COMMONWEALTH OF KENTUCKY

Quarterly Economic & Revenue Report

First Quarter
Fiscal Year 2014

Governor's Office for Economic Analysis

Office of State Budget Director

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Steven L. Beshear
Governor

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Governor's Office for Policy and Management
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October 31, 2013

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

Dear Governor Beshear:

The attached Quarterly Economic and Revenue Report summarizes the revenue and economic statistics for the first quarter of Fiscal Year 2014 (FY14). It also includes an interim economic and revenue forecast for the next three quarters of FY14.

General Fund receipts for the first quarter of FY14 totaled $2,274.4 million, an increase of 3.3 percent compared to the same period in FY13. Road Fund revenues totaled $397.7 million, an increase of 10.9 percent from the first quarter of FY13.

The interim General Fund forecast for the final three quarters of FY14 calls for an increase of 2.2 percent compared to the same period one year ago, resulting in receipts of $9,578.9 million for FY14, $55.0 million greater than the enacted estimate of $9,523.9 million.

The Road Fund, interim forecast for the final three quarters of FY14 is $1,183.6 million and calls for an increase of 4.5 percent over FY13. The interim estimate for the entire FY14 is $1,581.3 million, $13.1 million greater than the enacted estimate. Motor fuels tax receipts are forecasted to grow 6.6 percent in the final three quarters of FY14. This increase is due primarily to a rise in the forecasted average wholesale gasoline prices and its effect on the statutory rate of the motor fuels tax. Motor vehicle usage tax collections are expected to increase only 1.9 percent in the final nine months of FY14 after growing 13.7 percent in the first quarter.

Overall, the outlook for the next three quarters is positive, but with expectations for slow growth. We will continue to monitor the economic and fiscal conditions of the Commonwealth and will keep you apprised of any developments.

Sincerely,

Jane C. Driskell

Jane C. Driskell
State Budget Director

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Executive Summary

In accordance with KRS 48.400(2), the Office of State Budget Director (OSBD) has prepared a *Quarterly Economic and Revenue Report* for the first quarter of FY14. This report includes a current synopsis of the economic and fiscal conditions of the Commonwealth, as well as an outlook for the next three fiscal quarters.

The first-quarter edition of the *Quarterly Report* during odd-numbered years always coincides with the "preliminary revenue estimates" that are required by KRS 48.115 and KRS 48.120. To satisfy this requirement, OSBD works in conjunction with the Consensus Forecasting Group (CFG) to prepare current year and biennial revenue projections for the General Fund and Road Fund. Since the CFG met on October 2nd to discuss the state and national economies, and again on October 11th to reach a consensus on state revenues, this edition will be presenting estimates done with the CFG rather than our normal practice of presenting internal estimates.

This report is based on the Global Insight national outlook for September 2013 as well as the output from the Kentucky Macroeconomic Model (MAK) using the September national inputs. In the period of time since the release of the data used in this report, the federal government incurred a shut-down lasting approximately two weeks. While the shut-down resulted in a temporary disruption in the economy, no long-run impacts are embedded in the forecast.

Major points that will be discussed in this report include the following:

- The General Fund posted growth of 3.3 percent in the first quarter of FY14, marking the 14th consecutive quarter of positive growth since five successive quarters of decline beginning in the third quarter of FY09. Growth in the General Fund was propelled by a strong performance from both the corporation income and individual income taxes. Another highlight of the first quarter was a rebound in the sales and use tax, which grew 2.3 percent.

- The Road Fund also registered a sizable first quarter increase of 10.9 percent. Road Fund receipts have now recorded 15 consecutive quarters of growth since a collection of seven quarters of falling revenues beginning in the fourth quarter of FY08 and ending in the second quarter of FY10. Strong growth in the first quarter of FY14 was propelled by surges in both the motor fuels and motor vehicle usage accounts — the two largest Road Fund revenue sources which accounted for 87 percent of total first-quarter receipts.

- Kentucky General Fund revenues are projected to exceed the official enacted estimate of $9,523.9 million by $55.0 million in FY14. The Kentucky Road Fund is also expected to marginally exceed the FY14 enacted estimate of $1,568.2 million by a modest $13.1 million. Both funds benefited from improvements in the projections due to the strength of first-quarter performance.

- Kentucky non-farm employment rose by 1.3 percent in the first quarter. Post-recession employment growth continues to be sluggish, similar to the employment growth pattern from the 2001 recession. Leisure and hospitality services employment had the highest percentage growth in the first quarter, gaining 3.6 percent. Mining employment lost the most in percentage terms, losing 4.6 percent or 900 jobs.

- Kentucky personal income rose by 2.3 percent in the first quarter of FY14, below the national rate of growth and below a rate of growth expected at this stage of an economic recovery. Wage and salary growth in Kentucky has been especially weak. Over the past four quarters average growth has been 2.4 percent. By comparison, in FY11, average growth was 4.6 percent.

- Employment gains in the Commonwealth should slightly lag the national average, with growth in the non-farm sector of 1.5 percent for the remainder of the fiscal year. However, growth in the goods producing sector is expected to be greater than overall employment, with growth forecasted to be 1.6 percent in the remaining three quarters of FY14. Kentucky personal income growth is expected to be 3.2 percent, slightly lagging the national the average of 3.5 percent. The continued slow growth in personal income and wages and salaries will continue to influence the rate of revenue collection for the General Fund.

