THE TREASURY HUB
Banking and Treasury Markets

November 2020 Report

1. Executive Summary

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1.1 Introduction

Welcome to the second last edition of THE TREASURY HUB Banking and Treasury Markets Bulletin of 2020. While the year may be closing out, we still have the "minor" matters of Brexit and, for those in the hospitality and retail sectors, the Christmas run in.

On the currency front, USD continues to hold in a EUR/USD1.1630 to EUR/USD1.1930 range which is now in operation since the end of July. On the other hand, EUR/GBP has trended lower (strong GBP) since mid-September in the expectation that a hard Brexit will be avoided. This is expected to come to a head next week.

From an investment perspective the DOW is now in positive territory for 2020 having fully recovered all of its March losses. As mentioned in the previous bulletin, the impact of a small number of stocks known as the FAANGS has been significant and, in some cases, they are being seen as a hedge against a slowing economy as their sheer scale has seen them survive and thrive over the year.

As mentioned above, Brexit comes to a conclusion in the next week. Avoidance of a hard Brexit will mean dodging a bullet for many food companies. Let's hope it happens. But if it does, it will have been a huge gamble for many as other than getting ready to prepare customs documentation, many have made limited other arrangements. Preparation of 2021 budgets should include some level of strategic business review for many companies. Might be worth spending a little time in that space.

Increased corporate activity in the form of mergers and acquisitions continues to emerge. Please get in touch if considering either buying or selling.

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	-0.1350%	-0.3790%	-0.5140%
Interest	EUR 3-year	-0.2400%	-0.2600%	-0.5000%
Interest	GBP 3-year	-0.6640%	0.8140%	0.1500%
Interest	USD 3-year	-1.3360%	1.6560%	0.3200%
FX	EUR/GBP	5.7493%	0.8459	0.8975
FX	EUR/USD	5.3609%	1.121	1.1845
Equities	ISEQ	-1.969%	7315	7171
Equities	FTSE 100	-16.373%	7604	6359
Equities	Dow Industrial	2.1130%	28869	29479
Gilts	IE 10-yr	-0.312%	0.098%	-0.214%
Gilts	GB 10-yr	-0.4220%	0.794%	0.372%
Gilts	US 10-yr	-0.9630%	1.882%	0.919%

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.

Finally, against a backdrop of a reluctance to borrow more to get out of this economic slowdown, the Enterprise Ireland ("EI") Sustaining Enterprise Fund ("SEF") has gained a lot of traction, primarily due to the inclusion of a grant element of up to €200k (or 50% of the total amount sought if this is less than €400k).

One of the aspects of this process is that the relationship with your EI Development Advisor can be important. Similar to your banking relationship advisor, it may be beneficial to spend some time in 2021 with them in improving their knowledge of your business.

In the last bulletin, we suggested that Banking is already becoming more challenging so being proactive is important. We are seeing the fruits of proper relationship banking already in the past few weeks. Worth investing in the process.

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1.3 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. Current month readings in Ireland have improved but both Services and Construction readings are still in contraction territory. UK readings all fell in October although all three remain above 50. Lockdown and Brexit will impact in the remaining weeks of the year.

Table 2. Irish and UK PMI readings

Variable	Ireland	UK
Manufacturing PMI	50.3	53.7
Services PMI	48.3	51.4
Construction PMI	48.6	53.1

1.4 Brexit

We would appear to be in the final or week or so of negotiations on Brexit with both sides still holding out on their positions in certain areas. On balance, some sort of compromise deal is more likely but, assuming a hard Brexit is avoided, the next UK challenge is also likely to be political. Dominic Cummings was dismissed last week as the PM's senior advisor. But media is speculating that he won't go quietly and that the Chancellor could challenge Boris for the PM position in the next 6 months with assistance from said Mr Cummings. Never a dull moment in the UK it would appear.

1.5 Treasury Hub Activities

As mentioned last month, a lot of work has been undertaken using the financial planning grants from Enterprise Ireland and this, in turn, is now leading to refinancing work either with the banks and/or Enterprise Ireland through their SEF. Experience to date on the SEF has been broadly positive but these funds must be approved for dispersal for those that qualify by December 31st of this year with the last investment committee of EI in December 16th so this route to funding will not exist in the New Year.

1.6 Conclusion

Public health policy continues to have a major bearing on economic outlooks as well as financial markets trends. Markets may be a little too exuberant at the minute – US had 1 million Covid cases last week and with Thanksgiving to come, could be a rocky run into 2021 globally.

