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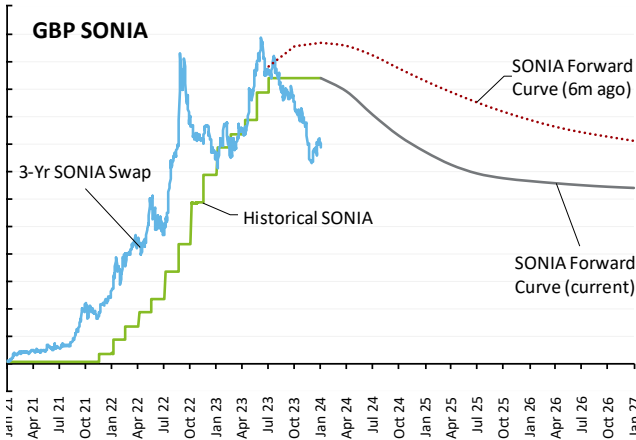
IR and FX Newsletter
February 2024



Interest Rate Markets

The first central bank meetings of 2024 – from the European Central Bank (“ECB”) and Federal Reserve (“Fed”) – yielded few surprises, with both monetary authorities holding their corresponding policy rates. Markets signal 140bps and 145bps of cuts for EURIBOR and SOFR during 2024, further presenting tactical opportunities for borrowers to lower the cost of funding, thanks to downward sloping curves.

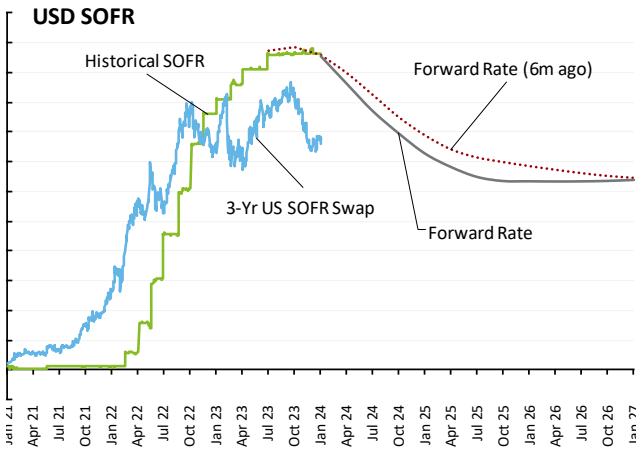
The Bank of England (“BoE”) met on 1st February, holding rates at their current level of 5.25%. Interestingly, 2 of the 9 members of the BoE’s monetary policy committee voted to hike by 25bps, whilst another voted to cut by 25bps, suggesting all options remain on the table for UK policymakers. Markets currently forecast c. 110bps of cuts by year-end.



- The underlying SONIA rate is currently at 5.19%
- BoE policymakers held rates, as anticipated, at their 1st February 2024 meeting, with the first 25bps cut priced in for June 2024.
- The 3-year SONIA Swap rate is 3.94%, vs. 5.28% 6 months ago, and up 22bps month-on-month (“MoM”).
- The forward curve remains downward sloping from Q2 2024.

	2-year	3-year	5-year
Swap rate (mid level)	4.23%	3.94%	3.62%
Cap @ 4.50% (premium)*	£0.84m	£1.30m	£2.42m
Cap @ 5.00% (premium)*	£0.47m	£0.84m	£1.78m

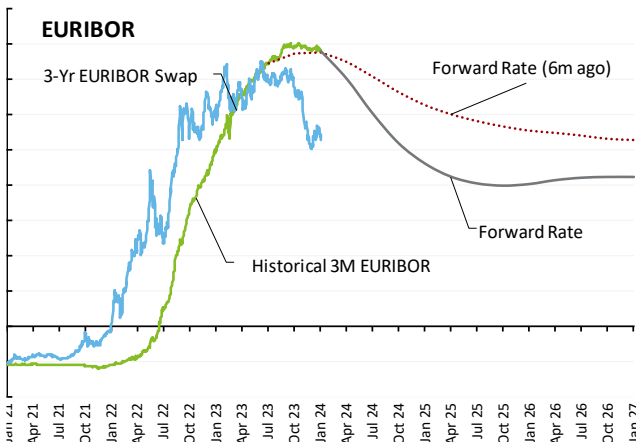
*£100m hedge notional



- SOFR is currently 5.31%, inside the Fed Funds target rate range of 5.25%-5.50%.
- The Federal Reserve held rates at their meeting on 31st January, with markets now forecasting the first 25bps rate cut in May 2024.
- The 3-year SOFR Swap rate is 3.80%, vs. 4.39% 6m ago, and up 2bps MoM.
- The forward curve is steeply inverted from Q2 2024.

