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IR and FX Newsletter
July 2023

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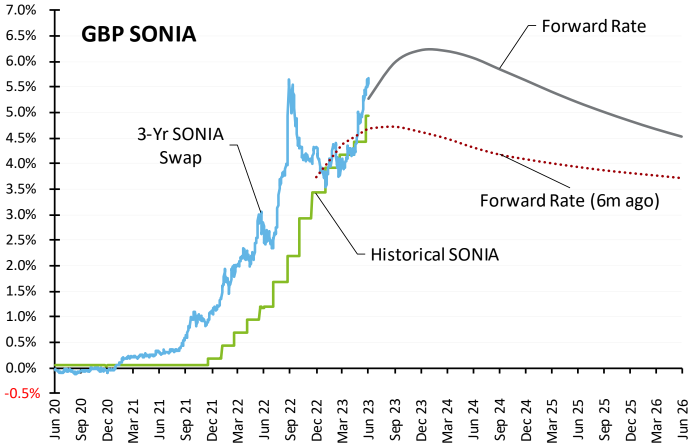
Interest Rate Markets

UK swap rates have continued to tear higher – up 85bps from the end of May – following a miss in inflation figures on 19th June, where CPI came in at 8.7% year-on-year ("YoY") for May versus a forecast 8.4%. Pertinently, the core inflation component *rose* by 7.1% YoY, and up from 6.8% in April, to levels last seen in March 1992. The last time core inflation was at these levels, the UK bank rate was over 10%.

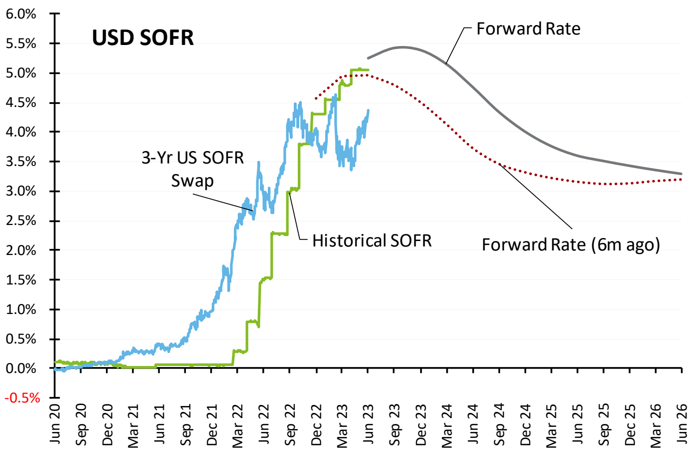
June was also a busy month in the monetary policy calendar, with the Federal Reserve ("Fed"), European Central Bank ("ECB"), and Bank of England ("BOE") all meeting. The Fed elected to 'skip' a hike at their meeting on 14th June, whilst the ECB hiked by 25bps a day later. The BOE, responding to the above-mentioned inflationary pressures, raised rates by 50bps, surprising markets that had anticipated a smaller hike of +25bps.



- The underlying SONIA rate is currently at 4.928%
- BOE base rate is at 5.00% following a 50bps hike at the most recent BOE meeting in June. The market is currently leaning towards a +50bps rise at the next meeting on 3rd August, with a further +70bps thereafter by year end.
- The 3-year SONIA Swap rate is 5.68%, vs. 4.32% 6 months ago, and up 85bps MoM.
- The forward curve is now downward sloping from Q1 2024.

