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ATCO's cost escalation forecasts for the AA6 (2025-2029) period

Updated in response to ERA's draft decision on ATCO's AA6 submission

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EXECUTIVE SUMMARY

Synergies provided a forecast cost escalation report in support of ATCO’s Proposed AA6 Access Arrangement. The purpose of this short report is to provide updated cost escalation forecasts in support of ATCO’s Proposed AA6 Revised Access Arrangement. The forecasts relate to the 2025-29 calendar years.

The updates follow the release of the Economic Regulation Authority’s (ERA’s) Draft Decision on ATCO’s AA6 Access Arrangement on 24 April 2024.

CPI and real labour cost escalators

Table 1 presents our updated CPI and real labour cost forecasts for the AA6 period.

Table 1 AA6 CPI forecasts

	CY25	CY26	CY27	CY28	CY29
CPI	2.49%	2.49%	2.49%	2.49%	2.49%
Real labour cost	1.02%	1.02%	1.02%	1.02%	1.02%

Source: Synergies

Our updated AA6 CPI forecast using the breakeven forecasting methodology is based on Australian Government nominal and indexed 5-year bond data in the 20 days to 30 April 2024.

The real labour cost forecast has been updated to reflect recent Australian Bureau of Statistics WPI data releases and the 2024/25 WA Budget forecasts for CPI and WPI.

Materials cost escalator

Material escalation in the AA6 period is forecast to grow in line with forecast CPI growth (ie. there is no forecast real materials cost growth). This is the same forecast as presented in our original report.

Opex productivity

Opex productivity in the AA6 period is forecast to be 0%. This is the same forecast as presented in our original report.

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1 Introduction

The purpose of this short report is to provide Synergies' updated CPI and real labour cost forecasts to be used in ATCO's response to ERA's draft decision on ATCO's AA6 submission.

The remainder of this report is structured as follows:

- Section 2 provides a brief update of expected economic trends in Australia and WA in the medium term focussed on inflation and wages.
- Section 3 presents our updated AA6 CPI forecast for the 2025-29 period applying the 'breakeven' methodology.
- Section 4 presents our updated AA6 real labour cost escalation forecast for the 2025-29 period derived by applying an amended version of ERA's preferred forecasting methodology.
- Section 5 presents our updated materials cost escalation forecast for the 2025-29 period.
- Section 6 presents our updated opex productivity forecast for the 2025-29 period.

2 Macroeconomic update

The purpose of this section is to provide a brief update of the macroeconomic outlook likely to impact on ATCO's cost escalation during the AA6 period.

2.1 RBA's May 2024 Monetary Policy Statement

The RBA's most recent Statement on Monetary Policy for May 2024¹ outlines its assessment of the state of the Australian economy and macroeconomic forecast to 2026.

It is the RBA's view that inflation continues to moderate in the Australian economy, but more gradually than previously expected. The RBA has revised its short-term forecast upwards, reflective of temporary factors impacting inflation. However, its longer-term view remains unchanged. The RBA expects inflation to remain above the target band (2% to 3%) until late 2025 and to reach the mid-point by mid-2026.

The RBA also views wage growth, as represented by the ABS Wage Price Index (WPI) All Industries series, to have likely reached its peak at 4.2% with stability expected in the short-term before a steady decline to 3.3% by mid-2026.

The RBA expects economic growth to remain subdued due to its restrictive monetary policy.

2.2 WA Treasury 2024/25 Budget

The WA Treasury's 2024/25 forecast present a similar view to the RBA, with inflation returning to the RBA's target band in 2025/26. WA Treasury also views All Industries wage growth to have peaked at 4.25% in 2023/24, with a steady decline to 3.00% by 2026/27.

Despite similar wage growth and inflation trend analysis, the WA Budget Overview 2024-25 is bullish about the state of the economy, stating;

The WA economy is firing on all cylinders, with 4.7% domestic growth in 2023, more than twice the growth of the national economy".²

The WA Government supports this view by highlighting strong business and infrastructure investment, low levels of state debt, combined with record population

¹ RBA, Statement on Monetary Policy – May 2024, pages 1-3, 19-51.