	2-year	3-year	5-year
Swap rate (mid level)	4.07%	3.80%	3.60%
Cap @ 4.50% (premium)*	\$0.61m	\$0.95m	\$1.85m
Cap @ 5.00% (premium)*	\$0.27m	\$0.53m	\$1.25m

*\$100m hedge notional



- 3-month EURIBOR is 3.90%.
- The ECB held rates at 4.00% at their meeting on 25th January. Markets now look towards the ECB’s first 25bps rate in either April or June this year.
- The 3-year EURIBOR Swap rate is currently 2.64%, vs. 3.48% 6 months ago.
- The forward curve is inverted from Q2 2024.

	2-year	3-year	5-year
Swap rate (mid level)	2.86%	2.64%	2.51%
Cap @ 3.00% (premium)*	€0.66m	€1.0m	€1.95m
Cap @ 3.50% (premium)*	€0.30m	€0.54m	€1.25m

*€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 5.19% and a vanilla 5y Swap is 3.62%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by **GBP 1.57m**.
- SOFR 3m at 5.27% and a vanilla 5y Swap is 3.60%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by **USD 1.67m**.
- EURIBOR 3m at 3.91% and a vanilla 5y Swap is 2.51%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by **EUR 1.40m**.



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: 4.81%, 3-year: 3.94%, 5-year: 3.62%
- USD swap: 1-year: 4.71%, 3-year: 3.80%, 5-year: 3.60%
- EUR swap: 1-year: 3.45%, 3-year: 2.64%, 5-year: 2.51%



Pre-hedging achieves even lower rates:

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

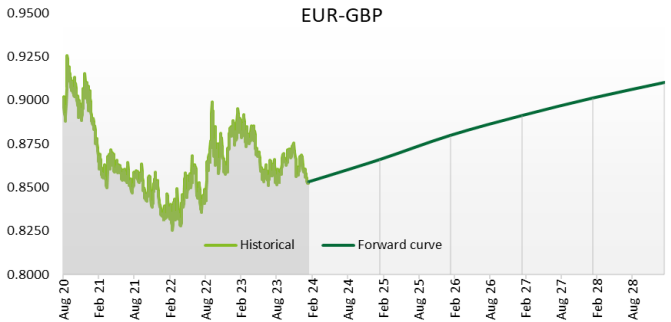
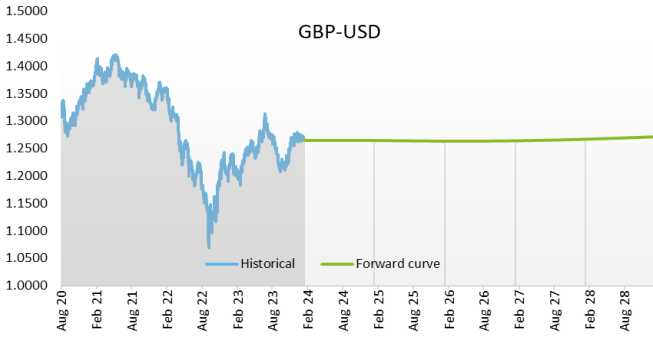
- GBP 5-year Swap starting in 6 months: 3.41%
- USD 5-year Swap starting in 6 months: 3.37%
- EUR 5-year Swap starting in 6 months: 2.26%



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 is flat month-on-month, with markets torn between the who will be the first to begin monetary easing; the Federal Reserve or Bank of England.
- Option premia steadied month-on-month, with prices largely flat versus December.
- Forward FX rates remain flat out through 5 years for GBP sellers, suggesting no deviation between interest rate environments across both countries.

- EUR-GBP depreciated marginally MoM as markets continued to predict when the ECB and BOE will begin lowering their respective rates.
- The cost of hedging via options for EUR-GBP fell by up to 13.50%, depending on the level of protection sought – see grid below.
- FX forward rates have steepened for EUR sellers out through 5 years, as markets price in the first rate cut from the ECB for April, and c. 140bps in total by the end of 2024.

GBP-USD Spot Rate: 1.269	<u>6mo</u>	<u>12mo</u>	<u>18mo</u>
Forward rate	1.268	1.268	1.266
GBP Put Option* (ATMS**)	\$2.62m	\$4.00m	\$4.85m
GBP Put Option* (5% OTMS***)	\$0.77m	\$1.92m	\$2.67m
* GBP 100m Put option premium			
** At-the-money Spot rate:	1.269		
*** 5% Out-of-the-money vs Spot rate:	1.205		

EUR-GBP Spot Rate: 0.852	<u>6mo</u>	<u>12mo</u>	<u>18mo</u>	<u>24mo</u>
Forward rate	0.858	0.865	0.872	0.879
GBP Put Option* (ATMS**)	€2.13m	€3.56m	€4.65m	
GBP Put Option* (5% OTMS***)	€0.38m	€1.23m	€2.02m	
* GBP 100m Put option premium				
** At-the-money Spot rate:	0.852			
*** 5% Out-of-the-money vs Spot rate:	0.895			

Data source: Refinitiv, ICE Data Services and Deloitte Analysis, as of 2nd February 2024

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