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# IR and FX Newsletter
## March 2024

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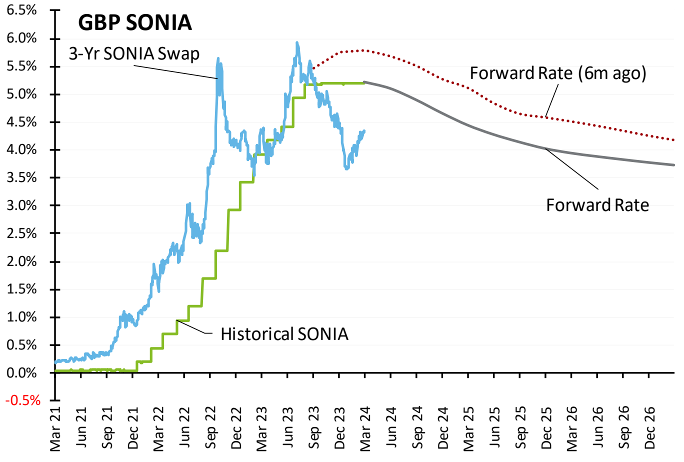
## Interest Rate Markets

Interest rates across the UK, US and EU have moved steadily higher in recent weeks, amid persistent inflationary pressures and in some instances, robust economic data. For example, market expectations for rate cuts from the Federal Reserve have fallen to c.75bps for 2024, in line with the FOMC Dot Plot and down from approximately 150bps at the start of January. This narrative also holds true for the European Central Bank and Bank of England, where just 90bps and 60bps of interest rate cuts are priced in respectively, down from 140bps and 110bps last month.

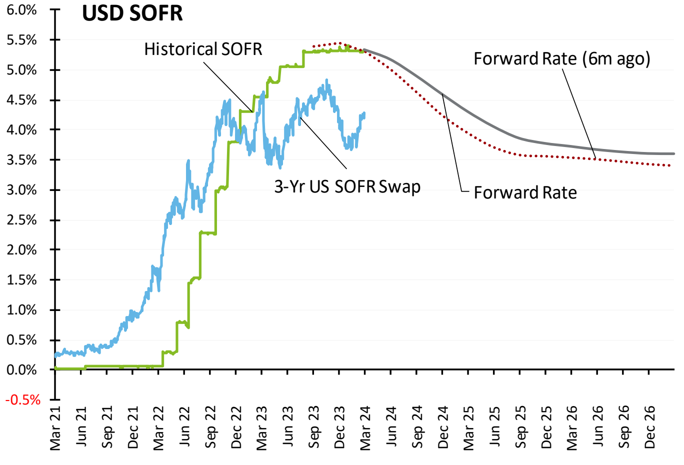
Consequently, 3-Yr SOFR swaps are 60bps above 2023 lows, as markets adjust to the repricing of central banks rate cut expectations. Nevertheless, the inverted forward curve still presents opportunities to fix rates below current floating levels for SOFR, EURIBOR and SONIA-exposed borrowers.




- The underlying SONIA rate is currently at 5.19%
- BofE policymakers held rates, as anticipated, at their 1st February 2024 meeting, with the first 25bps cut now priced in for August 2024, versus June this time last month.
- The 3-year SONIA Swap rate is 4.37%, vs. 5.20% 6 months ago, and up 39bps month-on-month.
- The forward curve is downward sloping from Q3 2024.

| | 2-year | 3-year | 5-year |
|---|---|---|---|
| Swap rate (mid level) | 4.61% | 4.37% | 4.09% |
| Cap @ 5.00% (premium)* | £0.63m | £1.21m | £2.39m |
| Cap @ 5.50% (premium)* | £0.39m | £0.79m | £1.78m |

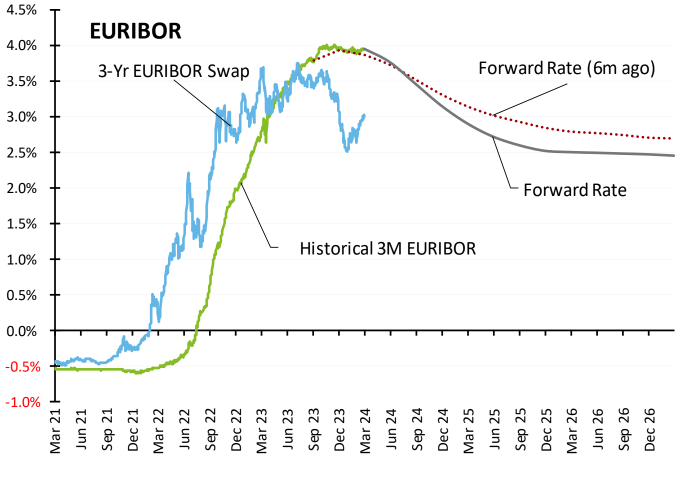
*£100m hedge notional




- SOFR is currently 5.31%, inside the Fed Funds target rate range of 5.25%-5.50%.
- The Federal Reserve held rates at their meeting on 31st January, with markets now forecasting the first 25bps rate cut in June or July 2024.
- The 3-year SOFR Swap rate is 4.24%, vs. 4.38% 6m ago, and up 40bps MoM.
- The forward curve is steeply inverted from Q2 2024.

