2. FISCAL STRATEGY AND OUTLOOK

- The Government's disciplined fiscal strategy continues to deliver strong budget results and balance sheet reforms. This strategy is driven by the State's commitment to maintain its triple-A credit rating and be prepared for the challenges of the future.
- The 2016-17 budget result is an expected surplus of $4.5 billion, which reflects a temporary boost in revenues from the State's asset recycling program. The Budget forecasts a surplus of $2.7 billion in 2017-18 and average surpluses of $2.0 billion across the budget and forward estimate years.
- Along with asset recycling and modest borrowings over the budget and forward estimates, these ongoing strong surpluses support the State's infrastructure investment of $72.7 billion over four years.
- To safeguard the State's long-term fiscal sustainability, the Government is controlling expense growth, managing public sector wages and driving efficiency across the public sector to support reinvestment in the delivery of frontline services.
- The outlook for revenue is challenging. Total revenue growth over the four years to 2020-21 averages 1.8 per cent per annum – which is softer relative to previous years due to a flattening of GST revenues and declining National Partnership Payments from the Commonwealth Government. National Partnership Payments are expected to fall to around a quarter of their 2016-17 value by 2020-21.
- For the second consecutive year, the government will end the year with negative net debt – projected to be -$7.8 billion at 30 June 2017.
- Net worth is forecast to reach more than one quarter of a trillion dollars by 30 June 2019, the first time this has been achieved by an Australian state government.

2.1 Introduction

The 2017-18 Budget continues the Government's record of strong economic and financial management by delivering budget surpluses, a $72.7 billion infrastructure program and record low net debt.

The Government is forecasting a surplus of $4.5 billion in 2016-17 and average surpluses of $2.0 billion over the budget year and forward estimates.

The 2016-17 surplus is supported by one-off revenues from asset recycling transactions.

Revenue growth over the budget and forward estimates continues to be supported by a strong housing sector, with growth in transfer duty and land tax. GST revenues from the Commonwealth Government are lower, with New South Wales' share of GST falling to record lows across the forward estimates as a result of its strong economic performance.

Expenses in 2016-17 are largely unchanged to what was forecast in the 2016-17 Half-Yearly Review. Expenses are expected to increase moderately each year over the budget and forward estimates as the Government invests in essential services including teachers, police, nurses, palliative care and family and community services case workers.

The successful completion of the lease of the NSW electricity network businesses and the concession of Land and Property Information titling and registry services has produced a negative net debt position for the second consecutive year. The State is estimated to have net debt of -$7.8 billion at 30 June 2017, the lowest since comparable records began in 1996-97.

Table 2.1 sets out the key budget aggregates for the general government sector from 2015-16 to 2020-21.

Table 2.1. General government sector key budget aggregates

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	Actual	Revised	Budget	Forward Estimates		
Revenue ($m)	74,532	78,008	79,885	80,224	82,471	83,770
Revenue growth (per cent pa)	7.1	4.7	2.4	0.4	2.8	1.6
Expenses ($m)	69,867	73,537	77,186	78,098	80,939	82,270
Expense growth (per cent pa)	4.7	5.3	5.0	1.2	3.6	1.6
Budget Result ($m)	4,664	4,472	2,698	2,126	1,532	1,500
Per cent of GSP	0.9	0.8	0.5	0.3	0.2	0.2
Capital Expenditure ($m)	9,351	10,943	14,515	16,491	10,707	7,939
Per cent of GSP	1.7	1.9	2.4	2.6	1.6	1.2
Net Lending/(Borrowing) Result ($m)	392	1,769	(6,447)	(8,682)	(3,742)	(950)
Per cent of GSP	0.1	0.3	(1.1)	(1.4)	(0.6)	(0.1)
Net Debt ($m)	(57)	(7,788)	(521)	9,864	15,850	18,583
Per cent of GSP	(0.0)	(1.4)	(0.1)	1.6	2.4	2.7

2.2 Budget position and outlook

Budget result

The 2016-17 budget result is expected to be $4.5 billion, $0.8 billion higher than in the 2016-17 Budget, primarily due to one-off revenues associated with transactions (including transfer duty and asset recycling initiative payments) and higher than expected distributions from SICorp driven by investment earnings. Against this, GST revenue and Commonwealth National Partnership payments have fallen.

