THE TREASURY HUB
Banking and Treasury Markets

April 2020 Report

1. Executive Summary

1.1 Introduction

Welcome to the latest version of THE TREASURY HUB Banking and Treasury Markets Bulletin. Last month we stated that it was probably the most volatile environment in which we have drafted this bulletin since its inception in 2018. March trumped February in that respect again.

We will continue to look at banking in Section 5. There will be a calm from now until May as the 3-month loan moratorium runs its course. **But the banks won't continue to roll such moratoria and, thereafter, they may tighten T&Cs and some companies will fail. So those best (and earliest) prepared will likely survive and, possibly, thrive.**

From an investment perspective all three equity indices that we track (ISEQ, FTSE and DOW) have moved further into negative return territory.

On the topic of EUR/GBP, our view that the rate would go back to 88p and possibly 90p was blown out of the water, hitting 95p briefly on March 19th but it has fallen steadily since March 23rd and currently sits just above the EUR/GBP0.88 level. The high-low move in Q1 of 14.7% is LARGER than the ANNUAL range for every year since 2008 with the exception of 2016 (the year of the Brexit vote). Yet it has hardly registered on the radar which, to be honest, has alarmed us. Currency volatility is high on the agenda of larger firms who may not have any larger % of their sales or purchases in foreign currency than smaller firms. We see poor currency management as being a possible means through which banks could extract higher margins and tighter fees in the months ahead as the logic is simple: they price risk – the higher the (perceived) risk, the higher the cost of lending to such borrowers. **So poor currency management will likely cause a "triple whammy": lower profits, higher interest costs and tighter loan terms and conditions.**

1.2 Markets in a Table: what's up and what's down?

Table 1. Key Metric Movements: 2020

Heading	Metric	YTD move	From	To
Interest	3-m euribor	-0.0940%	-0.3790%	-0.4730%
Interest	EUR 3-year	-0.2300%	-0.2600%	-0.4900%
Interest	GBP 3-year	-0.3640%	0.8140%	0.4500%
Interest	USD 3-year	-1.1760%	1.6560%	0.4800%
FX	EUR/GBP	3.1042%	0.8459	0.8730
FX	EUR/USD	1.7528%	1.121	1.141
Equities	ISEQ	-18.715%	7315	5946
Equities	FTSE 100	-20.239%	7604	6065
Equities	Dow Industrial	-10.409%	28869	25864
Gilts	IE 10-yr	-0.2490%	0.098%	-0.151%
Gilts	GB 10-yr	-0.2670%	0.794%	0.527%
Gilts	US 10-yr	-0.3630%	1.882%	1.519%

Please note that the % moves are in green if the metric has moved upwards and in red if it has moved downwards. It is NOT a statement as to whether this is a positive or negative move as one could be a borrower or depositor, a seller or buyer of currency, etc. Also, the % move for interest rates is in absolute terms while for currency and equities it is expressed in relative terms.

What the charts show: Red in so many areas, especially equity markets.

What they don't show: the volatility in others - see EUR/GBP as the perfect example.

Bond prices have risen as markets consider how governments will fund the cost of the crisis. Oil prices remain very low. This is covered in more detail in Section 4.

We have shortened the report this month as the key focus for almost all companies is on cashflow and their funding arrangements.

We have specifically focused over the past two years on working with and cementing our relationships with debt providers, both banks and non-banks.

Using banking experts is the best way to seek out an acceptable solution. We're here to help.

And check out the grants available from Enterprise Ireland and Local Enterprise Offices to finance sourcing the advice.

1.3 Forward-looking Indices

Forward-looking indictors known as Purchasing Manager Indices or PMIs are useful to monitor in the context of the economic outlook in Ireland and the UK. Readings above 50 indicate expansion while below 50 denotes contraction. The readings above 50 are from February and below 50 are for March. No need to say anymore.

Table 2. Irish and UK PMI readings

Variable	Ireland	UK
Manufacturing PMI	45.1	47.8
Services PMI	59.9	35.7
Construction PMI	50.6	52.6

1.4 Brexit

On the back burner for now.

