

Attachment 4.2

Synergies Consulting Report with updated Wage price index (WPI) forecasts for Western Power's AA4 regulatory period

Revised proposed access arrangement information

14 June 2018

Access arrangement information for the period
1 July 2017 to 30 June 2022



Updated WPI forecasts for Western Powers AA4 regulatory period

A report for Western Power to form part of its response to ERA's Draft Decision

June 2018

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1 Introduction

The purpose of this memorandum is to provide an update of the Wages Price Index (WPI) forecasts that Synergies developed for Western Power’s Access Arrangement submission for the five year period from 1 July 2017 to 30 June 2022 (AA4).¹

This update follows the release in May 2018 of the ERA’s Draft Decision on Western Power AA4 submission.²

1.1 ERA’s Draft Decision

In its Draft Decision, ERA presented Table 1 below noting that Synergies’ forecast of WPI for both the Electricity, Gas, Water and Waste Services (EGWWS) and All Industries sectors is higher than the Western Australian Treasury forecasts for the first few years of AA4.³

Table 1 Comparison of WPI forecasts

Escalator	2017-18	2018-19	2019-20	2020-21	2021-22	Average
CPI	2.0	2.5	2.5	2.5	2.4	2.4
Nominal WPI – All Industries Western Australia	2.4	2.8	3.0	3.1	3.1	2.9
WA Treasury WPI forecast	1.5	1.75	2.75	3.0	-	-
Nominal WPI – EGWWS Western Australia	2.9	3.3	3.5	3.6	3.7	3.4
Real WPI – EGWWS Western Australia	0.9	0.8	1.0	1.1	1.2	1.0

Source: ERA, Draft Decision on Proposed Revisions to the Access Arrangement for the Western Power Network, p 57

In its Draft Decision, ERA does not amend the labour escalation component based on the Real WPI EGWWS for WA, arguing that labour cost escalation is a relatively small component of Western Power’s proposed operating and indirect costs and there is still some uncertainty about other elements of Western Power’s proposed operating costs.⁴

¹ Synergies (2017), Wage price index (WPI) and consumer price index (CPI) forecasts, May

² ERA (2018), Draft Decision on Proposed Revisions to the Access Arrangement for the Western Power Network

³ ERA (2018), p 71

⁴ ERA (2018), p 71

Consequently, ERA requires Western Power to update its forecasts to reflect current data and will review the forecast as part of determining its final decision.

To this end, Western Power has asked Synergies to provide an update of its WPI forecasts for the AA4 regulatory period, while adopting a CPI forecast of 1.84% in accordance with ERA's Draft Decision.⁵

⁵ ERA (2018), Draft Decision on Proposed Revisions to the Access Arrangement for the Western Power Network, Appendix 5 Return on Regulated Capital Base, May, p 63

2 Synergies' updated WPI forecasts

This chapter presents our updated WPI forecasts for Western Power's AA4 regulatory period. It also explains the economic drivers underpinning our updated WPI forecasts and the reasons for some small differences between our original and updated forecasts.

2.1 Economic drivers underpinning WPI forecasts

Overall, Synergies maintains its view that annual growth in the WPI for the EGWWS sector will be stronger over the AA4 regulatory period than the relatively low growth rates observed in the AA3 regulatory period.

Recent weakness in inflation data is largely the result of under-utilised capacity in the Western Australia (WA) economy, which has been impacted more severely than the rest of Australia by the completion of large mining projects. As the WA economy adjusts to the post-mining investment boom era, we expect growth in State demand to strengthen, reducing under-utilised capacity. We expect this, along with the lagged effect of a lower exchange rate and an anticipated rise in oil prices, to increase wage pressures.

The EGWWS sector has historically had higher wages growth than the All Industries sector. This in part reflects its relatively high skill levels and unionisation. Recent weakness in the mining industry also pushed wages growth in the EGWWS sector down, as skilled workers in the mining sector sought work in other sectors, including the EGWWS sector.

