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IR and FX Newsletter
June 2025

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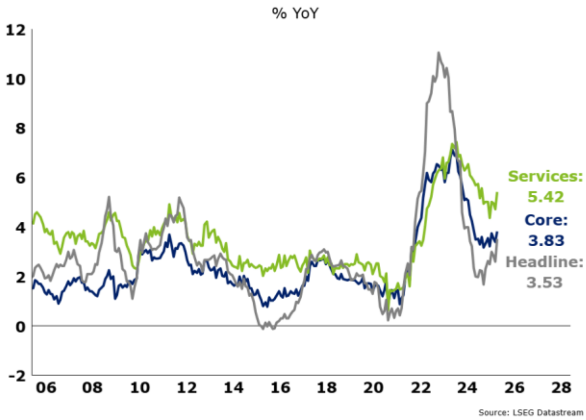
A Macro View: Global trade uncertainty continues

UK GDP growth came in stronger than expected, at 0.7%, in the first quarter, up from near-flat growth over the second half of 2024. Retail sales have also grown for four straight months, the first such occurrence since 2015, if we exclude the post-pandemic rebound in consumer demand. However, survey-based measures of consumer and business sentiment remain subdued amid heightened global trade uncertainty. Purchasing managers indices point to continued weakness in corporate activity across April and May.

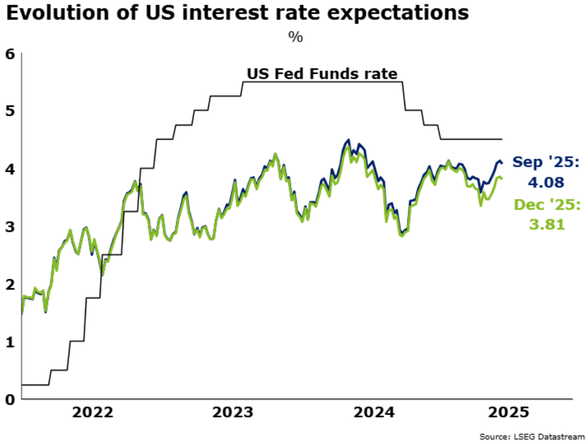
UK inflation rose to a 15-month high of 3.5% (adjoining chart) in April. The increase was driven by higher energy prices and transport costs. We expect inflation to stay at a similar level over the summer months before eventually falling towards the 2% target rate. However, limited rises in core inflation point to no material increases in underlying price pressures. This should provide room for the Bank of England (BoE) to continue easing monetary policy gradually, with financial markets expecting up to two 25 basis-point rate cuts by the end of the year.

UK: Headline & alternative measures of inflation



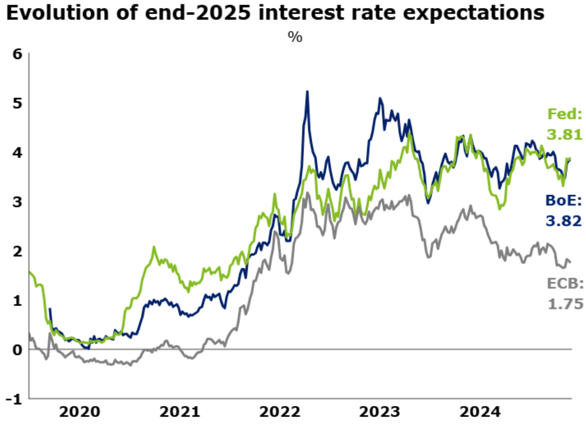
US manufacturing activity saw a partial rebound in May, likely supported by inventory stocking amid trade policy uncertainty. The latest GDP figures point to a contraction in the first quarter this year, while consumer sentiment has continued to deteriorate. Financial market volatility remains elevated, driven by trade announcements and concerns over the impact of the government's tax proposals on public debt. Rising inflation expectations have been accompanied with a slight rise in interest rate expectations over the past month (adjoining chart), with investors foreseeing the Federal Reserve (Fed) lowering its target rate to around 3.8% by the end of this year.

