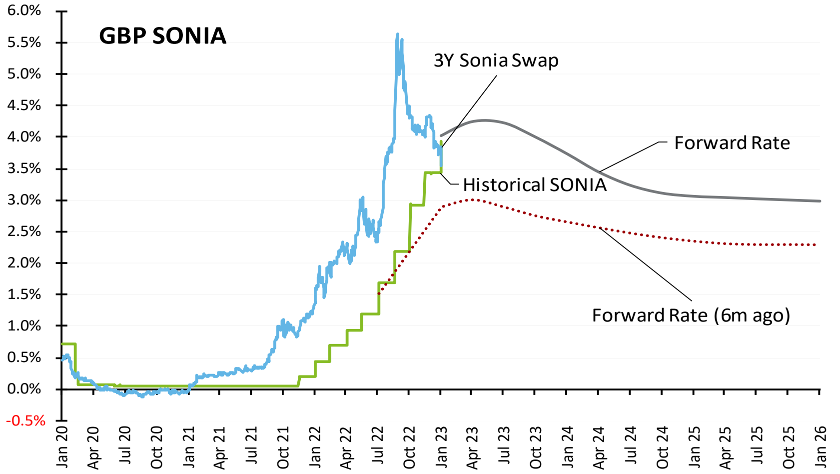
Market update - Interest Rates

03 February 2023

Interest Rate Markets

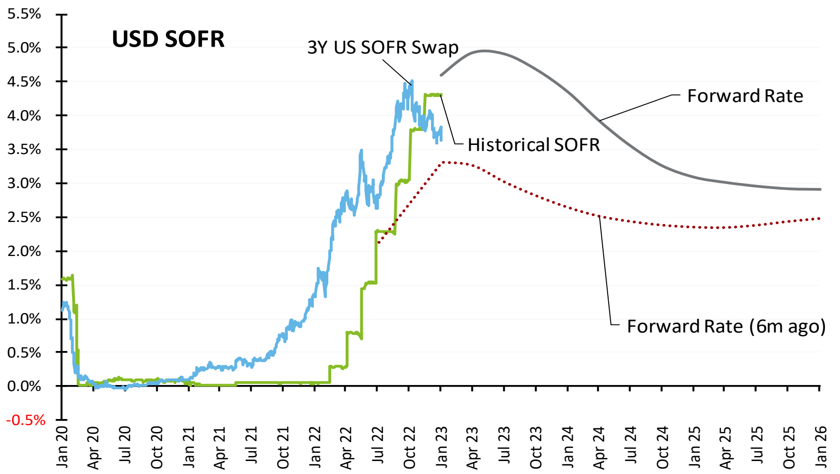
After a period of relative calm in the swap markets through January, the central banks rate announcements over the past days (both BoE and ECB increased rates by 50bps, the Fed by 25bps), have resulted in rapid changes to the outlook for the markets. GBP and EUR markets each moved c.25bps yesterday, ending, despite the rate hikes, at the lower end of the range: GBP 5Y Swap rates are now ~50bps below their December highs. Meanwhile, the US markets fell after publishing their bank rate, but have since rebounded following a strong US Non-Farm Payroll.
Due to the inverted shape of the forward curve for GBP and USD, **it is currently cheaper to fix the debt via interest rate swaps, than to stay floating** at current SONIA and SOFR rates.



- The underlying SONIA rate is currently at 3.93%
- BofE base rate is at 4.0%. The market currently expects between 0-25bps at the next meeting on 23 March, with a similar move expected to follow in May.
- The 3-year SONIA Swap rate is 3.55%, vs. 2.66% 6 months ago.
- The curve remains inverted after Q2 2023, decreasing hedging costs for longer tenors.