2. Foreign Exchange

2.1 EUR/GBP

As we come into the final six weeks of 2020, EUR/GBP has been more volatile than any year since the Brexit vote in 2016. The high/low range has been EUR/GBP0.8280 to EUR/GBP0.9500 which indicates that there have been great opportunities for both buyers and sellers of GBP during the year. Whether such opportunities were grasped depends on whether companies have strategies that they implement. As previously noted, our directional calls in this exchange rate have been good for most of the year-to-date.

The first graph below shows the trend for the past 3 months and it is evident that the market has increasingly formed the view that some sort of deal will be done, hence the GBP strengthening. The move from speculation to actual outcome on Brexit negotiations should complete before the end of the month. This will likely result in one final material move depending on the outcome and then…who knows? Brexit has been the main (almost exclusive) driver of GBP trends for the past 4 ½ years. 2021 ought to mean a "back to basics" approach of the markets. Economically, UK has a long way to go to recover. But that's for another day. Graph 2 overleaf shows the trend for 2020 highlighting this year's volatility. We will break out of the highlighted range in the next 2 weeks. We suggested learning more about FX options this year. We still think they are a tool to be deployed in a strategic manner. New Year's resolution maybe?

Graph 1. EUR/GBP: 3-month trend

Graph 2. EUR/GBP: 2020 to date

2.2 EUR/USD

EUR/USD graph below puts in context the moves of 2020. EUR/USD volatility of 12.94% (from EUR/USD1.2011 to EUR/USD1.0635) is in line with the average annual volatility for the last decade of 13.80%. The rate has stayed within a very tight range over Q3/Q4 to date pending the outcome of the US presidential election. Hasn't moved much since either as the market tries to assess the possible impact of the election on the US economy. A Republican–controlled Senate will thwart Democratic initiatives.

Last month we referenced the huge divide in American life that the campaign highlighted. It is a worry that the number one global economic power is in such a state. Very good piece in the Financial Times on this two weeks ago. https://www.ft.com/content/95c3cc61-0aea-495b-b4a4-4be66d930dee. Worth a read.

Graph 3. EUR/USD: 2020 to date

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

3-month euribor rate has fallen again to a new all-time low (-0.523%) in the past few weeks and has held below the -0.50% barrier in the process.

As we flagged over 12 months ago, the main impact of negative rates in 2020 has been on deposits. The impact of the pandemic has been to increase the level of deposits thereby exacerbating the problem. The only likely variable that might put upward pressure on interest rates in the short-term would be inflation and with central banks globally providing plenty of liquidity for now, this is not seen as a risk.

Graph 4. 3-month Euribor: five-year trend

As regards setting rates for 2021 budgets, we would suggest that Euribor will remain below 0% for the year.

3.2 EUR Medium-term Rates

Similar to the graph for 3-month Euribor, these rates have been largely negative for the past five years. The lowest point of the 3-year rate in 2020 was actually below the lowest for 3-month Euribor which, as previously referenced, the markets normally interpret as long-term interest rates going nowhere in the short to medium term. Therefore those that are considering fixing interest rates in 2021 can probably (for now) work off the assumption that the best (pre-margin) rate they will achieve will be 0%.

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

3.3 Summary

Nothing new to report here (or likely to report for now) so concentrate your efforts on negotiating good margins on your loans and pay more attention to cash management efficiencies in 2021 for value-add opportunities.

3.4 UK and US Interest Rates

UK interest rates continue to climb back, albeit slowly, from their all-time lows of earlier this year. Assuming no hard Brexit, the biggest challenge for the UK will be funding the massive and growing funding deficit. The UK neither has the scale of ECB nor the safe-haven (for now) status of USD. GBP borrowers need to watch this more closely in 2021.

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

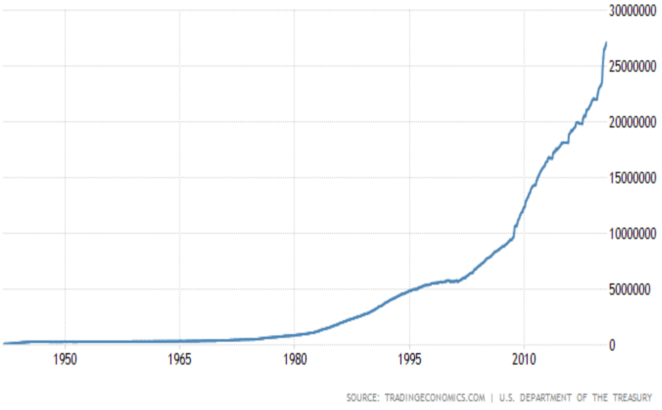
Graph 7. USD 3-year swap rates: five-year trend

US rates have had the wildest market fluctuations over the past 5 years as evidenced above. 2020 falls are totally pandemic-related and the US has adopted a different approach to its stimulus packages.

