

Banking and Financial Markets Review and Forecasts

1. Introduction

This is a short summary prepared by Treasury Solutions for LEO Cork City to aid local SMEs in their consideration of key financial risks in 2019. The summary is for information purposes only and advice should be sought from a professional advisor prior to taking any action. See www.treasurysolutions.ie or www.thetreasuryhub.ie or our Treasury Hub partner in Cork Buckley Kiely (www.buckleykiely.ie) for more information.

2. Banking Market activity

In general, on the banking front, the main banks have loan growth targets to hit in 2019 and 2018 finally saw net lending figures level off for the first time since the recession. There are a lot of uncertainties on the horizon in 2019 and there is a distinct possibility of a material slowdown in the US by 2020 at the latest. Prior to the last recession, we strongly encouraged clients to refinance while the market was good for borrowers (H1 2007). By focusing on the negotiation process and on the quality of the terms and conditions, it kept firms “alive” while others fell away (which is inevitable). **So, the most important message to relay in this document is to review your bank borrowing arrangements and consider refinancing in H1 2019.**

3. Interest Rate Review

Table 1. Summary Interest Rates

	<u>31/12/2018</u>	<u>02/01/2018</u>	<u>2018 high</u>	<u>2018 low</u>	<u>2017 high</u>	<u>2017 low</u>
3-m euribor	-0.3090%	-0.3290%	-0.3090%	-0.3290%	-0.3180%	-0.3320%
EUR 3-year	-0.0900%	-0.0100%	0.1070%	-0.0900%	0.0575%	-0.1506%
3-m libor	0.8000%	0.5190%	0.8100%	0.5175%	0.5288%	0.2765%
GBP 3-year	1.2118%	0.9161%	1.3685%	0.8686%	0.9947%	0.4898%

In the Eurozone, Euribor rates are starting to very slowly creep up as Quantitative Easing is finished by the ECB but this is not expected to have a material impact on variable rates of interest in 2019. Fixed rates (from 1 to 3 years) slipped back close to negative levels in December 2018. The pressure to fix the cost of debt has eased somewhat as a result. However, **the gap between fixed and floating rates is quite minimal again so don't discount the possibility.**

In the UK, Brexit outcome (hard or soft) and the resultant impact on GDP will drive UK interest rate trends in 2019.

In the US despite the Fed hiking by 25bp in December, short-term rates are now higher than long-term rates. **This indicates real concerns about the US economy possibly slipping into recession by 2020.**

4. Foreign Exchange Review

Table 2. Summary Foreign Exchange Rates

	<u>31/12/2018</u>	<u>2018 high</u>	<u>2018 low</u>	<u>Range %</u>	<u>2018 avge</u>	<u>2017 avge</u>	<u>2016 avge</u>
EUR/GBP	0.8948	0.9099	0.8618	5.58%	0.8849	0.8765	0.8193
EUR/USD	1.1376	1.2555	1.1214	11.96%	1.1811	1.1299	1.1065

Looking at EUR/GBP trends for 2018, the high/low range in the exchange rate was only 5.58% - the narrowest annual range since 2006. However, the average rate for the year was EUR/GBP0.8849 which represents the 4th year in a row that the average rate has weakened. Since the inception of the euro, 4 years is the longest such run (arising on two previous occasions). Brexit deal could drive rate back to EUR/GBP0.8500 but no deal could drive it to EUR/GBP1.000 if not beyond. The most imminent risk is the threat of a hard Brexit and the potential impact of that on EUR/GBP.

As mentioned previously, the concern is that the economic outlook for the US is worsening and this, in turn, assuming the outlook is better for other economies, would be USD-negative. A sustained break up through EUR/USD1.1500 could be significant for the USD. Expect further dollar volatility. **If you are an importer or exporter, make it your 2019 resolution to become more familiar with currency hedging techniques and instruments.**

5. Financial Markets

2018 was a volatile time on the financial markets with large falls in emerging markets, bitcoin, Oil and various shares at different points throughout the year. Bond yields also decreased in December.

One of my primary concerns is that while most countries are experiencing low unemployment and good economic growth, the state of government finances is poor - most are still running a deficit (i.e. spending more than they take in) and, as a result, their debt is growing...which is counter-intuitive at this stage of an economic cycle. In addition, the Central Banks are reining in Quantitative Easing (printing of money) and there is no consensus as to how that might impact on various asset classes. **The challenge will be to pick asset classes that may provide a positive return. For what it is worth, I shifted a material level of my pension assets into cash at the start of December until this period of uncertainty abates.**

6. Credit Ratings

S&P reviewed the main banks operating in the Irish market in December and upgraded the long-term ratings of AIB Bank plc, AIB Group UK, Permanent TSB and KBC Bank Ireland. It reaffirmed the ratings of Bank of Ireland and Ulster Bank Ireland. AIB, Bank of Ireland and Ulster Bank now have the same credit rating from S&P (BBB+ or 8 on a scale of 1 to 10 where 1 is best, 10 is worst for investment grade ratings). The consensus is that the banks are well capitalised, more profitable than their peers in Europe and that there is no apparent competitive threat to the current incumbents on the horizon. **The biggest risk identified was that the housing market (rising prices) could become a significant economic imbalance if it becomes credit-fueled and I suspect that the point may have been made against a backdrop of a drive to grow loan books in the next few years by the main banks.**