2. FISCAL STRATEGY AND OUTLOOK

- Across the next four years, the 2018-19 Budget is projecting average budget surpluses of $1.6 billion. The Government has maintained a strong operating position which is enabling additional investment in essential health, education, transport and disability services, despite a softening property market and a declining share of GST revenue.
- In 2017-18, New South Wales again leads the nation with a $3.9 billion surplus and negative net debt for the third year in a row.
- Net debt is projected to reach a record low of negative $9.8 billion at June 2018, driven by a strong operating result and proceeds from the Snowy Hydro sale. Over the four years to June 2022, the Government is maintaining net debt at a sustainable level consistent with a triple-A credit rating.
- The Government's strong fiscal management and successful asset recycling strategy, coupled with a strong economy, have enabled a record $87.2 billion infrastructure program across the budget and forward estimates.
- New South Wales continues to meet the targets outlined in the *Fiscal Responsibility Act 2012*, including maintaining its triple-A credit rating and keeping expense growth below long-term revenue growth of 5.6 per cent.
- The 2018-19 Budget also invests in the future of New South Wales by creating the NSW Generations Fund to share the proceeds of the State's success today with future generations.

2.1 Fiscal strategy

The NSW Government has delivered on its fiscal strategy — adhering to the requirements of the *Fiscal Responsibility Act 2012* (FRA), and maintaining sustainable finances while delivering the services and infrastructure required for a growing state. This has been achieved by:

- ensuring budget discipline to maintain surpluses
- funding capital expenditure through budget surpluses and asset recycling proceeds as much as possible, and
- maintaining prudent debt levels consistent with a triple-A credit rating (see Box 2.1).

The FRA makes New South Wales unique across Australian and international jurisdictions with its legislated requirement to maintain a triple-A credit rating. This objective is also supported by legislated fiscal targets and principles of sound financial management.[1]

Every year since 2012, the Government has met the fiscal targets mandated by the FRA, and the Government will again meet those targets in this Budget (see Table 2.1 and Appendix E *Performance and Reporting under the Fiscal Responsibility Act* for more details).

[1] The principles of sound financial management are: responsible and sustainable spending, taxation and infrastructure investment; effective financial and asset management, including sound policies and processes; and achieving intergenerational equity.

As the centrepiece of the State's fiscal strategy, the FRA helps limit the cost of government borrowing and helps maintain economic confidence in New South Wales. It also holds the Government to account – the Act's requirements cannot be changed without Parliament's approval. A statutory review of the FRA is currently underway and will be tabled in both houses of Parliament later this year.

Table 2.1: Fiscal objective and targets

Requirements of the *Fiscal Responsibility Act 2012*	Target met?	Explanation
Objective: Maintain the triple-A credit rating		
Standard & Poor's	✓	Reaffirmed AAA with a negative outlook[a] in September 2017
Moody's	✓	Reaffirmed Aaa with a stable outlook in October 2017
Target 1: Annual expense growth less than the long-term average revenue growth	✓	Annual expense growth is less than long-term average revenue growth (5.6 per cent) across all five years in this budget
Target 2: Elimination of the State's unfunded superannuation liability by 2030	✓	NSW is on track to be fully funded by 2030 based on the funding program at the last triennial review (December 2015)

