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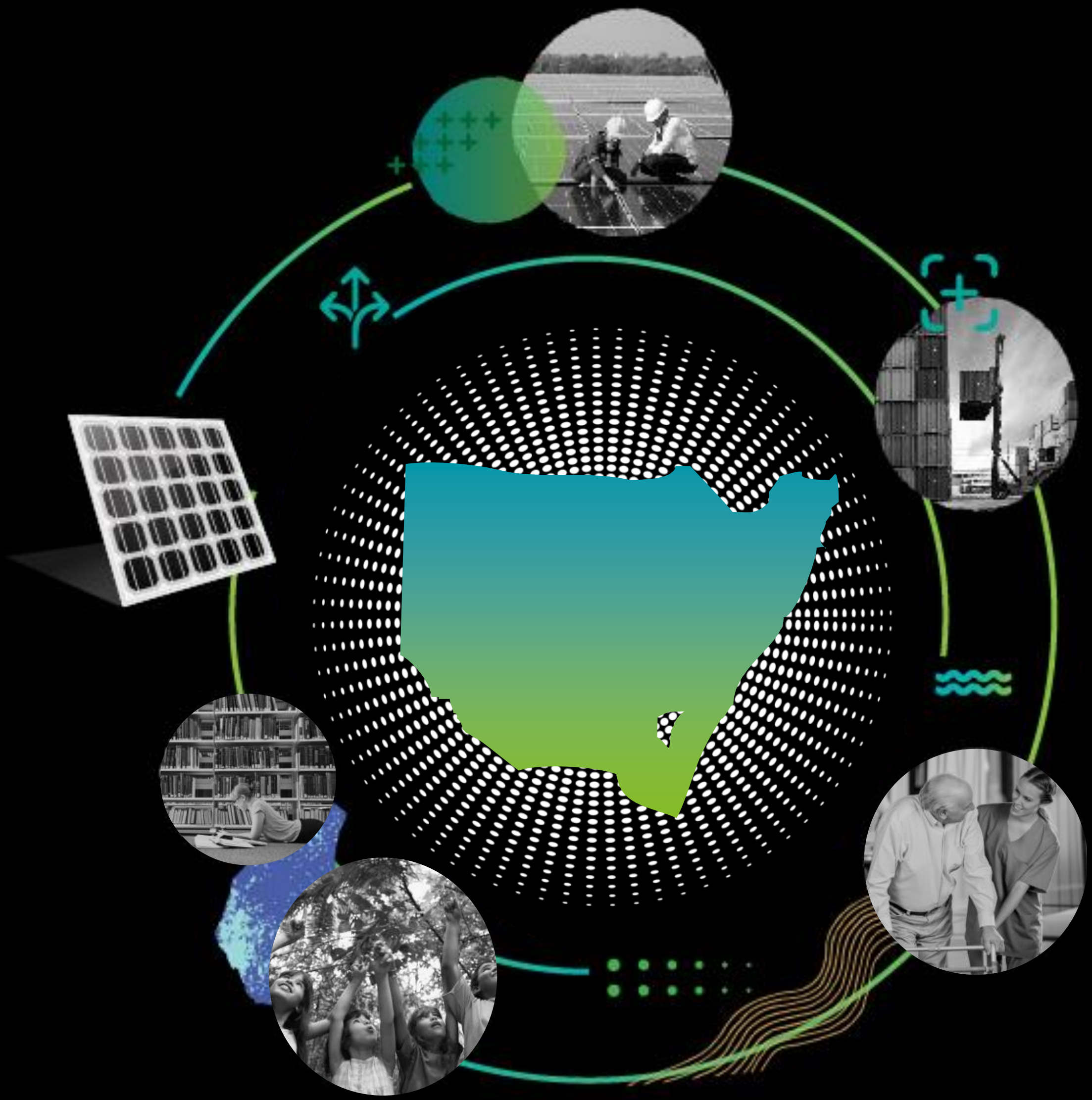


New South Wales Budget 2024-25

Sturdy budget puts services over cash splash

June 2024

Deloitte Access Economics

ECONOMIC OUTLOOK

A little bit of this, a little bit of that...but overall the Budget prioritises spending on services in the face of cost-of-living and GST pressures

The second Budget of the Minns Government plants a sensible foundation for economic growth in New South Wales. Unlike other state budgets this year, the NSW Government has shown relative spending restraint, rather than embarking on a cash-splash to 'beat' cost-of-living pressures and risking further fuelling inflation. New spending is on key areas of service need like disaster relief, housing and homelessness, and domestic and family violence programs. However, there was little new funding for the transition to net zero or other measures to drive investment and business productivity.

