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IR and FX Newsletter

May 2025

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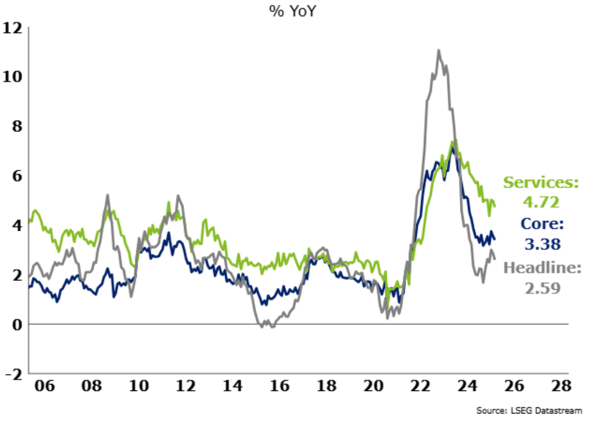
A Macro View: US rate expectations slide

Prior to the US administration's tariff announcements in early April, the latest monthly UK GDP data, for February, came in stronger than expected, with broad-based growth across sectors. Retail sales has also seen strong growth so far this year. But more up-to-date indicators of business and consumer sentiment suggest growing caution, with rising operating costs for businesses and elevated levels of uncertainty weighing on corporate and consumer spending. The flash purchasing managers indices also point to a contraction in business activity in April.

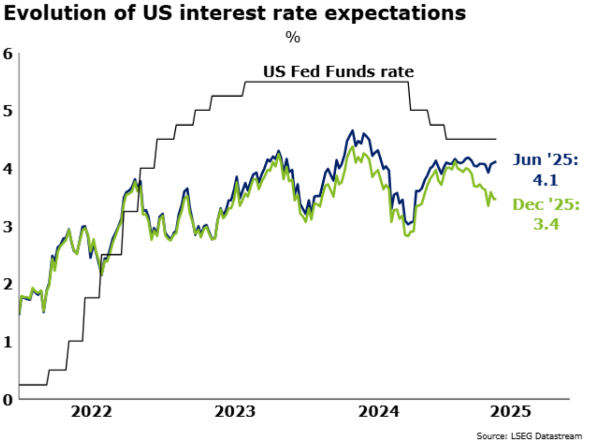
Inflation continued to ease from its recent high of 3.0% to 2.6% in March, however we expect higher energy prices to push it up to 3.5% in the third quarter. Despite this, relatively stable core and services inflation (adjoining chart) suggest underlying price pressures remain in check. This should provide room for the Bank of England to cut rates by a full percentage point by the end of 2025.

UK: Headline & alternative measures of inflation



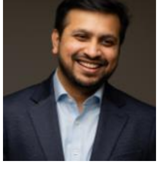
High frequency data continue to suggest a slowdown in activity in the US, with the latest GDP figures pointing to a contraction in the first quarter this year. Business activity slowed to its lowest level since 2023 while sentiment continued to deteriorate as trade-policy uncertainty reached a record high. Financial market volatility remains elevated while many economists have sharply downgraded their US growth forecasts for this year. Alongside this, rate expectations have fallen (adjoining chart), with investors now expecting the Federal Reserve to lower its target rate to around 3.4% by the end of this year.

Evolution of US interest rate expectations



Euro area growth has also been revised down, however to a lesser extent than the US. Rising global trade tensions have weakened expectations of a rebound in German growth this year, following a sharp contraction in 2024. However, economists are more optimistic about its medium-term prospects given recent fiscal expansion announcements. Growth is expected to slow across France, Italy and Spain, however Spanish growth remains well-above its long-term trend. Overall, persistent economic weakness and downside risks from global trade tensions, alongside the recent easing of inflation this year, mean markets expect two to three further rate cuts (adjoining chart) by the ECB this year.