² Government of Western Australia, WA Budget Overview – 2024-25, page 5.

growth, nation-leading export figures due to mining exports, below national average inflation, and the lowest unemployment figures in Australia.

Further to the WA Treasury's analysis, the Western Australia Treasury Corporation's (WATC) CPI analysis for Q1 2024 largely aligns with the RBA's assessment of inflation expectations. The WATC confirms that inflation is continuing to ease, although at a slower pace than previously forecast.

2.3 Commonwealth Treasury 2024/25 Budget

The Australian Government's Budget Overview and recent media releases from the Federal Treasurer present a more positive outlook than last year regarding inflation.

The economic parameter forecasts included in the 2024-25 Budget papers highlight expected inflation to reach 2.75% by the end of 2024/25 (45 basis points lower than the RBA's forecast for the same timeframe).

The Budget Overview supports the views presented by the RBA and WA Treasury regarding wages growth. The Budget also highlights a more positive GDP growth outlook over the short term, before aligning with the RBA in the longer term.

2.4 Latest labour cost forecasts used by Australian Economic Regulator (AER)

The AER released several electricity distribution network final determinations on 30 April 2024 relating to the 2024-29 regulatory period for each network.³ For these determinations, the AER relied upon a simple average of the Wage Price Index (WPI) based real labour cost forecasts developed by KPMG (for the AER) and Oxford Economics (for the networks). This is the AER's standard approach applied across all its electricity and gas revenue and price determinations.

KPMG's forecasts for National All Industries and National Utilities are presented in Table 2 (over page).⁴ KPMG's description of its National Utilities series appears to be one that it derives using several wage data sources, but that is closely aligned to the Australian Bureau of Statistics' WPI Electricity, Gas, Water and Waste Services (EGWWS) series.

³ The distribution determinations were made in relation to: Ausgrid; Endeavour Energy; Essential Energy; Power and Water Corporation; Evoenergy; and TasNetworks.

⁴ KPMG (2024), Wage Price Index Forecasts, Australian Energy Regulator, April, p 1

The KPMG forecasts are presented for the financial years from 2025-26 to 2028-29, which closely aligns to ATCO’s AA6 period from calendar year 2025 to 2029.

Table 2 AER nominal and real wage forecasts and associated EGWS premiums

WPI series	FY26	FY27	FY28	FY29	FY26-FY29 average
National All Industries WPI (Nominal wages)	3.3%	3.4%	3.4%	3.3%	3.4%
National Utilities WPI (Nominal wages)	3.6%	3.8%	3.8%	3.7%	3.7%
National Utilities WPI Growth Premium (Nominal wages)	0.3%	0.4%	0.4%	0.4%	0.4%
National All Industries WPI (Real wages)	0.7%	0.8%	0.8%	0.8%	0.8%
National Utilities WPI (Real wages)	0.8%	1.0%	1.2%	1.3%	1.1%
National Utilities WPI Growth Premium (Real Wages)	0.1%	0.2%	0.4%	0.5%	0.3%

Source: AER, KPMG

The forecasts show strong forecast nominal and real WPI growth at the national level for both the All Industries and Utilities series. Forecast average nominal and real wage growth for the National Utilities sector is 3.7% and 1.1% respectively over the FY26 to FY29 period. The forecasts also show increasingly strong annual real wage growth in the Utilities sector, increasing to 1.0% or above from FY26 to FY29, with the FY29 forecast at 1.3%.

In addition, these forecasts also show a National Utilities average nominal wage premium of 0.4% and average real wage premium of 0.3% from FY26 to FY29 indicating strong expected demand for labour in this sector.