The Treasurer has made a lot of the goods and service tax (GST) carve up and the implications for overall government revenue. Much less noise was made about the positive impact from higher stamp duty and land tax revenues. The government has chosen to spend more than it planned even six months ago and hasn't either identified major cuts or announced a plan for doing so. In the short term, support for the fragile economy is justified. But more fiscal consolidation work will be required in coming years, as rising debt sees the interest bill climbing to $10 billion a year by 2027-28.

Ups and downs

There's a lot to love about NSW – the primary destination for international migrants, globally-connected technology and finance industries, a diverse economy across multiple regions, and rich environmental and cultural assets.

But NSW is also a state with challenges. From the monumental task of skilling and reskilling the workforce for tomorrow's economy, accelerating the transition to net zero, and boosting productivity, to rapidly scaling up the supply of housing, there is a long to-do list. Those challenges contribute to Sydney's unaffordable housing market and high cost-of-living which are actively encouraging people – many of them young and productive – to move interstate. That vicious cycle means Sydney could be on track to lose the title of Australia's most populous city by 2030.

The key litmus test for any budget is whether it helps address the state's biggest challenges, short and long term. This Budget makes some progress, but there is plenty more heavy lifting for future years.

Macroeconomic outlook

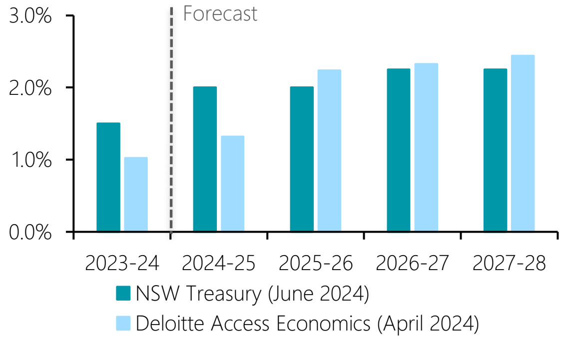
Overall, the Budget's economic forecasts are consistent with a soft landing in the economy. Economic growth is expected to pick up in 2024-25, with NSW Treasury expecting the state's economy to expand by 2.0%, up from forecast growth of 1.25% in 2023-24 (Chart 1). Deloitte Access Economics has a more pessimistic view of the year ahead, expecting economic growth of just 1.3% in 2024-25, as cost-of-living pressures continue to bite.

Households in NSW have been particularly squeezed. In April 2024, the average loan size for owner-occupier dwellings in NSW was $764,453, 22% higher than the national average. Larger mortgages have meant the share of household earnings going to mortgage payments in NSW has increased more than in all other states since May 2022. From this it is easy to see why rate rises hit a Sydney household harder than the Australian average.

As the pace of inflation decelerates, gradual improvements in real wages will support family budgets. NSW households will also benefit from the revamped Stage 3 tax cuts.

Chart 1: Growth expected to lift

Forecast annual growth in NSW real gross state product



Source: NSW Budget Papers, Deloitte Access Economics

Questions over a GST shortfall

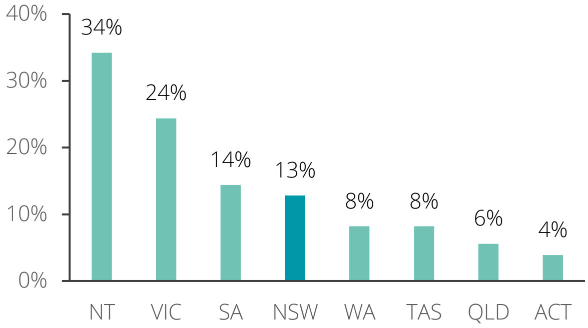
The budget deficit for 2023-24 has blown out to $9.7 billion from a forecast of $9.5 billion at the time of the 2023-24 Half-Yearly Review in December last year. A deficit of $3.6 billion is forecast in 2024-25, compared with a surplus of $475 million that was forecast in December. Operating deficits of between $1.5 billion and $2.5 billion are projected to 2027-28.

The Treasurer reiterates how GST allotments have buffeted the Budget – estimated to cost $11.9 billion over the next four years. Under the update, a lower share of national GST pool will be distributed to NSW due to a lower GST relativity. What the Treasurer fails to account for is that the decline is due to NSW receiving more revenue from a booming property market delivering higher stamp duties ($4.1 billion) and land tax, as well as higher coal royalties ($482 million) from soaring global energy prices. The state will also receive GST top-ups from a larger expected GST pool and Federal Government "no worse off" extensions reducing the Treasurer's claimed loss of $11.9 billion.

