COMMONWEALTH OF KENTUCKY

Quarterly Economic & Revenue Report

Third Quarter • Fiscal Year 2012

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Office of State Budget Director

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April 30, 2012

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 third quarter of Fiscal Year 2012 (FY12) and provides an interim estimate for the next three fiscal quarters for the General Fund and the Road Fund. General Fund receipts for the third quarter of FY12 totaled $2,115.1 million, an increase of 7.2 percent compared to the same period in FY11. Road Fund revenues totaled $353.6 million, an increase of 7.1 percent from the third quarter of FY11.

The official General Fund estimate for FY12 was revised at the December 2011 Consensus Forecasting Group (CFG) meeting to $9,007.7 million, which is $136.5 million higher than the FY12 enacted estimate and a 2.8 percent increase over FY11 collections. April's unofficial interim outlook calls for FY12 General Fund revenues of $9,066.1 million, representing 3.5 percent growth over FY11 revenues, and $58.4 million higher than the revised official estimate.

The official Road Fund estimate for FY12 is $1,412.5 million. The Road Fund revenues are forecasted to continue their growth in the final quarter of FY12, but at a less robust rate than what was seen in the first nine months. Growth rates for the fourth quarter of the current fiscal year and the first six months of FY13 are forecast to be 4.4 percent and 3.2 percent, respectively. The FY12 full-year forecast projects growth at 6.6 percent and $14.1 million more than the official revenue forecast. The official estimate for the first half of FY13 calls for revenue growth of 3.2 percent.

Underlying economic conditions have improved for the near-term forecast as you will see in this report. We will continue to monitor the economic and fiscal conditions of the Commonwealth and will keep you apprised of significant developments.

Sincerely,

Mary E. Lassiter

Mary E. Lassiter
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 third quarter of FY12. 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 provides a comparison between the official revenue estimates for the current year and the new interim estimates, as well as the first half of the upcoming fiscal year. The Consensus Forecasting Group (CFG) met in December 2011, and rendered official General Fund and Road Fund estimates, which are presented in Tables 5 and 6 of this report. Revenue estimates enacted by the 2012 Regular Session of the General Assembly subsequently modified the official estimates, and the differences will be highlighted in the final quarterly report of FY12.

In order 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 Global Insight as well as the MAK model for Kentucky which is developed, maintained, and operated by the OSBD.

Third quarter General Fund receipts increased $141.9 million, or 7.2 percent, over the same quarter in FY11. Corporate, property, and sales tax receipts provided most of the nominal General Fund growth. An improving economy helped propel tax receipts slightly ahead of the annual pace set by the CFG. General Fund collections are projected to exceed the official estimates by $58.4 million in FY12 with nominal growth of 1.3 percent in the fourth fiscal quarter, and 3.5 percent for the year.

Road Fund tax collections increased $23.5 million, or 7.1 percent, in the third quarter of FY12 compared to receipts in the same time frame last year. Motor fuels and motor vehicle license taxes provided the greatest share of the growth. Road Fund collections are projected to exceed the official estimates by $14.1 million in FY12 with growth of 4.4 percent in the fourth fiscal quarter, and 6.6 percent for the year.

For the national economy, real gross domestic product (real GDP) rose by 2.0 percent in the third quarter of FY12. While this is very modest growth during an expansion period, real GDP has grown in every quarter since the recovery period began, which occurred in the first quarter of FY10.

The chances of a "double-dip" recession have become less likely as the economy draws further from the official end of the recession. Global Insight now places an equal weight of 20 percent on both the optimistic and pessimistic economic scenarios with a 60 percent likelihood of the moderate-growth control forecast. Three pivotal issues have come to the forefront as keys to the near-term health of the national economy and will be discussed in great detail in the national outlook section of this report.

Kentucky employment grew by 3.7 percent in the third quarter. Eight of the 11 employment sectors grew in the third quarter, including manufacturing employment, which grew substantially with a 51,800 nominal job increase over the third quarter of FY11.

Kentucky wages and salary income, which comprises the largest share of personal income, grew by 5.5 percent over the second quarter. With solid growth over the past four quarters, wages and salaries is up 5.2 percent over third quarter of FY11. Kentucky income growth is expected to exceed the national average during the three-quarter duration of this forecast. Personal income growth in Kentucky is expected to be 4.2 percent in the first half of FY13 compared to the 4.0 percent national average. The rebound in employment for Kentucky will likely be higher as well, with 3.7 percent growth in non-farm employment in Kentucky versus 1.6 percent growth nationwide. Wage and salary growth comparisons are also favorable with 5.2 percent growth expected for Kentucky versus 4.2 percent nationally.

Third Quarter Revenue Receipts

GENERAL FUND

General Fund receipts in the third quarter of FY12 totaled $2,115.1 million compared to $1,973.2 million received in the third quarter of FY11, for an increase of 7.2 percent or $141.9 million. Revenues have grown in eight consecutive quarters following the five quarters of revenue declines during the recession. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these and other accounts is available in the Appendix.

Table 1 Summary General Fund Receipts Third Quarter, FY12, $ millions				
	FY12	**FY11**	**Diff ($)**	**Diff (%)**
Individual Income	696.7	692.8	3.9	0.6
Sales and Use	756.5	706.0	50.5	7.2
Property	174.4	116.0	58.4	50.4
Corporate Income	33.1	25.6	7.5	29.1
Coal Severance	72.8	69.9	2.9	4.1
Cigarette Taxes	58.5	57.3	1.3	2.2
LLET	36.8	42.0	-5.2	-12.5
Lottery	54.5	48.5	6.0	12.3
Other	231.8	215.1	16.7	7.8
Total	**2,115.1**	**1,973.2**	**141.9**	**7.2**

Total sales and use tax receipts for the quarter were $756.5 million compared to $706.0 million in the third quarter of FY11. The $50.5 million difference translates to an increase of 7.2 percent, a healthy rate of increase suggesting strong holiday sales and release of pent-up demand. Year-to-date sales and use tax receipts for FY12 have increased 5.2 percent.

Individual income tax receipts increased 0.6 percent in the third quarter of FY12. Receipts of $696.7 million were $3.9 million more than was collected in the third quarter of the previous fiscal year. Gains in withholding tax collections offset declines in estimated payments to produce the muted growth rate for the third quarter. Fiduciary and net return payments also decreased due to differences in the timing of refund disbursements.

