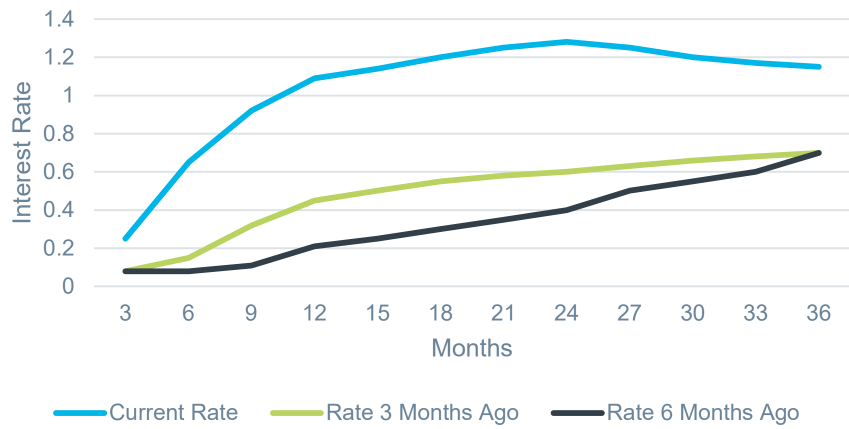
INDEPENDENT, SOLUTIONS DRIVEN

ATFS Bulletin November 2021
Interest Rate Management

Although the MPC did not raise interest rates at its last meeting at the beginning of November 2021, market consensus remains that there will be a hike of 15bps within the next three months followed by three further rises during the course of 2022. The change in market sentiment can be seen in Chart 1 below which illustrates the implied forward rates today, three months ago and 6 months ago for short term durations up to 36 months

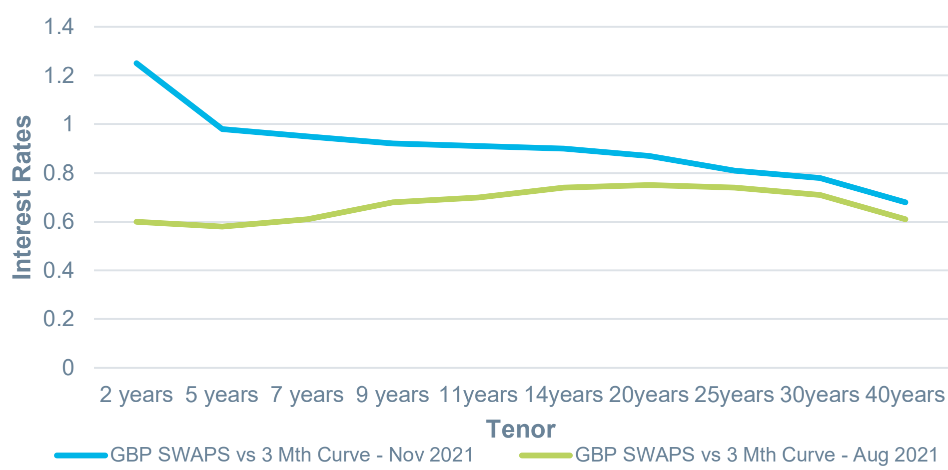
Chart 1 – Implied Market Rates



Source: Bloomberg Finance LP

Further illustration of the markets anticipated direction of interest rates can be seen in the Sterling Swap curve, which illustrates the difference between the varying Swap rate maturities. The curve has turned negative in the last three months, where short term rates now exceed those of a longer date. As per chart 2 below, the near-term swap rates (out to 5 years) are 50bps plus higher than they were three months ago. However, for tenors beyond 20 years there has been a very modest shift upwards.

Chart 2 – The Swap Yield Curve – Today versus 3 months ago



Source: Bloomberg Finance LP

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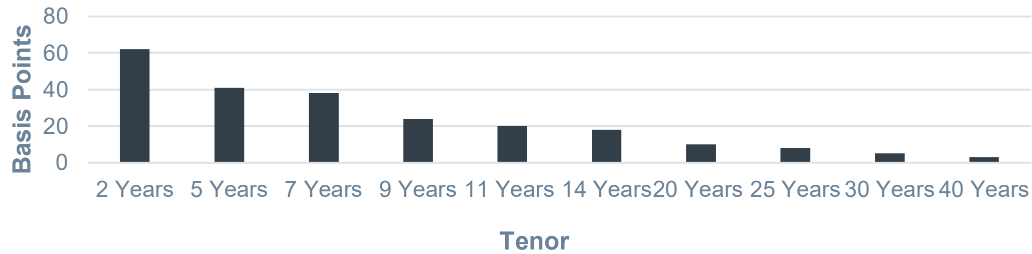
Chart 3 – Swap rate movement over past three months



Source: Bloomberg Finance LP

Key Considerations

Will negative interest rates return?

Do we think (short-term) interest rates are going to turn negative – there was considerable speculation earlier in 2021 that the MPC had given this serious thought. However, with CPI inflation now significantly above the MPC target of 2% per annum, there seems to be little chance that the MPC will signal any further reduction in Bank Rate.

How quickly will the MPC raise interest rates?

This really hinges on the inflation question. If sufficient members of the Committee believe that inflationary forces have taken a grip of the UK economy, then we could see rates rise to say 3% per annum or higher over the course of the next 24 months. On the other hand, if members of the MPC believe that the current inflation levels are transitory and the causes are exogenous, then we may see very little activity from the MPC over the next 24 months (perhaps rates could be raised to 50bps or even 75bps).

Tactically what should borrowers do?

Raising Finance

For those who are seeking to raise long-term finance, then the recent spike in the short-term market rates should have very little impact upon the decision. It could be argued that long-term rates have much further to rise than they have to fall (if the move to negative interest rates is discounted) and therefore locking into the current interest rate environment makes sense.

Long Term Fixed Rates

Given the inversion in the curve (see Chart 2 above) there is a good case for locking into a long-term fixed rate but starting the fixed rate in say 2 or 3 years' time. This avoids the immediate carry cost of paying for the fixed rate whilst simultaneously placing the surplus cash on the money markets.

Short Term Fixed Rates

For borrowers who are looking at a much shorter time horizon (say out to 5 years), the decision whether to fix or remain exposed to a floating rate of interest is more finely balanced. With the spread between short-term rates and a five-year fix currently circa 100bps, many borrowers may choose to remain on the floating rate in order to optimise cash flow. However, for others the decision may be influenced by such factors as (i) current position of the debt portfolio versus policy and (ii) headroom against debt servicing covenants.

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