Evolution of end-2025 interest rate expectations



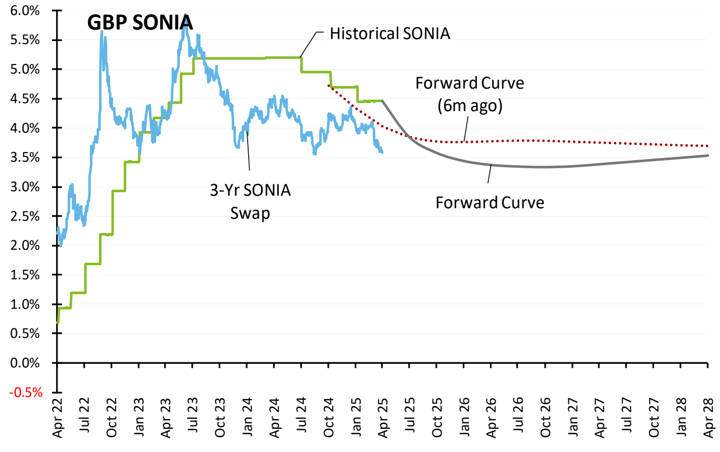
Debapratim De
Director, Economic Research

dde@deloitte.co.uk

Interest Rate Markets

In response to a weakening economic outlook and subdued inflation within the Eurozone, the European Central Bank (ECB) delivered a widely anticipated 25bps interest rate cut on April 17th, reaffirming its commitment to monetary easing.

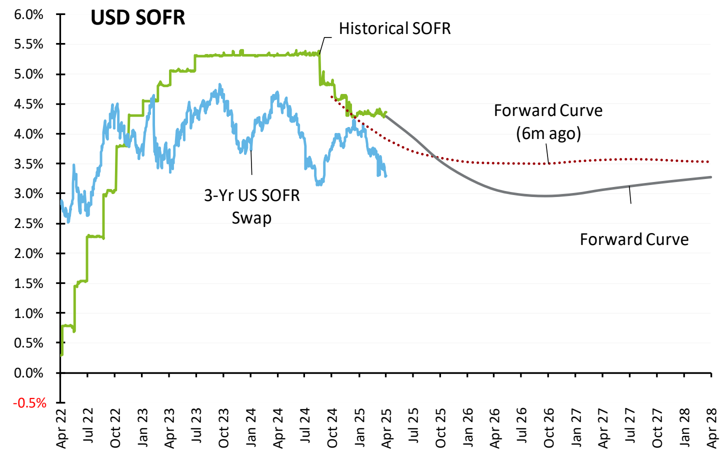
Market consensus regarding the actions of the Bank of England (BOE) and the Federal Reserve (Fed) at their upcoming May policy meetings remains unchanged from last month, anticipating a 25bps rate cut by the BOE and a hold by the Fed. The short-term rate environment is being driven by a concern over under-pressure economic growth metrics, while the medium-to-long term outlook is still concerned with inflationary forces.



- The underlying SONIA is 4.46%.
- The BOE held rates at 4.50% at their policy meeting on 20th March.
- Market expectations are for a 25bps cut, with a 96% probability, at its upcoming policy meeting scheduled for 8th May.
- The 3-year SONIA Swap rate is 3.52%, vs. 3.92% 6 months ago, and 41bps lower MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.56%	3.52%	3.58%
Cap @ 4.25% (premium)*	£0.35m	£0.83m	£2.29m
Cap @ 4.50% (premium)*	£0.25m	£0.68m	£1.99m
Cap @ 4.75% (premium)*	£0.20m	£0.57m	£1.75m

