THE TREASURY HUB
Banking and Treasury Markets
Bulletin

1. Executive Summary

1.1 Introduction

Welcome to the latest edition of THE TREASURY HUB Banking and Treasury Markets Bulletin of 2021. Domestically and internationally, the Summer has seen many markets ebb and flow – apart from the continuing focus on the economic recovery, inflation remains stubbornly high as all sort of component shortages and supply chain constraints impact on prices.

Corporate activity - buying and selling of business – remains strong across many sectors reflecting the high levels of investment funding available. There would be a uniform view that this would be a good time for sellers of businesses as prices paid (multiples of earnings) remain very strong, especially for sectors/companies in vogue as competitive bidding processes push valuations higher. **Please get in touch if you are thinking of buying or selling a business as, through The Treasury Hub, we have an ability to trawl the country for suitable sellers and buyers.**

On the currency front, GBP had a good (strong) Summer hitting 2021 lows against EUR (below 85p). USD had a not dissimilar pattern breaking below EUR/USD1.170. Both currencies have since retreated against EUR. Interest rate moves have been negligible at the short-end of the curve but this remains the great unknown – will inflation trends remain high forcing actions by Central Banks? This will be one of the big debates for the remainder of this year. Economic data, in general, continues to hold steady.

From an investment perspective, stock markets performed well over the Summer.

Section 5 looks at trends to watch for in the remaining 4 months of 2021.

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

Table 1. Key Metric Movements: 2021

Heading	Metric	YTD move	From	To
Interest	3-m euribor	-0.01%	-0.5460%	-0.5510%
Interest	EUR 3-year	0.10%	-0.5400%	-0.4370%
Interest	GBP 3-year	0.50%	0.0813%	0.5800%
Interest	USD 3-year	0.26%	0.2330%	0.4960%
FX	EUR/GBP	-4.08%	0.8937	0.8587
FX	EUR/USD	-3.16%	1.2248	1.1873
Equities	ISEQ	18.63%	7376	8750
Equities	FTSE 100	10.39%	6460	7131
Equities	Nasdaq	21.18%	12888	15618
Commodities	Brent Crude	40.927%	51.80	73
Commodities	Gold	-3.822%	1896.49	1824
Gilts	IE 10-yr	0.3300%	-0.300%	0.030%
Gilts	GB 10-yr	0.5220%	0.207%	0.729%
Gilts	US 10-yr	0.4040%	0.930%	1.334%

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.

We continue to keep the report short and focused on key aspects that companies need to manage from a financial perspective.

While equity markets have been strong performers in 2021, there appears to be a little more volatility in some of the other asset classes including Oil and Gold. The headlines remain for the more "exotic" stuff including cryptocurrencies and NTFs although we note that John Paulson, the man that made $20billon calling the sub-prime market correctly in the noughties, has recently referred to Crypto as a "worthless bubble". Time will tell.

On the macroeconomic front, apart from inflation, focus remains on GDP and house prices. Geo-politics will undoubtedly play a key part in economic trends in the months and years ahead. If you are looking to read something in this space, try Tim Marshall's "The Power of Geography". It's a good read and, in light of the recent US retreat from Afghanistan, is more pertinent than ever.

1.2 Forward-looking Indices

Forward-looking indictors known as Purchasing Manager Indices or PMIs are useful to monitor the economic outlook for Ireland and the UK. Readings above 50 indicate expansion while below 50 denote contraction. Irish indicators look good, and while construction eased back, we would expect a pick-up on the back of the Government housing plan just issued. In the UK, the figures are a little softer with Services being the most disappointing for a variety of reasons (end of stamp duty holiday, falling demand due to higher resi property transactions, etc.).

Table 2. Irish and UK PMI readings

Variable	Ireland	UK
Manufacturing PMI	62.8	60.3
Services PMI	63.7	55.0
Construction PMI	62.8	55.2

1.3 Macroeconomic Outlook

The global outlook remains generally positive although the huge stimulus packages unleashed due to the pandemic will need to stall (and be paid for) and the markets are starting to concentrate on both the latter aspect above and the timing (ability?) of Central Banks to reduce their quantitative easing initiatives.

