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2023 benchmark reserve capacity price for the 2025/26 capacity year

The Australian Energy Council (the “**AEC**”) welcomes the opportunity to make a submission to the Economic Regulation Authority (“**ERA**”) on its *2023 benchmark reserve capacity price for the 2025/26 capacity year draft determination* (“**Draft Determination**”).¹

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. Our members collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to millions of homes and businesses, and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 percent emissions reduction target by 2035, and is part of the Australian Climate Roundtable promoting climate ambition.

The AEC welcomes the increase in the Benchmark Reserve Capacity Price (“**BRCP**”) from \$165,700 per MW per year in 2022 to \$185,200 per MW per year in 2023. This will provide a useful price signal for generators to enter the market and partially assist with addressing the lack of revenue sufficiency outlined in the ERA’s *Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper*.²

The Draft Determination notes that the increase in the BRCP “is mostly due to a higher cost of capital from rising debt market interest rates and slightly offset by lower forecast steel and copper prices.”³ The AEC is concerned that the exchange rate assumptions are now incorrect, the reduction in forecast steel and copper prices are aggressive, and the increase in labour and construction costs are understated.

Exchange rate

It is understood that the ERA engaged PricewaterhouseCoopers (“**PwC**”) to forecast the AUD/USD exchange rate. In turn, “for the AUD/USD exchange rate and the change in the prices of steel and copper, PwC drew on historical price data and a range of forecasts from various investment banks and forecasting institutions.”⁴

Table 1 (below) shows PwC’s forecast AUD/USD exchange rate compared to the rates projected by some large financial institutions.

¹ See [2023 benchmark reserve capacity price for the 2025/26 capacity year: Draft determination](#)

² See [Triennial review of the effectiveness of the Wholesale Electricity Market 2022: Discussion paper](#)

³ See p1, [2023 benchmark reserve capacity price for the 2025/26 capacity year: Draft determination](#)

⁴ See p3, [2023 Benchmark Reserve Capacity Price: Cost escalation factors](#)

Source	4Q22	2023	2024	2025	2026
PWC	Not available	0.7169	0.7563	0.7750	0.7750
ING	0.63	0.6825	0.72	0.68	Not available
CIBC	0.63	0.6425	0.68	Not available	Not available

Table 1: PWC's AUD/USD exchange rate forecast compared to other institutions⁵

PWC's forecast AUD/USD exchange rate is notably higher than the forecasts from some financial institutions and the consequence is that PWC's rates materially reduce costs and lower the BRCP. The AEC suggests that the ERA further consider the forecast AUD/USD exchange rate and update the proposed BRCP accordingly.

Steel and copper prices

The ERA also engaged PWC to provide forecast copper and steel prices. Again, there is a large difference in the forecast prices between PWC and other sources.

Table 2 (below) shows PWC's forecast change in copper prices compared to forecasts from the Office of the Chief Economist, which is part of the Department of Industry, Science and Resources.

Source	2023	2024
PWC	-10.08%	-7.07%
Office of the Chief Economist (nominal prices)	-4.6%	-2.3%
Office of the Chief Economist (real prices)	-7.4%	-4.5%

Table 2: PWC's forecast copper price (USD) change compared to Office of the Chief Economist⁶