The 2017-18 budget result is higher than forecast at the 2016-17 Budget, primarily due to a stronger outlook for transfer duty and increased dividends from State Owned Corporations. This improved revenue outlook is also driving the increases in surpluses across the forward estimates relative to the 2016-17 Budget.

Table 2.2 provides a reconciliation of the changes in the budget estimates between the 2016-17 Budget, 2016-17 Half-Yearly Review and the 2017-18 Budget. The table separates the impact of Government policy decisions from parameter and other variations. The latter reflect the impact of changing economic conditions, budget assumptions, grants from the Commonwealth Government and other accounting adjustments.

Between the 2016-17 Half-Yearly Review and the 2017-18 Budget, revenue has improved through higher transfer duty receipts, new revenue policy measures (including an increase to the foreign investor surcharge for property transfer duty and land tax) and one-off revenues associated with transactions. There has also been a moderate increase in expenses to fund key services, which have been partially offset by new procurement savings measures and an increased efficiency dividend to help ensure that government continues to deliver value for money services.

New South Wales' strong performing economy and revenue position sees the State penalised under the current system for allocating GST. In comparison to the 2016-17 Budget, GST revenue has been revised down by $1.4 billion over the four years to 2019-20, with New South Wales' share of GST receipts reaching a historic low. New South Wales strongly advocates reform to horizontal fiscal equalisation that would see the distribution of GST move closer to an equal per capita basis (see Chapter 5).

Table 2.2. Reconciliation of 2017-18 Budget to 2016-17 Budget[(a)]

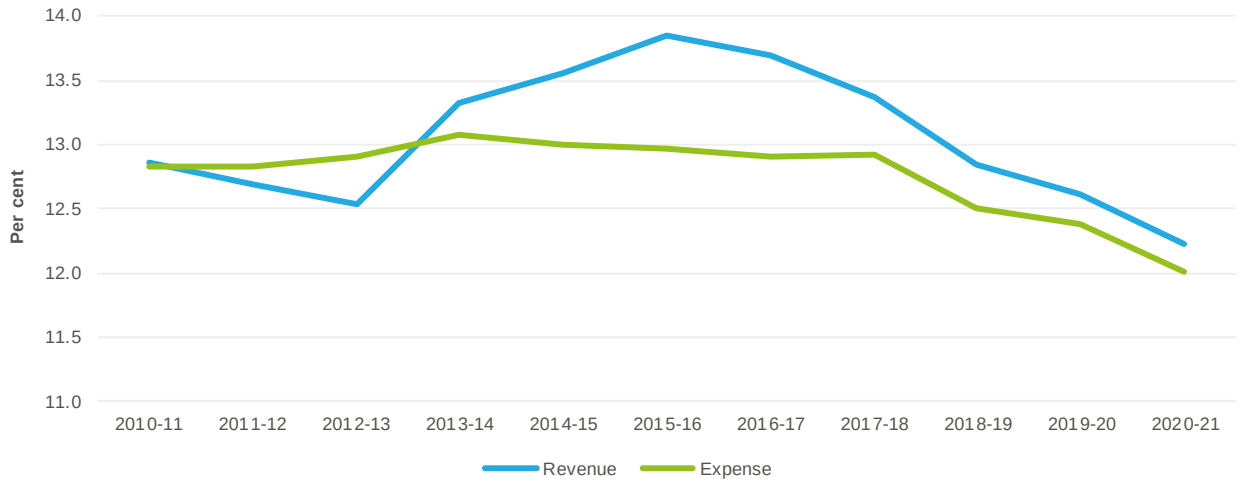
	2016-17 Revised	2017-18 Budget	2018-19 Forward Estimates	2019-20 Forward Estimates
	$m	$m	$m	$m
2016-17 Budget	**3,714**	**1,328**	**1,384**	**1,616**
Changes from 2016-17 Budget to 2016-17 Half-Yearly Review				
Policy measures				
Revenues	15	1,161	443	319
Expenses	(243)	(545)	(465)	(331)
Total policy measures	(228)	616	(22)	(12)
Parameter and other budget variations				
Revenues	608	(351)	(499)	(916)
Expenses	(121)	(95)	158	210
Total of parameter and other budget variations	487	(446)	(341)	(706)
Total policy measures and parameter and other budget variation	259	170	(363)	(718)
2016-17 Half-Yearly Review	**3,973**	**1,497**	**1,022**	**898**
Changes from 2016-17 Half-Yearly Review to 2017-18 Budget Result				
Policy measures				
Revenues	...	274	(128)	(213)
Expenses	(34)	(750)	(556)	(265)
Total policy measures	(34)	(476)	(684)	(478)
Parameter and other budget variations				
Revenues	208	1,492	2,548	2,263
Expenses	325	185	(759)	(1,151)
Total of parameter and other budget variations	533	1,677	1,789	1,112
Total policy measures and parameter and other budget variation	499	1,201	1,105	634
2017-18 Budget Result	**4,472**	**2,698**	**2,126**	**1,532**

