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IR and FX Newsletter

2 July 2026

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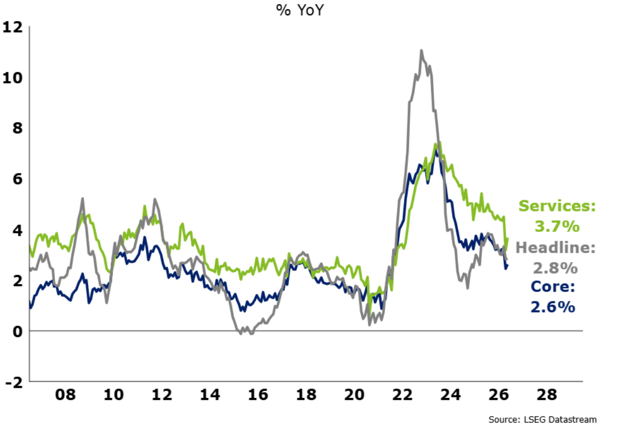
A Macro View: UK activity softens in the second quarter

Despite resilient UK economic growth in the first three months of 2026, more recent UK Purchasing Managers' Indices (PMI) report a decline in corporate activity in May and June, reflecting rising input costs and softer order books in light of the conflict in the Middle East. Geopolitical uncertainty continues to weigh on business confidence and coupled with a softening UK labour market; this means forecasters expect a slower pace of UK growth in the coming quarters.

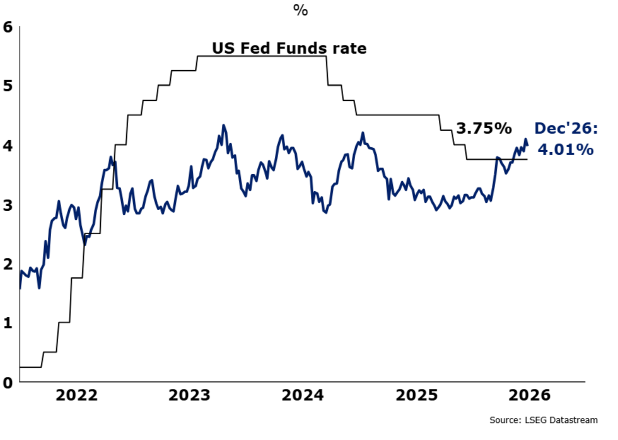
UK headline inflation remained steady at 2.8% in the year to May, supported by a cut in the government's cap on energy bills announced just before the conflict in the Middle East. The price of motor fuels continues to increase, however, and inflation is expected to rise over the second half of this year as the spike in oil and gas prices will increase the energy price cap for the quarter ahead. Rising input costs and fertiliser shortages are also expected to cause higher food price inflation. The Bank of England held interest rates in June while it assesses the longer-term inflationary impacts from the conflict against weaker business activity and a continued softening of the labour market.

UK: Headline & alternative measures of inflation



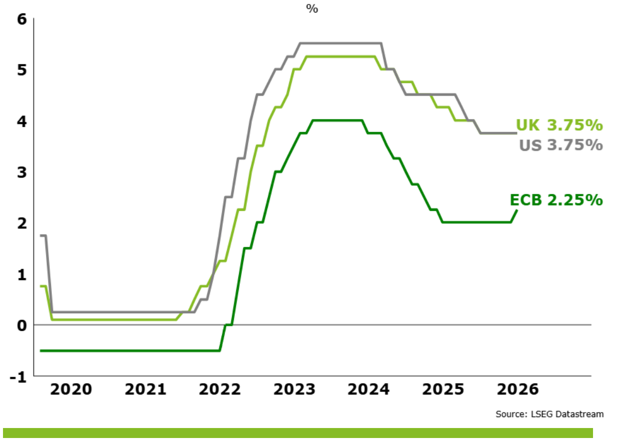
The latest US PMI data for May indicated continued growth in business activity, albeit at a slower pace than before the conflict. Ongoing shipping disruption in the Strait of Hormuz has raised input prices, however inventory building across the manufacturing sector has helped offset some of the impact to activity. Consumer confidence remains subdued, with inflation accelerating to 4.2% in May due to higher energy costs. US Markets now expect the Fed to raise interest rates in light of rising inflation (see adjoining chart). More data relating to interest rate projections are reflected overleaf.