1.4 Vaccines

Vaccines doses per 100 residents

Ireland: 139.1
European Union: 120.2
UK: 136.9
US: 112.6

(Source: Financial Times)

We promised to include this data for a few months. Total global doses now stands at 5.44 billion. Next month we will replace this section with inflation as that now appears to be more important in our opinion.

2. Foreign Exchange

2.1 EUR/GBP

Although the pace of vaccine deliveries in Europe versus strong rollout in the UK was a key factor earlier in the year, this has largely abated now as economies open up and there is a realisation that we will have to live with this virus for the foreseeable future.

So, as we turn the corner into Autumn, markets are homing in on other key questions:

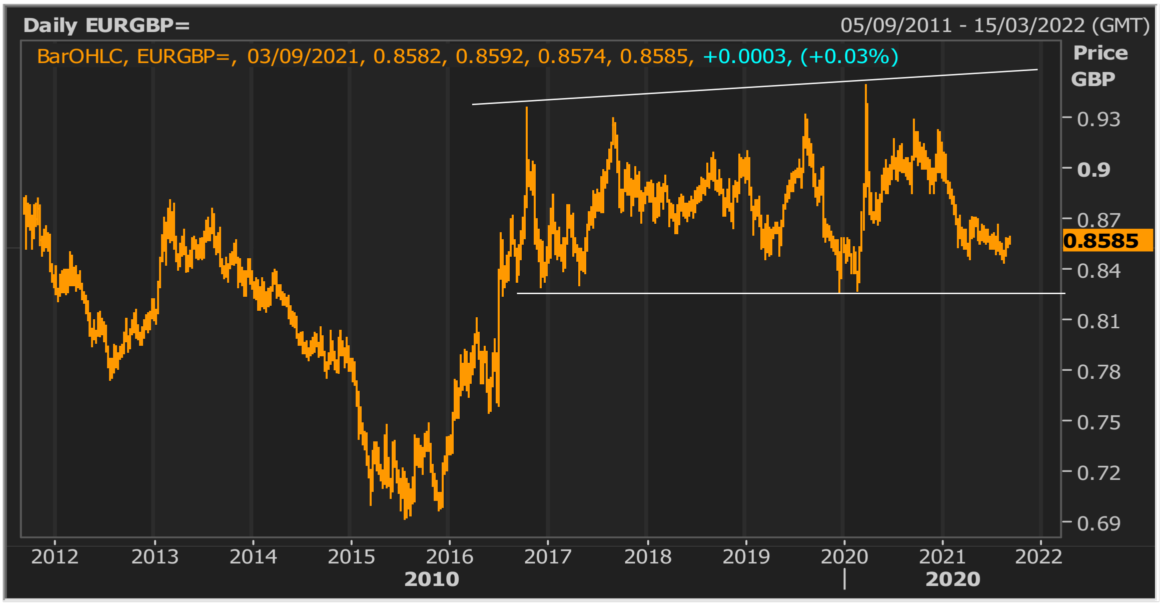
- When will we get back to pre-pandemic GDP levels?
- Are inflationary pressures temporary or permanent?
- When will supply chain pressures be alleviated?
- Impact of geopolitics on economic trends?

The 2021 trend in Graph 1 below shows a strengthening channel since February within a current range of EUR/GBP0.8444 to EUR/GBP0.8600. Will this be maintained for the rest of the year? The benefit to exporters of this positive trend in 2021 has been offset to some extent by increased costs. **The question for such exporters is to what extent these currency gains can be banked now and in the future?**

Graph 2 overleaf shows that the lower end of the range, longer-term, is circa EUR/GBP0.8250. Exporters managed to tolerate weak GBP in 2019 and 2020 so the current levels are 3%+ better than average rates over those years. The conclusion remains that any rate around or below EUR/GBP0.8500 is good value in that recent historic context. Irish exporters may still come under pressure from UK customers for price reductions to reflect stronger GBP so they may need to secure these rates.

