3. FISCAL STRATEGY AND OUTLOOK

- In recent years, the State's fiscal position has weakened. Growth in the State's expenses have far outpaced revenues. Expense growth peaked in 2021-22 at 25.0 per cent.
- At the 2023 Pre-election Budget Update, expenses were projected to total over $460 billion across the four years to 2025-26, resulting in five consecutive years of deficits with the largest deficit of $15.3 billion in 2021-22.
- High levels of spending left limited buffers to support the State in the event of a future shock, with the NSW Generations Fund (NGF) returns and the accounting treatment of rail spend through Transport Asset Holding Entity (TAHE) masking an ongoing underlying budget result deficit.
- The State's infrastructure program continued to expand, while high inflation was driving up input prices and the labour market was highly constrained. This has stretched the State's balance sheet, and higher debt has driven up interest expenses.
- Gross debt was expected to increase to $188.2 billion by June 2026 to fund infrastructure and invest in financial assets through the NGF, despite rising interest rates. This would have resulted in interest expenses of $7.0 billion by 2025-26 and net debt peaking at 14.0 per cent of gross state product (GSP) in June 2026.
- The 2023-24 Budget begins the task of repairing the State's fiscal position while delivering on the Government's election commitments to rebuild essential services, support families and provide targeted cost-of-living relief.
- Since the 2023 Pre-election Budget Update, State revenue is forecast to increase by $14.0 billion over the four years to 2026-27, supported by stronger transfer duty, land tax and payroll receipts. The Government has also delivered on the First Home Buyers Assistance Scheme, restructured mining royalties, and invested in increasing tax compliance.
- The Government's Comprehensive Expenditure Review has identified $13 billion in budget improvements, revenue, and reprioritisation measures – which will be reinvested into unfunded programs and essential services.
- As a result, the 2023-24 Budget now projects a deficit of $7.8 billion in 2023-24, before returning to an improved surplus of $844 million in 2024-25.
- Following the Government's Strategic Infrastructure Review, the State's infrastructure program is transitioning towards a more sustainable program that will place additional focus on delivering essential infrastructure. The program is projected to be $116.5 billion across the four years to 2026-27.
- The Government has taken steps to reduce the impact of the NGF and TAHE on the State's balance sheet, with gross debt projected to be $173.4 billion by June 2026, which is $14.8 billion below the 2023 Pre-election Budget Update. Net debt is now projected to peak at 12.6 per cent of GSP by June 2027, around 1.4 per cent lower than at the 2023 Pre-election Budget Update.

3.1 The State's recent fiscal pressures

Over the last four years, elevated levels of expense growth and increased borrowings have created significant budgetary pressures.

The State provided support to households and businesses through the COVID pandemic, with expense growth peaking at 25.0 per cent in 2021-22. However, expenses then remained high relative to historic trends, primarily due to new policy measures.

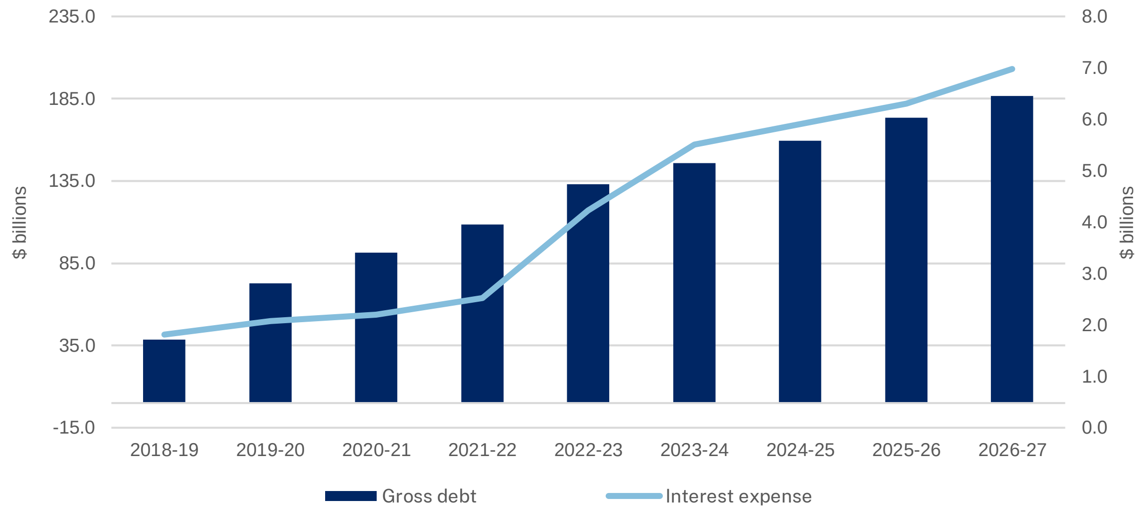
This resulted in significant budget deficits for the four years from 2019-20 to 2022-23, with the State projected to be in deficit again in 2023-24.