1.5 Treasury Hub Activities

The quarterly meeting of all of the firms was conducted by conference call. It was agreed that once the banks have consented to the 3-month moratorium, there will be a pause before they start to have a harder look at all businesses. **All members of The Treasury Hub will continue to swap market intelligence by benchmarking what banks are doing around the country from a lending perspective giving us market knowledge that is unmatched by any other accounting firm.**

We would also expect that there will be an increase in companies seeking equity injections and that may be required/assist in getting extra bank funding. Accordingly, companies may need to consider this as an option sooner rather than later.

1.6 Conclusion

The economic slowdown will be sharp and abrupt. Financial Times webinar yesterday polled attendees re shape of recovery with roughly 41% voting for "U"-shaped recovery while 40% expect a "W"-shaped recovery (as virus re-emerges). Either way those best prepared for bank negotiations (and it is only a matter of time before they commence) will likely fare best in sustaining their business. We look forward to working with existing and new clients to achieve this goal.

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2. Interest and Economic Review

2.1 EUR short-term rates

Background

The Euribor rate that we continue to monitor for the purposes of this bulletin (as it is the most relevant one for variable rate debt) is the 3-month rate.

Key Observations

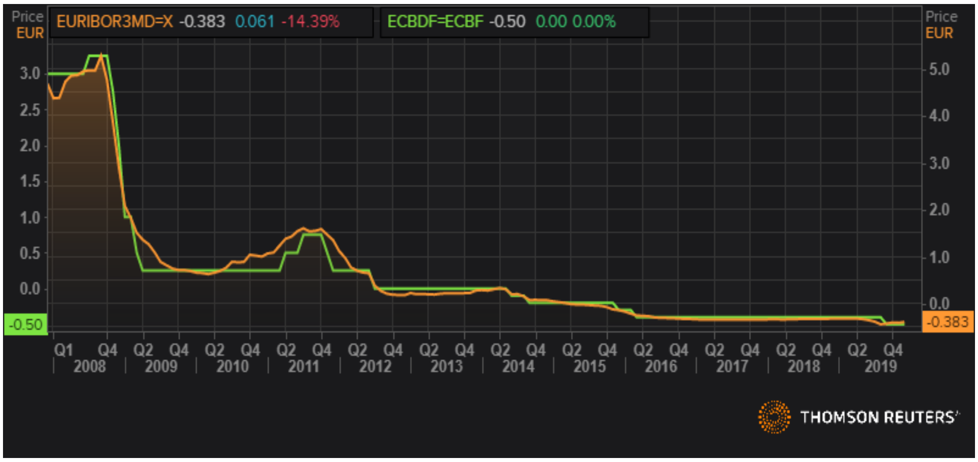
3-month Euribor rate remains negative at -0.36%.

While some have reflected on whether mass levels of government borrowing and printing of money will invariably lead to higher inflation, it is not an issue for the markets today. It could, of course, arise in due course as in the past the inflation of assets subsequent to a recession/depression assisted the recovery. We will watch in due course.

The graph below of the 3-year swap rate shows current rates easing back after picking up in the middle of March. As the banks are not quoting negative fixed rates (before margin) the best choice available is to possibly seek to secure a fixed (pre-margin) rate of 0% for as long a period as possible. Fixing at 0% for 5 to 7 years should no longer be an issue.

For now, we would suggest that variables rates may continue to offer the best option, especially if you think that your borrowing arrangements could come under strain as there is a technical reason why banks could charge for early close out of a fixed rate loan even if market rates remain unchanged**.**

Graph 1. 3-m Euribor versus ECB Base Rate: ten-year trend



Graph 2. EUR 3-year swaps: ten-year trend

2.3 UK and US interest rates

UK and US interest rates eased considerably in both February and March with the scale and pace of the easing being much more pronounced in the US. This easing is a direct consequence of the perceived likely economic impact of the coronavirus on the respective economies. Both countries appear to be been a little later than others in addressing the issue which could exacerbate both the scale of the economic impact and, consequently, the pace of recovery from same.