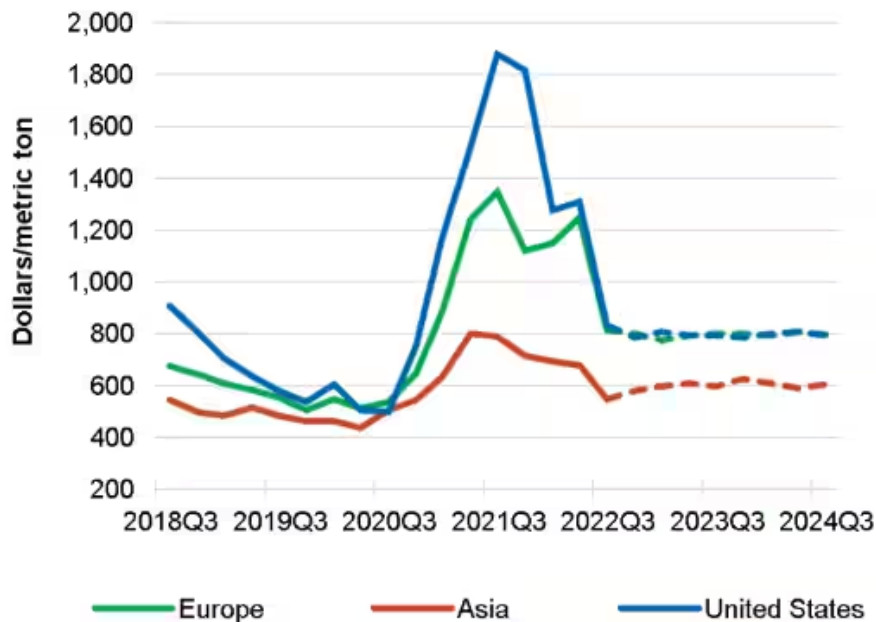
PWC also paints a bleak future for steel prices, predicting price changes to be -28.08% in 2023, -16.31% in 2024 and -11.39% in 2025.⁷ PWC notes that one of their sources of price data is IHS Markit. However, IHS Markit's most recent forecast for hot-rolled coil indicates that prices through to Q3 2024 will either be flat or slightly increasing in Asia; the prices are certainly not declining by up to 28%.

⁵ Source: [CIBC forecast update](#); [ING global economic and financial forecasts](#); PWC's [2023 Benchmark Reserve Capacity Price: Cost escalation factors](#)

⁶ Source: [Resources and Energy Quarterly: September 2022](#); PWC's [2023 Benchmark Reserve Capacity Price: Cost escalation factors](#)

⁷ See p14, [2023 Benchmark Reserve Capacity Price: Cost escalation factors](#)

Hot-rolled coil prices



Source: IHS Markit

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Source: [IHS Markit steel price outlook](#)

The AEC encourages the ERA to revisit the steel and copper price forecasts and ensure that accurate price changes are used to calculate the BRCP.

Labour costs

The Draft Determination has forecast 'labour costs – construction' increasing by 2.49% in 2022/23 and then rising by 2.74% through to 2025/26. This projected growth in labour costs is below the annual 3.4% change reported by the Australia Bureau of Statistics ("ABS").⁸

The local labour market is already buoyant and pushing labour costs upwards. In addition to that, more demand pressures will be created by the significant amount of investment in generation projects that will be required in the SWIS in the short term as a result of:

- The capacity that needs to enter the market to restore balance before an expected shortfall from 2025/26;
- The State Government's economy-wide goal of net zero by 2050;
- Synergy's plans to close coal-fired power plants by 2030 and build no new natural gas-fired power plants after 2030; and
- Private companies proactively adopting renewable energy alternatives.⁹

These factors will increase competition in the local labour market for skilled personnel and put upward pressure on labour costs.

⁸ See [Wage Price Index, Australia](#)

⁹ See [South32 to switch fossil fuels at alumina refinery as coal ends](#) and [Green alumina processing pilot in WA receives major backing from ARENA](#)

The forecast labour costs in the Draft Determination appear to be conservative and do not take into account the expected local demand for skilled personnel in the energy sector. The AEC suggests that the ERA reconsider the forecast 'labour costs – construction' used in the Draft Determination so that it better reflects local conditions.

Conclusion

The AEC appreciates the opportunity to provide feedback on the Draft Determination. The AEC considers that the proposed 2023 BRCP of \$185,200 per MW per year is understated. The PWC forecasts are anomalous compared to equivalent forecasts and supporting information. The AEC encourages the ERA to re-assess the BRCP on the basis of the above comments.

Any questions about our submission should be addressed to Graham Pearson, Western Australia Policy Manager by email to graham.pearson@energycouncil.com.au or by telephone on 0466 631 776.

Yours sincerely,

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