The rapidly escalating cost of the State's infrastructure program and relatively high levels of expenses have also greatly impacted the State's borrowing trajectory. General government gross debt has grown from $38.7 billion in June 2019 to $132.9 billion in June 2023.

The surge in debt issuance has also increased the State's exposure to interest rate and refinancing risks. Higher inflation has led to the Reserve Bank of Australia raising the cash rate 12 times since May 2022. This has increased the cost of servicing government debt, contributing to higher interest expenses. Additional borrowings to fund recent deficits have further driven up interest expenses, which are projected to cost $5.5 billion in 2023-24 alone.

The uncertain economic outlook (see Chapter 2 The Economy) is contributing to a volatile fiscal environment, with high inflation and the slowdown of the growth in the State economy remaining key issues in the medium-term.

Chart 3.1: General government gross debt and interest expense



3.2 Stabilising the State's fiscal position

The Government is committed to a more sustainable fiscal position, while balancing the delivery of targeted cost-of-living relief and bolstering essential services for the people of New South Wales.

This Budget introduces two key fiscal principles to guide the State's fiscal strategy:

- returning to, and then maintaining, a sustainable operating position
- stabilising and then maintaining a sustainable debt position.

More prudent management of the State's finances will help ensure recent deficits do not become entrenched, debt levels remain sustainable and interest expenses remain manageable.

Taxation revenue has increased by $17.6 billion over the four years to 2026-27 since the 2023 Pre-election Budget Update, principally driven by upward revisions to transfer duty, land tax and payroll tax. The strength in the NSW property market has resulted in a significant upwards revision to transfer duty and land tax of $9.5 billion and $4.9 billion respectively over the four years to 2026-27. Payroll tax has also been revised upward by $2.8 billion over the four years to 2026-27 since the 2023 Pre-election Budget Update, driven by strong demand in the labour market and rising wages. The Government has taken a restrained fiscal approach by directing some of the revenue improvement since the 2023 Pre-election Budget Update to the State's bottom line, helping rebuild the State's fiscal buffers.

The Government's Comprehensive Expenditure Review has identified $13.0 billion in budget improvement and reprioritisation measures over the five years to 2026-27.

This is comprised of $6.4 billion in budget improvement measures (including non-tax revenue measures) and $6.6 billion in reprioritisation and reprofiling measures. The savings and offsets are being directed to priority investments to support rebuilding essential services and the provision of further cost-of-living relief (see Box 5.1).

The Strategic Infrastructure Review has also helped guide the Government's infrastructure program back towards more sustainable levels by 2026-27 (see Box 3.2 for more information).

The Government has also taken steps to improve transparency in budget reporting by addressing legacy issues associated with the NGF and TAHE.

In this Budget, the budget result is presented with and without the net impact of the NGF. When the impact of the NGF is removed, the budget projects a small underlying deficit of $53 million in 2024-25, highlighting the need for continued fiscal discipline. See Box 3.1 for further information.

TAHE will transition from its current operating model as a statutory State-Owned Corporation to operating as a non-commercial public non-financial corporation. The new model will reform TAHE and eliminate some intra-government transactions that were required under the previous operating model This model lowers net debt by $4.3 billion in 2026-27.

Stabilising debt is critical to taking pressure off the State's interest expenses and avoiding further downgrades in the State's credit rating. Net debt is projected to peak at 12.6 per cent of GSP by June 2027, 1.4 per cent below the highest 2023 Pre-election Budget Update forecast of 14.0 per cent by June 2026. This pathway to fiscal sustainability will continue without privatising public assets.

The State's credit rating is reviewed by three credit rating agencies: Moody's, Fitch Ratings, and S&P Global. The State currently maintains a triple-A credit rating with Moody's and Fitch Ratings and a double-A plus rating with S&P Global (as of December 2021). For further information see Appendix E Performance and Reporting under the Fiscal Responsibility Act 2012.

