



Office of State Budget Director

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John E. Chilton
State Budget Director

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

August 15, 2017

Mr. Scott Brinkman
Secretary of the Executive Cabinet
Office of the Governor
Frankfort, Kentucky 40601

Mr. David Byerman
Director
Legislative Research Commission
Room 300, State Capitol
Frankfort, Kentucky 40601

Ms. Laurie Dudgeon
Administrative Office of the Courts
1001 Vandalay Drive
Frankfort, Kentucky 40601

Dear Mr. Brinkman, Mr. Byerman and Ms. Dudgeon:

Pursuant to Kentucky Revised Statutes 48.120 (1), on or before August 15th of each odd-numbered year, the Office of State Budget Director (OSBD), in conjunction with the Consensus Forecasting Group (CFG or Group), shall provide to each branch of government a budget planning report. The planning report shall contain:

- ❑ A baseline analysis and projections of economic conditions;
- ❑ Any potential consequences of the analysis for the Commonwealth's fiscal condition;
- ❑ The revenue estimates and implications for the General Fund and Road Fund for the current fiscal year and next four (4) fiscal years; and
- ❑ Projections of personal income, employment, and economic indicators that reflect economic conditions.

The General Fund, Road Fund, and MSA Tobacco Fund estimates were prepared in cooperation with the CFG, and represent an agreement by the Group as to the most likely outcome for revenues in the current fiscal year and the upcoming four years. The CFG consists of individuals knowledgeable about the state and national economies and the revenue and financial conditions of the Commonwealth. Appointed jointly by State Budget Director and the Legislative Research Commission, the members are: Dr. Frank O'Connor (Chair), Dr. Bruce Johnson, Dr. Alan Bartley, Dr. James McCoy, Ms. Janet Harrah, Mr. David Sinclair, and Dr. Christopher Bollinger. Major assistance was provided by the Office of State Budget Director: Gregory Harkenrider, Gene Zaparanick-Brown, Thomas Jones, Michael Jones, and Ghada ElDabbagh.

The CFG met on August 11, 2017, to discuss forecasts for the National economy, Kentucky economy, and state revenues. The documents that accompany this certification include both the approved General Fund and Road Fund revenue estimates in detail, as well as supporting documentation from OSBD.

In the development of the projections for the underlying economic forecast, OSBD staff presented the CFG three options to consider. First was the control economy, or estimates based on the June 2017 control scenario of IHS Markit Economics (formally known as Global Insight). Control estimates represent the most likely outcome according IHS and were given a 60% probability of outcome by IHS. Excerpts from the control forecast are outlined below.

IHS Markit continues to assume that a modest pro growth agenda is likely to be implemented by the end of 2017, although we have scaled back our assumption about corporate tax cuts. We now expect that the statutory rate will be reduced to only 25% (compared with the assumed 20 percent a month ago) and that fewer loopholes will be closed. If the current political turmoil were to escalate into a full-blown crisis, then the chances of any tax stimulus or infrastructure reforms being implemented would diminish considerably.

Meanwhile, there is ample evidence that the US economy is still chugging along at a 2.0–2.5% growth rate. In particular, while the most recent estimates show that real GDP growth in the first quarter was an anemic 1.2%, growth in final sales to domestic purchasers (GDP less inventories and exports—a much better gauge than GDP of the underlying growth rate of the US economy) was 2.1%. IHS Markit predicts that real GDP growth will be 2.3% this year and then accelerate to 2.7% in 2018—but only if fiscal stimulus is enacted.

Second was the pessimistic economy, or estimates based on the June 2017 pessimistic scenario of IHS Markit Economics. Pessimistic estimates were given a 25 percent probability of outcome according IHS. Excerpts from the pessimistic forecast are outlined below.