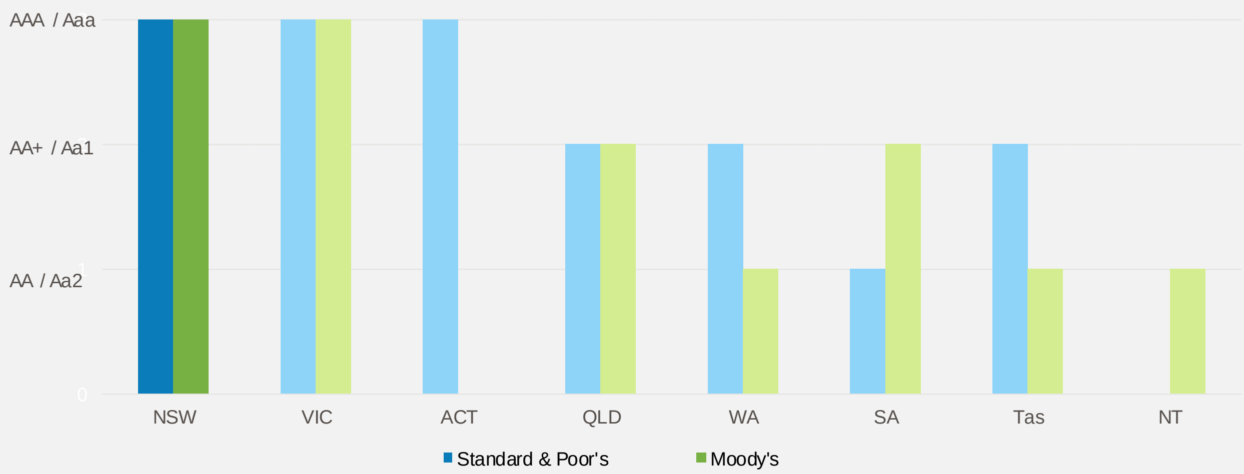
(a) Due to a negative outlook on the Commonwealth Government (a sub-sovereign cannot be rated higher than the sovereign)

Box 2.1: NSW belongs to the exclusive global triple-A club

New South Wales is one of only two Australian states rated triple-A by both major credit rating agencies. Internationally, there are only six state or provincial governments rated triple-A by Moody's and ten by Standard & Poor's (as at June 2018). This excludes the United States where states are assessed under a different methodology.

A triple-A credit rating reflects an independent assessment of a strong fiscal and economic position, a solid institutional framework and sustainable debt levels. Triple-A rated jurisdictions are also generally able to borrow at lower interest rates given their strength relative to lower-rated governments.

Chart 2.1: Credit ratings of Australian states and territories as at June 2018



The rating of a state government is capped by its sovereign's rating. As at June 2018, Standard & Poor's has the Commonwealth's triple-A rating on a negative outlook, which means there may be a rating downgrade in the next six months to two years. Consequently, Standard & Poor's also has the New South Wales, Victorian and Australian Capital Territory triple-A ratings on a negative outlook. In the event of a sovereign downgrade, NSW will continue to manage its fiscal position consistent with a triple-A credit rating.

The Government is also embarking on a once-in-a-generation improvement in the State's financial management practices. On 7 June 2018, the *Government Sector Finance Bill 2018* was passed by Parliament as the next stage in modernising these financial frameworks (see Box 2.2).

Box 2.2: A new framework to underpin financial management transformation

The Government is finalising its Financial Management Transformation program, following the launch of the Prime financial management system and a shift to an outcomes-focused budgeting framework.

The third and final pillar of the Financial Management Transformation program will reform the existing legislative framework, which dates back to the 1980s. It will modernise existing provisions on the use of financial services, which will allow for a broader range of banking services, and strengthen the Government's financial management performance, accountability and transparency, bringing New South Wales' financial management in line with international best practice.

2.2 Budget position and outlook

A $3.9 billion budget surplus is expected in 2017-18. Surpluses are also projected to continue across the four years to 2021-22 averaging $1.6 billion per year.

Relative to 2017-18, the budget surplus declines to $1.4 billion in 2018-19. This is predominantly due to additional investment in health, education and public transport, downward revisions to transfer duties from residential property transactions, and a lower final Commonwealth Asset Recycling Initiative payment.

A continuing focus on expense discipline supports budget surpluses across the forward estimates. These surpluses, along with asset recycling and modest borrowings, continue to support a record program of infrastructure projects.

Table 2.2: General government sector budget result aggregates

	2017-18 Revised	2018-19 Budget	2019-20	2020-21 Forward Estimates	2021-22
Revenue ($m)	80,461	81,081	83,709	85,728	88,668
Revenue growth (per cent p.a.)	3.0	0.8	3.2	2.4	3.4
Expenses ($m)	76,522	79,656	82,181	84,316	86,814
Expense growth (per cent p.a.)	5.5	4.1	3.2	2.6	3.0
Budget Result ($m)	3,939	1,425	1,528	1,412	1,855
Per cent of GSP	0.6	0.2	0.2	0.2	0.3