The increasing ratio of debt to GSP should be at the forefront of the Government's considerations around its future fiscal strategy. Forecast estimates for net debt to GSP have worsened since the Government's 2023-24 Budget, with net debt-to-GSP forecast to peak at 13.9% in 2026-27.

Chart 2: Modest but rising debt-to-GSP levels

Net debt-to-GSP, 2024-25 forecasts (per cent)



Note: ACT and TAS have not yet released a 2024-25 budget. Data for those jurisdictions sourced from 2023-24 budget forecasts.
Source: NT, VIC, SA, NSW, WA, QLD Budget Papers 2024-25, ACT, TAS Budget Papers 2023-24

REFORMS AND INVESTMENT FOR LONG TERM PROSPERITY

Lays the foundation of the Budget's long-term priorities

Housing: A for Effort, but we won't know the true grade for some time

Last year, the government declared that 'Housing is the NSW Government's top priority'. With Sydney's housing being among the most expensive in the world, such urgency is welcome. The Budget adds reforms, investments and programs – but until the public see real progress, people will ask: is it enough?

The big announcement in the budget is for 30,000 dwellings on surplus government-owned land- although details are scarce about where, when and by whom these homes will be built. Talk and ambition can be cheap.

6,200 new social housing units will help vulnerable households. They are a modest 2% of NSW's housing target for the next four years, and around 10% of the social housing waitlist. $450 million for Landcom to build dedicated essential worker housing will help those lucky enough to secure a place. They will also spend $810 million fixing 33,500 social homes that have fallen into disrepair- an efficient use of dollars.

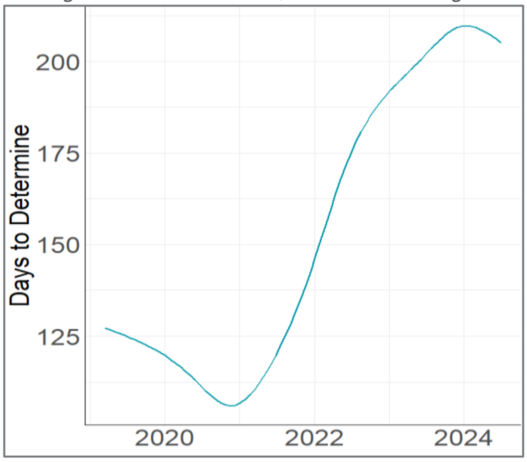
Since 2021, assessment times for multi-dwelling developments have nearly doubled- now sitting at over 200 days on average.

Building on the government's ambitious planning reforms and housing targets, $250 million to speed up the planning system will improve certainty and lower costs for developers. With high interest rates and construction costs challenging developers' finances, more rapid assessment & infrastructure support can get more projects off the ground and get keys in doors sooner.

But the $200 million to help local councils with infrastructure funding may be even more important, with many projects struggling as much for financial feasibility as they do to get planning approval. As the Master Builders Association has suggested – sector productivity will need to lift.

Chart 3: Housing Handbrake

Average assessment times for multi-dwelling DAs in NSW



Source: NSW Department of Planning, Housing, and Infrastructure, Deloitte Access Economics analysis. Note: smoothed moving average, multi-dwelling DAs defined as DAs adding at least 2 new dwellings.

Funding for crisis accommodation and homelessness will help some of the most vulnerable households in NSW bearing the brunt of the housing crisis. By some measures, homelessness increased by 34% from between 2022 and 2023.

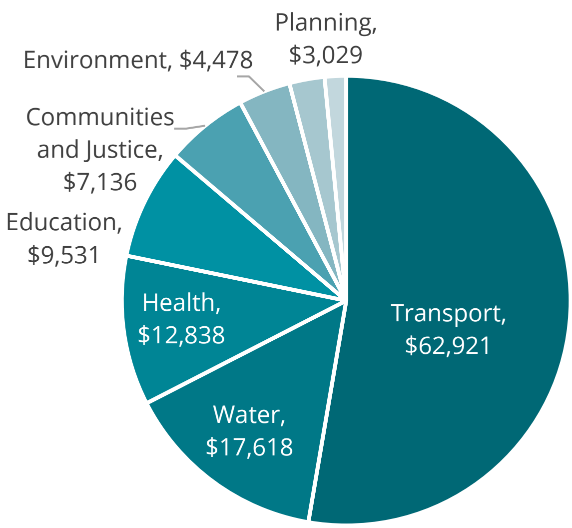
Investing in the West

Infrastructure investments, centred on Western Sydney, represent some of the most significant expenditure items in this Budget. While most of these projects are pre-existing commitments, the infrastructure program will average almost $30 billion annually over the forward estimates, double the level from a decade ago. Transport projects represent the bulk of this program, with multi-billion investments in Sydney Sydney Metro West ($13.4 billion), road and metro projects around Western Sydney Airport ($6.7 billion) and stage 2 of the Parramatta Light Rail ($2.1 billion). With the West expected to take the bulk of Sydney's growth, these transport projects will be necessary to keep people and goods moving around efficiently.