Similarly, Oxford Economics Australia’s nominal and real wage forecasts for the EGWS sector over the same period are 3.7% and 1.0% respectively.⁵

⁵ Oxford Economics Australia (2023), Electricity-Related Labour Escalation Forecasts, to 2028/29, Final Report, November, p 4

We consider the real wage growth forecasts of KPMG and Oxford Economics to be reasonable given the extent of planned significant infrastructure investment across the energy, water and transport sectors in Australia in the next five to ten years. This issue is discussed further in section 4.2 of our report.

3 CPI inflation

The purpose of this section is to present our updated annual CPI forecasts for ATCO’s AA6 regulatory period.

3.1 ERA’s Draft Decision

ERA’s Draft Decision included an inflation forecast of 2.51% (using a 20-day averaging period to 14 February 2024). ERA’s forecast is based on what is generally known as the ‘break-even’ inflation forecasting method and applied it in accordance with its Gas Rate of Return Instrument.

This method reflects the difference between nominal and index-linked Commonwealth Government long-term bond yields and provides a market-based forecast of inflation.

3.2 Synergies’ updated AA6 forecast

Our updated AA6 CPI forecast using the breakeven forecasting methodology is based on Australian Government nominal and indexed 5-year bond data in the 20 days to 30 April 2024.

Table 3 shows the Australian Government nominal and indexed bonds used in our calculation, which capture inflation expectations in the five year AA6 period from CY25 to CY30. These current bond issues most closely straddle the term of the AA6 period.

Table 3 Commonwealth Government bond data used in breakeven calculation

Bond issue	Maturity date	Type of bond	Current yield
Treasury Bond 154	21 November 2029	5-yr Nominal	3.96%
Treasury Bond 155	21 May 2030	5-yr Nominal	4.01%
Treasury Bond 414	21 November 2027	5-yr Indexed	1.31%
Treasury Bond 408	30 September 2030	5-yr Indexed	1.51%

Source: Yieldbroker

The implied 5-yr breakeven CPI forecast at 30 April 2024 is 2.49% calculated using the Fisher equation and based on a nominal bond yield of 3.94% and real bond yield of 1.41%.

3.3 Our recommendation

Table 4 presents our recommended CPI forecast for the for the AA6 regulatory period.

Table 4 AA6 CPI forecasts

	CY25	CY26	CY27	CY28	CY29
CPI	2.49%	2.49%	2.49%	2.49%	2.49%

Source: Synergies

We consider that for the reasons outlined in this Section 5, this recommendation is consistent with Clause 74(2) of the National Gas Rules, which requires that it must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.

4 Real labour cost escalator

The purpose of this section is to present our updated annual real labour cost forecasts for ATCO's AA6 regulatory period.

4.1 ERA's Draft Decision

In its AA6 submission, ATCO adapted ERA's preferred real labour cost forecasting methodology by developing a four-year average forecast rather than five-year average forecast. The rationale for this adaptation was because ERA's preferred methodology included a high near actual inflation value for 2022/23, which was inconsistent with much lower government and market inflation expectations.

ERA's Draft Decision accepted this adaptation given the circumstances but indicated that it would re-consider using its preferred five-year forecasting methodology in developing its final decision. Paragraph 145 of the Draft Decision Attachment 5: Operating Expenditure states (*italics added by Synergies*):⁶

The ERA has accepted ATCO's change in method and used a four-year average to determine the real labour escalation for this draft decision as the value in 2022/23 does not appear to be representative of expected CPI growth in the AA6. *However, the ERA will consider the reintroduction of a five-year average using the available data at the time of the final decision if appropriate.*

4.2 Synergies' updated forecasts

As noted in the preceding section, our forecasting approach adapts ERA's usual approach by calculating an average four-year rather than average five-year real labour cost escalation forecast for the AA6 period. However, we adopt the same five step calculations as ERA does as follows:

1. Estimate WA WPI for the regulatory period based on an average of latest WA Treasury forecasts. For the AA6 forecast, this is based on WA Treasury forecasts from 2025/26 to 2027/28. (ERA's usual approach would also include the 2023/24 'estimated actual' forecast.)
2. Estimate the premium (if any) of EGWWS WPI over the Australian All Industries WPI.
3. Add together the WA All Industries WPI forecast and the EGWWS premium to derive the nominal labour cost escalation forecast.

