Treasury Trends

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Interest Rate Risk Amid Central Bank-Led Uncertainty

In an economic landscape increasingly shaped by central banks having to navigate "*extreme*" uncertainty, interest rate risk has re-emerged as a critical issue for corporates, investors, and sovereign entities.

Reserve Bank of New Zealand Te Pūtea Matua *"Risks to the global outlook remain elevated."*

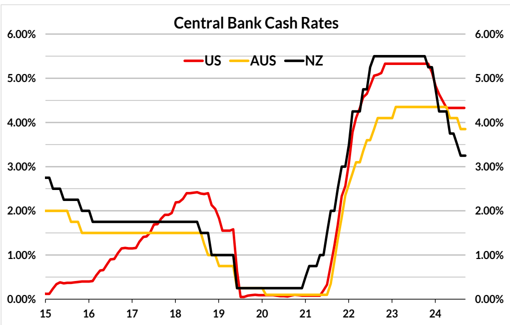
"Uncertainty about the economic outlook has diminished but remains elevated."

RESERVE BANK OF AUSTRALIA *"There is elevated uncertainty"*

Traditional forecasting models have been weakened by geopolitical shocks, policy unpredictability, and distorted yield curves. Consequently, managing interest rate risk now requires a more dynamic and unconventional approach, balancing robust risk frameworks with strategic agility.

The New Interest Rate Reality

Global interest rate regimes have undergone a seismic shift since the post-COVID recovery.



After an extended era of ultra-low rates and quantitative easing, central banks — including the Federal Reserve, RBA, and RBNZ — were forced into aggressive tightening cycles to combat inflationary pressures, before easing to various degrees — so far. Their strategies remain fluid and reactive, contributing to what many refer to as a volatile interest rate environment.

Key Points

- Uncertainty is ever present
- Accept forecasts for what they are
- Adopt a risk management approach, avoid the 'big call'
- Strategies should not be 'set and forget'

Key challenges include:

- Policy Volatility: Central banks now emphasise "*data dependency*" and may reverse course quickly, leading to rapid rate changes.
- Forecasting Failures: Inflation projections and rate paths from official sources have repeatedly missed the mark, undermining confidence in forward guidance.
- Yield Curve Distortions: Inverted yield curves, flat forward curves, and sudden steepenings reflect market uncertainty rather than macro clarity.
- Geopolitical & Supply Shocks: War, energy disruptions, and supply chain fragility persist as catalysts for interest rate instability.

Implications for Risk Management

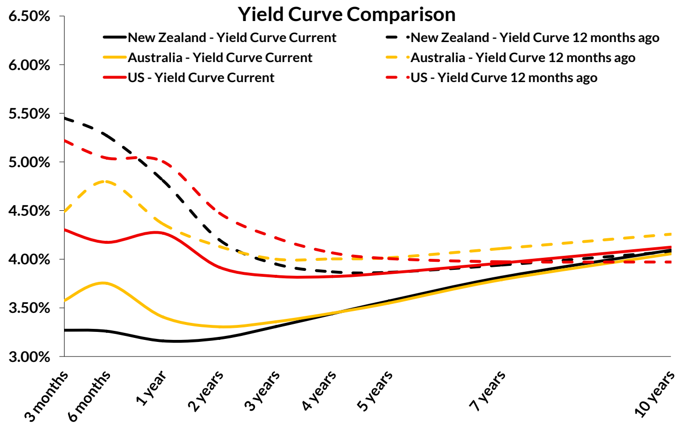
Interest rate risk can manifest in several forms: cash flow variability, mark-to-market gains/losses, refinancing risk, and duration mismatches. Traditional hedging tools such as swaps, options, caps, and collars remain essential, but need to be deployed with greater flexibility. The aim is not full insulation, but managed exposure that aligns with broader financial strategy.

Central bank and trading bank interest rate forecasts are valuable tools for understanding potential future economic conditions, but they remain just that — forecasts, not guarantees. These projections are based on current data, assumptions about economic trends, and models that attempt to predict complex and unpredictable behaviour. Both central banks and trading institutions regularly revise their forecasts in response to new information, such as inflation trends, employment data, geopolitical events, or shifts in global markets.

For businesses, investors, and policymakers, it is prudent to treat these forecasts as informative guides rather than definitive roadmaps.