(a) All totals show budget result impacts.

Revenue and expense outlook

Chart 2.1 shows general government revenues and expenses as a percentage of GSP. Both revenue and expense growth are projected to fall as a share of GSP over the forward estimates, with expenses remaining below revenue as a share of GSP.

Chart 2.1. General government revenues and expenses as a percentage of GSP



Revenue as a share of GSP temporarily increased over 2013-14 to 2017-18 due to historically low interest rates, record housing completions and population growth that supported strong transfer duty revenue growth, as well as one-off revenues associated with asset recycling transactions. Revenue as a share of GSP peaked in 2015-16 and remains above the average of 13.1 per cent until 2018-19.

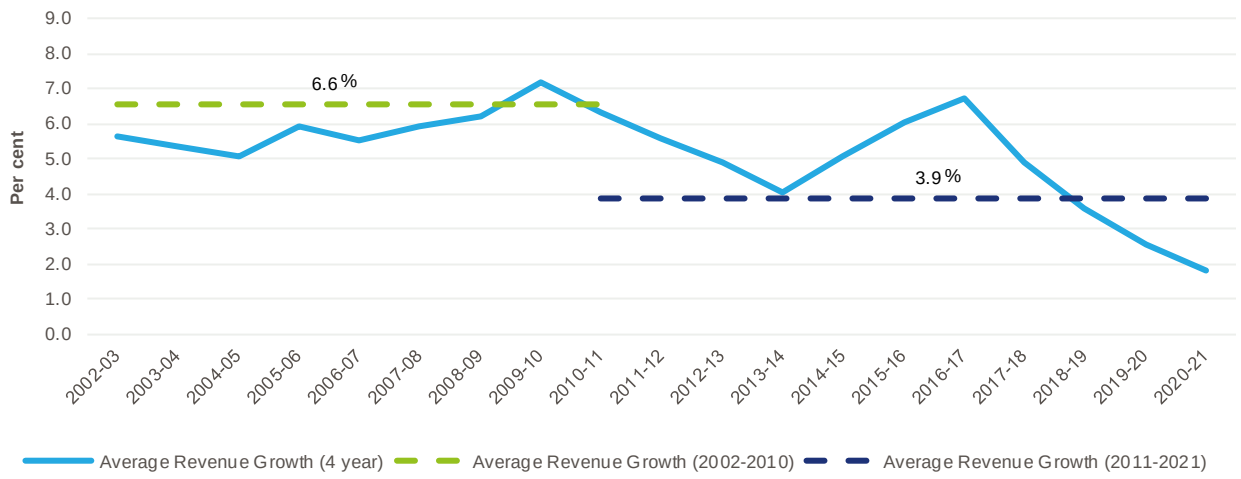
Over the budget and forward estimates, revenue is forecast to decline as a share of GSP as property transfer duty inflows return to trend, GST growth falls to record lows and the conclusion of the Government's poles and wires asset recycling program.

