3. FISCAL STRATEGY AND OUTLOOK

- The Government's COVID-19 response has helped contain the economic and fiscal impacts of the pandemic. The State's fiscal outlook has improved relative to the 2020-21 Budget and the 2020-21 Half-Yearly Review.
- Improvements to the economy and the revenue outlook are flowing through to the budget result. The budget result over the four years to 2023-24 is projected to improve by $2.2 billion compared to the 2020-21 Half-Yearly Review. This Budget is projecting a return to surplus in 2024-25.
- The Government will invest $108.5 billion in infrastructure over the four years to 2024-25, including new investments in schools, hospital redevelopments and the new Bradfield City Centre. These investments will support employment and economic growth.
- Net debt has improved in line with the economic recovery, to 13.0 per cent of Gross State Product (GSP) in June 2024. This is below the 14.7 per cent that was forecast at the previous Budget just seven months ago. With growth in the NSW Generations Fund (NGF) and an ongoing asset recycling program, net debt is projected to trend back down towards 7 per cent of GSP over the medium-term.
- New South Wales remains the only Australian state to retain its triple-A credit rating with Moody's. New South Wales' double-A-plus rating with S&P Global is the equal highest of all states in Australia.
- This Budget strengthens the NGF with legislative amendments to ensure it truly remains an intergenerational fund. The NGF balance is forecast to grow to over $90.0 billion by June 2031.
- Similar to the economic outlook, the fiscal outlook remains subject to volatility as a result of the ongoing management of COVID-19.

3.1 Fiscal strategy

This Budget's fiscal priorities are to:

- continue to support the economic and health response to COVID-19
- rebuild a fiscal buffer and maintain a strong balance sheet over the medium-term
- continue economic and balance sheet reforms that increase the State's long-term productivity.

This Budget directs resources to areas that support and create private sector employment and improve the overall productive capacity of the economy. This includes major investments in schools, hospitals, and transport.

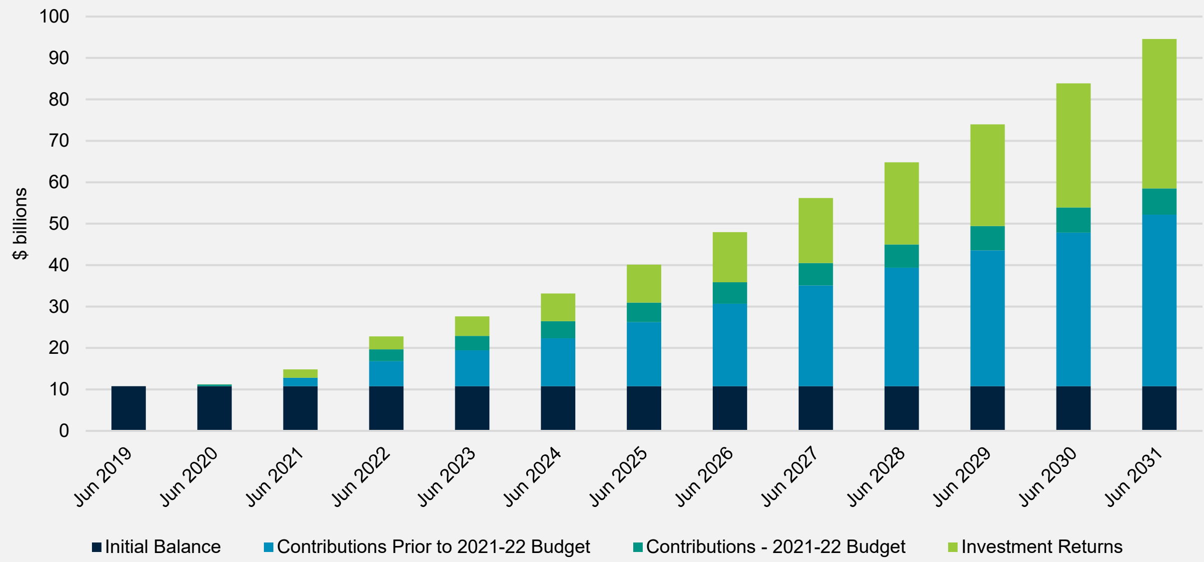
Over the last decade, the NSW Government has led the nation in balance sheet management, pioneering reforms such as asset recycling, cash and investment optimisation, and the establishment of a state sovereign wealth fund. This Budget continues that momentum with a strategy to borrow at sustainable levels while interest rates are low, leverage asset recycling and implement further balance sheet reform (see Chapter 6 – Managing the State's Assets and Liabilities for further detail on balance sheet reform).