Investment in school infrastructure is concentrated in the rapidly growing suburbs of Western Sydney, with the government committing to 51 new public preschools in the west, more than half of the state total.

Chart 4: Roads, Rails, Pipes and Beds

Capital spending over forward estimates ($million)



Source: NSW Budget Papers

More energy needed for the environment

The Budget takes modest steps towards the transition to net zero and greater use of renewable energy. There is a real cut in environmental production funding compared to the 2022-23 and 2023-24 levels. There's funding for the already announced Renewable Energy Zones (REZ) and Energy Security Corporation, and additional funds to connect REZs to the Port of Newcastle. There is also funding to extend the operating period for the Eraring Coal Power Station until 2027, underwriting Origin Energy's losses if that occurs. This is unlikely to have a major impact on the broader strategy towards net zero; it signals difficulty transitioning from fossil fuels, which may impact the state's interim target of reaching 50% reduction in emissions by 2030. Furthermore, the state is extending the energy bill relief measures.

SHORT-TERM SPENDING MEASURES

Deficits are going up, but spending is targeted and helping to overcome urgent issues; but a fiscal reckoning awaits.

Spending is up now, but slows in future

Spending in the Budget is expected to be $122 billion in 2024-25, $5 billion more than was expected just six months ago. And while some of that is caused by parameter variations, more is caused by new spending initiatives ($5.5 billion), which are only partially offset by savings ($2.4 billion). In the medium term, expenses as a proportion of the economy are expected to fall from around 14% of GSP in 2024-25 to 12% by 2027-28.

The quality of the additional spending for the most part looks pretty good. Disaster relief, homelessness support, domestic and family violence programs and funding to drive planning reforms – all worthy areas. But the largest single expense item is higher public sector wages, and it's only partial paid for by the Essential Services Fund. The Government came to power on a commitment to rip up the former Government's Public Sector Wages Cap. This was necessary to address the unsustainably low wages growth for front-line workers. But there is a risk expectations of permanently higher growth get baked into the system, reducing funding available for other government priorities across the board. Public sector efficiency will have to be a focus in coming years.

In a bit of a lost opportunity, the Budget does not trumpet a big list of savings. While the Treasurer indicated this would not be a slash and burn budget, equally, there is no major audit of the quality of spend across the NSW public service. (Partly, because some bigger cuts were made in the Government's first Budget, last year). In limiting the number of budget cuts, the Budget maintains a theme of accepting the investment legacies of the previous Government, rather than charting a course for a rebalanced NSW. Good budget policy needs on-going evaluation and redesign - a discipline yet to be baked into the budget process sufficiently well. And it would give the Government more space to fund its own priorities – for example, it might have been able to build new trains rather than spend $477m to refurbish old Tangara ones.

Targeting the right priorities

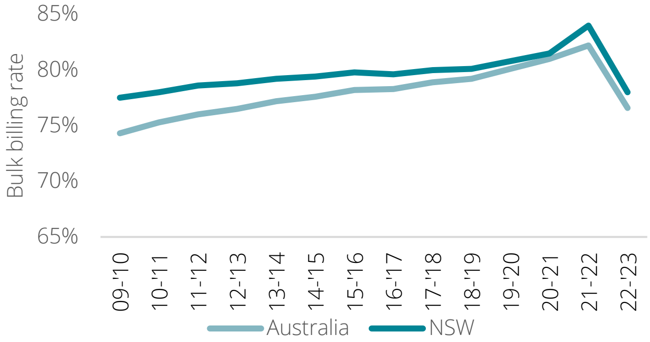
The Budget has prioritised investment into critical areas. This includes beneficial investment towards victims of domestic, family, and sexual violence (DFSV), and essential services in education and healthcare.