In the pessimistic scenario, the US economy suffers from a crisis of confidence, managing only feeble growth during the second half of 2018, as consumers and businesses react to an uncertain fiscal and monetary policy environment with guarded and more risk-averse behavior. Lack of progress in Washington calls into question all the promises and expectations of the new administration, bruising consumer and business confidence, and sending the stock market into negative

territory. In this scenario, the political and fiscal policy turmoil in Washington escalates. Congress and the president make no progress on any major policy initiatives this year. There is no tax or healthcare reform, and no fiscal stimulus. Even more routine action, including the omnibus budget bill and increase in the debt limit, is contentious and accomplished only at the last minute, provoking anxiety and a wait-and-see attitude. Uncertainty regarding future tax and healthcare policies causes business confidence to deteriorate, impacting capital spending and hiring plans. Consumers feel the pinch as well. With fewer job prospects and weaker wage gains, they pull back on spending.

Discouraged by the economic situation and disagreements between Congress and the administration, the stock market tumbles, losing more than 17% from its current high to its fourth quarter 2018 trough. Real consumer spending manages only 2.2% growth during 2018, versus 3.2% in the baseline, and housing starts in 2018 and 2019 are well below the baseline. Meanwhile, the commercial real estate sector deflates.

Third was the optimistic economy, or estimates based on the June 2017, optimistic scenario of IHS Markit Economics. Optimistic estimates were given a 10 percent probability of outcome according IHS. No excerpts from the optimistic forecast are included because the CFG did not base any of the revenue projections from the optimistic scenario.

All three scenarios from IHS Markit were used as inputs in the OSBD's MAK model, an analytical model that takes US trends in employment and income as predetermined variables in order to estimate Kentucky-specific forecasts for employment and personal income. Of highest importance is the Kentucky wages and salary forecast, which has a direct impact on the Kentucky individual income tax projections and the sales tax estimates.

After a lengthy and productive discussion, the CFG adopted the pessimistic forecast as the most likely outcome for the US and Kentucky economies for purposes of the General Fund revenue models. The OSBD staff prepared all three scenarios for consideration by the CFG, so the General Fund revenue numbers were reviewed, debated, and the pessimistic consensus was reached on the General Fund.

With regard to the Road Fund, CFG members debated between the control and pessimistic forecasts. Ultimately, consensus was reached around the control forecast, as the Road Fund is less connected to the economic and political assumptions made by IHS.

The estimates provided below were adopted by the CFG. It is important to note that, per statute, these estimates do not constitute a revision to the official revenue estimates on which the FY 2018 budget was predicated. Planning estimates extend out to FY22 in order to give agencies of government a basis for long-term decisions.

	General Fund	Road Fund	Tobacco MSA
FY18	\$10,668,200,000	\$1,504,800,000	\$109,300,000
FY19	\$10,952,900,000	\$1,513,000,000	\$119,500,000
FY20	\$11,267,900,000	\$1,516,900,000	\$118,100,000
FY21	\$11,551,300,000	\$1,507,900,000	\$116,800,000
FY22	\$11,844,200,000	\$1,519,400,000	\$115,500,000

Potential consequences of the analysis for the Commonwealth's fiscal condition are mixed. For the General Fund, adopting the pessimistic revenue projections translates into an anticipated FY18 revenue shortfall of \$206.2 million vis-à-vis the revenue enacted in the budget. As to the Road Fund, adopting the control revenue projections translates into an anticipated FY18 revenue surplus of \$26.6 million vis-à-vis relative to the official budgeted revenues. Finally, regarding the MSA Tobacco Fund, the preliminary revenue estimate for FY18 of \$109.3 million is \$16.5 million above the official estimate of \$92.8 million.

- Attachment 1: Letter from the CFG
- Attachment 2: General Fund estimates in detail
- Attachment 3: Road Fund estimates in detail
- Attachment 4: Pessimistic Forecast – employment, income, and key economic indicators
- Attachment 5: Control Forecast – employment, income, and key economic indicators

Please feel free to contact my office if you have any questions regarding the material included in this packet.

