

COMMONWEALTH OF KENTUCKY

QUARTERLY ECONOMIC & REVENUE REPORT

THIRD QUARTER
FISCAL YEAR 2014



GOVERNOR'S OFFICE FOR
ECONOMIC ANALYSIS

OFFICE OF
STATE BUDGET DIRECTOR





Office of State Budget Director

284 Capitol Annex, 702 Capitol Avenue
Frankfort, Kentucky 40601

Steven L. Beshear
Governor

(502) 564-7300
FAX: (502) 564-6684
Internet: osbd.ky.gov

Jane C. Driskell
State Budget Director

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

April 30, 2014

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

Dear Governor Beshear:

This Quarterly Economic and Revenue Report is a summary of the revenue and economic statistics for the third quarter of Fiscal Year 2014 (FY14) and provides an unofficial interim outlook for the next three fiscal quarters.

General Fund receipts for the third quarter of FY14 totaled \$2,162.9 million, an increase of 2.1 percent or \$44.0 million compared to the same period in FY13. Road Fund revenues totaled \$386.1 million, an increase of 8.2 percent or \$29.2 million over the third quarter of FY13.

The official General Fund estimate for FY14, which was rendered by the Consensus Forecasting Group (CFG) on December 19, 2013, is \$9,548.1 million. KRS 48.120 (3)-(5) stipulates that the appropriations of each branch of government be based on the official CFG estimates as modified by the General Assembly. The 2014 Regular Session modified General Fund receipts by \$4.8 million. As a result, the new official estimate is \$9,552.9 million. The unofficial FY14 interim estimate presented in the attached report is \$9,525.2 million. Growth in the fourth quarter is expected to improve slightly to 3.0 percent. The full year FY14 interim estimate represents growth of 1.9 percent compared to FY13 and is \$27.7 million below the official estimate. The interim outlook for the first half of FY15 calls for receipts of \$4,828.8 million and represents 2.5 percent growth over the same period in FY14.

The official Road Fund estimate for FY14 is \$1,582.6 million. The unofficial FY14 interim estimate presented in the attached report is \$1,571.6 million. Growth in the fourth quarter is expected to fall to zero as both motor fuels and motor vehicle usage taxes experience significant weaknesses. The full year FY14 interim estimate represents growth of 5.4 percent compared to FY13 and is \$11.0 million below the official estimate. The interim outlook for the first half of FY15 calls for receipts of \$768.9 million and represents a decline of 0.9 percent over the same period in FY14.

Governor Beshear
April 30, 2014
Page 2

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

Sincerely,

A handwritten signature in cursive script that reads "Jane C. Driskell". The signature is written in black ink and is positioned to the left of the typed name.

Jane C. Driskell
State Budget Director

TABLE OF CONTENTS

Executive Summary 1

Revenue Receipts - Third Quarter FY14

 General Fund 3

 Road Fund 5

The Economy - Third Quarter FY14

 National Economy 7

 Kentucky Economy 9

Interim Outlook

 General Fund 11

 Road Fund 13

 National Economy 15

 Kentucky Economy 16

Appendix

 Kentucky State Government - GF and RF Revenues 20-21

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 third quarter of FY14. As required by law, 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.

This third edition of the Quarterly Report presents the unofficial estimate for the final quarter of the fiscal year as well as a first look at the opening quarters of the upcoming fiscal year. The Consensus Forecasting Group (CFG) met in December 2013 and rendered official General Fund and Road Fund estimates, which are presented in Tables 5 and 6 of this report.

To fulfill the requirement to provide an update on current economic conditions, two sections of narrative information are included in this report. The first section profiles the most recent history of the US and Kentucky economies. Later, in the outlook section of the report, a three quarter outlook is provided using the control forecast from IHS Global Insight as well as the Kentucky Macroeconomic Model (MAK) which is developed, maintained, and operated by the OSBD.

Some of the highlights of this report are summarized here. For greater detail, please refer to the relevant portions of the report.

- Third quarter General Fund receipts increased \$44.0 million, or 2.1 percent over the third quarter of FY13 (see Table 1). Corporate income and property tax collections saw robust growth, offsetting significant losses in coal severance and limited liability entity taxes (LLET). Sales and use tax collections have increased in every quarter of FY14 and are up 3.1 percent year-to-date.
- The unofficial estimate generated in this report for the FY14 General Fund is \$9,552.9 million, just below the enacted revenue estimate (see Table 5). Growth in General Fund receipts is expected to increase slightly to 3.0 percent in the final quarter of FY14 and improve again in the first half of FY15. Individual income tax and sales and use tax receipts are expected to experience increased growth in the first half of FY15.
- Road Fund tax collections increased \$29.2 million, or 8.2 percent, in the third quarter of FY14 compared to receipts in the same time frame last year (see Table 2). Motor fuels, motor vehicle usage, and motor vehicle license taxes all provided significant growth. Motor vehicle usage tax receipts have increased for 16 of the past 17 quarters.

- Growth in Road Fund revenues is expected to be flat over the last quarter of FY14 and turn slightly negative in the first half of FY15. The unofficial estimate for the FY14 Road Fund is \$11.0 million less than the enacted estimate of \$1,582.6 million.
- The national economy, as measured by real gross domestic product (real GDP), grew at a rate of 2.6 percent in the second quarter of FY14 (see Table 3). Real GDP growth continues to be positive even as real government expenditures continue to decrease. The US saw a net increase of 2.2 million jobs in the third quarter of FY14.
- National and state economic growth was positive despite an unusually cold and long winter. Weather and other factors also contributed to higher gasoline prices, dampening consumer spending and investment. These adverse circumstances are expected to mitigate as the year progresses. The forecast in the housing market has been revised downward somewhat, but real consumption is expected to grow 2.5 percent.
- Kentucky personal income rose 4.0 percent in the third quarter of FY14, continuing its positive trend. Wage and salary growth measured just 1.7 percent as employment growth was positive but somewhat weak. Kentucky personal income growth is forecast to be higher than the US for all three quarters of the forecast horizon. Job growth is forecast to continue its positive trend with the service sector projected to create the greatest number of jobs.

Revenue Receipts

GENERAL FUND

General Fund receipts in the third quarter of FY14 totaled \$2,162.9 million, an increase of 2.1 percent over the previous year's total. Through the first three quarters of the fiscal year, General Fund receipts have increased 1.5 percent. The \$44.0 million increase in the third quarter was vital for keeping receipts on track to meet the official revenue forecast. After growing 3.3 percent in the first quarter, collections declined 0.7 percent in the second quarter.