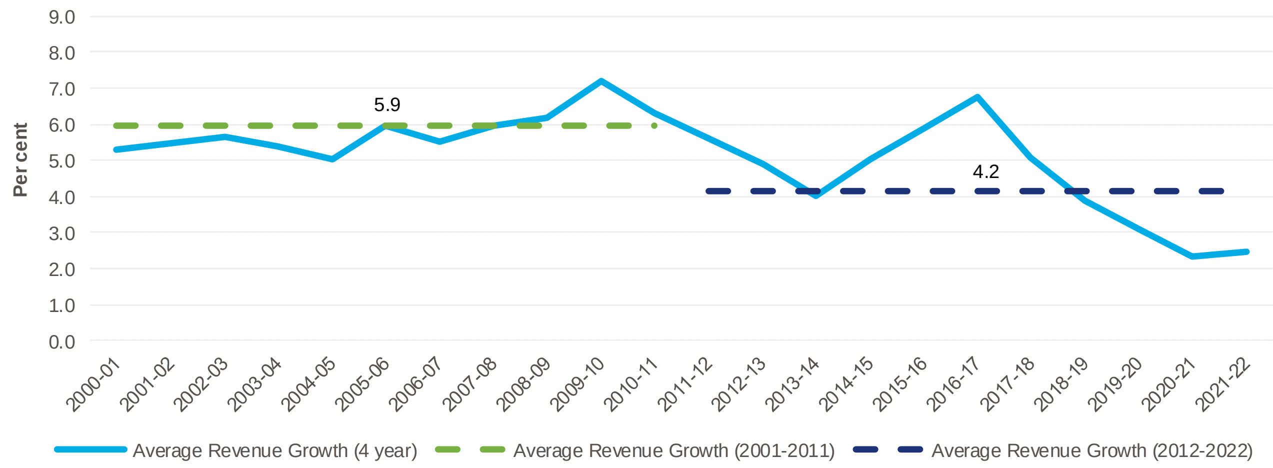
Revenue growth outlook

Four-year average revenue growth is forecast to be lower in the four years to 2021-22 than the two decade averages since 2001 (see Chart 2.2).

Average revenue growth rose in the period between 2013-14 and 2016-17 due to strengthening property and employment markets. The State also benefited from additional revenue associated with the Government's asset recycling strategy during these years, including Commonwealth Government incentive payments and one-off transfer duties.

The 3.0 per cent annual revenue growth figure for 2017-18 (see Table 2.2) is expected to be slightly higher than anticipated in the 2017-18 Half-Yearly Review, primarily due to higher than budgeted returns on the NSW Infrastructure Future Fund (NIFF).