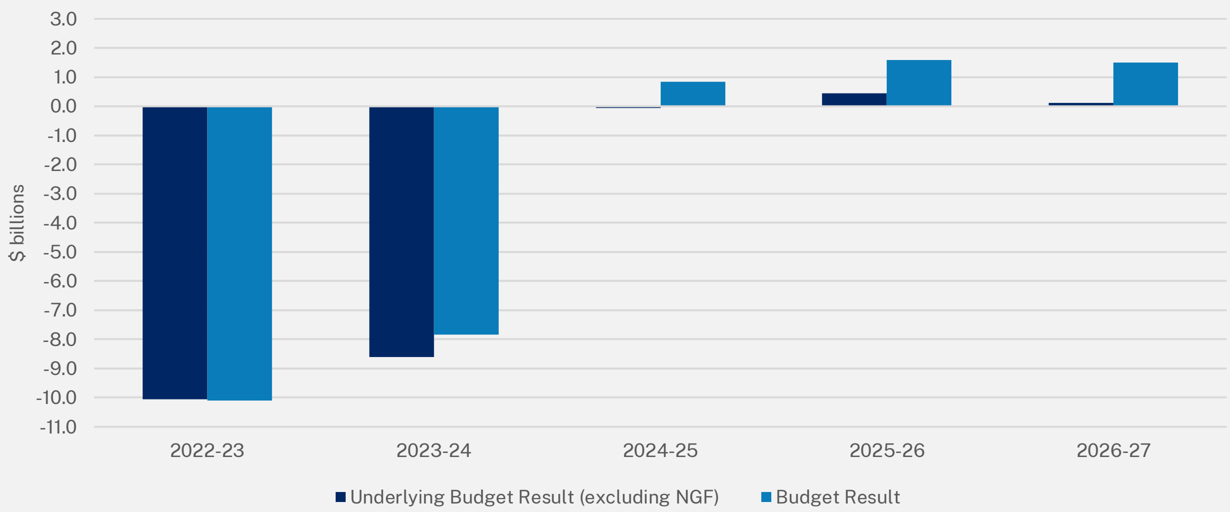
Box 3.1: Responsible, transparent financial management

Transparent budgeting supports better fiscal outcomes by allowing for greater accountability in the use of public funds. In recent years, as new initiatives such as the NGF and TAHE introduced additional complexity into the budget. As such, the need for improved transparency in budget reporting has increased.

This Budget includes improved reporting on the NGF, which was established in 2018. Legislation requires that NGF investment returns are used for debt retirement, meaning they are not available for general operating expenses.

To improve transparency around the State's operating position and better inform decision making, the 2023-24 Budget is reporting the general government budget result with and without the net impact of the NGF's investment returns (see Chart 3.2). This provides a better indication of the underlying sustainability of the Government's operating position, highlighting the need for a tighter fiscal policy stance moving forward.

Chart 3.2: General government budget result without the NGF net investment returns



3.3 The State's operating position remains challenging

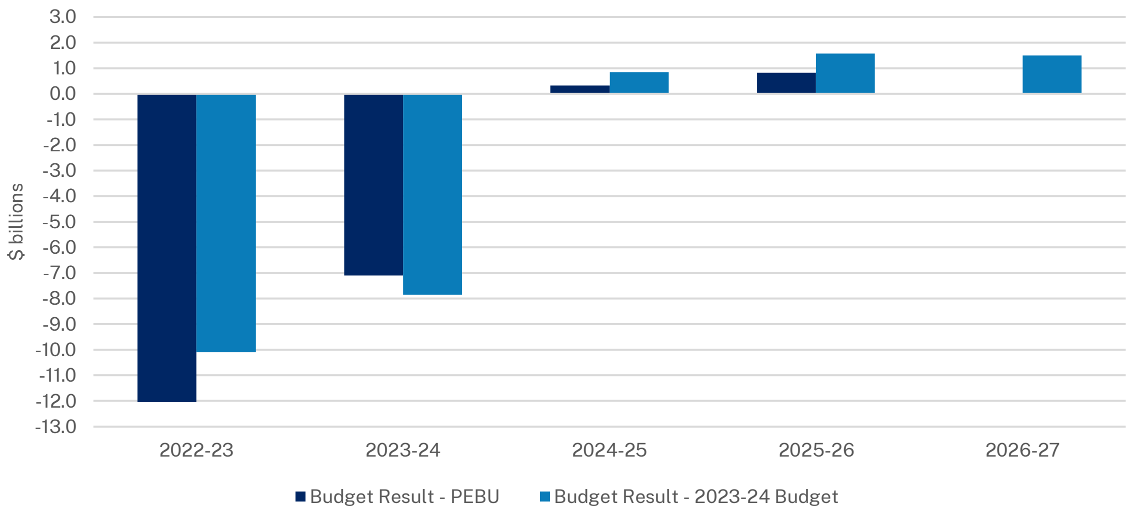
The State's overall financial performance has improved since the 2023 Pre-election Budget Update, with improvements to the projected surplus, gross debt and net debt across the forward estimates to 2026-27.