⁶ ERA (2024), Draft Decision on revisions to the access arrangement for the 4 Mid-West and South-West Gas Distribution Systems, Attachment 5: Operating Expenditure, Public Version, p 25

4. Estimate forecast average CPI based on WA Treasury forecasts using the same method applied for estimating WA WPI All Industries forecasts (in Step 1). (Again, ERA’s usual approach would include the 2023/24 ‘estimated actual’ forecast in the CPI average but our adapted approach does not.)

5. Use the CPI forecast to deflate the nominal labour cost escalation forecast to derive the real labour (real WPI) cost escalation forecast.

Calculation of each of the five steps is explained in the following sections.

4.2.1 Step 1: Western Australian WPI forecast

We have used the WA Treasury 2024/25 Budget forecasts for WPI All Industries for the years 2024/25 to 2028/29 to calculate a four-year average forecast of 3.31% as shown in Table 5.

Table 5 WPI growth estimate based on ERA approach

	2024-25 Budget Year	2025-26 Outyear	2026-27 Outyear	2027-28 Outyear	Average
WPI growth	3.75%	3.50%	3.00%	3.00%	3.31%

Source: WA Treasury Economic Forecasts – Major Economic Aggregates

We consider that the real labour cost forecast should continue to be a four-year average forecast rather than a five year-average forecast because WA Treasury’s ‘estimated actual’ WPI All Industries and CPI forecasts of 4.25% and 4.0% for 2023/24 respectively are not representative of forecasts for these variables from 2024/25 onwards given softening government agency and market inflation expectations.

Hence, a four-year average forecast from 2024/25 to 2027/28 better reflects WA Treasury’s WPI and CPI growth expectations over this period. It is also more consistent with WPI All Industries and EGWWS forecasts recently approved by the AER (discussed in section 2.4 of this report).

4.2.2 Step 2: Estimated premium of EGWWS WPI over Australian All Industries growth estimate

Figure 1 shows the percentage change from the corresponding quarter of previous year growth in the nominal EGWWS WPI and All Industries WPI since 2003. In the March quarter 2024, EGWWS WPI grew by 4.40% and All Industries WPI grew by 4.20%.

The 20-year average for EGWWS WPI is 3.41% and for All Industries WPI is 3.04%.

Figure 1 Annual quarterly movements in EGWWS WPI and All Industries WPI (nominal)



Source: ABS, Synergies calculations

Estimates of the EGWWS growth premium over the All Industries series for averaging periods of 5, 10, 15 and 20 years are shown in Table 6

Table 6 EGWWS WPI growth premium over Australian All Industries WPI over time

Averaging period	EGWWS WPI growth	All Industries WPI Growth	Premium
2004-2024 (20 year)	3.41%	3.04%	0.37%
2009-2024 (15 year)	3.02%	2.71%	0.30%
2014-2024 (10 year)	2.58%	2.44%	0.14%
2019-2024 (5 year)	2.82%	2.74%	0.08%

Source: ABS, Synergies calculations

While there is evidence that the EGWWS growth premium over All Industries growth has narrowed over time, wages growth in the EGWWS sector exceeds that in the economy-wide (All Industries) series when viewed across three of the four averaging periods. This reflects the relatively high skills of EGWWS workers and their substitutability in relation to comparable work performed in other key sectors like mining and construction.

Viewing Figure 1 above, it appears that the 2019-24 period is an anomaly reflecting the significant disruption to Australian economic activity and international supply chains in the post-Covid outbreak period. We note that in the March quarter 2023 and March quarter 2024, nominal EGWWS WPI percentage growth from the corresponding quarter of the previous year was 3.93% and 4.38% respectively indicating a strong pick-up from the declining growth period between 2019 and 2021 following the Covid outbreak. The

March quarter 2023 and 2024 growth is the strongest year-on-year quarterly growth since March 2013.