Individual income tax receipts increased 2.4 percent in the third quarter of FY14. Receipts of \$768.4 million were \$18.3 million more than was collected in the third quarter of the previous fiscal year. A solid increase in withholding collections helped offset declines in declaration payments and net payments with returns.

Total sales and use tax receipts for the quarter were \$761.4 million, compared to \$736.9 million in the third quarter of FY13. The \$24.6 million difference translates to an increase of 3.3 percent. Year-to-date sales and use tax receipts have increased 3.1 percent. The modest increase in sales tax receipts provides a most welcomed sign given annual declines during three of the past five fiscal years. Collections in this account have increased in each of the three quarters of this fiscal year.

Property tax collections increased 10.3 percent in the third quarter of FY14 but have declined 4.2 percent year-to-date. Collections of \$138.3 million compare to \$125.4 million received in the third quarter of the prior fiscal year. The majority of property tax collections are typically received in a four-month period, so even small timing issues can cause significant variations in quarterly totals. The third quarter increase partially offsets declines in the first two quarters and was generally broad-based with only Public Service Commission taxes declining among the major categories.

Corporation income tax receipts grew 15.6 percent, or \$8.2 million, during the third quarter of FY14. Receipts totaled \$61.2 million compared to \$52.9 million received a year earlier. Net payments with returns continued to boost receipts in this account, accounting for all of the quarterly increase. Net returns have increased 63.0 percent year-to-date and offset an 11.9 percent decline in declaration payments.

Table 1
Summary General Fund Receipts
Third Quarter, FY12, \$ millions

	FY14	FY13	Diff (\$)	Diff (%)
Individual Income	768.4	750.1	18.3	2.4
Sales and Use	761.4	736.9	24.6	3.3
Property	138.3	125.4	13.0	10.3
Corporation Income	61.2	52.9	8.2	15.6
Coal Severance	44.8	53.3	-8.5	-16.0
Cigarette Taxes	51.8	53.9	-2.1	-3.8
LLET	36.5	50.0	-13.5	-27.1
Lottery	53.5	53.5	0.0	0.0
Other	247.0	242.9	4.1	1.7
Total	2,162.9	2,118.9	44.0	2.1

LLET receipts have declined sharply in the past two quarters following a small increase in the first quarter of the fiscal year. Some of the decline can be attributed to amnesty collections received during FY13. Third quarter collections declined 27.1 percent and are down 17.5 percent through the first nine months of the fiscal year. Third quarter collections were \$36.5 million compared to \$50.0 million last year.

Coal severance tax receipts continued their prolonged decline in the third quarter as receipts fell 16.0 percent. Receipts of \$44.8 million compare to \$53.3 million collected in the third quarter of FY13. Tax receipts in this account have now fallen for the last eight quarters as severed tons continue to drop and the price of coal remains weak.

Cigarette taxes decreased in the third quarter as receipts of \$51.8 million were

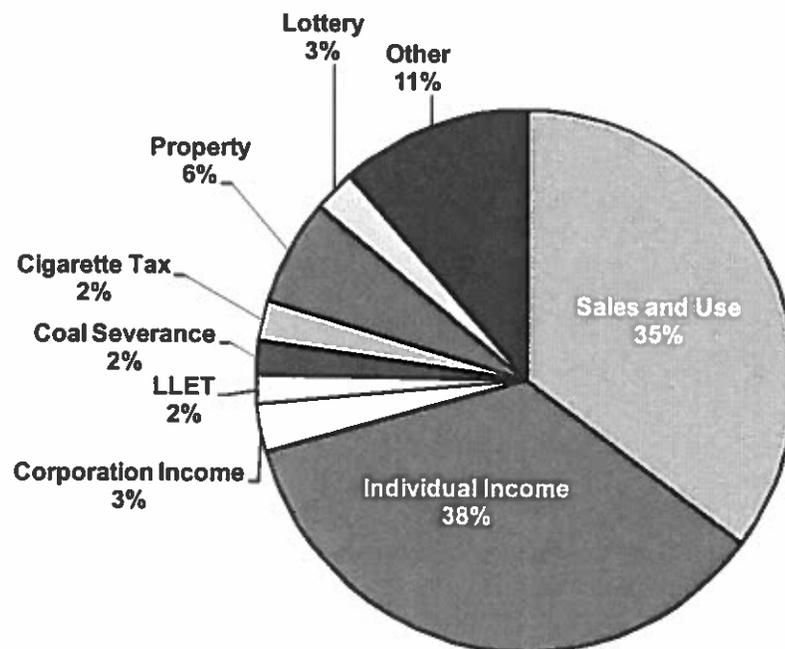
3.8 percent below that collected in the third quarter of FY13. Year-to-date, cigarette tax receipts have fallen 3.7 percent due to a decrease in demand.

Lottery receipts with revenues of \$53.5 million were identical to receipts from the third quarter of FY 13.

The "Other" category represents the remaining accounts in the General Fund, and collections in this account increased 1.7 percent with receipts of \$247.0 million.

Figure 1 details the composition of third quarter General Fund receipts by tax type. Seventy-three percent of General Fund revenues were collected in the areas of the individual income and sales taxes. The next largest source of revenue was the "other" account at 11 percent. The major

**Figure 1
General Fund Receipts Composition
Third Quarter, FY14**



components in this category include insurance premium, bank franchise, telecommunications, beer wholesale and inheritance taxes. Property tax accounted for six percent. Lottery receipts and corporation income accounted for three percent each fund. Finally cigarette taxes, coal severance and LLET taxes accounted for two percent.

ROAD FUND

Road Fund revenues rose 8.2 percent in the third quarter of FY14, the seventeenth consecutive quarterly increase. Receipts totaled \$386.1 million compared to the \$356.9 million received in the third quarter of the last fiscal year. Motor fuels continued to be the driving force for growth in Road Fund collections. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels tax receipts increased 8.4 percent, or \$16.3 million, during the third quarter of FY14. Receipts were \$210.7 million and compare to \$194.4 million collected during the third quarter of FY13. An increase in the motor fuels tax rate, coupled with a small increase in consumption, lead to the growth in collections.