Evolution of US interest rate expectations



Monthly data points to a fall in euro area activity for the first time this year in May, as rising trade uncertainty dampened activity and growth expectations across major European economies, including Germany, France, Italy and Spain. However, Spanish growth remains well-above its long-term trend and Germany's medium-term prospects have improved significantly following an announced fiscal expansion. Overall, persistent economic weakness and downside risks from global trade tensions, alongside the continued easing of inflation this year, mean markets expect two further rate cuts (adjoining chart) by the European Central Bank (ECB) this year.

Evolution of end-2025 interest rate expectations



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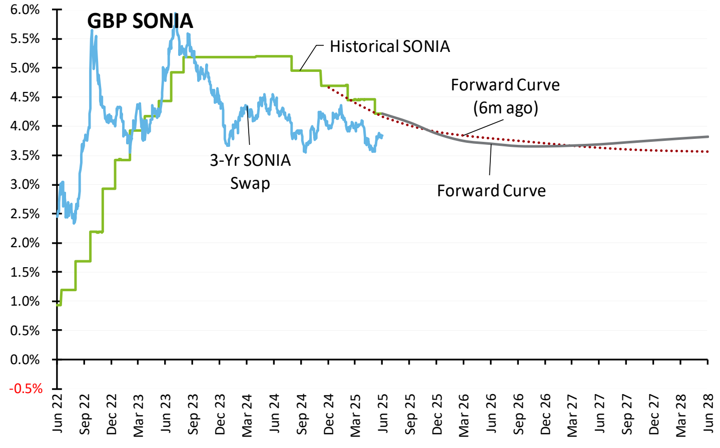
Interest Rate Markets

As anticipated, the BoE cut rates by 25 bps to 4.25% in its May policy meeting, while the Fed held rates steady, marking its third hold this year. Looking ahead, both central banks are projected to hold rates steady in their respective June meetings, whilst the ECB is expected to cut rates by 25 bps on 5 June.

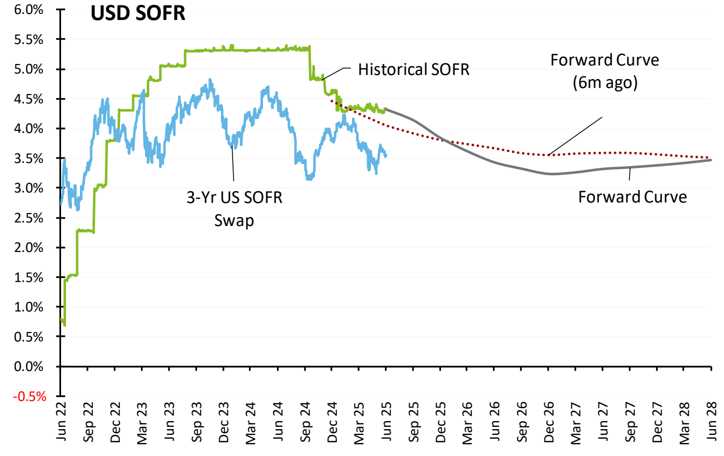
We are currently observing slightly U-shaped yield curves in the UK and US, while the Eurozone's curve has already shifted to be upward sloping. A U-shaped yield curve, where short-term and long-term government bond yields are higher than medium-term yields, has historically preceded recessions in both the US and the UK. This pattern was observed before significant economic downturns like the dot-com bubble burst in the early 2000s, the 2008 financial crisis, and around the time of the Brexit vote in the UK.



- The underlying SONIA is 4.21%.
- The BOE cut interest rates by 25 bps at its May 8th meeting to 4.25%.
- Market sentiment points towards a BOE hold at its 19th June meeting. Current pricing suggests an 93% probability of this.
- The 3-year SONIA Swap rate is currently 3.79%, vs. 3.91% 6 months ago, though up 23bps MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.82%	3.79%	3.85%
Cap @ 4.25% (premium)*	£0.38m	£0.92m	£2.50m
Cap @ 4.50% (premium)*	£0.25m	£0.71m	£2.11m
Cap @ 4.75% (premium)*	£0.18m	£0.58m	£1.83m