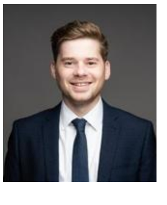
Evolution of US interest rate expectations



Euro area PMI data indicated a third consecutive month of contraction in activity in June, reflecting ongoing disruption to global energy production. Both input and output costs continue to rise, while business confidence remains weak. Forecasters expect subdued economic growth in Germany this year, delaying the recovery of the EU's largest economy despite plans for increased public spending on defence and infrastructure. Euro area inflation softened to 2.8% in June, down from 3.2% in May on softer energy price rises. Inflation is expected to remain above the 2% target level throughout the rest of 2026. The European Central Bank raised interest rates at its latest meeting, to 2.25% (adjoining chart), with markets expecting further rate rises by the end of the year.

US, UK and Euro area interest rates





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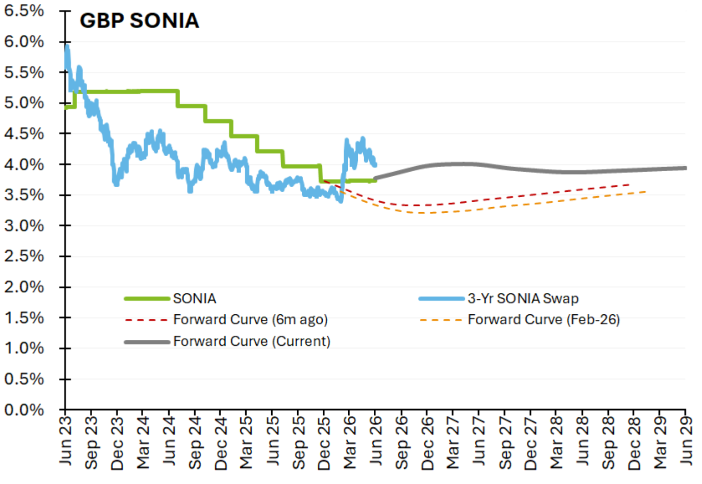
Interest Rate Markets

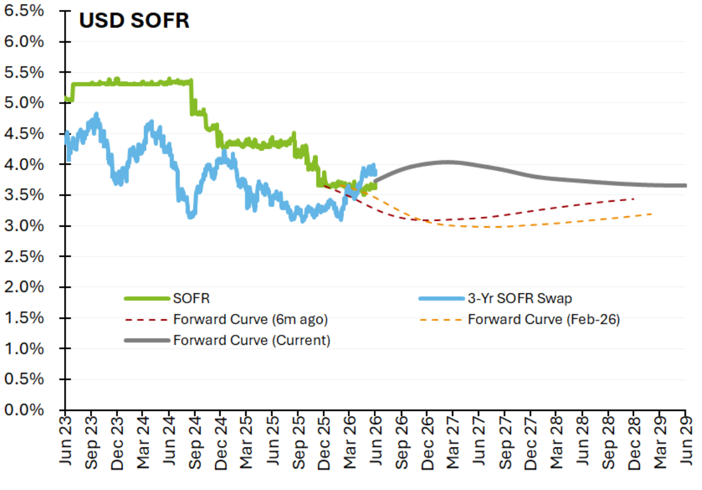
June kicked off with the ECB raising interest rates by 25bps while the BoE and Fed held rates. In the US, the narrative has shifted more hawkish as higher inflation (4.2% in May) and Fed communication have moved markets from expecting cuts toward pricing a greater risk of rate hikes. This hawkish outlook was, however, somewhat tempered by the US Supreme Court's recent decision to uphold the Federal Reserve's independence in a case involving Governor Lisa Cook. Had the Court ruled differently, undermining the Fed's autonomy, it would likely have been inflationary due to increased political influence from the US administration. Rate-hike expectations have eased in the UK and Eurozone, which are largely insulated from US political dynamics. While markets remain focused on persistent inflation, they are now pricing in only one additional rate hike for each region. Notably, financial market volatility has decreased from the heightened levels seen over recent months; however, relatively flat forward curves still indicate significant indecision regarding the future rate outlook.