	FY14	FY13	Diff (\$)	Diff (%)
Motor Fuels	210.7	194.4	16.3	8.4
Motor Vehicle Usage	108.8	103.3	5.5	5.4
Motor Vehicle License	33.5	28.7	4.8	16.7
Motor Vehicle Operators	4.0	3.8	0.2	5.9
Weight Distance	19.0	18.5	0.5	2.9
Income on Investments	1.3	0.9	0.4	41.8
Other	8.8	7.4	1.5	19.9
Total	386.1	356.9	29.2	8.2

Motor vehicle usage tax receipts increased 5.4 percent, or \$5.5 million, during the third quarter. Receipts were \$108.8 million compared to \$103.3 million collected during the same period last year. Collections in this account have now increased for six consecutive quarters and 16 of the past 17 quarters.

Motor vehicle license tax receipts were up 16.7 percent during the third quarter of FY14. Receipts of \$33.5 million compare to \$28.7 million received during the third quarter of FY13.

Motor vehicle operators' license fees totaled \$4.0 million, a 5.9 percent increase compared to the level observed a year ago.

Weight distance tax receipts of \$19.0 million increased 2.9 percent compared to receipts collected during the third quarter of last year. The weight distance tax has some significance as a leading indicator of economic activity, as it is a good proxy for goods in transit over Kentucky highways.

Income on investment receipts totaled \$1.3 million compared to \$0.9 in the third quarter of FY13.

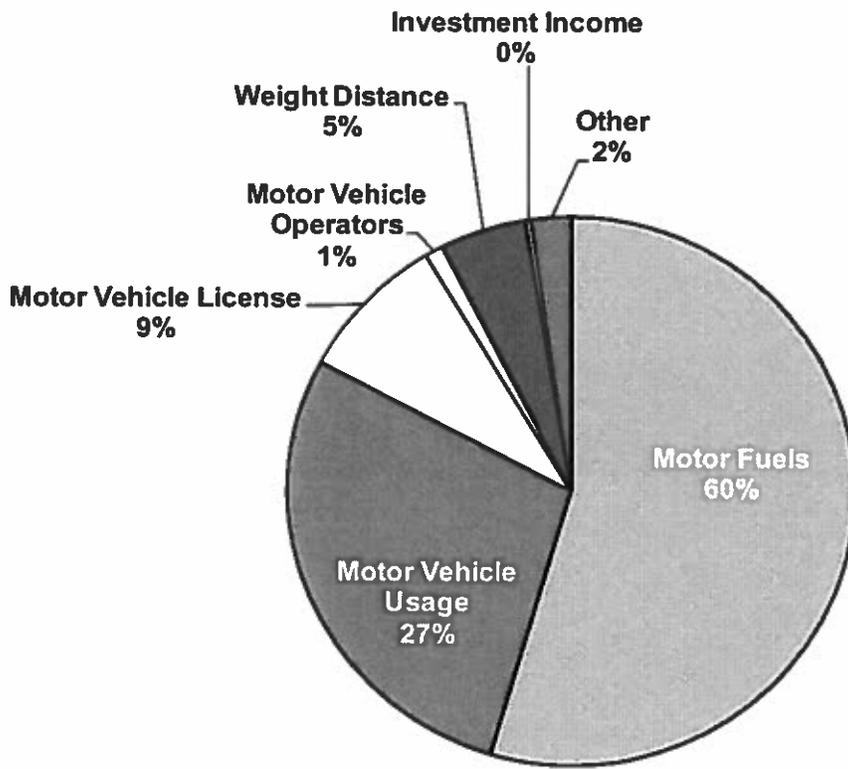
The remainder of the accounts in the Road Fund combined for an increase of 19.9 percent. Receipts for the "Other" category totaled \$8.8 million during the third quarter, compared to \$7.4 million in the third quarter of FY13.

Figure 2 details the composition of Road Fund revenues by tax type in the third quarter of FY14. Motor fuels taxes and the motor vehicle usage tax accounted for 87 percent of Road Fund revenues in the third quarter. The next-largest

sources of revenue were the motor vehicle license tax with nine percent followed by weight distance with five percent. The "Other" category accounted for two percent, while motor vehicle operators' li-

cense fees comprised one percent. Income on investment accounted for a negligible amount of the total Road Fund receipts.

Figure 2
Road Fund Receipts Composition
Third Quarter, FY14



The Economy

Third Quarter FY14

NATIONAL ECONOMY

Real gross domestic product (real GDP) is the sum of all goods and services sold within a country's physical boundaries in a given period and explicitly excludes those goods and services produced by US citizens outside the United States. Real GDP grew by 2.6 percent in the third quarter of FY14. On an adjacent-quarter basis, real GDP growth has softened for the last two quarters, falling from 1.0 percent in the first quarter, to 0.6 percent in the second quarter and to 0.4 percent in the third quarter. The soften-

ing in real GDP is largely a result of the softening occurring in real investment.

Real consumption grew by 2.2 percent in the third quarter and made up the largest absolute contribution to real GDP over the last four quarters (see Table 3). Real consumption makes up 68.1 percent of the real GDP. Since the end of the 2007 recession, real consumption has been the most steady among the real GDP components, with average adjacent-quarter growth of 0.6 percent. Adjacent-quarter real consumption growth has been 0.5, 0.5, 0.6 and 0.6 percent for the last four quarters, placing it

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

	Third Quarter			
	FY14	FY13	Chg	% Chg
Real GDP	15,989.9	15,583.9	406.0	2.6
Real Consumption	10,881.9	10,644.0	237.9	2.2
Real Investment	2,635.8	2,470.1	165.7	6.7
Real Govt. Expenditures	2,868.3	2,907.4	-39.1	-1.3
Real Exports	2,059.2	1,960.5	98.7	5.0
Real Imports	2,437.6	2,382.7	54.9	2.3
Personal Income (\$ billions)	14,414.9	13,925.9	489.0	3.5
Wages and Salaries (\$ billions)	7,282.3	7,040.4	241.9	3.4
Inflation (% chg CPI)	1.3	1.7	NA	NA
Industrial Production Index (% chg)	2.4	2.4	NA	NA
Civilian Labor Force (millions)	155.6	155.4	0.2	0.1
Total Non-farm Employment (millions)	137.7	135.5	2.2	1.6
Manufacturing Employment (millions)	12.1	12.0	0.1	0.6
Unemployment Rate (%)	6.6	7.7	NA	-13.9

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 Q3 are March 2014 estimates.

Source: IHS Global Insight Inc., March 11, 2014 data release

squarely on the trend line. Historically-speaking, 0.6 percent growth is low. The average for the decade of the 1980s, which included two recessions, was 0.8 percent and the average for the decade of the 1990s was 0.9 percent.