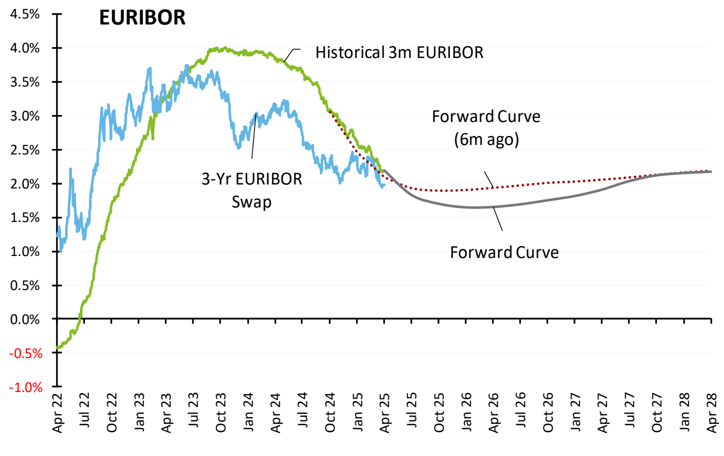
*£100m hedge notional



- 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 19th March.
- Market expectations are for further hold at the Fed's upcoming 7th May meeting (a 91% probability).
- The 3-year SOFR Swap rate is now 3.31% vs. 3.73% 6 months ago, and 26bps lower MoM.

	2-year	3-year	5-year
Swap rate (mid level)	3.38%	3.31%	3.35%
Cap @ 4.25% (premium)*	$0.31m	$0.71m	$1.89m
Cap @ 4.50% (premium)*	$0.20m	$0.54m	$1.60m
Cap @ 4.75% (premium)*	$0.14m	$0.43m	$1.38m

*$100m hedge notional



- 3-month EURIBOR is 2.16%.
- The ECB cut rates at their policy meeting, on 17th April, by 25bps to 2.25%.
- Market consensus indicates an 85% probability of another 25bps interest rate cut at the next policy meeting scheduled for 5th June.
- The 3-year EURIBOR Swap rate is currently 1.90%, vs. 2.21% 6 months ago, and 22bps lower MoM.

	2-year	3-year	5-year
Swap rate (mid level)	1.81%	1.90%	2.07%
Cap @ 2.25% (premium)*	€0.23m	€0.76m	€2.29m
Cap @ 2.50% (premium)*	€0.16m	€0.59m	€1.92m
Cap @ 2.75% (premium)*	€0.11m	€0.47m	€1.60m

*€100m hedge notional

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 30th April 2025

What can be done in the current Interest Rate markets?

Borrowers can still 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 4.18% and a vanilla 3y Swap is 3.52%. On a GBP 100m financing, swapping to fix reduces interest costs in year 1 by GBP 660k.
- SOFR 3m at 4.23% and a vanilla 3y Swap is 3.31%. On a USD 100m financing, swapping to fix reduces interest costs in year 1 by USD 920k.
- EURIBOR 3m at 2.19% and a vanilla 3y Swap is 1.90%. On a EUR 100m financing, swapping to fix reduces interest costs in year 1 by EUR 290k.

Hedges tenors do not materially impact the hedged rate:

While the forward curves still reflect expectations of rate cuts over the coming 6-12 months, there is then a bottoming out in forward rate projections ahead of anticipated rate rises thereafter. This continues to translate into relatively flat swap rates across the short-to-medium term:

- GBP swap: 2-year: 3.56%, 3-year: 3.52%, 5-year: 3.58%
- USD swap: 2-year: 3.38%, 3-year: 3.31%, 5-year: 3.35%
- EUR swap: 2-year: 1.81%, 3-year: 1.90%, 5-year: 2.07%

Pre-hedging:

Due to the relatively stable medium- to long-term rate environment, pre-hedging future debt (assumed closing is in 6 months) allows for locking in swap rates in advance at similar levels to spot-starting trades:

- GBP 5-year Swap starting in 6 months: 3.56%
- USD 5-year Swap starting in 6 months: 3.30%
- EUR 5-year Swap starting in 6 months: 2.11%

Funding of Hedging costs can be done at favourable rates

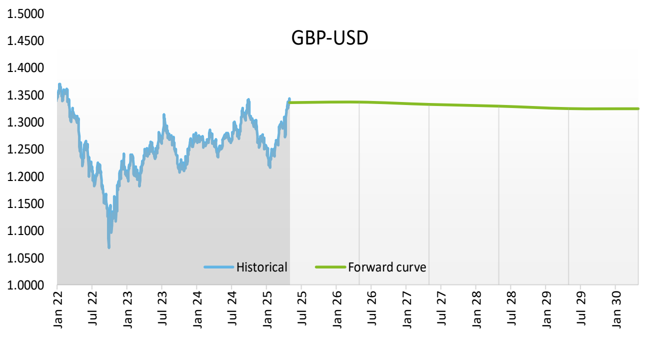
With the increase in rate volatility in recent weeks, hedging costs for Option products (such as Caps) have been impacted, these rising premium costs, generally paid upfront may be deferred over time. We are seeing many clients buy Caps in conjunction with Swap based hedging solutions allowing this deferral to arranged within the Swap trade itself. 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.