- Real gross domestic product (real GDP) increased by 1.4 percent in the first quarter of FY14 – the fourth consecutive quarter where real GDP growth has been below 2.0 percent. By comparison, real GDP growth below 3.0 percent is generally considered "low" for the period following a recession. Real consumption, which was also weak in the first quarter, grew by 1.9 percent. For real consumption, this was also the third consecutive quarter with growth below 2.0 percent. In the 27 quarters between the 2001 and 2007 recessions, real consumption growth averaged 3.0 percent. During the 15 quarters following the 2007 recession, real consumption growth has averaged 2.2 percent. Consumption has clearly been weaker during this recovery period than in previous recovery periods.

- The national economic outlook remains filled with more questions than answers. In periods of great uncertainty, consumers and businesses exercise additional caution before making decisions that will affect the future. Until the fog of uncertainty is lifted, growth rates will remain muted. Real private investment and real consumption anchored the modest FY14 growth.

Revenue Receipts

GENERAL FUND

General Fund receipts in the first quarter of FY14 totaled $2,274.4 million compared to $2,201.0 million in the first quarter of FY13, for an increase of 3.3 percent or $73.4 million. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these major accounts and a more disaggregated display is available in the Appendix. Receipts in the first quarter of FY14 reflect positive growth in General Fund and Road Fund revenue, much in line with the official revenue projections.

Table 1
Summary General Fund Receipts
First Quarter, FY14, $ millions

	FY14	FY13	Diff ($)	Diff (%)
Individual Income	931.3	901.9	29.4	3.3
Sales and Use	778.1	760.7	17.4	2.3
Property	55.8	65.7	-9.9	-15.1
Corporation Income	150.7	112.9	37.8	33.4
LLET	48.6	47.3	1.3	2.8
Cigarette Taxes	59.3	60.6	-1.3	-2.1
Lottery	48.5	48.5	0.0	0.0
Coal Severance	51.3	64.9	-13.6	-20.9
Other	150.7	138.4	12.3	8.9
Total	**2,274.4**	**2,201.0**	**73.4**	**3.3**

Individual income tax receipts increased 3.3 percent in the first quarter of FY14. Receipts of $931.3 million were $29.4 million more than was collected in the first quarter of the previous fiscal year. The rate of growth has subsided in each of the last three quarters since posting an 8.1 percent surge in the second quarter of FY13.

The sales and use tax collections were up 2.3 percent in the first quarter of FY14. Receipts of $778.1 million compare to the $760.7 million collected in the first quarter of FY13. The quarterly increase in sales and use tax collections is an encouraging sign considering that receipts have declined in three of the last five quarters.

Property tax collections were down 15.1 percent in the first quarter of FY14 due to timing of collections in the tangible and public service company accounts. Collections of $55.8 million compare unfavorably to $65.7 million received in the first quarter of the prior fiscal year.

Corporation income tax receipts posted an increase of 33.4 percent, or $37.8 million, during the first quarter of FY14. Receipts totaled $150.7 million compared to the $112.9 million received a year earlier. September is a declaration payment month for calendar-year filers. Both declarations and net returns posted significant growth during the quarter presumably due to continued expectations of sustained corporate profitability.

The limited liability entity tax (LLET) registered a $1.3 million increase in tax collections in the first quarter of FY14 when compared to FY13. Total collections in the current fiscal year totaled and compare to revenues of $47.3 million in the same period a year earlier.

The coal severance tax receipts decreased 20.9 percent, a continuation of the trend discussed in the previous quarterly report. Receipts of $51.3 million compare to $64.9 million collected in the first quarter of FY13.

Cigarette taxes fell 2.1 percent in the first quarter with receipts of $59.3 million compare to $60.6 million in the first quarter of FY13.

Lottery receipts with revenues of $48.5 million was identical to receipts from the first quarter of FY13.

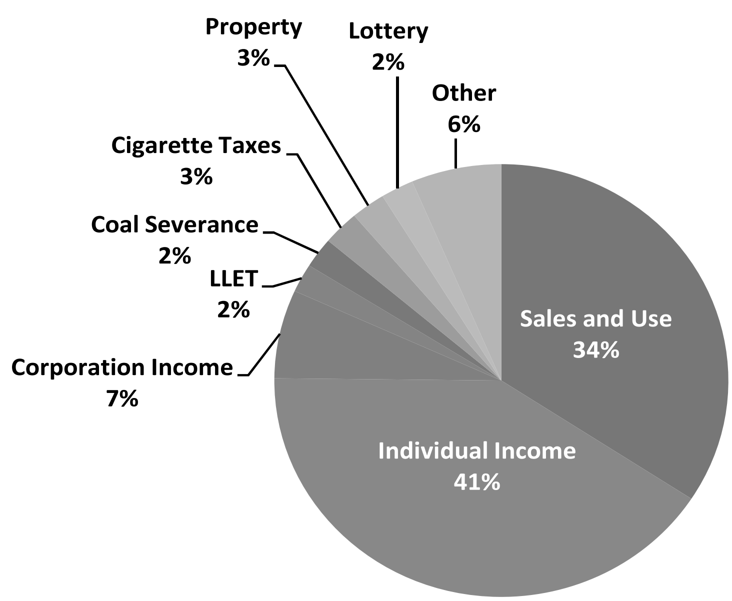
The "Other" category represents the remaining accounts in the General Fund, and collections in this account increased 8.9 percent with receipts of $150.7 million.

Figure 1 details the composition of first-quarter General Fund receipts by tax type. Seventy-five percent of General Fund revenues were collected in the individual income and sales and use accounts. The next largest source of revenue was corporation income receipts at seven percent. The "Other" account made up six percent. The major accounts in the "Other" category include insurance premiums tax, bank franchise tax, telecommunications tax, beer wholesale tax and the inheritance tax.

