

General Fund receipts totaled \$1.950 billion in the third quarter of fiscal year 2007 (FY07), increasing from FY06 by 5.2 percent. This represents \$95.5 million more than reported in the same period one year earlier. The Road Fund grew by 6.9 percent during the third quarter, and economic growth as measured by Kentucky personal income was up by 4.6 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 2005 and 2006 General Assemblies. Sales and use tax revenues were up by 1.1 percent. Individual income tax receipts rose 7.1 percent, and corporation income and license tax receipts were virtually flat when compared to last year.

Coal severance taxes declined by 10.7 percent, ending their recent climb. Cigarette taxes were down by 0.5 percent in the third quarter of FY07. Property taxes were 30.9 percent higher than a year earlier, affected by timing differences in collection of some accounts.

During the third quarter of FY07, lottery revenues fell by 2.9 percent compared to the third quarter of FY06. All other accounts in the General Fund combined for an increase of 9.1 percent, boosted by collections in the telecommunications excise tax.

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 6.9 percent. Motor fuels taxes rose by 9.1 percent, while motor vehicle usage taxes also expanded by 11.2 percent.

Motor vehicle license tax revenues grew by 3.0 percent, and motor vehicle operators' license tax receipts were up 0.7 percent from the third quarter of the previous fiscal year. The weight distance tax registered a decline of 0.7 percent. Investment income rose 126.6 percent due to higher Road Fund balances, and all other accounts in the Road Fund combined for a decrease of 21.4 percent.

The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 2.2 percent in the third quarter of FY07. U.S. personal income rose by 5.2 percent. Kentucky's economy as measured by personal income grew by 4.6 percent over the same period one year

earlier. Employment in the state grew by 0.4 percent as 7,500 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 FY07. Total revenues for the entire fiscal year are forecasted to reach \$8.594 billion, which is \$15.8 million less than the official revised revenue estimate approved by the Consensus Forecasting Group and modified by the 2007 General Assembly.



Among the major accounts, the outlook for the final quarter of FY07 is for sales and use tax revenues to rise by 4.2 percent, the individual income tax to grow by 16.9 percent, corporation income and license taxes to decrease by 34.4 percent, and coal severance tax receipts to dip by 4.0 percent.

The cigarette tax is forecasted to be flat in the fourth quarter of FY07, and property tax receipts will decline by 21.2 percent. Dividend payments from the lottery will fall by 28.3 percent. "Other" taxes and revenues will combine for an increase of 31.9 percent during the final quarter due primarily to additional revenues from abandoned property as well as investment income.

For the first two quarters of Fiscal Year 2008, General Fund receipts are forecasted to grow by 3.7 percent.

The interim outlook for the Road Fund anticipates an increase in revenues of 4.5 percent for the last quarter of FY07. This is \$2.8 million above the official consensus revenue estimate of January 2007. (No changes to the consensus revenue estimate that affect FY07 were made by the 2007 General Assembly.) Motor fuels taxes will

grow by 5.9 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to rise by 3.1 percent, and motor vehicle license tax receipts are forecasted to expand by 2.5 percent. Motor vehicle operators' license fees are projected to expand by 22.5 percent, and the weight distance tax will rise by 0.9 percent. Investment income will grow 30.3 percent due to higher Road Fund balances, and all other accounts in the Road Fund will combine for a decrease of 1.1 percent.

During the first two quarters of FY08, Road Fund revenues should grow by 3.2 percent.

The outlook for the national economy foresees real GDP growth of 2.2 percent over the remainder of FY07, and personal income is expected to grow by 5.6 percent. Nonfarm employment should rise by 1.3 percent from the same period of last year. In Kentucky, personal income is expected to rise by 4.6 percent, while employment should rise by 0.7 percent or 13,300 jobs. In the first two quarters of FY08, Kentucky personal income should accelerate to 5.4 percent, and employment growth should similarly rise to 1.2 percent.

Revenue Receipts . . .

GENERAL FUND

The third quarter of FY07 experienced solid growth following a tepid second quarter. Third-quarter growth rates were boosted by increased receipts from the individual income, corporation income and property taxes. Receipts in the third quarter totaled \$1.950 billion compared to \$1.855 billion received in the third quarter of FY06. The resulting growth rate was 5.2 percent, and compares to a growth rate of 4.2 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.



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 \$692.3 million, compared to \$684.6 million in the third quarter of FY06. The result is a growth rate of 1.1 percent and lags the 5.7 percent growth for the third quarter of last year.

Individual income tax posted receipts of \$633.2 million, compared to last year's third quarter receipts of \$591.4 million. The result was an increase of 7.1 percent,

and compares to a 10.4 percent decline for the third quarter of last year. The increase in this revenue source is due to lower refund payments compared to the same period of last year.

Combined corporation income and license tax receipts changed little in the third quarter of the fiscal year. Revenues of \$125.6 million were about equal to year-earlier figures of \$125.5 million. The stagnation in corporation income tax revenues reflects the slowdown in corporate profits growth.

Coal severance tax revenue ended its run of growth in the third quarter, with receipts down by 10.7 percent. Collections of \$51.6 million compare to the FY06 third quarter total of \$57.8 million.

Cigarette tax receipts (excluding the tax on other tobacco products) of \$39.9 million in the third quarter of FY07 lagged last year's total of \$40.1 million by 0.5 percent.

