



# **THE TREASURY HUB**

## **Banking and Treasury Markets**

### **May 2020 Report**



## 1. Executive Summary

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### 1.1 Introduction

Welcome to the latest version of THE TREASURY HUB Banking and Treasury Markets Bulletin. After last month's volatility, there was a bounce back in equity markets and a settling down of the interest rate markets.

For now we will continue to focus on banking in Section 5 of each bulletin. A further three-month loan moratorium has been approved by the banks but we do not expect to see third such period thereafter. The focus will very much sharpen in the intervening period on cash flow basics. As we have reiterated many times in the past, the strength and flexibility of the terms and conditions of the loan agreement will make life easier for those who have paid attention to such matters to date.

From an investment perspective all three equity indices that we track (ISEQ, FTSE and DOW) staged a recovery in the month and while the indices are still negative for 2020 to date, they have made back some of the previously lost ground. Interesting to note that the NASDAQ is actually in positive territory for the year.

On the topic of EUR/GBP, we have seen relative stability for the month. However the decision on whether or not to extend the Brexit deadline date of December 31, 2020 will soon come sharply into focus. On all Enterprise Ireland evaluation jobs, FX volatility must be modelled and we believe that it's management will increasingly be a key facet in the approval or otherwise of bank facilities and grant applications. **So, as mentioned in last month's bulletin, 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
<u>Interest</u>	3-m euribor	0.1290%	-0.3790%	-0.2500%
<u>Interest</u>	EUR 3-year	-0.0400%	-0.2600%	-0.3000%
<u>Interest</u>	GBP 3-year	-0.4640%	0.8140%	0.3500%
<u>Interest</u>	USD 3-year	-1.1760%	1.6560%	0.4800%
<u>FX</u>	EUR/GBP	2.7254%	0.8459	0.8696
<u>FX</u>	EUR/USD	-2.3277%	1.121	1.0955
<u>Equities</u>	ISEQ	-23.404%	7315	5603
<u>Equities</u>	FTSE 100	-22.396%	7604	5901
<u>Equities</u>	Dow			
<u>Equities</u>	Industrial	-16.409%	28869	24132
<u>Gilts</u>	IE 10-yr	-0.0090%	0.098%	0.089%
<u>Gilts</u>	GB 10-yr	-0.5630%	0.794%	0.231%
<u>Gilts</u>	US 10-yr	-1.2570%	1.882%	0.625%

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.

**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.**

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### 1.3 Forward-looking Indices

Forward-looking indicators 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. Not surprisingly readings are increasingly poor if not terrible (in the case of Construction PMI). The trend in these readings in the coming months will be watched very closely to give some indication of the speed of economic recovery.

**Table 2. Irish and UK PMI readings**

Variable	Ireland	UK
Manufacturing PMI	36.0	32.6
Services PMI	13.9	13.4
Construction PMI	4.5	8.2

### 1.4 Brexit

On the back burner for now. However, it is a factor in quite a number of the revised financial projections that we are doing for both banks and Enterprise Ireland with a hard Brexit likely to have a material impact on UK sales in addition to a probable adverse move in GBP against all major currencies. We expect this to be firmly back on the agenda by the time the next bulletin is issued.

### 1.5 Treasury Hub Activities

We conducted a survey of all the firms in The Treasury Hub in order to provide feedback to the Department of Finance following a request from them for same. A summary of the key findings are included in Section 5. 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.

### 1.6 Conclusion

There is a growing view that economic recovery will not fully materialise until 2022, with no international tourist travel expected for at least 12 months. Therefore the ability to maintain a cost base that is in line with respected revenue trends will be crucial for many firms over the next 12-18 months. In particular we await the outcome of the promised government loan guarantee scheme as we see this as being crucial to the recovery of the economy.

**For further details, please email Chris Ball.**

## 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 rose to -0.19% over the past few weeks before settling back again to -0.25%.

There is ongoing discussion of the deflation versus inflation argument. Data from China shows that factories have ramped up production again, but sales recovery is slower leading to prices falling. On the flip side, there are views from retail and hospitality that price increases may be required to compensate for new social distancing norms. For now, fears would appear to be on the deflation side. There is a risk that ECB will keep market rates low but that banks will increase margins to compensate for higher loan write-offs.

The graph below of the 3-year swap rate shows current rates trading in a tighter range for now. 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 is a route being taken by some companies recently.

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: ten-year trend



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



### 2.3 UK and US interest rates

UK and US interest rates have continued to ease considerably since the start of the year. This easing is a direct consequence of the perceived likely economic impact of the coronavirus on the respective economies, with talk of possible negative rates in the US yet. But while the cost of borrowing in the market continues to fall, the pressure is more likely to be on the availability of credit (loans). Plus, as mentioned above for EUR loans, banks may seek higher lending margins in return for the higher costs to them of low interest rates.

**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 -25% to -35% (compared to -15% forecast last month).

Unemployment increases will be lower as the government introduced a scheme to subsidise wages. Furlough scheme has registered 6.3 million workers with unemployment forecast to hit 9%. **Current projections are for UK budget deficit to be £273 billion in 2020.**

### 2.5 US Economic Outlook

The outlook for the US is even worse than for the UK. First time unemployment claims in April hit 22 million with the unemployment rate in April at 14.7%. Q1 GDP fell by 4.8%.

