

Ai Group Economics

New South Wales Budget and Outlook 2014-15

 AUSTRALIAN INDUSTRY GROUP

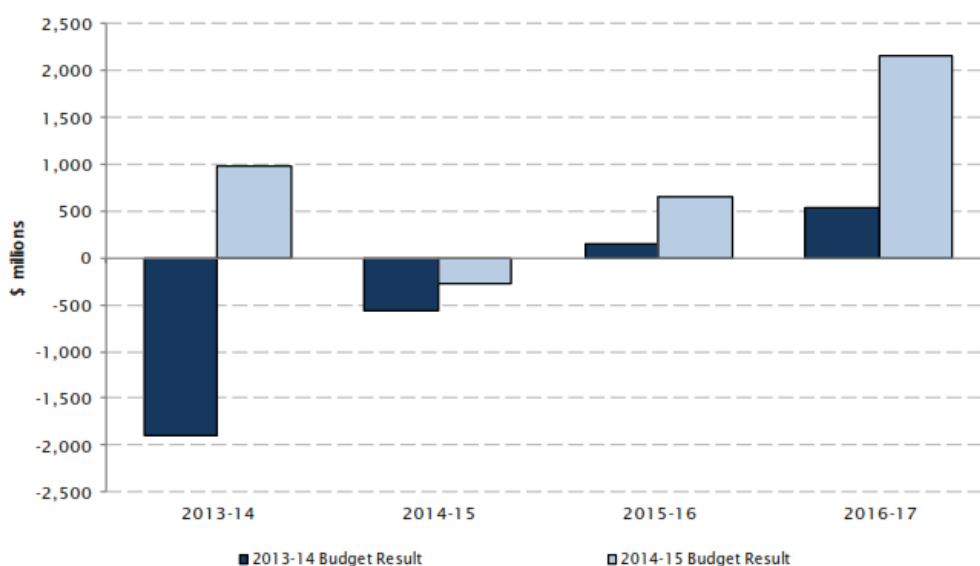
19 June 2014

NSW 2014-15 Budget Delivers an Improving Bottom Line

The **2014-15 NSW Budget** was handed down on Tuesday 17 June 2014. The Budget delivers a General Government deficit of \$283 million in 2014-15, an improvement on the Budget forecast for 2013-14 of \$563 million. In 2015-16, the Budget is expected to **return to a surplus** of \$660 million followed by stronger surpluses of \$2,155 million in 2016-17 and \$1,666 million in 2017-18 (see chart 1 and table 1). Measures to restrain expenditure growth; improve the net debt position and; increase investment in productive infrastructure were key features of the Budget. The Government also confirmed its fiscal strategy as focusing on supporting the maintenance of the State's triple-A credit rating.

The Government also reaffirmed that it would be seeking a mandate at the next state election in March 2015 for the transfer of 49% of its ownership of a range of electricity and transmission companies ("poles and wires") to the private sector, in the form of a 99 year lease. The disinvestment and the related additional infrastructure spending outlined in the \$20 billion Rebuilding NSW program are not reflected in the 2014-15 Budget.