Real investment grew by the largest amount among the five real GDP components, growing 6.7 percent in the third quarter compared to last year. Real investment makes up 16.5 percent of real GDP, making it the third largest contributor to real GDP. Real investment has been trending upward since the first quarter of FY10, but most recently has been softening. Adjacent-quarter growth has been 4.1, 1.1 and -0.8 percent for the last three quarters. The reported year-over-year growth rates for the last two years have been bolstered by two particular quarters of strong growth which occurred in the second quarter of FY12 (7.2 percent) and the first quarter of FY14 (4.1 percent). The recent softening and drop is not uncommon in the investment series. It is volatile relative to consumption and government expenditures, so there is no cause for alarm at this time.

Real government expenditures declined on an annual basis for the sixth consecutive quarter and dropped 1.3 percent in the third quarter. Real government expenditures make up 17.9 percent of real GDP, making it the second largest component of real GDP. Real government expenditures have been trending downward since the first quarter of FY10. Real government expenditures have declined in 14 of the last 15 quarters on an annual basis. Real GDP has fallen by \$244.7 billion since the first quarter of FY10, a 7.9 percent net decline.

Real exports rose in the third quarter by 5.0 percent compared to last year. However, on an adjacent-quarter basis, real exports declined by 0.2 percent compared to the second quarter of FY14. Similarly, real imports rose in the third quarter by 2.3 percent compared to last year. However, on an adjacent-quarter basis, real imports declined by 0.4 percent. Net exports, which are exports minus imports, rose to a deficit of \$378.4 billion in the third quarter of FY14. Net exports have moved substantially in the last year. In the first quarter of FY13, net exports were -\$422.2 billion. So the position of net exports has improved by \$43.8 billion in the last year, but is still in a substantial deficit.

US personal income rose by 3.5 percent in the third quarter compared to last year. US personal income grew by 0.8 percent on an adjacent-quarter basis in the third quarter. This is just slightly below the trendline of 1.0 percent growth since the end of the 2007 recession. With the exception of the third quarter FY13 decline, US personal income has been steady since the end of the 2007 recession.¹ US wages and salaries mirrored the growth of personal income and grew 3.4 percent in the third quarter, while all the other components of personal income grew for a combined 3.6 percent.

US non-farm employment rose by 1.6 percent in the third quarter. This is a net increase of 2.2 million jobs. US manufacturing employment increased by only 0.6 percent in the same time. Meanwhile, the civilian labor force growth has fallen to a near standstill. The civilian labor force has declined or been very weak since the

end of 2007 recession. The civilian labor force grew by 0.5, 0.5, 0.4, -0.3, and 0.1 percent for the last five quarters respectively. Outside of a recession it is very unusual for the labor force to decline. In the second quarter of FY14, the labor force declined by 0.3 percent. In the last 54 years, the labor force has declined in 12 different quarters. That is roughly one or two declines per recession. By contrast, the labor force contracted seven times following the 2007 recession, not counting the most recent decline, which is over four years removed from the end of the last recession.

KENTUCKY ECONOMY

Kentucky personal income increased by 4.0 percent in the third quarter. Kentucky personal income growth has largely returned to its pre-recession trendline. Before the recession, Kentucky personal income was trending at 1.1 percent average growth per quarter. In the period following the 2007 recession, Kentucky personal income growth has averaged 1.0 percent. In the most recent quarter, adjacent-quarter growth was 2.3 percent, which is well above the average.

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

	Third Quarter			
	FY14	FY13	Chg	% Chg
Personal Income (\$ millions)	164,243.4	157,984.5	6,258.9	4.0
Wages and Salary (\$ millions)	79,713.1	78,381.3	1,331.9	1.7
Non-farm Employment (thousands)	1,845.1	1,833.6	11.5	0.6
Goods-producing	312.8	313.2	-0.4	-0.1
Construction	67.3	67.4	-0.1	-0.1
Mining	17.4	17.7	-0.3	-1.8
Manufacturing	228.1	228.1	0.0	0.0
Service-providing	1,195.0	1,183.2	11.8	1.0
Trade, Transportation & Utilities	368.9	369.2	-0.3	-0.1
Information	26.1	26.4	-0.3	-1.2
Finance	88.3	88.2	0.0	0.1
Business Services	207.4	197.2	10.2	5.2
Educational Services	259.8	258.2	1.6	0.6
Leisure and Hospitality Services	179.6	179.0	0.5	0.3
Other Services	65.1	65.0	0.2	0.2
Government	337.3	337.2	0.1	0.0

Not Seasonally Adjusted. Data for FY14 Q3 are March 2014 estimates.

Source: IHS Global Insight Inc., March 11, 2014 data release

Wages and salaries income grew by 1.7 percent in the third quarter. On an adjacent-quarter basis, wages and salaries increased 0.7 percent in the third quarter compared to the second quarter. Wages and salaries make up 48.5 percent of total Kentucky personal income. Wages and salary growth has been low and has dropped to negative territory twice since the recession ended.

Dividends, interest and rent income grew by 4.7 percent in the third quarter compared to the third quarter of FY13. Dividends, interest and rent income is the third largest category of income and makes up 15.3 percent of all personal income.

Transfer income is the second largest component of personal income and makes up 23.4 percent of personal income. Transfer income grew by 3.9 percent in the third quarter compared to the same quarter last year. This is the second fastest growing component of Kentucky personal income. Proprietary income, the smallest income category, grew by 3.0 percent in the third quarter compared to the last year. Social insurance income, which makes up only

8.2 percent of Kentucky personal income, increased by 2.9 percent in the third quarter compared to the third quarter of FY13. Supplemental income grew by 1.2 percent.

Kentucky non-farm employment has been weak for several years. Non-farm employment grew by 0.6 percent in the third quarter compared to the third quarter of FY13. That is a net increase of 11,500 jobs in the last year. Business services employment was the sector with the highest growth during the third quarter, gaining 5.2 percent compared to the third quarter of FY13.

Employment decreased in four of the 11 supersectors in the third quarter. Included among the declining supersectors was trade, transportation and utilities, which is the largest supersector in Kentucky and dropped 0.1 percent. The biggest job losses in percentage terms occurred in mining, which declined by 1.8 percent and lost a nominal 300 net jobs in the third quarter compared to the third quarter of FY13.

¹ The third quarter FY13 growth rate of -1.0 percent is offset by the abnormally large growth rate of 2.7 percent in the second quarter of FY13. It is not uncommon for anomalies in the pay periods to occur, that is, periods where five official pay periods occur in a given month while only four such pay periods occurred in the previous period. However, it is rarer for this phenomenon to occur precisely in-between quarters. That appears to be the cause of the third quarter decline. If one were to split the net growth across both quarters, there would be 0.8 percent growth in both quarters.

