AEMC 2014 PRICE TRENDS REPORT

OVERALL NATIONAL average prices are falling in 2014/15 and expected to remain stable over the following two years. But trends vary across states and territories.

WHAT WILL EXPECTED AVERAGE ANNUAL PRICE TRENDS BE BETWEEN JULY 2014-17?

Price drivers vary considerably between states and territories although there are some common underlying trends.

HAVE YOU SHOPPED AROUND FOR A GOOD DEAL?

Typical savings an average customer might make from switching to a competitive market offer in 2013-14. Some consumers could save even more.
**Outcomes of the 2012 Rule Changes**

**Setting revenue allowances for regulated networks**

Regulation based on business efficiency means consumers don’t pay any more than necessary for the reliable supply of electricity and gas.

Allowed revenues for network businesses are now set using the expenditure required by prudent, efficient operators as a benchmark. Companies have incentives to beat the benchmarks so they can keep some of their savings and pass the rest on to customers.

**Outcomes of the 2014 Rule Changes**

**Structuring prices to empower consumers**

Making network prices reflect the cost of providing network services to individual consumers means everyone can make informed decisions about how they use electricity. These rules cover how much individual households will pay for their network services.

By July 2017, the prices we pay will reflect the different ways we use electricity and the costs of providing it. The rules put consumers in the driving seat.

The way we pay for power has to keep pace with our modern lifestyle. When prices reflect how much it costs to use different appliances at different times, consumers are able to make more informed decisions.

The rules include clear instructions for networks on the requirements to apply when determining how to structure network prices.

Earlier notification of network prices allow retailers and consumers to better prepare for price changes.

The AER is able to review the efficiency of past capital expenditure overspends when assessing future revenue proposals.

The AER works out revenues based on analysis of efficient costs including operating and capital expenditure, return on capital, depreciation, and tax liabilities.

The AER has to release reports on network business performance to compare business performance across jurisdictions and over time.

**Network Companies consult consumers and retailers on new tariffs and submit draft proposals to AER mid-year.**

Cost-reflective prices phased in no later than mid-year.
AEMC report: electricity prices moderating over the next two years

The Australian Energy Market Commission (AEMC) today released its 2014 Residential Electricity Price Trends report on factors driving electricity prices in each state and territory, which shows prices are mostly flat or falling.

The report analyses trends in the competitive market sectors of the electricity industry; the regulated networks sector; and resulting from government environmental policies. The factors driving each of the three are different, so understanding price trends involves looking into each individually.

The cost of supplying electricity has already fallen in 2014/15 following removal of the carbon price and is expected to remain stable over the following two years, although trends vary across the states and territories due to local factors.

AEMC Chairman John Pierce said the cost of poles and wires, which had previously led to significant price growth, was now expected to moderate under new rules introduced by the Commission.

“The cost of the regulated network sector is mainly flat or falling under a new, tighter regulatory framework introduced by the AEMC for the National Electricity Market, which is starting to be applied this year,” Mr Pierce said.

“The new rules better equip the Australian Energy Regulator to set efficient revenue allowances for network companies so people don’t pay more than necessary for the maintenance and upgrade of poles and wires.

“This year’s price trends report reflects the substantially lower revenue allowances proposed by the regulator for network businesses, including lower rates of return.”

Estimates in this year’s price trends report for the ACT, New South Wales and Tasmania include the effect of draft determinations made by the regulator under the new rules.

The new rules will be applied to network companies in other National Electricity Market states including Victoria, Queensland and South Australia, in the next round of draft determinations to be made by the AER between July 2015 and January 2016.

Mr Pierce said in the competitive market sectors oversupply of generation capacity was also affecting electricity prices.

“Falling demand is putting downward pressure on wholesale electricity prices over the reporting period, however this trend may not be sustained as the market adjusts to changing conditions and generators exit.

“Increased competition in electricity markets was also providing opportunities for consumers to switch electricity providers and save between 7 and 16 per cent on a better deal in states where market offers were available – or $93 to $247 on an annual bill.
“We would encourage consumers to take advantage of competition between service providers by shopping around and choosing a better deal to save on their bills.”

The removal of the carbon price has reduced electricity prices in 2014/15, however other environmental policies like the Renewable Energy Target and solar feed-in tariff schemes continue to place upward pressure on prices.

The annual Residential Electricity Price Trends report is part of the AEMC’s work to strengthen consumer engagement in energy markets.

The full report and further information is available at www.aemc.gov.au.

About the AEMC
We are the independent body responsible since 2005 for providing advice to Australian governments on development of the electricity and gas sector. We make statutory energy market rules which are applied and enforced by the Australian Energy Regulator (AER).