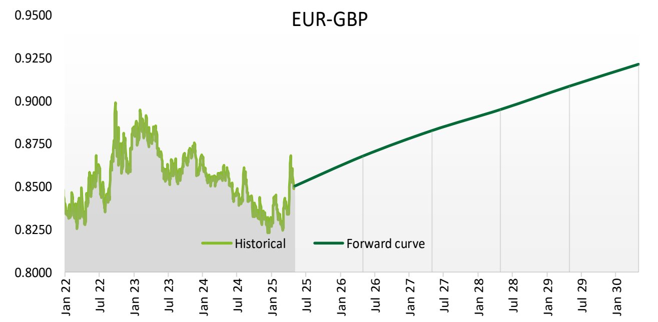
Structured Hedging solutions

Over the past few months many clients are incorporating two, or more, trades into their hedge solution; most commonly a combination of Swap and Cap trades, or trades with variable strike rates over time. The rationales for structuring more bespoke solutions varies, often to match uncertainties in business plans, or to reduce credit exposure to a bank counterparty, or even simply to overlay a degree of 'client view on rates outlook' without materially decreasing their risk management impact.

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 30th April 2025

Currency Markets





- GBP-USD strengthened over the course of April by 3.50%. Driven by U.S. dollar weakness relating to trade policy uncertainties alongside the UK's proactive economic and trade strategies.
- This rapid change in the GBP-USD FX rate has led to Option trade premia increasing by up to 33.0% MoM, depending on the protection levels sought, due to the raised volatility environment.
- Meanwhile FX Forward rates remain flat out through 5 years, with limited deviation between interest rate environments across both countries over the medium term.

- EUR-GBP appreciated slightly in April due to stronger UK economic data and diverging interest rate paths favouring sterling amid weaker Eurozone growth sentiment.
- Option premia increased by up to 53.0% MoM, depending on the protection levels sought.
- The widening interest rate differential between the EUR and GBP is pushing forward exchange rates beyond historical spot levels seen over the past 10 years. This presents a compelling opportunity for EUR sellers and GBP buyers, who may benefit from locking in such EUR strength, rather than remaining unhedged.

GBP-USD Spot Rate: 1.337	6mo	12mo	18mo
Forward rate	1.338	1.338	1.335
GBP Put Option* (ATMS**)	\$3.26m	\$4.54m	\$5.59m
GBP Put Option* (5% OTMS***)	\$1.07m	\$2.13m	\$3.15m

* GBP 100m Put option premium
** At-the-money Spot rate: 1.337
*** 5% Out-of-the-money vs Spot rate: 1.270

EUR-GBP Spot Rate: 0.850	6mo	12mo	18mo
Forward rate	0.859	0.868	0.876
GBP Put Option* (ATMS**)	€ 2.64m	€ 4.14m	€ 5.38m
GBP Put Option* (5% OTMS***)	€ 0.72m	€ 1.64m	€ 2.60m

* GBP 100m Put option premium
** At-the-money Spot rate: 0.850
*** 5% Out-of-the-money vs Spot rate: 0.893

Data source: Refinitiv and ICE Data ICE Data Derivatives, as of 30th April 2025

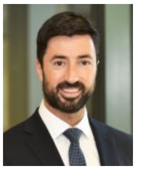
Hedging Advisory and Derivatives Execution team

Hedging Strategy Advice

Outsourced Derivative Execution

Financial Market Knowledge

Derivative Pricing Expertise

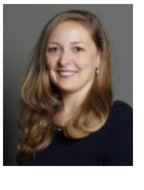


Paolo Esposito
Lead Director

+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

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