Interim Outlook

GENERAL FUND

The revenue forecasts presented in Table 5 and Table 6 were estimated using the March 2014 “control scenario” economic forecast from both IHS Global Insight and the Kentucky MAK model. The unofficial General Fund estimate presented in this report is \$9,552.9 million, and is \$27.7 million below the official enacted revenue estimate. This unofficial interim estimate is based on the most current revenue receipts and economic data.

Projected General Fund revenues for the next three quarters are shown in Table 5. After increasing 1.5 percent through the first three quarters of FY14, total General Fund revenues are forecasted to improve slightly, growing 3.0 percent in the final quarter of the fiscal year. Revenue growth is projected to increase by 2.5 percent in

the first half of FY15. Revenue growth has been solid in FY14 with the exception of the second quarter when collections declined 0.7 percent. One-time collections from the 2013 Tax Amnesty Program boosted FY13 receipts. This elevated base made growth difficult to achieve in the second quarter of FY14. Growth rates for the first three quarters of the fiscal year have been 3.3 percent, -0.7 percent, and 2.1 percent respectively.

Individual income tax receipts are composed of four components: withholding, declarations, fiduciary and net returns. The largest component of individual income tax receipts is withholding, which makes up approximately 98 percent of total individual income tax receipts. Revenues from this account have grown 2.4 percent thus far in FY14. The rate of growth is projected to slow to 2.0 percent

Table 5
General Fund Interim Forecast
\$ millions

	FY14						FY14		FY15	
	Q1, Q2 & Q3		Q4		Full Year		Official		Q1 & Q2	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	\$ Diff	Estimate	% Chg
Individual Income	2,625.0	2.4	1,182.5	2.0	3,807.5	2.3	3,812.3	-4.8	1,921.9	3.5
Sales & Use	2,318.6	3.1	792.4	2.5	3,110.9	2.9	3,099.3	11.6	1,596.1	2.5
Property	500.3	-4.2	51.4	43.2	551.7	-1.2	568.9	-17.2	369.2	2.0
Corporation Income	291.8	17.8	178.7	16.8	470.5	17.4	460.5	10.0	233.1	1.1
Coal Severance	148.9	-14.9	50.8	-8.8	199.6	-13.4	200.6	-1.0	98.4	-5.5
Cigarettes	169.0	-3.7	55.5	-12.3	224.4	-6.0	231.2	-6.8	114.5	-2.3
LLET	130.5	-17.5	86.8	-1.3	217.3	-11.7	231.7	-14.4	92.8	-1.2
Lottery	156.6	0.9	67.4	12.3	224.0	4.1	224.0	0.0	111.5	8.1
Other	534.7	1.0	184.5	0.1	719.2	0.8	724.4	-5.2	291.3	1.3
General Fund	6,875.4	1.5	2,649.8	3.0	9,525.2	1.9	9,552.9	-27.7	4,828.8	2.5

in the final quarter before strengthening over the first two quarters of FY15. Growth during that time frame is expected to be 3.5 percent.

Sales and use tax collections are poised to recover from their recent sluggish performance as the Kentucky and US economies strengthen. Revenues have declined in three of the past five years. Through the first three quarters of FY14, collections have increased 3.1 percent. This trend is forecasted to continue for at least the next three quarters as revenues are expected to grow 2.5 percent in the final quarter of FY14 and through the first half of FY15.

Growth in property tax revenues is expected to be a robust 43.2 percent in the fourth quarter of the fiscal year. However, that will not be enough to put collections in the black for the full year. Revenue receipts thus far have declined 4.2 percent. Since final quarter collections are only a small percentage of total property tax receipts, the fourth quarter increase will be relatively small in dollar terms. Typically, receipts in this account are highly influenced by timing issues and that is the case for the final quarter. The \$10.5 million of the \$15.5 million projected fourth quarter increase is the result of one-time events that occurred last year. Therefore, only \$5.0 million of the total receipts is economically driven. Property tax collections are forecasted to improve slightly in FY15 as collections will possibly grow 2.0 percent over the first two quarters.

Corporate income tax receipts are forecasted to continue their four-year rapid expansion before leveling off in FY15. Cor-

porate tax receipts declined 38.4 percent in FY09 and 11.2 percent in FY10. Receipts have skyrocketed in the last three years, growing 26.4 percent, 24.5 percent and 7.0 percent over the last three years respectively. Corporate tax receipts are expected to grow by 17.4 percent in FY14. Increased corporate profitability has led to the surge in tax revenue but the forecast calls for flat to declining profits which will have a direct impact on tax collections going forward. In the first half of FY15, growth is expected to be 1.1 percent.

Coal severance tax collections are estimated to continue to fall over the forecast period but while receipts may be lower, the rate of decline will begin to taper some. Receipts fell 22.7 percent in FY13 and through the first nine months of FY14 have declined 14.9 percent compared to FY13. The rate of decrease is expected to be 8.8 percent in the final quarter of FY14 and 5.5 percent over the first two quarters of FY15. The losses are due, in large part, to a decline in severed tons which is driven by a sharp decline in demand from power plants. Spot market prices have also stabilized, but are down from where they were two to three years ago when many of the contracts were set.

Cigarette smoking has declined both in Kentucky and nationally, as measured by the number of packs sold. This underlying trend continues to influence cigarette receipts in Kentucky. Cigarette receipts declined 3.7 percent in the first nine months of FY14 and are expected to continue to fall. Receipts in the fourth quarter of FY14 are forecasted to drop 12.3 per-

cent. Receipts are expected to decline 2.3 percent for the first half of FY15.

LLET receipts have fallen sharply relative to FY13 but are expected to level off over the forecast horizon. LLET collections have declined 17.5 percent through the first three quarters of FY14. Tax collections in this account have fallen in large part due to the Tax Amnesty Program which inflated FY13 receipts. Collections in the first half of FY15 are expected to return to a more reasonable rate, declining 1.2 percent.

Lottery receipts are determined by the Lottery Corporation's dividend schedule. Lottery receipts are projected to end FY14 at \$224.0 million, an increase of 1.9 percent. Prospects for FY15 appear strong with estimated collections growing 8.1 percent.

The "Other" category contains dozens of smaller accounts, which make up the remainder of the General Fund. Insurance premiums, bank franchise and telecommunications taxes are the three largest accounts in the "Other" category. The "Other" category of taxes is expected to rise a net 0.1 percent in the final quarter of FY14 and end the year with growth of 0.8 percent. Receipts in the first half of FY15 are expected to increase 1.3 percent.