Property taxes grew 50.4 percent in the third quarter of FY12 due to timing of collections in the tangible and public service property accounts. Collections of $174.4 million compare to $116.0 million received in the third quarter of the prior fiscal year.

Corporation income tax posted an increase of 29.1 percent, or $7.5 million, during the third quarter of FY12. Receipts totaled $33.1 million compared to the $25.6 million received a year earlier. The third fiscal quarter of each year is a low collection period for corporate taxes due to the schedule of payments for calendar-year filers.

The limited liability entity tax (LLET) saw a decrease in tax collections in the third quarter of FY12 when compared to FY11. Total collections in the current fiscal year totaled $36.8 million and compare to revenues of $42.0 million in the same period a year earlier.

Growth in the coal severance tax slowed to 4.1 percent, compared to year-to-date growth of 8.3 percent, due to a mild winter this fiscal year. Receipts of $72.8 million compare to $69.9 million collected in the third quarter of FY11. In the first half of FY12, coal receipts grew 10.3 percent, but demand for electricity waned due to an unseasonably warm winter.

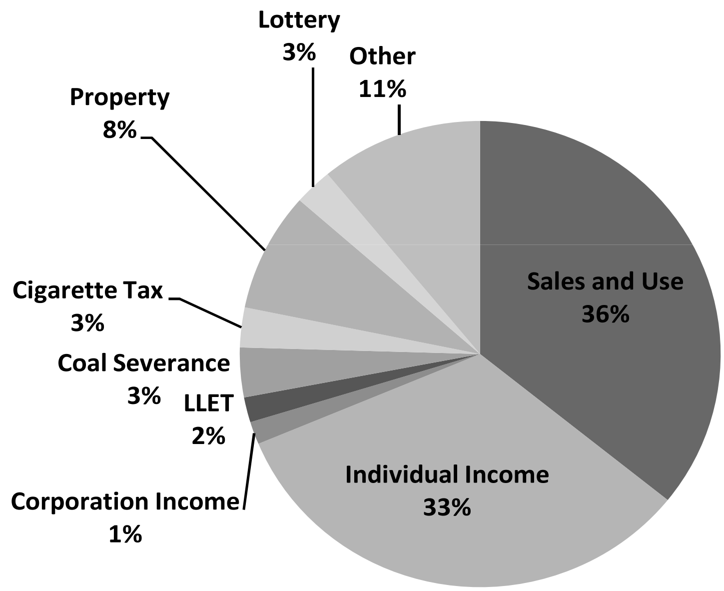
Cigarette taxes increased in the third quarter. Receipts of $58.5 million were 2.2 percent more than collected in the third quarter of FY11. The presence of substitutes for cigarettes, like little cigars and roll-your-own cigarettes appear to be eroding the tax base for traditional cigarette sales.

Lottery receipts of $54.5 million grew $6.0 million, or 12.3 percent over the total collected in the third quarter of FY11.

The "Other" category represents the remaining accounts in the General Fund, and collections in this account increased 7.8 percent with receipts of $231.8 million.

Figure 1 details the composition of third-quarter General Fund receipts by tax type. Sixty-nine 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 11.0 percent. The major components in this category include insurance premium taxes, the bank franchise tax, telecommunications taxes, alcohol sales and excise taxes, inheritance taxes, and mineral severance taxes. Property tax accounted for 8.0 percent. Coal severance, Lottery receipts and cigarette taxes accounted for 3.0 percent each. Finally, corporation income accounted for 1.0 percent.

Figure 1
General Fund Receipts Composition
Third Quarter, FY12



ROAD FUND

Road Fund revenues increased 7.1 percent in the third quarter of FY12. Receipts totaled $353.6 million compared to the $330.1 million received in the third quarter of last fiscal year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

Motor fuels tax receipts increased 10.4 percent during the third quarter of FY12. Receipts were $188.5 million and compare to $170.8 million collected during the third quarter of last year. While taxable gallons have been relatively flat, changes in the statutorily-defined fuels tax rate has accounted for the growth in this revenue source.

Table 2 Summary Road Fund Receipts Third Quarter, FY12, $ millions				
	FY12	FY11	Diff ($)	Diff (%)
Motor Fuels	188.5	170.8	17.7	10.4
Motor Vehicle Usage	102.1	100.7	1.5	1.5
Motor Vehicle License	33.6	28.0	5.6	19.9
Motor Vehicle Operators	3.8	3.8	0.0	0.1
Weight Distance	18.5	18.4	0.1	0.6
Investment Income	0.4	0.2	0.1	54.0
Other	6.7	8.2	-1.5	-18.6
Total	**353.6**	**330.1**	**23.5**	**7.1**

Motor vehicle usage tax receipts increased 1.5 percent, or $1.5 million, during the third quarter. Receipts were $102.1 million compared to $100.7 million collected during the same period last year. The trade-in credit for last year and pent up demand for autos this year have finally generated growth in this important source of Road Fund revenue.

Motor vehicle license tax receipts were up 19.9 percent during the third quarter of FY12. Receipts of $33.6 million compare to $28.0 million received during the third quarter of FY11. Motor vehicle license taxes were affected by truck license plates being higher than last year.

Motor vehicle operators' license fees totaled $3.8 million, a 0.1 percent increase compared to the level observed a year ago.

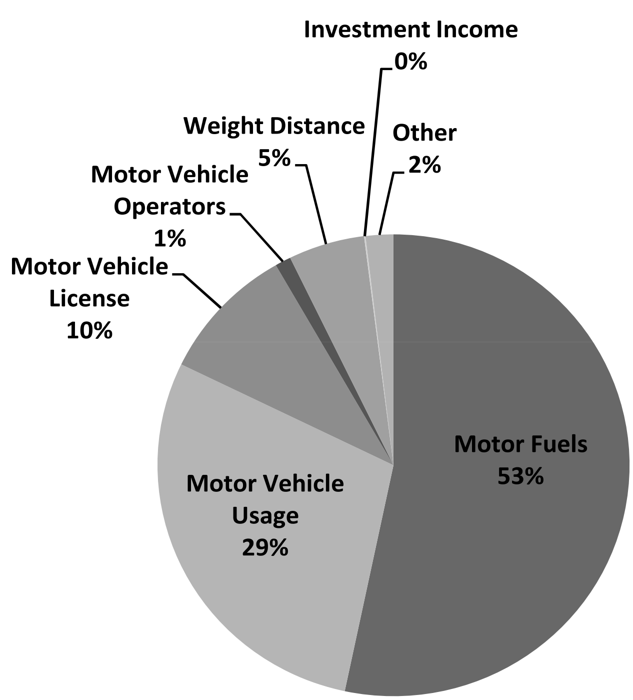
Weight distance tax receipts of $18.5 million increased 0.6 percent compared to receipts of $18.4 million collected during the third quarter of last year. The weight distance tax has some significance as a leading indicator of economic activity as it is a good proxy for goods in transit over Kentucky highways.