Chart 2.2: Four-year average revenue growth

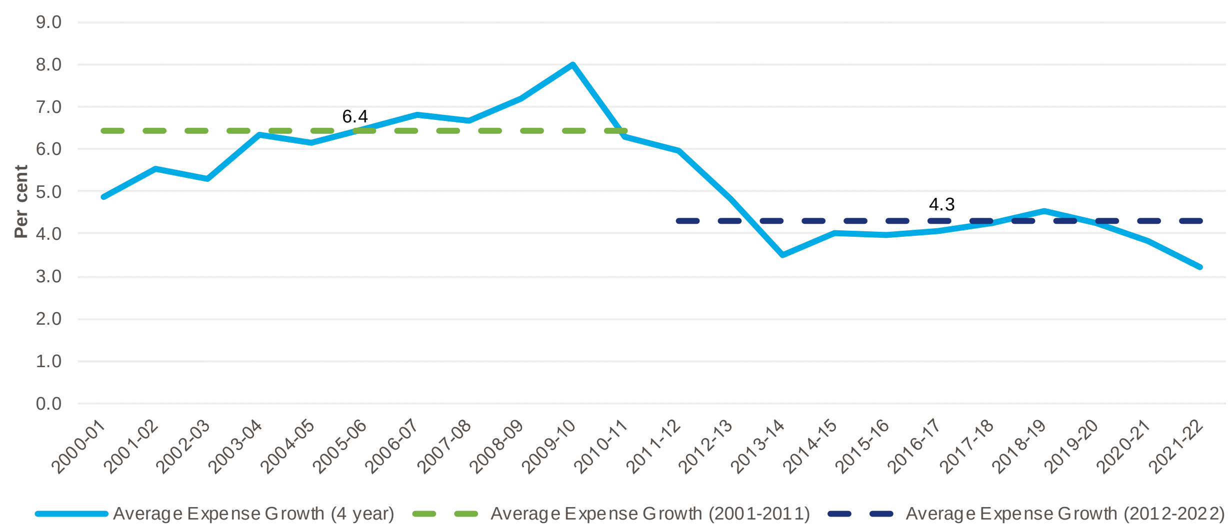


Four-year average revenue growth is projected to be 2.5 per cent across the budget and forward estimates, below the 4.2 per cent average for the decade to 2021-22. This is primarily due to lower transfer duties from a softening in residential property transaction volumes and prices. This is partially offset by upward revisions to GST revenue forecasts and mining royalties.

Expense growth outlook

Following a similar trend to revenue, four-year average expense growth is projected to be lower in the decade to the end of the forward estimates than in preceding decade (see Chart 2.3). Across the budget and forward estimates, four-year average expense growth is projected to be 3.2 per cent, below the 4.3 per cent decade average to 2021-22. This is well below expense growth in the previous decade and reflects careful management of public spending. Expenditure restraint will remain important to supporting a sustainable budget position in the years ahead as revenue growth moderates and cost pressures emerge in the delivery of essential services such as health, education and transport.

Chart 2.3: Four-year average expense growth



Changes in the budget result since 2017-18 Budget

Table 2.3: Reconciliation of 2018-19 Budget to 2017-18 Budget [(a)]

	2017-18 Revised	2018-19 Budget	2019-20 Forward Estimates	2020-21
	$m	$m	$m	$m
Budget result: 2017-18 Budget	**2,698**	**2,126**	**1,532**	**1,500**
Changes from 2017-18 Budget to 2017-18 Half-Yearly Review				
Policy measures				
Revenues	41	(63)	(55)	(56)
Expenses	(92)	(458)	(1,039)	(821)
Total policy measures	**(51)**	**(521)**	**(1,094)**	**(877)**
Parameter and other budget variations				
Revenues	(84)	593	726	880
Expenses	768	(106)	278	55
Total of parameter and other budget variations	**684**	**487**	**1,004**	**935**
Total policy measures, parameter and other budget variations	**634**	**(34)**	**(90)**	**58**
Budget result: 2017-18 Half-Yearly Review	**3,332**	**2,093**	**1,442**	**1,558**
Changes from 2017-18 Half-Yearly Review to 2018-19 Budget				
Policy measures				
Revenues	4	144	446	377
Expenses	(158)	(2,006)	(1,193)	(1,383)
Total policy measures	**(153)**	**(1,862)**	**(747)**	**(1,006)**
Parameter and other budget variations				
Revenues	615	182	121	757
Expenses	145	1,011	712	103
Total of parameter and other budget variations	**760**	**1,194**	**833**	**860**
Total policy measures, parameter and other budget variations	**607**	**(668)**	**86**	**(146)**
Budget result: 2018-19 Budget	**3,939**	**1,425**	**1,528**	**1,412**

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

The 2017-18 budget surplus has increased by $1.2 billion since the 2017-18 Budget and $607 million since the Half-Yearly Review.

The improvement since the 2017-18 Half-Yearly Review is driven largely by higher than anticipated returns from the NIFF. The residual movement since the 2017-18 Budget is largely attributable to better alignment of expenditure with planned project and service delivery schedules.

For 2018-19, the budget surplus is $668 million lower since the 2017-18 Half-Yearly Review, primarily driven by funding provided for additional health and transport services.