The State's projected return to surplus remains challenging. This Budget projects a deficit of $7.8 billion in 2023-24, a $740 million deterioration since the 2023 Pre-election Budget Update driven in part by increased grants expenses for Natural Disaster Relief and funding the full cost of several unfunded programs and policies.

The Budget is projected to return to surplus in 2024-25, revised up by $516 million to $844 million since the 2023 Pre-election Budget Update. Improved surpluses are forecast across the remainder of the forward estimates as the Government sees some of the revenue improvement since the 2023 Pre-election Budget Update flow through to the State's bottom line (see Chart 3.3).

Furthermore, the Government is projected to return to a net cash operating surplus in 2023-24 and maintain surpluses across the forward estimates. This means the Government is no longer borrowing to fund its operating expenses. See Chapter 6 Managing the State's Assets and Liabilities for more reporting on the State's cash operating position.

Chart 3.3: General government budget result, relative to the 2023 Pre-election Budget Update



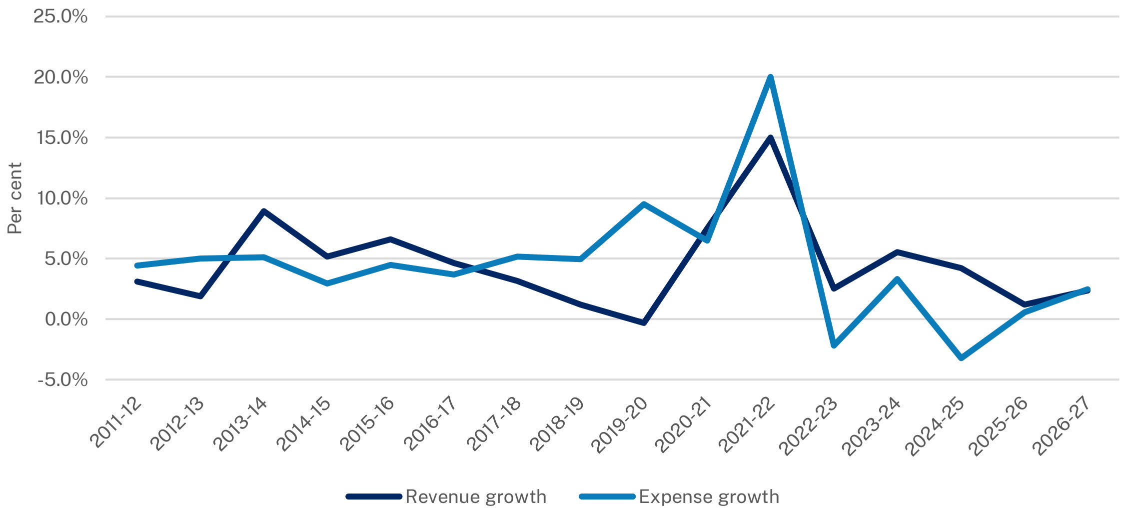
Expense and revenue growth projections to 2026-27

One indicator of a sustainable operating position is expense growth remaining in line with revenue growth. In this Budget, expense growth is projected to moderate to 2.5 per cent in 2026-27. This is lower than the long-term average revenue growth rate of around 5.6 per cent.

In this Budget, revenue growth is projected to moderate to 2.4 per cent by 2026-27 (See Chapter 4 Revenue for detailed analysis). This is significantly lower than the long-term average growth rate. However, by bringing expense and revenue growth back into line, the Government has been able to begin rebuilding the State's fiscal buffers.

Chart 3.4 shows the long-term trends in general government revenue and expense growth.

Chart 3.4: General government revenue and expense growth[(a)]



(a) Expense growth increased substantially in 2021-22 to 25.0 per cent. The changes in expense growth thereafter should be considered with respect to the effective rebasing of expenses to the elevated levels in 2021-22. In the absence of this context, the smaller increases in expenditure year on year following the spike in 2021-22 do not completely convey the elevated levels of expenditure which are persisting across the forward estimates.