- SONIA continues unchanged this year at 3.73%. After a decision to hold rates at current levels on 18 June (7-2 vote), markets are pricing an 86% chance of another hold in rates at the upcoming BofE MPC meeting on 30 July.
- The rise in the front end of the forward curve has softened from the heightened volatility seen in early March, though a single rate hike is still expected later this year.
- The 3-year SONIA Swap rate is 3.91%, vs. 3.51% 6 months ago, but down 11bps month-on-month.

	2-year	3-year	5-year
Swap rate (mid level)	3.92%	3.91%	3.96%
Cap @ 4.25% (premium)*	£0.44m	£0.93m	£2.29m
Cap @ 4.50% (premium)*	£0.34m	£0.76m	£1.97m
Cap @ 4.75% (premium)*	£0.27m	£0.63m	£1.71m

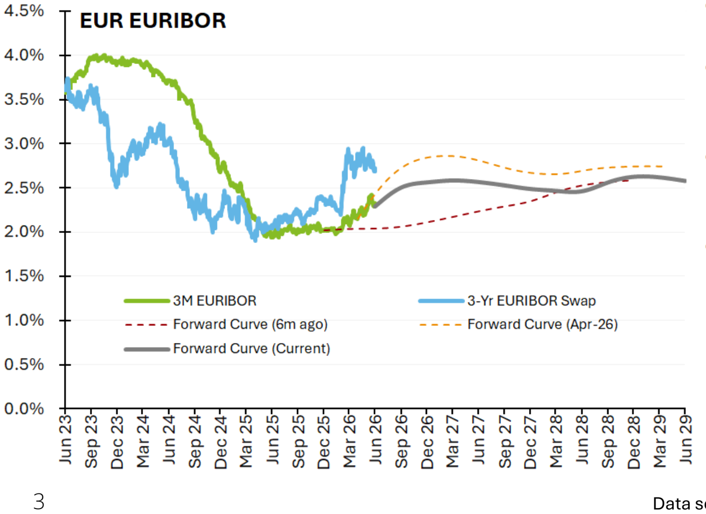
*£100m hedge notional



- The Federal Reserve's Federal Open Market Committee (FOMC) held the federal funds target range at 3.50% – 3.75% at its June 17 meeting but adopted a significantly more hawkish policy stance by removing language that had signalled potential easing.
- Markets currently price a 82% probability that rates remain unchanged at the July 29 meeting, following a low non-farm payroll print, adding just 57,000 jobs in June.
- The 3-year SOFR Swap rate is currently 3.83% vs. 3.27% 6 months ago; and similar to last month.

	2-year	3-year	5-year
Swap rate (mid level)	3.89%	3.83%	3.78%
Cap @ 4.00% (premium)*	$0.66m	$1.16m	$2.39m
Cap @ 4.25% (premium)*	$0.48m	$0.91m	$1.97m
Cap @ 4.50% (premium)*	$0.36m	$0.71m	$1.64m

*$100m hedge notional



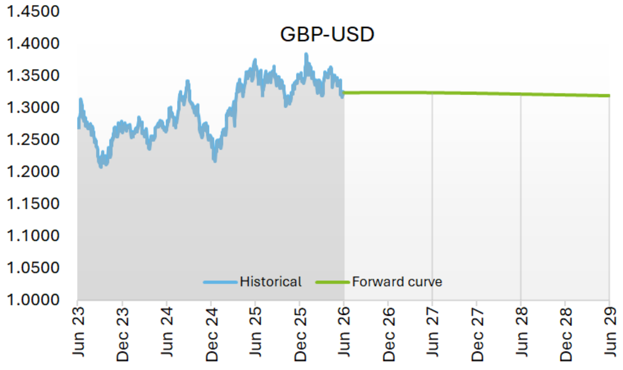
- 3-month EURIBOR has elevated to 2.29% after the ECB raised interest rates by 25bps at its meeting on 11 June.
- Following the current ceasefire in the Middle East, market expectations for further rate hikes have scaled back, with only one additional hike now anticipated by H1 2027.
- Medium to longer-term swap rates remain relatively flat, allowing investors to hedge longer-term exposures at similar rates.
- The 3-year EURIBOR Swap rate is currently 2.52% vs. 2.24% 6 months ago, but similar to last month.