Graph 1. EUR/GBP: 2021 trend

Graph 2. EUR/GBP: 10-year trend



2.2 EUR/USD

Graph 3 is the 2-year trend in EUR/USD as the current range has existed for close to 12 months now. This range is EUR/USD1.1661 to EUR/USD1.2224.

As mentioned previously, strong US economic data has underpinned the dollar along with varying degrees of speculation around the possibility of interest rate hikes and/or a reversal of QE by the Fed. The housing market is hot right now and while there is evidence of continuing labour market shortages, last week's unemployment data disappointed with a rise in jobs created of only 235k. However, USD also tends to benefit as a safe haven in times of uncertainty so future USD direction remains unclear at this point in time.

Graph 3. EUR/USD: 2-year trend

3. Interest and Economic Review

3.1 EUR Short-term Rates

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

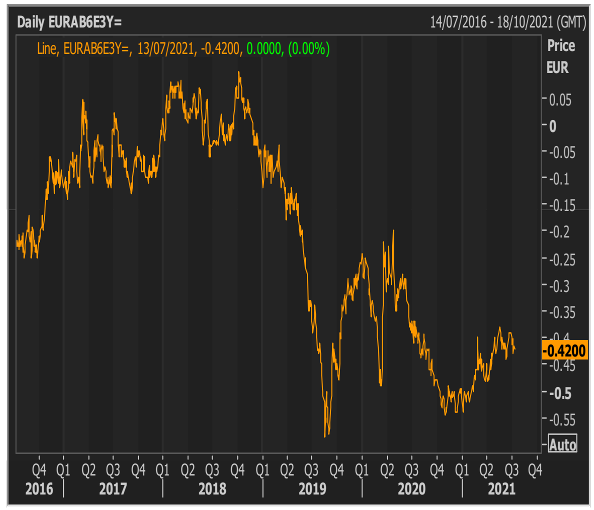
Having briefly started to move upwards in 2020, 3-m euribor has traded in a very narrow range for most of this year, around -0.53%. The ECB published its revised monetary policy strategy which had no impact on rates. So it's just steady as she goes in this space for now. If, as some expect, inflationary pressures are more permanent, longer-term rates will be the first to react to that. Short-term rates, as an indicator, are of limited value in that respect.

Graph 4. 3-month Euribor: 12-month trend

3.2 EUR Medium-term Rates

3-year swap rates (i.e. fixed rate before lending margins) have climbed over 2021 and it is this rate that borrowers need to monitor as longer-term rates will start to rise six to nine months in advance of any ECB move on short-term rates. As we have previously stated, it has been very difficult to date for either corporate or personal borrowers to get any real benefit from the ultra-low interest rate environment so the choice remains (i) if pre-margin fixed rate of 0% can be obtained and (ii) if yes, how far forward can that be fixed for? There are a couple of items that one needs to be aware of when fixing the cost of debt so get in contact if considering it.

Graph 5. EUR 3-year swaps: 5-year trend



3.3 Summary

Inflation remains the most important consideration in assessing the future prospects for interest rates. Eurozone inflation, which started the year at +0.9%, hit +3.0% in July. The equivalent figures for Ireland are -0.2% and +2.2%. Fuel and energy-related costs are driving the rate higher in most jurisdictions. Will be interesting to see what happens other categories such as food and clothing in the coming months, especially as supply shortages hit home prior to Christmas.

3.3 UK and US Interest Rates

UK inflation is now forecast to reach 4.0% (by end 2021 according to the latest Bank of England estimate of same. A recent Reuters poll put the date of the first UK rate hike in 2023 although a growing number put it more likely to be sooner than that date. The rise in UK longer-term interest rates is more pronounced than in the eurozone as evidenced below. The removal of Libor as a reference rate should now be firmly on the agenda for all GBP borrowers.