Box 3.1: Growing the NGF: the State's investment in future generations

The State's sovereign wealth fund, the NGF, was established by the NSW Government in 2018. It guards against intergenerational fiscal pressures and helps ensure sustainable levels of debt. Legislation was introduced (*NSW Generations Funds Act 2018* (the Act)) to ringfence and safeguard the fund, making clear the fund is to be used only for debt retirement purposes. Consequently, both major credit rating agencies, Moody's and S&P Global, recognise the NGF as a direct offset to the State's debt.

The NGF was initially seeded with $10 billion and has continued to grow. The Government's investment strategy for the NGF has produced strong returns, significantly above its objective of CPI plus 4.5 per cent. It returned 15.5 per cent over the 12 months to April 2021 and 8.6 per cent since inception. The NGF is now projected to reach more than $90.0 billion over the next decade.

Chart 3.1: NSW Generations Fund projected balance over the medium-term.



With the NGF's increasing size and significance, the Government is taking additional measures to strengthen its legislation. Amendments to the Act include:

- introducing more stringent reporting requirements, to improve the overall transparency and accountability of the fund
- stipulating revenue streams to be directed into the NGF, including mining royalties and State Owned Corporation distributions
- making the legislation even clearer that the fund can only be used for debt retirement.

Once the amendments are in force, the Government will report on the NGF as part of the State Budget (including its balance, outlook and any payments made). If a debt retirement payment is made, the Treasurer will provide a special report to Parliament.

New South Wales is now the only State in Australia to have a Moody's triple-A credit rating. As interest rates begin to rise, with the eventual withdrawal of the Reserve Bank of Australia's extraordinary monetary support, the State's strong credit rating will help ensure the State has access to funding at the lowest possible rates.

3.2 A measured return to surplus

This Budget delivers a $9.1 billion improvement in the budget result over the forward estimates with a deficit of $8.6 billion in 2021-22 that trends to a surplus of $465.7 million in 2024-25 (see Table 3.1)[1].

Box 3.2: Rebuilding fiscal capacity and strengthening the balance sheet

The pandemic had immediate and significant impacts on the State's fiscal position from revenue loss, increased expenditure and stimulus support.