Sincerely,



John E. Chilton
State Budget Director

- Copy with attachments to:
- Senator Robert Stivers, Senate President
 - Representative Jeff Hoover, Speaker of the House
 - Senator Chris McDaniel, Chair A&R Committee
 - Representative Steven Rudy, Chair A&R Committee

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August 14, 2017

John E. Chilton
State Budget Director
Office of the State Budget Director
Room 284, Capitol Annex
Frankfort, Kentucky 40601

Dear Mr. Chilton:

Pursuant to KRS 48.120, this memo contains the budget planning revenue estimates for the General Fund, Road Fund, and Master Settlement Agreement (MSA) for the FY 2018 – FY 2022 period. The planning estimates were developed by the Consensus Forecasting Group (CFG) in conjunction with the Office of the State Budget Director in accordance with KRS 48.120(1) and were adopted at the CFG meeting held on August 11, 2017.

The budget planning revenue estimates for the current fiscal year (FY 2018) and the next four fiscal years (2019 – 2022) are listed below.

Fiscal Year	General Fund	Road Fund	MSA
FY 2018	\$10,668,200,000	\$1,504,800,000	\$109,300,000
FY 2019	\$10,952,900,000	\$1,513,000,000	\$119,500,000
FY 2020	\$11,267,900,000	\$1,516,900,000	\$118,100,000
FY 2021	\$11,551,300,000	\$1,507,900,000	\$116,800,000
FY 2022	\$11,844,200,000	\$1,519,400,000	\$115,500,000

By October 15, 2017, the Consensus Forecasting Group, in accordance with their statutory responsibilities, will adopt the preliminary revenue estimates for the current fiscal year and the upcoming biennium. On or before the fifteenth legislative day of the upcoming 2018 Regular Session of the General Assembly, the Consensus Forecasting Group will adopt the final detailed revenue estimates for the General Fund, the Road Fund, and the MSA for the current and next two fiscal years.

Inherent in any forecast is the risk that actual receipts may differ from their forecasted values. The Kentucky economic and revenue forecasts adopted by the CFG are directly linked to the national forecast provided by Global Insight and represent an agreement as to the most likely outcome for revenues for the current fiscal year and the next two bienniums, given the information available on August 11, 2017.

Sincerely,

A handwritten signature in black ink, appearing to read "Frank O'Connor". The signature is written in a cursive, somewhat stylized font.

Frank O'Connor
Chairman, Consensus Forecasting Group
Professor of Economics
Eastern Kentucky University

General Fund
GOEA Pessimistic Forecast FY18 - FY22
(Millions of Dollars)
August 2017

Pessimistic Scenario	FY17	FY18		FY19		FY20		FY21		FY22	
	Actual	Estimate	%Chg								
Individual Income	4,393.9	4,554.7	3.7	4,672.9	2.6	4,796.8	2.7	4,956.3	3.3	5,123.8	3.4
Sales and Use	3,485.2	3,507.8	0.6	3,601.5	2.7	3,691.7	2.5	3,783.4	2.5	3,884.7	2.7
Property	602.1	600.8	-0.2	612.6	2.0	625.9	2.2	637.1	1.8	650.4	2.1
Corporation Income	497.5	559.8	12.5	610.9	9.1	675.7	10.6	689.1	2.0	696.6	1.1
LLET	245.6	186.6	-24.0	203.6	9.1	225.2	10.6	229.7	2.0	232.2	1.1
Coal Severance	100.5	101.0	0.5	87.0	-13.8	72.9	-16.2	61.0	-16.4	49.6	-18.7
Cigarette	221.4	219.2	-1.0	218.0	-0.5	216.5	-0.7	214.8	-0.8	213.0	-0.8
Lottery	241.6	243.0	0.6	249.0	2.5	256.0	2.8	262.0	2.3	268.0	2.3
Other	690.1	695.4	0.8	697.4	0.3	707.1	1.4	717.9	1.5	725.9	1.1
Total General Fund	10,477.8	10,668.2	1.8	10,952.9	2.7	11,267.9	2.9	11,551.3	2.5	11,844.2	2.5