Investment income increased 54.0 percent in the third quarter of FY12. Receipts of $0.4 million compare to $0.2 in the third quarter of FY11.

The remainder of the accounts in the Road Fund combined for a decrease of 18.6 percent. Receipts for the "Other" category totaled $6.7 million during the third quarter compared to $8.2 million in the third quarter of FY11.

Figure 2 details the composition of Road Fund revenues by tax type in the third quarter of FY12. Motor fuels taxes and the motor vehicle usage tax accounted for 82.0 percent of Road Fund revenues in the third quarter. The next-largest sources of revenue were the motor vehicle license tax with 10.0 percent followed by weight distance with 5.0 percent. The "Other" category accounted for 2.0 percent, while motor vehicle operators' license fees comprised 1.0 percent. Investment income accounted for less than one-half percent of total Road Fund receipts.

Figure 2
Road Fund Receipts Composition
Third Quarter, FY12



The Economy
Third Quarter FY12

NATIONAL ECONOMY

Real gross domestic product (real GDP) rose by 2.0 percent in the third quarter of FY12. While this is very modest growth during an expansion period, real GDP has grown in every quarter since the recovery period began, which occurred in the first quarter of FY10. Real GDP is defined as the sum of all final goods and services sold within a country's physical boundaries in a given year. Real GDP can be broken down into five major components: consumption, investment, government expenditures, exports and imports. Real GDP for the United States is estimated to have risen to $13,491.6 billion in the third quarter of FY12.

Real consumption makes up 70.5 percent of real GDP. Consumption grew 1.5 percent in the third quarter of FY12 over the third quarter FY11. Consumption in the third quarter of FY11, however, grew 2.8 percent over the third quarter of FY10. Consumption growth, while positive, is still lower than a trendline of consumption growth for the 10-year period preceding the recession. As the largest component of real GDP, consumption will need to grow at 2.5 percent or higher on a consistent basis for real GDP to escape its current morose state.

Real investment, which makes up 14.1 percent of real GDP, had both the largest absolute and percentage improvements among all the real GDP components in the third quarter. (See Table 3) Real investment has still not surpassed its pre-recession peak. During the 2007 recession, real investment fell by a net $869.1 billion, or 38.3 percent. It reached a trough in the fourth quarter of FY09. Real investment has sustained relatively stable growth since that time. Real investment has regained a net 58.8 percent of its recession losses.

Real government expenditures which makes up 18.4 percent of real GDP in the third quarter, have declined by a net 1.4 percent over the last five quarters. This decline has been fairly consistent, declining in four of the last five quarters. Real government expenditures have declined seven times in the 11 quarters since the end of the 2007 recession. It is common for government expenditures to decline immediately following a recession, as transfers in the form of unemployment payments and other welfare payments decline.

Both exports and imports have increased moderately over the last five quarters. Exports growth has outstripped imports growth and therefore the trade deficit has closed slightly over that time. The trade deficit is the difference between exports and imports. The trade deficit/surplus (or net exports, as it is sometimes called) is important to real GDP because imports are subtracted from real GDP and exports are added to real GDP. The trade deficit/surplus is a function of several factors, including import demand for the goods being exported abroad, the income level of the

Table 3
Summary of US Economic Series
Third Quarters of FY12 & FY11

	Q3			
	FY12	FY11	$ Chg	% Chg
Real GDP	13,491.6	13,227.9	263.7	2.0
Real Consumption	9,518.3	9,376.7	141.6	1.5
Real Investment	1,907.8	1,750.9	156.9	9.0
Real Govt. Expenditures	2,479.2	2,513.9	-34.7	-1.4
Real Exports	1,816.6	1,749.6	67.0	3.8
Real Imports	2,228.2	2,173.9	54.3	2.5
Personal Income ($ billions)	13,276.4	12,846.9	429.5	3.3
Wages and Salaries ($ billions)	6,883.3	6,578.2	305.1	4.6
Inflation (% chg of CPI)	2.9	2.1	NA	NA
Industrial Production Index (% chg)	3.8	5.4	NA	NA
Civilian Labor Force (millions)	154.5	153.3	1.2	0.8
Total Non-farm Employment (millions)	132.6	130.7	1.9	1.5
Manufacturing Employment (millions)	11.9	11.7	0.2	2.1
Unemployment Rate (percent)	8.2	9.0	NA	NA

Not Seasonally Adjusted. Real series are in billions of chained 2000 dollars.
GDP components do not sum to GDP because each component is converted
to real terms independently. Data for FY12 Q3 are March 2012 estimates.
Source: IHS Global Insight Inc., March 12, 2012 data release

importing country, the terms of trade (that is, the relative prices of goods being traded), and the exchange rate between the currencies of the trading countries. The trade deficit, which has expanded considerably in the last four decades, closed significantly during the 2007 recession, as the incomes of US buyers declined and purchased even less goods than foreign buyers purchased from US exporters. Following the trough in the 2007 recession, the trade deficit expanded for several quarters. By mid-2010, the trade deficit stabilized and has established above average improvement since then.

US personal income rose by 3.3 percent in the third quarter. This growth rate which spans five quarters is solid growth, but still below growth during most of the 2000's, preceding the 2007 recession. Recent growth in personal income is driven by solid growth in the wages and salaries component. Wages and salaries grew by 4.6 percent in the third quarter.

US non-farm employment rose by 1.5 percent or 1.9 million jobs in the third quarter over the third quarter of FY11. US manufacturing employment rose by a similar amount, gaining 2.1 percent over the third quarter of FY11. The unemployment rate improved from 9.0 percent to 8.2 percent during the same time period.