Third-quarter property tax receipts posted revenues that were 30.9 percent higher

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

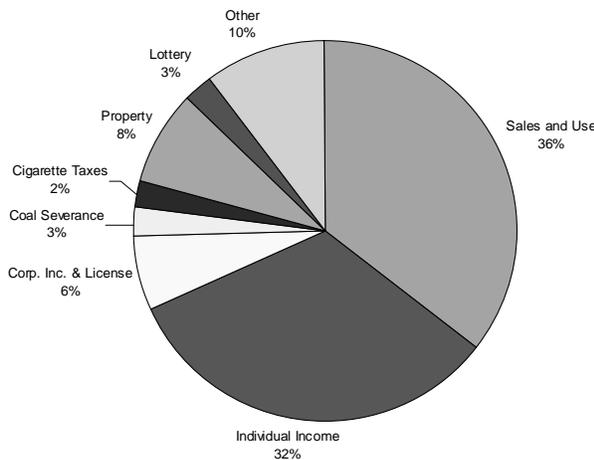
	<u>FY07</u>	<u>FY06</u>	<u>Diff</u> <u>(\$)</u>	<u>Diff</u> <u>(%)</u>
Sales and Use	692.3	684.6	7.7	1.1
Individual Income	633.2	591.4	41.8	7.1
Corp. Inc. & License	125.6	125.5	0.0	0.0
Coal Severance	51.6	57.8	-6.2	-10.7
Cigarette (inc. floor stocks tax)	39.9	40.1	-0.2	-0.5
Property	156.9	119.9	37.0	30.9
Lottery	49.5	51.0	-1.5	-2.9
Other	<u>201.0</u>	<u>184.2</u>	<u>16.8</u>	<u>9.1</u>
TOTAL	1,950.0	1,854.5	95.5	5.2

than in the third quarter of FY06. Fiscal Year 2007 third-quarter receipts of \$156.9 million compare with \$119.9 million from the third quarter of FY06. The increase is largely the result of timing changes in collections in the public services company property tax.

Lottery receipts were \$49.5 million which were 2.9 percent less than last year's third quarter total of \$51.0 million.

The "all other" category, which represents the remaining accounts of the General Fund, rose 9.1 percent in the third quarter. Third quarter receipts for FY07 were \$201.0 million and compare to \$184.2 million in FY06. Collections of \$13.5 million in the telecommunications excise tax were principally responsible for the increase since this tax was not included in General Fund receipts one year earlier.

**Figure 1
Third Quarter, FY07
General Fund Receipts**



ROAD FUND

The Road Fund reported an increase of 6.9 percent in the third quarter of FY07. Receipts totaled \$302.4 million and compare to \$283.0 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, FY07
(million \$)**

	FY07	FY06	Diff (\$)	Diff (%)
Motor Fuels	129.0	118.3	10.7	9.1
Motor Vehicle Usage	99.4	89.4	10.0	11.2
Motor Vehicle License	29.3	28.4	0.9	3.0
Motor Vehicle Operators	3.9	3.9	0.0	0.7
Weight Distance	21.1	21.2	-0.1	-0.7
Investment Income	4.1	1.8	2.3	126.6
Other	<u>15.7</u>	<u>20.0</u>	<u>-4.3</u>	<u>-21.4</u>
TOTAL	302.4	283.0	19.4	6.9

Motor fuels tax receipts grew at a rate of 9.1 percent during the third quarter due to the formula-driven increase in the tax rate tied to the price of gasoline. Receipts were \$129.0 million and compare to \$118.3 million collected during the third quarter of last year.

Motor vehicle usage tax revenues rose in the third quarter, with receipts increasing 11.2 percent. Receipts during the third quarter of FY07 totaled \$99.4 million and compare to \$89.4 million collected during the same period last year.

Motor vehicle license tax receipts increased 3.0 percent in the third quarter of FY07 to \$29.3 million.

Motor vehicle operators license tax receipts were \$3.9 million in the third quarter of FY07, up 0.7 percent from the third quarter the previous year.

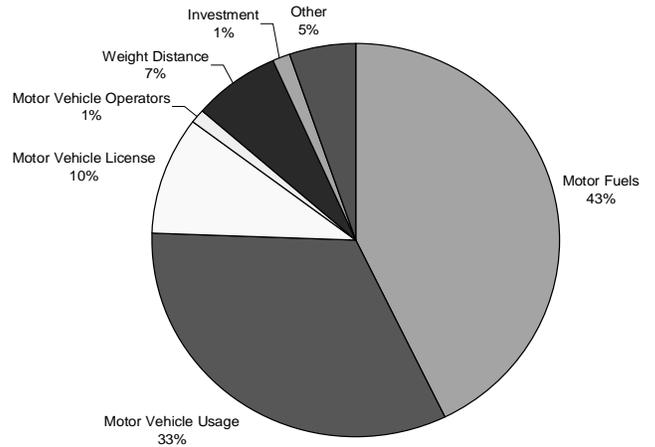
Weight distance tax receipts of \$21.1 million represent a 0.7 percent decrease from receipts of \$21.2 million during the third quarter of FY06.

Investment receipts of \$4.1 million were 126.6 percent higher than the total collected in the third quarter of FY06. Higher balances in the Road Fund are chiefly responsible.

The remainder of the accounts in the Road Fund combined for a decrease of 21.4 percent from a year earlier. In the “other”

category, revenues of \$15.7 million compare to \$20.0 million in the third quarter of FY06. The largest losses were in toll revenue (due to the abolition of remaining tolls on Kentucky parkways) and in departmental fees.

Figure 2
Third Quarter, FY07
Road Fund Receipts



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The Economy . . .

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 estimated to have increased by just 2.2 percent in the third quarter (January-March) of FY07. (This report was prepared prior to the release of third-quarter GDP data by the U.S. Bureau of Economic Analysis on April 27.) In the second quarter the growth rate was a more robust 3.1 percent. Most economists are of the opinion that real GDP growth of three percent or more is critical for the creation of net new jobs. Growth lower than three percent typically results in a hiring slump, though the work week may temporarily increase as businesses offer overtime work to current employees instead of hiring new workers.

There are four broad components of the economy that drive overall growth: consumption, investment, government spend-

ing, 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 3.3 percent for the third quarter, almost unchanged from the 3.4 percent growth a year ago. Durable-goods consumption slowed substantially from 6.6 percent a year ago to 4.3 percent in the third quarter. Much of the slowdown was a result of the weak housing market. Furniture purchases account for almost half of durable-goods consumption. Furniture purchases were up 8.5 percent in the third quarter, although that was a deceleration from the 14.3 percent increase a year ago. The purchase of nondurable goods also slowed from 4.5 percent in the third quarter of FY06 to 3.2 percent in the current third quarter. The slowdown in the purchase of goods was counterbalanced by a 3.1 percent increase in the consumption of services during January-March FY07 compared to a 2.3 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. Until recently investment spending had grown substantially. However, during the third quarter the investment component of real GDP decreased by 5.6 percent after posting robust growth of 6.2 percent in the previous year. All of the decline was in residential fixed investment, which was down 17.5 percent compared to a growth of 6.1 percent a year ago.