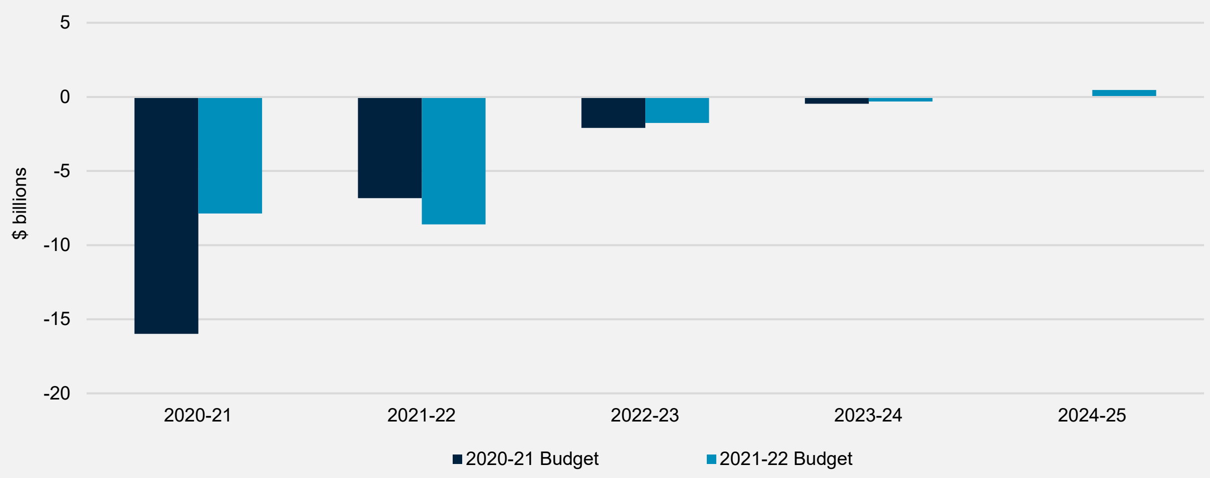
To rebuild fiscal capacity and strengthen its operating position, the Government set fiscal objectives in the last Budget to return to an operating surplus by 2024-25 and to bring net debt towards 7 per cent of GSP by June 2030. This will put the Government in a strong position to respond again to an unforeseen shock.

With the support of ongoing balance sheet reforms, asset recycling and expenditure control measures, this Budget confirms those objectives are on track to be met.

The improved outlook enables greater opportunities for infrastructure funding while maintaining sustainable levels of debt. Targeted infrastructure investment will help the State remain resilient to future events, stimulate economic activity and increase productive capacity.

An improvement in the State's operating and debt positions can help support the policy objective under the *Fiscal Responsibility Act 2012* (FRA) of maintaining a triple-A credit rating. The State is rated triple-A with Moody's and seeks to regain its triple-A rating with S&P Global over the forward estimates. Achieving the best possible credit ratings helps the Government limit its cost of borrowing and access the broadest domestic and international investor base possible. Relatively lower borrowing costs enable the Government to invest more in essential services and infrastructure.

Chart 3.2: NSW budget result comparison from 2020-21 Budget to 2021-22 Budget



The fiscal recovery is largely attributed to surging confidence and economic activity, driven by a strong public health response, sustained economic support and keeping the economy as open as possible (see Chapter 2 – The Economy). This has driven a faster recovery in the State's revenues.

[1] The full operating statement for the general government sector can be found at Appendix A1 – Statement of Finances.

On the expenditure side, the Government's targeted and temporary stimulus measures will continue in 2021-22 before they are projected to ease off across the forward estimates, as the economy recovers. This allows expenditure growth to return to pre-pandemic levels in line with the expense discipline and strong financial management historically delivered by this Government and recognised by both major credit rating agencies.

Table 3.1: General government sector budget result aggregates

	2019-20 Actual	2020-21 Revised	2021-22 Budget	2022-23	2023-24 Forward Estimates	2024-25
Revenue ($m)	81,367	87,626	93,846	96,792	98,479	100,328
Revenue growth (per cent p.a.)		7.7	7.1	3.1	1.7	1.9
Expenses ($m)	88,283	95,491	102,450	98,547	98,785	99,862
Expense growth (per cent p.a.)		8.2	7.3	(3.8)	0.2	1.1
Budget Result ($m)	(6,916)	(7,865)	(8,604)	(1,755)	(306)	466
GSP ($m)	629,300	644,200	680,100	697,300	725,100	758,000
Per cent of GSP	(1.1)	(1.2)	(1.3)	(0.3)	(0.0)	0.1

