



Road Map

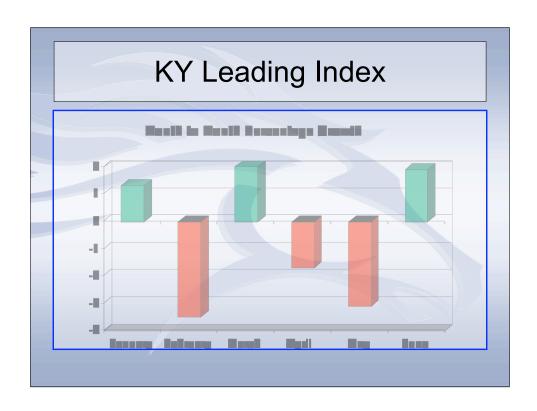


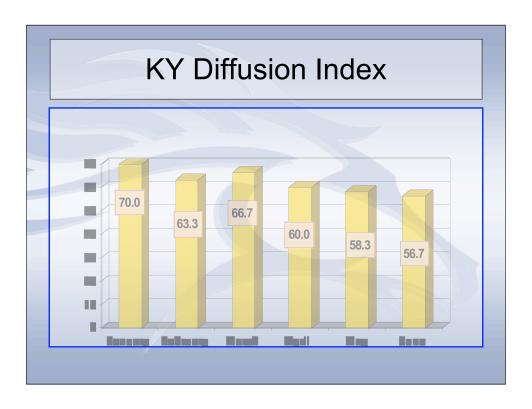
- Report on KY Leading Index changes
- The importance of state-specific economic indicators
- · Determination of reference series
- Cross-walking between real and fiscal economies
- · Indicator selection process
- Non-ergodic turning points

KY Leading Index

- Original Components
 - KY Labor intensity index
 - KY index of US leading indicators
 - Kentucky index of UI claims
 - Louisville help-wanted index
 - US manufacturing orders

- Revised as of April, 2006
 - U.S. Leading index was revised by the conference board, and no longer predicted KY turning points
 - Added an index of US manufacturing orders
 - Added US retail sales





Why do we need State Indicators?

- Third party external macro-economic forecasts are notoriously reluctant to pinpoint turning points
- State turning points do not match national turning points
- Policy makers need timely information on pending turning points ("Agents of Impatience" may make different decisions if they feel confident a turning point is pending.)

Determination of Reference Series

- Reference series or preponderance of data method?
- Leading indicators of economy, revenue, or both?
 - As revenue estimators, we ultimately care the most about fiscal economy
 - How closely do revenues mirror the economy?

The cross-walk

- KY has a blended reference series
- Revenues don't always behave predictably vis-à-vis the economy
- More research is needed on diffusion indices
 - During times between turning points, indicator advice is limited without diffusion analysis
 - Beyond turning points, a diffusion index predicts magnitude as well as direction

Indicator Selection

- Cautionary Advice
 - Don't be a homer (copper prices)
 - Sunk costs are sunk (F.W. Dodge)
 - Best data series require leg work
 - · Need more creative state-specific data
 - · Sharing of information among states
 - A leading index of component indicators
 - Combining related variables
 - Decreases volatility

Indicator Trials

- If I had a graduate student ...
 - Rail capacity
 - Commercial and Industrial electricity consumption
 - Truck miles on state highways
 - Delinquencies (state specific)
 - State specific fixed payments as a percentage of disposable income

Problems with New Data

- The problem with new variables:
 - Need a lot of history to match up to historical peaks and troughs
 - False peaks and troughs
 - Discontinuous data availability
 - New data releases must be regular and prompt

Non-ergodic Turning Points

- Not all recessions are created equal
- KY leading index in-sample performance
 - Clear turning points for the twin recession in early 1980's
 - Predicted short-lived recession of 1990
 - Predicted 2000 recession, but murky on the recovery
- Has the relationship between the economy and revenues changed over time?

Parting Shots

- Do not compromise on testing criteria
- · Roll up our sleeves and develop new data series
- Advocate leading indicators for individual revenue items rather than the economy
- Create a diffusion index
- Despite their limitations, leading indicators fill a much needed role of predicting turning points that States will not get from external macroeconomic models