ROAD FUND

Road Fund revenue surged 10.9 percent in the first quarter of FY14 as the three largest Road Fund accounts posted solid growth. Road Fund receipts totaled $397.7 million

Figure 1
General Fund Receipts Composition
First Quarter, FY14



compared to the $358.7 million received in the first quarter of FY13. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels tax receipts increased 11.2 percent during the first quarter of FY14. Receipts were $230.4 million and compare favorably to $207.1 million collected during the first quarter of FY13.

Motor vehicle usage tax receipts increased 13.7 percent, or $13.9 million, during the first quarter. Receipts were $115.6 million compared to $101.7 million collected during the same period last year.

Motor vehicle license tax receipts increased 5.7 percent during the first quarter of FY14. Receipts of $18.5 million compare to $17.5 million received during the first quarter of FY13.

Motor vehicle operators' license fees totaled $4.2 million, a 1.6 percent decrease compared to the level observed a year ago.

Weight distance tax receipts of $19.2 million increased 1.5 percent compared to receipts of $19.0 million collected during the first quarter of last year. The weight distance tax has some significance as a leading indicator of economic activity, as it is a rough proxy for goods in transit over Kentucky highways.

Investment income receipts of $0.8 million compared to $1.3 million in the first quarter of FY13.

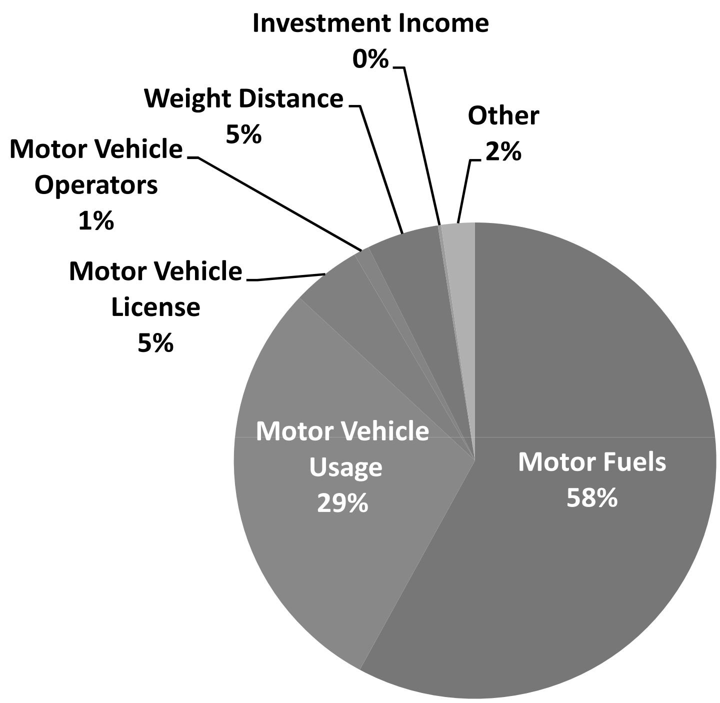
The remainder of the accounts in the Road Fund combined for an increase of 15.0 percent. Receipts for the "Other" category totaled $9.0 million during the first quarter, compared to $7.8 million in the first quarter of FY13.

Figure 2 details the composition of Road Fund revenues by tax type in the first quarter of FY14. Motor fuels taxes and the motor vehicle usage tax accounted for 87 percent of Road Fund revenues in the first quarter. The next-largest sources of revenue were motor vehicle license and weight distance taxes, each with five percent.

Table 2
Summary Road Fund Receipts
First Quarter, FY14, $ millions

	FY14	FY13	Diff ($)	Diff (%)
Motor Fuels	230.4	207.1	23.3	11.2
Motor Vehicle Usage	115.6	101.7	13.9	13.7
Motor Vehicle License	18.5	17.5	1.0	5.7
Motor Vehicle Operators	4.2	4.3	-0.1	-1.6
Weight Distance	19.2	19.0	0.3	1.5
Income on Investments	0.8	1.3	-0.5	-40.9
Other	9.0	7.8	1.2	15.0
Total	**397.7**	**358.7**	**39.0**	**10.9**

Figure 2
Road Fund Receipts Composition
First Quarter, FY14



The Economy
First Quarter FY14

NATIONAL ECONOMY

Real gross domestic product (real GDP) in the first quarter of FY14 increased by 1.4 percent over the first quarter of FY13. Real GDP is the sum of all final goods and services sold within a country's physical boundaries in a given year and explicitly excludes those goods and services which are produced by US citizens in other countries. This is the fourth consecutive quarter where real GDP growth is under 2.0 percent. Since the end of the recession, real GDP growth has been below two percent seven times and above two percent eight times. Only three times was quarterly growth above 3.0 percent. The highest post-recession growth rate was 3.3 percent which occurred in the third quarter of FY12. Growth in the first quarter of FY14 was the second lowest growth since the recession ended. Historically, these are low growth rates for the period following a recession trough.

Real consumption, which was also weak in the first quarter, made up the majority of the first quarter real GDP gains. See Table 3. Consumption is the largest component of real GDP and makes up 68.2 percent of real GDP. Real consumption grew by 1.9 percent in the first quarter of FY14. For real consumption, this was the third consecutive quarter with growth below 2.0 percent. In the 27 quarters between the 2001 and 2007 recessions, real consumption growth averaged 3.0 percent.