Relying too heavily on any single projection can lead to strategic blind spots. Effective risk management requires a flexible, scenario-based approach that accounts for the possibility of rates moving in unexpected directions. This means stress testing strategies under a range of interest rate scenarios and maintaining flexibility to adjust positions as conditions evolve.

Rather than making 'big calls', we generally favour a staged or stepped approach ('little, and often'), phasing in protection across different tenors to benefit from curve movements. This reduces regret risk and improves optionality.



In summary, while central and trading bank forecasts offer insight into potential rate movements, they should be viewed as part of a broader risk management framework—not as precise predictions on which to base critical decisions. Prudence lies in preparation for uncertainty, not in prediction.

Strategy - Not 'set and forget'

When considering an interest rate hedging strategy, several key factors must be evaluated to ensure alignment with financial objectives and risk tolerance. These include your risk management policy, existing debt facility limits, and compliance with hedge accounting standards.

It is important to recognise that business, debt forecast and financial markets all change over time, sometimes quickly. You need to be prepared to revise hedging positions as conditions shift. This is not to suggest a typical corporate borrower needs to start trading hedging instruments, far from that, but there needs to be a degree of flexibility in the hedging positions to accommodate change. A significant change in a debt forecast for example should prompt at least a review of the associated hedging strategy.

From a communications and transparency perspective, it is vital that there is a process in place to ensure stakeholders, especially Boards/ Councils are briefed on how rate risk is being managed under uncertainty.

Factor	Consideration
Policy	Alignment with internal risk management and governance
Facility Limits	Hedging within loan covenants and borrowing capacity
Hedge Accounting	Compliance with IFRS/GAAP to minimise P&L volatility
Flexibility	Ability to restructure or unwind positions as needs change
Instruments	Selection of swaps, caps, collars, etc.
Cost	Upfront and ongoing costs, including premium and execution fees
Duration/Structure	Match hedge term with debt profile and risk exposure

Conclusion

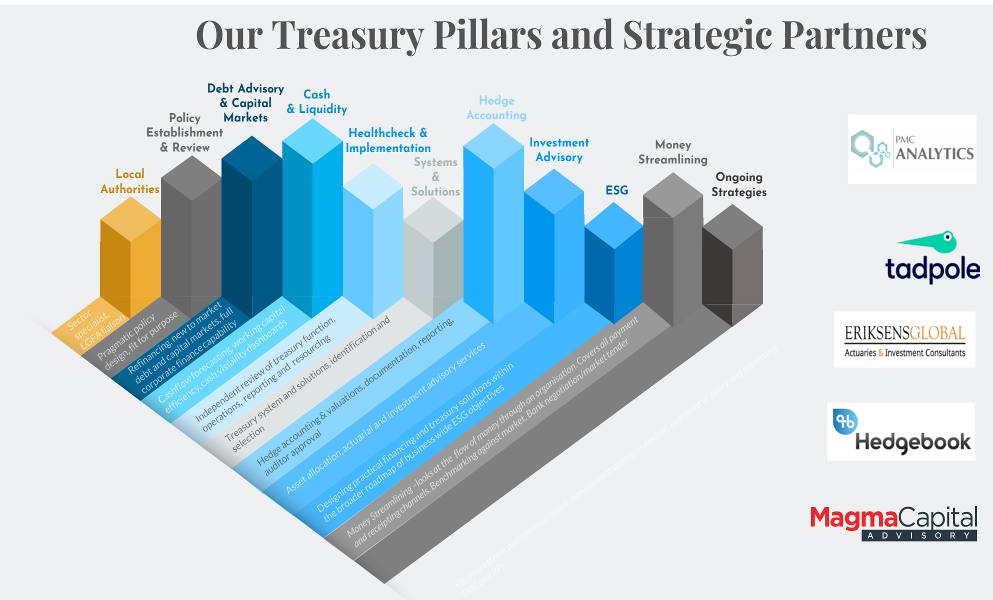
Interest rate risk management has entered a new phase, where historical norms no longer guide future actions. Central banks themselves are navigating unknowns — from persistent inflation to fiscal instability — leaving markets exposed to abrupt changes in direction.

In this context, organisations must adopt a nimble, strategic, and creative approach to interest rate risk, grounded in risk management fundamentals but unafraid to evolve.

Please speak with your advisor or contact us if you wish to discuss appropriate interest rate risk management policy settings or hedging strategies for your organisation.

The future may not be predictable, but it can be prepared for.

WHAT WE DO



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