Media contacts:
Communication Manager, Prudence Anderson 02 8296 7817 or 0404 821 935
Communication Specialist, Tim O’Halloran 0409 059 617 or 02 8296 7871

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Trends and drivers of residential electricity prices vary between states and territories

The 2014 Residential Electricity Price Trends report identifies factors driving electricity prices over the three years to 2016/17 in all states and territories. By providing this information at the request of the COAG Energy Council, the AEMC is seeking to strengthen consumer engagement in the market.

The purpose of the price trends report is to provide an understanding of the:

- cost components of the electricity supply chain that contribute to the overall price paid by residential consumers; and
- expected trends in each of these components.

The average prices presented in this report are specific to the 'representative consumer' for each jurisdiction and do not reflect the pricing outcomes for all residential consumers. The representative consumer is different for each state and territory and is determined using a consumption level provided to us by state and territory government officials.

This report does not attempt to forecast prices. Rather, we have analysed cost trends in the competitive market sector and the regulated network sector, while also accounting for the impact of government environmental policies. We report on how these trends affect overall prices paid by residential consumers, in order to identify the relative contribution to the price movements of these drivers.

Key findings

At a national average level, residential electricity prices have declined in 2014/15, and are expected to fall again in 2015/16 followed by a moderate rise in 2016/17. Price trends and drivers vary between states and territories due to local conditions and government policies, as shown by the differences in the annual average movements below.
Residential electricity prices have fallen in 2014/15 in most states and territories following the removal of the carbon price. The extent of this decrease varies between jurisdictions, as the savings are offset by changes in other components that make up electricity prices.

Average national prices are expected to fall again in 2015/16 before increasing moderately in 2016/17, with variations between states and territories. Jurisdictional trends will mostly be driven by changes in regulated network prices, which will depend on forthcoming regulatory determinations by the Australian Energy Regulator. These determinations will be made under the new framework for network regulation.

In 2014/15, the national average price is made up of around 50 per cent regulated network prices, 40 per cent competitive market costs and 10 per cent environmental policy costs. The following figure shows the price components for each year of the reporting period.

![Trend in national average supply chain components](image)

**Drivers of price trends**

We have identified two key drivers of price trends over the period from 2013/14 to 2016/17.

1. **Repeal of the carbon pricing mechanism**

   Across Australia, the carbon price was estimated to have made up between 5.4 and 10.5 per cent of the representative consumer’s bill in 2013/14. On a national average basis, the carbon price was estimated to contribute around 8 per cent to the representative consumer’s bill for each jurisdiction in 2013/14.

   Carbon pricing changed the relative cost of different generation technologies, making low emissions generators, such as wind and gas, cheaper relative to coal-fired generators. As most electricity in Australia is supplied by coal-fired generators, a price on carbon emissions increased wholesale energy purchase costs. These additional costs were reflected in the retail electricity prices paid by consumers.

2. **Falling electricity consumption**

   Declining annual electricity consumption has contributed to excess generation capacity in the National Electricity Market. This, together with additional renewable generation subsidised under the Renewable Energy Target, is putting downward pressure on wholesale electricity prices, which is expected to continue over the reporting period.

   Analysis by Frontier Economics shows that if electricity consumption declines further than forecast, wholesale electricity prices are unlikely to fall materially further. Prices in the spot market are currently close to the variable costs of the generators who generally set the wholesale price. This acts as a price floor as generators are unlikely to offer capacity into the market if they are unable to recover these costs.

**Regulated network prices**

Regulated network prices consist of the costs of the transmission and distribution networks, which connect electricity generators and end users, such as households.
For the second year running, the price trends report shows growth in regulated network prices continuing to moderate. This reflects a reduction in factors such as expectations of peak demand and the regulated rate of return. The regulated rate of return is a significant driver of network prices and has been decreasing due to lower financing costs.

The actual trend in regulated network prices over the reporting period will depend on the outcome of a series of revenue determinations to be made by the Australian Energy Regulator. These determinations will be made under the new network rules put in place by the AEMC in 2012.

The new rules enable the Australian Energy Regulator to develop better methods and processes to achieve efficient outcomes for consumers, including:

- arrangements for how the regulated rate of return is set;
- use of incentives to encourage efficient investment decisions;
- incorporating consumer considerations; and
- the application of benchmarking to compare the relative performance of the network businesses.

The full application of the new rules will apply to the next regulatory determination cycle for the transmission and distribution network businesses. New cycles commence in July 2015 for the Queensland, New South Wales, Australian Capital Territory and South Australian distribution networks, as shown in the figure below.