KENTUCKY ECONOMY

Kentucky personal income grew by 3.5 percent in the third quarter. The third quarter grew by 1.1 percent over the second quarter. There has been increased volatility in Kentucky personal income over the last several quarters. Personal income fell by a fractional amount in the first quarter of

FY12 compared to the fourth quarter of FY11. In the second quarter, personal income jumped 1.5 percent over the first quarter. The recent growth rates are moderate in a historical sense but are not quite as robust as the growth rates occurring at the same point in previous recovery periods. During the 1990's, single quarter growth rates were frequently above 1.5 percent.

Wages and salaries, which makes up the largest share of personal income, grew by 1.6 percent over the second quarter. With solid growth over the past four quarters, the wages and salaries component is up 5.2 percent over the third quarter of FY11. Proprietary income was the only major component of personal income which fell, but it only fell by 0.1 percent over the second quarter. The biggest gainer was dividends income, which rose by 2.2 percent over the second quarter. Proprietary and dividends income make up 5.6 percent and 14.4 percent of Kentucky personal income respectively.

Transfer income, which makes up 23.8 percent of Kentucky personal income, continues to rise during the recovery. The increase has occurred in both nominal terms and in terms of share of total personal income. Transfer income rose by 0.5 percent in the third quarter. In 1998, transfer income made up 16.8 percent of total personal income in Kentucky. The share of transfer income relative to total personal income has increased steadily since that time. Kentucky transfer income did not decline following the 2001 recession either. Kentucky transfer income has increased a net 5.7 percent since the first quarter of FY10.

Kentucky employment grew by 3.7 percent in the third quarter. The solid growth is widespread across the supersectors. Eight of the 11 supersectors grew in the third quarter. (See Table 4) The biggest winner in the third quarter was manufacturing employment, which grew by 24.6 percent or a 51,800 increase over the third quarter of FY11. Adjacent quarter growth for the last four quarters was 0.2, 1.0, 0.9, and 22.0 percent respectively.

Table 4
Summary of Kentucky Economic Series
Third Quarters of FY12 & FY11

	Q3			
	FY12	**FY11**	**$ Chg**	**% Chg**
Personal Income ($ millions)	150,376.0	145,323.0	5,053.0	3.5
Wages and Salary Income ($ millions)	77,743.9	73,889.0	3,854.9	5.2
Nonagricultural Employment (thousands)	1,852.7	1,786.2	66.5	3.7
Goods Producing (thousands)	355.2	300.5	54.8	18.2
Construction	68.9	67.6	1.3	2.0
Mining	24.1	22.4	1.7	7.5
Manufacturing	262.2	210.4	51.8	24.6
Service Providing (thousands)	1,170.9	1,153.5	17.3	1.5
Trade, Transportation & Utilities	369.3	364.1	5.2	1.4
Information	26.5	27.0	-0.4	-1.6
Finance	84.7	84.9	-0.2	-0.2
Business Services	189.2	184.1	5.0	2.7
Educational Services	258.1	253.9	4.2	1.7
Leisure and Hospitality Services	172.3	169.2	3.1	1.9
Other Services	70.7	70.3	0.4	0.5
Government (thousands)	326.7	332.2	-5.5	-1.7

Not Seasonally Adjusted. Data for FY12 Q3 are March 2012 estimates.
Source: IHS Global Insight Inc. and Governor's Office for Economic Analysis MAK model

Mining employment, which is largely coal and limestone mining employment, grew by 7.5 percent, or 1,700 jobs during the last year. Business services employment growth is a bit misleading. Business services employment grew by 2.7 percent over the third quarter of FY11. However, the growth has greatly declined over the past few quarters. Adjacent-quarter growth over the last four quarters has been 0.2, 2.9, 1.3 and -1.7 percent respectively. Overall, the last year has been a successful year for business services employment, which has grown by a net 5,000 jobs. The biggest declining component in the third quarter is government employment. Government employment includes both state and local level government employees. Government employment declined by 1.7 percent in the third quarter. Government employment is the second largest supersector employment category. The third quarter of FY12 marks the fourth consecutive quarter that government employment has declined.

Interim Outlook

GENERAL FUND

The revenue forecasts presented in Table 5 and Table 6 were estimated using the March 2012 "control scenario" economic forecast from both IHS Global Insight and the Kentucky MAK model. The FY12 estimates presented here show slight improvements since the Quarterly Economic and Revenue Report released in January 2012. Underlying economic conditions have improved for the near-term forecast, as illustrated in the Economic Outlook section of this report. Moreover, growth in the General Fund through the first nine months of FY12 stands at 4.3 percent, somewhat ahead of the 2.8 percent growth projected by the CFG in December 2011.

The official General Fund estimate for FY12 is $9,007.7 million, an increase of 2.8 percent over FY11 collections. Projected General Fund revenues for the next three quarters are shown in Table 5. As the table indicates, General Fund growth is projected to slow but remain positive at 1.3 percent over the final quarter of the fiscal year. This will generate 3.5 percent growth for the year and a projected positive difference of $58.4 million over the official estimates. It should be noted that revenue estimates enacted by the 2012 General Assembly for FY13 are in excess of the official estimates due to actions enacted in legislation. The official enacted estimates will be profiled in the fourth quarter report.