| | 2-year | 3-year | 5-year |
|---|---|---|---|
| Swap rate (mid level) | 4.52% | 4.24% | 4.00% |
| Cap @ 5.00% (premium)* | $0.64m | $1.06m | $2.15m |
| Cap @ 5.50% (premium)* | $0.28m | $0.62m | $1.51m |

*$100m hedge notional




- 3-month EURIBOR is 3.94%.
- The ECB held rates at 4.00% at their meeting on 25th January. Markets now look towards the ECB's first 25bps rate in June.
- The 3-year EURIBOR Swap rate is currently 2.93%, vs. 3.41% 6 months ago.
- The forward curve is inverted from Q2 2024.

| | 2-year | 3-year | 5-year |
|---|---|---|---|
| Swap rate (mid level) | 3.14% | 2.93% | 2.75% |
| Cap @ 3.50% (premium)* | €0.45m | €0.81m | €1.79m |
| Cap @ 4.00% (premium)* | €0.20m | €0.47m | €1.22m |

*€100m hedge notional

Data source: Refinitiv and ICE Data Services, as of 29th February 2024

## What can be done in the current Interest Rate markets?

### Borrowers can fix rates below the current floating rate:

Not only is there no additional cost to fix floating rate exposure, but the current downward forward curve allows borrowers to fix rates at levels below the current floating rate:

- SONIA 3m is 5.21% and a vanilla 5y Swap is 4.09%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by GBP 1.12m.
- SOFR 3m at 5.32% and a vanilla 5y Swap is 4.00%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by USD 1.32m.
- EURIBOR 3m at 3.94% and a vanilla 5y Swap is 2.75%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by EUR 1.19m.

### Longer- term hedges are cheaper than shorter-term hedges:

Because of the downward forward curve, long term hedges are cheaper than short term hedges:

- GBP swap: 1-year: 4.97%, 3-year: 4.37%, 5-year: 4.09%
- USD swap: 1-year: 5.01%, 3-year: 4.24%, 5-year: 4.00%
- EUR swap: 1-year: 3.58%, 3-year: 2.93%, 5-year: 2.75%

### Pre-hedging achieves even lower rates:

Pre-hedging future debt (assumed closing is in 6 months) is cheaper than at current hedge rates:

- GBP 5-year Swap starting in 6 months: 3.92%
- USD 5-year Swap starting in 6 months: 3.83%
- EUR 5-year Swap starting in 6 months: 2.62%

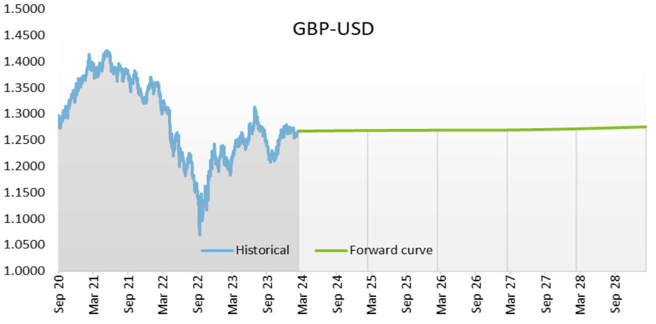
### Funding of Hedging costs can be done at favourable rates

Hedging costs for Option products (such as Caps) are typically paid upfront, however these costs can be deferred over time. This cost deferral can be done via the derivative desks at favourable rates (at SONIA, SOFR or EURIBOR, without additional margin), rather than via additional borrowing under the facility agreements (at SONIA, SOFR or EURIBOR plus margin).