CFG Official Estimate	FY17	FY18	
	Estimate	Estimate	%Chg
Individual Income	4,411.1	4,588.6	4.6
Sales and Use	3,539.8	3,638.4	4.7
Property	585.2	598.7	1.7
Corporation Income	579.4	553.1	1.6
LLET	223.7	221.6	-1.8
Coal Severance	120.7	107.6	-22.4
Cigarette	222.5	220.5	-2.5
Lottery	236.0	241.0	4.7
Other	698.0	704.9	3.1
Total General Fund	10,616.4	10,874.4	2.4

Difference	FY17	FY18
Individual Income	(17.2)	(33.9)
Sales and Use	(54.6)	(130.6)
Property	16.9	2.1
Corporation Income	(81.9)	6.7
LLET	21.9	(35.0)
Coal Severance	(20.2)	(6.6)
Cigarette	(1.1)	(1.3)
Lottery	5.6	2.0
Other	(7.9)	(9.5)
Total General Fund	(138.5)	(206.2)

Road Fund
GOEA Control Forecast FY18 - FY22
(Millions of Dollars)
August 2017

<u>Control Forecast</u>	FY17		FY18		FY19		FY20		FY21		FY22	
	Actual	%Chg	Estimate	%Chg	Estimate	%Chg	Estimate	%Chg	Estimate	%Chg	Estimate	%Chg
Motor Fuels	760.5	1.4	758.3	-0.3	763.8	0.7	763.1	-0.1	755.6	-1.0	768.5	1.7
Motor Vehicle Usage	499.8	3.2	495.5	-0.9	494.5	-0.2	495.8	0.3	491.0	-1.0	486.5	-0.9
Motor Vehicle License	111.9	-1.0	113.5	1.4	115.4	1.7	117.2	1.6	119.1	1.6	120.9	1.5
Motor Vehicle Operators	16.1	-1.3	16.4	1.7	16.6	1.2	16.7	0.6	16.8	0.6	16.9	0.6
Weight Distance	82.9	1.9	84.1	1.5	85.9	2.1	87.2	1.5	88.4	1.4	89.4	1.1
Investment	1.6	-35.9	1.5	-5.1	1.5	0.0	1.5	0.0	1.5	0.0	1.5	0.0
Other	35.1	0.7	35.5	1.1	35.3	-0.6	35.4	0.3	35.5	0.3	35.7	0.6
Total Road Fund	1,508.0	1.7	1,504.8	-0.2	1,513.0	0.5	1,516.9	0.3	1,507.9	-0.6	1,519.4	0.8

Official Forecast

Motor Fuels	747.3	749.8
Motor Vehicle Usage	469.5	485.7
Motor Vehicle License	105.0	105.6
Motor Vehicle Operators	16.1	16.3
Weight Distance	82.1	83.8
Investment	1.4	1.5
Other	35.5	35.5
Total Road Fund	1,456.9	1,478.2

Difference

Motor Fuels	13.2	8.5
Motor Vehicle Usage	30.3	9.8
Motor Vehicle License	6.9	7.9
Motor Vehicle Operators	0.0	0.1
Weight Distance	0.8	0.3
Investment	0.2	-
Other	(0.4)	-
Total Road Fund	51.1	26.6

Selected U.S. and Kentucky Economic Indicators
Global Insight: Pessimistic Scenario
 June 2015

