

Deloitte.

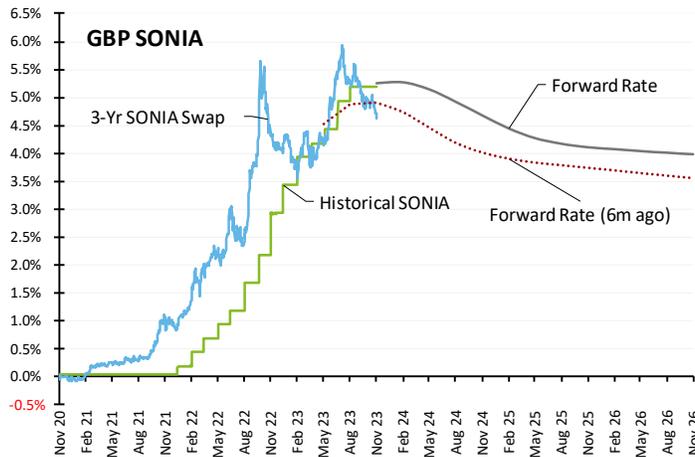


IR and FX Newsletter
November 2023



Interest Rate Markets

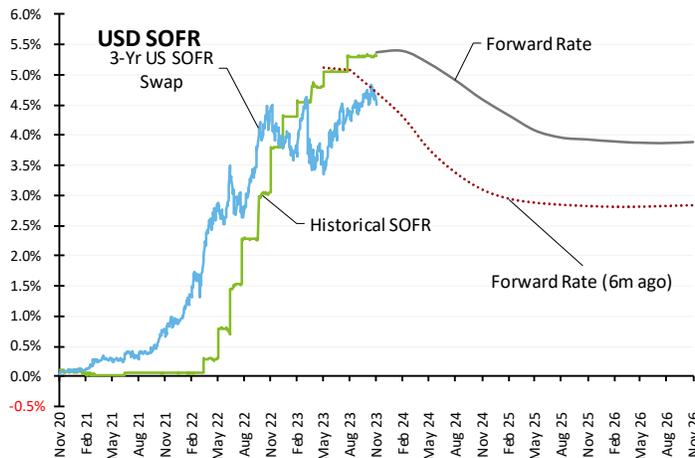
Despite the backdrop of above-target inflation in each jurisdiction, the central banks of Europe, the UK and the US all elected to hold policy rates at their respective monetary policy meetings between 26th October and 2nd November. The decision by each central bank marks the first time all three policy rates have been held since Q4 2021; an indication that this monetary tightening cycle might be nearing its end. However, inflation remains a pivotal talking point. Headline CPI data in the UK is still far higher than the Bank of England's 2% target, coming in at 6.7% year-on-year for September (versus a forecasted 6.6%). Consequently, hedging SONIA-linked debt is slightly costlier than USD and EUR-linked debt.



- The underlying SONIA rate is currently at 5.19%
- BOE base rate is at 5.25% following a pause at the BOE's meeting on 2nd November. Markets now lean towards no further hikes from the central bank during this monetary cycle.
- The 3-year SONIA Swap rate is 4.62%, vs. 4.26% 6 months ago, and down 37bps month-on-month ("MoM").
- The forward curve remains downward sloping from Q2 2024.

	2-year	3-year	5-year
Swap rate (mid level)	4.87%	4.62%	4.33%
Cap @ 5.50% (premium)*	£0.49m	£0.98m	£2.11m
Cap @ 6.00% (premium)*	£0.32m	£0.72m	£1.67m

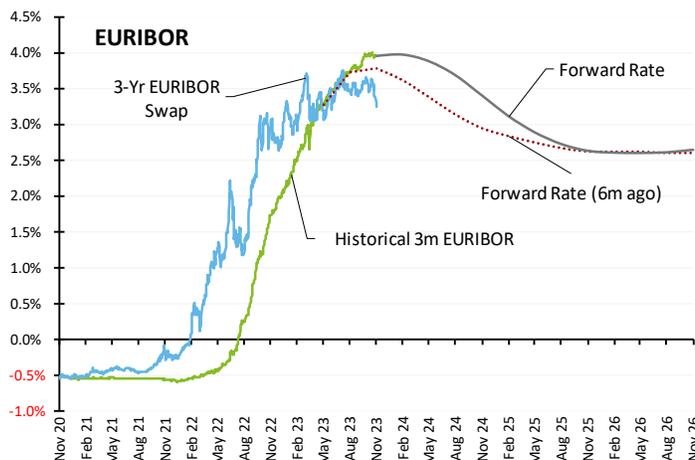
*£100m hedge notional



- SOFR is currently 5.38%, inside the Fed Funds target rate range of 5.25%-5.50%.
- The Federal Reserve held rates at their meeting on 1st November, whilst markets only assign a c. 25% probability of a further +25bps hike this cycle.
- The 3-year SOFR Swap rate is 4.50%, vs. 3.47% 6m ago, and down 16bps MoM.
- The forward curve is steeply inverted from Q2 2024.