Graph 6. GBP 3-year swaps: 5-year trend

Graph 7. USD 3-year swap rates: 5-year trend

As already mentioned, US interest rates have been impacted upon by rising inflation figures. To put them in perspective, inflation is up from +1.4% in January to 5.4% in both June and July. Food and energy prices are the key drivers of these figures.

US Government bond yields have bounced around over the Summer – from 1.60% in June to 1.20% in August and back to 1.36% currently**.**

3.4 UK Economic Outlook

Although the most recent PMI readings (see Section 1.2) were lower than prior months, some of that is attributed to the labour market – taking longer to fill vacancies with high staff turnover. A separate survey last week showed employers hunting for more staff than they were before the pandemic. Some of the slowdown is also attributable to supply chain disruptions i.e. manufacturers can't manufacture as much as they would like due to shortages of certain key components.

The July inflation rate figure of +2.0% was down from +2.5%. Retail sales fell by -2.5% in July while consumer credit was also slightly lower. Unemployment fell again to 4.7% with Youth Unemployment at 13.1%.but the Labour Force Participation Rate remains at 78.9%. Finally average wages in the UK are up from GB£539/week in July 2020 to GB£576/week in June 2021.

In previous bulletins we noted that the key challenge for the UK government going forward was the level of government borrowing. This week the Tory Government decided to increase national insurance rates (equivalent to our prsi) to start plugging the gaps. The danger of such a move, in the face of ongoing labour shortages, is that wage inflation emerges to offset the (effective) tax hike. Debt:GBP in the UK is expected to reach 107% by the end of 2021.

3.5 US Economic Outlook

US unemployment continues to fall again over the Summer. From a peak of 14.7% in April 2020, it dropped to 5.9% in June 2021 and to 5.2% in August.

The S&P 500 has now doubled since the March 2020 Covid low – this is the fastest doubling of the index since WWII and, based on historic trends, is three times faster than would have been expected.

The WSJ is also estimating that, globally, companies are now sitting on $6.84TRILLION of cash indicating that they are not investing as fast might have been expected – cash buffers are building "just in case".

The big news in the US over the Summer has been inflation. Annual inflation rate to end July matched the June 2021 rate of +5.4% (highest since August 2008). Producer prices were even higher, up +7.8% year-on-year to July 2021.

The squeeze on all sorts of costs is large. Shipping costs have increased so much that Hapag Lloyd, one of the largest shipping companies in the world, reported first half profits which exceeded the profits they made for the past DECADE as a whole. The figure of €2.7billion was a tenfold increase over the previous year. And yet schedule reliability is only 35%. The use of the words "shortage" and "inflation" in US second quarter results was its highest since 2010. The net margin of the S&P 500 in Q2 2021 was 13.1%.

At the risk of repeating ourselves, there are asset price bubbles everywhere and bubbles burst at some point. The European Securities and Markets Authority, in their most recent report, stated that they saw "very high risks across the whole of the ESMA remit".

Continue to tread cautiously is the message.

4. Wealth Management

4.1 Oil

Graph 8. Oil prices: 2-year trend

The Oil price has been all over the place in the past 18 months….albeit mainly up in the past 15 months! It has ranged between $65 and $77 per barrel since April of this year and the manner in which it has held up has surprised many as global demand is still not near where it might have been expected to be at this stage. Obviously OPEC has been instrumental in controlling supply but in driving up prices, it also makes shale production more economical….thereby increasing non-OPEC (mainly US) shale supply. Oil prices above $70 remains a reasonable outlook…for now.

4.2 Gold Price Trends

Graph 9. Gold prices: 5-year trend

Gold price has come off highs of last year but it has its supporters especially against a backdrop of a possible market correction in equities… a sort of a "safe haven" play. We think its worthwhile to continue to watch it for longer as a result.