Individual income tax receipts, which are composed of four components (withholding, declarations, fiduciary and net returns), are expected to increase by 2.6 percent in the final quarter of FY12 before showing more robust growth in the first half of FY13. The largest component of individual income tax

Table 5
General Fund Interim Forecast
($ millions)

	FY12 Q1, Q2 & Q3		FY12 Q4		FY12 Full Year		FY13 Q1 & Q2		FY12 Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Individual Income	2,425.6	2.5	1,077.9	2.6	3,503.5	2.5	1,819.1	5.2	3,484.2	19.3
Sales & Use	2,267.5	5.2	766.3	3.5	3,033.8	4.7	1,566.9	3.7	3,007.4	26.4
Property	491.5	5.3	46.3	-3.5	537.8	4.5	275.5	-13.1	518.8	19.0
Corporation Income	219.8	45.0	150.0	0.5	369.8	22.9	184.8	-1.0	333.5	36.3
Coal Severance	232.7	8.3	84.8	4.8	317.5	7.3	160.6	0.4	326.7	-9.2
Cigarettes	185.4	-4.1	69.0	-0.1	254.4	-3.0	122.9	-3.1	253.6	0.8
LLET	123.6	-11.6	65.0	-14.4	188.6	-12.6	90.3	4.0	218.3	-29.7
Lottery	156.0	8.7	55.0	-3.5	211.0	5.2	104.5	3.0	211.0	0.0
Other	499.4	1.3	150.3	-7.5	649.6	-0.9	280.6	4.9	654.2	-4.6
General Fund	6,601.5	4.3	2,464.6	1.3	9,066.1	3.5	4,605.2	2.6	9,007.7	58.4

receipts is withholding, which makes up 98 percent of total individual income tax receipts. Withholding, in turn, is closely tied to wages and salaries and employment in the state. As growth in these two series slightly exceeds the consensus projections, so too does the growth in withholding. Individual income tax receipts are expected to rise 5.2 percent in the first half of FY13.

Growth in sales and use tax collections is expected to remain healthy for the remainder of the fiscal year and the early half in FY13. Sales and use receipts are closely tied to personal income and disposable income. Sales and use receipts are forecasted to rise 3.5 percent in the final quarter after growing 5.2 percent in the first nine months of the fiscal year for an annual sum $26.4 million ahead of projections. Receipts are expected to increase 3.7 percent in the first six months of FY13.

Property tax revenues are expected to decline marginally by 3.5 percent in the final quarter of FY12 after strong growth in the third quarter. The disparity in growth rates is due to the volatile nature of the tax. Nearly two-thirds of total property tax receipts are collected during a three month period (November through January). With such a compressed collection schedule, small changes in the timing of collections can produce large fluctuations in growth rates. The full year of collections for FY12 are expected to rise a modest 4.5 percent over FY11, a sum $19.0 million greater than the CFG estimate. Receipts are expected to decline in the first half of FY13 due to a reversal of the timing trend from FY12.

Corporation income and LLET collections are performing as expected. The LLET is a backstop for the corporation income tax, meaning that when corporate profits and tax receipts fall, LLET collections rise and vice versa. That pattern is evident in FY12 collections as well as in the forecast. Over the first nine months of the fiscal year, corporation income tax collections grew 45.0 percent while LLET receipts declined 11.6 percent. For the remainder of FY12, corporate tax collections are expected to be relatively flat and LLET receipts are projected to decline 14.4 percent.

Coal severance receipts year-to-date in FY12 have grown 8.3 percent over FY11 levels. Severed tons continue their long-run decline; however, higher contract prices have kept receipts at all-time highs. The outlook for coal severance receipts is for growth of 4.8 percent in the fourth quarter of FY12 and 0.4 percent in the first quarter of FY13. If the fourth quarter projection holds, coal severance receipts will fall $9.2 million short of the official CFG estimate.

Both nationally and in Kentucky smoking has declined, as measured by the number of packs sold. Cigarette receipts declined 4.1 percent in the first nine months of FY12 but the downward trend is expected to stabilize over the forecast horizon. The outlook for cigarette tax receipts is for a nominal 0.1 percent decline for the remainder of FY12 and 3.1 percent drop in the first half of FY13.

Lottery receipts are determined by the Lottery Corporation's dividend schedule. Lottery receipts are projected to end FY12 at $211.0 million, an increase of 5.2 percent over FY11 levels. Expected receipts of $104.5 million for the first half of FY13 represent an increase of 3.0 percent.

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 7.5 percent in the final quarter before rising 4.9 percent in the first half of FY13. The fourth quarter decline in "Other" revenues is directly attributable to an accounting adjustment in the way investment income is recorded following the new federal guidelines requiring accrual accounting of net capital gains and losses.

ROAD FUND

Road Fund revenues are forecasted to grow in the final quarter of FY12, although at a less robust rate than was seen in the first nine months. Growth in revenues will continue, but at a slower rate, in the first two quarters of FY13 as shown in Table 6. Growth rates for the fourth quarter of the current fiscal year and the first six months of FY13 are forecast to be 4.4 percent and 3.2 percent, respectively. The FY12 full-year forecast is $14.1 million more than the official revenue forecast as approved by the CFG on December 21, 2011.

Motor fuels tax collections are forecasted to grow 6.8 percent over the final three months of FY12, due primarily to the increase in the tax rate on motor fuels. Receipts in the first two quarters of FY13 will slow, increasing only 4.6 percent, as higher gas prices reduce consumption.

Motor vehicle usage tax collections will remain strong in the fourth quarter, growing 5.6 percent. However, growth in this account will subside in the first two quarters of FY13, increasing only 3.7 percent.

The remaining components of the Road Fund contain large administrative components, which greatly affects their absolute levels and the timing of receipts. Therefore, 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 produce the estimates in this report.

Motor vehicle license taxes are forecasted to decrease 2.2 percent in the final quarter of FY12 and fall 15.9 percent in the first two quarters of FY13. The large decline is due to timing and one-time events which inflated FY12 receipts. Motor vehicle operators' licenses are projected to grow 5.6 percent in the remainder of the fiscal year and then increase 7.4 percent in the first six months of FY13. Weight distance tax revenue is expected to show improvement, increasing 2.9 percent for the remainder of the fiscal year and 4.0 percent over the first two quarters of FY13. Investment income is projected to fall 27.7 percent over the remainder of the fiscal year but increase $1.7 million in the first half of FY13. All other revenues should combine for a decrease of 21.3 percent during the last three months of FY12 and remain flat in the first two quarters of FY13.