	2-year	3-year	5-year
Swap rate (mid level)	5.98%	5.68%	5.07%
Cap @ 6.0% (premium)*	£1.19m	£1.79m	£2.73m
Cap @ 7.0% (premium)*	£0.56m	£0.93m	£1.55m

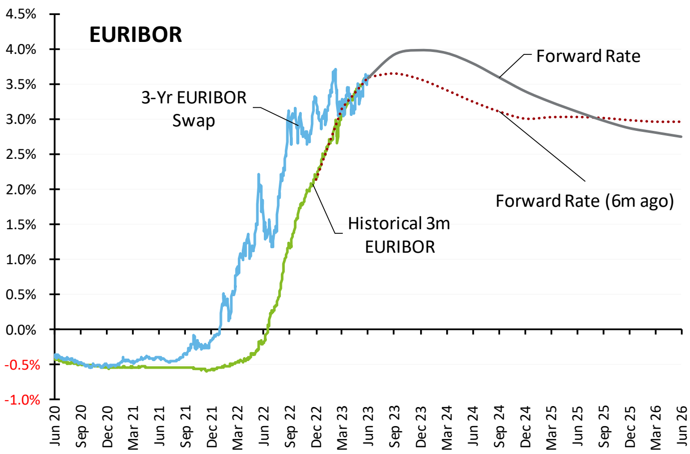
*£100m hedge notional



- SOFR is presently 5.06%, inside the Fed Funds target rate range of 5.00%-5.25%.
- The Fed chose to hold rates within their current range on 14th June. Markets now favour a +25bps move on 26th July. Rate cuts are now anticipated in Q2 2024.
- The 3-year SOFR Swap rate is 4.38%, vs. 4.03% 6m ago, and up 58bps in the past month.
- The forward curve is steeply inverted from Q1 2024.

	2-year	3-year	5-year
Swap rate (mid level)	4.78%	4.38%	3.92%
Cap @ 5.0% (premium)*	$0.93m	$1.29m	$2.13m
Cap @ 6.0% (premium)*	$0.29m	$0.51m	$1.14m

*$100m hedge notional



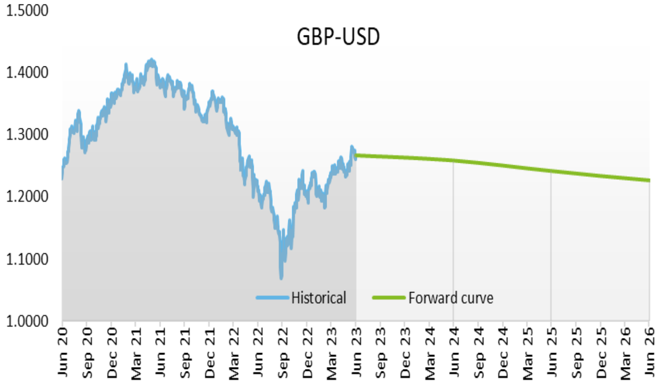
- 3-month EURIBOR is presently at 3.59%, up 12bps MoM.
- Another +25bps increase is expected 27th July, with an outside chance of a +50bps hike.
- Further out, an additional +25bps of hikes are priced in by December 2023.
- The 3-year EURIBOR Swap rate is currently 3.60%, vs. 3.23% 6 months ago.

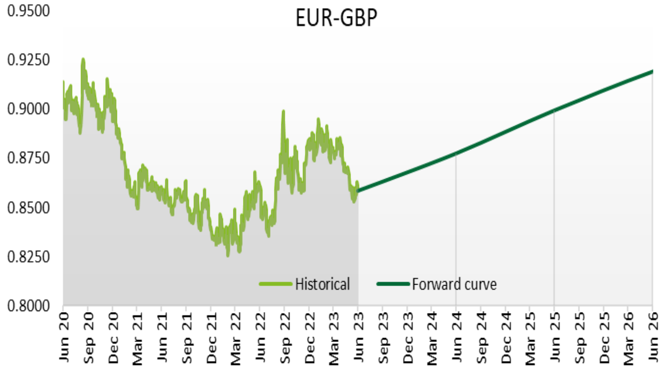
	2-year	3-year	5-year
Swap rate (mid level)	3.88%	3.60%	3.26%
Cap @ 4.0% (premium)*	€0.49m	€0.85m	€1.63m
Cap @ 5.0% (premium)*	€0.14m	€0.34m	€0.84m

*€100m hedge notional

Data source: Refinitiv and ICE Data Services, as of 30 June 2023

Currency Markets





- GBP-USD has moved 1.60% higher since the end of May, with GBP being the best performing G10 currency YTD against the dollar, predicated on elevated inflation and therefore, higher rate expectations.
- Option premia have continued to increase amid the backdrop of higher volatility; up 7-11% depending on the level of protection.
- Forward FX rates are lower out through 5 years for GBP sellers, demonstrating a higher-for-longer rate environment in the UK over that period.