Table 3
National Economic Indicators
Third Quarter, FY07

	FY06:3	FY07:3	Percent Change
Real GDP (billion 2000 \$)	11,316.4	11,570.5	2.2
Personal Income (billion \$)	10,721.4	11,276.4	5.2
Consumer Price Index (percentage change)	1.9	3.5	-
Industrial Production (percentage change)	5.0	1.5	-
Civilian Labor Force (millions)	150.4	153.2	1.8
Nonfarm Employment (millions)	135.4	137.4	1.5
Manufacturing Employment (millions)	14.2	14.1	-0.7
Unemployment Rate (percent)	4.7	4.6	-

Sources: Global Insight, Inc., and U.S. Dept. of Commerce, Bureau of Economic Analysis.
Data for FY07:3 are March 2007 estimates.

Government spending constitutes 17.0 percent of GDP and was up 2.1 percent.

Net exports have been reducing real GDP by consistently posting negative balances, were more favorable in the third quarter of FY07. The impact of the weak dollar was felt in the market as imports were up just 2.0 percent while exports increased by 7.8 percent.

Industrial production is a measure of the output of final products from heavy industries like mining and manufacturing. These industries continue to play a vital role in Kentucky's economy. Total industrial production was up just 1.5 percent during the third quarter compared to 5.0 percent a year ago. Most of the decline was in the oil and gas extraction and coal mining sectors. Overall the industrial production index for the mining sector fell by 1.2 percent compared to a 21.8 percent gain a year ago.

Personal income, which is a measure of spending power, was \$11,276.4 billion (annualized) in the third quarter of FY07, for a growth of 5.2 percent from a year ago. Inflation has been on the rise in response to a slight resurgence in energy prices. The CPI inflation rate for the third quarter is estimated to be 3.5 percent compared to just 1.9 percent a year ago.

The unemployment rate dropped slightly from 4.7 percent in the third quarter of FY06 quarter to 4.6 percent in the current third quarter. Nonfarm employment posted a gain of 1.5 percent during the third quarter, but slower than the 2.1 percent increase a year ago. The largest gains were posted in professional and business services (up 2.8 percent), while the

manufacturing sector continued to contract with a loss of 0.7 percent.

KENTUCKY ECONOMY

Kentucky's personal income, a broad measure of the state's economic performance, is estimated to be \$127.1 billion for the third quarter of FY07, an increase of 4.6 percent from a year ago. Wages and salaries constitute a little over half of personal income. Income derived from wages and salaries is estimated to have grown by 3.7 percent, compared to the national average of 4.5 percent. Wages and salaries income is essentially the product of total employment and wages per employee. Three sectors that contribute to Kentucky's lower growth are manufacturing; trade, transportation and utilities; and government. Together these sectors account for about 45 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 7,500 jobs during the third quarter compared to a year ago. This growth of 0.4 percent is compared to a 1.5 percent increase in national employment during the same period.

The strongest percentage gain was in mining (up 5.0 percent), and the largest addition in terms of jobs was in government. Almost all the employment increase in government was from state and local government educational services.

Manufacturing jobs in Kentucky continue to decline as companies restructure to remain profitable. During the first half of

FY07 the largest contraction was in the transportation equipment sector. In the third quarter, however, this sector seems to have stabilized for the short term, and the contraction shifted to the nondurable-goods sector. Employment declined in the chemical and petroleum industry as well as in the manufacture of apparel. Overall manufacturing employment contracted by 1.8 percent with a loss of 4,800 jobs.

Both construction and the other services sector registered employment losses in the third quarter. Nationally construction dipped because of the slowdown in the residential construction industry; in Kentucky the losses were mostly in heavy construction. The very broad “other services” sector lost a total of 700 jobs. These include repair services, dry cleaning, and personal care services.

Table 4
Selected Kentucky Economic Indicators
Third Quarter, FY07

	FY06:3	FY07:3	Change	Percent Change
Total Personal Income (\$ millions)	121,479	127,090	5,611	4.6
Wage & Salary Income (\$ millions)	66,968	69,456	2,488	3.7
Total Nonfarm Employment	1,844.6	1,852.1	7.5	0.4
Contract Construction	84.9	83.7	-1.2	-1.4
Mining	22.7	23.9	1.1	5.0
Manufacturing	263.2	258.4	-4.8	-1.8
Trade, Transportation & Utilities	379.6	380.7	1.2	0.3
Information	29.5	29.5	0.0	-0.1
Finance	90.0	91.5	1.5	1.7
Business Services	177.2	179.7	2.4	1.4
Educational and Health Services	237.0	239.8	2.8	1.2
Leisure and Hospitality Services	168.3	169.2	0.9	0.5
Other Services	76.2	75.5	-0.7	0.0
Government	315.9	320.1	4.2	1.3

Note: Numbers may not add up due to rounding.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis, GOEA, March 2007.

