Liquidity of the Interest Rate Swap Market

Westpac

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Anthony Meehan
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Dear Tony

LIQUIDITY OF THE INTEREST RATE SWAP MARKET

TransGrid has requested a professional opinion from an inter-bank financial markets participant, regarding the liquidity of the AUD Interest Rate Swap ("IRS") market. Westpac as one of the largest liquidity providers in the AUD IRS market is well placed to provide this opinion.

Background

The specific request was whether under *normal market conditions*, there was likely to be sufficient liquidity to absorb $22bn worth of 5 year IRS without materially impacting the price. The scenario was where all six regulated NSW Network Service Provider's ("NSPs") that will have their regulated revenue determined by the Australian Energy Regulator at the same time, attempted to hedge their interest rate exposure for 5 years, over a similar window. We understand that the hedges for each business would typically be placed over a twenty business day window. However, given the IRS product is an over-the-counter derivative, there does not exist any data to verify our view.

Analysis

The table sets out the assumed amount of debt for each NSP to be hedged:

NSP	AUDbn
Transgrid	3.6
AusGrid	8.8
Endeavour	4.2
Essential Energy	4.1
Actew / Transend	1.4
Total	22.1
1/20th	1.1
1/40th	0.6
1/60th	0.4
1/80th	0.27

Westpac's opinion is that in order not to distort the market and impact pricing, to hedge $22bn over consecutive business days, the maximum notional amount of 5yr IRS would be $300m per day. Should a syndicate of banks be used to execute the IRS, the $300m would be spread across the entire bank group.

The above table demonstrates that if a total of $22bn were to be hedged over a 20 business day window, $1.1bn of 5yr IRS would need to be cleared each day. In our opinion this is not feasible without materially impacting NSPs cost of funds. A significantly longer period of time would be required and not even sixty days but closer to eighty days would be required.

The requirement of the regulatory process to execute this volume of swaps in such a short period may attract a higher cost from the market even if it is spread over a period such as eighty business days. It is not possible to fully anticipate the response from the market from such a large volume of transactions.

This opinion assumes a normally functioning market absent of any market disrupting events.

The last regulatory reset of these NSPs occurred in early 2009 which could be considered the peak of the 'GFC'. Given the Interest Rate Swap product is an Over-The-Counter derivative there does not exist any data to confirm our view but it is unlikely that there would have been sufficient liquidity at this time.

Yours sincerely

Ed Hope	Dare Whalley
Associate Director, Derivative Sales	Director, Infrastructure & Utilities

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