If GST relativities had been fixed at 2016-17 levels, New South Wales' annual average revenue growth would be 0.8 per cent higher over the four years to 2021.

Chart 2.2 shows a similar decline in four-year average revenue growth over the forward estimates.

Revenue trends are detailed in Chapter 5 of this *Budget Statement*.

Chart 2.2. Four year average revenue growth [(a)]



(a) Four year average per cent change to indicated year.

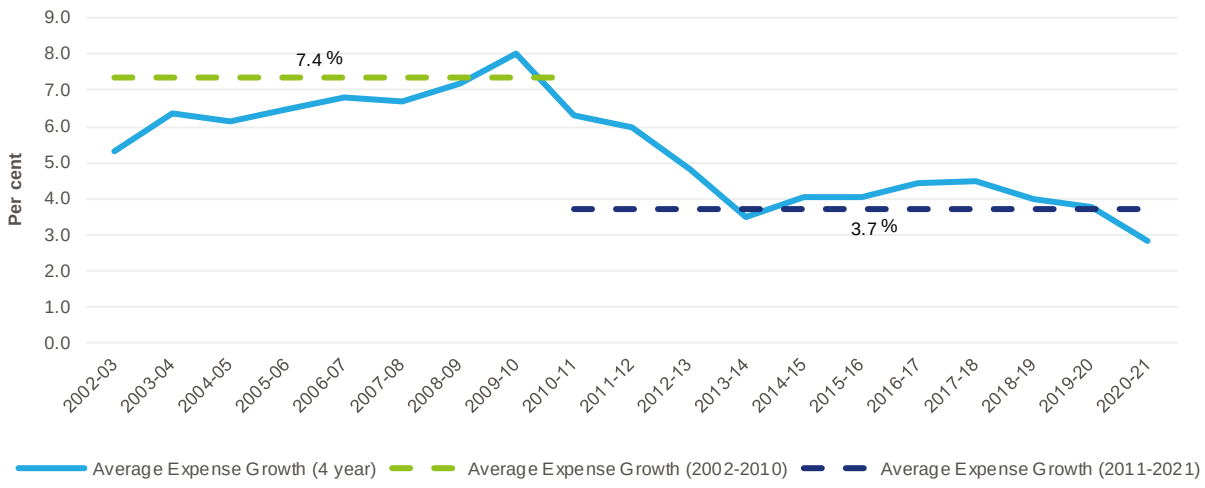
Expenses as a share of GSP are expected to fall over the forward estimates years (Chart 2.1), as the Government maintains control on expenses to match falling revenues.

The 2017-18 Budget includes a range of new expense measures for further investments in critical education, health, public safety and community services, cultural infrastructure, and the development of regional communities.

The Budget also includes a range of savings and offset measures to improve the efficiency of government spending and manage expense growth. These measures are in addition to previous strategies to manage expense growth, including moderating growth in public sector wages (see Chapter 6 of this *Budget Statement*).

Expense growth is expected to average 2.8 per cent over the four years to 2020-21, which is less than the average expense growth over the decade to 2020-21. Chart 2.3 shows four year average expense growth from 2002-03 to 2020-21.

Chart 2.3. Four year average expense growth [(a)]



(a) Four year average per cent change to indicated year.

2.3 Fiscal strategy

The State's fiscal strategy is guided by the *Fiscal Responsibility Act 2012* (FRA), the objective of which is to maintain the State's triple-A credit rating. The FRA also requires adherence to three principles of sound fiscal management:

- responsible spending, taxation and infrastructure investment
- effective financial and asset management
- achieving intergenerational equity by ensuring policy decisions have regard to the impacts on current and future generations.

The 2017-18 Budget delivers on the Government's fiscal strategy by delivering budget surpluses across the forward estimates and ensuring expense growth is sustainable and below long-term average revenue growth.

