



Econtech Pty Ltd

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Network Regulatory North
Australian Energy Regulator
PO Box 3131
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Dear Kaye

Forecast of Labour Cost Growth for South Australia

Thank you for commissioning us to provide the Australian Energy Regulator (AER) with forecasts of labour costs growth for South Australia. These forecasts were obtained from Econtech's Labour Cost Model (LCM) that provides forecasts of labour costs by state by industry over the period 2006/07 to 2015/16. The LCM allows for an independent assessment of labour cost conditions for the mining, electricity, gas & water supply and construction industries (and indeed all the 17 ANZSIC broad industries) in each state and territory. These forecasts could be used by AER in their draft transmission determination for ElectraNet, the transmission network operator in South Australia.

The LCM forecasts are fully consistent with Econtech's Murphy Model 2 (MM2) modelling outputs, including the existing national wage forecast and the state and industry employment forecasts. MM2 is Australia's leading national, industry and state forecasting model updated quarterly. The MM2 state forecasts cover gross state product, CPI, investment, consumption and demand, whilst the industry forecasts include production, investment, employment and exports and imports for the 17 ANZSIC¹ industry divisions. The information from MM2 is used to derive the labour cost forecasts from the LCM. Full details of the LCM model have been previously provided to AER in Econtech's report "Labour Costs Growth Forecasts" in August 2007.

As requested by AER, the labour cost forecasts take into account the labour productivity changes in South Australia and any skill shortages, infrastructure issues and other upside/downside risks over the period. Further, as requested by AER commentary in this letter has been limited to assumptions regarding future downturns in the mining and construction sectors and any specific state based factors.

Table 1 shows the historical data and Econtech's forecast of the average nominal wage growth rate for Australia and South Australia at the aggregate level and for the electricity, gas and water industry. As shown in this table, over the period 1986-1996, average wage growth in the overall electricity, gas and water industry was 5.4 per cent, compared to average wage growth of all industries in Australia of 4.5 per cent. A similar trend is also

¹ Australian and New Zealand Standard Industrial Classification

observed over the period 1996-2006, at both the national level and in South Australia. On average, wage growth in the electricity, gas and water industry is around 1 percentage point higher than the average wage growth of all industries. This trend is expected to continue in the forecast period of 2006-16, also shown in Table 1.

Table 1
Average Nominal Wage Growth (%)

	Overall Australia	Overall South Australia	Electricity, Gas and Water - Overall Australia	Electricity, Gas and Water - South Australia
1986-1996	4.5	4.3	5.4	5.1
1996-2006	3.9	3.5	5.4	5.4
2006-2016	4.6	4.8	5.7	5.8

Source: ABS and Econtech's LCM model

South Australia is expected to have higher wage growth than the national average in both the utilities sector and at the overall level. Demand for labour in South Australia is strong and population and labour supply growth is slow, relative to other Australian states,² which puts pressure on employers to offer higher wages to attract and retain workers.

A major reason for the above average wage growth in the utilities sector for South Australia and Australia as a whole is due to a skill shortage. Over the last decade, the Australian economy has experienced strong economic growth that has seen the unemployment rate fall to as low as 4.3 per cent in May 2007³. This has resulted in an extremely tight labour market, putting pressure on the available supply of skilled labour and resulting in a skills shortage in most professional occupations and trades. The effect of such a tightening in the labour market has been to put upward pressure on wages in some sectors, as businesses are being forced to offer higher wages to attract skilled workers. The utilities sector in particular has been hit hard by the skills shortage which has had an inflationary effect on wages as a large number of employers have been forced to offer higher wages in an effort to retain staff.

One of the main reasons that the electricity, gas and water industry has had such difficulty in retaining skilled staff has to do with demand booms in related industries. The electricity, gas and water industry employs a large proportion of electricians, electrical engineers and engineers; categories that are also employed extensively by the construction and mining industries. As such, the current mining and construction boom that has been taking place over the last few years has caused competition between the industries for these particular skills. This is exacerbated in South Australia by the buoyant housing construction sector, which has experienced particularly strong growth in the construction of medium density residential units. Consequently, wages growth in all three of these industries has generally been well above average in recent times as the jump in demand for skilled labour has exacerbated the effect of the underlying supply shortage.

Table 2 shows the historical data and Econtech's forecasts of labour cost growth rates each year for South Australia in the mining, construction and electricity, gas and water sectors. The growth rates for the three sectors broadly follow the same path of increasing growth rates in the forward forecasts. However, this growth becomes relatively modest in the later years of the forecasts as the effects of the mining boom wears down.

² Econtech, May 2007, *Australian National State and Industry Outlook*

³ Australian Bureau of Statistics, June 2007, *Catalogue Number 6202.0*

Table 2
Labour Cost Growth Rates in South Australia, 1995/96 to 2015/16 (%)

	Mining	Electricity, Gas & Water	Construction	Overall South Australia
1995-1996	8.6%	1.6%	16.3%	1.8%
1996-1997	3.9%	12.3%	-3.9%	2.3%
1997-1998	3.8%	8.5%	4.1%	2.0%
1998-1999	2.2%	1.9%	26.1%	5.8%
1999-2000	7.2%	4.8%	3.5%	1.7%
2000-2001	8.0%	8.2%	5.3%	6.4%
2001-2002	-2.8%	2.7%	0.8%	3.6%
2002-2003	6.4%	8.4%	-16.4%	3.8%
2003-2004	15.6%	4.6%	13.5%	0.6%
2004-2005	10.2%	0.1%	20.2%	4.8%
2005-2006	-1.2%	3.3%	-3.1%	4.4%
2006-2007	4.4%	7.3%	12.1%	8.2%
2007-2008	2.9%	4.5%	3.2%	4.0%
2008-2009	3.3%	5.4%	3.7%	4.5%
2009-2010	3.6%	7.4%	4.6%	5.2%
2010-2011	3.4%	6.9%	4.8%	5.1%
2011-2012	3.6%	6.1%	4.7%	5.0%
2012-2013	3.9%	5.8%	4.7%	4.9%
2013-2014	3.7%	5.5%	4.3%	4.5%
2014-2015	3.1%	4.9%	3.3%	3.5%
2015-2016	2.6%	4.7%	3.3%	3.5%

Source: Econtech's LCM model

If you require any more details please do not hesitate to contact me on (02) 9929-4700.

Yours sincerely

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