Table 6
Road Fund Interim Forecast
($ millions)

	FY12 Q1, Q2 & Q3		FY12 Q4		FY12 Full Year		FY13 Q1 &Q2		FY12 Official CFG	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	% Chg	Estimate	$ Diff
Motor Fuels	589.8	7.7	197.9	6.8	787.7	7.5	419.9	4.6	779.5	8.2
Motor Vehicle Usage	298.6	6.6	107.5	5.6	406.1	6.4	203.7	3.7	402.7	3.4
Motor Vehicle License	75.6	20.5	34.3	-2.2	109.9	12.4	35.3	-15.9	100.8	9.1
Motor Vehicle Operators	11.7	-1.8	4.0	5.6	15.7	0.0	8.5	7.4	15.8	-0.1
Weight Distance	56.4	1.0	18.7	2.9	75.1	1.5	39.4	4.0	79.4	-4.3
Investment	0.1	-90.4	0.6	-27.7	0.8	-62.5	1.7	639.1	0.5	0.3
Other	22.9	-4.7	8.4	-21.3	31.3	-9.8	15.8	0.0	33.8	-2.5
Total Road Fund	**1,055.1**	**7.3**	**371.5**	**4.4**	**1,426.6**	**6.6**	**724.3**	**3.2**	**1,412.5**	**14.1**

NATIONAL ECONOMY

The previous three quarterly reports released by the OSBD depicted a national economy beset with uncertainties. Corporate profits remained strong, but employment and wages were stagnant due to the uncertainty of a global rebound in aggregate demand. Monetary policy and quantitative easing have helped to maintain a low cost of capital, but the new banking requirements have made it more difficult to turn excess financial reserves into loans outstanding. As the recovery matured, the export sector was showing signs of a stable source of demand for domestic goods and services – until economic woes in the economies of our global trading partners doused the fire. Finally, fairly robust GDP growth in the final calendar quarter of 2011 left economists to contemplate whether the new growth was a portent of an acceleration of the recovery or, simply, an inevitable inventory adjustment partially attributable to the desire of businesses to narrow margins to avoid redundancy in the marketplace.

The chances of a "double-dip" recession have become less likely as the economy draws further from the official end of the recession. Global Insight now places an equal weight of 20 percent on both the optimistic and pessimistic economic scenarios, with a 60 percent likelihood of the moderate-growth control forecast. Three pivotal issues have come to the forefront as keys to the near-term health of the economy: fuel prices, labor markets, and the economic well-being of our trading partners.

Risks of higher fuel prices remain the biggest short-run risk. As summer approaches, the typical seasonal price volatility will be layered on top of the risk premium from political unrest in Iran and the Middle East. Any supply disruptions could further escalate fuel prices, especially if shipping through the Strait of Hormuz becomes risky or uncertain. Higher fuel prices lead to lower levels of disposable income, as a higher percentage of household income is needed for transportation costs. Higher transportation costs also lead to higher inflation, as the cost to bring goods to market increase. Both lower disposable income and higher prices depress current discretionary consumption, a major component of GDP. During the holiday season, US consumption finally rebounded after the prolonged period of deleveraging from the housing crash. The improved employment outlook will help buoy consumption provided that fuel prices don't appreciably escalate.

Labor markets have improved thus far in calendar year 2012. Economists touted improved employment numbers as a barometer of the strength on the recovery, but the increase in employment has not triggered a concomitant increase in output. In fact, the GDP outlook in the near term is not as robust as the news from the labor market. Global Insight points to a couple of possible reasons, both related to quirks in the data. A mild winter tends to make the employment numbers look better as fewer workers are disrupted by inclement weather. Also, the GDP and output numbers look softer than usual because of the comparison to the fourth calendar quarter of 2011, which was high due to the much-heralded inventory replacement effect. Another possible explanation is the aftermath of a prolonged recession, where employment dropped sharply without sharp losses in output. Output-per-worker gains helped corporations keep output more stable than the input of labor, thus leading to profitability opportunities through cost reductions. Much of the gain from cutting labor costs have already been realized, so additional increases in output will create a higher demand for labor. The next step to growing corporate profits must come from growing revenues, which typically requires new productive machinery and additional workers.

The other prominent risk to the near-term prosperity of the domestic economy is the relative health of US trading partners. In particular, the Eurozone and China are the most closely watched economies with the potential to create world-wide shock waves. The Eurozone risks have diminished sharply due to the massive financial stimulus injected into the banking system. Europe in large measure followed the same game plan as the US Federal Reserve System: A large influx of reserves to help mitigate the balance sheet issues of large national banks and restore confidence. The situation in China also has similarities to the Great Recession in the US, but the magnitudes are different due to the emerging nature of China's double-digit infrastructure and prosperity growth. A hard landing for the national economy still predicts growth of 5 or 6 percent, much lower than the prior decade but growth nonetheless. Recent data from the region supports a much softer landing as production and freight traffic have once again begun to escalate.

Control, optimistic, and pessimistic variations of the basic forecast involve the matters of degree at which the aforementioned risks play out in the coming months. The control scenario assumes that fuel prices rise modestly but then subside as global risks eventually wane. It also assumes that output rises in rough proportion to employment with no declines in marginal productivity. Finally, US trading partners will have rough patches in the immediate term, but both China and the Eurozone will show resilience by the end of 2012.

The upside risk involves a scenario where the private sector recovers more quickly than expected due to moderating fuel prices, improvement in foreign trade, and a consumption sector of GDP that fuels a more robust increase in output. Financial markets will respond by easing credit to consumers ready to start buying again after a long period of deleveraging. Global Insight has assigned a 20 percent probability to the pessimistic scenario and a 20 percent probability to the upside scenario. All of the state economic and revenue projections use only the control forecast from Global Insight, which continues to carry an overwhelming majority as the desired point estimate.

The pessimistic scenario is triggered by an immediate jump in fuel prices, where $5.00 per gallon gasoline replaces the nominal ceiling nationwide. The drop in discretionary spending short-circuits the health of the consumption sector and derails improvement in the labor market. Further deterioration in the health of our global trading partners provides additional downward pressure on economic aggregates and ignites a short-term double-dipped recession.

KENTUCKY ECONOMY

A comparison of tables and 7 and 8 show that personal income growth in Kentucky is expected to be 4.2 percent in the first half of FY13 compared to the 4.0 percent national average. The rebound in employment for Kentucky will likely be higher as well, with 3.7 percent growth in non-farm employment in Kentucky versus 1.6 percent growth nationwide. Wage and salary growth comparisons are also favorable with 5.2 percent growth expected for Kentucky versus 4.2 percent nationally.

Early in the recovery, US growth rates in employment and wages outpaced the Kentucky comparisons. This was partially attributable to the more muted declines in peak to trough economic aggregates in Kentucky versus the country as a whole. That pattern of growth rates has now reversed in the short-term forecast.

