

Tough Budget sees NSW retain AAA rating

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Key points

- **NSW Treasurer Eric Roozendaal has unveiled a tough Mini-Budget.** Taxes have been increased, expenses cut and the state's massive capital works program reprioritised. The government's fiscal austerity has achieved its desired intention, with **S&P affirming the state's AAA rating** a short time ago, though the outlook remains negative.
- **Even with tough new policy measures the budget bottom line has deteriorated.** The budget is forecast to post an operating deficit of \$917mn in 2008-09, a \$1,185mn turnaround from the \$268mn surplus expected in June. The budget is forecast to return to surplus thereafter, though the magnitude of the surpluses are expected to be somewhat smaller in 2009-10 and 2010-11 than previously expected. Over the four years from 2008-09, the state's operating balance has deteriorated by \$1,920mn relative to Budget forecasts (and that doesn't even include the 2007-08 outcome, which came in at a surplus of \$73mn, some \$627mn less than forecast in June).
- **Revenues have been revised up by \$5,139mn over the four years from 2008-09,** despite a \$3bn reduction as a result of weaker economic conditions. This reflects higher Commonwealth payments (which are mirrored by higher expenses) and new revenue measures worth \$3,039mn. Significant measures include:
 - Coal royalty rates will be increased from January 2009 adding \$1,171 to the budget bottom line over the next four years.
 - The deferral of a number of stamp duties that were due to be abolished, saving the budget \$932mn over four years.
 - From the 2009 land tax year, the marginal land tax rate will be increased to 2% for taxable land holdings above \$2.25mn, adding \$680mn to the budget over four years.
- **Expenses have been revised up by \$7,059mn over the four years from 2008-09.** Aside from increased expenses associated with higher Commonwealth payments, this increase reflects higher superannuation expense provisions due to lower investment returns, more conservative estimates of the cost of service delivery in key areas, and expenditure on initiatives including for new buses, regional development and low Socio-Economic Status schools. However, this has been partly offset by measures that will reduce expenses by around \$3.3bn over the four years to 2011-12.

Key NSW Mini-Budget forecasts

	08-09	09-10	10-11	11-12
Net operating balance (\$mn)	-917	138	573	900
Change since Budget (\$mn)	-1,185	-654	-202	121
Real GSP (% ch.)	1¼	1½		
Employment (% ch.)	½	½		
Unemployment rate (%)	5¼	5¾		
Wages (% ch.)	3¾	3½		
Sydney CPI (% ch.)	3¾	3		

Source: NSW Mini-Budget

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- **The failure of the government's electricity reforms has prompted a review of the state's capital program.** Total capital expenditure over the next four years is now expected to be \$56.8bn, \$890mn less than previously forecast. There has also been a reprioritisation of the program, with a number of major rail projects deferred or staged to fund other capital purchases and generate budgetary savings.
- **The government is also continuing to investigate the sale of state assets to fund its capital works program.** Asset sales worth an extra \$866mn over the next four years have been approved since the Budget. However, this does not include any revenue from the recently announced electricity reform package or the potential sale of businesses including NSW Lotteries, WSN Environmental Solutions, Pillar, and the RTA's non-standard number plates business.
- **Overall, net debt is forecast to be \$1.1bn lower than expected at Budget time** (though higher as a % of GSP), with the combination of savings on the capital works program and increased asset sales more than offsetting the effect of weaker budget results.
- **The economic outlook for NSW has been downgraded significantly.** GSP growth is expected to be just 1¼% in 2008-09 (down from 2% previously expected) and 1½% in 2009-10, both years well below the medium term projection of 3¼%. Employment growth is expected to slow to just ½% per annum in each of the next two years and the unemployment rate is forecast to rise to 5¾% in 2009-10.
- **Even this more pessimistic outlook seems too optimistic to us.** Recent partial data suggest the NSW economy has continued to deteriorate in recent months, and is on the verge of recession (if indeed it is not already there). We expect growth to be just ½% in 2008-09 and 1¼% in 2009-10.
- **The Mini-Budget also raises the risk of exacerbating the downturn in the NSW economy.** The effect of policy decisions in this budget has been to raise taxes by \$3bn and cut expenses by \$3.3bn over the next four years. This equates to almost ½% of GSP per annum over the next four years.
- **That said, the NSW government had little choice but to deliver a fiscally restrained budget, regardless of the economic circumstances,** a point highlighted by the prompt affirmation of the state's AAA credit rating. However, the downside risks to the state economy – both relative to the government's forecasts and because of the measures contained in the Mini-Budget – suggest it's going to be a difficult couple of years for the government and people of NSW.

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