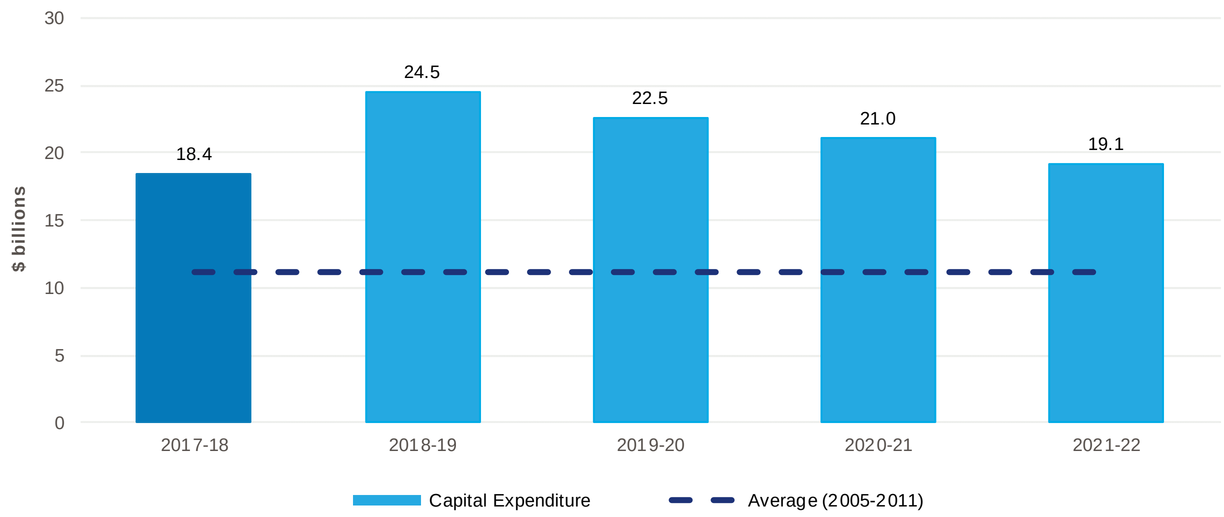
For the remaining two years of the forward estimates, there are no major changes in the budget result since the 2017-18 Budget and Half-Yearly Review.

Capital expenditure and net debt outlook

A key Government priority is to build the infrastructure needed as New South Wales continues to grow.

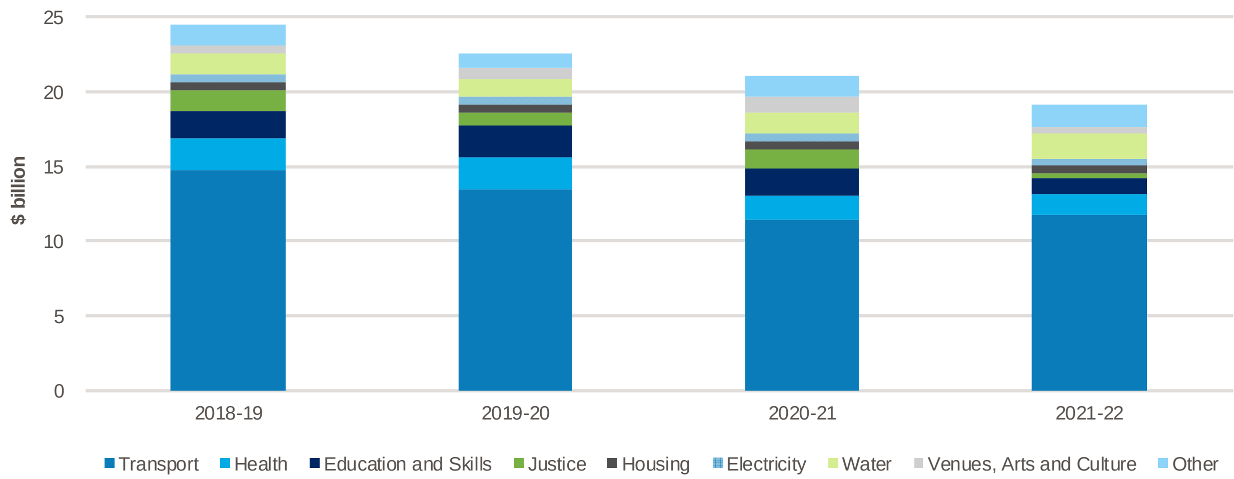
The 2018-19 Budget delivers record capital expenditure of $87.2 billion projected over the four years to 2021-22. This is $14.5 billion more than the comparable four-year total at the 2017-18 Budget and well above historic levels (see Chart 2.4). New South Wales' capital spending as a proportion of GSP is the highest of all mainland states. At 3.9 per cent in 2018-19, this compares with an average of 2.7 per cent for all other states and territories.