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
OUTPUT							
US Real GDP (Bil 2000\$)	16,513	16,847	17,192	17,402	17,783	18,235	18,620
	1.7%	2.0%	2.0%	1.2%	2.2%	2.5%	2.1%
Industrial Production Index, Total	-1.8%	0.4%	2.7%	1.2%	2.3%	2.4%	1.5%
Industrial Production Index, Durables	1.3%	0.6%	1.8%	0.9%	1.8%	1.7%	1.4%
INCOME							
KY Personal Income (Mil\$)	173,079	178,955	186,624	193,090	200,939	210,190	219,287
	3.6%	3.4%	4.3%	3.5%	4.1%	4.6%	4.3%
KY Wage & Salary Income (Mil\$)	87,009	90,908	94,438	97,054	100,220	104,421	108,976
	4.7%	4.5%	3.9%	2.8%	3.3%	4.2%	4.4%
KY Supplements to W&S (Mil\$)	22,224	23,089	24,168	25,194	26,166	27,047	28,024
	3.5%	3.9%	4.7%	4.2%	3.9%	3.4%	3.6%
KY Proprietors' Income (Mil\$)	11,211	11,393	11,944	12,220	12,571	12,924	13,257
	3.1%	1.6%	4.8%	2.3%	2.9%	2.8%	2.6%
KY Dividend, Interest, & Rent (Mil\$)	26,422	27,038	28,160	28,816	30,068	31,967	33,158
	1.7%	2.3%	4.1%	2.3%	4.3%	6.3%	3.7%
KY Transfer Payments (Mil\$)	42,486	43,475	45,460	47,958	50,767	53,576	56,510
	2.9%	2.3%	4.6%	5.5%	5.9%	5.5%	5.5%
KY Social Insurance (Mil\$)	14,186	14,761	15,344	15,915	16,582	17,440	18,298
	3.5%	4.1%	3.9%	3.7%	4.2%	5.2%	4.9%
US Personal Income (Bil\$)	15,729	16,270	16,937	17,581	18,384	19,355	20,259
	3.8%	3.4%	4.1%	3.8%	4.6%	5.3%	4.7%

Selected U.S. and Kentucky Economic Indicators
Global Insight: Pessimistic Scenario
 June 2015

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
EMPLOYMENT							
KY Nonfarm Employment (Thous)	1,901.2 1.6%	1,929.3 1.5%	1,941.6 0.6%	1,944.1 0.1%	1,953.2 0.5%	1,968.6 0.8%	1,981.7 0.7%
US Nonfarm Employment (Mil)	143.1 1.9%	145.4 1.6%	146.9 1.0%	147.2 0.3%	148.2 0.6%	149.8 1.1%	151.4 1.0%
KY Manufacturing Employment (Thou)	245.0 2.8%	251.5 2.6%	253.5 0.8%	255.0 0.6%	258.5 1.4%	262.7 1.7%	265.1 0.9%
US Manufacturing Employment (Mil)	12.4 0.6%	12.4 0.1%	12.4 0.5%	12.5 0.5%	12.6 1.2%	12.8 1.4%	12.9 0.9%
OTHER KEY MEASURES							
Consumer Sentiment Index (Michigan)	91.5	94.4	96.6	88.3	92.0	91.8	88.2
Rate of Inflation (%)	0.7%	1.9%	1.9%	1.9%	2.4%	2.7%	2.6%
US Retail Sales (%)	2.6%	3.9%	3.4%	3.3%	4.8%	4.9%	4.3%
US Corporate Profits(%)	-8.9%	11.5%	5.5%	9.9%	10.4%	1.2%	-0.3%
Three-month Treasury Bills (%)	631.0%	214.3%	103.5%	-22.1%	33.4%	76.1%	15.5%
Oil Price, West Texas (\$/barrel)	40.29	46.52	47.82	50.53	60.15	69.43	75.81

MAK: Macromodel of Kentucky
 Governor's Office for Economic Analysis
 Office of State Budget Director

Selected U.S. and Kentucky Economic Indicators
Global Insight: Control Scenario
 June 2017