As noted in section 2.4 of our report, the recent average nominal labour cost forecast for the FY26 to FY29 period for the EGWWS sector recently approved by the AER in relation to the electricity and gas network sectors is 3.7% over the FY26 to FY29 period. The forecasts also show strong average real wage growth in the Utilities sector of 1.1%, with annual forecasts increasing to 1.0% or above from FY26 to FY29, with the FY29 forecast at 1.3%.

Having regard to the long term EGWWS and All Industries WPI data going back to 2000, we consider that a premium of 0.37% is reasonable given the expected strength of WA and Australian labour market conditions in the AA6 regulatory period arising from strong growth in infrastructure activity across the energy, water, mining and construction sectors.

EGWWS workers have highly substitutable skillsets for workers in these sectors, which could be expected to result in a higher EGWWS premium than in recent history. Strong Australian and international demand for EGWWS workers arising from planned energy decarbonisation infrastructure construction will also likely influence Australian EGWWS labour market conditions over the next decade. Oxford Economics Australia formed a similar view given the strength of expected demand for EGWWS labour both from within the sector and in sectors competing for this type of labour:⁷

We expect to see the continuation of critical skilled labour shortages and competition for scarce labour - particularly from the mining and construction sectors - which will push up wage demands in the utilities sector. Mining investment is now picking up and is forecast to see significant increases over the next 2 years to FY25 and remain at elevated levels to the end of the decade.

Further, the strong union presence in the EGWWS sector could be expected to result in outcomes for collective agreements (which cover around 65% of the EGWWS workforce) remaining above the wage increases for the All Industries average. This is particularly the case given the sustained real wage falls for the EGWWS sector and more broadly between 2021 and 2023.

Accordingly, we have adopted an EGWWS premium of 0.37% for incorporation in the real labour cost escalation forecast, which we consider is most likely to reflect tight labour market conditions for EGWWS workers in ATCO's AA6 regulatory period.

⁷ Oxford Economics Australia (2023), Final Report, p 3.

4.2.3 Step 3: Nominal labour cost escalation forecast

The nominal labour cost escalation forecast is calculated by summing the WA WPI estimate from Step 1 (3.31%) and the estimated EGWWS premium from Step 2 (0.37%).

The resulting nominal EGWWS labour cost escalation forecast is **3.68%**.

4.2.4 Step 4: CPI estimate for use in real labour cost escalation forecast

The CPI forecast that ERA uses in calculating its real labour cost escalation forecast is based on WA Treasury 2024/25 forecasts shown in Table 7. We have calculated a four year CPI average of 2.63% using these forecasts.

Table 7 CPI growth estimate based on ERA approach

	2024-25 Budget year	2025-26 Outyear	2026-27 Outyear	2027/28 Outyear	Average
CPI growth	3.00%	2.50%	2.50%	2.50%	2.63%

Source: WA Treasury Economic Forecasts – Major Economic Aggregates

4.2.5 Real labour cost escalation forecast

The ERA uses the following formula to calculate real labour cost escalation:⁸

$$\text{Real labour escalation growth rate \%} = \frac{1 + \text{Average growth in WPI}}{1 + \text{Average growth in CPI}} - 1 * 100$$

Substituting our WPI estimate (inclusive of EGWWS premium) and CPI estimate from the preceding sections gives the following estimate for the real labour escalation growth rate in Table 8.

Table 8 Real labour cost escalation inputs and outcome

Variable	% change
Annual average of WA All Industries WPI	3.31%
Plus premium of EGWWS WPI on All Industries WPI	0.37%
Equals nominal labour escalation forecast per year	3.68%
Less forecast CPI inflation per annum	2.63%
Equals labour escalation	1.02%

Source: Synergies using WA Treasury forecasts for WA All Industries and CPI inflation

Therefore, our forecast of the EGWWS real labour cost escalation growth rate for the AA6 regulatory period is **1.02%**.