ROAD FUND

Road Fund revenues are forecasted to be flat in the final quarter of FY14. This will be the first non-positive quarter since the fourth quarter of FY10. Growth in revenues may decline slightly in the first two quarters of FY15 as shown in Table 6. Growth rates for the fourth quarter of the

current fiscal year and the first six months of FY14 are forecast to be 0.0 percent and -0.9 percent respectively. The FY14 full-year forecast is \$11.0 million less than the official revenue forecast as approved by the CFG on December 19, 2013.

Motor fuels tax collections are forecasted to grow 0.2 percent over the final three months of FY14, due to an essentially unchanged motor fuels tax rate as well as flat consumption in taxable motor fuels. Receipts in the first two quarters of FY15 may remain modest as fuels collections decline by 0.8 percent.

Motor vehicle usage tax collections are expected to decline in the fourth quarter, falling 1.5 percent. The decline in this account is expected to continue over the first two quarters of FY15 as the impact of HB440 takes effect. HB440 allows for a trade-in credit on new vehicle purchases and will reduce collections by an estimated \$34.0 million in FY15.

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 together assessed recent growth patterns as well as administrative and statutory factors.

Motor vehicle license tax is forecast to decrease 11.1 percent in the final quarter of FY14 and rise 3.6 percent in the first two quarters of FY15. Motor vehicle operators' license is projected to grow 4.7 percent in the remainder of the fiscal year and increase by 8.4 percent in the first six months of FY15. Weight distance tax revenue is forecast to grow in both the final quarter of the fiscal year as well as in the

first half of FY15. Income on investment is expected to decline over the remainder of the fiscal year but increase in the first half of FY15. All other revenues should com-

bine for an increase of 12.5 percent during the last three months of FY14 and remain flat in the first two quarters of FY15.

Table 6
Road Fund Interim Forecast
\$ millions

	FY14						FY14		FY15	
	Q1, Q2 & Q3		Q4		Full Year		Official CFG		Q1 & Q2	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	\$ Diff	Estimate	% Chg
Motor Fuels	668.9	8.4	221.6	0.2	890.5	6.2	900.7	-10.2	454.6	-0.8
Motor Vehicle Usage	325.7	6.8	120.1	-1.5	445.8	4.4	448.4	-2.6	209.7	-3.3
Motor Vehicle License	70.1	9.7	34.2	-11.1	104.2	1.9	101.3	2.9	37.9	3.6
Motor Vehicle Operators	12.1	1.3	4.3	4.7	16.4	2.2	16.1	0.3	8.8	8.4
Weight Distance	57.7	2.5	18.8	1.2	76.5	2.1	76.1	0.4	40.0	3.4
Income on Investments	2.1	-28.4	0.7	-119.5	2.8	-803.5	2.8	0.0	1.2	37.9
Other	25.5	2.8	9.9	12.5	35.4	5.3	37.2	-1.8	16.7	0.0
Road Fund	1,162.1	7.4	409.5	0.0	1,571.6	5.4	1,582.6	-11.0	768.9	-0.9

NATIONAL ECONOMY

As we enter the fourth quarter of FY14, one cannot help but look back at the previous quarter's unusually harsh winter and contemplate the implications of a return to normal weather patterns. The impact of the weather on the most recent quarter's real GDP has been significant, and the growth rate for third quarter of FY14 is expected to be revised down. In the Federal Reserve's *Beige Book*, the words "weather", "snow" or similar expressions were used 140 times, reflecting the economic drag the weather placed on the economy.

Fortunately, the areas of the economy impacted by the severe weather are exhibiting signs of improvement. Light-vehicle sales were greatly reduced during the beginning of the last quarter, but the March light-vehicle sales came in at an annual rate of 16.3 million. Vehicle sales are expected to remain strong over the next quarter and should continue to add to real GDP.

Other services that will directly impact real GDP include natural gas production and healthcare. The winter months saw extreme draw downs in natural gas inventories and significant increases in natural gas sales. The expected decline in usage over the next several quarters will reduce real GDP growth.

With the start of the Affordable Care Act and the influx of millions of previously uninsured individuals, healthcare spending showed strong growth in early calendar 2014. While the recent trend of higher co-pays and deductibles has moderated

the increase in consumption slightly, the overall expectation is for continued increases in healthcare spending and consumption.

One of the major changes in the national forecast is the expected growth in housing. The forecast for single family housing starts has been lowered from 755,000 units to approximately 700,000 units. While the weather has certainly played a part, the growth in housing permits and construction contracts has been lackluster, and homebuilders have indicated increased pessimism in recent surveys. The recent increases in material prices have reduced the margins earned by builders and reduced flexibility in pricing power needed to help keep the pace of inventory at recent levels. The overall impact will be a positive contribution to real GDP but at a reduced rate and a tempering of the growth in home prices.

Consumer spending is expected to remain in the 2.5 percent range for the rest of FY14, following a 2.1 percent increase in the second quarter of FY14. Real disposable income should rise 2.1 percent on a year-over-year basis compared to the 2.3 percent rise in the last fiscal quarter.

The overall level of consumer spending for the next two fiscal quarters will also be impacted by gasoline prices. The recent increases in gasoline prices have raised concerns for the prices going forward. These early season fluctuations occur each year due to a series of factors. The peak time for refinery maintenance occurs in the first quarter of each year after winter heating oil demand declines. This is also the time when refineries begin switching

to required summer-grade blends. The change in production processes requires significant down-time resulting in a reduction in gasoline production, causing existing prices to increase. Additionally, the summer-grade gasoline is more expensive to produce. The overall result is a seasonal increase in gasoline prices.

This year also included a rapid rise in ethanol prices. The price premium of East Coast spot ethanol is usually equal to the approximate costs of transportation from the Mid-West to the eastern region and averages \$0.25 per gallon. However, the price differential increased to over \$1.00 per gallon as logistical constraints involving Mid-Western railroads delayed shipments. The extremely cold temperatures and a series of unfortunate rail accidents involving the shipping of domestically produced crude oil slowed the average speed of trains transporting ethanol to many gasoline blending terminals by twenty percent. The overall impact was a significant increase in the cost of ethanol used in blending gasoline and a sharp drawdown in the stockpiles of ethanol.

