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NSW State Budget 2007-08

The new fiscal approach

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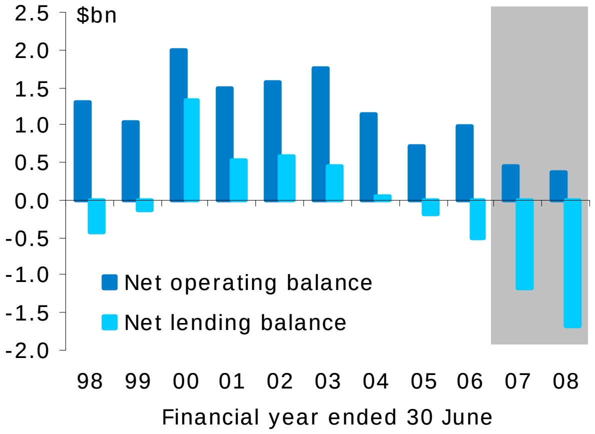
NSW Treasurer Michael Costa's 2007-08 Budget is the last of the State and territory budgets to be released and confirms that State governments across mainland Australia have adopted a new fiscal approach. Debt is no longer a dirty word as State governments ramp up capital expenditures to address supply constraints in the economy.

The NSW Budget presents a decent bottom line - the general government's net operating surplus is $444mn in 2006-07 and $376mn in 2007-08. However, there is a question mark over the 2006-07 surplus since it includes a $401mn stamp duty assessment on the sale of Sydney Airport that is being contested by the Commonwealth Government.

Regardless of the outcome of the Commonwealth's challenge, the State's financial position in 2006-07 is looking significantly stronger than it did in last year's Budget. In total, there is a $2.1bn turnaround from the $696mn deficit expected last year (including the payment of $960mn debt accrued during the construction of the Epping to Chatswood Rail Line). The improvement is primarily attributable to transfer duties from one-off commercial property transactions ($751mn higher) and very strong investment income returns ($835mn higher).

A broader measure of the State's financial position is the net lending balance. This is set to be in deficit, primarily reflecting infrastructure-related borrowings.

General government financial position



Source: NSW State Budget 2007-08

The Government's commitment to its capital program is clear with $12.5bn provided for capital works in 2007-08 or nearly $50bn over the next four years. As a share of the State's economy, this takes capital spending to its highest in over a decade.

Concomitant with the increased capital spending is an elevated level of debt. By the end of the forward estimates period (30 June 2011), NSW public sector net debt is estimated to reach $39.3bn (9.3% of GSP). This represents a turnaround from the very low debt levels of the past few years to a more moderate position. Ratings agency S&P has confirmed that the increased debt will not threaten the State's credit rating.

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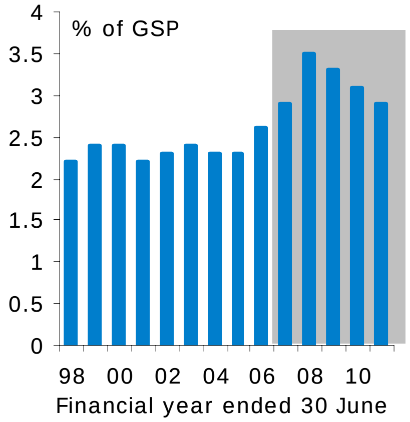
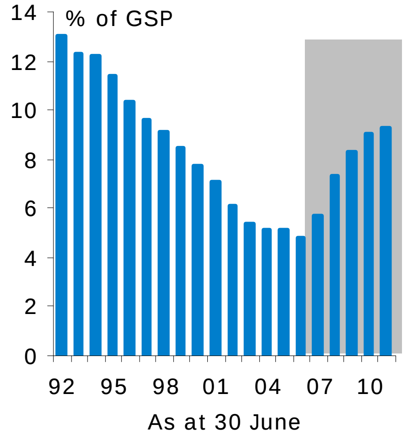
Public sector capital spending to be the highest in a decade



Public sector net debt set to increase



Source: ABS Cat. No. 5220.0; NSW State Budget 2007-08

From the public's perspective, the management and delivery of the infrastructure projects will be at least as important as the actual dollar amount committed with the Cross City Tunnel episode not forgotten.

From an economic perspective, investment to alleviate the economy's supply constraints is welcome. And with the national economy in a strong position, State governments are finding it easier to make those investment decisions now. However, there will be a significant lag before the capital expenditure translates into actual infrastructure.