	2-year	3-year	5-year
Swap rate (mid level)	3.80%	3.55%	3.28%
Cap @ 4.0% (premium)*	£0.66m	£1.08m	£2.17m
Cap @ 5.0% (premium)*	£0.21m	£0.47m	£1.19m

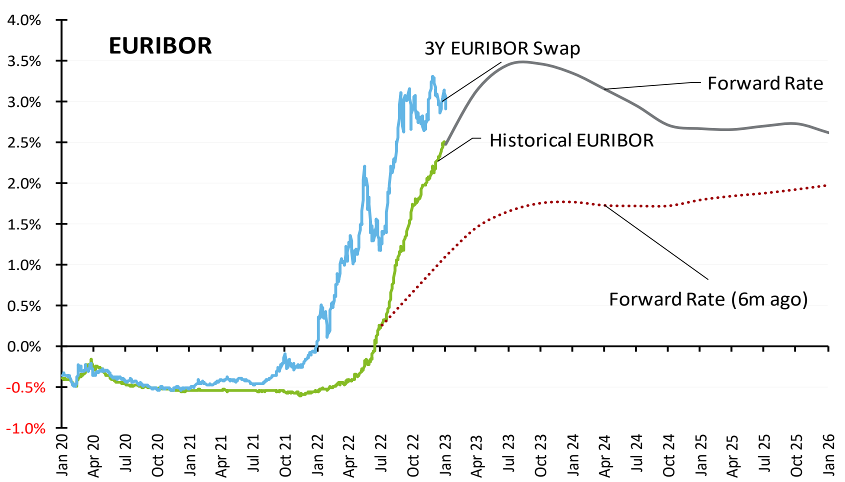
*£100m hedge notional



- SOFR is presently 4.31%, reflecting the +75bps of hikes at the last two Fed meetings.
- A further 25bp hike is favoured from the Fed for the 22 March meeting, with a 0-25bps move priced in for May.
- The 3-year SOFR Swap rate is 3.64%, vs. 2.82% 6m ago.
- Swap rates remain steeply inverted, resulting in cheaper longer-term trades.

	2-year	3-year	5-year
Swap rate (mid level)	4.09%	3.64%	3.27%
Cap @ 4.0% (premium)*	$1.05m	$1.33m	$2.07m
Cap @ 5.0% (premium)*	$0.21m	$0.36m	$0.81m

*$100m hedge notional



- 3-month EURIBOR continues to climb steadily and is presently 2.483%.
- A 25-50bps hike is priced for the ECB's March meeting, taking the bank deposit rate to 2.75-3.00%. May forecasts a further 25-50bps increase.
- The 3-year EURIBOR Swap rate is currently 2.91%, vs. 1.40% 6 months ago, although this is ~30bps lower than one month ago.

	2-year	3-year	5-year
Swap rate (mid level)	3.16%	2.91%	2.74%
Cap @ 3.0% (premium)*	€0.58m	€0.91m	€1.79m
Cap @ 4.0% (premium)*	€0.17m	€0.34m	€0.90m

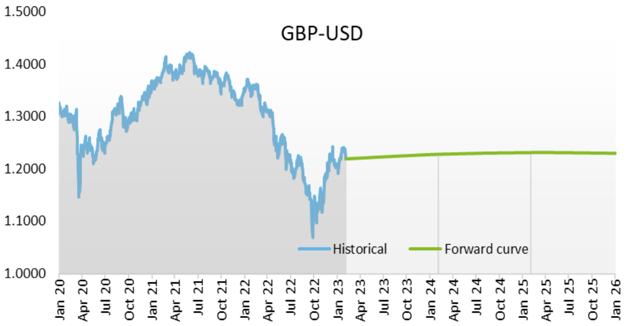
*€100m hedge notional

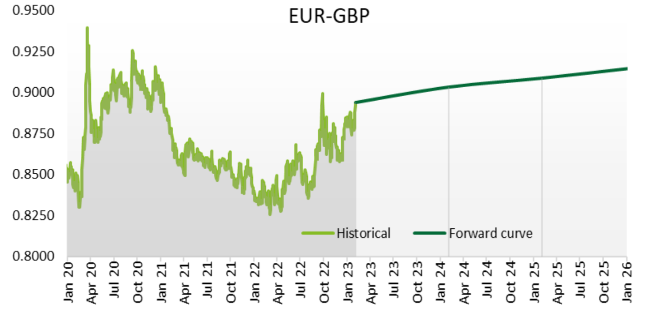
Data source: Refinitiv and ICE Data Services, as of 02 February 2023