Table 3
Summary of US Economic Series
First Quarter FY14 & FY13

	First Quarter			
	FY14	FY13	$ Chg	% Chg
Real GDP	15,753.2	15,534.0	219.2	1.4
Real Consumption	10,736.9	10,541.0	195.9	1.9
Real Investment	2,553.9	2,456.5	97.4	4.0
Real Govt. Expenditures	2,892.0	2,988.8	-96.8	-3.2
Real Exports	2,019.5	1,961.6	57.9	3.0
Real Imports	2,431.7	2,398.0	33.7	1.4
Personal Income ($ billions)	14,174.6	13,701.6	473.0	3.5
Wages and Salaries ($ billions)	7,121.4	6,904.7	216.7	3.1
Inflation (% chg CPI)	1.6	1.7	NA	NA
Industrial Production Index (% chg)	2.0	3.3	NA	NA
Civilian Labor Force (millions)	156.1	154.9	1.2	0.7
Total Non-farm Employment (millions)	136.2	133.9	2.3	1.7
Manufacturing Employment (millions)	12.0	11.9	0.0	0.4
Unemployment Rate (%)	7.5	8.0	NA	-7.1

Not Seasonally Adjusted. Real series are annual rate, billions of chained 2000 dollars.
Components do not sum to GDP because they are annualized independently.
Data for FY14 Q1 are September 2013 estimates.
Source: IHS Global Insight Inc., September 17, 2013 data release

During the 15 quarters following the 2007 recession, real consumption growth has averaged 1.8 percent. Consumption has clearly been weaker during this recovery period than in previous recovery periods.

Real investment grew by 4.0 percent in the first quarter. Real investment grew the fastest among the five real GDP components. Real investment makes up 16.2 percent of real GDP. The investment-to-real GDP share has been rising since the first quarter of FY10, but is still down significantly from its peak of 19.2 percent which occurred in the fourth quarter of FY00. During the 2007 recession, investment was the hardest hit in both absolute and percentage terms among the GDP components. From peak to trough, real investment fell by 34.9 percent, a loss of $969.1 billion. Four years later, real investment still has not returned to its previous peak. Real investment has grown by a net $749.2 billion since the trough, a recovery of only 77.3 percent of the total recession losses. By comparison, it took only 10 quarters for real investment to surpass its prior peak following the 2001 recession.

Real government expenditures fell by 3.2 percent in the first quarter. Real GDP currently makes up 18.4 percent of real GDP. It is common following recessions for government expenditures to decline, as stimulus spending and transfer payments recess. Real government expenditures peaked in the first quarter of FY10, when real government expenditures made up 21.6 percent of real GDP. Since then, real government expenditures have declined by a net $221.0 billion. Real GDP has declined in 12 of the last 16 quarters following the peak in real government expenditures.

US personal income rose by 3.5 percent in the first quarter of FY14. While this is not historically 'high', it is a solid growth rate and an improvement over the last two quarters. US wages and salaries, which makes up 50.2 percent of personal income, rose by 3.1 percent in the first quarter. Wages and salaries income growth has also struggled some in the last three quarters. By comparison, wages and salary growth was 5.1 percent at this point following the 2001 recession.

KENTUCKY ECONOMY

Kentucky personal income rose by 2.3 percent in the first quarter. Since the recession ended, Kentucky personal income returned to its previous peak in just six quarters. Non-wages and salary income fell in the third quarter of FY13, causing a drag on annual personal income growth for the last three quarters. Over the past four quarters average personal income growth has been 2.4 percent. By comparison, in FY11, average growth was 4.6 percent.

Kentucky non-farm employment rose by 1.3 percent in the first quarter. Kentucky non-farm employment has grown at a modest pace over the last three years. Since the first quarter of FY11, non-farm employment grew a net 4.5 percent, or an increase of 79,100 seasonally-adjusted jobs. This FY14 first quarter performance is due to some solid gains in three different services employment sectors. See Table 4. Trade, transportation and utilities employment rose by a net 10,800 jobs, which was the largest mover in absolute terms. Leisure and hospitality employment rose by 6,300 jobs, a 3.6 percent increase. That was the largest increase in percentage terms. Business services employment rose by 5,600 jobs. Five sectors lost jobs in the first quarter: mining, manufacturing, information services, other services and government employment.

Table 4
Summary of Kentucky Economic Series
First Quarter FY14 & FY13

	First Quarter			
	FY14	**FY13**	**$ Chg**	**% Chg**
Personal Income ($ millions)	156,819.8	153,306.0	3,513.8	2.3
Wages and Salary ($ millions)	78,864.5	77,173.0	1,691.5	2.2
Non-farm Employment (thousands)	1,850.6	1,827.3	23.3	1.3
Goods-producing	314.6	311.5	3.1	1.0
Construction	67.9	67.0	0.9	1.4
Mining	18.9	19.8	-0.9	-4.6
Manufacturing	226.1	227.2	-1.2	-0.5
Service-providing	1,202.2	1,177.0	25.2	2.1
Trade, Transportation & Utilities	380.9	370.0	10.8	2.9
Information	25.8	26.5	-0.7	-2.8
Finance	89.3	86.7	2.6	3.0
Business Services	197.8	192.2	5.6	2.9
Educational Services	260.2	257.8	2.3	0.9
Leisure and Hospitality Services	180.6	174.3	6.3	3.6
Other Services	67.7	69.4	-1.7	-2.4
Government	335.5	336.3	-0.8	-0.2

Not Seasonally Adjusted. Data for FY14 Q1 are September 2013 estimates.
Source: IHS Global Insight Inc., September 17, 2013 data release

Interim Outlook

GENERAL FUND

KRS 48.115 and KRS 48.120 requires the OSBD and the CFG to prepare preliminary revenue estimates on or before October 15th of each odd-numbered year. Since the timing of these estimates coincides with the KRS 48.400 (2) requirement to produce quarterly internal estimates, this report will use the estimates done in conjunction with the CFG at the October 11th meeting since the control estimates were adopted. These revenue forecasts are presented in Table 5 and Table 6. Both the General Fund and the Road Fund were estimated using the September 2013 "control scenario" economic forecast from both IHS Global Insight and the Kentucky macroeconomic model. The FY14 estimates presented here highlight the final three fiscal quarters of the year.