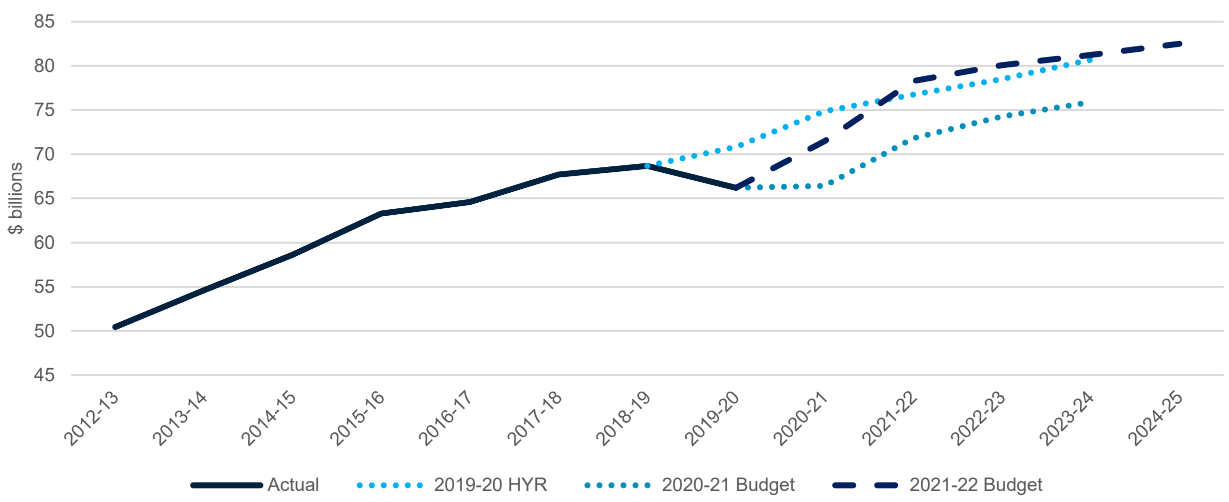
Revenue uplift from a faster economic recovery

Since the 2020-21 Budget, the average revenue growth rate has increased from 3.4 per cent per year to 4.9 per cent across the four years to 2023-24. The last Budget saw significant revenue write-downs during the pandemic. This Budget shows a strong upswing as the economy recovers (See Chapter 4 – Revenue for detailed analysis).

Payroll tax has improved with stronger-than-expected employment growth and transfer duties have strengthened in line with the property market, driven by confidence amongst first home buyers and low interest rates. GST has also improved due to the stronger outlook for household spending and dwelling investment, supported by Government stimulus.

Chart 3.3 demonstrates that forecast revenue levels are now projected to exceed pre-pandemic estimates in 2021-22 and beyond.

Chart 3.3: General government revenue (excluding tied grants) - current projection compared to pre-pandemic expectations



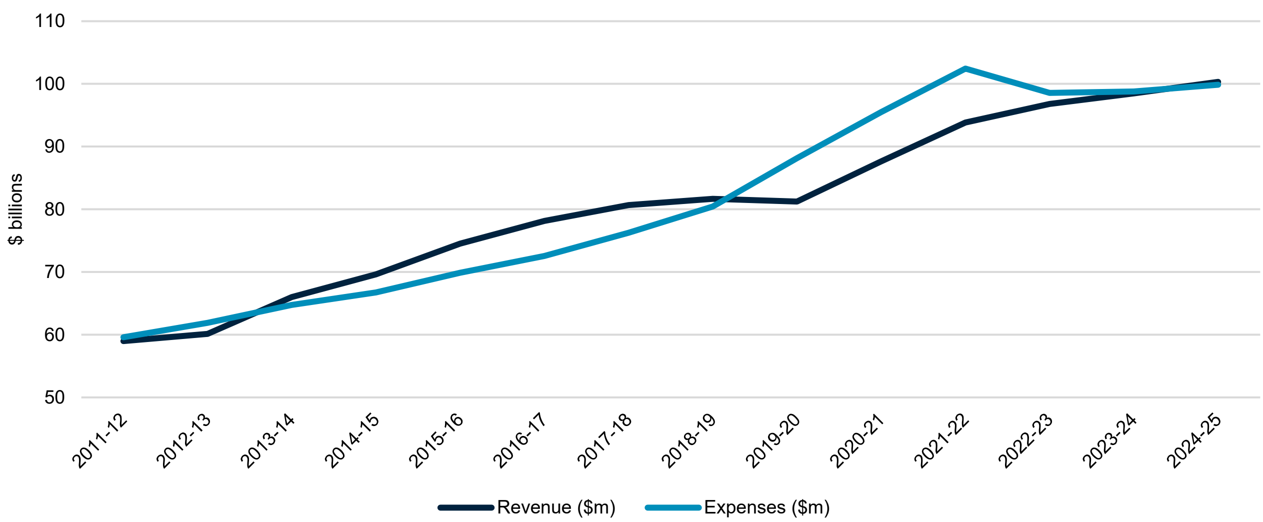
Expenses to moderate over the forward estimates as stimulus eases