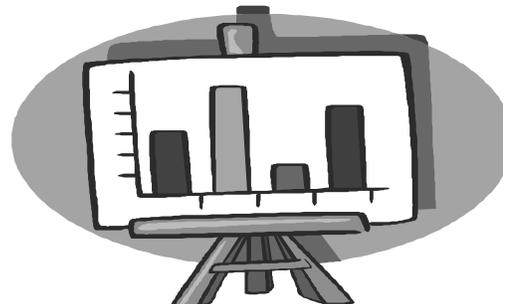


Figure 3
Personal Income: KY vs. U.S.
(Index FY00 = 100)

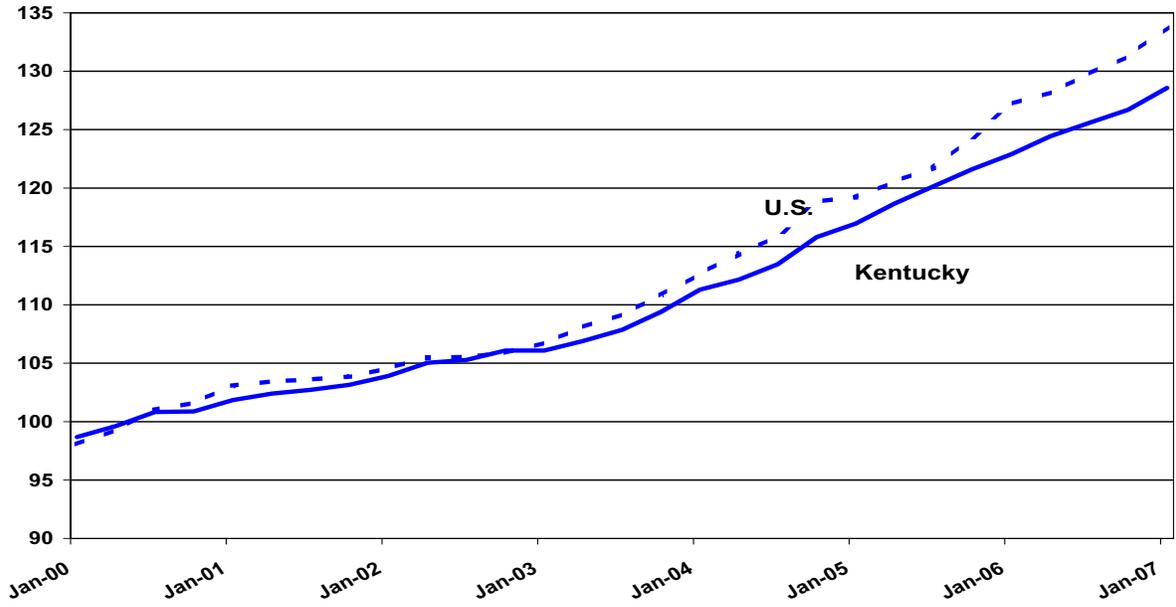
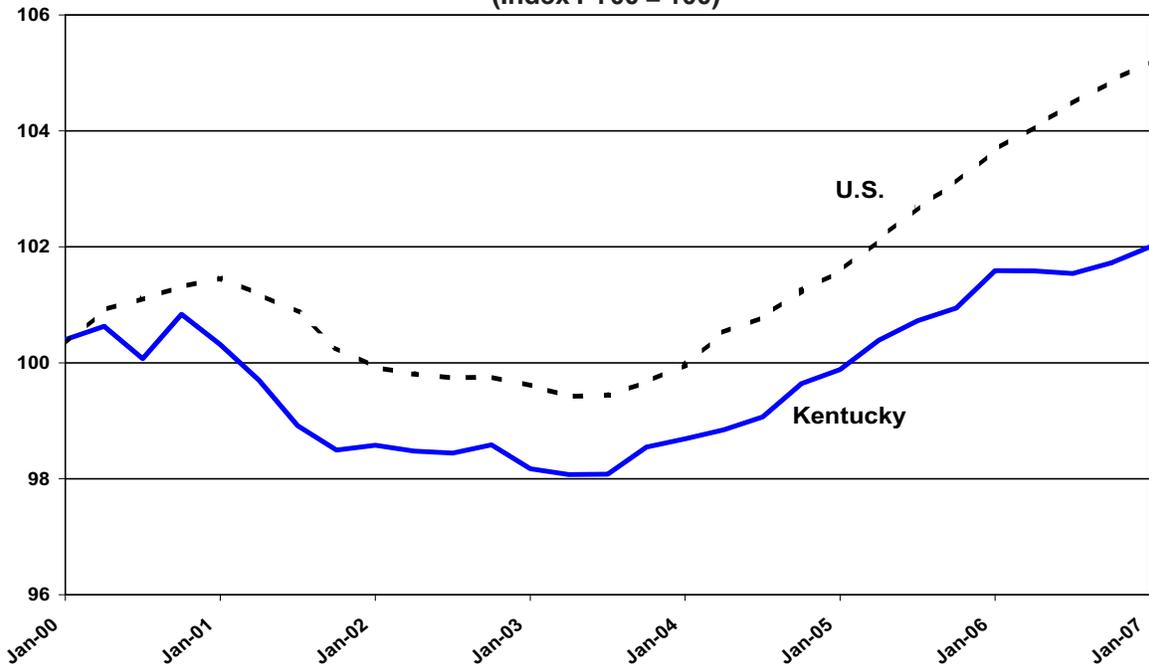


Figure 4
Nonfarm Employment Growth: KY vs. U.S.
(Index FY00 = 100)



Interim Outlook . . .

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 2007 General Assembly. General Fund revenues were \$6.209 billion in the first three quarters of FY07, a growth rate of 3.3 percent from the same period a year ago. General Fund revenues are anticipated to total \$2.385 billion in the fourth quarter of FY07, yielding a growth rate of 0.7 percent. For the entire fiscal year, total General Fund collections are expected to grow 2.6 percent, with total revenues of \$8.594 billion. Compared to the official revenue estimates including changes from the 2007 legislative session, General Fund revenues are projected to be \$15.8 million lower in FY07 as shown in Table 6.

Anticipated revenues for the first two quarters of FY08 are \$4.416 billion, corresponding to a growth rate of 3.7 percent from the previous fiscal year. Growth is expected to be strongest in the individual income tax and property tax.

Total sales and use tax receipts for the first three quarters of FY07 were \$2.101 billion, representing an increase of 2.3 percent from the same period a year ago. The projected rate of growth for the remaining quarter is 4.2 percent. Total sales and use tax receipts for the fiscal year are forecast to be \$2.828 billion, a decrease of \$5.1 million from the official estimate. In the first two quarters of FY08, the sales and use tax will grow by 2.9 percent.