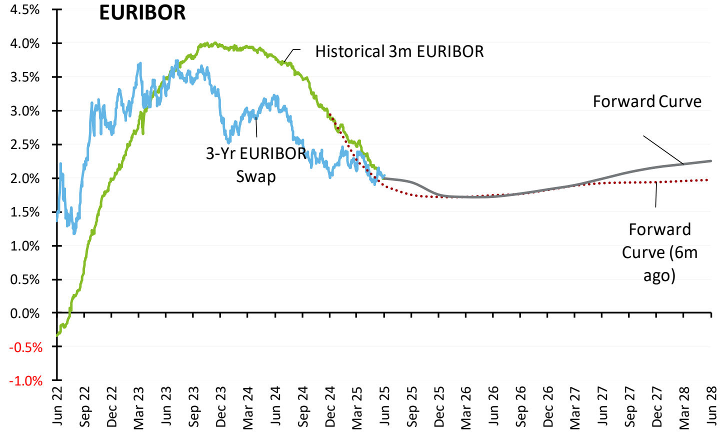
*£100m hedge notional



- SOFR is inside the Fed Funds current target rate range of 4.25%-4.50%, at 4.33%, following a decision to hold rates on 7th May.
- Market expectations are for further hold at the Fed's upcoming 18th June meeting (a 96% probability).
- The 3-year SOFR Swap rate is now 3.56% vs. 3.82% 6 months ago, but up 10bps MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.65%	3.56%	3.59%
Cap @ 4.25% (premium)*	$0.58m	$1.08m	$2.52m
Cap @ 4.50% (premium)*	$0.38m	$0.81m	$2.10m
Cap @ 4.75% (premium)*	$0.25m	$0.62m	$1.77m

*$100m hedge notional



- 3-month EURIBOR is 2.00%.
- The ECB cut interest rates by 25 bps at its April 17th meeting to 2.25%.
- Market sentiment points towards another ECB rate cut at its upcoming June 5th meeting. Current pricing suggests an 95% probability of a 25bps reduction.
- The 3-year EURIBOR Swap rate is currently 1.92%, vs. 1.91% 6 months ago, and flat MoM.

	2-year	3-year	5-year
Swap rate (mid level)	1.83%	1.92%	2.11%
Cap @ 2.25% (premium)*	€0.23m	€0.76m	€2.34m
Cap @ 2.50% (premium)*	€0.15m	€0.59m	€1.94m
Cap @ 2.75% (premium)*	€0.10m	€0.46m	€1.61m

*€100m hedge notional

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 2nd June 2025

What can be done in the current Interest Rate markets?

Borrowers can still fix rates below the current floating rate:

The current shape of the forward curve still allows borrowers to fix rates at levels below the current floating rate, though the market expectations for material further cuts to bank rates are diminishing:

- SONIA 3m is 4.18% and a vanilla 3y Swap is 3.79%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by GBP 390k.
- SOFR 3m at 4.31% and a vanilla 3y Swap is 3.56%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by USD 750k.
- EURIBOR 3m at 2.00% and a vanilla 3y Swap is 1.92%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by EUR 80k.

Hedges tenors do not materially impact the hedged rate:

While the forward curves still reflect a degree of rate cutting, most pertinently in the US, over the coming 6-12 months, there has been a reduction in this sentiment in recent weeks leading to a bottoming out in forward rate projections ahead of anticipated rate rises thereafter. This continues to translate into relatively flat swap rates across the short-to-medium term:

- GBP swap: 2-year: 3.82%, 3-year: 3.79%, 5-year: 3.85%
- USD swap: 2-year: 3.65%, 3-year: 3.56%, 5-year: 3.59%
- EUR swap: 2-year: 1.83%, 3-year: 1.92%, 5-year: 2.11%

Pre-hedging:

Due to the relatively stable medium- to long-term rate environment, pre-hedging future debt (assumed closing is in 6 months) allows for locking in swap rates in advance at similar levels to spot-starting trades:

- GBP 5-year Swap starting in 6 months: 3.84%
- USD 5-year Swap starting in 6 months: 3.59%
- EUR 5-year Swap starting in 6 months: 2.17%

