Deloitte.

IR and FX Newsletter
March 2025

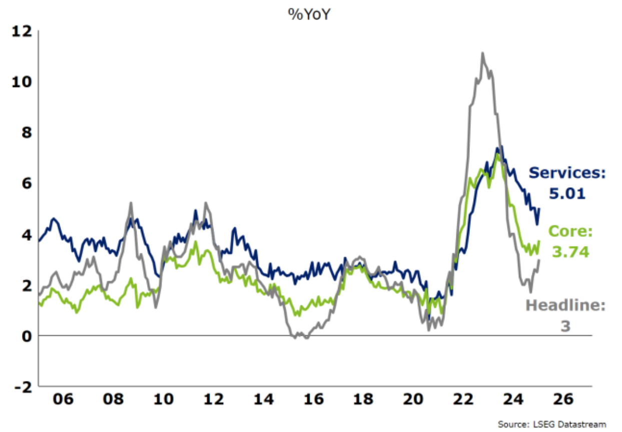
MAKING AN IMPACT THAT MATTERS since 1845

A Macro View: US rate expectations slide

The UK recovery has lost steam. GDP data and purchasing managers indices point to sluggish growth in fourth quarter of 2024 and so far this year. Consumer confidence has improved somewhat in the recent months but corporate sentiment and investment intentions remain weak. Despite this backdrop, we expect a modest acceleration in growth this year, driven primarily by significant fiscal easing and supported by further interest rate cuts. Growth should pick up over the summer months with the full impact of additional government spending felt in the second half of the year.

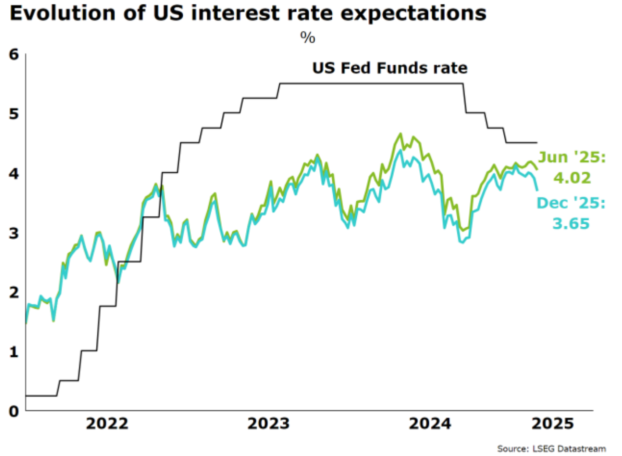
Headline inflation has risen sharply in the UK – to 3% in January from a low of 1.7% in September last year, driven primarily by higher food and energy prices. We expect it to rise further, peaking at around 3.5% later this year. But measures of underlying price pressure, such as core inflation and price rises for non-volatile services have remained relatively steady (see adjoining chart). This should maintain room for two, if not three, additional rate cuts by the Bank of England this year.

UK: Headline and alternative measures of inflation



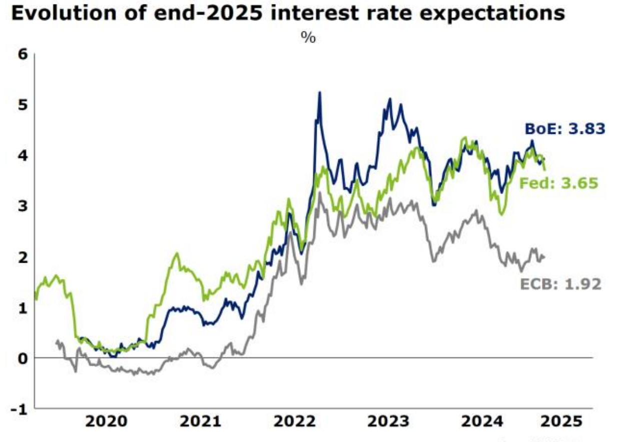
Economists expect deregulation and tax cuts to support US growth this year, with consensus forecasts at 2.2%, which is close to the US's long-term trend. But recent high-frequency data show some signs of weakness, with a sharp fall in consumer confidence in February, a decline in personal spending, falls in new manufacturing orders and weaker-than-expected service sector growth reflected in the latest purchasing managers indices. As a result, rate expectations have fallen (adjoining chart), with investors now expecting the Federal Reserve's target rate to hover around 3.65% by the end of this year.