In summary, the forecast calls for growth much in line with the projections used by the CFG during the December 2011 official estimates. The projections for some of the national economic aggregates have actually increased since the official estimates, but the main revenue drivers (employment, wages, and personal income) are very much congruous if not slightly better than our official estimates. One positive note is that the upside and downside risks have equalized at a 20 percent chance. Another positive note is that Kentucky’s nominal employment and income levels have improved vis-à-vis their national counterparts. Kentucky now appears to be slightly outperforming the national economy.

Table 7
US and Kentucky Economic Outlook
Fourth Quarter of FY11 & FY12

	Q4			
	FY12	**FY11**	**Chg**	**% Chg**
United States				
Real GDP	13,561.7	13,271.8	289.9	2.2
Real Consumption	9,577.2	9,392.7	184.5	2.0
Real Investment	1,936.3	1,778.4	157.9	8.9
Real Government Expenditures	2,468.6	2,508.2	-39.6	-1.6
Real Exports	1,831.9	1,765.0	66.9	3.8
Real Imports	2,247.1	2,181.4	65.7	3.0
Personal Income ($ billions)	13,418.7	12,955.3	463.4	3.6
Wage & Salary ($ billions)	6,949.4	6,617.1	332.3	5.0
Inflation (% chg CPI)	2.2	3.3	NA	NA
Industrial Production Index (% chg)	4.7	3.8	NA	NA
Civilian Labor Force (millions)	154.8	153.5	1.2	0.8
Total Nonfarm Employment (millions)	133.1	131.2	1.8	1.4
Manufacturing Employment (millions)	12.0	11.7	0.3	2.5
Unemployment Rate (percent)	8.3	9.0	-0.8	NA
Kentucky				
Personal Income ($ millions)	151,867.9	146,671.0	5,196.9	3.5
Wage & Salary ($ millions)	78,461.0	74,418.0	4,043.0	5.4
Non-farm Employment (thousands)	1,856.8	1,788.0	68.8	3.8
Goods Producing (thousands)	355.7	302.2	53.4	17.7
Service Providing (thousands)	1,175.6	1,155.4	20.2	1.7
Government (thousands)	325.6	330.4	-4.8	-1.4

Not Seasonally Adjusted. Real series are in billions of chained 2000 dollars.
Data for FY12 Q4 are estimates based on the IHS Global Insight Control scenario.
Source: IHS Global Insight Inc., March 12, 2012 data release

Table 8
US and Kentucky Economic Outlook
First and Second Quarters of FY12 & FY13

	Q1 & Q2		
	FY13	**FY12**	**% Chg**
United States			
Real GDP	13,660.2	13,380.8	2.1
Real Consumption	9,652.9	9,458.6	2.1
Real Investment	1,987.9	1,826.9	8.8
Real Government Expenditures	2,448.0	2,493.7	-1.8
Real Exports	1,875.1	1,794.6	4.5
Real Imports	2,291.4	2,198.2	4.2
Personal Income ($ billions)	13,628.5	13,107.8	4.0
Wage & Salary ($ billions)	7,054.9	6,769.4	4.2
Inflation (% chg CPI)	1.9	3.5	NA
Industrial Production Index (% chg)	3.9	3.8	NA
Civilian Labor Force (millions)	155.2	153.8	0.9
Total Nonfarm Employment (millions)	133.8	131.8	1.6
Manufacturing Employment (millions)	12.1	11.8	2.9
Unemployment Rate (percent)	8.1	8.9	NA
Kentucky			
Personal Income ($ millions)	153,946.6	147,670.7	4.2
Wage & Salary ($ millions)	79,499.9	75,568.2	5.2
Non-farm Employment (thousands)	1,863.3	1,796.0	3.7
Goods Producing (thousands)	354.8	303.8	16.8
Service Providing (thousands)	1,184.0	1,163.8	1.7
Government (thousands)	324.4	328.5	-1.2

Not Seasonally Adjusted. Real series are in billions of chained 2000 dollars.
Data for FY13 Q1 & Q2 are estimates based on the IHS Global Insight Control scenario.
Source: IHS Global Insight Inc., March 12, 2012 data release