The interim forecast for the individual income tax calls for an increase of 16.9

Table 5
General Fund: Interim Estimate
(millions of dollars)
April 2007

	FY07		FY07		FY07		FY08	
	Quarters 1, 2, & 3		Quarter 4		Full Year		Quarters 1 & 2	
	Actual	% Chg Year Ago	Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Estimate	% Chg Year Ago
Sales & Use	2,101.3	2.3	726.2	4.2	2,827.5	2.8	1,449.2	2.9
Individual Income	2,131.3	1.2	949.9	16.9	3,081.2	5.6	1,698.5	13.4
Corporation Inc. & Lic.	648.7	15.1	315.7	-34.4	964.4	-7.7	386.4	-26.1
Coal Severance	163.0	-0.1	58.8	-4.0	221.8	-1.2	109.4	-1.8
Cigarette Tax	124.7	-8.1	42.2	0.0	166.9	-6.2	80.5	-5.0
Property	449.0	1.0	45.5	-21.2	494.5	-1.6	332.6	13.8
Lottery	138.1	7.9	44.5	-28.3	182.6	-3.9	93.8	5.8
Other	453.2	9.4	202.1	31.9	655.3	15.5	265.7	5.3
GENERAL FUND	6,209.4	3.3	2,384.8	0.7	8,594.2	2.6	4,415.9	3.7

Table 6
FY07 Interim General Fund Revenue Estimate
Compared to Official Estimate
(millions of dollars)

	<u>Interim FY07 Estimate</u>	<u>Adjusted CFG* FY07 Estimate</u>	<u>Difference FY07 Estimate</u>
Sales & Use	2,827.5	2,832.6	-5.1
Individual Income	3,081.2	3,120.1	-38.9
Corporation Inc & Lic	964.4	984.3	-19.9
Coal Severance	221.8	225.5	-3.7
Cigarette	166.9	169.2	-2.3
Property	494.5	487.1	7.4
Lottery	182.6	182.6	0.0
Other	<u>655.3</u>	<u>608.6</u>	<u>46.7</u>
Total General Fund	8,594.2	8,610.0	-15.8

The fiscal impact of the 2007 Legislative session has been included in both the Interim and the CFG data.

percent for the remainder of FY07, amounting to collections of \$949.9 million in the final quarter of the fiscal year. The individual income tax rose by 1.2 percent in the first three quarters of FY07. 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 projected to grow by 5.6 percent. Compared to the official estimate, individual income tax receipts are forecasted to be \$38.9 million lower in FY07. For the first half of FY08, individual income tax receipts are expected to rise by 13.4 percent to \$1.699 billion.

The outlook for the corporation income tax is for a decrease of 34.4 percent in the final three months of FY07, representing collections of \$315.7 million. These anticipated collections will bring the FY07 total to \$964.4 million, including payments from

the recently-abolished corporation license tax. Corporation income and license tax revenues will experience the mirror effect of the shift in reporting requirements for limited-liability pass-through entities. Corporation tax revenues are forecasted to be \$19.9 million lower than the official consensus forecast. Corporate tax receipts are expected to fall 26.1 percent in the first six month of FY08.

Growth in the coal severance tax leveled in the first three quarters of FY07, with receipts only 0.1 percent below the same period a year earlier. Expectations are that growth has peaked in this revenue source, and a gradual decline will begin in the fourth quarter, with a loss of 4.0 percent compared to the fourth quarter of last year. Total FY07 collections will be \$221.8 million, a decrease of \$3.7 million from the official estimate. In the first two quarters of FY08, coal tax receipts will continue to drift downward by 1.8 percent to \$109.4 million.

In the first three quarters of FY07, cigarette tax collections totaled \$124.7 million, registering a decline of 8.1 percent when compared to the same period one year earlier. Revenues in the earlier period were boosted by a one-time floor stocks tax, which accounts for most of the apparent decline. The outlook for the remaining three months of the fiscal year is for \$42.2 million in revenue, with growth flat when compared to the same period of FY06. Overall for the fiscal year, cigarette tax receipts are forecast to fall by 6.2 percent to \$166.9 million, primarily due to loss of floor stocks tax revenue. Cigarette tax receipts are forecast to fall by 5.0 percent in the first half of FY08.

Property tax revenues totaled \$449.0 million in the first three quarters of FY07, representing growth of 1.0 percent from a year earlier. It is expected that in the final quarter of FY07, property tax revenues will fall by 21.2 percent to \$45.5 million. Total property tax receipts for FY07 are estimated to be \$494.5 million, a decrease of 1.6 percent. In the first two quarters of FY08, property tax receipts will rise by 13.8 percent due to timing differences.

Lottery revenues rose 7.9 percent in the first nine months of FY07. In the final quarter, lottery revenues are expected to fall by 28.3 percent to \$44.5 million. For the entire fiscal year, lottery receipts are forecast to be \$182.6 million. Lottery receipts are expected to rise 5.8 percent in the first six months of FY08.

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 FY07, receipts in this category rose 9.4 percent compared

to the prior year. During the last quarter of FY07 this category should experience growth of 31.9 percent, bringing total fiscal year receipts to \$655.3 million. Strong growth in this category is anticipated due to additional abandoned property revenues and higher investment income. Total FY07 receipts are forecast to be \$46.7 million above the official revenue estimate. For the first half of FY08, “other” revenues should grow by 5.3 percent.

ROAD FUND

Road Fund revenues are forecasted to continue to grow by 4.5 percent over the final three months of FY07 and 3.2 percent in the first two quarters of FY08 as shown in Table 7. This forecast is \$2.8 million higher than the official revised consensus revenue estimate as shown in Table 8.

Motor fuels tax receipts grew by 7.5 percent in the first three quarters of FY07 to \$421.5 million. This is principally due to a change in forecasted gasoline prices and its effect on the statutory rate of the motor fuels tax. Growth in this account will continue into the final quarter of the fiscal year with receipts of \$144.3 million, a growth rate of 5.9 percent. Motor fuels tax receipts are expected to exceed the official revenue estimate by \$1.9 million.