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
OUTPUT							
US Real GDP (Bil 2000\$)	16,513	16,847	17,279	17,703	18,075	18,489	18,899
	1.7%	2.0%	2.6%	2.5%	2.1%	2.3%	2.2%
Industrial Production Index, Total	-1.8%	0.4%	3.2%	2.5%	2.0%	1.8%	1.6%
Industrial Production Index, Durables	1.3%	0.6%	2.3%	2.0%	1.8%	1.6%	1.5%
INCOME							
KY Personal Income (Mil\$)	173,079	178,928	186,914	195,471	204,690	214,055	223,637
	3.6%	3.4%	4.5%	4.6%	4.7%	4.6%	4.5%
KY Wage & Salary Income (Mil\$)	87,009	90,903	94,735	98,653	102,655	106,904	111,430
	4.7%	4.5%	4.2%	4.1%	4.1%	4.1%	4.2%
KY Supplements to W&S (Mil\$)	22,224	23,100	24,155	25,116	26,234	27,352	28,436
	3.5%	3.9%	4.6%	4.0%	4.5%	4.3%	4.0%
KY Proprietors' Income (Mil\$)	11,211	11,364	11,934	12,417	12,746	13,066	13,470
	3.1%	1.4%	5.0%	4.0%	2.6%	2.5%	3.1%
KY Dividend, Interest, & Rent (Mil\$)	26,422	27,050	28,271	29,745	31,553	33,204	34,605
	1.7%	2.4%	4.5%	5.2%	6.1%	5.2%	4.2%
KY Transfer Payments (Mil\$)	42,486	43,462	45,413	47,929	50,713	53,608	56,668
	2.9%	2.3%	4.5%	5.5%	5.8%	5.7%	5.7%
KY Social Insurance (Mil\$)	14,186	14,764	15,393	16,154	16,941	17,774	18,632
	3.5%	4.1%	4.3%	4.9%	4.9%	4.9%	4.8%
US Personal Income (Bil\$)	15,729	16,270	16,981	17,845	18,776	19,725	20,688
	3.8%	3.4%	4.4%	5.1%	5.2%	5.1%	4.9%

Selected U.S. and Kentucky Economic Indicators
Global Insight: Control Scenario
 June 2017

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
EMPLOYMENT							
KY Nonfarm Employment (Thous)	1,901.2 1.6%	1,929.3 1.5%	1,945.3 0.8%	1,961.6 0.8%	1,975.7 0.7%	1,988.0 0.6%	1,999.3 0.6%
US Nonfarm Employment (Mil)	143.1 1.9%	145.4 1.6%	147.2 1.2%	148.9 1.1%	150.4 1.0%	151.7 0.9%	153.0 0.9%
KY Manufacturing Employment (Thou)	245.0 2.8%	251.5 2.6%	254.2 1.1%	258.5 1.7%	262.7 1.6%	265.2 0.9%	266.2 0.4%
US Manufacturing Employment (Mil)	12.4 0.6%	12.4 0.1%	12.4 0.7%	12.6 1.5%	12.8 1.5%	12.9 0.6%	12.9 0.3%
OTHER KEY MEASURES							
Consumer Sentiment Index (Michigan)	91.5	94.4	98.8	100.0	97.8	97.1	96.6
Rate of Inflation (%)	0.7%	1.9%	1.9%	2.0%	2.6%	2.8%	2.6%
US Retail Sales (%)	2.6%	3.9%	4.0%	4.8%	5.0%	4.9%	4.5%
US Corporate Profits(%)	-8.9%	11.5%	9.1%	9.5%	1.2%	3.0%	3.2%
Three-month Treasury Bills (%)	631.0%	214.3%	131.2%	61.6%	34.7%	2.0%	0.0%
Oil Price, West Texas (\$/barrel)	41.74	49.16	51.97	55.14	67.29	77.78	83.23

MAK: Macromodel of Kentucky
 Governor's Office for Economic Analysis
 Office of State Budget Director