4.3 Equity Markets

Equity markets have had a good summer across the board and have powered ahead. Couple of things to watch: (i) impact of Chinese government squeeze on listed companies there (if included in world indices) and (ii) ongoing ability of companies to pass on cost increases to their customers. If the latter results in inflation than it will impact on demand unless we get wage growth. Current levels look "fruity". Be more vigilant for rest of the year.

Graph 10. ISEQ 5-year trend

Graph 11. FTSE 5-year trend

Graph 12. NASDAQ 5-year trend

5. Potential trends to watch

5.1 Summary

	High Risk	Medium Risk	Low Risk
EUR/GBP		No repeat of Brexit risk from this time last year. Range-trading expected	
EUR/USD		More likely to benefit (strengthen) if financial markets take a downturn (flight to safety)	
3-m Euribor			Going nowhere. No change in ECB Base Rate in 2021
3-y € Swap			Not likely to go anywhere for now. Inflation will drive this
LIBOR	GBP LIBOR is being discontinued from the end of this year so any GBP borrowings or derivatives based on this need to be addressed immediately		
Irish Banking	With two participants leaving the market, choice is narrowing. Must start working on any loans to be refinanced at least 12 months in advance		
Equities	Correction due?		
Bonds		Incredibly long bull run over. Where to from here? Back to inflation trends?	
Oil		Already been very volatile in 2021. Should be more settled	
Gold		Direction depends on whether or not a safe haven play emerges.	

5. Half Year Review

5.2 Macro Trends

Geo-politics

- China and Russia likely to fill any gaps left by the US
- US focus to shift to Far East (work with allies such as Japan and Taiwan) – what will Chinese policy be on Taiwan and Hong Kong?
- Where to from here for Eastern Europe, especially Ukraine?
- Europe remains heavily dependent on gas supplies that come from or through Russia (or Russian-influenced territory)
- Iran's role and impact in the Middle East is also critical to that region
- Arguably more volatile globally than at any time in the past 30 years…with a power shift from West to East.

China

- Chinese government has its own issues to manage internally
- Big crackdown on local private enterprise – government able and willing to exert significant influence. Element of seeing this as an opportunity to redistribute wealth?
- This, in turn, is already having an impact on Chinese stock market
- Birth rates are falling and population has probably peaked
- Huge debt levels also now being closely watched (managed?) by government
- Big population to keep happy…has its challenges in the 21st century.

Reversal of globalisation

- Move from "Just in time" to "Just in case"
- Limitations of single global supply chain (or heavy dependance on one area) have come to the fore - also linked to geo-political risk above
- Pandemic leading to the "Great Resignation"? Flexibility and quality of life become the priorities
- Multinationals will pay higher corporation tax rates
- Impact of ESG on the concept? And with Climate Change?

Others

- While global warming is rapidly becoming a problem, the cost of addressing it is also large. So, will conservation win over consumerism? Or can both survive hand in hand?
- The ultimate knock-on effect of global warming in Europe (if not properly addressed) will be mass movement of people. And given that developing countries suffer the consequences without being the cause, the developed world will need to treat the cause or deal with the consequences
- Will cryptocurrencies become mainstream or crash and burn? Worthwhile putting a small element of an investment portfolio into them for diversification?
- Will the Big Tech backlash from governments continue?

Risks for Ireland?

- Corporation tax increases could be positive (if only moving from12.5% to 15%). But negative if the base income taxed here is reduced by other countries
- Radical rethink of attitude to home owning is required
- Could there be a private equity bubble yet? Best to hold back and buy cheaper in 2 years?
- Evolution of financial services – are we back to an oligopoly or will (global) fintech kill the Irish banking sector?
- Brexit impact yet to fully play out? Bring opportunities with it?
- Or does the increased EU trade drive requirements for more language skills? Should we target UK-based professionals to move here?
- Is the next government inevitably going to be left-leaning? Impact on taxes and investments? Sooner than you think? (Remember Albert Reynolds – "it's the little things that get you in the end")
- Lots to consider so get the basics right, have good quality and readily available management information, have sufficient access to funding at all times and be adaptable!