Chart 1: Budget Result: 2013-14 compared with 2014-15 Budget



Source: NSW Budget Statement, Budget Paper No. 2, 2014-15

Table 1: NSW fiscal and economic projections

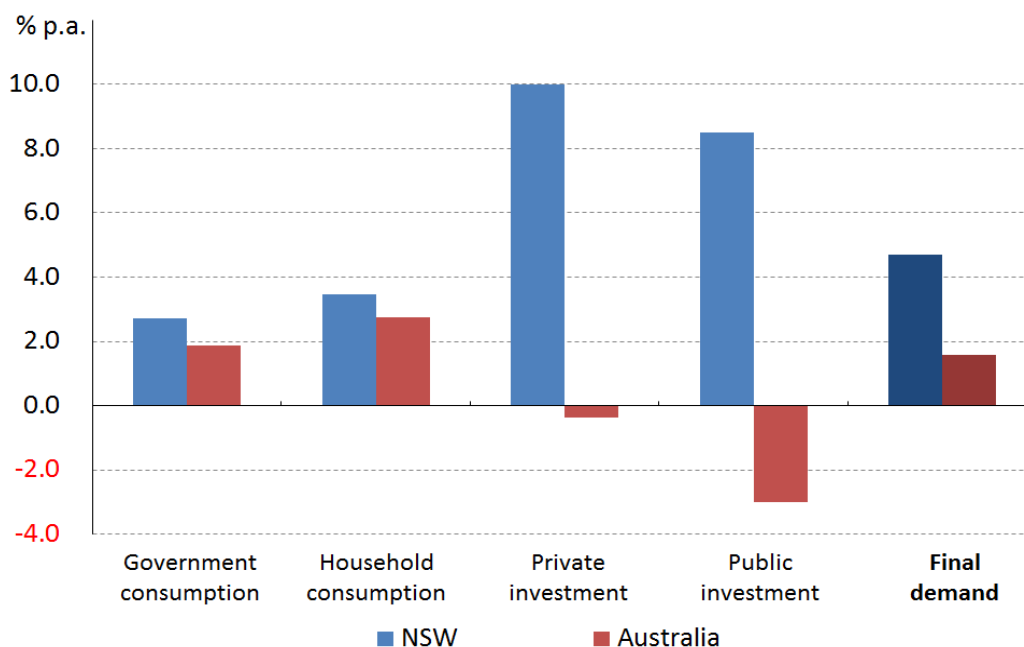
	2012-13 (A)	2013-14	2014-15	2015-16	2016-17	2017-18
Fiscal Balance (\$ million)	-1,300	988	-283	660	2,155	1,666
Real GSP (% p.a.)	1.8	3.0	3.0	3.0	-	-
Real state final demand	1.7	3.25	3.25	3.25	-	-
Unemployment rate (%)	5.2	5.75	5.5	5.25	-	-
Inflation (yr to June qtr)	2.6	3.0	2.25	2.75	-	-
Wage Price Index (% p.a.)	3.1	2.5	3.0	3.50	-	-

Source: NSW Budget Statement, Budget Paper No. 2, 2014-15

NSW economic performance and outlook

The **NSW economy has been building momentum in 2013-14** supported by a strong pick-up in dwelling investment and strengthening household consumption growth and public investment. The latest ABS National Accounts for the March quarter (Q1) 2014 showed that **state final demand in NSW, which excludes international trade, grew by a solid 2.4% q/q to be 4.7% p.a. higher.** (see chart 2). Annual growth in NSW state final demand outperformed final demand growth Australia-wide which grew by 1.6% in the year to Q1 2014. The increase in NSW final demand in Q1 was driven by a **sharp rise in private investment** (up 9.3% q/q and 10.0% p.a., seasonally adjusted). This added 2.3 percentage points to growth in state final demand in the quarter. Public investment in NSW increased by 3.2% q/q (+8.5% p.a.) in Q1, while government spending grew moderately by 1.2% q/q and 2.7% p.a., broadly in line with national growth rates.

