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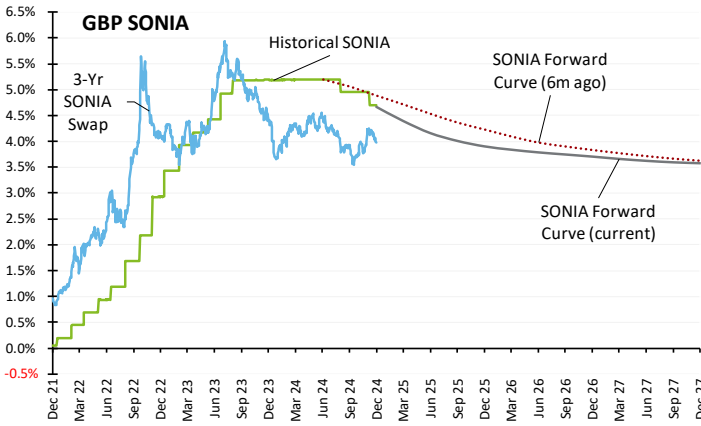
IR and FX Newsletter
December 2024



Interest Rate Markets

November saw both the Bank of England (BOE) and The US Federal Reserve (Fed) cut interest rates by 25bps, meeting market expectations, however, this recent synchronicity in monetary policy may not last. Market outlooks for future rate cuts are diverging: a December rate cut by the Fed is widely expected, but the probability of a similar move by the BOE has fallen to just 13%. Despite timing differences to future rate cuts, the current projected 'terminal' rate is c. 3.5% in both jurisdictions.

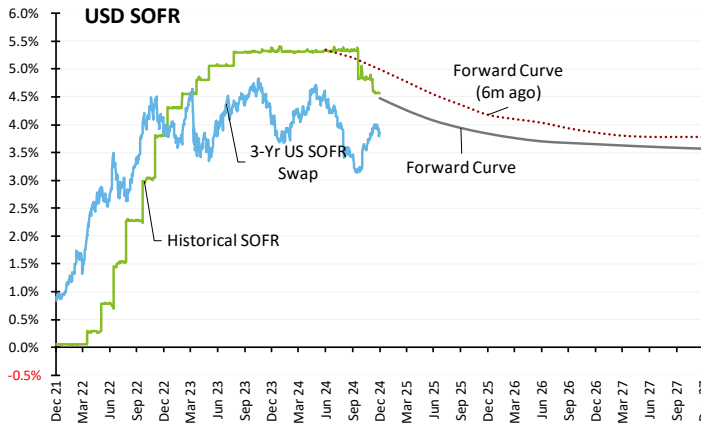
Meanwhile, markets anticipate continued rate cuts from the European Central Bank (ECB), pricing in a strong likelihood of a fourth drop of 25bps this year.



- The underlying SONIA is 4.70%.
- The BOE cut rates at their policy meeting by 25bps on 7 November to 4.75%. Markets are pricing in an 87% chance of the BOE holding rates on 19 December, with a 13% probability of a 25bps cut.
- The 3-year SONIA Swap rate is 3.93% vs. 4.41%, 6 months ago, and 25bps lower MoM.
- The forward curve remains inverted through summer 2025.

	2-year	3-year	5-year
Swap rate (mid level)	4.07%	3.93%	3.79%
Cap @ 4.50% (premium)*	£0.49m	£0.96m	£2.14m
Cap @ 5.00% (premium)*	£0.25m	£0.61m	£1.57m
Cap @ 5.50% (premium)*	£0.16m	£0.43m	£1.22m

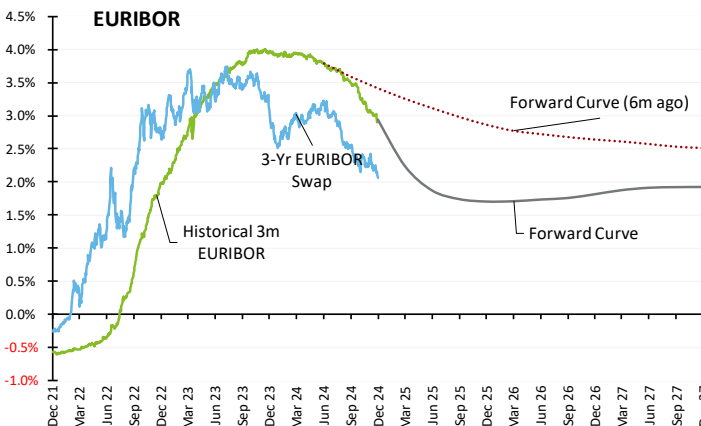
*£100m hedge notional



- SOFR is inside the Fed Funds current target rate range of 4.50%-4.75%, at 4.57% following a 25bps rate cut on 7 November.
- Market expectations are leaning towards another rate cut at its upcoming December 18th meeting. Current pricing suggests a 61% probability of a 25bps reduction.
- The 3-year SOFR Swap rate is 3.85% vs. 4.42% 6m ago, though static MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.97%	3.85%	3.73%
Cap @ 5.00% (premium)*	\$0.27m	\$0.59m	\$1.48m
Cap @ 5.50% (premium)*	\$0.17m	\$0.42m	\$1.13m
Cap @ 6.00% (premium)*	\$0.11m	\$0.30m	\$0.89m