Graph 3. GBP 3-year swap rates: five-year trend

Graph 4. USD 3-year swap rates: twelve-month trend

2.4 UK Economic Outlook

Q2 GDP drop is estimated to be -15% (compared to -6% for 2008 financial crisis and -8% in the Great Depression).

Unemployment increases will be lower as the government introduced a scheme to subsidise wages but with the government shouldering the burden of the weight of the response to soften the above blows, **current projections are for UK budget deficit to rise from 2% to 11% of GDP by 2020/21 causing Debt:GDP% to increase from 80% to 105% as the scale of the deficit hits GB£200m (Source: Capital Economics).**

2.5 US Economic Outlook

The outlook for the US is even worse than for the UK. Goldman Sachs are calling a contraction of -34% in Q2 followed by growth of +19% in Q3. The US has not gone with a wage subsidization approach and, accordingly, layoffs are already on the rise with the unemployment rate projected to hit 15%. First time unemployment claims for the past two weeks have been 3.3 million and 6.6 million respectively, the latter being much worse than analysts had predicted.

2.6 Political Outlook

Governments are central to the response and recovery from this crisis. Therefore, political policies (and beliefs) will have a major impact on the level and scale of government intervention. The UK Tory Party has implemented policies to date that Jeremy Corbyn would be proud of. The political fallout won't be for a while but there is a possibility that Boris Johnston could be ousted if the UK death figures are higher than expected. In the US Donald Trump had bet on the economy for his re-election. That's not going to be an effective platform now so his position will have to change. Presidential ratings tend to improve in the middle of conflict. Will he try to deflect blame to China and take some sort of stance? Time will tell but the election in November just got tighter to call.

3. Foreign Exchange Review

3.1 EUR/GBP

The high-low move in this currency pair in Q1 2020 has been EUR/GBP0.8280 to EUR/GBP0.9500 – a range of 14.73%. This is greater than the annual move for every year since 2008 with the exception of 2016 (Brexit vote year). The graph below shows the graph for 2020 to date with the vertical lines signifying the moves on any one day – the most volatile of which saw the rate move almost 3.5p in a single day.

So, exporters AND importers have both been afford opportunities to hedge at rates not seen in a number of years.

Action required:

1. Draw up actual strategies and implement them
2. Leave orders with your currency providers e.g. to sell GB£100k if the rate hits EUR/GBP0.88.This allows exporters to benefit from sudden moves in their favour
3. Consider the use of FX options, especially for “tail risk” events and/or in dealing with uncertain amounts.

Get in touch if you require further details but be careful before using options in particular. They are extremely useful in the right hands…but need to be used appropriately.

Graph 5. EUR/GBP in 2020

While we know that currency management is low on the list of priorities of a lot of companies, if you have GBP sales or purchases, the rate that you achieve impacts directly on your profits and cash…and with downward pressure on both, one could argue that it becomes more important to hedge appropriately in the current environment. We believe that poor/no currency management could be used by lenders to force higher borrowing margins as loans are refinanced as a result of the crisis. Leave that thought with you.

3.2 EUR/USD

This rate has also bounced around over the past 6 weeks and moved from EUR/USD1.14 to EUR/USD1.07 in 10 days in March.

Graph 6. EUR/USD: two-year trend

USD has probably benefitted from safe haven status as would normally be the case in past crises. Where to from here? The impact on the US economy we believe will be very significant. This would ordinarily be bad for the currency (i.e. weaken it) but Europe will also be adversely hit so which will weaken first?