Chart 2: Growth in State Final Demand in NSW, Q1 2014

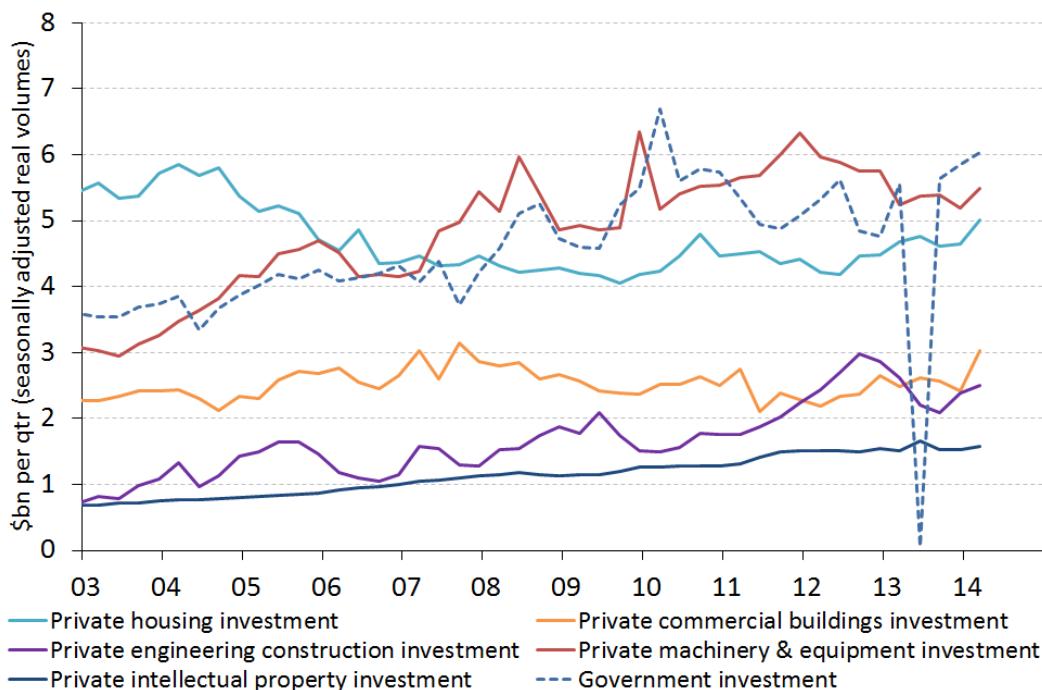


Source: ABS National Accounts, Mar 2014

Dwelling investment picked-up strongly in Q1 2014, increasing 7.9% q.q (and 6.9% p.a.) after weaker than expected investment in the first half of 2013-14 (see chart 3). There was also evidence of an improvement in **non-dwelling (commercial) construction** which increased by 15.4% in Q1 to be 8.1% p.a. higher over the year. This

is consistent with leading indicators (finance commitments and non-residential building approvals) which have exhibited a broadly improving trend since mid 2013. Furthermore, private investment in **new machinery and equipment** rose by 9.2% q/q (10.5% p.a.), the highest quarterly growth rate in just over four years. Although **engineering construction** continued to expand in Q1 2014 (up by 5.2% q/q), it was 4.0% lower on an annual basis reflecting the softening in the pipeline of resource related investment as coal projects are completed. Nevertheless, state public infrastructure investment on major road and rail projects will provide firm support for engineering construction activity and the NSW economy over the next two years.

Chart 3: Key components of fixed capital investment in NSW



Source: ABS National Accounts, Mar 2014

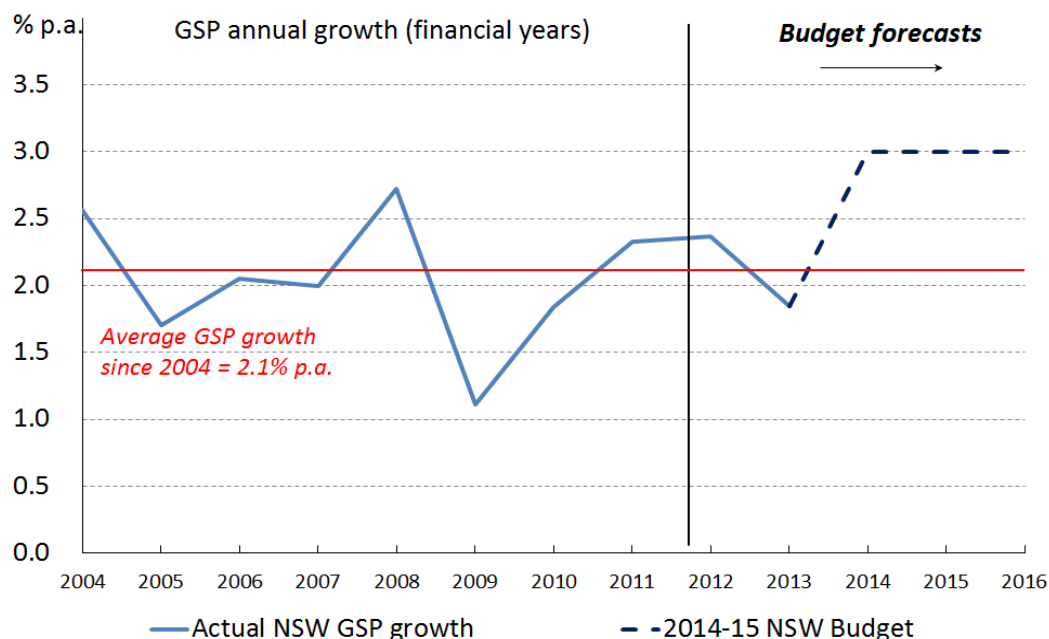
The NSW Treasury forecasts that **Gross State Product (GSP)** in 2013-14 will grow by an above trend 3.25% p.a. (see table 1 and chart 1) up slightly on NSW Treasury's Mid-Year Review. Economic growth is forecast to be sustained at this above-trend rate in 2014-15 and 2015-16 with growth underpinned by rising household consumption, solid dwelling investment and state public infrastructure investment.