Table 3.1 shows a reconciliation of the Budget Result movements between the 2022-23 Budget and this Budget. Further details of revenue and expense movements are set out in Chapter 4 Revenue and Chapter 5 Expenditure.

Table 3.1: Reconciliation of 2022-23 Budget to 2023-24 Budget[(a)]

	2022-23 Revised $m	2023-24 Budget $m	2024-25 $m	2025-26 Forward Estimates $m	2026-27 $m
Budget result: 2022-23 Budget	(11,260)	(2,796)	601	1,431	N/A
Changes from the 2022-23 Budget to 2023 Pre-election Budget Update					
Revenues	1,627	1,876	3,683	2,748	N/A
Expenses	2,397	6,187	3,956	3,356	N/A
Total budget result impact	(770)	(4,311)	(273)	(607)	
Budget result: 2023 Pre-election Budget Update	(12,031)	(7,107)	328	824	N/A
Changes from the 2023 Pre-election Budget Update to 2023-24 Budget					
Revenues	927	3,803	3,524	3,013	N/A
Expenses	(1,000)	4,543	3,008	2,256	N/A
Total budget result impact	1,927	(740)	516	758	N/A
Budget result: 2023-24 Budget	(10,104)	(7,847)	844	1,582	1,508

(a) Positive amounts reflect a positive impact on the budget result e.g., an increase in revenue or a decrease in expenses.

3.4 Delivering the Government's essential infrastructure plan

In this Budget, the Government has begun the work of prioritising infrastructure spend toward essential services and supporting the development of new housing supply. The State's infrastructure program has increased significantly in recent years and infrastructure spending for the four years from 2023-24 to 2026-27 is projected to be $116.5 billion.

Funding for the capital program is comprised of State funding, public-non-financial corporations sources, such as own source revenue, and Australian Government grants. The majority of State funding is provided through borrowings, with approximately 63 per cent of the infrastructure program from 2022-23 to 2026-27 projected to be funded by borrowings. This is down from approximately 80 per cent debt funding of the infrastructure program at the 2023 Pre-election Budget Update.

Borrowings incur interest expenses, and the cost for new and refinanced borrowings has grown significantly in the current climate of higher interest rates. The Government's interest expenses over the forward estimates are expected to reach $7.0 billion in 2026-27.

Box 3.2 provides more information on the Government's infrastructure review.

Box 3.2: A long-term fiscally responsible approach to the State's infrastructure program

In recent years, the State's infrastructure program has continued to expand, while high inflation was driving up input prices and market capacity was highly constrained. The State has seen record levels of capital slippage (e.g., $6.8 billion in 2022-23). The program has stretched the State's balance sheet, with the 2023 Pre-election Budget Update projecting gross debt to rise to $188.2 billion by June 2026 and interest expenses to $7.0 billion by 2025-26.

In April 2023, the Government commissioned an independent expert, Ken Kanofski, to undertake a review of the State's infrastructure program – the Strategic Infrastructure Review. The Review was commissioned in response to significant challenges facing the NSW infrastructure program, driven by substantial cost escalation, the ongoing impacts of COVID and the need for a fairer distribution of investment.

The Review was tasked with identifying infrastructure projects and programs that should no longer proceed, be delayed or de-scoped, to get the State's infrastructure pipeline back on stable footing.

Following the Review, the Government has agreed to delay or descope projects worth more than $2.5 billion, including:

- the Great Western Highway Duplication
- Ultimo Powerhouse Museum
- the Fast Rail Program
- Wyangala Dam Wall Raising and the New Dungowan Dam and pipeline augmentation.

As a result of reprioritised funding, the NSW Government has been able to increase investment in new and upgraded schools, hospitals and public transport infrastructure without the privatisation of public assets.

The Review also recommended more coordinated decision making for future infrastructure investment, stronger central oversight and coordination of the infrastructure program, and to strengthen the alignment between infrastructure planning and housing completions.

The Government will review and streamline the business case and planning processes to ensure that the State's finite resources are being directed toward developing the highest priority proposals that demonstrate strong value for money.

The Government's ambition is for an ongoing infrastructure program that is fair, sustainable and well targeted to deliver the essential services communities need. Through this Budget, the Government is taking its first steps to achieve a more sustainable level of spending of around 2 per cent of GSP by 2026-27 and contribute to stabilising debt (see Chart 3.5).

Chart 3.5: Infrastructure program as a per cent of GSP