Chart 2.4: Capital expenditure in the non-financial public sector



Whilst a majority of the record infrastructure spend is directed towards transport projects, the Government is also investing considerably in health, education, justice and other priority areas (see Chart 2.5).

Chart 2.5: Capital expenditure by sector



Funding the State's record infrastructure program while simultaneously maintaining net debt levels consistent with a triple-A credit rating is made possible by delivering budget surpluses and the use of asset recycling proceeds (see Box 2.3). Across the budget and forward estimates, approximately $68 billion will come from these sources.

Box 2.3: Successful asset recycling strategy delivers for New South Wales

The Government's asset recycling strategy is enabling a once-in-a-generation investment in infrastructure benefitting communities across New South Wales.

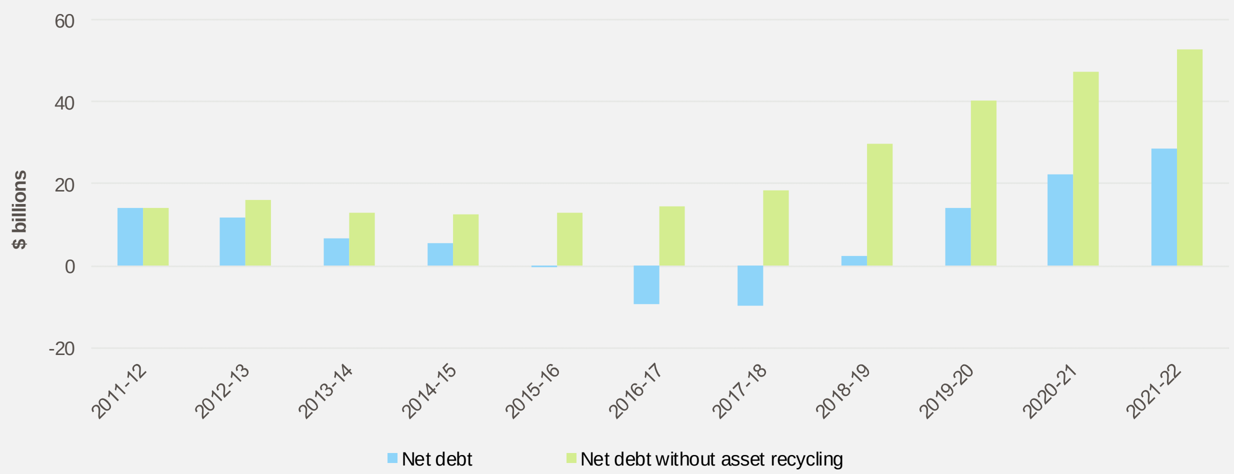
Together with budget surpluses delivered by disciplined fiscal management, asset recycling has allowed the Government to invest in much needed roads, trains, buses, schools and hospitals across the State. This has been done without an overreliance on borrowings and has helped maintain debt levels consistent with a triple-A credit rating.

In March 2018, the NSW Government sold its 58 per cent shareholding in Snowy Hydro Limited to the Commonwealth Government, enabling $4.2 billion to be spent on infrastructure in regional and rural NSW. The transaction is a continuation of the NSW Government's asset recycling strategy and exit from the electricity generation sector. It also allows the Commonwealth Government to begin the Snowy 2.0 project, investing a further $3 billion to increase the generator's capacity and creating 5,000 jobs in the NSW Snowy Region.

The upcoming sale of 51 per cent of WestConnex is expected to be completed after the 2018-19 Budget. Consistent with past practice, this will not be reflected in the budget until the transaction has been completed. WestConnex sales proceeds are earmarked to fund the third and final stage, the critical M4-M5 Link, connecting two of Sydney's busiest motorway corridors.

Without asset recycling, net debt would have reached $52.7 billion by June 2022 compared with the $28.7 billion currently projected in the 2018-19 Budget (see Chart 2.6 below).

Chart 2.6: Net debt comparison without asset recycling measures(a)



(a) Does not include the impact of the sale of WestConnex or any other future asset recycling measures.