- EUR-GBP traded 0.43% lower in the last month, as markets continue to expect higher UK rates for longer, than in the Eurozone.
- The cost of hedging via options for EUR-GBP has risen again, between 11-15%, depending on the level of protection sought; see the grid below. This continues to result from heightened macroeconomic volatility.
- Short-term interest rates rose by a greater extent in the UK than in the Eurozone in June, explaining the steepening of FX Forward rates.

GBP-USD Spot Rate: 1.258	6mo	12mo	18mo
Forward rate	1.260	1.259	1.254
GBP Put Option* (ATMS**)	$2.81m	$4.07m	$5.16m
GBP Put Option* (5% OTMS***)	$1.00m	$2.05m	$2.98m
* GBP 100m Put option premium			
** At-the-money Spot rate:	1.258		
*** 5% Out-of-the-money vs Spot rate:	1.195		

EUR-GBP Spot Rate: 0.877	6mo	12mo	18mo
Forward rate	0.883	0.890	0.895
GBP Put Option* (ATMS**)	€2.00m	€3.19m	€4.14m
GBP Put Option* (5% OTMS***)	€0.52m	€1.35m	€2.15m
* GBP 100m Put option premium			
** At-the-money Spot rate:	0.877		
*** 5% Out-of-the-money vs Spot rate:	0.921		

Data source: Refinitiv and ICE Data Services, as of 30 June 2023

Hedging Advisory and Derivatives Execution team

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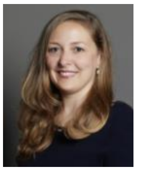

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Counterparty and credit risk management

Amidst the volatile banking market, proactive counterparty risk management takes centre stage on the Treasury agenda. As companies strive to optimise yield, they must carefully balance it with the necessity of mitigating counterparty risk - whilst cash is King, diversification is Queen! Even for organisations with small or no dedicated treasury functions, assessing alternatives and changing strategies from simply holding cash in bank account (e.g. originating from funding or profits) does not need to be a time consuming task; simple changes can reduce counterparty and credit risk significantly.

In the current market, treasurers must prioritise:

- ✓ Diversifying cash and investments for resilience against counterparty failures
- ✓ Developing contingency plans and risk mitigation strategies to address potential failures and disruptions
- ✓ Implementing robust reporting and control processes to enhance visibility and automate risk monitoring

Key questions

- How concentrated is the core banking group? Does it need to be diversified?
- How regularly do you review the creditworthiness of counterparties?
- How diversified are your investments including indirect exposures in investments like MMFs?
- Are your exposure management control processes adequate to prevent or deal with limit breaches?
- Has the risk appetite of the business changed due to changes in market conditions? Are your counterparty limits in line with the risk appetite?

Potential ways to leverage technology

- One single source of truth for banking exposure across all cash, asset classes and reporting through TMS
- Automated system alerts to any actual or potential breaches of counterparties limits
- Real time monitoring and risk metrics to enable visibility of comprehensive and up to date risk positions
- Scenario analysis and stress testing to simulate market conditions to assess and proactively develop risk mitigation strategies
- Automate market data gathering, credit rating feeds and company information to prioritise analysis over data gathering

Treasury Advisory Team

Treasury strategy, policy and governance

Liquidity and investment policy

Cash management solutions

Creating a single source of truth

Real time calculations

Alerting of policy breaches

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