Underlying economic conditions have softened somewhat for the near-term forecast, as illustrated in the Economic Outlook section of this report. The cloud of uncertainty has not changed appreciably since the previous biennial estimates were officially adopted by the CFG in December 2011. This, coupled with small forecasting variances in FY12 and FY13, provides confidence that we remain on a revenue path consistent with the enacted revenue estimates.

Projected General Fund revenues for the next three quarters are shown in Table 5. As the table indicates, General Fund growth is projected to be 2.5 percent in FY14. Growth in the first quarter of FY14 was 3.3 percent and projected growth for the remaining three quarters of FY14 is projected to be 2.2 percent. In nominal terms, the preliminary

Table 5
General Fund Interim Forecast
$ millions

	FY14						FY14	
	Q1		Q2, Q3, & Q4		Full Year		Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Individual Income	931.3	3.3	2,891.6	2.5	3,822.9	2.7	3,691.0	131.9
Sales and Use	778.1	2.3	2,307.5	2.1	3,085.6	2.1	3,173.4	-87.8
Property	55.8	-15.1	521.3	5.8	577.1	3.4	547.9	29.2
Corporation Income	150.7	33.4	318.6	10.7	469.3	17.1	367.1	102.2
LLET	48.6	2.8	197.1	-0.9	245.7	-0.2	227.3	18.4
Cigarette Taxes	59.3	-2.1	174.0	-2.3	233.3	-2.3	249.9	-16.6
Lottery	48.5	0.0	175.5	5.2	224.0	4.1	218.0	6.0
Coal Severance	51.3	-20.9	153.2	-7.5	204.5	-11.3	353.4	-148.9
Other	150.7	8.9	565.8	-1.7	716.5	0.4	695.9	20.6
General Fund	**2,274.4**	**3.3**	**7,304.5**	**2.2**	**9,578.9**	**2.5**	**9,523.9**	**55.0**

estimate for FY14 $9,578.9 million – which compares favorably to the enacted estimate of $9,523.9 million (a positive difference of $55.0 million comparing the current estimate to official).

Individual income tax receipts are expected to increase by 2.5 percent during the final three quarters of FY14. The largest component of individual income tax receipts is withholding, which makes up approximately 95 percent of total individual income tax receipts. Withholding is closely tied to wages and salaries and employment in the state. Recent gains in employment and wages have been modest, hence the muted growth projected for the individual income tax in the near term.

Growth in sales and use tax collections is expected to pick up slightly following a decline of 1.0 percent in FY13. Sales and use receipts are closely tied to personal income and disposable income. Sales and use receipts grew 5.4 in FY12, a rate of growth that proved unsustainable. Since that rate of growth in the sales tax exceeded growth in incomes, our models correctly predicted some one-time spending trends that usually follow recessionary periods from pent-up demand. Positive growth gave way to a full-on retreat in FY13. Fiscal Year 2014 has started off with a welcomed 2.3 percent growth rate in the first quarter – marking only the second time in the previous five quarters where sales tax receipts posted year-over-prior-year quarterly growth. The estimates call for sustained growth of 2.1 percent for the remainder of the year for a sales tax receipt total of $3,085.6 million in FY14.

Property tax revenues are expected to increase by 5.8 percent over the forecasting horizon. The state rate on real property remained at 12.2 cents per $100 in valuation for property assessed as of January 1, 2013. Due to the effects of the recession on the housing market, the state millage rate on real property has remained at 12.2 cents since the valuation year 2008, an unprecedented occurrence of five consecutive years without a rate decline. As the housing market shores up, growth in new property and existing values can be expected to resume more normal trends, but housing values have been rigid given the most recent recession that was triggered by excessive valuations. For FY14, property tax receipts are expected to total $577.1 million which is an increase of 3.4 percent growth over FY13 receipts.

The corporation income tax and the LLET were designed to be complementary. The LLET is a backstop for the corporation income tax. That is, when corporate profits and tax receipts fall, LLET collections rise and vice versa. That pattern broke down in FY13 as both taxes increased sharply. In FY13, corporation income tax collections grew 7.0 percent while LLET receipts grew at a more rapid 22.6 percent pace. For the forecasting horizon, both taxes should continue to post solid growth. The corporation income tax is expected to grow 10.7 percent, based on sustained profitability, and the LLET tax is projected to be virtually flat for the remainder of FY14. The FY13 LLET receipts contained additional receipts due to Tax Amnesty efforts. These additional receipts should continue into the future, but will not result in additional growth.

LLET receipts grew 2.8 percent in the first quarter of FY14. Growth for the corporation income tax is expected to moderate to 10.7 percent in FY14 following sizable growth of 33.4 percent in the first fiscal quarter of the year.

Cigarette tax receipts declined 6.3 percent in FY13 but the accelerated downward trend is expected to stabilize over the forecast horizon. The outlook for cigarette tax receipts is for a modest 2.3 percent decline in the final three quarters of FY14. A downward trend in smoking rates is still expected, but the $1.00 per pack increase in the tax rate for Illinois is expected to have a small positive revenue impact for cigarette purchases in Kentucky.

Lottery receipts are determined by the Lottery Corporation's dividend schedule. The estimate for FY14 is $224.0 million. Lottery receipts over the final three quarters of FY14 are expected to produce growth over the prior year, primarily due to a board-approved expansion in products authorized for sale by the Kentucky Lottery Corporation.

Coal severance receipts fell short of the official estimate in FY13 and are expected to decline further in FY14. Energy markets and coal markets in particular, have become quite volatile in the wake of technological advances in natural gas and oil extraction. Increased use of natural gas, slowing global demand, and unseasonable weather all combined to depress coal demand and coal prices.