Funding of Hedging costs can be done at favourable rates

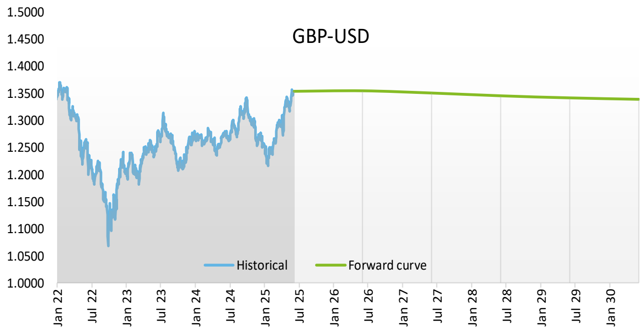
Interest rate volatility rose during early May, but has calmed in recent weeks, such that hedging costs for Option products (such as Caps) have seen a slight reduction in premia vis-à-vis 1 month ago. We continue to see many clients buy Caps in conjunction with a Swap based hedging solution to allow for a deferral of the option premium within the Swap trade itself. This cost deferral can often be done via the derivative desks at favourable rates (at SONIA, SOFR or EURIBOR, without application of the similar financing margins); further, debt covenants are not so impacted from this cost deferral.

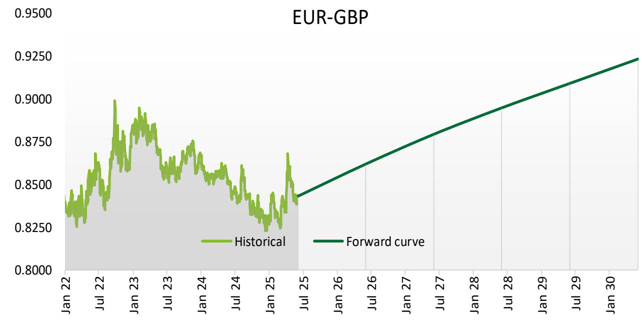
Structured Hedging solutions

Over the past few months many clients are incorporating two, or more, trades into their hedge solution; most commonly a combination of Swap and Cap trades, or trades with variable strike rates over time. The rationales for structuring more bespoke solutions differ, and we encourage discussion to understand and validate any structuring of hedge products to ensure alignment with any varied requirements and priorities of a specific transaction.

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 2nd June 2025

Currency Markets





- The ‘Cable’ exchange rate strengthened by 2.0% over the course of May, peaking at GBP-USD 1.36, its highest value in three years. This was mainly driven by US dollar weakness amid renewed US-China trade tensions, along with the UK's proactive economic and trade strategies.
- Option premia decreased by up to 22.4% MoM, depending on the protection levels sought.
- Meanwhile FX Forward rates remain flat out through 5 years, with limited deviation between interest rate environments across both countries over the medium term.

- The EUR-GBP exchange rate appreciated slightly again this month, likely due to stronger UK economic data and improved economic prospects stemming from the UK's new trade deals with both the US and India.
- Option premia decreased by up to 22.2% MoM, depending on the protection levels sought.
- The widening interest rate differential between the EUR and GBP is pushing forward exchange rates far beyond historical spot levels seen over the past 10 years. This presents a compelling opportunity for EUR sellers and GBP buyers, who may benefit from locking in such EUR strength, rather than remaining unhedged.

GBP-USD Spot Rate: 1.354	6mo	12mo	18mo
Forward rate	1.355	1.355	1.352
GBP Put Option* (ATMS**)	$2.99m	$4.27m	$5.37m
GBP Put Option* (5% OTMS***)	$0.83m	$1.87m	$2.83m
* GBP 100m Put option premium			
** At-the-money Spot rate:	1.354		
*** 5% Out-of-the-money vs Spot rate:	1.286		

EUR-GBP Spot Rate: 0.843	6mo	12mo	18mo
Forward rate	0.852	0.862	0.871
GBP Put Option* (ATMS**)	€ 2.56m	€ 4.09m	€ 5.42m
GBP Put Option* (5% OTMS***)	€ 0.56m	€ 1.47m	€ 2.46m
* GBP 100m Put option premium			
** At-the-money Spot rate:	0.843		
*** 5% Out-of-the-money vs Spot rate:	0.885		

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 2nd June 2025

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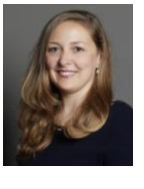

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