With the dramatic increase in domestic oil production, improved availability for rail delivery of domestic oil, and reduced differences the amount that refiners have to pay for crude oil, gasoline prices during the summer season will be approximately the same as the previous summer. As we enter the summer season, gasoline inventories are well below their normal range. This represents an increase in the impacts from weather-related supply disruptions, unplanned refinery outages, or other supply shocks which may affect gasoline prices. The forecast for this summer season is for prices to climb to an average of \$3.80 per

gallon in May, and then gradually decline to an average of \$3.60 for the remainder of the summer.

KENTUCKY ECONOMY

Kentucky personal income grew 4.0 percent year-on-year in the third quarter as the economy continues to rebound from sluggish growth (see Table 4). This elevated growth is forecast to continue for the next two quarters (see Table 8). As recorded in Table 7, in the fourth quarter personal income of Kentuckians is forecast to again grow at a faster rate than the US rate overall, and to further pick up momentum through the first two quarters of FY15 (see Table 8).

The employment picture in Kentucky continues to brighten as the economy expands. The overall unemployment rate has remained below eight percent for data reported through February, significantly down from its post-recession high of 10.7 percent in the third quarter of FY10. Kentucky has added jobs in FY14 and further employment gains are projected to continue albeit at a rate slightly less than the US overall (see Tables 7 & 8). While coal production and employment continues to decline in Eastern Kentucky, the West Kentucky coal fields report gains in output and employment. The service sector is expected to create the greatest number of jobs, and the St. Louis Federal Reserve reports that job growth in leisure, hospitality, professional, and business services have led the way in the Louisville zone thus far in FY14. Manufacturing is forecast to see greater positive gains further out, and the government sector is projected to add jobs as well (see Table 8).

A remarkably cold and long winter may have been somewhat of a drag on consumer activity in Kentucky in the third quarter; housing activity appears to have been weakened by the inclement weather. Higher gasoline prices may also have been a damper on consumer spending as refineries finish seasonal maintenance and switch from winter to summer blends.

Given the relatively positive performance of the Kentucky economy in the third quarter, one can reasonably expect improved growth as temperatures warm and gasoline prices stabilize. As wages and salaries grow at higher rates, consumption and investment activities in the Bluegrass will follow positively into FY15.

Table 7
US and KY Economic Outlook
Fourth Quarter FY14 & FY13

	Q4		
	FY14	FY13	% Chg
United States			
Real GDP	16,094.2	15,679.7	2.6
Real Consumption	10,957.2	10,691.9	2.5
Real Investment	2,654.8	2,524.9	5.1
Real Govt. Expenditures	2,877.7	2,904.5	-0.9
Real Exports	2,087.5	1,998.4	4.5
Real Imports	2,465.2	2,422.9	1.7
Personal Income (\$ billions)	14,559.9	14,086.2	3.4
Wages and Salaries (\$ billions)	7,367.2	7,117.6	3.5
Inflation (% chg CPI)	1.5	1.4	NA
Industrial Production Index (% chg)	2.5	2.0	NA
Civilian Labor Force (millions)	155.6	155.6	0.0
Total Non-farm Employment (millions)	138.3	136.1	1.6
Manufacturing Employment (millions)	12.1	12.0	1.0
Unemployment Rate (%)	6.5	7.5	NA
Kentucky			
Personal Income (\$ millions)	166,013.0	158,560.3	4.7
Wage & Salary (\$ millions)	80,659.3	78,391.0	2.9
Non-farm Employment (thousands)	1,851.7	1,833.7	1.0
Goods Producing (thousands)	313.9	313.2	0.2
Service Providing (thousands)	1,200.5	1,184.5	1.4
Government (thousands)	337.3	336.0	0.4

Not Seasonally Adjusted. Real series are annual rate, billions of chained 2000 dollars.
Source: IHS Global Insight, Inc. and the Kentucky Governor's Office for Economic Analysis MAK model, March 2014.

Table 8
US and KY Economic Outlook
First Half FY15 & FY14

	Q1 & Q2		
	FY15	FY14	% Chg
United States			
Real GDP	16,274.2	15,886.1	2.4
Real Consumption	11,068.5	10,778.1	2.7
Real Investment	2,746.3	2,641.7	4.0
Real Govt. Expenditures	2,885.9	2,886.8	0.0
Real Exports	2,113.8	2,040.6	3.6
Real Imports	2,519.5	2,441.8	3.2
Personal Income (\$ billions)	14,827.3	14,264.4	3.9
Wages and Salaries (\$ billions)	7,510.9	7,197.7	4.4
Inflation (% chg CPI)	1.8	1.4	NA
Industrial Production Index (% chg)	2.8	2.9	NA
Civilian Labor Force (millions)	156.3	155.2	0.7
Total Non-farm Employment (millions)	139.2	136.9	1.7
Manufacturing Employment (millions)	12.3	12.0	2.0
Unemployment Rate (%)	6.3	7.1	NA
Kentucky			
Personal Income (\$ millions)	168,712.2	160,290.6	5.3
Wage & Salary (\$ millions)	82,009.1	78,886.8	4.0
Non-farm Employment (thousands)	1,863.0	1,840.5	1.2
Goods Producing (thousands)	317.3	313.8	1.1
Service Providing (thousands)	1,208.1	1,189.4	1.6
Government (thousands)	337.6	337.4	0.1

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 and Q2 are March 2014 estimates.