The previous Budget witnessed strong growth in expenses as the Government implemented its health and economic response to the pandemic. This Budget sees a further increase in expense growth in 2021-22 to 7.3 per cent (up from previous projections of -3.7 per cent in the 2020-21 Budget) due to the Government's commitment to job creation, economic recovery, and supporting communities impacted by natural disasters.

Expense growth is projected to taper off to an average of 1.1 per cent across the forward estimates, bringing expense growth back under the long-term average revenue growth rate and in line with the target set out in the FRA. The easing is a consequence of phasing out the temporary stimulus, coupled with the Government's measures to control expenditure, while still protecting front-line service delivery.

As with the economic and revenue outlook, the fiscal outlook is subject to risk arising from the unprecedented global pandemic (for more detail see Appendix B – Fiscal Risks).

Chart 3.4: Revenue and expenses from 2011-12 to 2024-25



Changes in the budget result since the 2020-21 Half-Yearly Review

Table 3.2 outlines the changes to the budget result, along with a reconciliation to the previous Budget. The variations to the budget result since the Half-Yearly Review include:

- an upward revision of $5.4 billion in 2020-21, primarily driven by an improvement in State revenue
- a downward revision of $2.8 billion in 2021-22, primarily due to supporting communities impacted by natural disasters and investments in productivity and service delivery
- an overall improvement of $2.2 billion across the four years to 2023-24 with a return to surplus in 2024-25, driven by an improved revenue outlook and moderating expenses (as the Government phases out its stimulus measures).

Table 3.2: Reconciliation of 2020-21 Budget to 2021-22 Budget[(a)]

	2019-20 Actual $m	2020-21 Revised $m	2021-22 Budget $m	2022-23 Forward Estimates $m	2023-24 Forward Estimates $m
Budget result: 2020-21 Budget	(6,916)	(15,984)	(6,830)	(2,091)	(460)
Changes from 2020-21 Budget to 2020-21 Half-Yearly Review					
Revenues	-	2,505	2,156	1,967	1,566
Expenses	-	(182)	1,165	1,337	1,227
Total budget result impact	-	2,687	990	630	339
Budget result: 2020-21 Half-Yearly Review	**(6,916)**	**(13,297)**	**(5,840)**	**(1,461)**	**(121)**
Changes from 2020-21 Half-Yearly Review to 2021-22 Budget					
Revenues	-	2,972	4,001	4,224	3,983
Expenses	-	(2,460)	6,766	4,518	4,168
Total budget result impact	-	5,432	(2,764)	(294)	(185)
Budget result: 2021-22 Budget	**(6,916)**	**(7,865)**	**(8,604)**	**(1,755)**	**(306)**

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

3.3 Using the State's strong balance sheet to support the economy

Continued investments to transform the State's infrastructure landscape

This Budget[2] includes $85.6 billion over four years in infrastructure investment for the general government sector, including:

- $2.7 billion over four years for the M6 stage 1 extension
- $2.1 billion over four years, as part of a total $3.3 billion investment, for 44 new and upgraded schools across the State
- $2.0 billion over four years for the Great Western Highway Upgrade
- $1.3 billion for the Bankstown-Lidcombe Hospital and Community Health Services Redevelopment
- $870.0 million for enabling works for the new Bradfield City Centre
- $168.7 million over four years for the Muswellbrook bypass, New England Highway.