As we have covered in previous bulletins, the US has a huge and growing funding deficit which it can finance by simply printing more dollars. This strategy will work for as long as there are willing US bond investors in the markets.

US government debt in October was USD2,7135,477 million. Chart below from tradingeconomics.com shows how this has grown since 1950.

Graph 8. US Government Debt:1950 to date



3.5 UK Economic Outlook

As expected Q3 GDP bounced back, up 15.5% following contraction in both Q2 (-19.8%) and Q1 (-2.5%). The rebound was driven by Consumption (+ 18.3%) and business/construction investment (+15.1%). Retail sales have grown for 3 months in a row with September being +4.7% higher than the previous year. Unemployment is up to 4.8% with furlough schemes hiding the true figure. Different metric is more telling – weekly hours worked at 925 million was down 127.6 million hours versus last year. Government debt at the end of September was £2.06 trillion, another all-time high.

No change to our pessimistic view of the outlook for the UK for now, although avoidance of a hard Brexit will improve the outlook marginally.

3.6 US Economic Outlook

US unemployment continues to fall from 14.7% in April to 6.9% in October. Q3 GDP grew at an annualized rate of 33.1% after Q2 GDP contraction of -32.9%. Inflation remains positive at +1.2%, retail sales were a strong +5.4% YonY in September while building permits (planning permissions) hit another post-March 2007 high in September.

On the face of it, the metrics are all moving in the right direction and a change of President should be positive for foreign trade and foreign policy. The growing funding deficit remains the elephant in the room. But it remains ignored for now.

3.7 Political Outlook

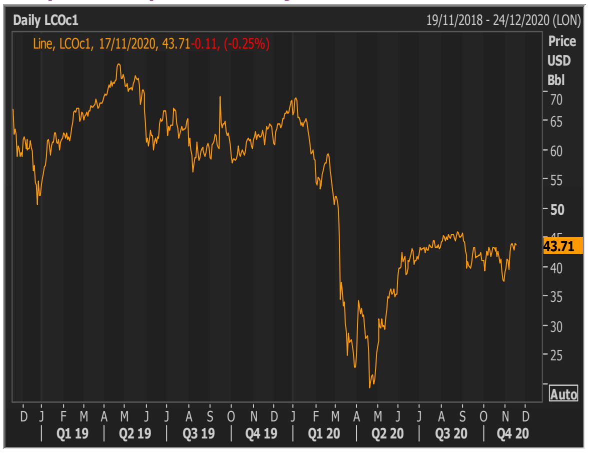
Joe Biden may have won but Donald Trump has yet to concede. Media carrying all sorts of reports of him trying to push through as much of his agenda as he can in the transition period. Also speculation that his plan is to promote Don Jr as the next generation member to carry the Republican mantle. What's certain is that he is not finished by a long shot with US politics.

In the UK, last month we suggested that Boris Johnson's position looked precarious for various reasons. The shock dismissal of Dominic Cummings has merely strengthened our view. He also seems to be suffering from "Long Covid" which won't help him either. Could his reign be short-lived and end in 2021? Paddy Power has the odds of him being replaced as PM as 11/8 in 2021 and 4/6 (i.e. odds on) in 2022!

4. Wealth Management

4.1 Oil

Graph 9. Oil prices: two-year trend



Oil prices continue to trade between $38 and $45 since late May. News of improving economic prospects driving it up and the opposite driving it down. General market commentary is surprised that is hasn't fallen below $40 given increasing supply and ongoing pandemic problems (new vaccine news notwithstanding). Continue to recommend close monitoring for now for next trend movement.