This Budget continues to deliver an unprecedented infrastructure program, utilising the Government's successful asset recycling strategy, cash and liquidity reforms, and improved debt management. The Government remains committed to maintaining credit metrics consistent with a triple-A credit rating (see Box 2.1).

Box 2.1: Securing the State's triple-A credit rating

Both major international credit ratings agencies, Moody's and Standard and Poor's, currently rate New South Wales as triple-A, which is the highest possible credit rating.

New South Wales' triple-A rating signals to investors that the State is a good place to invest. The triple-A rating reflects the strong financial position of the State and means that investors in the State's debt can be confident in the Government's management of the State's fiscal position and in the strength of the State's balance sheet. It is also a signal that the NSW economy is broadly based and resilient to shocks.

These factors make jurisdictions with a triple-A rating attractive to investors. They also mean that jurisdictions with a triple-A rating are generally able to borrow at lower interest rates than other jurisdictions with a weaker credit rating.

In Australia, the credit rating of a state government also reflects the rating agencies' assessments of the strength of the Commonwealth Government. Ratings agencies take this into account because a large portion of state revenues come from the Commonwealth Government through GST and other payments. The ratings agencies assess that state ratings are effectively capped by the Commonwealth Government's credit rating.

Both Moody's and Standard & Poor's reaffirmed the State's triple-A credit rating in 2016 following the 2016-17 Budget. However New South Wales' outlook was changed by Standard & Poor's to negative in late July 2016 as a direct result of the same change being made to the Commonwealth Government's outlook.

In the event of a Commonwealth Government downgrade, New South Wales is committed to retaining a fiscal position that is consistent with a standalone triple-A credit rating. This will ensure the Government maintains its focus on the principles of sound long-term financial management and the continued delivery of sustainable services and infrastructure.

2.4 Asset recycling and the balance sheet

The Government concluded its successful poles and wires divestment program with the long-term partial lease of Endeavour Energy announced in May 2017. This followed the Government's April 2017 announcement of the successful concession of Land and Property Information's titling and registry services, with a tight regulatory framework and contractual safeguards to ensure the continued security of property rights and data.

The 2017-18 Budget includes the impact of the recently completed transactions and the full $2.2 billion associated with the Asset Recycling Initiative National Partnership Agreement with the Commonwealth Government.

With the partial lease of Endeavour Energy, the concession of Land and Property Information and the partial lease of Ausgrid (reflected in the 2016-17 Half-Yearly Review), holdings of cash have increased and net debt has fallen significantly. Net debt is now estimated to be -$7.8 billion at 30 June 2017. The impact of TransGrid was previously reflected in the 2015-16 Half-Yearly Review.

Net debt is expected to rise as the proceeds of transactions are reinvested in infrastructure, reaching $18.6 billion by 30 June 2021, representing 2.7 per cent of GSP.

A successful divestment of at least a 51 per cent share of Sydney Motorway Corporation (the company delivering WestConnex) would further improve the State's balance sheet position (see Box 2.2).

The State's net worth is forecast to grow over the budget and forward estimates, driven by financial management reforms, active financial liability management and record levels of infrastructure investment. New South Wales is forecast to become the first Australian state government with a net worth of more than one quarter of a trillion dollars by 30 June 2019. Net worth rises from $137.7 billion at 30 June 2012 to an estimated $237.9 billion at 30 June 2018 and $273.2 billion at 30 June 2021, representing an increase of 98.3 per cent from 2012 to 2021.

Net debt and net worth are explored further in Chapter 7 of this *Budget Statement.*

Box 2.2: Easing congestion across Western Sydney

On 12 May 2017, the Government announced it will proceed with the sale of at least a 51 per cent stake in Sydney Motorway Corporation (SMC), to help fund the final stage of WestConnex. The Government expects this transaction to receive substantial interest from local and international investors.

SMC was established by the State to finance WestConnex by incorporating an initial NSW Government investment alongside the Commonwealth Government and private sector debt supported by toll revenue. This financing strategy was established to enable the State to recycle its equity investment in SMC and effectively use the sale proceeds from the initial stages to help fund the final stage of WestConnex.