The "Other" category contains dozens of smaller accounts, which make up the remainder of the General Fund. Insurance premiums tax, bank franchise and telecommunications tax are the three largest accounts in the "Other" category. The "Other" category of taxes is expected to fall 1.7 percent during the forecasting horizon compared to FY13. The "Other" accounts totaled $713.8 million in FY13. The "Other" accounts are estimated to be $716.5 million for FY14. Tax Amnesty in FY13 resulted in higher than usual receipts for the "Other" category. No amnesty receipts are expected in FY14, which sets a high bar for growth in FY14.

ROAD FUND

Road Fund revenues are forecasted to increase 4.5 percent over the remaining three quarters of FY14 as shown in Table 6. Motor fuels, the largest Road Fund account, is expected to account for the majority of the increase in revenue. Motor vehicle usage, motor vehicle operators, weight distance, investment and "Other" are forecast to increase and will help offset a decline in motor vehicle license collections.

Motor fuels tax receipts are forecasted to grow 6.6 percent in the final three quarters of FY14. This increase is due primarily to a rise in the forecasted average wholesale gasoline prices and its effect on the statutory rate of the motor fuels tax. A higher average wholesale price of gasoline will raise the variable portion of the motor fuels tax rate, generating increased tax revenues. Taxable gallons are expected to increase over FY13 levels bolstering the revenue gains from the higher tax rate.

Motor vehicle usage tax collections are expected to increase only 1.9 percent in the final nine months of FY14 after growing 13.7 percent in the first quarter. The higher than normal growth in the first quarter is partly the result of a timing issue which will depress collections over the final nine months of the fiscal year.

To estimate the growth of 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 to formulate the projections. Motor vehicle license taxes are forecasted to decrease 2.7 percent in the final three quarters of FY14. Motor vehicle operators' licenses are projected to rise 1.0 percent in the remainder of the fiscal year. Weight distance tax revenue should grow 0.5 percent for the remainder of the fiscal year. Investment income should increase $3.2 million over FY13. All other revenues should combine for growth of 3.6 percent during the last nine months of FY14.

Table 6
Road Fund Interim Forecast
($ millions)

	FY14						FY14	
	Q1		Q2, Q3, & Q4		Full Year		Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Motor Fuels	230.4	11.2	673.0	6.6	903.4	7.8	850.4	53.0
Motor Vehicle Usage	115.6	13.7	331.2	1.9	446.8	4.7	410.8	36.0
Motor Vehicle License	18.5	5.7	82.5	-2.7	101.0	-1.2	99.3	1.7
Motor Vehicle Operators	4.2	-1.6	11.9	1.0	16.1	0.3	15.9	0.2
Weight Distance	19.2	1.5	56.3	0.5	75.5	0.8	86.0	-10.5
Income on Investments	0.8	-40.9	2.0	NA	2.8	NA	2.3	0.5
Other	9.0	15.0	26.7	3.6	35.7	6.2	103.4	-67.7
Road Fund	**397.7**	**10.9**	**1,183.6**	**4.5**	**1,581.3**	**6.0**	**1,568.2**	**13.1**

NATIONAL ECONOMY

As we reach the conclusion of the first quarter of FY14, we find ourselves again balancing a small improvement in the economy's fundamentals with the continuing policy uncertainty from Washington, DC. Exactly a year ago, we sought to identify the impact of the "fiscal cliff", the colloquial name for the automated spending reductions and budgetary sequestrations that were set to go into effect if policy makers could not find common ground. Now, we look towards the second quarter of FY14, and must identify the potential impacts of a federal government shut-down.

While the federal government employees, businesses, and citizens directly impacted by a federal shut-down will bear the direct impact and burden of a shut-down, the analysis of the impact to the economy must be tempered with a careful consideration of the overall, potential magnitude of the political stalemate. Since 1976, there have been 17 federal government shut-downs, averaging a median time of one week. It has been widely estimated that each week of a shut-down results in a loss of 0.1 to 0.2 percentage points of quarterly GDP growth.

A shut-down of the federal government will lead to slower economic growth, as the furloughs, closures, and contracting activities result in some declines in economic activity. However, the majority of the impact will be recovered by the end of the quarter. The political rancor will be unlikely to cause long-term harm to the continued slow expansion path of the national economy, but the fiscal and regulatory uncertainty only adds to consumer and business hesitation to make firm future economic plans.

This uncertainty has been most evident in the labor markets. Monthly job creation through August has averaged just 180,250 — below the pace set in 2012 and well under the steady 200,000 a month that would signal an economy fully recovering from a recession. The larger concern is masked by the continual decline in the unemployment rate. The largest component of the decline in the unemployment rate comes from a smaller percentage of the working-age population participating in the labor market. The labor participation rate, a measure of the population working or actively seeking work, declined to 63.2 percent in August. This is the lowest rate in the past 35 years. One potential reason for the decline in participation may be the type of jobs being created in our current economy.

The jobs that are being created are largely in the service sector, including healthcare, food service, and retail. These positions tend to be associated with low wages and part-time employment and have a reduced impact on the incentives for the unemployed to join the workforce through a lower replacement wage.

One of the strongest sectors of late in the national economy has been housing. The pace of housing gains, however, will ebb to a more sustainable rate as we continue into FY14. In August, the pace of existing home sales crept higher, to an annualized rate of 5.48 million, from 5.39 million in July. For 2013 as a whole, existing-home sales should total nearly five million, a healthy 7.5 percent increase from 2012. Higher mortgage rates have contributed to the slowing rates of growth, including a decrease in the pace of permit requests for new construction. In many areas of the country, there are not enough prepared lots to allow for the continued rapid expansion of new home construction, further constraining builder's ability to meet the market demand. Overall, these are all temporary issues, and the low levels of inventory have been supporting an increase in home prices.