There is a risk that the sizeable capital program will crowd out private investment and place further pressure on costs at a time when labour and materials are already in short supply. In this context, there is also a risk that the projects will face delays due to input shortages.

Rural and regional NSW will receive 46% of the total infrastructure spending.

Details of Key Budget Measures

The Government identifies four priority areas:

- $12.5bn will be spent on **health** in 2007-08 with a focus on prevention and early intervention strategies including breast screening, state-wide eyesight screening of pre-schoolers and a program to help the elderly stay at home. In addition, $157mn will be spent on Mater Hospital at Newcastle as a privately financed project.
- $11.2bn will be spent on **education**, including funding for 31 major school projects, 11 new TAFE projects and a program of literacy and numeracy assessment at the Kindergarten level.
- $5.8bn will be provided for **public transport** and **roads**, with new projects including the $100mn 'pinch point' strategy, $100mn Victoria Road upgrade, and $120mn to purchase 265 new buses.
- **Community** and **disability services** will receive funding for a range of programs which will provide increased support for carers and expand early intervention services.

The general government's activities will be supplemented by public trading enterprise (PTE) projects including Sydney Water's **desalination plant** ($1.9bn).

On the revenue side, the Budget offers some tax reductions:

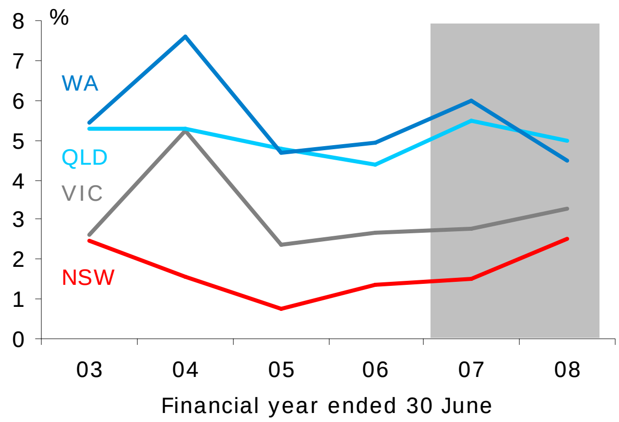
- The rate of **land tax** will be cut to 1.6% (from 1.7%) from 1 January 2008. This will reduce revenue by an estimated $467mn over four years.
- The abolition of **mortgage duty** will be accelerated, starting with owner occupied residences from 1 September 2007. This will reduce revenue by $1.4bn over four years.

- **Stamp duty** on **hire goods** will be abolished from 1 July 2007 and on **leases** from 1 January 2008. This will reduce revenue by $570mn over four years.

Economic Forecasts

For many years, **economic growth** in NSW has lagged the rest of Australia,[1] and this is set to continue. There will be a pick-up, with the NSW Treasury forecasting the economy to grow by 2.5% in 2007-08, up from an estimated 1.5% in 2006-07. But based on State Treasury forecasts, this will remain the slowest rate of growth amongst the Australian States.

Economic growth in NSW will continue to lag the rest of Australia



Source: ABS Cat. No. 5220.0; Various State Budgets 2007-08

Some factors have contributed to slower conditions in NSW, in particular the housing cycle downturn and Dutch disease. The latter is when strong demand for Australia's commodities contributes to a stronger currency and places pressure on other trade based industries, particularly manufacturing. However, these factors cannot fully explain the NSW predicament given that it is performing below other non-mining States and given the State's sizeable endowment of coal.

Looking forward, the economy is expected to be driven by solid consumption, an improvement in business investment and the public sector's strong infrastructure investment. A significant positive is the expected pick-up in dwelling investment. At present, dwelling completions are running well behind demographic requirements resulting in a lower vacancy rates and rising rents.

Employment growth is expected to be 1.5% in 2007-08, around the national average. **Inflation** and **wage** pressures are forecast to be similar to the national average.

Figure: NSW economic forecasts

	2005-06 Actual	2006-07 Forecast	2007-08 Forecast
Real gross state product	1.4	1.5	2.5
Employment	1.6	1.75	1.5
Unemployment rate	5.3	5.25	5
Consumer price index	3	2.75	2.5
Wage price index	4.1	4	4

Source: Australian Bureau of Statistics; NSW Treasury

[1] As an incident, the Victorian economy will this year overtake the NSW economy in per capita terms for the first time in over 20 years.

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