When the investment of State Owned Corporations is taken into account[3], capital expenditure is projected to reach $108.5 billion over the four years to 2024-25. Road, rail and other transport infrastructure account for 65.5 per cent of this investment, demonstrating the productivity enhancing nature of the infrastructure program. A detailed analysis of this infrastructure program is available in Budget Paper No. 3 *Infrastructure Statement*.

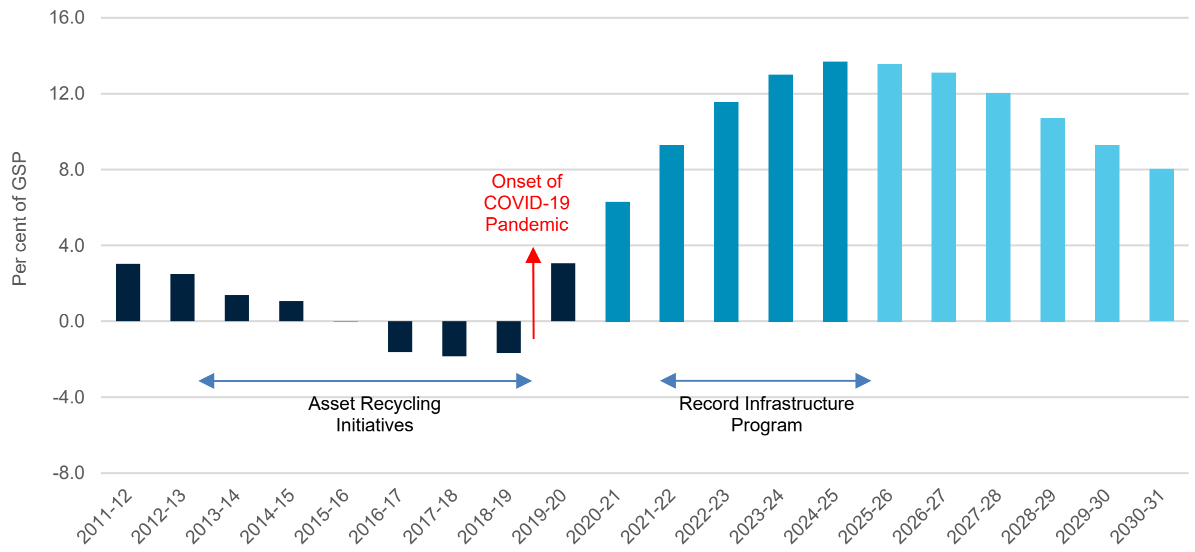
Delivering the State's infrastructure program while rebuilding the State's fiscal capacity is possible because of the Government's strong financial management, utilising the NGF and asset recycling. The NGF acts as a direct offset to the State's debt and will continue to grow over time. The continuation of the State's successful asset recycling program (and its reinvestment) means the State will be able to deliver on its commitments by drawing upon a mix of cash operating surpluses, existing cash and financial assets, and borrowings.

[2] The balance sheet for the general government sector can be found at Appendix A1 – Statement of Finances.
[3] When combined, the general government sector and public non-financial corporations sector is known as the non-financial public sector. See *How to Read the Budget Papers* for more information.

Maintaining sustainable levels of debt over the next decade

Net debt is projected to be 9.3 per cent of GSP ($63.3 billion) at June 2022. It will peak at 13.7 per cent of GSP ($103.9 billion) by June 2025 before trending back down across the planning years. With the support of further asset recycling initiatives such as the proposed sale of WestConnex, the State's net debt to GSP position will trend towards 7 per cent of GSP, helping to ensure sustainable levels of debt and balance sheet resilience.