The 2017-18 Budget recognises the funding for the final stage of WestConnex. However, in line with usual budget practice, the 2017-18 Budget does not reflect the divestment of at least a 51 per cent stake in SMC as it has not yet been completed.

2.5 Long-term fiscal gap

The FRA requires the Government to assess the NSW long-term fiscal gap every five years and to report the impact of new measures on the fiscal gap in each annual budget.

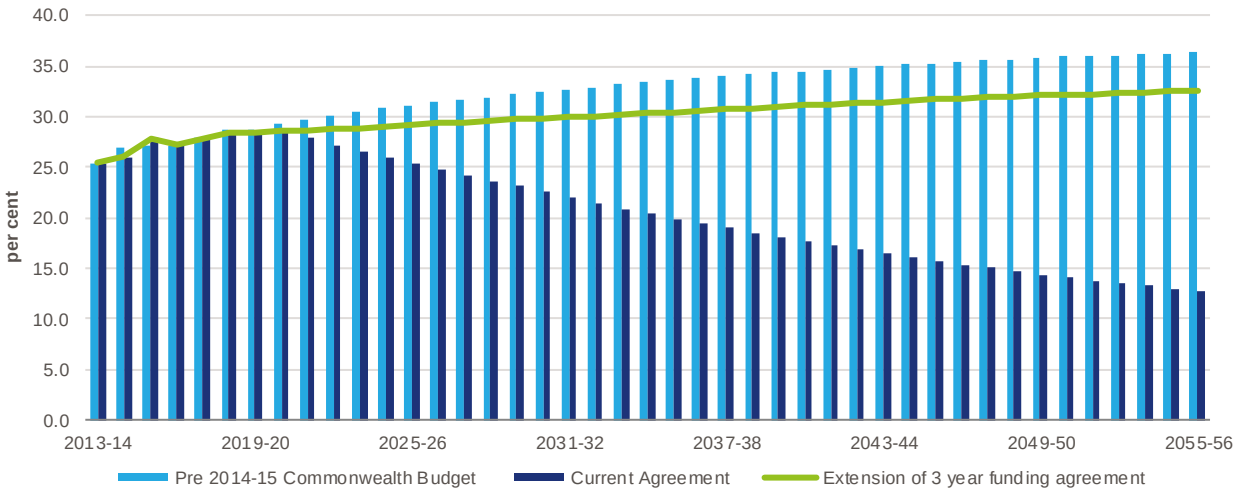
The fiscal gap is the change in the general government primary balance as a share of gross state product, currently over the period 2014-15 to 2055-56. The primary balance is revenues less expenditures, including net capital expenditure, but excluding interest transactions.

The *2016 Intergenerational Report* highlighted the impact of the ageing population on the demand for government services and infrastructure. If current trends were to continue, a widening fiscal gap will emerge between state government revenues and service and infrastructure requirements. At the 2016-17 Budget, this gap was projected to be 3.4 per cent of GSP by 2055-56.

The NSW fiscal gap has marginally increased by 0.1 per cent as a result of measures in this Budget, and is now projected to be around 3.5 per cent of GSP by 2055-56. The change is attributable to slightly lower revenue growth, as well as small increases in both expenses and capital expenditure.

Just under two thirds of this fiscal gap is accounted for by health, largely due to projected declines in the Commonwealth funding share from 27.3 per cent currently, to 12.7 per cent by 2055-56 (Chart 2.4). This contrasts with the pre-2014-15 Budget health funding arrangement, where the Commonwealth funding share was projected to increase to 36.4 per cent by 2055-56.

Chart 2.4. Declining Commonwealth health funding share



While negotiations around future Commonwealth health funding continue, if the current temporary agreement is not extended beyond 2019-20, Commonwealth health funding will revert to growth in population plus CPI and not keep up with expenses. If the current three year agreement is extended, the Commonwealth share of health funding is projected to increase to 32.5 per cent by 2055-56.