4.2 Gold Price Trends

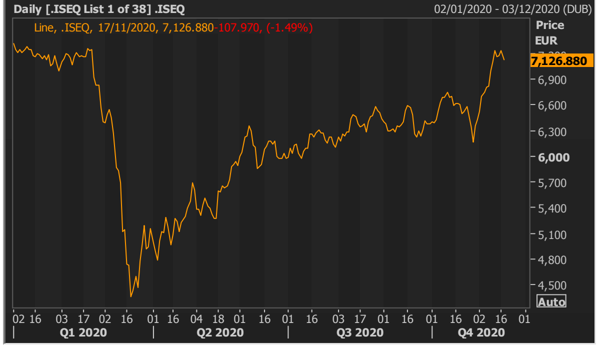
Graph 10. Gold prices: two-year trend

This we monitor as a hedge against adverse economic outlooks. The fact that it is holding up for now despite positive vaccine news this week gives an idea about the fragility of the recovery. Some are predicting another stock market correction hence why this may continue to form part of investors portfolios for now. Think we will continue to monitor in 2021.

4.3 Equity Markets

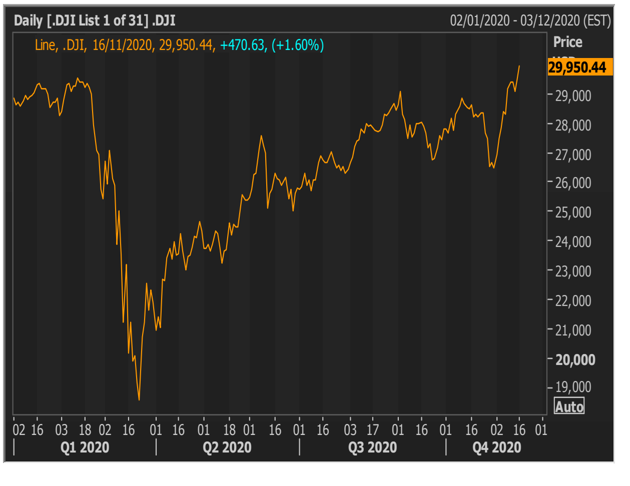
Stock market in Ireland has almost recovered its lost ground since March while the US (Dow) has surpassed it. The UK lags the others (still off 16% from the start of the year). Differing attitudes to shares going forward. Some see the FAANGs shares as being "safe haven" with sellers emerging as the outlook improves – Apple and Facebook are both off their Q3 peaks but Google (Alphabet) is still climbing. Tesla remains a star performer (up from $72 in March to $408 today).Outlook is uncertain as everyone knows that stock price recovery has been fueled by cheap money - economic outlooks don't justify many prices. But may be time to look at value stocks again.

Graph 11. ISEQ



Graph 12. FTSE

Graph 13. DOW



5. Budget 2021 Considerations

The content below looks at items that may be worth considering when putting together 2021 Budgets for your business.

5.1 Interest Rates

- EUR interest rates going nowhere. Assume a cost of funds of zero% if loans are priced off Euribor
- Deposit rates will remain in negative territory. Assume -0.75% at least
- If refinancing in 2021, expect upward pressure on bank margins. With negative interest rates, it is costing banks to hold deposits. Therefore they need to make better returns on lending
- UK interest rates not expected to increase much either in 2021.

5.2 FX Forecasts

EUR/GBP	Dec 20	Mar 21	Jun 21	Sep 21
AIB	0.84-0.90	0.85-0.91	0.85-0.91	0.85-0.91

- HSBC is forecasting weaker GBP in 2021 regardless of whether or not a Brexit deal is done, on the grounds that post-Brexit trade will be more difficult and there will be non-tariff barriers to trade in the form of increased costs. They are forecasting EUR/GBP0.90 by year end and EUR/GBP0.9174 by end 2021. In a no-deal scenario, they forecast parity in the currency pair
- They are also forecasting GBP/USD1.25 for next year end (assuming a Brexit deal, GBP/USD1.10 if no deal) which would imply EUR/USD1.1468
- Citibank meanwhile are very bearish on USD and are asking if it could fall by as much as 20% next year. They believe that a successful vaccine will cause investors to sell US shares (as US stocks are too highly valued vis-à-vis other parts of the world) thereby prompting USD sales. Their view is that the current market signals reflect similar bear trend in early 2000's after a bullish 1990s.

5.3 Irish Economic Outlook (Source: EU)

	2019	2020	2021	2022
GDP % yoy	5.6	-2.3	2.9	2.6
Inflation % yoy	0.9	-0.5	0.3	1.6
Unemployment %	5.0	5.3	8.9	8.7
Budget % of GDP	0.5	-6.8	-5.8	-2.5
Gross debt % GDP	57.4	63.1	66.0	66.0
Current account % GDP	-11.3	5.7	0.2	-1.1