On 27 November 2014, the Australian Energy Regulator released draft determinations for regulated networks in New South Wales, Australian Capital Territory and Tasmania. These determinations proposed reductions in allowed revenue of between 20-30 per cent compared to the previous regulatory period.

### Competitive market costs

Competitive market costs include wholesale energy purchase costs and the costs of retailing electricity to consumers.

Wholesale energy purchase costs are expected to remain stable over the reporting period due to:

- subdued electricity consumption growth in most jurisdictions; and
- an oversupply of generation capacity.

The Large-scale Renewable Energy Target is contributing to the oversupply as it mandates more generation capacity irrespective of changes in electricity consumption. The cost incurred by retailers to comply with the scheme is included in the environmental policy component of this report and is forecast to increase by around 21 per cent per year.

Low wholesale energy costs due to the current oversupply are unlikely to be sustained in the medium term as unprofitable generators are being forced to exit the market in response to low wholesale prices. The 1,000 MW Wallerawang power station and the
150 MW Redbank power station shut down permanently in 2014, along with a number of temporary closures.

As generators exit the market, the reduction in supply will eventually cause wholesale prices to rise to a level that supports the financial viability of the remaining power stations.

**Environmental policy costs**

The carbon pricing mechanism, Renewable Energy Target and state and territory feed-in tariff and energy efficiency schemes impact on residential electricity prices.

While the repeal of the carbon price has seen a drop in environmental policy costs in 2014/15, these are expected to increase across most jurisdictions in the following years due to the Renewable Energy Target and the effect of legacy solar feed-in tariff schemes.

On a national average basis, costs associated with the Renewable Energy Target are expected to increase in the following way:

- an average annual increase of 21 per cent in Large-scale Renewable Energy Target costs; and
- an average annual decrease of 10 per cent in Small-scale Renewable Energy Scheme costs.

It is expected that Renewable Energy Target costs will make up 5 per cent of the national average price in 2016/17.

These trends are based on existing government legislation and assume the Renewable Energy Target continues in its current form during the reporting period.

Costs associated with the solar feed-in tariff schemes are higher in some jurisdictions than others and are a key driver of price movements in Queensland.

**Increase choices for consumers**

Competition has resulted in an increasing number of retail electricity offers and consumers can save on their electricity bills by shopping around for the best deal.

- In states and territories where both *standing offers* and *market offers* are available, residential consumers that are still on the *standing offer* can realise substantial savings by switching to a competitive *market offer*. This saving ranges between 7 per cent in Queensland to 16 per cent in Victoria.
- Consumers that are already on a *market offer* may benefit from switching to another *market offer* that is more suited to their individual circumstances.
- In jurisdictions where there is only one retailer, consumers may benefit from switching to a different offer with the same retailer, depending on individual consumption patterns.

The AEMC is currently implementing a number of reforms from its Power of Choice review that will enable consumers to make more informed decisions about how they use and pay for energy services.

**Information sources**

Information for this report has been sourced from jurisdictional governments and regulators.

We have sourced information from the Australian Energy Regulator in relation to transmission and distribution network prices and from retailers operating in the relevant states for our analysis of *market offer* prices.

The AEMC commissioned independent modelling of wholesale energy purchase costs, carbon pricing mechanism costs and Renewable Energy Target costs. Modelling was undertaken based on current knowledge and assumptions as well as existing legislation and is available on our website.

Information on prices in future years may differ from actual outcomes as they are sensitive to uncertainties and changes in the factors that drive prices across the electricity supply chain. These include changes in:

- energy consumption by consumers across the states and territories;
• government policies, such as those relating to the Renewable Energy Target and jurisdictional environmental schemes; and
• network prices following the finalisation of new regulatory determinations for individual network businesses.

About the AEMC
The Australian Energy Market Commission is the independent body responsible for providing advice to Australian governments on the electricity and gas sector. It makes energy market rules that are applied and enforced by the Australian Energy Regulator.

The Residential Electricity Price Trends report is part of the AEMC’s work to empower families, businesses and industry to participate confidently in all parts of the energy supply chain, where they desire to do so. It provides annual information to help consumers better understand the factors which drive residential electricity prices.

For information contact:
AEMC Chairman, John Pierce (02) 8296 7800
AEMC Chief Executive, Paul Smith (02) 8296 7800

Media:
Communication Manager, Prudence Anderson 02 8296 7817 or 0404 821 935
Communication Specialist, Tim O’Halloran 0409 059 617 or 02 8296 7871

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