International trade has also been a driver of recent growth and will continue to be for the remainder of FY14, with a forecasted increase of 4.5 percent in real exports for the remainder of the fiscal year. Along with the United States, other advanced economies, including Canada and Australia, have surpassed their pre-recession highs. While the Euro zone and the United Kingdom have resumed overall growth, their economies have not regained their pre-recession levels. Finally, Japan continues to lag the rest of the developed world and has returned to level of GDP last achieved in 2007.

Overall, the outlook for the next three quarters is positive, but slow growth. GDP is expected to grow 2.2 percent over the next three quarters, and consumption is also forecast to grow by 2.2 percent. Government expenditures (all levels, federal, state, and local), will continue to decline. Oil and energy prices will also continue to decline, helping to keep core inflation low. Lastly, the continued weak performance of the job market will most likely prevent the Federal Reserve from changing the current interest rate policies and asset purchasing until the third quarter of FY14.

Table 7
US Economic Outlook
Quarters 2, 3, & 4

	Q2, Q3, & Q4			Full Year	
	FY14	FY13	% Chg	FY14	% Chg
Real GDP	15,944.9	15,601.5	2.2	15,897.0	2.0
Real Consumption	10,874.4	10,639.8	2.2	10,840.0	2.1
Real Investment	2,652.9	2,480.4	7.0	2,628.2	6.2
Real Govt. Expenditures	2,891.0	2,915.6	-0.8	2,891.2	-1.5
Real Exports	2,065.9	1,976.2	4.5	2,054.3	4.1
Real Imports	2,517.4	2,395.0	5.1	2,495.9	4.2
Personal Income ($ billions)	14,511.9	14,019.8	3.5	14,427.6	3.5
Wages and Salaries ($ billions)	7,286.0	7,074.1	3.0	7,244.9	3.0
Inflation (% chg CPI)	1.5	1.7	NA	1.5	NA
Industrial Production Index (% chg)	2.7	2.3	NA	2.6	NA
Civilian Labor Force (millions)	157.1	155.5	1.1	156.9	1.0
Total Non-farm Employment (millions)	137.5	135.1	1.8	137.1	1.7
Manufacturing Employment (millions)	12.1	12.0	1.3	12.1	1.0
Unemployment Rate (%)	7.3	7.7	NA	7.4	NA

Not Seasonally Adjusted. Real series are annual rate, billions of chained 2000 dollars.
Components do not sum to GDP because they are annualized independently.
Data for FY14 Q2 through FY13 Q4 are September 2013 estimates.
Source: IHS Global Insight Inc., September 17, 2013 data release

KENTUCKY ECONOMY

Employment gains in the Commonwealth should slightly lag the national average, with growth in the non-farm sector of 1.5 percent for the remainder of the fiscal year. However, growth in the goods producing sector is expected to be greater than overall employment, with growth forecasted to be 1.6 percent in the remaining three quarters of FY14. The strongest sector of employment growth in the goods producing sectors is expected to be in construction with 3.6 percent growth. Employment in government—including federal, state, and local—is expected to continue to slow as government at all levels adjust to continued budgetary constraints. Overall, the sector is expected to decline by 0.2 percent for the remainder of FY14.

As shown in Table 8, Kentucky personal income growth is expected to be 3.2 percent, slightly lagging the national average of 3.5 percent. The continued slow growth in personal income and wages and salaries will continue to influence the rate of revenue collection for the General Fund. Specifically, the sales and use tax accounts for approximately one-third of the Commonwealth's revenues. The forecast is for very moderate growth in the collection of sales and use taxes, with 2.1 percent growth expected for the remainder of the fiscal year. The combination of slow income growth and a sales tax base that is reflecting an ever smaller por-

Table 8
Kentucky Economic Outlook
Quarters 2, 3, & 4

	Q2, Q3, & Q4			Full Year	
	FY14	FY13	% Chg	FY14	% Chg
Personal Income ($ millions)	160,175.0	155,149.5	3.2	159,336.2	3.0
Wages and Salary ($ millions)	80,410.4	77,965.6	3.1	80,023.9	2.9
Non-farm Employment (thousands)	1,863.0	1,836.4	1.5	1,859.9	1.4
Goods-producing	318.1	313.1	1.6	317.2	1.4
Construction	69.0	66.6	3.6	68.8	3.0
Mining	19.1	18.7	2.3	19.0	0.5
Manufacturing	228.1	227.4	0.3	227.6	0.1
Service-providing	1,210.8	1,186.9	2.0	1,208.6	2.0
Trade, Transportation & Utilities	383.8	375.2	2.3	383.0	2.4
Information	26.1	25.4	2.9	26.0	1.5
Finance	89.5	88.4	1.2	89.4	1.6
Business Services	200.8	193.6	3.7	200.1	3.5
Educational Services	261.5	258.2	1.3	261.2	1.2
Leisure and Hospitality Services	182.1	178.2	2.2	181.7	2.5
Other Services	67.0	67.9	-1.4	67.2	-1.6
Government	336.1	336.8	-0.2	336.0	-0.2

Not Seasonally Adjusted.
Source: IHS Global Insight, Inc. and the Kentucky Governor's Office for Economic Analysis MAK model, September 2013.

tion of the average household budget implies that the growth in expected revenues will remain constrained.

One recent trend that may help Kentucky consumer spending is the dramatic decrease in gasoline prices that is expected for the next two quarters of the fiscal year. The fall season is traditionally associated with declining gasoline prices. The peak season for driving has passed, refinery capacity is at its peak, and the refineries begin producing winter-grade blends. The winter-grade blends are cheaper to produce than the summer-grade blends which results in lower costs. However, this season has experienced unprecedented declines in the cost of butane. This will have some impact on normal seasonal price declines.