Evolution of US interest rate expectations



Growth is expected to accelerate in the euro area this year but from a very low base. Germany – Europe's largest economy – is to register an expansion this year after contracting in 2024, while growth is set to slow in France and Spain. But concerns remain over the impact of potential US tariffs and political wrangling in France and Germany over economic policymaking. Overall, weaker prospects for growth and downside risks mean markets see three further rate cuts by the ECB this year.

Evolution of end-2025 interest rate expectations



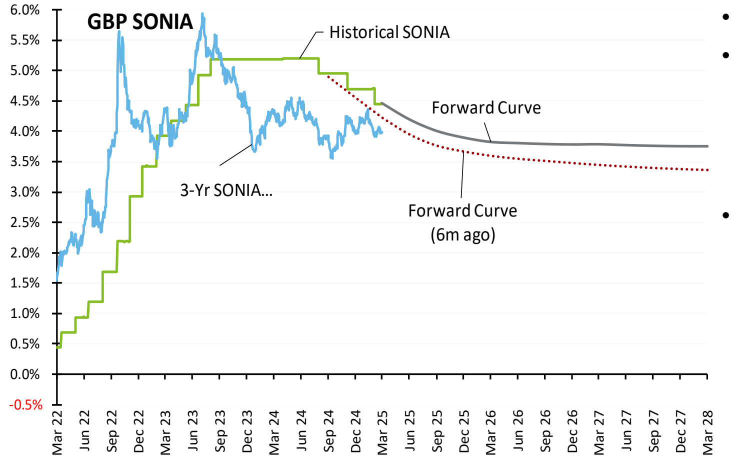
Debapratim De
Director, Economic Research

dde@deloitte.co.uk

Interest Rate Markets

The Bank of England (BOE), as widely expected, lowered its benchmark interest rate by 25 bps to 4.50% on February 6th. Market consensus now anticipates that both the BOE and the Federal Reserve (Fed) will leave interest rates unchanged at their upcoming March policy meetings.

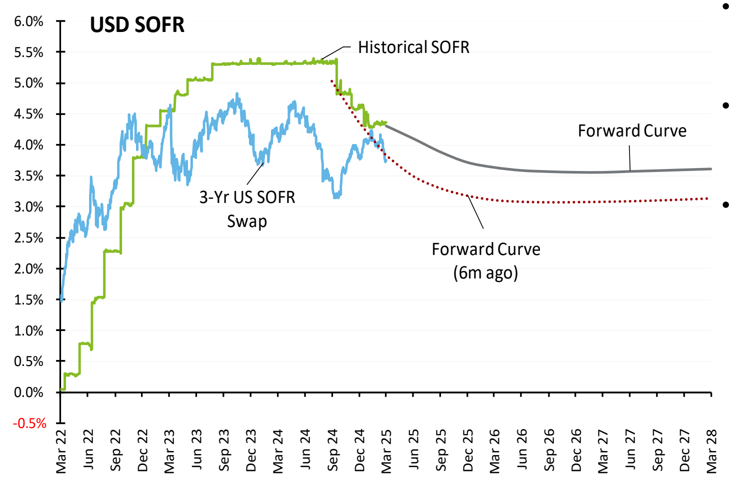
The European Central Bank (ECB) is expected to continue cutting rates, with markets pricing in a 96% chance of a further 25 bps reduction on March 6th. This move would continue the ECB's accommodative policy stance, aimed at supporting economic growth, especially as eurozone inflation eases toward its 2% target.