- **NSW employment** is expected to grow at a rate of 0.5% p.a. in 2013-14 in year average terms. However, growth is expected to strengthen to an above trend pace of 1.75% p.a. in 2014-15 before picking up to 2% p.a. in 2015-16. This improvement is expected to be driven by improving activity in labour intensive sectors, such as dwelling construction, retail, tourism and manufacturing.
- **Inflation** is expected to moderate over the next financial year after experiencing a recent strengthening due to pressures from both tradeable and non-tradeable inflation. The Sydney Consumer Price Index is expected to increase at a rate of 2.25% p.a. in the year to June 2015 from an expected rate of 3.0% p.a. in the year to June 2014. This reflects the impact of the abolition of the carbon tax, partially offset by the impact of staged increases in the tobacco excise. Sydney CPI growth is the forecast to rise to 2.75% p.a. in 2015-16, in part due to a further rise in the tobacco excise.
- **Wages** growth, as measured by the Wage Price Index, is expected to rise from 2.5% p.a. forecast rate in 2013-14 to 3.0% 2014-15, followed by a further firming to 2.75% p.a. in 2015-15. This pick up is expected to be driven by an increase in private sector wages growth as the unemployment rate and terms of trade stabilise, and the economy grows at above-trend rates.

The key risk to the outlook for the NSW economy was noted in the Budget as centering on the timing and profile of the recovery in NSW non-mining business investment. Further downside risks are expected from heightened

consumer caution, a persistently high exchange rate and the impacts on the NSW economy of slower growth in the rest of Australia.

Chart 1: NSW GSP growth, actual and Budget forecast



Source: ABS National Accounts: State Accounts, 2012-13; NSW Treasury.

Budget initiatives affecting business

A range of initiatives were announced in the 2014-15 Budget that will support NSW business. These include:

- A **\$15.0 billion infrastructure expenditure program** in 2014-15 (6.4% above the expected outcome for 2013-14) with the program being sustained at around \$15 - \$16.7 billion per year over the forward estimates to 2017-18. Major investments will include:

Transport: \$31.8 billion of capital works, including expenditure of \$9.1 billion in 2014-15, an increase of 3.3% on 2013-14 estimated expenses. Key areas of expenditure over the four years to 2017-18 include major upgrades to the Pacific Highway (\$5.8 billion), North West Rail Link (\$5.2 billion), WestConnex Motorway project (\$3.8 billion), Western Sydney Growth Roads (\$557 million), South East Light Rail Link (\$401 million) and \$109 million to commence road upgrades to support the Badgerys Creek Airport. A total of \$400 million will also be set aside to start work on identifying the highest priority corridor for the introduction of a **light rail system in Parramatta** and to carry out a detailed feasibility study.

Health: \$4.4 billion of capital works to 2017-18, including \$1.3 billion in 2014-15, for health sector upgrades and redevelopments. Major projects starting in 2014-15 include the redevelopment of the Westmead, Gosford and St George hospitals.

Education: \$1.9 billion for education capital works to 2017-18 including \$1.3 billion for new schools and upgrades at existing schools, a TAFE construction program (\$300 million), information technology works (\$250 million).

- An increase in the threshold of the **First Home Buyers Grant** for new homes to \$750,000. This is an increase of \$100,000 to improve housing affordability and support new residential building construction.

- The removal of all remaining **IGA taxes** from 1 July 2016. This includes the transfer duty on non-real business assets such as patents and intellectual property, mortgage duty on business transactions and duty on unlisted marketable securities.
- A **WorkCover premium reduction** of 5 per cent on average in 2014-15 across 414 industries with the budget estimating that this will result in a total saving to NSW businesses of more than \$113 million a year. However, other changes in the formula for calculating premiums are likely to temper the immediate benefits in terms of premiums paid by many businesses.
- Employers hiring a redundant worker from a designated employer will receive an **additional \$1,000 payroll tax rebate** under the Job Action Plan (Fresh Start Support) where the worker is made redundant between 1 January 2014 and 30 June 2015. This is in addition to the existing \$5,000 rebate in the current Job Action Plan.
- Expenditure of \$83 million (via the Housing Acceleration Fund) to support **essential infrastructure in South West Sydney** and enable faster land release. \$73 million will be allocated to the Department of Planning & Environment to support the development of new homes in Western Sydney, including the delivery of essential infrastructure.
- A new \$110 million **Regional Tourism Infrastructure Fund** which will deliver through the Restart NSW program, infrastructure works to facilitate regional tourism growth in NSW.
- \$340 million to be reserved from the Port of Newcastle transaction proceeds towards the **urban renewal of the Newcastle** central city area. This is in addition to \$60 million previously reserved in Restart NSW for this purpose and \$60 million allocated from the Hunter Infrastructure Fund. A further \$150 million of Restart NSW funds will be reserved for the completion of the Newcastle Inner City Bypass. An allocation of \$100 million will also be reserved for Hunter region infrastructure from the NSW Government's major infrastructure fund for projects which pass an appropriate economic assessment by Infrastructure NSW. This is in addition to a \$185.2 million budget allocation from the Hunter Infrastructure Fund for projects including road upgrades, urban renewal initiatives, the Newcastle light rail scoping study and various health infrastructure projects.
- \$39 million to be directed to the **Country Towns Water Supply and Sewerage Program** to deliver more affordable and sustainable water supplies and sewerage systems to regional communities.
- Total funding of \$14 million has been allocated to support the Office of the NSW Small Business Commissioner including the **Small Biz Connect program**.
- The **Innovate NSW program** will receive a further \$3.9 million to support small and medium enterprises to collaborate with industry and end-users to develop leading edge products and services.
- An additional \$55.3 million allocation will be made to the **State Investment Attraction Scheme** aimed at improving the State's economic performance, drive economic growth in regional areas and complement the Jobs Action Plan.
- Total funding of \$70 million to the **Resources for Regions Program** which seeks to help relieve infrastructure constraints and support NSW communities affected by mining located at areas such as Cobar, Lithgow, Mid-Western Regional, Muswellbrook, Narrabri, Newcastle, Singleton and Wollongong.
- \$7.7 million for the **Medical Devices Fund** to support the development of medical devices that will lead to improved treatment and patient outcomes.