	2-year	3-year	5-year
Swap rate (mid level)	4.80%	4.50%	4.29%
Cap @ 5.50% (premium)*	\$0.40m	\$0.69m	\$1.59m
Cap @ 6.00% (premium)*	\$0.21m	\$0.43m	\$1.17m

*\$100m hedge notional



- 3-month EURIBOR is 3.95%.
- The ECB held rates at 4.00% at their meeting on 26th October. Markets have now almost entirely priced out any further rate hikes from the ECB, with rate cuts anticipated to begin in April 2024.
- The 3-year EURIBOR Swap rate is currently 3.25%, vs. 3.13% 6 months ago.
- The forward curve is inverted from Q1 2024.

	2-year	3-year	5-year
Swap rate (mid level)	3.50%	3.25%	3.14%
Cap @ 4.00% (premium)*	€0.19m	€0.45m	€1.31m
Cap @ 4.50% (premium)*	€0.09m	€0.28m	€0.97m

*€100m hedge notional

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 5.24% and a vanilla 5y Swap is 4.33%. On a GBP 500m financing, swapping to fix reduces interest costs in year 1 by **GBP 4.55m**.
- EURIBOR 3m at 3.95% and a vanilla 5y Swap is 3.14%. On a EUR 500m financing, swapping to fix reduces interest costs in year 1 by **EUR 4.05m**.
- SOFR 3m at 5.38% and a vanilla 5y Swap is 4.29%. On a USD 500m financing, swapping to fix reduces interest costs in year 1 by **USD 5.45m**.



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: 5.25%, 3-year: 4.62%, 5-year: 4.33%
- EUR swap: 1-year: 3.96%, 3-year: 3.25%, 5-year: 3.14%
- USD swap: 1-year: 5.29%, 3-year: 4.50%, 5-year: 4.29%



Pre-hedging achieves even lower rates:

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

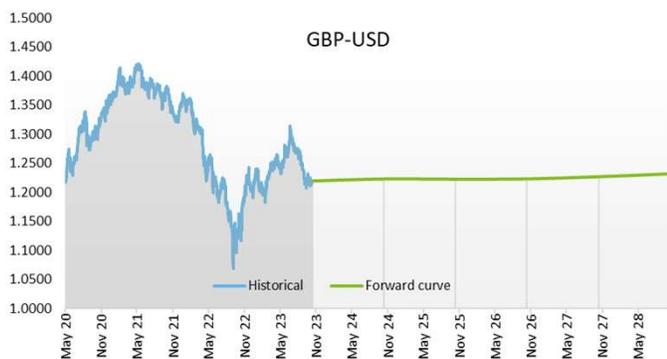
- GBP 5-year Swap starting in 6 months: 4.18%
- EUR 5-year Swap starting in 6 months: 2.91%
- USD 5-year Swap starting in 6 months: 4.16%



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, EURIBOR or SOFR, without additional margin), rather than via additional borrowing under the facility agreements (at SONIA, EURIBOR or SOFR plus margin).

Currency Markets



- GBP-USD gained 0.5% MoM as surprising UK inflation data reinforced the prospect of 'higher for longer' rates from the Bank of England. However, amid broader risk-off sentiment, the dollar remains well supported.
- Option premia fell between 3-8% depending on the level of protection, as continued falling rate expectations were reflected in a drop in volatility levels.
- Forward FX rates are now higher out through 5 years for GBP sellers, suggesting a higher-for-longer rate environment in the US.

- EUR-GBP increased by close to 1% MoM as markets took stock of a pause in interest rates by both central banks. Furthermore, falling inflation data across the continent suggests an end to the ECB's monetary tightening is near.
- The cost of hedging via options for EUR-GBP has fallen significantly, between 14-22%, depending on the level of protection sought – see grid below.
- FX forward rates are still higher for EUR sellers out through 5 years, as markets registered the upside surprise to UK inflation data for September.

GBP-USD Spot Rate: 1.219	6mo	12mo	18mo
Forward rate	1.222	1.223	1.223
GBP Put Option* (ATMS**)	\$2.65m	\$3.88m	\$4.79m
GBP Put Option* (5% OTMS***)	\$0.90m	\$1.97m	\$2.80m
* GBP 100m Put option premium			
** At-the-money Spot rate:	1.219		
*** 5% Out-of-the-money vs Spot rate:	1.158		

EUR-GBP Spot Rate: 0.873	6mo	12mo	18mo
Forward rate	0.879	0.886	0.894
GBP Put Option* (ATMS**)	€1.87m	€3.12m	€4.15m
GBP Put Option* (5% OTMS***)	€0.39m	€1.17m	€1.95m
* GBP 100m Put option premium			
** At-the-money Spot rate:	0.873		
*** 5% Out-of-the-money vs Spot rate:	0.916		

Data source: Refinitiv and ICE Data Services, as of 2nd November 2023

Hedging Advisory and Derivatives Execution team



Hedging Strategy Advice



Outsourced Derivative Execution



Financial Market Knowledge



Derivative Pricing Expertise



Paolo Esposito
Lead Director

+44 20 7007 8964
pesposito@deloitte.co.uk



Mark Beckett
Director

+44 20 7303 7849
mbeckett@deloitte.co.uk



Svenja Schumacher
Director

+44 20 7007 9363
scschumacher@deloitte.co.uk

Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please [click here](#) to learn more about our global network of member firms.

© 2023 Deloitte LLP. All rights reserved.
Designed by CoRe Creative Services. RITM1299442