This Budget takes a comprehensive approach in supporting victims and improving the prevention of domestic and family violence. This is much needed action and follows a tragic string of deaths of female victims of DFSV in the first half of 2024 and subsequent 'No More' national rallies against gender-based violence held across Sydney, Hobart and Adelaide. The Budget commits $245.6 million package delivered over four years to tackle DFSV. The package includes critical funding to increase the number of support staff, with $48.1 million to expand the presence of specialist workers from 20 to 30 refuges. Understanding the drivers of gendered violence is particularly critical to the development of evidence-based prevention, which the Budget addresses with a $38.3 million to implement NSW's first dedicated Domestic, Family and Sexual Violence Primary Prevention Strategy.

The Budget's targeted investment in education and healthcare supports more productive Australians. The Government is providing payroll tax relief to bulk-billing GP clinics, which will likely reduce reliance on emergency departments and increase accessibility of healthcare. Additionally, $481 million is being invested in urgent care services and discharge services which will support more positive healthcare outcomes and productivity measures.

Chart 5: Decline in Medicare bulk billing rates

Percentage of bulked billed services of total MBS services



Source: Department of Health and Aged Care, 2023

Additionally, significant funding has been directed to supporting public education across the life-cycle. The Government has committed to building 100 new pre-schools. $8.9 billion in the Rebuilding Public Education Program, will fund 5 new public schools, and will cover the cost of 7 new primary schools. South-Western Sydney and North-Western Sydney are set to benefit the most. Vocational education is being supported with an additional $8.9 million investment in Fee Free training for all apprentices and trainees, and $83.1 million to support permanent teaching staff within TAFE NSW.

Longer term

State budgets don't often feature major economic reforms, and in that regard, the 2024-25 NSW Budget isn't very different. Still, there are a few seeds planted that will bear fruit in the future.

The Budget includes a measure to consolidate the government's investment funds into OneFund – which it hopes will deliver efficiencies, returns and less risk. Netting an additional $1.6 billion over four years, it sounds almost too good to be true.

Alongside the Budget, the Government has released a proposed NSW Performance and Wellbeing Framework with eight Wellbeing Themes and 28 Outcomes – moving beyond purely measuring the state by traditional economic metrics will be a good thing.

Land tax thresholds are frozen for commercial, secondary and investment properties, delivering $1.5 billion over four years and more in time. Previously indexed to property price changes, the threshold has almost tripled since 2010, rising to just over $1 million. A greater share of investors and holiday-home owners will now be gradually subject to the tax, and land tax bills will increase more rapidly in property upswings. Land tax is probably the most efficient tax available to the state government; it encourages better use of land, and unlike income, payroll or stamp duties, doesn't negatively distort people's work or housing decisions.

CONSIDERATIONS FOR THE FUTURE

Toll reform, lowering construction costs, productivity growth and fiscal consolidation will be on the agenda going forward.

What's on the horizon?

The rising cost to drivers of Sydney's toll roads has been a major focus for this Government. To date, the Government has managed these pressures, including by capping drivers' weekly tolls at $60, as well as providing toll relief and rebates for heavy vehicles, at a cost of more than $650 million over the next two years. Longer-term reform is potentially on the horizon. The much-anticipated Independent Tolling Review Final Report will be released shortly, and the Government has set aside an initial $16.6 million to continue the work. The challenge will be to deliver for drivers without damaging the reputation of NSW as a good place to invest.

Construction cost rises and challenging market conditions are a key barrier to achieving the government's lofty ambitions on housing. The productivity commission was recently tasked with identifying the most important of these barriers and finding the actions needed to address them. If NSW is to hit its target of 377,000 homes over the next five years, then significant improvements will be needed.

The budget isn't exactly brimming with policies to encourage business investment and productivity growth. The biggest run productivity gets is in the little-read Appendix F, where higher productivity growth is one of two hypothetical 'scenarios'. The budget asks: What if productivity suddenly leapt by an extra 2.5 per cent over the next four years? The government needs a strategy to drive productivity growth, not just imagine it happening.

We get some clues about why productivity growth isn't the focus it could be in table F.2 in the Budget papers. Even with a miracle lift in productivity growth, extra revenue for the state budget is modest – an extra half a billion a year in GST revenue, and a similar amount in stamp duty and land tax. It's the federal government's budget – through income and company taxes – that benefits the most from economic growth. Which is why both National Competition Policy in the 1990s and the current Housing Accord offer federal incentives to states that deliver reforms.

Next years' Budget will come at a time when inflationary pressures should have receded, the economic outlook will be brighter and interest rates could be coming down. Unless there are big revisions to revenue and expenses, it means the government will again have the task of trying to rein in spending. It will be doing so closer to an election, and the government may regret not having taken more pain in 2024. The next 12 months will also give the government more time to think about how it can support greater productivity growth in the economy and the transition to net zero.

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