NSW state economy, data summary

	NSW	Vic	Qld	SA	WA	Tas	Australia
Economy size (2012-13)							GDP
GSP, real \$bn	471.4	333.4	294.5	94.2	253.0	24.2	1,525.0
% of national GDP	30.9	21.9	19.3	6.2	16.6	1.6	100.0
Economy structure (2012-13)							% of GDP
Agriculture, % of GSP	1.4	2.4	2.7	4.8	1.0	7.4	2.1
Mining, % of GSP	3.1	2.0	10.3	4.1	34.3	1.6	9.6
Manufacturing, % of GSP	7.3	7.9	6.8	8.2	4.7	7.1	6.8
Construction, % of GSP	5.2	5.9	8.8	7.4	12.0	6.3	7.6
Retail, % of GSP	4.2	5.2	5.2	5.0	3.2	5.5	4.5
Transport, % of GSP	4.8	4.7	5.5	4.6	4.4	5.8	4.8
Financial services, % of GSP	11.5	10.4	5.1	7.3	2.9	6.4	8.0
Professional services, % of GSP	7.5	8.1	5.1	5.2	5.0	3.2	6.6
Public administration, % of GSP	4.9	4.1	5.5	5.8	2.8	6.8	5.2
Health, % of GSP	6.4	7.0	6.8	7.8	4.0	9.4	6.3
Education, % of GSP	4.6	5.4	4.3	5.1	2.7	6.7	4.5
Population size (2013)							
Population, mn	7.4	5.7	4.7	1.7	2.5	0.5	23.131
% of national total	32.0	24.8	20.1	7.2	10.9	2.2	100.0
Population structure (2013)							
% female	50.3	50.5	50.1	50.4	49.5	50.1	50.2
% born outside Australia (2011)	28.3	28.7	22.5	23.7	33.4	12.5	26.9
Median age, years	37.8	37.3	36.6	39.8	35.8	41.2	37.3
% aged 65 years and over	15.2	14.6	13.6	16.7	12.5	17.3	14.4
Labour market (April 2014)							
Employment growth, % p.a.	0.3	-0.1	2.6	-1.2	2.2	3.4	0.9
Unemployment rate, %	5.4	6.5	6.3	6.6	5.2	7.5	5.9
Participation rate, %	63.1	64.2	66.3	62.0	68.2	60.9	64.8
Wages and prices (March Quarter 2014)							
Wage price index (WPI, private sector) % p.a.	2.5	2.6	2.7	3.4	2.3	2.3	2.6 (WPI)
Capital city headline CPI, % p.a.	2.8	2.8	3.1	2.9	3.1	2.8	2.9 (CPI)

Sources: ABS various publications.

Ai Group Economics and Research Team

Julie Toth

David Richardson

Pip Freebairn

Yi Ming Hu

Gareth Shaw (part time)

Elle Spyropoulos (part time)

Chief Economist

Manager, Economics and Business Services

Senior Adviser, Economic Policy

Economist

Research Coordinator

Research Assistant

(03) 9867 0124

(02) 9466 5456

(03) 9867 0261

(03) 9867 0231

(03) 9867 0280

(03) 9867 0108