Motor vehicle usage tax collections rose by 3.5 percent to \$298.4 million in the first nine months of the fiscal year and are expected to grow by 3.1 percent in the final quarter of FY07. Total FY07 collections are forecasted to be \$408.9 million, \$4.1 million above the official estimate. Growth is expected to be negative for this account in the first half of FY08 due to legislation permitting temporary licenses to be issued

for 60 rather than 30 days, which will delay motor vehicle usage tax payments for the first month of the new fiscal year.

To estimate all other components of the Road Fund, officials of the Kentucky Transportation Cabinet and staff of the Governor's Office for Economic Analysis assessed recent growth patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to increase 2.5 percent in the final quarter of FY07 and rise 4.7 percent in the first half of FY08. Motor vehicle operators' licenses are

projected to rise by 22.5 percent in the remainder of the fiscal year, but growth will slow to 2.5 percent in the first six months of FY08. Weight distance tax revenue should expand by 0.9 percent for the remainder of this fiscal year, and rise by 2.5 percent in the first two quarters of FY08. Investment income should grow by 30.3 percent due to higher fund balances for the remainder of FY07, and rise by 15.9 percent in the following two quarters. All other revenues should combine for a decline of 1.1 percent during the last quarter of FY07 due to the loss of toll revenues, but will rise by a sharp 26.5 percent in the first half of FY08.

Table 7
Road Fund: Interim Forecast
(millions of dollars)
April 2007

	FY07		FY07		FY07		FY08	
	Quarters 1, 2 & 3		Quarter 4		Full Year		Quarters 1 & 2	
	Actual	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago
Motor Fuels	421.5	7.5	144.3	5.9	565.8	7.1	307.5	8.4
Motor Vehicle Usage	298.4	3.5	110.5	3.1	408.9	3.4	186.2	-6.4
Motor Vehicle License	60.8	-0.9	33.3	2.5	94.1	0.2	33.1	4.7
Motor Vehicle Oprs	11.9	12.3	4.9	22.5	16.8	15.1	8.2	2.5
Weight Distance	64.4	0.4	21.4	0.9	85.8	0.6	44.4	2.5
Investment	11.0	250.7	4.3	30.3	15.3	139.1	8.0	15.9
Other	<u>22.3</u>	<u>-31.0</u>	<u>8.9</u>	<u>-1.1</u>	<u>31.2</u>	<u>-24.5</u>	<u>19.6</u>	<u>26.5</u>
Road Fund	890.3	4.5	327.6	4.5	1,217.9	4.5	607.0	3.2

Table 8
FY07 Interim Road Fund Revenue Estimate
Compared to Official Estimate
April 2007
(millions of dollars)

	<u>Interim Estimate</u>	<u>Official Estimate</u>	<u>Difference</u>
Motor Fuels	565.8	563.9	1.9
Motor Vehicle Usage	408.9	404.8	4.1
Motor Vehicle License	94.1	94.9	-0.8
Motor Vehicle Operators	16.8	16.2	0.6
Weight Distance	85.8	86.3	-0.5
Investment	15.3	15.3	0.0
Other	<u>31.2</u>	<u>33.7</u>	<u>-2.5</u>
Road Fund	1,217.9	1215.1	2.8

NATIONAL and KENTUCKY ECONOMY

The economic outlook presented here is for the three-quarter period from April to December 2007. In terms of fiscal years this period encompasses the final quarter of FY07 (April to June 2007) and the first half of FY08. The national outlook is based on Global Insight's March 2007 forecast, and the Kentucky outlook is from GOEA's March 2007 forecast. The outlook was prepared prior to the release of third-quarter GDP data by the U.S. Bureau of Economic Analysis on April 27.

NATIONAL ECONOMY

During the final quarter of FY07 the economy is expected to expand by 2.2 percent—the same pace as in the previous quarter. Productivity is expected to increase substantially and lower oil prices are forecasted to bring inflation under control. These positive factors, however, are not enough to counter the continued dismal outlook for the housing market and its effect on investment activity. Nonfarm

employment is expected to be up 1.3 percent during the final quarter of FY07.

In the first half of FY08 real GDP growth is expected to improve slightly in response to improvements in productivity. Real GDP is expected to increase by 2.5 percent compared to 3.0 percent for the same period a year ago. Employment in non-farm industries is forecasted to rise by 1.1 percent during the first half of FY08 compared to 1.4 percent a year ago.

The consumption component of GDP has typically been the major factor in sustaining growth. During the last quarter of FY07 real consumption expenditures are projected to increase by 3.1 percent, about the same amount as a year ago. Durable goods consumption is expected to be up 4.4 percent primarily from the demand for furniture and related items. Though the slump in the housing market has dampened the furniture market, spending on furniture is forecasted to grow by a robust 8.3 percent in the fourth quarter of FY07. Overall consumption growth during the first half of FY08 is expected to be 3.0 percent compared to 3.2 percent in the first half of FY07.

There has been a noticeable decline in investment activity due to the overbuilt housing market. The outlook is for continuation of that trend. During the fourth quarter of FY07 investment is expected to further decline by 5.2 percent followed by a decline of 2.3 percent in the first half of FY08.

Table 9
Economic Outlook: Fourth Quarter of FY07

	FY06 Q4	FY07 Q4	Percent Change
United States			
Real GDP (billion 2000 \$)	11,388.1	11,640.0	2.2
Personal Income (billion \$)	10,807.3	11,407.2	5.6
Consumer Price Index (percent)	5.0	2.4	-
Industrial Production (percent)	6.5	1.4	-
Nonfarm Employment (millions)	135.9	137.7	1.3
Manufacturing Employment (millions)	14.2	14.1	-1.1
Unemployment Rate (percent)	4.6	4.8	-
Kentucky			
Personal Income (mil\$)	122,993	128,671	0.7
Wage & Salary Income (mil\$)	67,560	69,984	3.6
Nonfarm Employment ('000)	1,844.5	1,857.8	0.7
Goods producing ('000)	368.1	366.6	-0.4
Service Providing ('000)	1,160.0	1,170.6	0.9
Government ('000)	316.4	320.6	1.3

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA.
Data for FY07 are March 2007 estimates.