However, as economic activity recovers and inflation picks up, we expect EGWWS WPI growth to increase from current relatively low levels, which we expect will drive somewhat higher nominal wage increases as workers attempt to maintain the real value of their wages in what we expect to be a more buoyant labour market.

2.2 WPI and CPI summary

Table 2 (over page) presents our updated WPI forecasts for the AA4 regulatory period, incorporating the latest input data from publicly available sources.

We also show our average annual updated AA4 forecast with the annual average forecast presented in our May 2017 report.

Table 2 Updated AA4 CPI and wages forecasts (% change, financial year average)

	2017-18	2018-19	2019-20	2020-21	2021-22	Updated AA4 average	May 2017 AA4 average
CPI							
Australia	1.84	1.84	1.84	1.84	1.84	1.84	2.30
Nominal WPI – EGWWS							
Western Australia	2.21	3.13	3.40	3.41	3.41	3.11	3.40
Nominal WPI –All Industries							
Western Australia	1.71	2.63	2.98	3.01	3.05	2.68	2.90
Real WPI – EGWWS							
Western Australia	0.37	1.29	1.56	1.57	1.57	1.27	1.20

Source: Synergies forecasts

Our updated WPI forecasts are somewhat lower than our original forecasts, except for the Real WPI – EGWWS series.

The reasons for the differences between our updated and May 2017 forecasts are summarised below.

2.3 CPI

The lower average annual CPI forecast of 1.84% in ERA’s Draft Decision compared to our original annual average CPI forecast (2.3%), is an input into our updated nominal and real WPI forecasts.

2.4 Nominal WPI EGWWS and All Industries

It is evident from Table 2 that our updated nominal WPI EGWWS average annual forecast over the AA4 regulatory period is somewhat lower than our earlier forecast (3.11% compared to 3.40%), reflecting a slower recovery in wages growth in the post-mining boom period in WA than originally forecast.

The forecast growth differential between the WPI EGWWS and WPI All Industries series reflects an average annual historical growth differential of 0.5% observed back to 1998. As previously noted, the differential is partly due to the relatively stronger bargaining power of workers in the EGWWS sector compared to the Australian All Industries average.

Reflecting ERA’s concerns that Synergies’ original WPI All Industries forecasts were higher than the Western Australian Treasury forecasts over the AA4 regulatory period,

Table 3 indicates that our updated forecasts remain somewhat higher but are closely aligned with the latest WA Treasury forecasts.⁶ The annual average differential is only 0.23 percentage points.

Table 3 WPI All Industries forecasts 2017-18 to 2021-22 (% change, financial year average)

	2017-18	2018-19	2019-20	2020-21	2021-22	AA4 average
WA Treasury Nominal WPI –All Industries						
Western Australia	1.50	1.75	2.75	3.00	3.25	2.45
Synergies Nominal WPI –All Industries						
Western Australia	1.71	2.63	2.98	3.01	3.05	2.68

Source: Synergies and WA Treasury web site

2.5 Real WPI EGWWS

Real WPI is a function of our nominal WPI EGWWS and CPI forecasts. The real WPI EGWWS is somewhat higher in our updated forecasts, reflecting a relatively lower CPI forecast (as per ERA’s Draft Decision) compared to our updated lower nominal WPI EGWWS forecasts.

The lower CPI forecast is an input into our nominal WPI forecasts and contributes to the lower updated numbers. However, this downward influence on WPI growth has been partly offset by the effects of the expected strengthening in labour market conditions over the AA4 regulatory period.

We have not presented real WPI All Industries forecasts in this report because ERA prefers to use the WPI EGWWS series for its real labour escalation forecasts in its most recent electricity and gas network determinations (for Western Power, ATCO Gas and the Dampier to Bunbury Natural Gas Pipeline).

⁶ https://www.treasury.wa.gov.au/Treasury/Economic_Data/Economic_Forecasts/