Market update - FX

03 February 2023

Currency Markets





- GBP-USD is up 3.50% from its January lows, as markets were boosted by a more optimistic global outlook, as well as the prospect of peak inflation. However, gains have been capped due to UK recessionary concerns.
- Forward rates remain flat out to 3 years, implying consistent rates from the BofE vis-à-vis the Fed.
- Options to sell GBP against USD are less expensive than a month ago while the underlying FX rate has crept up.

- EUR-GBP has continued to appreciate, up 2.3% from its January lows. The ECB now appears to be the more hawkish of the two, whilst a more robust economy and a milder winter have aided the euro's rise.
- Changes to short-term interest rates in both jurisdictions did little to alter the longer-term interest rate differentials, which drive the forward FX rates.
- Options to sell GBP against EUR are also lower in cost than a month ago, though against a backdrop of a slightly weaker outright GBP level.

GBP-USD Spot Rate: 1.222	6mo	12mo	18mo
Forward rate	1.227	1.232	1.234
GBP Put Option* (ATMS**)	$2.55m	$3.47m	$4.21m
GBP Put Option* (5% OTMS***)	$1.08m	$1.94m	$2.62m
* GBP 100m Put option premium			
** At-the-money Spot rate:	1.222		
*** 5% Out-of-the-money vs Spot rate:	1.161		

EUR-GBP Spot Rate: 0.893	6mo	12mo	18mo
Forward rate	0.897	0.901	0.904
GBP Put Option* (ATMS**)	€2.32m	€3.41m	€4.23m
GBP Put Option* (5% OTMS***)	€0.78m	€1.67m	€2.41m
* GBP 100m Put option premium			
** At-the-money Spot rate:	0.893		
*** 5% Out-of-the-money vs Spot rate:	0.937		

Data source: Refinitiv and ICE Data Services, as of 02 February 2023

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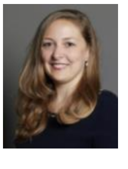

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The other side of the rising interest rates…

With rising interest rates also comes the opportunity to invest surplus cash for incremental interest income making cash flow forecasting, real time cash visibility and reporting even more crucial.

The current market conditions therefore make it more critical than ever for Treasurers to rethink and improve practices around:

- ✓ *Cash generation* – for example, levers around optimising working capital and other liquidity sources;
- ✓ *Gain visibility of cash* and create robust processes that increases organisations' focus on cash, especially over the cash holdings parked in their bank accounts.

…still holds true and the need to review where pockets of cash is held across your business has never been more vital

Key questions to ask

- Do you have daily and automated visibility?
- Is your cash centralized so you have easy access to all your global cash?
- Is any part of your cash 'trapped'?
- Does your investment policy allow you to leverage various investment products and counterparts available to optimize return on surplus cash?
- Is you working capital optimized, can you unlock cash?
- Are there any opportunities to reduce operational costs and improve EBITDA?

Potential ways to optimise cash

- Use of technology for instant visibility of global cash – this can and should all be automated.
- Internal technology or bank led cash pools to reduce the existence of idle cash in the business
- Use of investment options such as fixed term investments, MMFs, commercial paper, short term bonds etc.
- Use of a Cash Czar or a Working Capital Czar to drive a cash focused culture in the organisation
- Diagnostic and operational cost reduction

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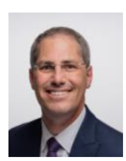

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