The weak dollar is expected to cause a surge in exports and at the same time restrict imports. The trade-weighted exchange rate is forecasted to drop by 4.4 percent in the fourth quarter and then by a further 4.5 percent during the first half of FY08. U.S. exports are forecasted to show gains of 8.1 percent in last quarter of FY07, and continue with 7.8 percent growth in the first half of FY08. The corresponding import numbers are 3.0 percent and 3.6 percent.

The unemployment rate is expected to average 4.8 percent in the fourth quarter and then increase slightly to 4.9 percent during the first half of FY08.

STATE ECONOMY

Kentucky's economy should strengthen in the upcoming three quarters, but will expand at a slower rate than the national average. In the final quarter of FY07 personal income is expected to increase by 4.6 percent compared to a 5.6 percent increase nationally. During the first half of FY08 personal income is forecasted to be up

a more robust 5.4 percent and the national average is forecasted to be just slightly higher with an increase of 5.6 percent. The lower growth in Kentucky is primarily from the concentration of employment in relatively slow-growing manufacturing sectors.

The job market showed steady recovery in FY06 and then slowed down substantially in much of FY07. During the first three quarters of FY07 total nonfarm employment in Kentucky was up by 0.7 percent, less than half the growth rate of 1.6 percent that occurred a year earlier. The forecast assumes that the combination of factors that caused the sluggish employment growth will begin to turn in Kentucky's favor beginning in the fourth quarter of FY07. Specifically, the major layoffs in the transportation equipment sector have already taken place and gasoline prices have peaked for the near-term. Nonfarm employment growth is forecasted to increase by 0.7 percent in the final quarter of the year, followed by a more substantial increase of 1.2 percent in the first half of FY08.

Employment in goods-producing industries has declined dramatically during the last few years in Kentucky due to both productivity gains and the layoffs in the transportation equipment sector. However, the lower dollar and increased consumer demand are expected to result in gains in the next three quarters. During the fourth quarter of FY07 employment in the goods-producing sector is expected to decline by 0.4 percent in contrast to the 1.3 percent decline in the previous quarter. Then, during the first half of FY08, as manufacturing recovers, employment in the

Table 10
Economic Outlook: First Half of FY08

	FY07 Q1 & Q2	FY08 Q1 & Q2	Percent Change
United States			
Real GDP (billion 2000 \$)	11,475.0	11,764.2	2.5
Personal Income (billion \$)	11,003.7	11,624.7	5.6
Consumer Price Index (percent)	0.5	1.7	-
Industrial Production (percent)	1.6	2.3	-
Nonfarm Employment (millions)	136.7	138.2	1.1
Manufacturing Employment (millions)	14.2	14.0	-1.5
Unemployment Rate (percent)	4.6	4.9	-
Kentucky			
Personal Income (mil\$)	124,681	131,413	5.4
Wage & Salary Income (mil\$)	67,994	71,421	5.0
Nonfarm Employment ('000)	1,845.3	1,866.6	1.2
Goods producing ('000)	366.2	365.9	-0.1
Service Providing ('000)	1,159.7	1,178.7	1.6
Government ('000)	319.4	321.9	0.8

Sources: Global Insight, Inc. and U.S. Department of Commerce, BEA.
Data for FY07-FY08 are March 2007 estimates.

goods-producing sectors is expected to register a drop of just 0.1 percent.

Service-providing industries are forecasted to do well during the fourth quarter of

FY07 with an addition of 10,600 jobs. The growth rate during the first half of FY08 is expected to be a robust 1.6 percent.