APPENDIX

KENTUCKY STATE GOVERNMENT - GENERAL FUND REVENUE

	Third Quarter FY 2012	Third Quarter FY 2011	Percent Change	Year-To-Date FY 2012	Year-To-Date FY 2011	Percent Change
TOTAL GENERAL FUND	**$2,115,087,283**	**$1,973,154,602**	**7.2%**	**$6,601,473,199**	**$6,326,610,527**	**4.3%**
Tax Receipts	$2,047,810,733	$1,906,818,879	7.4%	$6,377,995,392	$6,105,198,939	4.5%
Sales and Gross Receipts	$913,290,718	$856,423,547	6.6%	$2,697,468,116	$2,586,982,194	4.3%
Beer Consumption	1,286,767	1,279,362	0.6%	4,427,063	4,518,679	-2.0%
Beer Wholesale	11,264,313	11,068,184	1.8%	39,167,918	38,905,143	0.7%
Cigarette	58,536,650	57,255,647	2.2%	185,369,081	193,191,495	-4.0%
Distilled Spirits Case Sales	28,990	25,631	13.1%	87,221	(262,235)	---
Distilled Spirits Consumption	2,808,378	2,505,497	12.1%	8,459,555	8,065,427	4.9%
Distilled Spirits Wholesale	7,434,388	6,423,748	15.7%	22,017,096	20,662,241	6.6%
Insurance Premium	50,101,632	47,201,616	6.1%	90,675,929	87,673,571	3.4%
Pari-Mutuel	423,587	280,767	50.9%	1,729,470	2,899,983	-40.4%
Race Track Admission	19,349	1,972	881.3%	158,348	148,623	6.5%
Sales and Use	756,509,427	706,018,493	7.2%	2,267,516,164	2,156,176,174	5.2%
Wine Consumption	717,892	661,594	8.5%	2,063,959	1,920,649	7.5%
Wine Wholesale	3,684,834	3,419,814	7.7%	10,691,732	10,278,001	4.0%
Telecommunications Tax	15,327,784	15,178,608	1.0%	48,902,438	46,728,988	4.7%
OTP	5,132,476	5,057,603	1.5%	16,180,129	15,967,403	1.3%
Floor Stock Tax	6,489	(18,028)	---	14,251	45,011	-68.3%
License and Privilege	**$211,216,988**	**$199,215,117**	**6.0%**	**$487,676,040**	**$478,194,517**	**2.0%**
Alc. Bev. License Suspension	68,405	109,068	-37.3%	203,205	302,608	-32.8%
Coal Severance	72,802,345	69,927,941	4.1%	232,728,662	214,958,194	8.3%
Corporation License	(294,873)	1,325,588	---	432,165	10,242,141	-95.8%
Corporation Organization	13,092	27,532	-52.4%	34,759	56,400	-38.4%
Occupational Licenses	26,262	34,887	-24.7%	69,332	99,371	-30.2%
Oil Production	4,390,066	1,969,086	122.9%	8,940,510	5,718,769	56.3%
Race Track License	11,375	7,700	47.7%	206,375	216,450	-4.7%
Bank Franchise Tax	90,705,058	75,461,592	20.2%	92,593,333	78,365,472	18.2%
Driver License Fees	150,409	141,233	6.5%	455,847	454,566	0.3%
Minerals Severance	1,412,211	2,103,747	-32.9%	10,309,604	10,105,973	2.0%
Natural Gas Severance	5,165,089	6,103,885	-15.4%	18,107,180	17,911,156	1.1%
Limited Liability Entity	36,767,549	42,002,858	-12.5%	123,595,069	139,763,418	-11.6%
Income	**$729,767,108**	**$718,408,316**	**1.6%**	**$2,645,369,085**	**$2,519,115,967**	**5.0%**
Corporation	33,109,894	25,643,345	29.1%	219,792,035	151,567,676	45.0%
Individual	696,657,214	692,764,971	0.6%	2,425,577,050	2,367,548,291	2.5%
Property	**$174,426,342**	**$115,977,440**	**50.4%**	**$491,526,712**	**$466,819,322**	**5.3%**
Building & Loan Association	0	262,960	-100.0%	(46,134)	209,779	---
General - Real	93,486,663	54,990,677	70.0%	245,173,570	239,662,509	2.3%
General - Tangible	56,472,835	43,959,196	28.5%	172,138,170	159,470,802	7.9%
Omitted & Delinquent	4,311,141	8,935,195	-51.8%	15,869,622	29,368,939	-46.0%
Public Service	19,591,203	7,280,057	169.1%	57,068,602	36,812,761	55.0%
Other	564,501	549,355	2.8%	1,322,882	1,294,532	2.2%
Inheritance	**$10,673,117**	**$8,477,671**	**25.9%**	**$30,501,011**	**$29,303,781**	**4.1%**
Miscellaneous	**$8,436,461**	**$8,316,789**	**1.4%**	**$25,454,429**	**$24,783,158**	**2.7%**
Legal Process	4,973,475	4,871,262	2.1%	14,954,303	15,108,387	-1.0%
T. V. A. In Lieu Payments	3,404,963	3,404,199	0.0%	10,437,149	9,587,824	8.9%
Other	58,023	41,328	40.4%	62,977	86,946	-27.6%
Nontax Receipts	**$66,260,541**	**$64,501,316**	**2.7%**	**$221,270,519**	**$217,948,028**	**1.5%**
Departmental Fees	8,873,303	8,962,918	-1.0%	18,975,361	21,011,586	-9.7%
PSC Assessment Fee	1,747	(186,945)	---	5,437,974	8,728,213	-37.7%
Fines & Forfeitures	6,439,231	6,753,398	-4.7%	19,109,163	19,654,144	-2.8%
Interest on Investments	145,579	160,514	-9.3%	561,711	510,670	10.0%
Lottery	54,471,122	48,500,000	12.3%	155,971,122	143,500,000	8.7%
Sale of NOx Credits	20,000	0	---	20,000	22,513	-11.2%
Miscellaneous	(3,690,440)	311,431	---	21,195,188	24,520,903	-13.6%
Redeposit of State Funds	$1,016,008	$1,834,407	-44.6%	$2,207,287	$3,463,559	-36.3%

KENTUCKY STATE GOVERNMENT - ROAD FUND REVENUE

	Third Quarter FY 2012	Third Quarter FY 2011	Percent Change	Year-To-Date FY 2012	Year-To-Date FY 2011	Percent Change
TOTAL ROAD FUND	**$353,550,851**	**$330,056,756**	**7.1%**	**$1,055,060,112**	**$983,059,189**	**7.3%**
Tax Receipts-	$348,898,790	$324,574,865	7.5%	$1,039,576,071	$965,403,057	7.7%
Sales and Gross Receipts	**$290,602,265**	**$271,408,455**	**7.1%**	**$888,396,619**	**$827,492,581**	**7.4%**
Motor Fuels Taxes	188,468,355	170,756,803	10.4%	589,791,648	547,485,243	7.7%
Motor Vehicle Usage	102,133,910	100,651,652	1.5%	298,604,971	280,007,338	6.6%
License and Privilege	**$58,296,525**	**$53,166,410**	**9.6%**	**$151,179,453**	**$137,910,476**	**9.6%**
Motor Vehicles	33,568,688	27,987,065	19.9%	75,561,028	62,686,052	20.5%
Motor Vehicle Operators	3,835,045	3,829,302	0.1%	11,719,259	11,930,402	-1.8%
Weight Distance	18,475,811	18,370,820	0.6%	56,375,994	55,806,572	1.0%
Truck Decal Fees	29,696	17,248	72.2%	106,814	84,301	26.7%
Other Special Fees	2,387,285	2,961,975	-19.4%	7,416,358	7,403,149	0.2%
Nontax Receipts	**$4,464,385**	**$5,474,434**	**-18.5%**	**$14,715,416**	**$15,914,645**	**-7.5%**
Departmental Fees	3,851,080	4,813,977	-20.0%	12,955,096	13,549,880	-4.4%
In Lieu of Traffic Fines	196,139	194,241	1.0%	565,700	568,579	-0.5%
Investment Income	379,881	246,719	54.0%	610,070	1,109,666	-45.0%
Miscellaneous	37,285	219,497	-83.0%	584,549	686,521	-14.9%
Redeposit of State Funds	$187,676	$7,456	2417.1%	$768,625	$1,741,486	-55.9%