*\$100m hedge notional



- 3-month EURIBOR is 2.93%.
- The ECB cut rates at their policy meeting by 25bps on 17th October to 3.25%. Market consensus indicates an 85% probability of a 25bps interest rate cut at the next meeting on 12th December.
- The 3-year EURIBOR Swap rate is currently 1.94%, vs. 3.22% 6 months ago, and 42bps lower MoM.
- The forward curve is steeply inverted through summer 2025, though upward sloping thereafter. Swaps of varying tenors are tradable at around 2%

	2-year	3-year	5-year
Swap rate (mid level)	1.96%	1.94%	1.95%
Cap @ 3.25% (premium)*	€0.09m	€0.31m	€1.01m
Cap @ 3.75% (premium)*	€0.05m	€0.20m	€0.73m
Cap @ 4.25% (premium)*	€0.03m	€0.14m	€0.53m

*€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 well below the current floating rate:

- SONIA 3m is 4.63% and a vanilla 5y Swap is 3.79%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by **GBP 0.84m**.
- SOFR 3m at 4.43% and a vanilla 5y Swap is 3.73%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by **USD 0.70m**.
- EURIBOR 3m at 2.93% and a vanilla 5y Swap is 1.95%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by **EUR 0.98m**.



Longer- term hedges are cheaper than shorter-term hedges:

Because of the downward forward curve, long term hedges remain cheaper than short term hedges in the UK and US, while the Eurozone drops rates sharply over the next 12 months they then flatten thereafter.

- | | | | |
|-------------|----------------|----------------|---------------|
| • GBP swap: | 2-year: 4.07%, | 3-year: 3.93%, | 5-year: 3.79% |
| • USD swap: | 2-year: 3.97%, | 3-year: 3.85%, | 5-year: 3.73% |
| • EUR swap: | 2-year: 1.96%, | 3-year: 1.94%, | 5-year: 1.95% |



Pre-hedging achieves even lower rates:

Pre-hedging future debt (assumed closing is in 6 months) is cheaper than at current hedge levels; most significantly in the UK and the US:

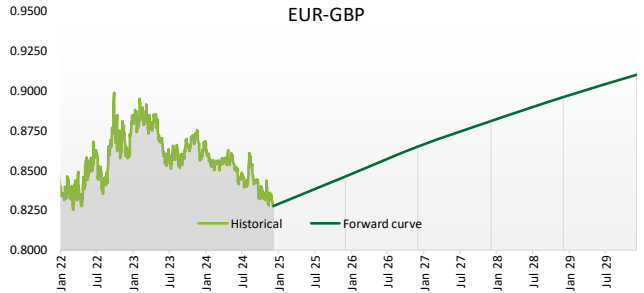
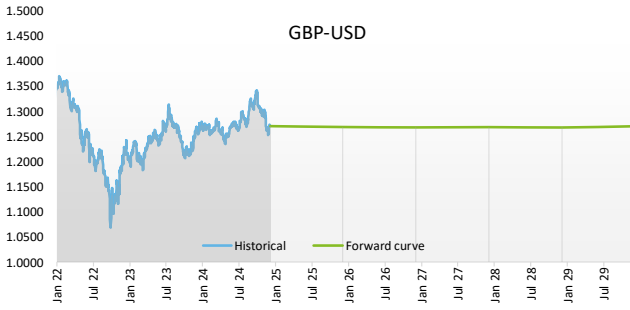
- GBP 5-year Swap starting in 6 months: 3.69%
- USD 5-year Swap starting in 6 months: 3.65%
- EUR 5-year Swap starting in 6 months: 1.90%



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 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.

Currency Markets



- The GBP-USD spot rate has remained relatively flat MoM as markets weigh the Fed's expected rate cuts against the BOE's more cautious stance, against the backdrop of the Trump election win that drove USD strength in early November.
- The decreased volatility in GBP-USD seen in recent days has reduced the cost of hedging via options by up to 5% from a month ago, though still higher than the months prior.
- Forward FX rates remain flat out through 5 years for GBP sellers, suggesting little deviation between interest rate environments across both countries over the medium term.

- The EUR-GBP Spot rate has remained flat MoM as markets digest ongoing rate cuts by both the ECB and BOE.
- Option premia decreased by up to 28% MoM, depending on the protection levels sought.
- Favourable forward exchange rates for EUR sellers persist over the 5-year horizon, driven by expectations of a sustained interest rate differential, with the BOE maintaining relatively higher rates compared to the ECB, which is expected to set rates below those in the UK.

GBP-USD Spot Rate: 1.271	6mo	12mo	18mo
Forward rate	1.270	1.270	1.269
GBP Put Option* (ATMS**)	\$2.86m	\$4.09m	\$4.94m
GBP Put Option* (5% OTMS***)	\$0.97m	\$2.00m	\$2.78m

* GBP 100m Put option premium
 ** At-the-money Spot rate: 1.271
 *** 5% Out-of-the-money vs Spot rate: 1.208

EUR-GBP Spot Rate: 0.828	6mo	12mo	18mo
Forward rate	0.836	0.846	0.856
GBP Put Option* (ATMS**)	€ 2.01	€ 3.39	€ 4.57
GBP Put Option* (5% OTMS***)	€ 0.36	€ 1.13	€ 1.95

* GBP 100m Put option premium
 ** At-the-money Spot rate: 0.828
 *** 5% Out-of-the-money vs Spot rate: 0.869

Data source: Refinitiv and ICE Data Services, as of 2nd December 2024

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