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	Third Quarter FY 2007	Third Quarter FY 2006	%	Year-To-Date FY 2007	Year-To-Date FY 2006	%
			Change			Change
TOTAL GENERAL FUND	\$1,949,990,682	\$1,854,460,967	5.2%	\$6,209,380,301	\$6,008,847,946	3.3%
Tax Receipts	1,879,670,858	1,787,400,335	5.2	5,988,634,400	5,794,874,544	3.3
Sales and Gross Receipts	818,956,621	795,572,112	2.9	2,434,860,908	2,352,181,007	3.5
Beer Consumption	1,391,215	1,424,158	-2.3	4,681,627	4,709,968	-0.6
Beer Wholesale	9,931,890	10,142,141	-2.1	34,043,348	33,315,882	2.2
Cigarette	39,921,122	40,127,818	-0.5	124,648,116	123,628,523	0.8
Cigarette Floor Stock	9,278	(23,948)	---	9,746	12,096,847	-99.9
Distilled Spirits Case Sales	25,100	24,008	4.5	73,908	70,704	4.5
Distilled Spirits Consumption	2,516,172	2,449,734	2.7	7,530,450	7,421,468	1.5
Distilled Spirits Wholesale	6,355,260	6,058,379	4.9	18,718,863	17,419,250	7.5
Insurance Premium	46,866,408	45,069,518	4.0	85,997,432	83,878,368	2.5
Pari-Mutuel	531,972	551,774	-3.6	2,752,608	2,842,135	-3.2
Race Track Admission	6,154	3,575	72.1	190,362	185,739	2.5
Sales and Use	692,283,797	684,585,740	1.1	2,101,268,559	2,053,055,512	2.3
Wine Consumption	597,384	574,014	4.1	1,742,652	1,397,058	24.7
Wine Wholesale	2,958,437	2,805,580	5.4	8,459,053	7,833,084	8.0
Telecommunications Tax	13,532,641	0	---	38,429,556	0	---
Other Tobacco Products	2,029,791	1,779,621	14.1	6,314,628	4,326,470	46.0
License and Privilege	132,097,588	143,346,129	-7.8	276,009,602	306,667,568	-10.0
Alc. Bev. License Suspension	195,180	63,300	208.3	452,561	161,950	179.4
Coal Severance	51,635,185	57,810,692	-10.7	163,020,348	163,249,282	-0.1
Corporation License	4,671,059	9,689,749	-51.8	9,367,603	40,819,720	-77.1
Corporation Organization	19,182	36,358	-47.2	73,588	173,569	-57.6
Occupational Licenses	39,966	23,760	68.2	111,528	69,596	60.2
Oil Production	1,389,983	1,473,422	-5.7	4,500,679	4,680,805	-3.8
Race Track License	7,975	4,200	89.9	283,675	265,275	6.9
Bank Franchise Tax	63,327,091	58,216,380	8.8	63,265,997	58,859,204	7.5
Driver License Fees	143,649	139,637	2.9	452,213	436,934	3.5
Minerals Severance	2,357,086	2,653,185	-11.2	11,128,461	11,373,901	-2.2
Natural Gas Severance	8,311,231	13,235,446	-37.2	23,352,950	26,577,333	-12.1
Income	754,099,184	707,239,601	6.6	2,770,652,557	2,628,796,282	5.4
Corporation	120,894,206	115,827,798	4.4	639,351,879	522,918,089	22.3
Individual	633,204,977	591,411,802	7.1	2,131,300,677	2,105,878,193	1.2
Property	156,863,215	119,855,326	30.9	449,039,295	444,809,938	1.0
Bank Deposits	503,861	496,163	1.6	504,423	503,204	0.2
Building & Loan Association	37,973	193,176	-80.3	463,526	241,498	91.9
Distilled Spirits	0	3,693	-100.0	506,754	406,835	24.6
General - Intangible	(401)	7,211,602	-100.0	48,841	30,715,268	-99.8
General - Real	70,618,656	63,280,790	11.6	219,626,472	208,386,186	5.4
General - Tangible	57,857,571	43,810,926	32.1	161,929,061	135,188,784	19.8
Omitted & Delinquent	5,246,500	1,904,872	175.4	26,303,380	19,720,600	33.4
Public Service	22,598,716	2,955,391	664.7	39,653,327	49,644,837	-20.1
Other	337	(1,286)	-126.2	3,512	2,727	28.8
Inheritance	8,761,438	12,868,890	-31.9	32,164,555	36,362,503	-11.5
Miscellaneous	8,892,813	8,518,277	4.4	25,907,484	26,057,246	-0.6
Legal Process	6,074,656	6,063,148	0.2	18,559,343	18,785,835	-1.2
T. V. A. In Lieu Payments	2,755,921	2,403,178	14.7	7,281,406	7,044,076	3.4
Other	62,237	51,951	19.8	66,735	227,334	-70.6
Nontax Receipts	67,503,477	66,971,037	0.8	210,336,494	208,848,635	0.7
Departmental Fees	7,784,930	6,452,841	20.6	20,652,317	17,865,161	15.6
PSC Assessment Fee	16,106	1,908	744.2	12,297,512	8,780,069	40.1
Fines & Forfeitures	5,632,048	6,571,658	-14.3	19,578,869	19,612,245	-0.2
Interest on Investments	369,355	327,996	12.6	1,061,209	870,654	21.9
Lottery	49,500,000	51,000,000	-2.9	138,125,113	128,000,000	7.9
Sale of NOx Credits	412,100	990,000	-58.4	611,600	1,126,000	-45.7
Miscellaneous	3,788,938	1,626,635	132.9	18,009,875	32,594,505	-44.7
Redeposit of State Funds	2,816,346	89,595	3043.4	10,409,407	5,124,767	103.1

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	Third Quarter FY 2007	Third Quarter FY 2006	%	Year-To-Date FY 2007	Year-To-Date FY 2006	%
			Change			Change
TOTAL ROAD FUND	\$302,400,941	\$282,974,714	6.9%	\$890,291,860	\$851,961,705	4.5%
<u>Tax Receipts-</u>	<u>293,528,221</u>	<u>274,581,733</u>	<u>6.9</u>	<u>862,628,390</u>	<u>828,942,597</u>	<u>4.1</u>
<u>Sales and Gross Receipts</u>	<u>237,317,216</u>	<u>215,225,763</u>	<u>10.3</u>	<u>719,884,660</u>	<u>680,549,590</u>	<u>5.8</u>
Motor Fuels Taxes	129,031,644	118,307,427	9.1	399,384,686	373,788,811	6.8
Motor Fuels Use & Surtax	8,846,602	7,433,139	19.0	21,883,898	18,039,479	21.3
Truck Trip Permits (fuel)	76,160	98,640	-22.8	229,380	285,920	-19.8
Motor Vehicle Usage	99,362,810	89,386,557	11.2	298,386,696	288,435,380	3.5
<u>License and Privilege</u>	<u>56,211,005</u>	<u>59,355,970</u>	<u>-5.3</u>	<u>142,743,730</u>	<u>148,393,007</u>	<u>-3.8</u>
Motor Vehicles	29,253,304	28,400,056	3.0	60,828,542	61,406,790	-0.9
Motor Vehicle Operators	3,887,768	3,860,645	0.7	11,912,313	10,632,042	12.0
Weight Distance	21,105,642	21,248,030	-0.7	64,389,451	64,131,628	0.4
Truck Decal Fees	72,083	123,339	-41.6	142,134	199,009	-28.6
Other Special Fees	1,892,208	5,723,901	-66.9	5,471,290	12,023,538	-54.5
<u>Nontax Receipts</u>	<u>8,744,903</u>	<u>7,810,249</u>	<u>12.0</u>	<u>27,356,431</u>	<u>21,493,316</u>	<u>27.3</u>
Departmental Fees	3,145,946	4,031,062	-22.0	11,342,189	12,252,431	-7.4
In Lieu of Traffic Fines	300,960	328,092	-8.3	865,358	944,044	-8.3
Highway Tolls	1,029,486	1,505,087	-31.6	3,717,208	4,677,131	-20.5
Investment Income	4,084,476	1,802,870	126.6	11,005,443	3,138,538	250.7
Miscellaneous	184,034	143,138	28.6	426,232	481,172	-11.4
Redeposit of State Funds	127,818	582,732	-78.1	307,039	1,525,792	-79.9