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By Email

Dear Mr Pattas

AER's 2016-2020 Final Decision - Inflation rate

I am writing in relation to the inflation rate to be applied in the AER's Final Decision for United Energy for the 2016 to 2020 regulatory control period. We understand that the AER will publish its Final Decision on 26 May 2016.

In making your Final Decision, we would like to draw your attention to the attached *Statement on Monetary Policy* issued by the Reserve Bank of Australia (RBA) on 5 May 2016¹. Section 6, Economic Outlook, sets out the RBA's forecast inflation for the period 2016 to 2018 – refer to table 6.1, replicated below for ease of reference:

Table 6.1: Output Growth and Inflation Forecasts^(a)
 Per cent

	Year-ended					
	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
GDP growth	3	2½–3½	2½–3½	2½–3½	2½–3½	3–4
CPI inflation	1.7	1	1–2	1½–2½	1½–2½	1½–2½
Underlying inflation	2	1½	1–2	1½–2½	1½–2½	1½–2½
	Year-average					
	2015	2015/16	2016	2016/17	2017	2017/18
GDP growth	2½	2½	2½–3½	2½–3½	2½–3½	2½–3½

(a) Technical assumptions include A\$ at US\$0.75, TWI at 62.5 and Brent crude oil price at US\$47 per barrel; shaded regions are historical data
 Sources: ABS; RBA

The above table shows that the RBA is forecasting inflation to be between 1.0 – 2.5 per cent over the period in the first two years of the current regulatory control period.

This forecast further supports our position that the AER's current forecasting method is currently over-estimating inflation.

¹ RBA, Statement on Monetary Policy, May 2016, Table 6.1. Found at: <http://www.rba.gov.au/publications/smp/2016/may/>

In its Preliminary Determination, the AER adopted an inflation forecast of 2.5 per cent for the 2016 to 2020 regulatory period. This is based on the methodology that has been adopted by the AER since 2008, which involves:²

- For the first two years of the regulatory period, taking the mid-point of the RBA *forecast* range for CPI inflation. The AER relied on the RBA's November 2015 *Statement on Monetary Policy* for the purposes of its Preliminary Determination. For these two years, the RBA has published a forecast range of 2 – 3 per cent, with a mid-point of 2.5 per cent;³ and
- For the following eight years, taking the mid-point of the RBA *target* range for CPI inflation, being 2.5 per cent (as this range is 2 to 3 per cent).

The RBA's most recent inflation forecasts for the first two years of the regulatory period, contained in its May 2016 *Statement on Monetary Policy*, are lower than those in its November 2015 *Statement on Monetary Policy*.

We maintain the view set out in our Revised Regulatory Proposal that the AER's current forecasting method is currently over-estimating inflation.

In making its Final Decision, we strongly encourage the AER to revisit its position on inflation in light of the revised inflation forecasts contained in the RBA's May 2016 *Statement on Monetary Policy* and to adopt our proposed inflation rate of 2.01 per cent.

Please do not hesitate to contact Stephanie McDougall on 03 8846-9538 or Stephanie.mcdougall@ue.com.au if you would like to discuss any of the issues raised in this letter.

Yours sincerely



Andrew Schille

General Manager

Regulation and Corporate Affairs

² Preliminary Decision, p 3-256.

³ RBA, *Statement on Monetary Policy*, November 2015, Table 6.1.