Source: IHS Global Insight Inc., March 11, 2014 data release

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	Third Quarter FY 2014	Third Quarter FY 2013	%	Year-To-Date FY 2014	Year-To-Date FY 2013	%
			Chg			Chg
TOTAL GENERAL FUND	\$2,162,899,038	\$2,118,906,190	2.1	\$6,875,351,358	\$6,775,365,905	1.5
Tax Receipts	\$2,096,530,028	\$2,049,817,236	2.3	\$6,636,838,475	\$6,530,731,193	1.6
Sales and Gross Receipts	\$918,080,496	\$895,354,371	2.5	\$2,744,214,016	\$2,679,819,665	2.4
Beer Consumption	1,400,987	1,289,718	8.6	4,616,598	4,534,682	1.8
Beer Wholesale	12,504,795	11,161,056	12.0	43,008,412	38,919,642	10.5
Cigarette	51,797,652	53,851,595	-3.8	168,971,129	175,382,917	-3.7
Distilled Spirits Case Sales	32,677	29,761	9.8	95,851	91,462	4.8
Distilled Spirits Consumption	3,062,769	2,858,081	7.2	8,929,175	8,930,094	0.0
Distilled Spirits Wholesale	8,608,391	7,803,728	10.3	25,267,677	23,570,796	7.2
Insurance Premium	52,538,432	53,266,673	-1.4	95,865,106	95,076,701	0.8
Pari-Mutuel	464,116	572,630	-19.0	1,306,213	2,914,791	-55.2
Race Track Admission	53,546	1,755	2951.0	158,660	127,825	24.1
Sales and Use	761,433,288	736,869,239	3.3	2,318,574,624	2,248,765,382	3.1
Wine Consumption	786,844	724,361	8.6	2,190,267	2,154,769	1.6
Wine Wholesale	4,292,939	3,813,306	12.6	11,651,713	11,189,819	4.1
Telecommunications Tax	16,133,287	18,038,448	-10.6	47,977,012	52,044,202	-7.8
OTP	4,970,773	5,070,339	-2.0	15,603,825	16,101,674	-3.1
Floor Stock Tax	0	3,680	—	(2,246)	14,908	—
License and Privilege	\$192,123,960	\$209,075,005	-8.1	\$418,070,927	\$460,111,471	-9.1
Alc. Bev. License Suspension	84,925	91,483	-7.2	248,190	295,417	-16.0
Coal Severance	44,759,528	53,307,154	-16.0	148,853,329	174,872,562	-14.9
Corporation License	445,863	(80,146)	—	850,581	(523,470)	—
Corporation Organization	10,640	40,528	-73.7	31,417	88,287	-64.4
Occupational Licenses	24,897	23,318	6.8	95,503	59,559	60.4
Oil Production	3,228,983	2,633,282	22.6	9,687,467	7,857,329	23.3
Race Track License	113,225	11,375	895.4	248,375	208,086	19.4
Bank Franchise Tax	100,631,924	96,296,436	4.5	102,898,234	98,393,398	4.6
Driver License Fees	151,527	147,469	2.8	473,169	473,408	-0.1%
Minerals Severance	2,362,081	2,317,146	1.9	11,238,665	9,866,489	13.9
Natural Gas Severance	3,802,229	4,238,335	-10.3	12,993,397	10,355,397	25.5
Limited Liability Entity	36,508,136	50,048,626	-27.1	130,452,601	158,165,009	-17.5
Income	\$829,547,886	\$803,029,770	3.3	\$2,916,767,324	\$2,810,955,209	3.8
Corporation	61,150,024	52,920,386	15.6	291,795,867	247,790,696	17.8
Individual	768,397,862	750,109,383	2.4	2,624,971,457	2,563,164,513	2.4
Property	\$138,313,810	\$125,356,479	10.3	\$500,345,479	\$522,472,308	-4.2
Building & Loan Association	0	0	—	5,753	(15,820)	—
General - Real	72,639,727	61,355,723	18.4	252,758,998	252,095,110	0.3
General - Tangible	61,159,829	55,589,714	10.0	182,766,679	185,167,404	-1.3
Omitted & Delinquent	2,863,582	2,420,747	18.3	13,878,831	32,390,691	-57.2
Public Service	1,080,038	5,410,495	-80.0	45,138,613	51,474,266	-12.3
Other	570,633	579,801	-1.6	5,796,605	1,360,658	326.0
Inheritance	\$11,256,244	\$8,770,657	28.3	\$35,332,816	\$29,406,310	20.2
Miscellaneous	\$7,207,633	\$8,230,955	-12.4	\$22,107,913	\$27,966,230	-20.9
Legal Process	4,237,965	4,781,077	-11.4	12,343,139	14,760,733	-16.4
T. V. A. In Lieu Payments	2,936,351	3,422,542	-14.2	9,731,066	13,177,925	-26.2
Other	33,317	27,336	21.9	33,709	27,572	22.3
Nontax Receipts	\$66,157,755	\$67,506,340	-2.0	\$237,064,214	\$241,817,608	-2.0
Departmental Fees	7,064,617	7,922,590	-10.8%	15,284,979	17,985,835	-15.0%
PSC Assessment Fee	136,861	14,834	822.6%	14,836,217	13,091,284	13.3%
Fines & Forfeitures	6,790,684	6,641,578	2.2%	18,928,322	21,767,510	-13.0%
Income on Investments	(157,487)	(263,325)	—	(855,924)	1,079,039	—
Lottery	53,500,000	53,500,000	0.0%	156,639,743	155,266,568	0.9%
Sale of NOx Credits	6,804	0	—	55,242	27,604	100.1%
Miscellaneous	(1,183,724)	(309,337)	—	32,175,635	32,599,769	-1.3%
Redeposit of State Funds	\$211,254	\$1,582,613	-86.7%	\$1,448,669	\$2,817,104	-48.6%

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	Third Quarter FY 2014	Third Quarter FY 2013	%	Year-To-Date FY 2014	Year-To-Date FY 2013	%
			Chg			Chg
TOTAL ROAD FUND	\$386,144,532	\$356,913,697	8.2	\$1,162,147,288	\$1,082,076,745	7.4
Tax Receipts-	\$378,471,061	\$351,141,756	7.8	\$1,143,448,152	\$1,063,746,110	7.5
Sales and Gross Receipts	\$319,569,427	\$297,708,809	7.3	\$994,618,688	\$922,095,590	7.9
Motor Fuels Taxes	210,724,898	194,410,982	8.4	668,878,240	617,186,622	8.4
Motor Vehicle Usage	108,844,529	103,297,827	5.4	325,740,448	304,908,968	6.8
License and Privilege	\$58,901,634	\$53,432,947	10.2	\$148,829,464	\$141,650,520	5.1
Motor Vehicles	33,467,273	28,687,592	16.7	70,054,745	63,873,631	9.7
Motor Vehicle Operators	3,982,166	3,759,500	5.9	12,104,835	11,942,222	1.4
Weight Distance	19,033,380	18,505,215	2.9	57,726,445	56,338,740	2.5
Truck Decal Fees	15,353	33,414	-54.1	37,372	69,828	-46.5
Other Special Fees	2,403,462	2,447,226	-1.8	8,906,067	9,426,099	-5.5
Nontax Receipts	\$5,529,680	\$6,523,450	-15.2	\$14,781,479	\$16,366,471	-9.7
Departmental Fees	3,864,163	5,303,143	-27.1	11,559,488	12,446,703	-7.1
In Lieu of Traffic Fines	144,874	195,774	-26.0	410,229	538,723	-23.9
Income on Investments	1,272,166	897,800	41.7	2,143,043	2,988,148	-28.3
Miscellaneous	248,477	126,732	96.1	668,719	392,898	70.2
Redeposit of State Funds	\$2,143,790	(\$751,509)	—	\$3,917,657	\$1,964,164	99.5