⁸ ERA (2021). Final decision on proposed revisions to the Dampier to Bunbury Natural Gas Pipeline access arrangement 2021 to 2025, 1 April, p.119.

4.3 Comparison of ATCO and ERA’s estimation methodologies

Table 9 below presents updated real labour cost forecasts using both forecasting methodologies. The WPI All Industries and CPI forecasts are WA Treasury 2024/25 budget forecasts.. We have applied a 0.37% EGWWS premium in both calculations for a like-for-like comparison while recognising that ERA rejected inclusion of an EGWWS premium in its AA6 draft decision.

Table 9 AA6 real labour cost forecasts

Variable	ATCO’s 4-year forecasting methodology	ERA’s usual 5-year methodology
1. Annual average All Inds WPI forecast (Treasury)	3.31% (3.75% + 3.5% + 3.0% +3.0%)	3.50% (4.25% +3.75% +3.5% +3.0% +3.0%)
2. EGWWS Premium	0.37%	0.37%
3. Nominal EGWWS Growth	3.68%	3.87%
4. Forecast CPI (Treasury)	2.63% (3.0%+2.5%+2.5%+2.5%)	2.90% (4.0% +3.0% +2.5% +2.5% +2.5%)
5. Real labour cost escalator	1.02%	0.94%

The difference in real labour cost forecasts is due to ATCO’s methodology excluding WA Treasury’s ‘Estimated actual’ WPI and CPI forecasts for 2023/24 (4.25% and 4.0% respectively), whereas ERA’s usual methodology includes these estimated actuals in calculating the average WPI and CPI forecasts.

In presenting these updated real labour cost forecasts, it is worth noting that the CPI forecast using ATCO’s methodology is 2.63%, which is closer to the updated breakeven inflation forecast of 2.49% than the 2.90% CPI forecast estimated using ERA’s usual methodology.

4.4 Weighting of real labour cost escalator

In its most recent gas determinations, the AER has applied a real labour cost escalator benchmark weighting of 62% for labour and 38% for non-labour.⁹

The AER weightings were based on econometric analysis of gas distribution by both ACIL Allen and Economic Insights, and which has been submitted to the AER previously. For these reasons, we consider the AER’s gas distribution network-specific weightings to be appropriate for ATCO.

⁹ AER (2022), Australian Gas Networks (Victoria and Albury) Access Arrangement 2023 to 2028 (1 July 2023 to 30 June 2028), Draft Decision, Attachment 5 Operating expenditure, December, p 23

4.5 Our recommendation

Table 10 presents our recommended real EGWWS labour cost escalation forecast for the AA6 regulatory period.

Table 10 AA6 Real labour cost forecasts

	CY25	CY26	CY27	CY28	CY29
Real labour costs	1.02%	1.02%	1.02%	1.02%	1.02%

Source: Synergies

We consider that for the reasons outlined in this Section 4, this recommendation is consistent with Clause 74(2) of the National Gas Rules, which requires that it must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.

5 Materials escalation

The purpose of this section is to present our updated real materials cost escalation forecasts for ATCO's AA6 regulatory period.

5.1 ERA's Draft Decision

ERA accepted ATCO's proposed zero real escalation of material costs in the 2025-29 period.

5.2 Synergies' updated AA6 forecast

In our cost escalation report for ATCO we noted that given (i) the relatively small proportion of materials in ATCO's opex (ii) the limited availability of fit-for-purpose PPI and CPI sub-component escalators and (iii) the absence of any reliable 5 year forecasts for the PPI and CPI sub-component indices, it is not feasible to develop materials cost escalator forecasts that would be reliable.

We noted that a fallback for ATCO would be ensuring that any material opex sub-categories that it is concerned may grow by more than CPI forecast growth in the AA6 period should be removed from the base step trend calculation and subject to a ground up cost calculation.

5.3 Our recommendation

Table 11 presents our recommended real labour cost forecast for the AA6 regulatory period. It assumes zero real growth of materials escalation ie. forecast growth in materials costs aligns with forecast movements in CPI.