- The underlying SONIA is 4.45%.
- The BOE cut rates by 25bps to 4.50% at their policy meeting on 6th February. Market sentiment suggests a 95% probability that the BOE will maintain the current bank rate at its upcoming policy meeting scheduled for 20th March.
- The 3-year SONIA Swap rate is 3.91%, vs. 3.93% 6 months ago, though flat MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.97%	3.91%	3.86%
Cap @ 4.25% (premium)*	£0.53m	£1.09m	£2.51m
Cap @ 4.50% (premium)*	£0.37m	£0.85m	£2.12m
Cap @ 4.75% (premium)*	£0.27m	£0.69m	£1.83m

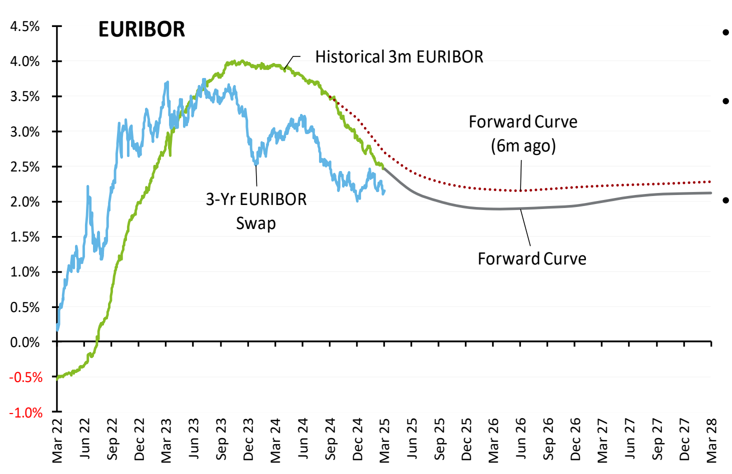
*£100m hedge notional



- SOFR is inside the Fed Funds current target rate range of 4.25%-4.50%, at 4.36%, following a decision to hold rates on 29th January.
- Market expectations are still leaning towards a hold, at its upcoming policy meeting scheduled for 19th March.
- The 3-year SOFR Swap rate is 3.73% vs. 3.42% 6 months ago, though 24bps lower MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.81%	3.73%	3.71%
Cap @ 4.25% (premium)*	$0.45m	$0.93m	$2.20m
Cap @ 4.50% (premium)*	$0.30m	$0.71m	$1.84m
Cap @ 4.75% (premium)*	$0.22m	$0.56m	$1.56m

*$100m hedge notional



- 3-month EURIBOR is 2.46%.
- The ECB cut rates at their policy meeting by 25bps on 30th January, to 2.75%.
- Market consensus still indicates a 96% probability of another 25bps interest rate cut at the next policy meeting scheduled for 6th March.
- The 3-year EURIBOR Swap rate is currently 2.04%, vs. 2.24% 6 months ago, and 14bps lower MoM.

	2-year	3-year	5-year
Swap rate (mid level)	2.02%	2.04%	2.10%
Cap @ 2.75% (premium)*	€0.14m	€0.49m	€1.48m
Cap @ 3.00% (premium)*	€0.10m	€0.38m	€1.23m
Cap @ 3.25% (premium)*	€0.07m	€0.29m	€1.02m

*€100m hedge notional

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 03rd March 2025

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 shape of the forward curve still allows borrowers to fix rates at levels below the current floating rate:

- SONIA 3m is 4.41% and a vanilla 5y Swap is 3.86%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by GBP 0.55m.
- SOFR 3m at 4.31% and a vanilla 5y Swap is 3.71%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by USD 0.60m.
- EURIBOR 3m at 2.46% and a vanilla 5y Swap is 2.10%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by EUR 0.36m.