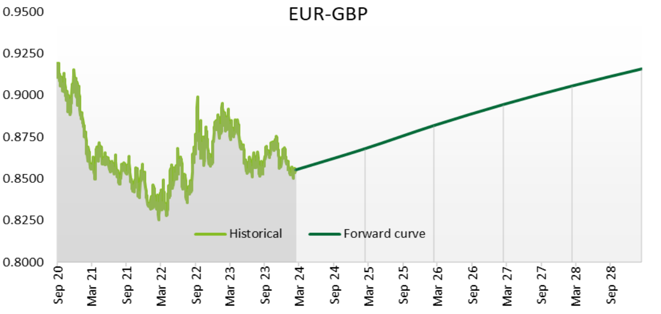


Data source: Refinitiv and ICE Data Services, as of 29th February 2024

## Currency Markets




- GBP-USD is once again flat month-on-month, with inflationary pressures remaining persistent in both markets. Investors slightly favour more rate cuts from the Federal Reserve (75bps) than the Bank of England (60bps) in 2024.
- Option premia fell by up to 25% indicatively month-on-month, depending on the protection sought, reflecting a rangebound currency pair.
- Forward FX rates remain flat out through 5 years for GBP sellers, suggesting little deviation between interest rate environments across both countries.




- Similarly, EUR-GBP is flat MoM as markets continued to predict when the ECB and BOE will begin lowering their respective rates.
- The cost of hedging via options for EUR-GBP fell by up to 21%, depending on the level of protection sought, amid a lower volatility FX backdrop.
- FX forward rates are still steep for EUR sellers out through 5 years, as markets price in the first rate cut from the ECB for June, versus August from the Bank of England.

| GBP-USD Spot Rate: 1.262 | 6mo | 12mo | 18mo |
|---|---|---|---|
| Forward rate | 1.263 | 1.263 | 1.263 |
| GBP Put Option* (ATMS**) | $2.35m | $3.59m | $4.35m |
| GBP Put Option* (5% OTMS***) | $0.58m | $1.60m | $2.27m |

* GBP 100m Put option premium

** At-the-money Spot rate: 1.262
*** 5% Out-of-the-money vs Spot rate: 1.199

| EUR-GBP Spot Rate: 0.856 | 6mo | 12mo | 18mo |
|---|---|---|---|
| Forward rate | 0.862 | 0.868 | 0.875 |
| GBP Put Option* (ATMS**) | €1.95m | €3.30m | €4.37m |
| GBP Put Option* (5% OTMS***) | €0.30m | €1.11m | €1.88m |

* GBP 100m Put option premium

** At-the-money Spot rate: 0.856
*** 5% Out-of-the-money vs Spot rate: 0.898

Data source: Refinitiv and ICE Data Services, as of 29th February 2024

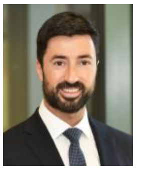
## Hedging Advisory and Derivatives Execution team

Hedging Strategy Advice

Outsourced Derivative Execution

Financial Market Knowledge

Derivative Pricing Expertise



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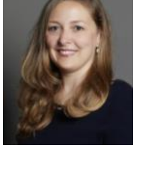

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# Managing tax in a volatile market...

Volatility in interest rates, foreign exchange and commodity markets, combined with ongoing global tax reforms (such as the Global Minimum Tax under Pillar 2) imposes many challenges to multinational corporations and investors when assessing the tax implications and risks of financing/treasury operations. It is therefore critical for treasury, tax and accounting professionals to consider the tax angle in financing operations in order to balance:

*Optimise cash generation, effective tax rate and reduce overall cost of capital WHILST...*

*Mitigating tax volatility and effectively hedge profit and loss volatility in respect of unrealised and realised amounts.*

*Managing tax risk associated with complex financial instruments and ensuring compliance with different tax systems and ongoing global tax reform.*

There are simple actions that can be taken to manage tax risk - ranging from intra-group transactions to tax authority elections - however they should be implemented as an integrated part of a commercial hedging strategy.

## Key areas that our team can provide support

- Manage accounting profit and tax volatility as a result of unrealized fair value and foreign exchange movements associated with hedging instruments
- Reduce external cost of hedging/financing so as to optimize cost of capital with different funding mechanisms (including complex financial instruments)
- M&A tax advice on deal contingent derivatives and acquisition financing.
- Compliance and HMRC engagement support for complex financial instruments
- Managing foreign exchange volatility on global cash management and cash pooling arrangements in multiple currencies.
- Assess tax risk associated with financing and hedging arrangements on international tax compliance/new legislation:
  - International tax reform (OECD) including Global Minimum tax.
  - Interest deductibility/loss restriction rules in multiple jurisdictions.

## National Treasury Tax team

- Finance and Treasury Tax Advisory
- Hedging and Forex Management Tax Solutions
- Tax Advisory associated with cash management and debt restructuring
- Tax Controversy (Finance and Treasury)
- Cash repatriation and international financing

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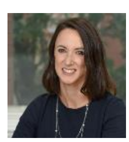

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