3.3 Summary

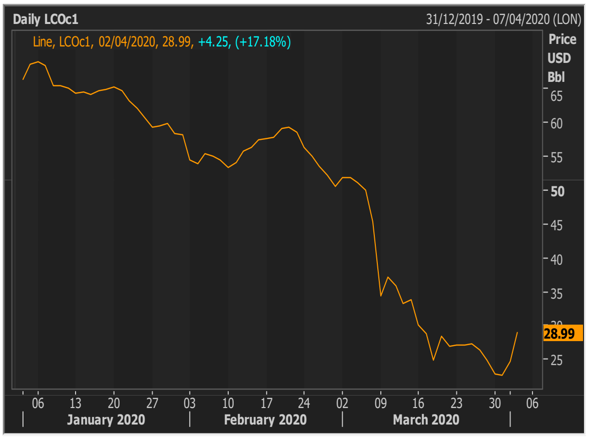
As all economies will be adversely impacted upon by the coronavirus, the key questions will be the scale of impact relative to each other and political issues. In the Eurozone, the key question is will it hold together or will more fragments appear? Brexit still hangs over the UK and must be resolved while in the US, the presidential election will be a key driver (as it will impact on the economic policies that will be pursued).

In short, there’s a lot more volatility to come both upwards and downwards in all currency pairs. Will present opportunities as well as risks.

4. Wealth Management

4.1 Oil

Graph 7. Oil prices: 2020 trend



Oil price decrease initially caused by a row between Saudi Arabia and Russia but then exacerbated by falling demand due to slowing economies. Has risen $7 per barrel in the past 2 days.

4.2 Gold Price Trends

Graph 8. Gold prices: twelve-month trend

We started to watch this as a hedge in case of an economic slowdown. It remains on the list to watch as a result.

4.3 Equity Markets

Graphs below are 12-month trends for ISEQ, FTSE and DOW.

Graph 9. ISEQ

Graph 10. FTSE

Graph 11. DOW

5. Banking Review

5.1 Bank conduct to date

- Response to loan moratorium has been largely positive
- Interest still accrues so it will have a cost but will be worth it if the cashflow benefit aids financial survival in the short-term
- Any refinancings that were in train pre-crisis have stalled as the banks deal with the moratorium issue. Should restart from next week
- No indication to date that banks will attempt to change term sheets from what had been previously agreed but we will continue to monitor
- Even large companies are not getting much leeway. Policy in one of main banks is to deal with waivers out to June only. Flexibility for H2 depends on when we are up and running again and will be looked at from July onwards
- BIG QUESTION IS WHAT WILL HAPPEN IN 6-8 WEEKS TIME AS THE LOAN MORATORIUM PERIOD COMES TO AN END?

5.2 What are best in class companies doing?

- Cashflow forecasts are crucial to produce but also difficult to produce given high levels of uncertainty
- Producing cashflow forecasts that can be flexed easily and often
- Accessing liquidity as quickly as possible. Big focus on working capital management. Reduce capex
- Companies that sell to or buy from abroad have all identified foreign exchange volatility as a major risk, not just to P&L and Cashflow but it could impact materially and adversely on liquidity and terms of associated loans

5.3 Action Points

- Two types of cashflow forecasts may be required: medium-term (say to end 2020) to manage overdraft and loans compliance/required levels of overdrafts and short-term to manage the next month (daily cashflow for a rolling 4 weeks)
- The medium-term forecast may require firms to produce a “hopeful” forecast and a “baseline” forecast for internal consideration, the former being a lower level of activity compared to pre-crisis but based on a gradual economic recovery while the latter should reflect a stripped back operation to keep the business functioning which can be scaled back up in line with improving economic activity
- The reason why this is suggested is that banks tend to take any forecasts given to them and flex them for a worse than forecast outcome so have considered both and assess a range of possible outcomes PRIOR to having bank discussions
- Production of updated short-term cashflows will be essential to run the business and this will require the establishment of a process which specifies required inputs (and who provides them) and actions (e.g. sales and cash collection targets)
- This level of micromanagement will be necessary and bear in mind that as your bank can also see the activity on your current account, they will have a window to your actual performance – it won’t be possible to hide it from them

5.4 Source of Available Grants (see other emails from the firm)

- Enterprise Ireland
- Local Enterprise Offices.