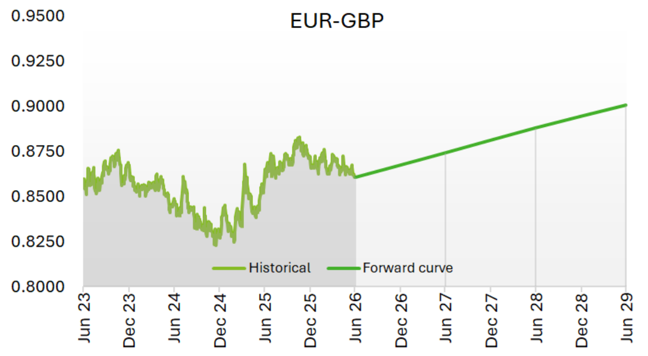
	2-year	3-year	5-year
Swap rate (mid level)	2.50%	2.52%	2.56%
Cap @ 2.75% (premium)*	€0.27m	€0.65m	€1.62m
Cap @ 3.00% (premium)*	€0.19m	€0.50m	€1.32m
Cap @ 3.25% (premium)*	€0.11m	€0.33m	€0.95m

*€100m hedge notional

Data source: Refinitiv, ICE Data Derivatives and Deloitte Analysis, as of 30 June 2026

Currency Markets





- In June, Sterling weakened by 1.1% against the US dollar, reaching 1.332 by 2 July, and has fallen 3.0% over the past year. GBP/USD saw a 2.2% intra-month swing (3 cents) during the month, which was slightly less volatile than May and not particularly high considering the current global landscape
- This weakness is attributed to several factors, including the easing of interest rate hike expectations in the UK, contrasting with the hawkish stance of the US Federal Reserve which, despite holding rates, signalled a greater risk of future rate hikes.
- Despite global events over the past month, implied market volatility has not changed significantly, keeping option pricing very similar to last month.

- Over the last month, EUR has weakened by 0.8%, with Sterling rising to its strongest level in a year at 0.856, breaking a key resistance band on 1 July 2026.
- This recent movement is primarily driven by softer Eurozone inflation figures (2.8% in June 2026, lower than market expectations), which have tempered expectations for further ECB interest rate hikes, while the BoE maintains a more stable policy, thereby preserving Sterling's yield advantage.
- 1-year forward rate is currently 0.869 compared to the current spot rate of 0.856, reflecting a forward premium for EUR/GBP of approximately 1.5% (compared to 1.9% last year).

GBP-USD Spot Rate: 1.332	6mo	12mo	18mo
Forward rate	1.333	1.334	1.333
GBP Put Option* (ATMS**)	$2.56m	$3.75m	$4.69m
GBP Put Option* (5% OTMS***)	$0.74m	$1.68m	$2.51m
* GBP 100m Put option premium			
** At-the-money Spot rate:		1.332	
*** 5% Out-of-the-money vs Spot rate:		1.265	

EUR-GBP Spot Rate: 0.856	6mo	12mo	18mo
Forward rate	0.862	0.869	0.876
GBP Put Option* (ATMS**)	€ 1.89m	€ 3.21m	€ 4.30m
GBP Put Option* (5% OTMS***)	€ 0.36m	€ 1.12m	€ 1.89m
* GBP 100m Put option premium			
** At-the-money Spot rate:		0.856	
*** 5% Out-of-the-money vs Spot rate:		0.899	

Data source: Refinitiv, ICE Data Derivatives and Deloitte Analysis, as of 2 July 2026

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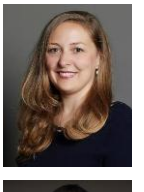

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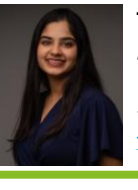

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