Butane is a byproduct of both oil refining and natural gas production, both of which have increased dramatically in the US in the last few years. Butane can regularly trade for $1 per gallon discount to the price of crude oil or natural gasoline, and the winter-grade gasoline may increase the butane percentage from two percent in the summer to 10 to 12 percent, resulting in both an expansion of the fuel supply and a significant decrease in the cost of production. The decrease in price for butane has allowed for the price of gasoline to fall by approximately seven percent in the recent quarter, and the price of gasoline should continue to decline by another five to seven percent for the next two quarters. For the Commonwealth, relief at the pump may allow consumers and businesses to expand their level of consumption spending.

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	First Quarter FY 2014	First Quarter FY 2013	Percent Change
TOTAL GENERAL FUND	**$2,274,371,371**	**$2,200,997,313**	**3.3%**
Tax Receipts	$2,199,470,101	$2,124,964,740	3.5%
Sales and Gross Receipts	$925,913,669	$906,547,741	2.1%
Beer Consumption	1,645,641	1,729,884	-4.9%
Beer Wholesale	15,629,990	14,184,212	10.2%
Cigarette	59,321,186	60,598,643	-2.1%
Distilled Spirits Case Sales	31,410	33,835	-7.2%
Distilled Spirits Consumption	3,017,521	3,015,552	0.1%
Distilled Spirits Wholesale	8,099,634	7,430,202	9.0%
Insurance Premium	33,549,607	30,626,987	9.5%
Pari-Mutuel	832,213	1,435,748	-42.0%
Race Track Admission	93,393	80,617	15.8%
Sales and Use	778,109,121	760,726,690	2.3%
Wine Consumption	778,066	666,152	16.8%
Wine Wholesale	3,486,011	3,339,811	4.4%
Telecommunications Tax	15,983,293	17,099,416	-6.5%
OTP	5,335,523	5,575,935	-4.3%
Floor Stock Tax	1,061	4,057	-73.8%
License and Privilege	**$114,780,056**	**$119,830,971**	**-4.2%**
Alc. Bev. License Suspension	86,192	73,367	17.5%
Coal Severance	51,328,611	64,922,357	-20.9%
Corporation License	257,638	(494,583)	---
Corporation Organization	8,215	40,248	-79.6%
Occupational Licenses	44,235	14,995	195.0%
Oil Production	3,452,773	2,550,783	35.4%
Race Track License	95,000	95,000	0.0%
Bank Franchise Tax	1,179,658	(1,064,417)	---
Driver License Fees	162,725	170,198	-4.4%
Minerals Severance	4,620,982	3,523,589	31.1%
Natural Gas Severance	4,963,497	2,748,426	80.6%
Limited Liability Entity	48,580,532	47,251,009	2.8%
Income	**$1,081,972,066**	**$1,014,825,371**	**6.6%**
Corporation	150,708,356	112,946,738	33.4%
Individual	931,263,710	901,878,633	3.3%
Property	**$55,813,418**	**$65,736,044**	**-15.1%**
Building & Loan Association	5,753	4,180	37.6%
General - Real	28,606	(292,418)	---
General - Tangible	28,874,841	28,198,052	2.4%
Omitted & Delinquent	7,343,127	18,570,515	-60.5%
Public Service	14,936,142	18,989,651	-21.3%
Other	4,624,949	266,063	1638.3%
Inheritance	**$13,634,679**	**$9,387,227**	**45.2%**
Miscellaneous	**$7,356,213**	**$8,637,387**	**-14.8%**
Legal Process	3,933,671	5,227,526	-24.8%
T. V. A. In Lieu Payments	3,422,542	3,409,861	0.4%
Other	0	0	---
Nontax Receipts	**$74,396,868**	**$75,514,838**	**-1.5%**
Departmental Fees	3,652,228	5,850,096	-37.6%
PSC Assessment Fee	14,249,716	13,073,529	9.0%
Fines & Forfeitures	6,209,984	8,284,846	-25.0%
Income on Investments	(156,001)	1,175,263	---
Lottery	48,500,000	48,500,000	0.0%
Sale of NOx Credits	39,000	6,500	500.0%
Miscellaneous	1,901,942	(1,375,396)	---
Redeposit of State Funds	**$504,401**	**$517,735**	**-2.6%**

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	First Quarter FY 2014	First Quarter FY 2013	Percent Change
TOTAL ROAD FUND	**$397,739,666**	**$358,700,978**	**10.9%**
Tax Receipts-	$391,400,461	$351,939,876	11.2%
Sales and Gross Receipts	**$346,004,008**	**$308,794,972**	**12.0%**
Motor Fuels Taxes	230,409,640	207,144,135	11.2%
Motor Vehicle Usage	115,594,369	101,650,837	13.7%
License and Privilege	**$45,396,453**	**$43,144,904**	**5.2%**
Motor Vehicles	18,512,832	17,513,454	5.7%
Motor Vehicle Operators	4,239,038	4,307,355	-1.6%
Weight Distance	19,238,326	18,961,724	1.5%
Truck Decal Fees	17,110	19,890	-14.0%
Other Special Fees	3,389,146	2,342,481	44.7%
Nontax Receipts	**$4,873,807**	**$5,065,306**	**-3.8%**
Departmental Fees	3,643,175	3,387,559	7.5%
In Lieu of Traffic Fines	142,589	171,580	-16.9%
Income on Investments	786,969	1,331,049	-40.9%
Miscellaneous	301,074	175,119	71.9%
Redeposit of State Funds	**$1,465,398**	**$1,695,795**	**-13.6%**