### 2.6 Political Outlook

New Irish government to be formed by June. Tories taking flack for handling of the crisis. Keir Starmer performs well as new Labour leader. No idea how US Presidential race will play out as poor Trump performance could be offset by claims about Joe Biden's past inappropriate behaviour.

### 3. Foreign Exchange Review

#### 3.1 EUR/GBP

Having seen a high-low move in this currency pair in Q1 2020 of EUR/GBP0.8280 to EUR/GBP0.9500 (14.73%), the rate settled back into a range of EUR/GBP 0.8680 to EUR/GBP0.8800. The graph below shows the trend for 2020 to date.

As mentioned in the previous bulletin, exporters AND importers have both been afforded opportunities to hedge at rates not seen in a number of years. We see potential for GBP weakness in June onwards if the UK decides not to seek an extension to the Brexit date of December 31<sup>st</sup>, 2020.

Actions required:

1. Identify rate at which UK sales are at a breakeven level (no gain, no loss)
2. Establish hedging strategy around this risk
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**



Currency management and sensitivity analysis is a part of the Enterprise Ireland standard financial data pack. Banks will also assess same. So any applications for new debt or loans will require both analysis and the drafting of an appropriate risk management response. It will not be possible to ignore it, especially if the hard Brexit materializes on 31<sup>st</sup> December 2020.

#### 3.2 EUR/USD

This rate having bounced around from EUR/USD1.14 to EUR/USD1.07 in 10 days in March also re-established itself a narrow range below EUR/USD1.1000 again.

**Graph 6. EUR/USD: two-year trend**



## 4. Wealth Management

### 4.1 Oil

Graph 7. Oil prices: 2020 trend



Graph is Brent Crude. Had a volatile April, dropping as low as just under \$20/barrel before recovery to \$30/barrel in recent days. Further price increases expected to be slow depending on economic recovery prospects.

### 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. Not surprisingly, this continues to have an inverted relationship with economic growth. Price level holding up as economies shut down. 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. All three recovered somewhat in April but the jury is out as to whether this will be sustained.

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. Extension of a further three months now confirmed.
- Sense that there won't be a third extension unless the Central Bank changes regulations. In fact, flexibility provided by relationship banking appears to be 'overruled' by regulatory issues.
- To date, companies on semi-annual principal repayments are getting permission to defer one but not two repayments. Deferral of second repayment to be adjudicated on at a later date.
- Any refinancings that were in train pre-crisis have been kick-started again.
- SBCI COVID-19 loan scheme (the old Brexit Loan Scheme) has its critics as it is not structured as a working capital loan.
- Rumours that the very successful SBCI 10-year loan will be relaunched in June. To be confirmed.
- Government announced loan guarantee scheme of €2 billion but it requires legislative approval so won't be enacted before June at earliest.

### 5.2 What are best in class companies doing?

- Cashflow forecasts, cashflow forecasts, cashflow forecasts.
- Layering costs if possible so that they can increase in line with recovery in revenues.
- Accessing liquidity as quickly as possible. Some are drawing down available bank facilities and placing the funds on deposit 'just in case'.
- Some sitting on a lot of surplus cash have placed higher levels of deposits into AAA-rated Money Market Funds (and away from banks).
- Currency management still very high on the agenda.

### 5.3 Survey Results

#### What's working?

- LEO supports are being taken up and working to a point. Some also using the online trading vouchers to establish online presence
- Wage subsidy scheme, both the COVID Pandemic payment and TWSS (allowing for administrative backlogs). It also needs to be simplified if tapering moving forward.

#### What's not working?

- SBCI debt support – unimaginative and ill-conceived instrument for getting liquidity to businesses that need it most
- SBCI have just rebranded the Brexit Loan (same issues apply, 3-year term etc.)
- Pillar Bank supports, clients are not trusting the same. AIB sent out letters to companies who had availed properly of moratorium to tell them they had arrears that needed to be corrected. Concerns about impact of this message at annual reviews etc as it's a default.
- Limited interest in debt up until the past week or so as everyone was in disaster recovery mode – some clients are getting applications ready as they see they need some capital to adapt to 'new normal'. The working capital loan is of limited use

#### Other Comments/Suggestions

- Having seen how remote working can work, albeit not a five day a week scenario but certainly something will be developed in some for in the post COVID era. Days of a 5-day working week from the office are over
- The VAT Holiday/reduction for hospitality will be needed to allow it to try and resurrect itself
- Recovery will be slow and painful for some sectors and incentives need to be targeted rather than wholesale such as the Wages Subsidy
- Government funded staycation programme – free days/week at hotels once movement is allowed again to get activity into the sector quickly.

## 5. Banking Review

### 5.3 Other Comments/suggestions

- Little desire for borrowing – same as pre-COVID. Clients still in fear of debt. This has maybe been a positive, otherwise may have been more concerned of over leveraging
- Solvent companies with assets are acting already:
  - Directors close to (or past) normal retirement are considering not opening and just winding down/ceasing
- Potential insolvent companies with good trade:
  - Considering how effective of Scheme of Arrangements may be
  - Examinership
  - Possibility of pre-pack liquidation.

### 5.4 Action Points

- We continue to reiterate the need to produce cashflows on at least two scenarios.
- 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 short-term cashflows by week for 8 weeks, by month thereafter to end 2020 will be essential to run the business and this will require the establishment of a process which facilitates weekly updates of the forecasts.

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

- Enterprise Ireland.
- Local Enterprise Offices.
- Please avail of all the various types of assistance – see [www.gov.ie](http://www.gov.ie) reopening business.