Longer-term hedges remain an attractive proposition:

While the forward curves are not as downward sloping as was seen through much of 2024, there is still limited-to-no premium associated with hedging longer tenors, as would be typical in a 'normal' rate environment:

- GBP swap: 2-year: 3.97%, 3-year: 3.91%, 5-year: 3.86%
- USD swap: 2-year: 3.81%, 3-year: 3.73%, 5-year: 3.71%
- EUR swap: 2-year: 2.02%, 3-year: 2.04%, 5-year: 2.10%

Pre-hedging:

Pre-hedging future debt (assumed closing is in 6 months) allows for locking in swap rates in advance with limited premium over spot-starting trades:

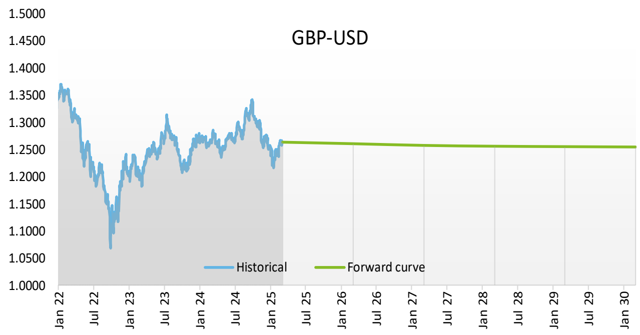
- GBP 5-year Swap starting in 6 months: 3.80%
- USD 5-year Swap starting in 6 months: 3.65%
- EUR 5-year Swap starting in 6 months: 2.09%

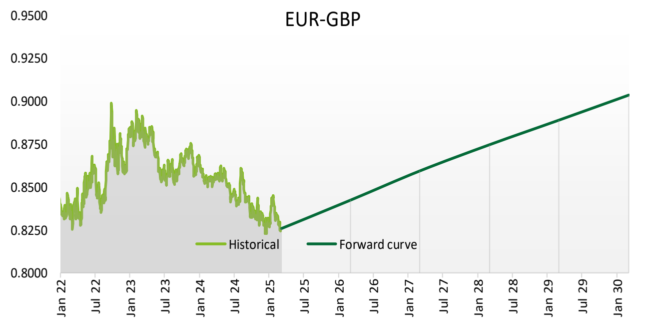
Funding of Hedging costs can be done at favourable rates

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.

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 03rd March 2025

Currency Markets





- GBP-USD strengthened marginally during February. While inflation remains above target in the UK, stronger-than-anticipated retail sales and GDP data have bolstered investor sentiment.
- Option premia decreased by up to 11.0% MoM, depending on the protection levels sought.
- 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 6.0% MoM, depending on the protection levels sought.
- The widening interest rate differential between the EUR and GBP is placing upward pressure on forward exchange rates, pushing them beyond historical spot levels seen over the past 10 years. This presents a compelling opportunity for EUR sellers and GBP buyers, who would benefit even further by hedging rather than remaining unhedged.

GBP-USD Spot Rate: 1.263	6mo	12mo	18mo
Forward rate	1.261	1.260	1.259
GBP Put Option* (ATMS**)	$2.73m	$3.93m	$4.80m
GBP Put Option* (5% OTMS***)	$0.90m	$1.91m	$2.68m

* GBP 100m Put option premium
** At-the-money Spot rate: 1.263
*** 5% Out-of-the-money vs Spot rate: 1.200

EUR-GBP Spot Rate: 0.826	6mo	12mo	18mo
Forward rate	0.834	0.843	0.852
GBP Put Option* (ATMS**)	€ 2.35m	€ 3.86m	€ 5.21m
GBP Put Option* (5% OTMS***)	€ 0.40m	€ 1.24m	€ 2.18m

* GBP 100m Put option premium
** At-the-money Spot rate: 0.826
*** 5% Out-of-the-money vs Spot rate: 0.867

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 03rd March 2025

Hedging Advisory and Derivatives Execution team

Hedging Strategy Advice

Outsourced Derivative Execution

Financial Market Knowledge

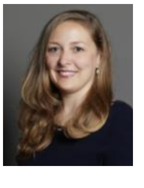
Derivative Pricing Expertise

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.

Designed by CoRe Creative Services. RITM1299442