Chart 3.5: Projected net debt to GSP over the medium-term(a)



(a) Chart 3.5 does not include the impact of upcoming asset recycling, including WestConnex or other transactions that are currently the subject of scoping studies.

Box 3.3: Funding infrastructure from the State's balance sheet

The NSW Government has delivered in excess of $150.0 billion in infrastructure since 2011-12[4]. This record program has created jobs, boosted productivity and improved standards of living. Investments in health infrastructure over this time have particularly assisted the health response to the pandemic.

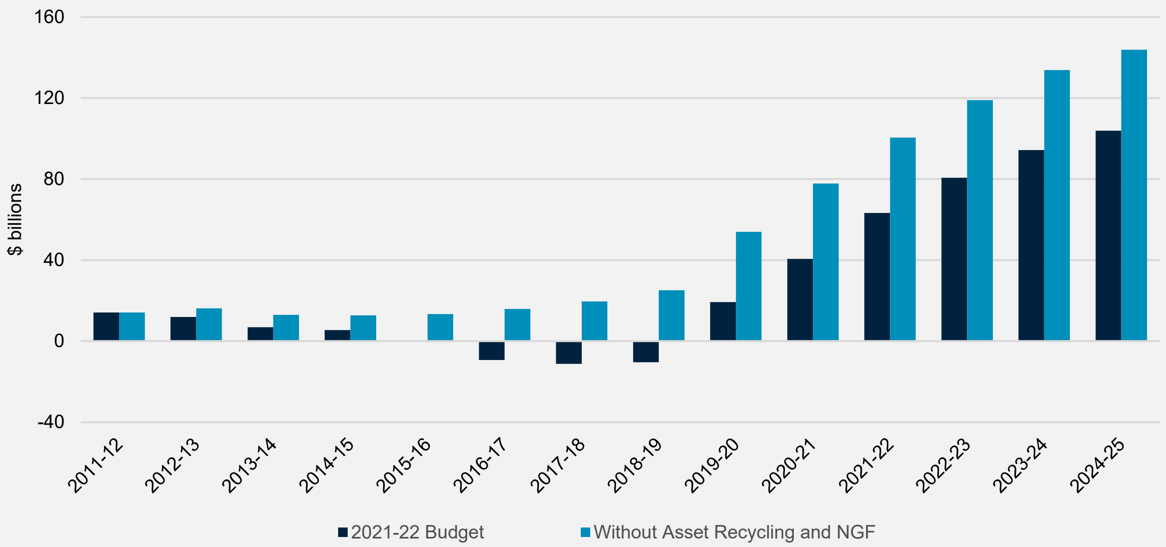
Prior to the onset of the pandemic, the Government minimised the debt funding required for this infrastructure program, through delivery of a series of strong operating results and a successful asset recycling program. Minimising the use of debt was a sound approach as the cost of borrowing was relatively elevated at the time.

During COVID-19, the Government expanded its infrastructure program to support the economy. The Government expects to deliver an estimated $25.4 billion in infrastructure in 2020-21, with $30.4 billion projected for 2021-22, more than any other state in Australia.

This Budget sees the Government continue to support the NSW economy, with a $108.5 billion pipeline of infrastructure planned across the four years to 2024-25. This investment will have multiple benefits – it delivers critical infrastructure projects that improve lives, and it promotes employment and economic growth.

While the cost of borrowing is low, the State is drawing on its balance sheet to help fund the record infrastructure program. The Government will use sustainable levels of debt and asset recycling to establish new infrastructure assets. At the same time, the NGF will be used to offset the State's debt burden. In the absence of these measures, the State's debt levels would be significantly higher by around $40.0 billion in June 2025. Chart 3.6 illustrates the benefits of the Government's active balance sheet management approach.

Chart 3.6: Impacts of asset recycling on the State's net debt position



[4] Between 2011-12 and 2019-20