Table 11 AA6 Real materials cost forecasts

	CY25	CY26	CY27	CY28	CY29
Materials	0.00%	0.00%	0.00%	0.00%	0.00%

Source: Synergies

We consider that for the reasons outlined in this Section 5, this recommendation is consistent with Clause 74(2) of the National Gas Rules, which requires that it must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.

6 Opex productivity factor

The purpose of this section is to present our updated opex productivity factor forecast for ATCO's AA6 regulatory period.

6.1 ERA's Draft Decision

In response to ATCO's proposed zero opex productivity assumption and EGWWS premium of 0.40% for the 2025-29 period, ERA's Draft Decision stated that given a business with no productivity growth is unlikely to sustain real wage growth at above-average rates in the long term, it is not reasonable to expect wages growth for ATCO to exceed average wages growth without increases in ATCO's productivity in the AA6 period.

6.2 Synergies' updated AA6 forecast

Our original recommendation for a zero productivity factor for the 2025-29 period recognised ERA's approach to determining an opex productivity assumption for the current (AA5) regulatory period. This was that ATCO's capex forecasts were principally sustaining and network growth projects, which are unlikely to influence opex productivity in any material way.

We have re-confirmed with ATCO that its AA6 forecasts regarding the growth/scale drivers of connections numbers and gas throughput reflect:

- declining gas throughput; and
- slow growth in total new connections.

We consider that these growth/scale forecasts, in aggregate, are weak and as such are unlikely to materially drive improvements in ATCO's opex productivity in the AA6 period.

We recognised that ATCO may make opex productivity improvements in the AA6 period. Its historical opex productivity performance demonstrates achievement of such improvements, which ultimately has been to the long-term benefit of gas consumers connected to the Mid-West and South-West distribution systems.

However, the key point is that rather than incorporating a forecast of opex productivity improvement in the AA6 opex forecast given unsupportive forecast capex and growth/scale factors, ATCO's past performance suggests it will, to the extent possible, seek out opex productivity improvements. If achieved, these improvements would be reflected in ATCO's AA7 base year opex to the benefit of its gas consumers.

ERA’s Draft Decision did not address these contextual issues, rather relying solely on its view that forecast real wage growth in the EGWWS sector in excess of forecast All Industries real wage growth is incompatible with a zero productivity assumption.

We accept ERA’s view that productivity growth is the key driver of real wage growth over the long term. This relationship implies that for a profit-seeking business, real wage growth must be funded by productivity improvement to be sustainable. However, evidence suggest that this relationship does not always hold rigidly but rather is dependent on internal and external circumstances facing a business, including overall economic activity, sectoral and wider labour market conditions, and the nature of its workforce (skilled or unskilled, unionised or not).

The Productivity Commission has commented on the real wage and productivity relationship as follows:¹⁰

In the long run, growth in real wages is driven almost entirely driven by labour productivity growth. In the shorter term, factors such as relative bargaining power and economic shocks - such as large movements in the terms of trade - can lead to deviations in the relationship between real wages and productivity. Sometimes wage growth lags productivity growth, other times it can overshoot.

Given expected strong demand for labour in the EGWWS sector across Australia over the AA6 period, we consider that it is reasonable to expect ATCO’s real wages growth to exceed its productivity growth. This is particularly the case given ATCO’s output growth is expected to be relatively modest, which will act to dampen its potential productivity growth.

6.3 Our recommendation

Table 12 presents our recommended opex productivity factor forecast for the AA6 regulatory period.

Table 12 AA6 opex productivity forecasts

	CY25	CY26	CY27	CY28	CY29
Opex productivity	0.00%	0.00%	0.00%	0.00%	0.00%

Source: Synergies

We consider that for the reasons outlined in this Section 5, this recommendation is consistent with Clause 74(2) of the National Gas Rules, which requires that it must be

¹⁰ Productivity Commission (2023), PC productivity insights Productivity growth and wages – a forensic look, September, p 1.

arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.